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**University Examinations 2016/2017**

THIRD YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR

 OF COMMERCE

 **BFC3327: FINANCIAL ACCOUNTING THEORY**

 **DATE: DECEMBER 2016 TIME: 2HOURS**

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

**QUESTION ONE (30 MARKS)**

1. Write concise note on the objectives of income measurement, which you may recommend to the standards setting committee in improving the existing financial reporting practices (10 marks)
2. 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

 95,000 195,000

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

|  |  |  |
| --- | --- | --- |
|  | Year 1 Kshs | Year 2Kshs |
| RevenueExpense Depreciation Net income  | 82,500(45,000) 37,500 | 90,755(45,000) 45,755 |

**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 41/3 years
* All revenue is received at the end of the year
* There are no operating expenses except depreciation
* All net income is paid out as a dividend. The balance of cash is banked at no interest return
* The price indices for year 1 and year 2 are as follows

1st Jan year 1 100

31st Dec year 1 105

31st Dec year 1 110

**Required:**

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

**QUESTION TWO (20 MARKS)**

1. “Inflation accounting is an element but a useless creature with a prodigious appetite for extra data. It is the sterile offspring of a scandalous marriage between high financial economics and mismanaged economics”

Required:

In light of the above statement, summarise some of the arguments that can be advanced to defend historical cost accounting (6 marks)

1. ABC ltd has 300 staff aged between 35-64 whose salary per employee per year is as shown below

Age (years) average annual /employee

35-44 400,000

45-54 500,000

55-64 600,000

Assume further that the discount rate of the company is 10% and that all the staff are 35 years of age now. Using Lev and Schwarts model calculate the value of the human capital

(14 marks)

**QUESTION THREE (20 MARKS)**

The following entry appeared in the balance sheet of Rising Value Ltd. For the financial year ended 31 March 1992 for furniture and fittings

Historical cost Accumulated Depreciation Net Book Value

 Based on Historical Cost

Kshs. Kshs. Kshs.

5,200 3,400 1,800

Depreciation charged in the current year profit and loss account on furniture and fittings was ksh. 1,400(ksh. 900 on 1998 purchase and kshs. 500 on 1991 purchases)

Relevant specific price indices were 150 for 1988, 200 for 1991 and 225 at 31 march 1992

**Required:**

1. Calculate and state the depreciation charge for furniture and fittings based on current cost accounting principles to be entered in the 1992 profit and loss account. How the entry for the assets furniture and fittings in the current cost accounting balance sheet as at 31 March 1992. State the amount credited to current cost reserve in that balance sheet for furniture and fittings (20 marks)

**QUESTION FOUR (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. 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

 (20marks)

**QUESTION FIVE (20 MARKS)**

1. Explain the role of accounting theory in the practice of accountants (8 marks)
2. Describe ways of measuring the value of human resources in a firm (12 marks)