CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF MASTER OF BUSINESS ADMINISTRATION

MBAD 813: ADVANCED FINANCIAL ACCOUNTING

STREAMS: MBA Y2S1 - PART TIME

TIME: 3 HOURS

DAY/DATE: WEDNESDAY 6 /10/ 2021 2.30 PM – 5.30 PM

INSTRUCTIONS:
- Answer Question One (COMPULSORY) and any other THREE.
- Do not write on the question paper

QUESTION ONE

a) "Inflation accounting is an element but a useless creature with a prodigious appetite for extra data. It can be compared to a relationship between high financial economics and mismanaged economics"

Required:
In light of the above statement, summarise some of the arguments that can be advanced to defend Historical cost accounting. [10 Marks]

b) Halake Ltd Acquired Tsunami Ltd a few years ago when the Capital and Retained profit stood at sh.5000000 and sh.6000000 respectively.

The following statement of financial position relate to the two companies as at 30th June 2018.

	Halake Ltd		Tsunami Ltd	
Non Current Assets	Sh'000	Sh. 000	Sh.000	Sh.000
Tangible – PPE	50,000.00			40,000

20,000 Ordinary shares in Tsunami Ltd	30,000.00			
		80,000.00		40,000
Current assets				
Inventory	3,000.00		8,000.00	
Accounts Receivables	20,000.00		17,000.00	
Cash at bank	2,000.00	25,000.00	-	25,000.00
TOTAL ASSETS		105,000.00		65,000.00
Ordinary Shares of sh.1 each		45,000.00		25,000.00
Capital Reserves		12,000.00		5,000.00
Retained profits		30,000.00		23,000.00
		87,000.00		53,000.00
Current Liabilities				
Accounts Payable		18,000.00		12,000.00
		105,000.00		65,000.00

Required:

Prepare the consolidated statement of financial position of Halake Ltd and it's Subsidiary Tsunami Ltd as at 30 June 2018. [8 Marks]

c) Yoer Ltd. Contributes sh.60 million annually to a pension scheme On 1 January 2016, the actuarial valuation showed that the scheme had a surplus of sh.320 million. The actuary recommended non-contribution to the scheme for three years than a resumption of annual contribution of sh.40 million per annum for the following seven years before reverting to the standard annual contribution of sh.60 million.

For the average remaining service years of employees, calculate the pension expense and pension liability or prepayment. [8 Marks]

d) Wana Ndege Ltd engages in real estate business owning only one property. The company's main income is rental income.

The statement of financial position of the company as at the end of the year 2019 and year 2020 is as follows:

	2019	2020
	KShs	KShs
Assets		
Building (net)	150,000	105,000
Cash	45,000	90,000
90,000		
	95,000	195,000
195,000		

The comparative income statements for both year 2019 and year 2020 are given below:

	2019 Kshs	2020 Kshs
Revenue Expense Depreciation Net	82,500 (45,000) 37,500	90,755 (45,000) 45,755

Additional Information

- The company was formed on January 1st Year 2019 through a cash investment of KSh 195,000.
- The building was acquired on January 1st Year 2019 at a cost of 195,000. Expected useful life is 41/3 years.
- All revenue is received at the end of the year.
- There are no operating expenses except depreciation.
- All net income is paid out as a dividend. The balance of cash is banked at no interest return.
- The price indexes for Year 2019 and Year 2020 are as follows:

1st Jan	2019	100
31st Dec	2019	105
31st Dec	2020	110

Required:

Prepare the statement of financial position and income statement for the two years using current purchasing power approach. [10 Marks]

e) Define the term' external reconstruction' and differentiate between amalgamation and external reconstruction. [4 Marks]

QUESTION TWO

a) In the context of IAS 17 (Leases), briefly explain the meaning of the following terms:

i. Finance lease [2 Marks]

ii. Guaranteed residual value [2 Marks]

iii. Interest rate implicit in the lease [2 Marks]

b) Mwokozi holdings entered into a lease agreement on 1st January 2013 for a establishing a banana factory in Tharaka Nithi County to enhance devolution. The lease period was for 5 years and annual rent was sh.600,000. Basic repairs and maintenance are to be paid for by the lessee. Mwokozi holdings had borrowed this funds from Trans-National Sacco at a cost of 15%. This is a finance lease and was considered non-cancellable. Depreciation is to be charged on straight line basis

Required

i) Journal entries in the lessee's book at the inception of the lease. [3 Marks]

ii) The finance charges to be recorded in the income statement of the lease over the lease period using actuarial method [6 Marks]

iii) Lessor's account in the lessee's books [5 Marks]

Hint: PVIFA, 15%, 5 Years = 2.1523

QUESTION THREE

a) Explain the following terms with reference to International Accounting Standard 19 (Employee Benefits):

i. Current service cost [2 Marks]

ii. Past service cost [2 Marks]

iii. Vest employee benefit [2 Marks].

b) Abal Ltd contributes sh.30 million per annum to a pension scheme and treats the amount as current service cost pension expense. On 1 July 2018, the actuarial valuation of the scheme showed a deficit of sh.600 million. The actuary recommended that the deficit be cleared within four years by paying sh.150 million per year in addition to the annual service costs. The average remaining service life of employees in the scheme on 1 July 2018 was eight years.

Required:

For each of the remaining eight service years of the employees, calculate the pension expense and pension liability or prepayment. [6 Marks]

c) The share capital of Salama Ltd is made up of the following items:

10,000 6% 1 preference shares	10,000
10,000 1 ordinary shares	10,000

On 1 January 2018, Hamasi Ltd acquired 3,000 preference shares and 7,500 ordinary shares when the retained profits of salama Ltd amounted to sh.4,000. The cost of investment of the date of acquisition was sh.15,000. Goodwill arising on consolidation is amortized over a period of 5 years.

The following income statement relate to the two companies for the year ended 31 December 2019.

		Hamas Ltd	Salama Ltd
		Sh	Sh
Sales		200,000.00	98,000.00
Cost of Sales		(90,000.00)	(40,000.00)
Gross Profit		110,000.00	58,000.00
Operating expenses		(35,000.00)	(19,000.00)
Profit before tax		75,000.00	39,000.00
Taxation		(23,000.00)	(18,000.00)
Profit after tax		52,000.00	21,000.00
	Preference	-	(600,000)
Dividends	Ordinary	(14,000.00)	(2,000.00)
		38,000.00	18,400.00
Retained profits b/f		79,000.00	23,000.00
Retained profits c/f		117,000.00	41,400.00

Additional Information.

During the year ended 31.12.2019 Hamasi Ltd sold an item of plant to Salama Ltd. The plant cost Hamasi Ltd sh.15,000 and Hamasi Ltd reported a profit of sh.5,000 on the sale. This transaction is included in the sales and cost of sales of Hamasi Ltd. It is the policy of the group to charge depreciation of 20% on cost for plant.

During the year Salama Ltd sold some goods amounting to sh.20,000 (cost to Salama ltd). Salama Ltd reported profit of 20% on cost. Half of these goods are still in the inventory of Hamasi Ltd. Hamasi ltd has not yet accounted for it's share of proposed dividends in Salama Ltd.

Required:

Prepare the consolidated income statement for the year ended 31 December 2019.[8 Marks]

QUESTION FOUR

a) Kenya Curious (KC) Limited purchased 80% of the ordinary share capital of Tanzania Artefacts (TA) Limited, a company incorporated in Tanzania; on 1 october 2015 when there was a credit balance on the profit and Loss Account of Tanzania (T) shillings 630 million. Both companies sell a range of products to tourists and to the tourist industry. The following is the Income Statement and Statement of Financial position as at 30th Sept 2018.

	Tsh 000.	Tsh 000		Tsh.000	Tsh 000
	KC	TA	PPE at Net Book Value	KC	TA
Revenue	930	2,211	Land and buildings	90	1,764
Opening inventory	52	537	Equipment	60	84
Purchases	780	1,353	Motor vehicles	12	60
	832	1,890		162	1,908
Closing inventory	(57)	(702)			
Cost of sales	775	1,188	Investment in subsidiary	312	
Gross profit	155	1,023	Current Assets:		
Operating expenses	(29)	(99)	inventory	57	702
Depreciation	(18)	(76)	Receivables	160	660
	(47)	(175)	Bank	31	264
Operating profit	108	848		248	1,626
Dividend from	8		Current liabilities		
Profit before tax	116		Payables	91	396
Taxation	(33)	(242)	Taxation	7	132

Profit after tax	83	606	Proposed dividend	40	420
Dividends: Interim paid	(20)	(112)		138	948
Proposed final	(40)	(420)		110	678
	(60)	(532)		584	2,586
	23	74			
Retained profit:			Financed by:		
For the year	23	74	Ordinary shares Sh.10	400	1,400
Brought forward	161	1,112	Retained Profits	184	1,186
Carried forward	184	1,186		584	2,586

Additional information

1. In the year ended 30 September 2018, KC Limited sold goods worth Ksh.98 million to TA Limited. These goods had cost KC Limited Ksh.82 milllion. In the group accounts, the unrealized profit at the commencement of the year was Ksh.6 million and Ksh.8 million at the end of the year. Group policy is to recover the whole of the unrealised profit from group stock and from the company which made the profit, the minority interest bearing its share if appropriate. Dividends payable to minority interests are shown as current liabilities.

2. Both companies were established on 1 October 2016. The land, buildings and equipment of both companies were purchased on his date. All the motor vehicles in both companies were replaced on 29 September 2017- No depreciation had been charged on these motor vehicles in the year ended 30 September 2017.
   Both companies charge depreciation on the straight line basis at the following rates:
   Land and buildings: 2% per annum on cost (the land is leasehold and had 50 years remaining at 1 October 2013
   Equipment : 10% per annum
   Motor vehicles : 25% per annum
3. The fair values of TA's assets and liabilities on 1 October 2015 were the same as book values.

4. Sales, purchases and expenses occur evenly over the year. In TA, debtors represent 4 months' sales; creditors represent 3 months' purchases; stock represents 6 months'

purchases. At 30 September 2018, TA owed KC Tsh.288 million, whilst KC's books showed that TA owed Ksh.24 million.

5. KC has not yet accounted for the dividend receivable from TA. The interim dividend was paid when the exchange rate was Ksh.1 = Tsh.11.2.
6. Relevant rates of exchange are:

1 October 2013	Ksh.1 = Tsh.6	30 September 2017	Ksh.2 =Tsh.10
1 October 2015	Ksh.1 = Tsh.7	31 March 2018	Ksh.1 = Tsh.11
31 March 2017	Ksh.1 =Tsh.9.3	30 June 2018	Ksh.1 = Tsh.11.7
30 June 2017	Ksh.1 = Tsh.9.6	30 September 2018	Ksh.1 = Tshh.12

Average for the year to 30 September 2018 Ksh.1 =Tsh.11.

Required:

The directors of KC Limited have directed you to prepare the consolidated income statement for the year ended 30 September 2018 using Functional currency method (goodwill is impaired at the rate of 20% per annum and it is an asset of the holding company) [20 Marks]

QUESTION FIVE

a) List and explain briefly the powers of liquidator [5 Marks]

b) Nagala supermarket Ltd deals in imported goods which are paid for in foreign exchange. Following the recent depreciation of the Kenyan shilling the company has incurred exchange losses on trade debtors and its business has become generally uncompetitive and consequently forcing the company into a voluntary liquidation on 1 November 2017:

As at 1 November 2017:

1. The company had a bank loan of Sh. 625,000 which was secured on furniture and fittings. The furniture and fittings realized Sh.1,000,000.
2. Assets not specifically pledged realizes Sh.4,250,000
3. Liquidation expenses amounted to Sh.187,500
4. Salaries payable to messengers for the last three months amounted to Sh.22,500, Sh.60,000 was four months salary payable to clerks.
5. Unsecured trade creditors were Sh.1,092,500
6. The share capital comprised of 10,000 8% preference shares of Sh. 100 each and 25,000 ordinary shares of Sh.100 each.

7. Calls in arrears were;
   Sh.25 on 10,000 ordinary shares
   Sh.40 on 8,000 ordinary shares
   Sh. 50 on 7,000 ordinary shares

Required:

The liquidator's statement of receipts and payments with the appropriate support schedule.

[15 Marks]

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