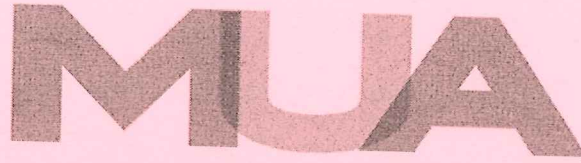


The
Management
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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

BCM 221: ACCOUNTING FOR LIABILITIES

DATE: 3RD APRIL 2025

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

- a) Examine four components of pension expense and their effect (4 Marks)
- b) The shareholders equity section of the balance sheet of National foods included the following a/cs at Dec 31, 2022

	(\$ in millions)
Shareholder's equity	
Common stock, 120 million at \$1 par	\$120
Paid in capital-excess of par	836
Retained earnings	<u>2,449</u>
Total shareholders' equity	<u>\$3,405</u>

Required:

- a) During 2023, several transactions affected the stock of National foods. Prepare the appropriate entries for these events. (9 Marks)
- On March 11, National foods sold 10 million of its 9.2% preferred shares, \$1 par per share, for \$44 per share-by-share purchase contract. 50% of the selling price was received for the remainder. The shares were not issued but held in escrow until the note was paid.
 - On November 22, 1 million common shares, \$ 1 par per share, were issued in exchange for eight labeling machines. Each machine was built to custom specifications so no cash price was available. National foods stock was listed at \$10 per share.
 - On November 23, 1 million of the common shares and 1 million preferred shares were sold for \$60 million. The preferred shares had not traded since March and their mkt value was uncertain.
- ii) Prepare the shareholders equity section of the comparative balance sheet for National foods at December 31, 2023 and 2022. Assume that net income for 2023 was \$400 million and only other transactions affecting shareholders' equity was the payment of the 9.2% dividend on the 11 million preferred shares (\$ 1 million) (12 Marks)

QUESTION TWO

Afya pensioners is a funded, non-contributory defined benefit scheme that was established by the management of Afya Food processors Limited in 1950. The directors have always expensed the company's contribution to the scheme in the period of contribution and also credited to the income statement of any period, any refunds made from the scheme during the period in question. As a result of the above policy, material variations in costs and incomes of Afya Food Processors Limited have arisen in the past years. These worsened by any contribution holidays or redundancies of employees. In this year's audit, the auditors. Ujuzi and Associates, described the company's pension accounting policy as "inadequate" as the resulting accounts do not give a true and fair view of pension costs to the employer. The auditors have also pointed out that current policy can be used to manipulate the company's profit levels. The auditors have suggested that either of two approaches (the accrued benefits or prospective benefits) be adopted the management in accounting for pension costs.

Required:

- (i) Do you agree with the auditors positions? Why? **(2 Marks)**
- (ii) Explain three reasons why there may be variations in the regular pension costs to the employer. **(6 Marks)**
- (iii) Describe the two accounting approaches suggested by the auditor. What is their effect on the pension fund? **(4 Marks)**
- (iv) What would be the main objective of adopting an accounting standard, with respect to pension costs, for organisation like Afya Food Processors Limited? **(3 Marks)**

QUESTION THREE

Sumias Sugar Company Limited is in the process of finalizing its financial statements for the year ended 31 March 2023. Its loss before taxation for the year is Sh.110 million. Included in this figure is a capital gain on the sale of some land: the capital gain was Sh.20 million. In arrival at loss figure, non-allowable expenses (for taxation purposes) of Sh.10 million had been incurred and a non-allowable depreciation charge of Sh.120 million had also been made. The equivalent tax-allowable capital allowances (wear and

tear deductions and farm works deductions) figure was Sh.50 million.

The performance of the company depends very much on how much cheap sugar is imported tax free from COMESA region. However, the directors have an assurance from the Treasury that suitable action will be taken. Based on this assurance you have projected that profit in the year to 31 March 2024 will be Sh.150 million; there will be a non-allowable expenses of Sh.20 million in the year to 31 March 2024 , and it is envisaged that a non-taxable capital gain will be made of Sh.10 million (you have included these in the projected profit of Sh.150 million). The capital allowances figure will be Sh.80 million and the depreciation charge will be Sh.130 million.

At 31 March 2022, there was a deferred tax liability due to accelerated capital allowances of Sh.500 million and a deferred tax asset on a tax loss brought forward of Sh.20 million. The rate of corporation tax throughout the period should be taken to be 30%. Tax losses can be carried backwards in Kenya, but can be carried forward indefinitely.

Required:

- i) Compare the tax liability for the year ended 31 March 2003 and the estimated liability for the year ending 31 March 2004. (1 Mark)
- ii) Illustrate the part of the income statement from "profit (loss) before tax" to "profit (loss) after tax" and showing the tax charge or credit in its separate components and as a sub-total, for both years. (4 Marks)
- iii) Prepare the reconciliation of expected tax based on accounting profit/ (loss) to the tax charge / (credit), for both years. (4 Marks)
- iv) Compute the deferred tax figures in the Balance Sheets, offsetting if appropriate, and the movement on the deferred tax account for both years. (6 Marks)

QUESTION FOUR

Bodyline sells sports goods and clothing through a chain of retail outlets. It offers customers a full refund facility for any goods returned within 28 days of their purchase provided they are unused and in their original packaging. In addition, all goods carry a warranty against manufacturing defects for 12 months from their date of purchase. For most goods the manufacturer underwrites this warranty such that Bodyline is credited with the cost of the goods that are returned as faulty. Goods purchased from one manufacturer, Header, are sold to Bodyline at a negotiated discount which is designed to compensate Bodyline for manufacturing defects. No refunds are given by Header, thus Bodyline has to bear the cost of any manufacturing faults of these goods.

Bodyline makes a uniform mark up on cost of 25% on all goods it sells, except for those supplied from Header on which it makes a markup on cost of 40%. Sales of goods manufactured by Header consistently account for 20% of all Bodyline's sales.

Sales in the last 28 days of the trading year to 30 September 2023 were \$1,750,000. Past trends reliably indicate that 10% of all goods are returned under the 28-day return facility. These are not faulty goods. Of these 70% are later resold at the normal selling price and the remaining 30% are sold as 'sale' items at half the normal retail price.

In addition to the above expected returns, an estimated \$160,000 (at selling price) of the goods sold during the year will have manufacturing defects and have yet to be returned by customers. Goods returned as faulty have no resale value.

Required:

Describe the nature of the above warranty/return facilities and calculate the provision Bodyline is required to make at 30 September 2023:

- (i) For goods subject to the 28 day returns policy; and (7 Marks)
- (ii) For goods that are likely to be faulty. (8 Marks)

QUESTION FIVE

On January 1, 2023 BAT group issued \$8,000,000 of 11% bonds, dated January 1. Interest is payable semiannually on June 30 and Dec 31. the bonds mature in four years. Market yield for bonds of similar risk and maturity is 10%

- i) Compute the price these bonds sold for yield the 10% market rate and record their issuance by the BAT group. **(5 Marks)**
- ii) Prepare an amortization schedule that determines interest at the effective rate and record interest on the 1st interest date, June 2023 **(10 Marks)**

QUESTION SIX

Pat co. leases an automobile with a fair value lease an automobile with a fair value of sh 8,725 from John Simon motors Inc, on the following terms.

- Non-cancelable term of 50 months
- Rental of sh 200 per month (at end of each month; present value at 1% per month is sh 7,840)
- Estimated residual value after 50 months is sh 1,180 (the present value at 1% per month is sh 715) pat co guarantees the residual value of sh 1,180
- Estimated economic life of automobile is 60 months
- Pat company's incremental borrowing rate is 12% a year (1% month) Simon's implicit rate is unknown

Required:

- i) What is the nature of the lease to Pat Company? **(1 Mark)**
- ii) Compute the present value of the minimum lease payments **(8 Marks)**
- iii) Record the lease on Pat company's books at the date of inception **(2 Marks)**
- iv) Record the first month's depreciation on Pat co.'s books (assume straight line) **(2 Marks)**
- v) Record the 1st months lease payment **(2 Marks)**