KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2014/2015

DIGITAL SCHOOL OF VIRTUAL AND OPEN LEARNING

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

BAC 301: ADVANCED FINANCIAL ACCOUNTING

DATE: Tuesday, 28th April 2015 **TIME:** 11.00 a.m. – 1.00 p.m.

INSTRUCTIONS:

- **Answer all questions.**
- **Show the necessary workings**

QUESTION ONE

a) Outline 5 benefits of a partnership business converting into a limited liability company **(5 marks)**

b) X, Y and Z have been in partnership for several years, sharing profits and losses in the ratio
3: 2: 1. Their last balance sheet which was prepared on 31 October 2014 is as follows:

Balance Sheet of X, Y and Z as at 31 October 2014

	Sh	Sh	Sh
Fixed assets At cost		20,000	
Less Depreciation		(6,000)	
			14,000
Current assets			
Stock	5,000		
Debtors	21,000		
		26,000	
Current liabilities			
Bank	13,000		
Creditors	17,000		
		(30,000)	
			(4,000)
			10,000
Capital X			4,000
Y			4,000
Z			2,000
			10,000

Despite making good profits during recent years they had become increasingly dependent on one credit customer, Smithson, and in order to retain his custom they had gradually increased his credit limit until he owed the partnership Sh18, 000. It has now been discovered that Smithson is insolvent and that he is unlikely to repay any of the money owed by him to the partnership. Reluctantly X, Y and Z have agreed to dissolve the partnership on the following terms:

(*i)* The stock is to be sold to Nelson Ltd for Sh 4,000.

(*ii)* The fixed assets will be sold for Sh 8,000 except for certain items with a book value of Sh 5,000 which will be taken over by X at an agreed valuation of Sh 7,000.

(*iii)* The debtors, except for Smithson, are expected to pay their accounts in full.

(*iv*) The costs of dissolution will be Sh 800 and discounts received from creditors will be Sh 500. Z is unable to meet his liability to the partnership out of his personal funds.

Required:

(*a*) Realisation account; **(7 marks)**

(*b*) Capital accounts to the partners recording the dissolution of the partnership. **(8 marks)**

(Total: 20 marks)

QUESTION TWO

a) Outline five weaknesses of historical cost accounting **(5 marks)**

b) The following are historical cost financial statements of ABC ltd

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2014

	2013 sh000	**2014 sh 000**
Fixed assets	1000	950
stock	500	550
debtors	600	800
Cash& bank	400	500
creditors	(500)	(400)
dividends	(200)	(250)
tax	(100)	(200)
Net assets	**1700**	**1950**
Ordinary share capital	800	800
Revenue reserves	800	1070
loan	100	80
	1700	**1950**

INCOME STATEMENT FOR YEAR ENDED 31 DECEMBER 2014

Opening stock	(500)
purchases	(1000)
Closing stock	550
Gross profit	**1170**
Expenses(dep 50)	(400)

interest	(50)
Profit before tax	**720**
tax	(200)
Profit after tax	**520**
dividends	(250)
Retained profits	**270**
Add retained profits b/d	800
Retained profits c/d	**1070**

‘a)Price indices

- At purchase of fixed assets 110
- At issue of shares 100
- At 31-dec-2013 160
- At 31-oct-2013 155
- At 31-dec-2014 180
- At 31-oct-2014 175
- Average 2014 170
- At 30-june-2014 165

b) Stocks are acquired 2 months before the year end
c) Half of the interest was paid on 30-june-2014 and part of the loan was paid
d) Balance of interest was paid at year end

REQUIRED

CPP income statement for year ended 31-dec-2014 (15 marks)

(Total 20 marks)

QUESTION THREE

	Sh	Sh	Sh
2010	6650	2000	400
2011	6800	400	800
2013	6700	400	1200
2014	5800	2800	800
Corp tax rate	33%		

Required

Using full provision method show: Income statement extracts for corporation tax and deferred tax for 4 years 2010-2014 **(15 Marks)**

QUESTION FOUR

a) Outline a five of business activities and/or events that may give rise to contingent liabilities and contingent assets **(5 marks)**

b) Explain the criteria for recognition of a contingent liability **(3 marks)**

c) The date is 3 December 2008. The financial statements and the audit report are due to be signed next week. However, the following additional information on two material events has just arisen. The company's yearend was 30 September 2008.

Event 1 – Occurred on 10 October 2008

The springs in a new type of mattress have been found to be defective making the mattress unsafe for use. There have been no sales of this mattress; it was due to be marketed in the next few weeks. The company's insurers estimate that inventory to the value of $750,000 has been affected. The insurers also estimate that the mattresses are now only worth $225,000. No claim can be made against the supplier of springs as this company is in liquidation with no prospect of any amounts being paid to third parties. The insurers will not pay ZeeDiem for the fall in value of the inventory as the company was underinsured. This entire inventory was in the finished goods store at the end of the year and no movements of inventory have been recorded post year-end.

Event 2 – Occurred 5 November 2008

Production at the ShamEve factory was halted for one day when a truck carrying dye used in colouring the fabric on mattresses reversed into a metal pylon, puncturing the vehicle allowing dye to spread across the factory premises and into a local river. The Environmental Agency is currently considering whether the release of dye was in breach of environmental legislation. The company's insurers have not yet commented on the event.

Required:

(a) For each of the two events above: Explain with reasons whether the events are adjusting or non-adjusting according to IAS 10 *Events* after *the Reporting Period.* **(6 marks)**

(b) Explain the accounting treatment of each of the of the above events

(1 marks)

(Total: 15 marks)