

The
Management
University
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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

BCM 221 : ACCOUNTING FOR LIABILITIES

DATE: 8TH APRIL 2026

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:

REPORTING FRAMEWORK FOR LIABILITIES IN MIFUMO TECH LTD

Mifumo Tech Ltd (MTL) is a medium-sized technology company based in Nairobi, Kenya. As part of its expansion and operations, the company engages in several financing activities, ranging from short-term borrowings to long-term debt and obligations to shareholders.

The financial year ends on 31st December 2022, and the following transactions took place:

Current Liabilities

On 1st October 2022, MTL borrowed KES 20 million from the Bank, repayable within 6 months. The loan carries an annual interest rate of 12%, payable on maturity.

During December 2024, MTL collected KES 5 million in advance from customers for services that will be provided in 2023.

On 31st December 2022, the Board declared dividends of KES 3 million on ordinary shares, which had not yet been paid by year-end.

Long-term Liabilities

On 1st January 2022, MTL issued 10,000 bonds at a par value of KES 1,000 each. The bonds carry an 8% annual coupon rate, with interest payable semi-annually, and will mature after 5 years.

Shareholders' Equity

On 1st July 2022, MTL issued 50,000 ordinary shares at KES 20 each, which were fully paid and allotted to investors.

MTL demonstrates how businesses account for and report liabilities under International Financial Reporting Standards (IFRS). Current liabilities, such as short-term borrowings, customer advances, and dividends payable, are obligations

expected to be settled within one year, while long-term liabilities, such as bonds, represent commitments extending beyond the operating cycle. Shareholders' equity, on the other hand, reflects owners' residual interest after liabilities are settled.

Through proper classification and recording of these transactions, MTL ensures transparency, accuracy, and compliance with global reporting standards. This not only improves comparability with international peers but also enhances investor confidence. The case also highlights the importance of distinguishing between debt financing and equity financing.

Ultimately, MTL's sound accounting for liabilities enables management to make informed decisions on financing strategies while ensuring that stakeholders receive reliable information about the company's financial health.

Required:

- a) Using IFRS guidelines, classify each of MTL's transactions as either a current liability, long-term liability, or equity item. Prepare an extract of the Statement of Financial Position as at 31st December 2022, showing how these items would appear under liabilities and equity. **(15 Marks)**
- b) Discuss the financial implications for MTL of choosing debt financing (bank loan and bonds) compared to equity financing (ordinary shares) **(5 Marks)**
- c) Prepare journal entries to record the KES 20 million bank loan on 1st October 2022, including the accrued interest expense up to 31st December 2022 **(5 Marks)**

QUESTION TWO

On January 1, 2021, Muskan a lessor Company and Fiche a lessee Company signed a 3-year non-cancelable lease for an asset with an estimated economic life of 3 years, with financial years ending in December. The agreement involves no collection uncertainties, and the lessor's performance is complete.

Additional information:

- i. The three lease payments are KES 36,556 each, payable on January 1, 2021, 2022, and 2023.
- ii. The fair market value of the asset at the inception of the lease is KES 100,000, which is also the carrying value (cost) on the lessor's books.
- iii. The lessee's incremental borrowing rate is 10%, which is also the lessor's implicit interest rate.

Required:

- a) Compute the present value of minimum lease payments and show that it equals the fair value of the asset (KES 100,000) **(5 Marks)**
- b) Prepare the necessary journal entries in the books of the lessee for the year 2001, including:
 - Initial recognition of the lease liability and right-of-use asset.
 - Lease payment on January 1, 2021.
 - Interest expense and depreciation expense for 2021 **(10 Marks)**

QUESTION THREE

Kaya Limited is a manufacturing company based in Nairobi. The company's financial accountant is preparing the financial statements for the year ended 31 December 2023.

The following information is available:

- i. Accounting profit before tax for the year amounted to KSh 18,000,000.
- ii. The profit includes the following items:
 - Depreciation expense (per accounting records): KSh 2,400,000
 - Capital allowances (per tax rules): KSh 3,000,000
 - Provision for doubtful debts: KSh 600,000 (not yet allowed for tax)
 - Entertainment expenses: KSh 300,000 (not deductible for tax purposes)

-Interest income on government bonds: KSh 400,000 (tax-exempt)

iii. The corporation tax rate is 30%.

iv. At the beginning of the year (1 January 2023):

-Deferred tax liability was KSh 420,000.

-There were no deferred tax assets.

v. It is estimated that the provision for doubtful debts will be allowed for tax deduction in the following year (2024).

Required:

- a) Compute the taxable profit for Kaya Limited for the year ended 31 December 2023. **(5 Marks)**
- b) Determine the current income tax expense for the year. **(2 Marks)**
- c) Compute the deferred tax asset or liability at year-end. **(4 Marks)**
- d) Show how the income tax expense will be reported in the financial statements. **(4 Marks)**

QUESTION FOUR

MajiTech Ltd, a Kenyan water engineering company, prepared its financial statements for the year ended 31st December 2023. In March 2024, while preparing for audit, the accountant discovered the following errors:

1. Revenue error: In 2022, sales of KES 2 million were mistakenly recorded twice.
2. Depreciation error: For the year 2023, depreciation on machinery amounting to KES 500,000 was omitted.
3. Inventory error: Closing inventory at 31st December 2022 was overstated by KES 800,000 due to a miscount.

Additional information:

- The corporate tax rate is 30%.
- Comparative financial statements are presented.
- MajiTech Ltd follows IFRS and IAS 8 for error corrections.

Required:

- a) Identify the type of each error (prior-period error or current-period error) and explain the appropriate correction method under IAS 8 **(11 Marks)**
- b) Briefly discuss the impact of restatements on financial statement users and the disclosures MajiTech Ltd must provide under IAS 8. **(4 Marks)**

QUESTION FIVE

- a) At 31st December 2023, Octa Pension Limited's actuary provided the following information relating to its defined benefit pension plan:
 - Present value of defined benefit obligation (DBO): **KES 50,000,000**
 - Fair value of plan assets: **KES 38,000,000**
 - Current service cost for the year: **KES 4,000,000**
 - Interest cost on obligation: **KES 5,000,000**
 - Expected return on plan assets: **KES 3,000,000**
 - Benefits paid during the year: **KES 2,000,000**

Required:

- 1) Calculate the net defined benefit liability at year-end. **(3 Marks)**
 - 2) Compute the pension expense to be recognized in profit or loss for 2023 **(5 Marks)**
 - 3) Show the journal entry to record the pension expense. **(2 Marks)**
- b) Discuss limitations of using Earnings Per Share (EPS) as a performance measure **(5 Marks)**

QUESTION SIX

- a) Explain the difference between share capital and retained earnings **(5 Marks)**
- b) Discuss the challenges companies face in measuring fair value of complex financial instruments. **(5 Marks)**
- c) Que Ltd is facing a pending lawsuit. Discuss the factors that management should consider under IAS 37 (Provisions, Contingent Liabilities and Contingent Assets) in determining whether to recognize a liability, disclose it, or do nothing **(5 Marks)**