MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

SECOND YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF COMMERCE

BAC 201: ACCOUNTING FOR LIABILITIES AND EQUITIES

DATE: 7/5/2019 **TIME: 2.00-4.00 PM**

INSTRUCTIONS: Attempt Question One and any other Two Questions

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Mueni lost her inventory in a fire on 17 march 2009.The last time that stock taking had been done was on 31 December 2008, the last balance sheet date, when the inventory was valued at cost at sh.39, 000,000.Purchase from then until 17 march 2009 amounted to sh 163,400,000 and sales in that period were sh 197,000,000.All sales were made at a uniform gross profit margin of 20%.

Required

i) Calculate the amount for sales. (3 marks)
ii) Prepare trading account for the period 2009. (7 marks)

b) Giving reasons classify the following as either liability or equity.

i) Company B issues ordinary shares. Shareholders are entitled to a pro rate share of any dividends or other distributions of the entity. Dividends are discretionary. 3 marks
ii) The facts are the same as in a) except that ,because of legal requirements in its jurisdiction, Company B is required to pay an annual dividend of at least 10 % of the par value of its issued shares. (3 marks)

iii) The facts are the same as in A above However, in this example, on company B jurisdiction, tax is not payable on distributed profit under sh. 2,000,000. A 50 % tax rate applies to all undistributed profits and to any distributed profits in excess of sh. 2,000,000.Consequently, company B always plans to make dividend payment of at least 2,000,000 in the light of the significant tax benefit. (3 marks)

iv) The facts are the same as in ii. However, in this example, company B must redeem the shares for par in the event of an initial public offering (IPO). Company B has discretion on whether or not to initiate an IPO. (3 marks)

v) Company B has 1000,000 preference shares in issue, which are all held by institutional investors. The preference shares must be redeemed for cash on the earlier of five years from the issue date of the shares or the date upon which SME A initiates an IPO.SME A has discretion on whether or not to initiate an IPO. (3 marks)

c) There are some financial instruments that meet the definition of a liability but are classified as equity because they represent the residual interest in the asset an entity. Comment. (5 marks)

QUESTION TWO (20 MARKS)

The following are summaries of the of the cash book and bank accounts of J Duncan who does not keep his books using the double entry system.

Bank summary	shs. 000	shs. 000
Balance on 1 january 2008		16,000
Receipts	32,000	
Accounts receivable	8,200	60,200
Cash banked		76,200
Payments		
Trade accounts payable	37,000	
Rent	2,800	
Machinery	15,000	

Wages	12,200	
Insurance	2,900	
Accounts receivable (dishonoured cheque)	500	
Loan interest	600	71,000
Balance on 31 December 2008		5,200
Cash summary	shs	shs
Balance on 1 January 2008		600
Receipts		
Cash sales	28,000	
Accounts receivable	800	28,800
		29,400
Payments		
Drawings	19,000	
Repairs	600	
Electricity	1,500	
Cash banked	8,200	29,300
Balance on 31 December 2008	100	
The following referred to 2008	shs	
Bad debts written-off	800	
Discount received	700	
Goods withdrawn by J Duncan for own use	600	
Credit note issued	2,400	

The following additional information is available	1st January 2008	31 Dec 2008
	Shs	shs
Inventory	8,200	6,400
Machinery	25,200	31,800
Rent prepaid	400	
Rent owing		500
Account receivable	12,600	10,000
Account payable	4,800	5,000
Loan from bank at 8%	10,000	10,000
Loan interest owing		200

You are required to:

a) Calculate the value of J Duncan s capital on 1 January 2008. (10 marks)

b) Prepare the income statement for the year ending 31 December 2008 (10 marks)

QUESTION THREE (20 MARKS)

Company C has a 31 December year-end. On 1 January 2015 Company C has ordinary share capital of sh. 200,000,000, which was contributed at par on incorporation of Company C. The par value of the shares of the entity is sh. 2 per share.

On 1 January, 2015 the entity issues as further 300,000,000 ordinary shares at sh. 10 per share. The shares are issued for cash.

Also on 1 January, 2015, as an incentive to encourage investment, each shareholder is permitted to buy one share option for every share purchased on 1 January 2015 at sh. 1 per option. Each option allows the holder to buy one share on 31 January 2016 at sh. 8. per share. 200,000 ,000 share options are purchased.

On 31 January 2016 190 ,000,000 share options are converted into ordinary shares and 10,000,000 options lapse.

Required

a) Journal entries on
   i) January 1 2015. (8 marks)
   ii) December 2015. (8 marks)

b) Statement of financial position as at January 31, 2016. (4 marks)

QUESTION FOUR (20 MARKS)

a) Explain the distinguishing features of a finance lease. (6 marks)

b) Highlight the factors which give rise to deferred taxation according to IAS 12 (8 marks)

c) Explain the following terms as per the IFRS:

   (i) Equity
   (ii) Financial liability instrument?

QUESTION FIVE (20 MARKS)

Assume that accompany purchased a fixed asset in 1st January 2012 at a cost of kshs. 24,000,000. The residual value of the asset is assumed to be Nil, and it is to be depreciated as a straight-line basis over 4 years. The company claims 100%first year allowance and the corporation tax rate for each of the four years is assumed to be 35% profit after charging depreciation is kshs 120,000,000 in each of the four years and there are no other timing differences. No capital expenditure taxes place in 2013, 2014 and 2015

Required

i) Compute deferred tax (5 marks)

ii) Analyse timing differences (5 marks)

iii) Calculate profit after tax for each of the years (5 marks)

iv) Journal entries to record the income tax expense and related deferred tax liability for tax years 2012 and 2013. (5 marks)