The Co-operative University College of Kenya

(A Constituent College of Jomo Kenyatta University of Agriculture & Technology)

END OF SEMESTER EXAMINATIONS APRIL - 2015

EXAMINATIONS FOR BACHELOR OF CO-OPERATIVE BUSINESS YEAR III SEMESTER II

UNIT CODE: HCOB 2208

UNIT TITLE: INTERMEDIATE ACCOUNTING II

DATE: TIME:

INSTRUCTIONS:
Answer question **ONE (compulsory)** and any other **TWO** questions

QUESTION ONE

a) Define the term note payable (2 Marks)

b) Distinguish between redeemable and non-redeemable bonds (2 Marks)

c) Distinguish between accrued liabilities and unearned revenues (2 Marks)

d) Explain the difference in the treatment of mortgage principal repayment and interest repayment in the final financial statements of an entity (4 Marks)

e) The actuarial valuation of Golden Treasures Retirement Benefit Scheme as at 31st December 2001 showed a deficiency of Shs90 Million. The actuary recommended that the company eliminated the deficiency by three lump sum payments of Shs 30 Million each in addition to the standard contribution of Shs 10 Million per annum. The contributions would continue at Shs 10 Million per annum thereafter. The average remaining service life of employee in the scheme as at 31st December 2001 was 10 years.
Required:
Determine the charge in the income statement and the figure to be disclosed in the scheme's balance sheet as a net pension liability or prepayment in each of the years 2002 to 2011 (10 Marks)

f) Suppose the actuarial valuation at 31st December 2001 of Gloden Treasures Retirement Benefit Scheme showed a surplus of Shs 260 million. The actuary then recommended that the company eliminates this surplus by taking a contribution holiday for the first two year, and then paye yearly contributions of Shs 30 million for eight years. After the eight years, the standard contribution would be Shs 50 Million per annum. The average remaining service life of employees in the scheme as at 31st December 2001 was 10 years.

Required:
Compute the figure to be charged in the income statement and the figure to be disclosed in the balance sheet of the scheme as a net pension liability or prepayment in each of the years 2002 to 2011. (6 Marks)

QUESTION TWO

Hisa Company Ltd. Was incorporated in 2003 with an issued share capital of 2,500,000 ordinary shares of Shs 10 each and 1,000,000 7% cumulative Participating preference shares of Shs 10 each. All the shares were paid for in full.

In 2007 the company issued 2,500 10% debentures of Shs 1,000 each. The terms of issue stipulated that each debenture is convertible into 75 ordinary shares of Shs 10 each on 31st December 2003 and those not converted will be redeemed at par on 31st December 2008.

On 1 March 2013, the company granted its directors opinions to take up 500,000 ordinary shares at a price of Shs 12 per share

On 1 April, 2014, the ordinary shares were split into shares of Shs. 2.50 each and on 1 December, 2014 a further 3,000,000 ordinary shared were issued at fair value to satisfy the purchase of certain business rights acquired.

On 2 December 2014, 200,000 of the above options were taken up when the fair value of the shares was Shs 6 each. The average fair value of the shares during the year was Shs 5 each. The following information has been extracted from the consolidated income statements for the years ended 31st March, 2014 and March 2015

In 2007, the company issued 2,500 10% debentures of Shs 1,000 each. The terms of issue stipulate that each debenture is convertible into 75 ordinary shares of Shs 10 each on 31st December 2003 and those not converted will be redeemed at par on 31st December, 2008

On 1 March 2013, the company granted its directors options to take up 500,000 ordinary shares at a price of Shs 12 per share

On 1 April 2014, the ordinary shares were split into shares of Shs 2.50 each and on December 2014 a further 3,000,000 ordinary shares were issued at fair value to satisfy the purchase of certain business rights acquired.

On 2nd December 2014, 200,000 of the above options were taken up when the fair value of the shares was Shs 6 each. The average fair value of the shares during the year was, Shs 5 each. The following information has been extracted from the consolidated income statements for the years ended 31st March 2014 and 31st March 2015.

	2015	**2014**
	Shs '000'	**Shs '000'**
Net operating income	19,800	18,410
Income from investments	420	360
Net income before taxations and extraordinary items	20,220	18,770

Taxation	(7,630)	(6,920)
Net income after taxation	12,590	11,850
Less: Minority interest	(1,270)	(1,440)
Profit attributable to members of the group	11,320	10,410
Extraordinary items	(2,000)	(1,500)
Profit after and extraordinary items	9,320	8,910
Dividends (note 1)	(4,000)	(3,200)
Retained profits for the year	5,320	5,710
Retained profits brought forward	18,530	12,820
Retained profits carried forward	23,850	18,530

Note

Dividends paid 31st march:

On ordinary shares	3,200	2,400
On preference shares	800	800
	4,000	3,200

Required:

a) Calculate the basic earnings per share figure to be disclosed in the published accounts of Hisa Company Ltd. For the years ended 31 March 2014 and 31 march 2015 (10 Marks)

b) Calculate the diluted earnings per share figure to be disclosed in the published accounts of Hisa Company Ltd. For the year ended 31 March 2015. Assume a tax rate of 32.5% (8 Marks)

c) Discuss the usefulness of the earnings per share figure. (2 Marks)

QUESTION THREE

a) IAS 12 (revised) "Income Taxes" required enterprises to provide for deferred tax in full for all deferred tax liabilities with only limited expectations. The original IAS 12, and the equivalent Kenyan Accounting Standard, allowed an enterprise not to recognize deferred tax assets and liabilities where there was reasonable evidence that timing difference differences would not reverse for some considerable period ahead; this was known as a partial provision method.

The Original IAS 12 did not refer explicitly to fair value adjustments made on a business combination and did not require an enterprise to recognize a deferred tax liability in respect in respect of asset revaluations. The revised IAS 12 now requires deferred tax adjustment for these items and classifies them as temporary differences.

Required:

i) Explain why the IASC decided to require recognition of the deferred tax liability for all temporary differences (with certain exceptions) rather than allowing the partial provision method (5 Marks)

ii) Discuss the reasons why IAS 12 (revised) requires enterprises to provide for deferred taxation on revaluations of assets and fair value adjustments on business combination. (5 Marks)

b) K Limited has the following balance sheet and tax bases at 30 June 2014, before providing for any deferred tax in the year to 30 June 2014.

	Carrying Values		**Tax bases**	
	Shs. '000'	**Shs. '000'**	**Shs. '000'**	**Shs. '000'**
Non-current assets				
Buildings (Factory)		100,500		22,500
Plant and equipment		156,000		39,000
Investment in M Ltd.: Cost		1,977		1,977
Long-term quoted investment		198,000		198,000
		456,477		
Current Assets	45,000		45,000	
Current liabilities				
Trade payables	(40,500)		(40,500)	
Provision for repairs	(900)		(Nil)	
	(41,400)	3,600		
Capital and reserves		460,077		
Equity capital		30,000		30,000
Revaluation reserve		73,500		-
Retained profit		298,047		-
Shareholders' funds		401,547		
Non-current liabilities				
Long-term loan	30,000		33,000	
Deferred tax (Bal. b/l)	27,030		27,030	
		57,030		
Deferred income:				
Grant from World Bank		1,500		
		460,077		

1. K Limited acquired 100% of the ordinary share capital of M limited on 30 June 2014. The net assets of M limited as on this day were as follows:

	Fair Value Shs.'000'	Carrying value Shs.'000'	Tax value Shs.'000'
Building (Factory)	1,500	900	300
Plant and equipment	120	90	45
Inventory	372	342	342
Trade receivable	330	330	330
Current liabilities	(495)	(495)	(315)
	1,827	1,167	702

M Limited does not carry a deferred tax liability in its accounts

2. K Limited's director decided to revalue K Limited's buildings at Shs 150 million and the plant and equipment to Shs 180 million, investments were not to be revalued. K

limited's buildings had cost Shs 135 million and the plant and machinery Shs 210 million.

3. The tax rate changed from 35% to 30% in the current year.
4. During the year, the directors agreed to provide Shs 900,000 for future repairs to the buildings. The expense is allowable for tax when it is paid
5. The grant from the World Bank is included as deferred income in the balance sheet and is not taxable.
6. Goodwill arising on acquisition is not an allowable expense for tax purposes. Since the subsidiary was acquired on 30th June 2014, no amortization has been charged in the financial statements.
7. K Limited raised a long term loan of Shs 33,000,000 during the year and recorded it net of transaction costs. The transaction costs of Shs 3,000,000 are allowable for tax in the year ended 30 June 2014.

Required:

Calculate the deferred tax expense for K Limited which would appear in the group financial statements under IAS 12 (revised) "Income Taxes" for the year ended 30 June 2014. (10 Marks)

QUESTION FOUR

Mr. Eama wishes to sell his minority shareholding of Shs 3,000 Shs 10 shares in Zebra Crafts Limited. Zebra Crafts Limited is a private company with an issued share capital of Shs 1,500,000

The current shareholders and their shareholding are as follows:

Shareholder	Shareholding (Shares)
Mr. Athmany	73,500
Ms. Boiyon	36,000
Mr. Chewe	24,000
Ms. Duale	13,500
Mr. Eama	3,000

The income statement for the five years to 30 June 2014 is as follows:

Year ended 30 September	2010	2011	2012	2013	2014
	Shs . '000'	Shs . '000'	Shs . '000'	Shs . '000'	Shs . '000'
Sales	47,880	50,400	67,200	101,640	140,400
Cost of sales	(20,805)	(21,900)	(35,040)	(62,460)	(93,720)
Gross profit	27,075	28,500	32,160	39,180	46,680
Administration expenses	(10,260)	(10,800)	(12,000)	(14,400)	(16,800)
Distribution costs	(15,330)	(16,140)	(18,000)	(21,600)	(25,200)
Operating profit	1,485	1,560	2,160	3,180	4,680
Taxation	(456)	(480)	(720)	(1,080)	(1,630)
Profit after tax	1,029	1,080	1,440	2,100	3,050
Ordinary dividend	(250)	(270)	(288)	(300)	(315)
Retained profit	799	810	1,152	1,800	2,735

The gross dividend yield on quoted companies operating in the same business sector is 12%. You are advised that this yield should be increased to 18% to allow for lack of marketability. The rate of corporation tax should be taken to be 30% through the period being considered.

Required:

a) Discuss the relevance of dividends in the valuation of Mr. Eama's shareholding. Illustrate your answer from the data given (5 Marks)
b) Explain the factors you would take into account when estimating the future dividends and when estimating the investor's required yield. (5 Marks)
c) Explain how your approach when valuing a minority interest could be influenced by the size of the shareholding, or the fact that the owner is a party related to other significant shareholders. (5 Marks)