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**University Examinations 2015/2016**

THIRD YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE

OF

 BACHELOR OF COMMERCE

**BFC 3227: FINANCIAL ACCOUNTING THEORY**

**DATE: APRIL 2016 TIME: 2 HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two***questions.

**QUESTION ONE (30 MARKS)**

1. During the just concluded ICPA (K) conference at the Kenya School of Monetary Studies, it was pointed out that “the current annual accounts and financial reports” by companies are inadequate in terms of contents, disclosures and therefore have no higher reporting utility that meets the needs of users and stakeholders. Further it was noted that the “Balance sheet” the “Profit and Loss Account” and “the Statement of cash flows” are all met for shareholders with no significant address to other classes of users of financial statements.

**Required:**

1. Discuss the inadequacies in accounting and financial reporting that are likely to feature in the current approaches of financial reporting through the use of annual accounts and financial statements as noted in the ICPA (K) conference. (5 marks)
2. Elucidate clearly the term disclosure in the context of financial reporting and illustrate how accounts and financial statements can have adequate disclosures with regard to non-current assets of a company. (3 marks)
3. Explain the circumstances in which accounts and financial statements may fail to meet the needs of users and hence fail to provide higher financial reporting utility to stakeholders. (4 marks)
4. The following information was extracted from the records of stocks exchange market authority in one of the African Countries.

Sasa Public Limited Liability Company Financial Position as at 31st March 2016

|  |  |
| --- | --- |
| **Assets**  |  |
| **Non Current Assets (NBV)** |  |
|  | Shs Million |
| Property, Plant & Equipments  | 1,036 |
| Long term Investments  | 200 |
| Investment properties  | 250 |
| **Current Assets**  |  |
| Debtors (Loans) | 10,750 |
| Bank  | 2,100 |
| Cash  | 450 |
| Short term investment in GOK treasury Bills  | 1,514 |
| Total Assets  |  |
| Financed by: |  |
| Ordinary share capital Shs.20 par value each | 1,000 |
| Share premium  | 300 |
| Assets revaluation reserve  | 186 |
| Profit and Loss Balance  | 1,500 |
| **Non Current Liabilities**  |  |
| Long term Customers Deposits  | 7,500 |
| **Current liabilities**  |  |
| Trade creditors (Customer Deposit) | 5,500 |
| Other Trade Creditors  | 314 |
| Total Shareholders’ funds & liabilities  |  |

**Required:**

1. Explain the disclosures that the reporting directors (“accountants”) should make with regard to
* Current assets of sasa ltd (2 marks)
* Liabilities of Sasa Ltd (2 marks)
* Firm’s Risk exposure (2 marks)
1. Discuss the limitations of substance over form theoretical concepts of accounting

(3 marks)

1. Explain other measures that governments and stakeholders can make enhance and foster higher financial reporting utility on accounts and financial statements of banks and firms in the financial sectors of the African Economies. (5 marks)
2. Highlight the merits of quality accounting and financial information to the markets (4 marks)

**QUESTION TWO (20 MARKS)**

1. Discuss two elements of a financial statement. (3 marks)
2. Illustrate, analytically, how the concept of time interval, accrual, business entity and the going concern may have contribut4ed to the classification of non-current and current assets and liabilities, working capital and permanent capital in an enterprise.

(6 marks)

1. Describe at least three approaches that have been used in the development of accounting theories (6 marks)
2. Elucidate the role of Auditing theory, agency theory and legimate theory on the development and advancement of accounting as a discipline of study and practice. (3 marks)
3. Explain some of the challenges that accountants may face in practice in applying the consistency concept on financial transactions accounting and reporting (2 marks)

**QUESTION THREE (20 MARKS)**

It is generally agreed that sales revenue should only be ‘realized’ and so ‘recognized’ in the trading, profit and loss account when:

1. When a cash sale is made.
2. The customer promises to pay on or before a specified future date, and the debt is legally enforceable.

The prudence concept is applied here in the sense that revenue should not be anticipated, and included in the trading, profit and loss account, before it is reasonably certain to ‘happen’.

**Required:**

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

1. Goods have been acquired by the business, which it confidently expects to resell very quickly.
2. A customer places a firm order for goods.
3. Goods are delivered to the customer.
4. The customer is invoiced for goods.
5. The customer pays for the goods.
6. The customer’s cheque in payment for the goods has been cleared by the bank. (20 marks)

**QUESTION FOUR (20 MARKS)**

Mauzo Ltd engages in real estate business owning only one property. The company’s main income is rental income.

The balance sheet of the company as at the end of the year 1 and year 2 is as follows:

|  |  |  |
| --- | --- | --- |
|  | **Year 1** | **Year 2** |
|  | **Kshs** | **Kshs** |
| Assets  |  |  |
| Building (net) | 150,000 | 105,000 |
| Cash  | 45,000 | 90,000 |
|  |  |  |

The comparative income statements for both year 1 and year 2 are given below:

|  |  |  |
| --- | --- | --- |
|  | **Year 1** | **Year 2** |
|  | **Kshs** | **Kshs** |
| Revenue  | 82,500 | 90,755 |
| Expense  |  |  |
| Depreciation  |  |  |
| Net Income  |  |  |

Additional Information

* The company was formed on January 1st, Year 1 through a cash investment of Ksh. 195,000.
* The building was acquired on January 1st Year 1 at a cost of 195,000. Expected useful life is years.
* All revenue is received at the end of the year.
* There is no operating expenses except depreciation.
* Al net income is paid out as a dividend. The balance of cash in banked at no interest return.
* The price indexes for Year 1 and Year 2 are as follows.

1st Jan Year 1 100

31st Dec Year 1 105

31st Dec Year 2 110

**Required:**

Prepare the balance sheet and income statements for Mauzo Ltd for the two years using the current purchasing power approach. (20 marks)

**QUESTION FIVE (20 MARKS)**

The phrase “Public Interest” has been used to justify government objective of regulating and controlling accounting and accounting information despite the fact that accountancy bodies like ICPA (k) do administer codes of conduct and ethics for accountants.

**Required:**

1. Explain and justify with concrete reasons why government and their agencies should regulate and control accounting and accounting information in a given country. (5 marks)
2. Discuss the importance of legislation to the theory and development of conceptual framework of accounting. (5 marks)
3. Highlight some of the demerits of government controls and regulations of the accounting practice and profession in Kenya. (4 marks)
4. Highlight the role of ICPA (K). Have the codes issued by the accountancy body been effective in regulating the professional conduct and ethics of accountants in Kenya? Discuss (6 marks)