MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BANKING, ACCOUNTING & FINANCE

THIRD YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF COMMERCE

BAC 302: ADVANCED FINANCIAL ACCOUNTING II

DATE: 17/4/2019 **TIME: 8:30 – 10:30 AM**

INSTRUCTIONS:

i) Answer question one and any other two questions.
ii) Marks allocated for each question are shown at the end of the question.
iii) Show your working where necessary.

QUESTION ONE: COMPULSORY (30 MARKS)

a) Briefly explain any TWO types of pension schemes (4 marks)

b) Explain the following terms as used in Accounting;
   i) Associate (2 marks)
   ii) Cash Generating Asset (2 marks)
   iii) Subsidiary (2 marks)
   iv) External reconstruction. (2 marks)
   v) Fixed price contract (2 marks)

c) A Kenyan Company Kilele Ltd. makes up its accounts to 31 December each year. On 15 September 2018 it purchased an item of machinery from Zawadi Company in Tanzania on credit for Tsh. 3,000,000 when the exchange rate was; Tsh. 20 for Ksh 1. The asset was paid for on December 15, 2018 when the exchange rate was Ksh. 21: Ksh 1.

Required:
   i) Show the journal entry in the books of Kilele Ltd to record the transaction on 15 September, 2018. (3 marks)
   ii) In the books of Kilele Ltd, show Zawadi Company Account as at 31 December 2018. (3 marks)

d) Giving relevant examples, distinguish between provisions and contingencies. (4 marks)

e) The following information was extracted from the books of Pendo Ltd relating to its assets.

Details	A	B	C
	Sh. '000'	Sh. '000'	Sh. '000'
Carrying amount	850	1275	1020
Net realizable value	935	1062.5	850
Value in use	1020	1105	765

Required:

i) Determine the recoverable amount of each asset (3 marks)

ii) Determine the impairment loss if any. (3 marks)

QUESTION TWO (20 MARKS)

Lusiola Ltd, acquired 90% of the ordinary shares of Kacheliba Ltd. on 1 April 2016 for Sh. 30 million when Kacheliba Ltd's retained earnings were Sh. 15 million.
The balance sheets of the two companies as at 31 March 2018 were as follows:

	Lusiola Ltd	**Kacheliba Ltd**
Non – Current Assets	**Sh. "000"**	**Sh. "000"**
Property, plant and equipment	26,400	16,200
Investment in Kacheliba Ltd.	30,000	-
Other investments	1,000	6,000
	57,400	22,200
Current Assets		
Inventory	9,500	4,000
Accounts receivable	7,200	1,500
Bank	300	-
	17,000	5,500
Total Assets	**74,400**	**27,700**
Equity and Liabilities		
Ordinary share capital (Sh. 10 each)	10,000	5,000
Retained earnings	48,600	6,300
	58,600	11,300
Non – Current Liabilities		
12% Debentures	4,000	6,000
Current Liabilities		
Accounts payable	6,700	5,200
Taxation	4,100	700
Dividends payable	1,000	-
Overdraft	-	4,500
	11,800	10,400
Total equity & Liabilities	**74,400**	**27,700**

Additional Information;

i) The movement in Kacheliba Ltd's retained earnings since acquisition was as follows:

	Sh. "000"
Balance as at 1 April 2016	15,000
Loss for the year ended 31 March 2017	(3,000)
Loss for the year ended 31 March 2018	(1,700)
Dividend paid in the year ended 31 March 2018	(4,000)
Balance as at 31 March, 2018	**6,300**

ii) Lusiola Ltd. accounted for its share of Kacheliba Ltd's dividend as a credit to income. The group policy on dividend is to credit group income with dividends paid out of post – acquisition profit only.

iii) On the date of acquisition, the fair values of Kacheliba Ltd's assets were approximately equal to their book values except for;
- Plant which had a net replacement value of Sh. 6.0 milion in excess of its book value and an estimated remaining useful life of five (5) years.
- Investments with market value of Sh. 8 million.

iv) There were no acquisitions or disposals of non – current assets since 1 April 2016.

v) The group policy in relation to goodwill arising from acquisition was to capitalize it and amortize it over six (6) years. However, goodwill was tested for impairment from 1 April 2017 to 31 March 2018 and found to be impaired by 16.67%. Amortization for the year ended 31 March 2017 had been provided.

vi) On 27 March 2018, Lusiola Ltd sold goods to Kacheliba Ltd for Sh. 600,000. These goods had not been received by 31 March 2018 and were excluded from Kacheliba Ltd's inventory. Lusiola Ltd. charges goods at a standard mark – up on cost of 20%. Prior to this transaction, the agreed purchase ledger account balance of Kacheliba Ltd with Lusiola Ltd. was Sh.1, 400,000.

Required:

Group statement of financial position as at 31 March 2018.

QUESTION THREE (20 MARKS)

Major Ltd is a holding company with several subsidiaries. Given below is the consolidated profit and loss account of the company and its subsidiaries for the financial year ended 31 December 2017 and the consolidated comparative balance sheets as at 31 December 2016 and 2017.

Consolidated Profit & Loss Account for the year ended 31 December 2017

	Sh. "m"
Sales	120125
Cost of sales	(96100)
Gross profit	24025
Profit on disposal of a subsidiary	525
	24550
Operating expenses	(14675)

Finance costs	(2125)
Profit before tax	7750
Taxation: Current	(3325)
Deferred	1325
Profit after tax	5750
Share of associates profit after tax	2125
Non – Controlling Interest	(625)
	7250
Interim dividend paid	(1000)
Final divided proposed	(1500)
Retained profit	**4750**

Consolidated Statement of Financial Position as at 31 December

	2017	**2016**
	Sh. "m"	**Sh. "m"**
Non – Current Assets		
Property, Plant & Equipment	70775	58625
Investment in associate company	15925	9500
Goodwill	7500	7125
Patents	4000	4250
	98200	79500
Current Assets		
Inventory	3550	3200
Trade receivables	5950	5350
Bank balance & Cash in hand	1950	1575
	11450	10125
Total Assets	**109650**	**89625**
Capital & Liabilities		
Equity and Reserves		
Ordinary share capital	35000	25000
Share premium	12500	10000
Revaluation reserve	8750	5000
Retained profit	12750	8000
	69000	48000
NCI	4125	4500
	73125	52500
Non – Current Liabilities		
Finance Lease	11250	15000
Deferred tax	4000	4625
Debentures	12000	9000
	27250	28625
Current Liabilities		
Trade payables	3350	3125
Current tax	1800	2350
Finance lease	1625	1250
Interest payable	1000	775
Proposed dividends	1500	1000
	9275	8500
Total capital and liabilities	**109650**	**89625**

Additional information;

1. During the year ended 31 December 2017, Major Ltd purchased 80% of the issued ordinary shares of Minor Ltd for Sh.12.5 billion. The purchase consideration was settled by Major Ltd by issuing its 200 million ordinary shares of Sh. 25 each at a premium of 30%. The balance of the consideration was settled in cash. The fair values of the net assets of Minor Ltd at the date of acquisition were as follows:

	Sh. "m"
Property, Plant and Equipment	13025
Inventory	1200
Trade receivables	1400
Bank balance & Cash in hand	450
Deferred tax	(700)
Trade payables	(850)
Current tax	(525)
	14000

2. On 30 September 2017, Major limited sold its 60% holding in the ordinary shares issued by Zama Ltd at a profit of Sh. 525 million. The shares in Zama Ltd were acquired at Sh. 5125 million when the fair value of the net assets of the company was Sh. 7.5 billion
3. At the date of disposal of the shares in Zama Ltd, the net assets of the company were as follows:

	Sh. "000"
Property, Plant & Equipment	9925
Inventory	1075
Trade receivables	1275
Bank balance & Cash in hand	(375)
Debentures	(1250)
Trade payables	(700)
Current tax	(450)
Interest payable	(125)
	9375

4. Goodwill on acquisition of Zama Ltd had been impaired by 40% by the time of the disposal of its shares. Impairment loss on goodwill for the year ended 31 December 2017 was included in the operating expenses.
5. In order to reflect the true fair value of its non – current assets, Major Ltd revalued its assets on 31 March 2017 and incorporated the revaluation into its books.
6. Depreciation expense provided for the year ended 31 December 2017 was Sh. 4200 million.
7. Major Ltd. purchased additional ordinary shares in the associate company on 31 August 2017 at a cost of Sh.5250 million.
8. Finance costs include Sh. 1.0 billion interest on finance lease liabilities.
9. Interest payable included Sh. 300 million as at 31 December 2016 and Sh. 375 million as at 31 December 2017 attributable to finance lease liabilities.

Required:

Consolidated Cash Flow Statement of Major Ltd and its subsidiaries for the year ended 31 December 2017 (Use indirect Method)

QUESTION FOUR (20 MARKS)

Pungufu Ltd which has been posting trading losses has decided to re-organize its capital on 31 October 2016, a trial balance extracted from the books of the company after the income statement had been prepared, showed the following;

Details	Shs '000'	Shs '000'
6% cumulative pref. share capital (Sh. 10 par value)		150,000
Ordinary share capital (Sh. 10 par value)		200,000
Share premium		40,000
Accumulated losses	114,375	
Preliminary expenses	7,250	
Goodwill	55,000	
Trade payables		43,500
Trade receivables	31,200	
Bank overdraft		51,000
Leasehold property: Cost	80,000	
Accumulated depreciation		30,000
Plant and machinery - Cost - Accumulated depreciation	210,000	62,500
Inventory	79,175	

Approval of the court was obtained for a scheme of capital reduction whose terms were as follows:-

i) The par value of the preference shares was to be reduced to Sh. 7.5 per share.

ii) The par value of the ordinary shares was to be reduced to Sh. 1.25 per share

iii) One Sh. 1.25 ordinary share was to be issued for each Sh. 10 preference dividend in arrears. The preference dividend had not been paid for the past three financial years (Financial year to 31 October 2016 inclusive)

iv) The balance on the share premium account was to be utilized for purposes of capital reduction.
v) The value of plant and machinery was to be written down to Sh. 75 million
vi) The accumulated losses as well as goodwill were to be written off.
vii) After the resolution authorizing the scheme of capital reduction had been passed 50 million ordinary shares were issued at par for cash payable in full upon application.

Assume all transactions were completed on 31 October 2016.

Required:

a) Capital reduction account as at 31 October 2016. (10 marks)

b) Ordinary Share Capital account & Bank account (4 marks)

c) Statement of financial position as at 1 November 2016 after completion of all the transactions. (6 marks)

QUESTION FIVE (20 MARKS)

a) Explain how the following methods can be used to account to for construction contracts.
   i) Percentage of completion method (2 marks)
   ii) Completed contract method (2 marks)

b) Vihiga Construction Company Ltd. entered into a contract to build an administration block for Rongo Manufacturers Limited on 15 October 2015. The construction was to start on 1 January, 2016 and be completed in three years. The contract price was Sh. 850,000,000.00
The following is the information pertaining to the contract from the books of Vihiga Construction Company Limited.

Year ended 31 December;

	2016	**2017**	**2018**
	Sh. "m"	Sh. "m"	Sh. "m"
Cost incurred in the year	300	330	120
Estimated cost to completion	300	270	-
Progress billings in the year	270	480	100
Cash collections in the year	240	360	200
General administration costs	15	20	18

Required:

Using the percentage of completion method;
i) Compute the realized gross profit for each of the three years (6 marks)
ii) Prepare the profit and loss accounts for each of the three years (6 marks)
iii) Prepare the statement of financial position extracts for each of the three years. (4 marks)