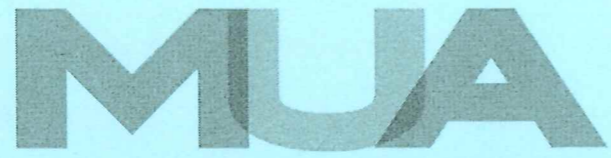


The
Management
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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

ACC 311 : FINANCIAL ACCOUNTING THEORY

DATE: 17TH DECEMBER 2024

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

QUESTION ONE

Read the following case and answer the questions that follow:

HUMAN RESOURCE ACCOUNTING AND COMPENSATION PRACTICES AT PRUDENTIAL PLC: LEGALISED DISCRIMINATION?

There is a general consensus that employees are the greatest asset that any organization possesses. This can be justified by the fact that all other organizational assets require some human intervention for them to be productive. From an economics perspective, labour is one of the factors of production besides land, capital and entrepreneur. Labour and the entrepreneur are humans. The productivity of land and capital cannot be maximized without human input.

Rensis Likert was a great proponent of Human Resource Accounting (HRA). He argued that since human beings are the greatest asset that an organization possesses, expenditures incurred by organizations on recruitment and selection of employees, training and development of employees etc. should be treated as investments. This is unlike conventional accounting which treats such and other employee related expenditures as mere revenue expenditures which are expensed within the income statement (profit and loss account).

Though cognizant of the importance of employees in an organization, Prudential PLC, like many other organizations, find it impracticable at least for the time being, to fully implement the tenets of Rensis Likert and other social scientists. How would the valuations of each employee be determined? For other physical assets, valuation may be done using various methods such as historical cost, replacement cost, current market value as well as present value. Physical assets also get depreciated over their useful economic life. How would depreciation or appreciation on human assets be determined? Furthermore, the International Financial Reporting Standards are yet to recognize HRA in the manner in which its proponents argue it out.

According to a story told about 'The Animal Farm', 'all animals are equal but some animals are more equal than others'. There are significantly huge disparities between salaries and other compensation schemes offered by Prudential PLC. The senior executives such as the Chief Executive Officer (CEO), Chief Finance Officer (CFO) and other senior executives are paid monthly salaries and allowances in excess of

one million Kenya Shillings each. In addition, these senior executives are entitled to other benefits such as free holidays fully paid for by the employer, travels using the Company's jet etc. On the sharp contrast, other employees' monthly salaries are within the range of Ksh 20,000 to Ksh 100,000. Even professionally trained employees and University graduates are paid remuneration within this latter range.

The Chief Executive Officer (CEO) of Prudential PLC wasn't the founder of the company. An analysis of the industry average depicts no correlation between executive pay versus performance, nor does it depict any correlation in terms of peer executive compensation comparisons. Over the recent years, there have been high fluctuations in profitability from year to year for Prudential PLC whereas executive pay has been on an upward trend over the same periods.

Executive compensation practice with huge disparities between senior executives and other employees may appear very surprising and strange. However, it is a practice that is common amongst many modern-day companies, unfair as it may seem. Are there any justifications for the executive compensation practice? Is it a legalized form of discrimination?

Required:

Based on the above case study and relevant knowledge on Human Resource Accounting (HRA) and Executive Compensation;

a) Assess five difficulties encountered by Prudential PLC and other organizations in the implementation of the tenets of Human Resource Accounting (HRA).

(5 Marks)

b) Produce six justifications for the practice of executive compensation that may be relied upon by modern organizations and which should be emulated by Prudential PLC.

(12 Marks)

c) Critique the practice of executive compensation citing examples from Prudential PLC and experiences from other organizations.

(8 Marks)

QUESTION TWO

- a) Demonstrate the negative repercussions of the existence of 'information asymmetry' in the financial sector of an economy. **(6 Marks)**
- b) Appraise three main reasons why companies quoted on a stock exchange practice earnings management citing examples. **(9 Marks)**

QUESTION THREE

- a) Describe the main features that show the importance of 'accounting theory'. **(5 Marks)**
- b) Evaluate the ethical concerns that may be advanced on the practice of 'earnings management'. **(10 Marks)**

QUESTION FOUR

- a) Propose three main factors responsible for advancements in financial reporting in the modern era. **(6 Marks)**
- b) Apply the three degrees of Efficient Market Hypothesis to stock exchanges of your choice. **(9 Marks)**

QUESTION FIVE

- a) Demonstrate the significance of 'inflation accounting' to financial reporting by multinational enterprises. **(5 Marks)**
- b) Compose five qualitative features of financial statements that guide development of accounting standards. **(10 Marks)**

QUESTION SIX

- a) Examine five objectives of Human Resource Accounting (HRA) as envisaged by Rensis Likert. **(5 Marks)**
- b) Design five principles that guide professional conduct according to Institute of Certified Public Accountants of Kenya (ICPAK) underpinning the essence of each. **(10 Marks)**