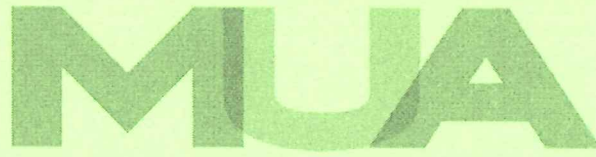


The
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UNDERGRADUATE UNIVERSITY EXAMINATIONS
SCHOOL OF MANAGEMENT AND LEADERSHIP
DEGREE OF BACHELOR OF COMMERCE

BCM 221: ACCOUNTING FOR LIABILITIES

DATE: 9TH AUGUST 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 Case Study below carefully and answer the questions that follow:

Savage, a public limited company, operates a funded defined benefit plan for its employees. The plan provides a pension of 1% of the final salary for each year of service. The cost for the year is determined using the projected unit credit method. This reflects service rendered to the dates of valuation of the plan and incorporates actuarial assumptions primarily regarding discount rates, which are based on the market yields of high-quality corporate bonds. The expected average remaining working lives of employees is twelve years. The directors have provided the following information about the defined benefit plan for the current year (year ended 31 October 2023):

- (i) The actuarial cost of providing benefits in respect of employees' service for the year to 31 October 2023 was \$40 million. This is the present value of the pension benefits earned by the employees in the year.
- (ii) The pension benefits paid to former employees in the year were \$42 million.
- (iii) Savage should have paid contributions to the fund of \$28 million. Because of cash flow problems \$8 million of this amount had not been paid at the financial year end of 31 October 2023.
- (iv) The present value of the obligation to provide benefits to current and former employees was \$3,000 million at 31 October 2022 and \$3,375 million at 31 October 2023.
- (v) The fair value of the plan assets was \$2,900 million at 31 October 2022 and \$3,170 million (including the contributions owed by Savage) at 31 October 2023. The actuarial gains recognised at 31 October 2022 were \$336 million.

With effect from 1 November 2022, the company had amended the plan so that the employees were now provided with an increased pension entitlement. The benefits became vested immediately and the actuaries computed that the present value of the

cost of these benefits at 1 November 2022 was \$125 million. The discount rates and expected rates of return on the plan assets were as follows:

	31 October 2022	31 October 2023
Discount rate	6%	7%
Expected rate of return on plan assets	8%	9%

The company has recognized actuarial gains and losses in profit or loss up to 31 October 2022 but now wishes to recognize such gains and losses outside profit or loss in a 'statement of recognized income and expense'.

Required:

- a) Show the amounts which will be recognised in the Balance Sheet, Income Statement and the Statement of Recognised Income and Expense of Savage for the year ended 31 October 2023 under IAS19 'Employee Benefits', and the movement in the net liability in the balance sheet. (Your calculations should indicate the changes in the present value of the obligation and the fair value of the plan assets during the year. Ignore any deferred taxation effects and assume that pension benefits and the contributions paid were settled at 31 October 2023.)

(21 Marks)

- b) Explain how the non-payment of contributions and the change in the pension benefits should be treated in the financial statements of Savage for the year ended 31 October 2023.

(4 Marks)

QUESTION TWO

- a) Assume that a company had estimated that during the year ended 2014, the corporation tax payable was sh 1000,000 and this amount remained unpaid as at 31 December 2014. On 30 June 2015 the company agrees with the tax authorities on the amount due and this is paid on the same date. Meanwhile during the year

ended 31 December 2015, the firm estimates that the corporation tax payable for the year as sh. 1,200, 000. The company had made installment tax payments for year 2015 for sh. 800,000. Compute the income tax expense and the balance sheet liability for the year 2005 assuming that the actual tax liability for 2014 agreed with the tax authority was:

(i) Sh 1,100,000 (2 Marks)

(ii) Sh.900,000 (3 Marks)

- b) Broadfield Co purchased 5% debentures in X co at 1 January 20 x 3 (their issue date) for KSh.100,000. The term of the debentures was 5 years and the maturity value is KSh.130,525. The effective rate of interest on the debentures is 10% and the company has classified them as held-to-maturity financial asset. At the end of 20 x 4 x Co went into liquidation. All interest had been until the date. On 31 December 20 x 4 the liquidator of X Co announced that no further interest would be paid and only 80% of the maturity value would be repaid, on the original repayment date. The market interest rate on similar bonds is 8% on that date.

Required

- a) Calculate the debenture value just before the impairment became apparent. (3 Marks)
- b) Compute the debenture value as at 31 December 20 x 4, after the impairment. (4 Marks)
- c) Prepare a journal entry on how the debenture will be reported in the financial statements for the year ended 31 December 20 x 4. (3 Marks)

QUESTION THREE

- a) On 1 January 20 x 1 Biashara Co purchases a debt instrument for its value of KSh. 1,000. The debt instrument is due to mature on 31 December 20 x 5. The instrument has a principal amount of KSh.1,250 and the instrument carries fixed interest at 4.72% that is paid annually. Show how Biashara Co. accounts for the debt instrument over its five-year term. **(10 Marks)**
- b) Examine five advantages of leasing to business organisations **(5 Marks)**

QUESTION FOUR

- a) Fable supplies Ltd sold 100 phones during the month of December 2020 for sh. 5,000 each. Assuming that the estimated warranty expense is equal 4% of sales, record the aggregate sales and estimated warranty expense and liability for December, 2020. **(5 Marks)**
- b) The General Manager of Pacis Ltd is paid a bonus of 4% of net income (income after bonus and tax). For the year ending 31st December 2020 Pacis Ltd reported income of sh. 2,400,000 before bonus and income tax. The tax rate is 30%. Required: Compute the amount of the bonus and show the journal entry to record the bonus. **(5 Marks)**
- c) Deferred tax is the corporation tax that is likely to be incurred on the activities of a company during a particular period but, because of differences between the way activities are included in the accounting profit and taxable income, will be paid in another period. Examine the significance of deferred taxation. **(5 Marks)**

QUESTION FIVE

(a) In the context of IAS 17 (Leases), briefly explain the meaning of the following terms:

(i) Finance lease. (2 Marks)

(ii) Guaranteed residual value. (2 Marks)

(iii) Contingent rent. (2 Marks)

(b) Silversands Manufacturing Company Ltd. has entered into an agreement with a finance company, to lease a machine for a four-year period. Under the terms of the agreement, the machine is to be made available to Silversands Manufacturing Company Ltd. on 1 January 2019, when an immediate payment of Sh. 2,550,000 will be made, followed by seven semi-annual payments of an equivalent amount. The fair market price of the machine on 1 January 2019 is expected to be Sh. 16,320,000. The estimated life of this type of machine is four years. The implicit rate of interest in the transaction is 6.94% payable semi-annually and the corporate tax rate is 30%. Silversands Manufacturing Company Ltd. has a policy of depreciating machines of this type over a four year period on the straight line basis. Assume the lease is to be capitalized.

Required:

(i) Show how the above transactions will be reflected in the profit and loss account of Silversands Manufacturing Company Ltd. for each of the four years ending 31 December 2019, 2020, 2021 and 2022. (9 Marks)

QUESTION SIX

The shareholders equity section of the balance sheet of National foods included the following a/cs at Dec 31, 2022

Shareholder's equity	(\$ in millions)
Paid in capital	
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:

During 2023, several transactions affected the stock of National foods. Prepare the appropriate entries for these events.

- a) 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. **(5 Marks)**

- b) 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. **(5 Marks)**

- c) 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. **(5 Marks)**

