

CHUKA



UNIVERSITY

## UNIVERSITY EXAMINATIONS

## EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

## BCOM 313: ADVANCED FINANCIAL ACCOUNTING II

STREAMS: Y3S2

TIME: 2 HOURS

DAY/DATE: THURSDAY 12/04/2018

11.30 A.M. – 1.30 P.M.

**INSTRUCTIONS:**

- Answer QUESTION ONE and any other TWO questions.

**QUESTION ONE**

HB Ltd has been experiencing dwindling sales in its business operations due to competition from other agents dealing in telecommunication equipment. On 1 January 2012, HB Ltd. Decided to diversify its operations to the information technology (IT) industry by acquiring SL Ltd, a company dealing in the manufacture of IT equipment and software design.

The summarized financial statement of HB Ltd. and SL Ltd. were as follows:

## Statement of comprehensive income for the year ended 30 September 2012:

	HB Ltd Sh. '000'	SL Ltd Sh. '000'
Revenue	60,000	24,000
Cost of sales	(42,000)	(20,000)
Gross profit	18,000	4,000
Other income: Interest received	75	-
Dividend received	<u>400</u>	<u>-</u>
	18,475	4,000
Expenses:		
Distribution costs	(3,500)	(100)
Administrative expenses	(2,500)	(100)
Finance costs	-	(200)
Profit before tax	12,475	3,600
Income tax expense	<u>(3,000)</u>	<u>(600)</u>
Profit after tax	<u><b>9,475</b></u>	<u><b>3,000</b></u>

Statement of financial position as at 30<sup>th</sup> September 2012:

	<b>HB Ltd.</b> <b>Sh. '000'</b>	<b>SL Ltd.</b> <b>Sh. '000'</b>
<b>Non-current assets:</b>		
Property, plant and equipment	19,320	8,000
Investments	<u>11,280</u>	=
	33,800	<u>8,000</u>
<b>Current assets:</b>		
Inventories	5,000	3,000
Accounts receivable	4,200	3,400
Cash at bank	<u>5,800</u>	<u>1,600</u>
	<u>15,000</u>	<u>8,000</u>
Total assets	45,600	16,000
	=====	=====
Equity and liabilities:		
Capital and reserves:		
Ordinary shares of Sh. 10 each	10,000	2,000
Retained earnings	25,600	8,400
	35,600	10,400
<b>Non-current liability:</b>		
10% debentures	-	2,000
<b>Current liabilities:</b>		
Accounts payable	7,500	3,200
Current assets	<u>2,500</u>	<u>400</u>
	<u>10,000</u>	<u>3,600</u>
Total equity and liabilities	45,600	16,000
	=====	=====

**Additional information:**

1. HB Ltd acquired 80% of the ordinary share capital of SL Ltd. for Sh. 10,280,000 and also acquired half of the 10% debentures in the company.
2. The fair value of the assets of SL Ltd. at the date of acquisition were the same as their book values except for plant whose fair value was more by Sh. 3.2 million. As at 1 January 2012, the plant had a remaining useful life of four years. SL Ltd. depreciates plant on straight line basis on cost.
3. During the post-acquisition period, HB Ltd. sold goods to SL Ltd. for Sh. 12 million. These goods had cost HB Ltd. Sh. 9 million. Subsequently SL Ltd. sold some of the goods purchased from HB Ltd. at sh. 10 million for Sh. 15 million. C
4. On 30 June 2012, HB Ltd. and SL Ltd. paid dividends of Sh. 1,000,000 and Sh. 500,000 respectively.

5. Included in the accounts receivable and payable is Sh. 750,000 being the amount SL Ltd. owed HB Ltd.
6. Goodwill is considered to be impaired by 25% as at September 2012. Goodwill is classified as an administrative expense by the group companies.

**Required:**

- (a) Group statement of comprehensive income for the year ended 30 September 2012. (10 marks)
- (b) Group statement of financial position as at 30 September 2012. (10 marks)
- (c) Explain the circumstances under which a group may be exempted from preparing consolidated financial statements. (10 marks)

**QUESTION TWO**

Soma Ltd., publishing and printing company, extracted the following trial balance as at 31 October 2015:

	Sh. '000'	Sh. '000'
Property, plant and equipment: Cost	907,722	
Accumulated depreciation		108,000
Intangible assets	120,000	
Inventory	120,700	
Accounts receivable	168,120	
Provision for doubtful debts		620
Cash in hand	100	
Accounts payable		127,450
Bank overdraft		50,754
12 $\frac{1}{2}$ % debentures		200,000
Bank loan		270,000
Corporation tax		47,500
Share capital		60,000
Retained profits		119,046
Sales		1,574,500
Cost of sales	670,396	
Salaries and wages	238,720	
Distribution cost	86,560	
Administrative expenses	165,592	
Interest charge	<u>79,960</u>	
	<u>2,555,870</u>	<u>2,557,870</u>

**Additional Information**

1. Details of property, plant and equipment were as follows:

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Values as at 1 November 2014	Cost	Accumulated depreciation
	Sh. '000'	Sh. '000'
Freehold property (land Sh. 350 million)	500,000	-
Plant and machinery	200,000	90,000
Office equipment	<u>107,722</u>	<u>18,000</u>
	807,722	108,000
	=====	=====

The company had been providing for depreciation on freehold property which comprised land and buildings. These were acquired on 1 November 2005, on which date the buildings were estimated to have a useful life of 50 years. The directors have now agreed to provide depreciation from the date of acquisition.

Depreciation on the other items of property, plant and equipment is to be provided for as follows:

Plant and machinery	-15% on straight line basis
Office equipment	-10% on reducing balance basis

A plant which cost Sh. 100 million was acquired during the year.

- The cost of inventory as at 31 October 2015 included items valued at Sh. 9.6 million that were considered to be obsolete. The remaining inventory had a value of Sh. 111.1 million.
- Provision for doubtful debts at 5% of the accounts receivable is to be made.
- The bank loan is repayable in ten equal annual installments of Sh. 30 million.
- The corporation tax amounting to Sh. 47.5 million represents the estimated tax charge for the previous year. This liability was agreed with the tax authority at Sh. 45 million. Current year tax is estimated to be Sh. 85 million.
- The details of salaries and wages were:

	Sh. '000'
Factory wages	125,510
Warehouse wages	32,716
Office salaries	79,780
Directors' remuneration	<u>714</u>
	238,720
	=====

The interest charges comprise:

	Sh. '000'
Bank overdraft interest	25,460
Bank loan interest	42,000
12 $\frac{1}{2}$ % debenture interest	<u>12,500</u>

79,960  
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Intangible assets are to be mortised over 5 years. Amortization and depreciation charges are to be treated as part of the cost of sales.

The directors propose to pay dividend amounting to Sh. 21 million in respect of the year ended 31 October 2015.

**Required:**

- (a) Comprehensive Income statement for the year ended 31 October 2015. (7 marks)
- (b) Statement of changes in equity for the year ended 31 October 2015. (Show the column for retained profits only). (3 marks)
- (c) Statement of financial position as at 31 October 2015. Include relevant notes, using only the information provided, to ensure that the financial statements meet the requirements of International Financial Reporting Standards (IFRSs). (10 marks)

**QUESTION THREE**

Beta Ltd. has been suffering from adverse trading conditions largely due to the effect of obsolescence on its product. This has resulted in losses in each of the last five years. The company is unable to secure an extension of its present overdraft and creditors are pressing for payment.

The directors feel that a new product just developed by the company will make it profitable in the future but they are worried that a winding up order may be made before this can be achieved.

The following is the balance sheet as at 31 October 2000.

	Sh.	Book Values Sh.	Present Sh.	Values Sh.
<b>Fixed assets</b>				
Goodwill			800,000	-
Parents, trademarks etc.			<u>300,000</u>	100,000
			1,100,000	
Freehold land and building		2,500,000		3,500,000
Plant and Machinery		<u>1,100,000</u>	<u>3,600,000</u>	<u>800,000</u>
			4,700,000	
<b>Current assets</b>				
Stock and debtors		1,400,000		1,200,000
Listed shares at cost		<u>400,000</u>		300,000
		1,800,000		
<b>Creditors falling due within one year</b>				
Trade	(2,400,000)			

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Overdraft	<u>(700,000)</u>	<u>(3,100,000)</u>	
Net current liabilities			<u>(1,300,000)</u>
Total assets			3,400,000

**Share capital and reserves**

Called up share capital			
Sh. 20, 5% cum preference shares			
Fully paid (dividends are 3 years in arrears)	1,000,000		1,000,000
Ordinary shares of Sh. 20 each fully paid	3,600,000		3,600,000
Shares premium account	1,500,000		1,500,000
15% mortgage loan secured on freehold land	1,500,000		1,500,000
Profit and loss account	<u>(4,200,000)</u>		<u>(4,200,000)</u>
	3,400,000		

The following additional information is available:

1. Scheme costs are estimated at Sh. 200,000.
2. Preference shares rank in priority to ordinary shares in the event of winding up.
3. The bank had indicated that they would advance a loan of up to Sh. 1,000,000 provided that the overdraft is cleared and a second mortgage on the freehold land is given.
4. To ensure speedy production of the new product. It would be necessary to expend Sh. 600,000 on new plant.
5. The creditors' figure of Sh. 2,400,000 includes Sh. 300,000 that would be preferential on a liquidation.

**Required:**

- (a) Suggest a scheme of capital reduction and write up the capital reduction account. (15 marks)
- (b) Distinguish between Internal and External reconstruction. (5 marks)

**QUESTION FOUR**

- (a) Discuss any five limitations of Historical cost Accounting as it applies in accounting for price level changes. (10 marks)
  - (b) Discuss the circumstances under which a company can be wound up. (10 marks)
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