**CHUKA UNIVERSITY**

**UNIVERSITY EXAMINATIONS**

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

**BCOM 213: INTERMEDIATE ACCOUNTING II**

**STREAMS: BCOM Y2S2** **TIME: 2 HOURS**

**DAY/DATE: MONDAY 27/09/2021** **11.30 A.M. – 1.30 P.M.**

**INSTRUCTIONS**

- **Answer question ONE and any other TWO questions**
- **Do not write on the question paper**

**Question one**

a) Using illustrations, distinguish between constructive obligation and legal obligation. (4 marks)

b) Differentiate the following:

i. Deferred tax asset and deferred tax liability. (3 marks)

ii. Temporary differences and permanent differences. (3 marks)

c) Elgon Limited's trial balance for the year ended 30th Sept 2017 was as follows:

| **Item** | **Sh. '000'** | **Sh. '000'** |
|---|---|---|
| Sales | | 236200 |
| purchase | 127850 | |
| Distribution costs | 8000 | |
| Administrative expenses | 5400 | |
| Debenture interest | 2400 | |
| Land and building (at valuation) | 130000 | |

| | | |
|---|---|---|
| Plant and equipment (cost) | 84300 | |
| Software (at cost 1st oct 2014) | 10000 | |
| Available for sale investment | 12000 | |
| Depreciation (1st Oct 2016) plant and equipment | | 24300 |
| Software | | 6000 |
| Trade receivable | 55000 | |
| Inventory (1st oct 2016) | 19450 | |
| Trade payables | | 15200 |
| Bank | | 350 |
| Ordinary share capital (par value sh. 10) | | 40000 |
| Share premium | | 20000 |
| 10% preference shares (redeemable) | | 20000 |
| 12% debentures | | 40000 |
| Available for sale investment reserve | | 5000 |
| Revaluation reserve (PPE) | | 40000 |
| Retained Earnings | | 4350 |
| Deferred tax | | 3000 |
| | 454400 | 454400 |

**Additional information:**

a) The closing inventory as at 30th Sept 2017 was valued at a cost of 8.5 m

b) On 1st Oct 2016, Elgon Ltd revalued the land and building

| | Cost (000) | valuation (000) |
|---|---|---|
| | 1st Oct 2012 | 1st Oct 2016 |
| Land | 20000 | 25000 |
| Building | 80000 | 105000 |

The building had an estimated useful life of 40 years when they acquired and this has not yet changed. The relevant entries in the revaluation reserve have already been passed. Depreciation of the building is treated as an administrative cost.

c) Plant and equipment are depreciated at 20% per annum on the reducing balance basis. Software is amortized using some of years digit method over 5 years and is treated as an administrative cost.

d) The available for sale investments had decline in the market value of 1.2m which was not reflected in the account as at 30/6/2017. Meanwhile a revaluation reserve of available for sale investments had a balance of sh.5m before the current year valuations.

e) At AGM held on 31st July 2017, the shareholders improved a bonus issue of 1 ordinary share for every 10 shares held as at 30th sept 2016. These bonus share had not been reflected in the books of the company.

f) The estimated current year's tax is 11.3m. The taxable temporary difference as at 30/9/2017 amounted to 16m.

g) Directors propose to pay ordinary shareholders a final divided of sh. 1 per share (bonus shares don't rank)

h) The applicable corporate tax rate is 30%

Required: Statement of comprehensive income, statement of financial position and statement of changes in equity for the year ended 30 June 2018. (20 marks)

**Question two**

a) A company has decided to change its depreciation method to better reflect the patterns of use of its equipment.

   Required: Identify the nature of accounting change and explain how it will be applied in the financial statements. (3 marks)

b) On 1st January 2016, Mteti LTD issued sh. 650,000, 10% three-year debentures values when the effective rate of interest was also 10%. At the end of the first accounting period, market interest rates had fallen to 8%. In the subsequent year, the market rates rose to 12%. The liability is presumable being held for trading purposes. The issue cost incurred were sh. 50,000. The financial year of the company ends on 31st December.

   Required:

   i. Explain how the bond is classified and show the journal entry in the book of Mteti Ltd. On 1st January 2016.

   ii. Journal entries to record finance charges and statement of income extract for the year ended 31st December 2016, 2017 and 2018.

c) Explain the meaning of the term 'provision' highlighting the circumstances under which provisions are recognized. (5 marks)

**Question three**

Mwana Mwema co ltd began its operation on 1st January 2015. It acquired a plant at a cost of 20 million. The plant has an estimated useful life of 5 years. The plant is depreciated at 50% per annum for capital allowances in the first year, 30% of the cost in the second year and 20% in its third year. The company has been earning a profit before tax of 100,000,000 per annum for each of the five years ending 31st December 2019.

Required

Prepare income statement and statement of financial position extract showing the current tax expenses and deferred tax each of the five years. (20 marks)

**Question four**

a) Using examples, distinguish between financial liabilities at amortized cost and financial liabilities at fair value or loss (FVTPL).

b) The following information was extracted from the books on Mnono Ltd for the year ended 31 December 2017.

1/1/2017 existing ordinary shares 2,000,000

31/3/2017 rights issue of 1 share for every 5 existing shares at sh.90. The market price before issue was sh.100.

**Required:**

i. Compute the weighted average number of ordinary shares (WANOS). (5 marks)

c) Explain the methods of accounting for product warranties. (4 marks)

d) A company provides a two year warranty for a new product. It sold 8000 units of the product at sh. 2,000 per unit by the end of the year. From the past experience with a similar product the company estimates that warranty cost will amount to 1.5% of the sales revenue by the end of the year. The company has paid out sh. 50,000 in relation to the warranty claims.

**Required:**

Journal entries to recorded the transactions in the books of the company assuming the company applies the accrual basis. (6 marks)

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