UNIVERSITY OF EMBU

2017/2018 ACADEMIC YEAR

SECOND SEMESTER EXAMINATIONS

FIRST YEAR EXAMINATION FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

DAC 501: FINANCIAL ACCOUNTING

DATE: APRIL 25, 2018 **TIME: 8:30 AM – 11:30 AM**

INSTRUCTIONS:

Answer ANY FOUR Questions

QUESTION ONE (25 MARKS)

a) Explain any three reasons to illustrate the importance of a conceptual framework in financial accounting (6 marks)

b) Discuss the primary objectives of financial reporting as indicated in Statement of Financial Accounting Concepts No. 1. (3 marks)

c) Briefly describe the primary qualities of useful accounting information. (4 marks)

d) The third level of the conceptual framework consists of concepts that implement the basic objectives of level one. These concepts explain which, when, and how financial elements and events should be recognized, measured, and reported by the accounting system. Briefly discuss any two basic assumptions and two basic principles as specified in the third level of the conceptual framework. (8 marks)

e) Explain why it has not been possible to achieve a universal agreement on a conceptual framework. (4 marks)

QUESTION TWO (25 MARKS)

a) Mlachake Limited's year-end inventory at the 31 December amounted to Sh.164,300 valued at cost. However, some inventory items were damaged prior to year-end and will require repair work that will cost an estimated Sh.1,280. When repaired, the items can be sold for 90% of cost. The cost of these damaged goods was Sh.2,400. Determine the value of the closing inventory in accordance with IAS 7. (5 marks)

b) Explain the importance of ratio analysis to a business enterprise. (4 marks)

c) The following information was extracted from the financial statements of Sunrise Ltd. and Sunset Ltd. in respect of the year ended 30 September 2017:

Statement of comprehensive income extracts for the year ended 30 September 2017:

	Sunrise Ltd.	**Sunset Ltd.**
	Sh. '000'	**Sh. '000'**
Sales	497,000	371,000
Cost of sales	258,000	153,000
Operating profit	138,000	79,000
Interest expense	19,000	-

Statement of financial position extracts as at 30 September 2017:

	Sunrise Ltd.	**Sunset Ltd.**
	Sh. '000'	**Sh. '000'**
Non-current assets	142,000	92,000
Current assets:		
Inventory	100,000	87,000
Debtors	46,000	42,000
Cash at bank	40,000	44,000
Current liabilities	98,000	108,000
Long-term loan	33,000	-
Shareholders' funds	197,000	157,000

Required:

For each company, compute the following ratios:

i) Acid test ratio (3 marks)

ii) Inventory turnover (3 marks)

iii) Return on capital employed (4 marks)

iv) Debt equity ratio (3 marks)

v) On the basis of the ratios computed above, explain which of the two companies would provide better investment. (3 marks)

QUESTION THREE (25 MARKS)

The following trial balance was extracted from the books of Red Apple Ltd. For the year ended 31st December 2017.

	Sh.000	Sh. 000
Ordinary share capital 14.4 million ordinary shares of Sh. 10 each.		144,000
Gross profit for the year		259,000
Retained profits 1st January 2017		5,768
Trade debtors	10,920	
Creditors		371
Share premium		6,475
Investments	168,000	
Goodwill	756	
Discounts allowed and received	1,351	840
Salaries and wages	17,255	
Rent and rates	9,240	
Interim dividends paid	3,234	
Auditors fees	2,695	
Directors fees	8,876	
Loan interest and bank charges	1,498	
General administrative expenses	4,389	
Stock on 31st December 2017	8,820	
Freehold land and buildings at cost	95,560	
Plant and machinery at cost	59,500	
Accumulated depreciation on machinery 1st January 2017		10,150
Motor vehicles at cost	43,400	
Provision for depreciation on motor vehicles 1st January 2017		17,700
Bank balance	6,100	
Provision for doubtful debts		500
Cash in hand	3,210	
	444,804	444,804

The following additional information has been provided:

1. The corporation tax rate is estimated at 30% of the current years' net profit.
2. The directors propose to transfer Sh. 120,000,000 to a general reserve account and to pay sufficient dividends to bring the total dividends of the year to10% of the share capital.
3. It was decided to amortize goodwill over a 10-year period commencing 2017.
4. Adjust the provision for bad debts to 1% of debtors.
5. Provide for depreciation as follows: Plant and machinery; 5% on straight-line basis and motor vehicles at 20% on reducing balance basis.

Required:

a) Income statement for the year ended 31st December 2017. (10 marks)

b) Statement of change in equity for the year ended 31st December 2017. (5 marks)

c) Statement of financial position as at 31st December 2017. Include relevant notes using only the information provided to ensure that the financial statements meet the requirements of international financial reporting standards (IFRS) (10 marks)

QUESTION FOUR (25 MARKS)

a) Identify any three users of accounting information. For each of the identified users of financial statements, discuss the kind of information they may require, why they require it and the decisions they make from that information. (6 marks)

a) Briefly explain the objectives and scope of IAS 7 (Cash Flow Statements). (6 marks)

b) The following are extracts from the financial statements of Wewe Ltd. As at 31 March:

	2018		2017	
	Sh.'000'	**Sh.'000'**	**Sh.'000'**	**Sh.'000'**
Fixed assets:				
Goodwill		2,800		2,900
Freehold land and building		16,800		12,000
Plant and machinery (NBV)		5,860		6,350
Investment at cost		3,600		3,750
		29,060		25,000
Current assets:				
Stocks	10,050		8,700	
Accounts receivable	6,140		7,800	
Investments	1,710		840	
Cash at hand and bank	200		430	
	18,100		17,770	
Current liabilities				
Bank overdraft	(2,390)		(6,540)	
Accounts payable	(5,850)		(5,250)	
Proposed dividends	(450)		(380)	
Taxation	(820)		(600)	
	(9,510)		(12,770)	
Net current assets		8,590		5,000
		37,650		30,000
15% debentures		(7,500)		(9,000)
		30,150		21,000
Capital and reserves:				
Authorised, issued and paid Sh.10				
Ordinary shares		18,000		15,000

Share premium	1,500	750
Revaluation reserve	4,500	-
Retained profit	6,150	5,250
	30,150	21,000

The profit and loss appropriation account for the year ended 31 March 2002 is given below:

	Sh.'000'	**Sh.'000'**
Net profit before tax		2,400
Less: Corporation tax		900
Profit after tax		1,500
Dividends:		
Interim (paid)	150	
Proposed (paid)	450	600
		900

The following additional information is provided:

1. Profit for the year is arrived at after charging:

	Sh.'000'
Depreciation on plant and machinery	1,150
Goodwill amortisation	420

2. During the year, plant with a net book value of Sh.750,000 was sold for Sh.1,470,000. The plant had originally cost Sh.3,000,000.
3. The investments portfolio was reduced by selling one block of shares at a profit of sh.160,000.

Required:

Prepare cash flow statement in accordance with IAS 7. (13 Marks)

QUESTION FIVE (25 MARKS)

a) Explain the criteria for determining whether hyperinflation exists in accordance to International Accounting Standard (IAS) 29. (5 marks)

b) Explain the various components of financial statements as set out in International Accounting Standard (IAS) 1. (5 marks)

c) Explain any two events after the balance sheet date according to International Accounting Standard (IAS) 10. (4 marks)

d) Explore any three indicators of corporate failure. (3 marks)

e) Explain the accounting treatment that would be applicable in dealing with the following transactions relating to the accounts of Mlachake Ltd. for the year ended 31 December 2014:

   i) A debtor who owed the company Sh 200,000 was declared bankrupt on 1 February 2015. 25% of the debt had been recovered when the accounts were approved by the directors on 15 March 2015. (2 marks)

   ii) Some items of inventory purchased for Sh 300,000 were damaged in the warehouse during the year. These items were repaired at Sh 50,000 and sold to a customer on 2 February 2015 at 75% of the normal selling price of Sh.400,000. (3 marks)

   iii) On 10 December 2017, the company secured an order worth Sh 1.2 million from a foreign based company. The goods were shipped on 10 January 2015 and included in sales for December 2017. (3 marks)

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