(Knowledge for Development)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2020/2021 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER

MAIN EXAMINATION

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: ADVANCED FINANCIAL ACCOUNTING

COURSE TITLE: BCA 321/BCA319

DATE: 18-5-2021 **TIME: 8.00AM-10.00AM**

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

This Paper Consists of 8 Printed Pages. Please Turn Over.

SECTION A (COMPULSORY)
QUESTION ONE

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 IASC standards may not be rigorously and consistently applied. For example, a recent study authored by the former IASC secretary-general identifies non-compliance with IASC 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 IASC requirements in their reports on an issuer's financial statement.

In addition, the SEC staff has noted inconsistent applications of IAS 22, *Business Combinations*. The staff has received a number of requests to accept characterizations of business combinations as "unitings of interests" despite IAS 22's clear intention that uniting of interest accounting be used only in rare and limited circumstances. In addition, the SEC staff, based on its review of filings involving foreign private issuers using IASC standards, has identified a number of situations involving not only inconsistent application of the standards but also misapplication of the standards. In these circumstances, the SEC staff has required adjustments to the financial statements in order to comply with IASC standards.

The Interpretive Role of the Standard-Setter

In order for a set of accounting standards to be fully operational, the standard-setter must support reasonably consistent application of its standards. A standard-setter's responsibility for ensuring consistent application of its standards includes providing an effective mechanism for identifying and addressing interpretive questions in an expeditious fashion.

The IASC began addressing interpretive issues in 1997 with the creation of its Standing Interpretations Committee (SIC) to provide resolution of interpretive issues arising in the application of the IASC standards that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance.

The Restructuring of the IASC

The IASC has published a restructuring plan which is expected to result in an independent Board whose members are selected based on technical expertise, with oversight provided by an independent set of Trustees. The restructuring also is expected to integrate the roles of the IASC and those of national standard-setters.

At this time, we do not anticipate adopting a process-oriented approach (like our approach to the FASB) to IASC standards. Instead, we expect to continue a product-oriented approach, assessing each IASC standard after its completion. Nonetheless, the quality of the standard-setter has relevance to our consideration of the IASC standards, particularly with respect to implementation and interpretation questions. Since many of the IASC standards are new or relatively new, application issues may arise that require the response of an effective and high quality standard setter. Additionally, the quality of the standard-setter has critical implications for the development and acceptance of future standards.

An effective high quality standard-setter is characterized by:

- an independent decision-making body;
- an active advisory function;
- a sound due process;
- an effective interpretive function;
- independent oversight representing the public interest; and
- adequate funding and staffing.

The Role of the Regulator in the Interpretation and Enforcement of Accounting Standards

While the Commission has the authority to establish accounting standards, historically we have looked to the private sector for leadership in establishing and improving accounting standards to be used by public companies. As a result, the Commission has recognized the FASB as the private sector body whose standards it considers to have substantial authoritative support. This partnership with the private sector facilitates input into the accounting standard-setting process from all stakeholders in U.S. capital markets, including financial statement preparers, auditors and users, as well as regulators. Our willingness to look to the private sector, however, has been with the understanding that we will, as necessary, supplement, override or otherwise amend private sector accounting standards.

The SEC staff is involved with the application of accounting standards on a daily basis through its review and comment process. This review process, administered by the Division of Corporation Finance, allows the staff to review and comment on a company's application of GAAP and related SEC disclosure requirements. The SEC staff would have the same significant interpretive and enforcement role in the application of the IASC standards when those standards are used to prepare financial statements included in SEC filings. To perform that role, our staff would need to develop expertise regarding the IASC standards.

However, other jurisdictions accepting IASC standards may develop conflicting interpretations or may accept applications of IASC standards that would not be acceptable in the United States and other jurisdictions, in part, because of lack of expertise, resources, or even the authority to question a company's application of accounting standards. We are seeking to identify ways to reduce the development of diverging interpretations of IASC standards.

QUESTIONS

Q.1 Do the core standards provide a sufficiently comprehensive accounting framework to provide a basis to address the fundamental accounting issues that are encountered in a broad range of industries and a variety of transactions without the need to look to other accounting regimes? Why or why not? **(5 marks)**

Q.2 Should we require use of U.S. GAAP for specialized industry issues in the primary financial statements or permit use of home country standards with reconciliation to U.S. GAAP? Which approach would produce the most meaningful primary financial statements? Is the approach of having the host country specify treatment for topics not addressed by the core standards a workable approach? Is there a better approach? **(5 marks)**

Q.3 Are there any additional topics that need to be addressed in order to provide a comprehensive set of standards? **(5marks)**

Q.4 what has your experience been with the effectiveness of the regulation of accounting profession in reducing inconsistent interpretations and applications of IAS standards? Has the regulator been effective at identifying areas where interpretive guidance is necessary? Has the regulator provided useful interpretations in a timely fashion? Are there any additional steps the IASC should take in this respect? If so, what are they? **(5 marks)**

Q.5 is there significant variation in the interpretation and application of IASC standards permitted or required by different regulators? How can the risk of any conflicting practices and interpretations in the application of the IASC standards and the resulting need for preparers and users to adjust for those differences be mitigated without affecting the rigorous implementation of the standards? **(5 marks)**

Q.6 in considering changes in our current financial reporting requirements, we will consider the effects of possible changes on the ability of our enforcement program to provide an effective deterrent against financial reporting violations by foreign issuers, their corporate officials and their auditors. Would further recognition of the IASC standards impair or enhance our ability to take effective enforcement action against financial reporting violations and fraud involving foreign companies and their auditors? If so, how? **(5 marks)**

(Total: 30 marks)

SECTION B (CHOOSE ANY TWO QUESTIONS)
QUESTION TWO

a) In line with IAS 2, briefly define and comment
   i) Normal capacity (2M)
   ii) Fixed and variable overhead (2M)
   iii) Excluded costs (2M)

Kibabii Ltd. offered 200,000 ordinary shares for sale to the public at a par value of Sh.25 each on 1 April 2014, payable as follows:

- On application, Sh.5 due on 15 April 2014
- On allotment, Sh.5 due on 30 April 2014
- On first call, Sh.7.50 due three months after allotment
- On second and final call, Sh.7.50 due three months after the first call.

Additional information:

1. The company received applications for 530,000 shares on the due dates. Applications for 30,000 shares were rejected and the application money refunded. The rest of the applicants were allotted shares on a prorate basis.
2. One month after allotment, one shareholder of 2,000 shares remitted Sh.25, 000 as calls in advance. The rest of the calls were received on the due dates except for money due on second and final call for Sh.8, 000 shares which were paid three months late.
3. The surplus application monies were treated as calls in advance.
4. The company's articles of association provided for charging of interest on calls in arrears at 10% per annum.

Required:

Ledger accounts to record the above transactions. (14 marks) **(20 marks)**

QUESTION THREE

3a) IAS 16: property, plant and equipment gives certain criteria to be satisfied before an item of property, plant and equipment should be recognized as an asset. State these criteria and state the value at which the asset should be measured initially. Give six examples of directly attributable costs that could be included in the value and four examples of cost that should not be included in the value. (4 marks)

3b) Kioko, Licha and Mengo had started a partnership on 1 April 2002 when they contributed capital of Sh.9 million, Sh.3 million from Kioko, Sh.2 million from Licha and Sh.4 million from Mengo. No salaries were to be paid to any of the partners, but interest would be credited at 20% per annum – computed on these amounts – and any remaining profit was to be shared equally amongst the partners.

As at 31 March 2012, the balance sheet of the partnership was as follows (shown horizontally for conciseness):

Assets:				Capital and Liabilities	Kioko	Lich	Mengo	Total
Property, plant and equipment				Capital	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'
	Cost Sh.'000'	Depreciation Sh.'000'	NBV Sh.'000'	Fixed Capital Accounts	3,000	2,000	4,000	9,000

Freehold land	2,000	Nil	2,000	Current Accounts	3,190	2,000	1,500	6,600
Buildings	3,000	900	2,100					
Plant and machinery	12,000	3,000	9,000	Current Liabilities				
Motor vehicles	4,000	3,000	1,000	Trade payables				7,360
	21,000	6,900	14,100					
Current assets:								
Inventory		4,400						
Trade receivables		3,400						
Cash at bank		1,150	8,950					
			23,050					23,050

The business was run by the partners to 31 March 2013. They decided to convert the partnership into a limited company with effect from 1 April 2013. This was to be achieved as follows:

1. Property, plant and equipment had been depreciated on opening cost (no assets had been bought or sold in the year to 31 March 2013) by 3% on buildings, 12½% on plant and machinery and 12½% on motor vehicles. The company would take over the land, buildings, plant and machinery at Sh.5 million, Sh.4 million and Sh.10 million respectively. The partnership owned three motor cars which had all be bought at the same time: the one Kioko uses cost Sh.1.6 million; the one Licha uses cost Sh.1.4 million; the one Mengo uses cost Sh.1 million; all the cars have a useful life of eight years and a residual value of nil. Each partner was to take over the motor car he uses – Kioko's for Sh.400,000, Licha's for Sh.260,000 and Mengo's at Sh.205,000.

2 Inventory valued at cost for Sh.5.2 million was to be transferred to the company for Sh.5.7 million. One trade receivable for Sh.1.2 million was to be collected personally by Kioko; the partners estimated that only Sh.840,000 would be collected from this debtor. Sh.2.9 million, the balance of trade receivables, would be transferred to the company at book value. Trade payables in the partnership at 31 March 2013 stood at Sh.5.1 million. If payment could be made by 30 April 2013, this liability could be settled for Sh.4.5 million. It was agreed by the three partners that they would introduce Sh.3.22 million immediately to raise the cash in the business to an amount just sufficient to clear this liability immediately so that trade payables could be transferred at Sh.4.5 million. The actual payment to creditors was made by the company a few days later. Kioko paid Sh.1,225,000 into the

partnership bank account; Licha paid in Sh.355,000 and Mengo paid in Sh.1,640,000.

3. The new company, Kiligo Limited, had an authorized share capital of 2 million shares of Sh.10 each. These shares would be issued to the partners at a premium of 50% in satisfaction of the purchase consideration.

4. Kioko had made drawings of Sh.1,440,000 in the year, Licha Sh.960,000; Mengo Sh.1,200,000.

Required:

(a) Prepare the realization account of the partnership as at 31 March 2013 (6 marks)

(b) Prepare the partners' capital accounts for the year ended 31 March 2013 (current accounts should be closed off to the capital accounts as early as possible) (6 marks)

(c) Prepare the opening Balance Sheet of Kiligo Limited. (4 marks)

(Total: 20 marks)

QUESTION FOUR

4a) Identify the main items of information that require disclosure under IAS 14 (Segment Reporting)

(3 marks)

4b) Trendsetters Limited operates two branches, one in Nairobi and one in Mombassa. These two branches are supplies from a warehouse in Athi River town where the Head Office of the Company is situated. All purchases are made at the head office. Goods are charged to both branches all selling price, which is head office cost plus 50%. All cash receipts in the branches are banked daily. The following figures relate to the company's performance for the year ended 30 September 2015 and financial position as at that date.

	Head Office Sh. '000'	**Nairobi Branch Sh. '000'**	**Mombas a Branch Sh. '000'**
Cash sales banked		110,820	168,000
Credit sales		12,300	8,400
Stock at cost, 1 October 2014	11,750		
Stock at selling price, 1 October 2014		18,300	24,150
Purchases	233,175		
Expenses paid	19,540	9,008	10,825
Goods sent to branches (selling price)		124,155	180,225
Goods received from debtors		12,100	8,525
Property, plant and equipment			

(Net Book value: 30 September 2015)	25,000	28,000	35,000
Debtors at 1 October 2014		1,200	1,100
Bank overdraft at 1 October 2014	11,800		
Trade creditors at 1 October 2014	42,550		
Trade creditors at 30 September 2015	41,200		
Ordinary share capital: 3 million Sh.10	30,000		
shares	45,946		
Retained earnings at 1 October 2014			

Additional information:

1. Head office expenses are apportioned equally to the branches.
2. A debt for Sh.75,000 became had during the year at Mombasa branch.
3. Goods were transferred at selling price from Nairobi to Mombasa branch at Sh.405,000 and from Mombassa branch to Nairobi at Sh.900,000.
4. On 31 May 2015, the day's takings of Sh.525,000 were stolen from Mombassa branch. On 26 December 2014, goods at a selling price of Sh.66,000 had been stolen from Nairobi branch
5. Stocktaking on 30 September 2015 revealed a deficiency of Sh.54,000 at Nairobi branch and a surplus of Sh.30,000 at Mombassa branch (both figures being a selling price) Since no information could not be found for the shortfall in Nairobi, management agreed to account for this as a nominal loss. The surplus in Mombassa was due to goods being sold at a price in excess of the authorized selling price. This was to be reported as a separate line item in the profit and loss account.
6. The directors proposed a dividend of 20% on 30 September 2015.
7. Income should be provided for 30% of the net profit for the year (assume the taxable profit and the accounting profit are the same figure) Installment tax of Sh.13,000,000 was paid in the year. All bankings in the branches are transferred electronically to the head office bank account out of which all expenses are paid. Ignore depreciation of property, plant and equipment.

Required:

(a) A stock account and a mark-up account for each branch in column format (8 marks)

(b) A profit and loss account for each branch and combined total commencing with the gross profit for each branch. (5 marks)

(c) The head office bank account and a statement of financial position as at 30 September 2015. (4 marks)