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(Knowledge for Development)

KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS
2017/2018 ACADEMIC YEAR
FIRST YEAR FIRST SEMESTER
MAIN EXAMINATION

FOR THE MASTER OF BUSINESS ADMINISTRATION

COURSE CODE: MBA 803

COURSE TITLE: FINANCIAL REPORTING AND CONTROL

DATE: 19/01/2018

TIME: 9.00 A.M - 11.00 A.M

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other THREE (3) Questions in Section B

TIME: 3 Hours

KIBUCO observes ZERO tolerance to examination cheating

This Paper Consists of 9 Printed Pages. Please Turn Over.

SECTION A (COMPULSORY)

THE NEED FOR A FINANCIAL REPORTING INFRASTRUCTURE

Effective financial reporting begins with management, which is responsible for implementing and applying properly a comprehensive body of accounting principles. Rigorous and consistent application of accounting standards also depends on implementation efforts of the standard-setter, auditors and regulators. There are concerns that current ACCOUNTING standards may not be rigorously and consistently applied. For example, a recent study authored by the former ACCOUNTING secretary-general identifies non-compliance with ACCOUNTING standards by a number of the 125 companies surveyed. It also cites examples of auditors who failed to identify properly a lack of compliance with ACCOUNTING requirements in their reports on an issuer's financial statements.

High quality financial reporting cannot be guaranteed solely by developing accounting standards with the strongest theoretical bases; financial reporting may be weak if conceptually sound standards are not rigorously interpreted and applied. If accounting standards are to satisfy the objective of having similar transactions and events accounted for in similar ways, preparers must recognize their responsibility to apply these standards in a way that is faithful to both the requirements and intent of the standards, and auditors and regulators around the world must insist on rigorous interpretation and application of those standards. Otherwise, the comparability and transparency that are the objectives of common standards will be eroded.

In this respect, it is difficult to evaluate the effectiveness of certain of the ACCOUNTING standards at this stage. First, there is little direct use of ACCOUNTING standards in developed capital markets. Second, even where ACCOUNTING standards are used directly in those markets, a number of the new or revised standards may not have been implemented yet. For that reason, financial statements currently prepared using ACCOUNTING standards may not reflect the improvements achieved by the ACCOUNTING in the core standards project. Therefore, preparers, users and regulators may not have significant implementation experience with respect to those standards to assist us in our evaluation of the quality of the standards as they are applied.

In order for anybody of standards to be able to be rigorously interpreted and applied, there must be a sufficient level of implementation guidance. The ACCOUNTING standards frequently provide less implementation guidance than U.S. GAAP. Instead, they concentrate on statements of principles, an approach that is similar to some national standards outside the United States. Also, the ACCOUNTING has formatted its standards by using bold ('black') lettering to emphasize basic requirements of the standards while placing explanatory text in normal ('gray') lettering. We believe that the requirements of an ACCOUNTING standard are not limited to the black lettered sections and that compliance with both black and gray letter sections of ACCOUNTING standards should be regarded as necessary. Additionally, the ACCOUNTING has published a basis for conclusions for only two of its standards. The basis for conclusion in U.S. standards often is useful in promoting consistent understanding of the standard setter's reasoning and conclusions.

Comparability may be achieved with respect to less detailed standards through common interpretation and practice by companies and auditors who are familiar with the standards. Earlier standard-setting organizations in the United States, such as the Accounting Principles Board, followed this approach and developed less detailed standards. Our experience with that approach was not favorable, however, and led to the current organization and approach to standard-setting under the FASB.

Q.a After considering the issues discussed above, what do you believe are the essential elements of an effective financial reporting infrastructure? Do you believe that an effective infrastructure exists to ensure consistent application of the accounting standards? If so, why? If not, what key elements of that infrastructure are missing? Who should be responsible for development of those elements? What is your estimate of how long it may take to develop each element? **(10 marks)**

Q.b Is the level of guidance provided in accounting standards sufficient to result in a rigorous and consistent application? Do the ACCOUNTING standards provide sufficient guidance to ensure consistent, comparable and transparent reporting of similar transactions by different enterprises? Why or why not? **(5 marks)**

Q.c Are there mechanisms or structures in place that will promote consistent interpretations of the ACCOUNTING standards where those standards do not provide explicit implementation guidance? Please provide specific examples. **(5 marks)**

Q.d In your experience with current Accounting standards, what application and interpretation practice issues have you identified? Are these issues that have been addressed by new or revised standards issued in the core standards project? **(5 marks)**

Q.e Is there significant variation in the way enterprises apply the current Accounting standards? If so, in what areas does this occur? **(5 marks)**

SECTION B (CHOOSE ANY THREE QUESTIONS)

QUESTION TWO

Mr. James Bulayi formed Malimia Traders, a sole proprietorship five years ago. His initial capital injection was Sh.1,000,000 cash. For a number of years, Bulayi's wife maintained the accounting records, but early in 2013 she became seriously ill. Mr. Bulayi consulted a CPA firm whose manager told him "you keep a record of your cash receipts and payments and a list of your assets and liabilities, at the beginning and end of the year, and I will prepare financial statements for you at the end of the year".

On 31 October 2013, Mr. Bulayi presented the following data to the Manager of the CPA firm.

	Sh.
Cash receipts during the current year:	1,906,900
Collections from trade debtors	400,000
Proceeds of bank loan (repayable before 31 October 2014)	873,000
	15,900

Cash sales	<u>180,000</u>
Interest on overdue customers account	<u>3,375,800</u>
Rent from building property	
Total cash receipts	
Cash payments during the current year:	
Trade creditor	2,256,500
Acquisition of equipment	250,000
Operating expenses	476,100
Insurance premium	9,800
Withdrawals by owner for personal use	110,000
Carriage inwards	124,000
Bank loan (including interest of Sh.6,000)	156,000
Other liabilities	<u>34,000</u>
Total cash payments	<u>3,416,400</u>

Additional information:

- i) Although the primary source of revenue is from trading Malimia Traders also earns income from rent and interest. Malimia Trader conducts business from the ground floor of its two-floor storey building. The first floor is rented to a shoe-retailer for a monthly rent. The retailer pays 6 months rent in advance on 1 March and 1 September every year. Malimia Traders increased rent from Sh.15,000 per month to Sh.20,000 per month with effect from 1 September 2013. Malimia Traders charges interest on overdue customers accounts, which customers usually pay together with the principal amount due. Interest owing by customers on 31 October 1993 was Sh.5,000.
- ii) The following balances of assets and liabilities were extracted on 31 October 2012

	Sh
Prepaid insurance	19,000
Cash at bank	184,600
Trade debtors ,	585,600
Interest due on customers accounts ,	9,000
Stock	389,000
Equipment net	1,240,000
Building net	2,000,000
Bank loan	100,000
Interest owing on bank loan	5,000
Trade creditors	475,000
Other liabilities	34,000

- iii) Sh.14,000 of debts had been written off during the accounting period, of which Sh.8,500 was from sales of the previous accounting year, Bulayi estimated that

Sh.14,200 of the 31 October 2013 debtors balances may be uncollectable and a provision is required.

- iv) Returns inwards and returns outward all applicable to current year's sales and purchases are Sh.60,000 and Sh.50,000 respectively.
- v) Cash discount taken by credit customers in the year are Sh.41,300 discounts on purchases are Sh.64,000.

Depreciation is to be provided on reducing balance on fixed assets held at year end at the rate of 5% per annum on building and 25% per annum on equipment. There were no disposals of plant assets during the year.

Interest owing on the bank loan at 31 October 1993 is Sh.17,500. The amount paid for insurance includes a premium of Sh 8,000 paid to cover the firm against fire for the Co. six months to 31 January 2014.

Stock in hand on 31 October 2013 was valued at Sh985,000

On 31 October 2013 the amounts owing to suppliers was Sh.523,000 and the amount owing by customers was Sh,663,2000 (excluding interest on overdue accounts). All purchases of stock are on credit.

Ground rent and land rates for the year amounted to Sh.50,000 The bills received in respect of the two are not yet paid.

Required:

Malimia Traders' **Income statement** for the year ended 31 October 2013 and a statement of financial position as at that date. **(Toatal: 25 marks)**

QUESTION THREE

PREPARATION OF PUBLISHED FINANCIAL STATEMENTS

The accountant of Wislon Co. has prepared the following list of account balances as at 31 December 2015

	Sh '000'
50c ordinary shares (fully paid)	350
7% Sh.1 preferred shares (full paid)	100
10% debentures (secured)	200
Retained earnings 1.1 2015	242
General reserve 1.1 2015	171
Land and buildings 1.1 2015 (cost)	430
Plant and machinery 1.1 2015 (cost)	830
Aggregate depreciation	
Building 1.1 2015	20
Plant and machinery 1.1 2015	222
Inventory 1.1 2015	190
Sales	2,695
Purchases	2,152

Preferred dividend	7
Ordinary dividend (interim)	8
Debenture interest	10
Wages and salaries	254
Light and heat	31
Sundry expenses	113
Suspense account	135
Trade accounts receivable	179
Trade accounts payable	195
cash	126

Notes

- (a) Sundry expenses include Shs. 9 million paid in respect of insurance for the year ending 1 September 2016. Light and heat does not include an invoice of Shs. 3,000 for electricity for the three months ending 2 January 2016, which was paid in February 2016. Light and heat also includes Shs. 20 million relating to salesmen's commission.
- (b) The suspense account is in respect of the following items.

	Shs. million
Proceeds from the issue of 100,000 ordinary shares	120
Proceeds from the sale of plant	<u>300</u>
	420
Less consideration for the acquisition of Mary & Co.	<u>285</u>
	<u>135</u>

- (c) The net assets of Mary & Co. were purchased on 3 March 2015. Assets were valued as follows.

	Shs. Million
Investments	231
Inventory	<u>34</u>
	<u>265</u>

All the inventory acquired was sold during 2015. The investments were still held by Wislon at 31.12.2015. Wislon amortises goodwill over 5 years, with a full charge made in the year of acquisition.

- (d) The property was acquired some years ago. The buildings element of the cost was estimated at Shs.100, 000 and the estimated useful life of the assets was fifty years at the time of purchase. As at 31 December 2015 the property is to be revalued at Shs.800 million.
- (e) The plant which was sold had cost Shs350, 000 and has a net book value of Sh. 274,000 on 1.1 2015. Shs.36, 000 depreciation is to be charged on plant and machinery for 2015.
- (f) The debentures have been in issue for some years. The 50p ordinary shares all rank for dividends at the end of the year.
- (g) The Management to provide for:
- i) Debenture interest due
 - ii) A final dividend of 2c per share
 - iii) A transfer of general reserve of Shs. 16,000
 - iv) Audit fees of Kshs.4,000.

- (h) Inventory as at 31 December 2016 was valued at Shs.220,000 (cost).
 (i) Taxation is to be provided as at Shs.30,000. Assume tax rate of 30%.
 Required

Prepare the financial statements of Wislon Co. as at 31 December 2016 to produce notes to the statements. **(Total: 20 marks)**

QUESTION FOUR

- (a) Explain the legal provisions regarding the establishment and subsequent use of the following reserves:

- (i) Share premium account. (4marks)
 (ii) Capital redemption reserve fund. (4marks)

- (b) Masaba Company Ltd. is a retail provider with an authorised share capital of 800,000 Sh.20 ordinary shares and 250,000 8% Sh.20 redeemable preference shares.

The following financial information reflects the position of the company as at 31 December 2011 after preparing the Trading, profit and loss account:

	Sh.
	'000'
Provision for depreciation Fittings	1,500
Motor vehicles	3,740
Goodwill	1,200
Issued share capital: 600,000 Sh.20 Ordinary shares	12,000
250,000 Sh.20 Redeemable preference shares	5,000
Share premium account	400
Trade debtors and prepayments	1,708
Land and buildings at valuation (Cost Sh.4, 400,000)	18,400
Capital redemption reserve fund	3,000
Fittings at cost	3,000
Motor vehicles at cost	7,940
10% Debentures	1,600
Trade creditors and accruals	960
Short-term investments (Market value Sh.860,000)	780
Stock at 31 December 2011	2,960
Bank overdraft	540
Revaluation reserve	1,000
Net profit for the year	1,440
Retained profit at 1 January 2011	4,460
General Reserve	1,100
Provision for doubtful debts	48
Interim dividend paid - Ordinary	600
- Preference	200

The following resolutions relating to year ended 31 December 2011 have been passed by the board of directors of the company

1. Transfer Sh.500, 000 to General Reserve.
2. Provide for 5% final dividend and final preference dividend on shares issued and outstanding on 31 December 2011.
3. Make a bonus issue of 100,000 fully paid ordinary shares from the retained profits account.

Required:

- (i) The appropriations account of Masaba Company Ltd. for the year ended 31 December 2011. (4 marks)
- (ii) The statement of financial position of Masaba Company Ltd. as at 31 December 2011. (8 marks)

(Total: 20 marks)

QUESTION FIVE

Given below are the comparative balance sheets of Tausi Ltd., a trading company, for the years ended 31 October 2010 and 2011:

	2011		2010	
	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'
Assets				
Non current assets:				
Goodwill	23,500		32,650	
Premises	200,000		80,000	
Plant and machinery	290,100		278,200	
Office equipment	<u>126,250</u>	639,850	<u>87,360</u>	478,210
Current assets:				
Stock	88,890		67,815	
Debtors	57,890		52,015	
Bank	<u>9,210</u>	<u>155,990</u>	-	<u>119,830</u>
		<u>795,840</u>		<u>598,040</u>
Capital and Liabilities				
Capital:				
Ordinary shares	425,000		250,000	
10% redeemable preference shares	75,000		160,000	
Share capital	33,000		-	
Capital redemption reserve	30,000		-	
	38,000		12,000	

General reserve	<u>22,300</u>	<u>623,300</u>	<u>11,200</u>	433,200
Profit and loss account				
Non-current liability		63,000		50,000
Bank loan				
Current liabilities	49,820		40,290	
Creditors	30,500		28,500	
Current tax	26,000		18,000	
Proposed ordinary dividends	3,200		5,420	
Accruals	—	<u>109,540</u>	<u>22,630</u>	<u>114,840</u>
Bank overdraft		<u>795,840</u>		<u>598,040</u>

The following additional information is provided:

- Some of the redeemable preference shares which had been issued at par, were redeemed at a premium of 2%. To finance the redemption and comply with the Companies Act requirements, the company simultaneously carried out the following:
 - Issued 5,500,000 additional ordinary shares of Sh.10 at a total premium of Sh.34,700,000.
 - Transferred sufficient amounts to the capital redemption reserve.
 - Financed the premium on redemption out of the premium received on issue of the additional ordinary shares.
- Preference dividends are paid at the end of each financial year on shares outstanding then.
- Part of plant and machinery which had cost Sh.60,000,000 on acquisition and on which Sh.42,000,000 accumulated depreciation had been provided was sold for Sh.25,000,000 during the year.
- Included in the depreciation charge for the year is Sh.15,100,000 in respect of plant and machinery.
- New office equipment was purchased in the year for Sh.55,000,000. There was no disposal of office equipment during the year.
- It is the company's policy not to depreciate premises. The change in the premises account balance was due to a revaluation of the asset.
- The revaluation reserve arising in (6) above was all to finance the issue of fully paid-up bonus shares of Sh.10 each to ordinary shareholders.
- A new bank loan of Sh.25,000,000 was received in the year. Bank interest of Sh.8,000,000 was also paid in the year.
- Current tax liability is in respect of the tax charge for the respective year.
- During the year ended 31 October 2011 an interim dividend of Sh.14,000,000 was paid.

Required:

Cash flow statement in accordance with IAS 7

(Total: 20 marks)