SOUTH EASTERN KENYA UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

FIRST SEMESTER EXAMINATION FOR THE MASTER OF BUSINESS ADMINISTRATION

DAC 501: FINANCIAL ACCOUNTING

DATE: 5TH DECEMBER, 2016 TIME: 9.00-12.00PM

INSTRUCTIONS:

(i) Answer Question ONE and any other Three questions

(ii) Do not write on the question paper

(iii) Show your working(s) clearly

QUESTION ONE (COMPULSORY)

Each of the following statement represents a decision made by the chief accountant of **KENIA LTD,** on which your advice is asked.

1. A building purchased by the company 5 years ago for sh. 600,000 including the land on which it stands, can be sold for sh. 800,000. The chief accountant instructs the new value of sh. 800,000 be entered in the accounts.
2. Material included in the inventory that cost sh. 480,000 has become obsolete. The chief accountant contends that no loss can be realized until the goods are sold, and so the material is included in the inventory at sh. 480,000.
3. In as much as profits for the year appear extremely small, no depreciation of property, plant and equipment is to be recorded as an expense.
4. The company occupies the building in which it operates under a long-term lease requiring annual rental payments. It sublets certain office space not required for its own purpose. The chief account credits rents received against rents paid to get net rent expense.

5. A flood during the year destroyed or damaged a considerable amount of uninsured inventory. No entry was made on this loss because the chief accountant reasons that the ending inventory will, of course, be reduced by the amount of the destroyed or damaged merchandise, and therefore its cost will be included in the cost of goods sold and the net income figure will be correct.
6. The company provides housing for certain employees and adjusts their salaries accordingly. The chief accountant contends that the cost to the company of maintaining this housing should be charged to "wages and salaries".
7. The entire cost of a new delivery truck is to be charged to an expense account.
8. The company has paid a large sum for an advertising campaign to be done the coming financial year to promote a new product that will not be placed on the market until the following year. The chief accountant has charged this amount to a prepaid expense account.
9. The company operates a cafeteria for the convenience of its employees. Sales made by the cafeteria are credited to the regular sales account for product sales; food purchased and salaries paid for the cafeteria operations are recorded in the regular purchase and payroll accounts.
10. A customer leaving the building slipped on an icy spot on the stairway and wrenched his back. He immediately entered a suit against the company for permanent physical injuries and claims damages in the amount of sh. 640,000. The suit has come to trial. The chief accountant has made an entry charging a special loss account and crediting a liability account.

Required:

You are to state (i) whether you agree with the chief accountant's decision (5 marks)

(ii) The reasons supporting your position. Consider each decision independently of all others. (10 marks)

b) Kas Flow Ltd. is a company owned and operated by Mr. Kano Simba. During the year 2011 the company replaced sh. 7,200,000 of the company's fully depreciated equipment with new equipment costing sh. 9,200,000. Although a midyear dividend of sh. 2,000,000 was paid, Mr.

Simba found it necessary to borrow sh. 2,000,000 from his bank on two year note. He feels further borrowing may be needed since the cash account is dangerously low at year end.

Given below is the income statement and cash flow statement as Mr. Simba's account calls them for the year 2011.

Kas Flow Ltd.

Income statement for the year ended 30 September 2011

	Sh.	Sh.
Sales		80,000,000
Cost of goods sold	(56,000,000)	
Operating expenses	(19,000,000)	(75,000,000)
Profit before taxes		5,000,000
Income taxes		(880,000)
Net income		4,120,000

Mr. Simba is concerned about what he sees in the above statement and how they relate to what he knows has generally happed. He turns to you for help. Specifically he wants to know why has the income statements shows a profit when he knows the cash balance decreased from sh. 4,400,000 to sh. 600,000 during the year. To answer Mr. Simba's worries you ask for and receive the following condensed Balance sheet data.

Kas Flow Ltd

Comparative balance sheet as at 30 September

	2011	**2010**
Assets		
Current assets		
Cash	600	4400
Accounts receivable (net	7120	5280
Inventory	11400	7000

Prepaid expenses	280	120
	19400	6800
Property, plant and equipment		
Equipment	16000	14000
Accumulated depreciation / equipment	4400	9600
Total property plant and equipment	11600	4400
Total Assets	31000	21200
Liabilities and shareholders' Equity		
Current liabilities		
Accounts payable	3480	4000
Accrued liabilities	240	440
Total current liabilities		
Notes payable	200	
Mortgage notes payable	6400	
Total liabilities	12120	44400
Shareholders' Equity		
Common stock	16000	16000
Retained earnings	2880	760
Total shareholders' equity	18880	16760
Total liabilities and shareholders' equity	31000	21200

Required:

Prepare a cash flow statement using he indirect method in compliance with international Accounting Standards (IAS) no. 7 to explain to Mr. Simba why he is having difficult time keeping sufficient cash on hand. (10 marks)

c) Accounting standards are methods of or approaches to preparing accounts which have been chosen and established by the bodies overseeing the accounting profession. They are essentially working rules established to guide accounting practice.

Required:

Enumerate the role of Accounting standards in guiding accounting practice. (5 marks)

(Total: 30 marks)

QUESTION TWO

a) Given that prudence is the main consideration, explain under what circumstances, if any, revenue might be recognized at the following stages of a sale.

i. Goods have been acquired by the business, which it confidently expects to resell very quickly.

ii. A customer places a firm order for goods.

iii. Goods are delivered to the customer.

iv. The customer is invoiced for goods.

v. The customer pays for the goods.

The customer's cheque in payment for the goods has been cleared by the ban. (5 marks)

b) The Accountants Act Cap (1977) establishes the Institute of Certified Public Accountants of Kenya (**ICPAK**) and two boards, known as the Registration of Kenya Accountants Board (**RAB**) and Kenya Accountants and Secretaries National Examination Board (**KASNEB**)

Required:

i. Outline the functions of

a. ICPAK

b. RAB

c. KASNEB (5 marks)

(Total: 10 marks)

QUESTION THREE

a) Differentiate between accrual basis of accounting an cash basis of accounting and explain the concept of profit under each of the basis. (2 marks)

b) Mwenda Pole Limited has presented the following draft Balance Sheet as at 30th November 2007 to you.

MWENDA POLE LIMITED

DRAFT BALANCE SHEET AS AT 30TH NOVEMBER, 2007

Assets		**sh. 000**
<u>Non-current Assets</u>		
Delivery equipment at cost		16000
Accumulated Depreciation		(<u>6250</u>)
		9750
Long-term investment		<u>52000</u>
		61750
<u>Current Assets</u>		
Inventories		25700
Accounts receivable	34360	
Allowance for uncollectible debts	(<u>2577)</u>	31783
Prepaid rent		200
Cash		84065
		<u>141748</u>
		<u>203498</u>
EQUITY AND LIABILITIES		
<u>Capital and reserves</u>		
Share capital		15000
Retained earnings		16673
Share holders funds		166673
<u>Non-current liabilities</u>		
Notes payable		4050
<u>Current Liabilities</u>		
Accounts payable		14620
Salaries payable		1000
P.A.Y.E		5,687
N.S.S.F		123
Corporate tax		7252

Dividends payable	4,000

After perusal of the related records, you identify the following:

1. The retained profit as at 30th November 2006 mounted to shs.6,053,000.
2. Inventory amounting to shs. 2,300,000 was wrongly omitted in the stock count of 30th November 2007.
3. Receipt of sh. 500,000 for goods to be delivered sometime in January 2008 was included in the sales figure for the year ended 30th November 2007. It is the company's policy to recognize revenue at point of sale.
4. The allowance for bad debts was to be equal to 5% of the accounts receivable balance as at 30th November 2007.
5. Sh. 50,000 with respect to the prepaid rent balance presented in the balance sheet had expired. Adjustment for the same had not been made.
6. A provision of sh. 180,000 in respect of audit fees has not been made.
7. Included in the depreciation charge for the year is depreciation amounting to sh. 450,000 provided using the reducing balance method. It should have been provided using the straight line method at the rate of 10% p.a on cost.
8. Instalment tax of sh. 252,000 had been paid during the year. The same has not been recorded in the books.
9. Sales include goods with a selling price of Kshs. 700,000 which had been stolen from the warehouse. The goods had been marked up at 25% above cost.
10. An electricity bill amounting to Kshs. 126,000 is under dispute. The accountant decided not to record the same until the dispute is resolved.
11. The sales director is entitled to a 5% commission on profit for the year before charging such commission. The accountant had correctly computed the commission based on the earlier reported profit.

Required:

1. Compute the correct profit or loss for the period ended30th November, 2007. (5 marks)
2. Prepare the correct balance sheet of Mwenda Pole Limited as at 30th November 2007. (3 marks)

(Total: 10 marks)

QUESTION FOUR

a) Explain what is meant by materiality in relation to financial statements and state two factors affecting the assessment of materiality. (4 marks)

b) Explain what makes information in financial statements relevant to users. (3marks)

c) Two characteristics contributing to reliability are 'neutrality' and 'purchase'. Explain the meaning of these two terms. Explain how a possible conflict between them could arise and how that conflict should be resolved. (3 marks)

(Total: 10 marks)

QUESTION FIVE

Kajairo Mercantile is planning to expand its operations during the coming year. Its financial position and the results of its operation for the year are shown below in summary form.

Kajairo Mercantile

Statement of Financial Position

As at December 31, 2013

Assets	**sh '000'**
Non-current assets	
Property, plant and equipment	178,000
Current assets	
Inventory	19,800
Accounts receivable, net	21,400
Cash	11,600
	52,800
Total assets	**230,800**

Kajairo Mercantile

Income statement

For the year ending December 31, 2013

	Sh '000'	Sh '000'
Sales		26,000
Less expenses:		
Cost of goods sold	161,200	
Depreciation	1,500	
Other expenses	74,400	237,100
Net income		22,900

A planned expansion during 2014 will result in the following

1. Cash increase of sh. 3,400,000
2. Accounts receivable increase of sh. 3,000,000
3. Inventory increase of sh. 6,500,000
4. Property, plant and equipment increase, net of depreciation of sh. 10,400,000
5. Accounts payable increase of sh. 3,300,000
6. Sales increase of 30 percent
7. Cost of goods sold increase to 68 percent of sales.
8. Depreciation increase to sh. 1,800,000
9. Other expenses increase to sh. 76,800,000

Required:

a) Compute the following ratios for Kajairo Mercantile for 2013 and 2014 as projected.

i. Current ratio
ii. Quick ratio
iii. Accounts receivable
iv. Number of days in the collection period
v. Inventory turnover
vi. Number of days in the selling period
vii. Debt to equity ratio
viii. Proprietary ratio
ix. Return on equity ratio

Assume, where applicable, that the year-end balances in the statement of financial position are representative of averages. (9 marks)

b) Do you recommend the expansion? Why or why not? (1 mark)

(Total: 10 marks)

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