KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

BAC 201: ACCOUNTING FOR LIABILITIES AND EQUITIES

DATE: TUESDAY 29TH NOVEMBER 2016 **TIME: 4.30 P.M. - 6.30 P.M.**

INSTRUCTIONS: ***Answer ALL questions***

QUESTION ONE

a) Explain the principle guidelines to reporting contingent liabilities (6 marks)

b) On September 1st, 2016, Kamakia borrowed Ksh 800,000 from Eazy Credit Ltd in exchange for a Note due in 6 months with a stated interest rate of 9%. Assuming that Kamaki's Year-end is December 31st , Prepare;

i) Journal entries to record issuance of the Note (2 marks)

ii) Journal entries to accrue interest on 31st December, 2015 (2 marks)

iii) The necessary Journal entries to record the transactions when the bond matures (Assume a reap year)

(4 marks)

c) On May 1, 2016, Exel ltd issued a one-year noninterest-bearing Note with aface amount of Ksh 1,060,000 in exchange for equipment valued at Ksh 1,000,000. You are required to;

a) Determine the effective rate of interest applicable to the Note (2 marks)

b) Prepare the necessary journal entries to accrue interest on 31st December 2016 (2 marks)

(Total 18 marks)

QUESTION TWO

i) In relation to accounting for long-term bonds, distinguish between

a) Secured and unsecured bonds (2 marks)

b) Term, Serial and Callable bonds (2 marks)

ii) Amason Ltd a mining company located in Kilifi county intend to raise additional capital to finance its operations. After weighing all the available options, the finance manager advised the management to issue Ksh 10 millions of 8% term bond on 1st January 2017 due on January 1st 2022 with interest payable each 1st July and 1st January. The investor's requires an effective-interest rate of 10%.

Required.

a) Compute the discount on bond payable (2 marks)

b) Prepare a five years' bond discount amortization schedule using effective interest method(8 marks)

c) Prepare Journal entries to record the issuance of the bond, the first interest payment and the interest expense to be accrued at December 31st 2022. (3 marks)

(Total 18 marks)

QUESTION THREE

Caterpillar Financial Services Corp. (a subsidiary of Caterpillar) and **Sterling Construction Corp.**sign a lease agreement dated January 1, 2011, that calls for Caterpillar to lease a front-end loader to Sterling beginning January 1, 2011. The terms and provisions of the lease agreement, and other pertinent data, are as follows.

- The term of the lease is five years. The lease agreement is noncancelable, requiring equal rental payments of $25,981.62 at the beginning of each year (annuity due basis).
- The loader has a fair value at the inception of the lease of $100,000, an estimated economic life of five years, and no residual value.
- Sterling pays all of the executory costs directly to third parties except for the property taxes of $2,000 per year, which is included as part of its annual payments to Caterpillar.
- The lease contains no renewal options. The loader reverts to Caterpillar at the termination of the lease.

- Sterling's incremental borrowing rate is 11 percent per year.

- Sterling depreciates, on a straight-line basis, similar equipment that it owns.

- Caterpillar sets the annual rental to earn a rate of return on its investment of 10 percent per year; Sterling knows this fact.

Required.

a) Does the lease meet the criteria for classification as capital lease? Explain (2 marks)

b) Prepare a lease amortization schedule in the books of the lesee (8 marks)

c) Prepare the necessary journal entries to record the transactions in the book of the lesee (7 marks)

(Total 17 marks)

QUESTION FOUR

a) On January, 2011, Medex Co. Ltd acquired sh 10million machine with an economic life of four years and no residual value. The company uses the sum-of-the-years'-digits method of depreciation for income tax purposes and the straight-line method for financial accounting purposes. Assuming that the company earns 8 million each year (before depreciation expenses and income taxes);

i) Show the effects of depreciation timing differences on pre-tax accounting income and taxable income (5 marks)

ii) Show the journal entries to record income taxes assuming a corporate tax rate of 30% (6 marks)

iii) Show a partial income statement for the first year (3 marks)

b) SitwellCorporation started it operation in Kenya in the year 2016. During this first year of operations, it had the following transactions pertaining to its common stock.

Jan. 10:	Issued 800,000 shares for cash at Sh 60 per share.
Mar. 1:	Issued 50,000 shares to attorneys in payment of a bill for Sh350,000 for services rendered in helping thecompany to incorporate
July 1:	Issued 300,000 shares for cash at Sh 80 per share.

Sept.1 Issued 600,000 shares for cash at Sh 100 per share.

Required:

(a) Prepare the journal entries for these transactions, assuming that the common stock has a par value of sh30 per share. (4 marks)

(Total 18 marks)