

FINANCIAL ACCOUNTING & REPORTING

July-August 2023

Time allowed- 3:30 hours

Total marks- 100

[N.B. - The figures in the margin indicate full marks. Questions must be answered in English. Examiner will take account of the quality of language and of the manner in which the answers are presented. Different parts, if any, of the same question must be answered in one place in order of sequence.]

- | | Marks |
|--|-------|
| 1. a) Explain the concept of 'fair presentation' and compare it with 'true and fair view'. | 5 |
| b) Explain the concept of 'substance over form' and its relationship to 'fair presentation'. | 5 |
| 2. a) Bonds with a nominal value of Tk. 200,000 were issued at Tk. 157,763 on 1 January 2018. The coupon rate is 4% while the effective interest rate is 9.5%. Interest is paid annually in arrears. Redemption is at par in five years. Issue costs are immaterial. | |

Requirement:

Calculate the carrying amount of the bonds in the statement of financial position at 31 December 2018 and at each subsequent year end until redemption.

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- b) A company purchased a portfolio of financial assets for Tk. 30,000 on 1 July 2021. On 31 December 2021, the next financial year end, the portfolio had a fair value of Tk. 34,000. On 16 May 2022 one quarter of the portfolio of financial assets was sold for Tk. 10,000.

Requirement:

Calculate the amount recognized in profit or loss on disposal on the alternative bases that the financial assets were classified as: i) Held for trading, ii) Available for sale

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- c) On 1 January 2022, West Limited had only 50m Tk. 1 ordinary shares in issue, which had been in issue for many years. During the year ended 31 December 2022 West Limited entered into the following financing transactions:

(1) On 1 January 2022 West Limited issued 20m 8% Tk. 1 preference shares at par. The preference shares are redeemable at par on 30 June 2027. The appropriate dividend in respect of these shares was paid on 31 December 2022.

(2) On 30 June 2022, West Limited issued 10m 12% Tk. 1 irredeemable preference shares at par. Dividends are discretionary and non-cumulative. The appropriate dividend in respect of these shares was paid on 31 December 2022.

In reviewing the draft financial statements of West Limited, the auditors drew attention to an error which had begun in the previous year's financial statements. Expenditure had been capitalized as an intangible asset which did not meet the criteria in IAS 38. The carrying amount of the intangible asset included in the draft statement of financial position was as follows:

	Tk. (in million)
At 1 January 2022	4.5
Costs incurred during 2022	2.0
Amortization charge	(0.5)
At 31 December 2022	6.00

The draft profit for 2022, before adjusting for these capitalized costs, was Tk. 15 million. Retained earnings at 1 January 2022 were Tk. 75 million.

Requirement:

Prepare extracts from the financial statements of West Limited for the year ended 31 December 2022 to the extent the information is available, showing how the above would be reflected in those financial statements.

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3. Presented below is the statement of financial position of Sargent Corporation for the current year, 2022.

SARGENT CORPORATION
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2022

Investments	Tk. 640,000	Equity	Tk.1,770,000
Property, plant & equipment	1,720,000	Non-current liabilities	960,000
Intangible assets	265,000	Current liabilities	380,000
Current assets	485,000		
	Tk.3,110,000		Tk.3,110,000

The following information is presented.

- (i) The current assets section includes cash Tk 150,000, accounts receivable Tk.170,000 less Tk.10,000 for allowance for doubtful accounts, inventory Tk.180,000, and unearned service revenue Tk.5,000, Inventory is stated at the lower-of-FIFO-cost-or net realizable value.
- (ii) The investments section includes land held for speculation Tk.40,000; investments in ordinary shares, short-term (trading) Tk.80,000 and long-term (non-trading) Tk.270,000; and bond sinking fund Tk.250,000. The cost and fair value of investments in ordinary shares are the same.
- (iii) Property, plant, and equipment includes buildings Tk.1,040,000 less accumulated depreciation Tk.360,000, equipment Tk.450,000 less accumulated depreciation Tk.180,000, land Tk.500,000, and land held for future use Tk.270,000.
- (iv) Intangible assets include a franchise Tk.165,000 and goodwill Tk.100,000.
- (v) Current liabilities include accounts payable Tk.140,000; notes payable—short-term Tk.80,000 and long-term Tk.120,000; and income taxes payable Tk.40,000.
- (vi) Non-current liabilities are composed solely of 7% bonds payable due 2023.
- (vii) Equity has share capital—preference, Tk.5 par value, authorized 200,000 shares, issued 90,000 shares for Tk.450,000; and share capital—ordinary, Tk.1 par value, authorized 400,000 shares, issued 100,000 shares at an average price of Tk.10. In addition, the corporation has retained earnings of Tk.320,000.

Requirement:

Prepare a statement of financial position in good form, adjusting the amounts in each statement of financial position classification as affected by the information given above.

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4. Following are the case referred to you by your supervisor for your expert professional advice/guidelines:

- a) On 1 January 2022, Entity A issued a 10-year bond with a par value of BDT 150 000 and an annual fixed coupon of 8%, which is also the market rate for similar bonds at the date of issue. The market rate on these bonds (which is payable at 31 December) is based on the LIBOR of 5% + 3% “credit risk of entity A”. By the end of the year, LIBOR had decreased to 4.75% and consequently bonds with a similar credit risk to those issued at the beginning of the year were trading at 7.75% (LIBOR of 4.75% + 3% “credit risk”). The credit quality of Entity A deteriorated by the end of the year. Consequently, its’ credit risk increased and Entity A’s bonds were in fact trading at 7.85% (LIBOR of 4.75% + 3.1%) on 31 December 2022. Assume that these bonds are measured at fair value through profit and loss.

Requirement:

You are required to prepare the journal entries of Entity A for the year ended 31 December 2022

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- b) TPR has a contract to buy 300 meters of silk from India Co each month for Tk. 18 per meter. From each meter of silk, TPR makes one silk dress. TPR also incurs labor and other direct variable costs of Tk. 16 per dress.

Usually, TPR can sell each dress for Tk. 40 but in late July 20X8 the market price falls to Tk. 28. TPR is considering ceasing production since TPR thinks that the market may not improve.

If TPR decides to cancel the silk purchase contract without two months’ notice, it must pay a cancellation penalty of Tk. 2,400 for each of the next months.

Requirement:

- i) Is there a present obligation on 31 July 2022?
 - ii) What amount should be recognized in respect of the contract in the financial statements of TPR for the period?
- c) Entity Z enters into a 5-year lease of a floor of a building, with an option to extend the lease for a further 5 years. Lease payments are Taka 50,000 per annum during the initial term and Taka 55,000 per annum during the optional period, all payable at the beginning of each year. To obtain the lease, Entity Z incurs initial direct costs of Taka 20,000 (Taka 15,000 to the former tenant occupying the floor and Taka 5,000 for real estate commissions). The lessor agrees to reimburse the lessee the real estate commission of Taka 5,000. At the commencement date, Entity Z concludes that it is reasonably certain to exercise the option to extend the lease.

Therefore, the lease term is 10 years. Entity Z’s incremental borrowing rate is 5% per annum. This rate reflects the fixed rate at which it could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, with similar collateral.

Requirement:

Pass the entries required to record the lease transactions in the books of the lessee and what would be the status of the financial position at the end of the year.

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5. Paxar Limited (Paxar) reported the following activities and results at the time of finalizing its financial statements for the year ended 31 December 2022:
- Advertising cost incurred BDT 15 million. This cost is to be allowed as a tax deduction over 5 years from 2021 to 2025.
 - Trade and other payables amounted to BDT 40 million as on 31 December 2022 which include unearned commission of BDT 10 million. Commission is taxable when it is earned by the company. Tax base of remaining trade and other payables is BDT 25 million.
 - Other receivables amounted to BDT 17 million as on 31 December 2022 which include dividend receivable of BDT 8 million. Dividend income was taxable on receipt basis at 20% in 2021. Tax base of remaining other receivables is BDT 6 million.
 - On 1 April 2022, Paxar invested BDT 40 million in a fixed deposit account for one year at 10% per annum. Interest will be received on maturity. Interest was taxable on receipt basis at 10%.
 - On 1 January 2020, a machine was acquired on lease for a period of 4 years at annual lease rental of BDT 28 million, payable in advance. Interest rate implicit in the lease is 10%. Under the tax laws, payments are allowed on cash basis in the year of payment.
 - Details of fixed assets are as follows:
 - On 1 January 2018 Paxar acquired a plant at a cost of BDT 250 million. It has been depreciated on straight line basis over a useful life of six years. Paxar is also obliged to incur decommissioning cost of BDT 50 million at the end of useful life of the plant. Applicable discount rate is 8%.
 - On 1 July 2022 Paxar sold one of its four buildings for BDT 60 million. These buildings were acquired on 1 January 2018 at a cost of BDT 100 million each having useful life of 30 years.

The dismantling costs will be allowed for tax purposes when paid. Tax depreciation rate for all owned fixed assets is 10% on reducing balance method. Further, full year's tax depreciation is allowed in the year of purchase while no depreciation is allowed in the year of disposal. Applicable tax rate is 30%.

Requirement:

Compute the deferred tax liability/asset to be recognized in Paxar Limited's statement of financial position as on 31 December 2022. Show detailed calculation.

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6. You have recently been appointed as an interim finance manager at BD Limited, a company whose previous finance director left the company part way through the year. The company has produced draft financial statements based on the notes prepared by the previous finance director before he left the company.

The company has decided always to measure any non-controlling interest in an acquire at its proportionate share of net assets at the acquisition date.

The main transaction in the year was the acquisition of 49% of the ordinary share capital of SM Limited on 1 July 2021. This has been accounted for using the equity method in accordance with IAS 28 Investment in Associates.

Upon further investigation, you discover that on the same date, BD Limited's professional advisors acquired 2% of SM Limited and signed a 'memorandum of understanding' in which the firm of advisors agreed to always vote in agreement with BD Limited's wishes.

You have been provided with the draft consolidated financial statements of the BD Limited Group, along with the separate financial statements of SM Limited:

Income statement for year ended 30 June 2022

	BD Limited (Tk. '000)	SM Limited (Tk. '000)
Revenue	34,520	17,640
Expenses	(21,940)	(13,880)
Operating profit	12,580	3,760
Share of profit of associate	490	-
Finance costs	(1,460)	(1,720)
Profit before tax	11,610	2,040
Income tax	(3,270)	(1,040)
Profit for the year	8,340	1,000

Statement of financial position at 30 June 2022

	BD Limited (Tk. '000)	SM Limited (Tk. '000)
ASSETS		
Property plant and equipment	34,880	20,000
Goodwill	9,540	-
Investment in associate	10,090	-
	<u>54,510</u>	<u>20,000</u>
Current assets (nil cash)	6,300	4,500
Total assets	<u>60,810</u>	<u>24,500</u>

EQUITY AND LIABILITIES

Capital and reserve		
Issued ordinary share of Tk. 1	1,500	1,000
Share premium	23,060	-
Retained earnings	9,230	4,400
Equity	<u>33,790</u>	<u>5,400</u>
Non-current liabilities		
Debt	17,310	16,300
Current liabilities	9,710	2,800
Total equity and liabilities	<u>60,810</u>	<u>24,500</u>

You are provided with the following information:

- (1) The consolidation for the investment in SM Limited was satisfied by a cash payment of Tk. 9.6 million on 1 July 2021. The share purchase agreement stated that if the profit after tax of SM Limited excluding intra group transactions, exceeded Tk. 1.2 million in the year ended 30 June 2022 then BD Limited would make a cash payment of Tk. 2 million as further consideration in November 2022. BD Limited's advisors estimated that the probability of SM Limited achieving this earnings target was such that the fair value at the acquisition date of this possible cash payment was Tk. 500,000. Despite this estimate BD Limited has on previous finance director's advice, not accounted for this additional consideration, because the draft profit after tax is only Tk. 1 million.
- (2) The carrying amount of SM Limited's net assets at the acquisition date were the same as their fair value.
- (3) BD Limited's bankers have a clause in their loan agreement that states that should the total debt in the consolidated financial statements of BD Limited exceed Tk. 30 million, then a penalty charge of Tk. 1 million arises. This penalty is allowable for tax purposes, and BD Limited pays tax at the rate of 30%.
- (4) During the year ended 30 June 2022, SM Limited sold goods to BD Limited for Tk. 500,000, at a mark up of 25% on cost. One quarter of these goods were held as inventory by BD Limited at 30 June 2022. BD Limited owes SM Limited Tk. 140,000 in respect of these transaction at 30 June 2022. BD Limited has not made any adjustments for these inventories in the equity accounting calculations for SM Limited.
- (5) BD Limited charged SM Limited Tk. 250,000 as a management fee in December 2021, in accordance with an instruction from previous finance director. BD Limited has included the full Tk. 250,000 in revenue. SM Limited paid the amount on 12 January 2022 and presented it in expenses.
- (6) SM Limited has not paid any dividend in the year ended 30 June 2022.

Requirements:

- a) A revised consolidated statement of financial position and income statement for BD Limited, taking into account of the transactions listed above.
- b) Calculations of earnings per share, gearing and interest cover for both the draft financial statements and those you have prepared in part (a). Explain why there are differences (if any) between the two sets of figures.

---The End---

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