

FINANCIAL ACCOUNTING & REPORTING

March-April 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) The move towards global accounting standards has been successful - do you agree? Please justify your answer? | 5 |
| | b) What are the financial accounting and ethical issues you would consider when selecting or changing an accounting policy? | 5 |

2. a) On 20 October 2022 the directors of a parent company made a public announcement of plans to close a steel works. The closure means that the group will no longer carry out this type of operation, which until recently has represented about 10% of its total revenue. The works will be gradually shut down over a period of several months, with complete closure expected in July 2023. At 31 December output had been significantly reduced and some redundancies had already taken place. The cash flows, revenues and expenses relating to the steel works can be clearly distinguished from those of the subsidiary's other operations.

Requirement:

How should the closure be treated in the financial statements for the year ended 31 December 2022? 5

- b) A car dealer sells a new car, together with 50 liters of fuel per month for a year and one year's servicing, for Tk. 2,700,000. The fair values of these components are: car Tk. 2,800,000, fuel Tk. 120,000 and servicing Tk. 80,000.

Requirement:

How should Tk. 2,700,000 be recognized as revenue? 5

- c) In which of the following circumstances might a provision be recognized? 5
- i) On 13 December 2022, the Board of an entity decided to close down a division. The accounting date of the company is 31 December. Before 31 December 2022 the decision was not communicated to any of those affected and no other steps were taken to implement the decision.
 - ii) As (i) above except that the Board agreed a detailed closure plan on 20 December 2022 and details were given to customers and employees.
 - iii) A company is obliged to incur clean up costs for environmental damage (that has already been caused).
 - iv) A company intends to carry out future expenditure to operate in a particular way in the future.
- d) An entity owns a building which originally cost Tk. 200,000. The property is depreciated over 50 years on a straight - line basis with no residual value. The entity adopts a policy of revaluation for property. The property has so far had three valuations as follows:

At the start of year 2: valuation Tk. 230,000

At the start of year 4: valuation Tk. 260,000

At the start of year 6: valuation Tk. 300,000

Requirement:

Calculate the annual depreciation charge for years one to six, the transfer to revaluation surplus through other comprehensive income in years 2, 4, and 6 and the transfers from revaluation surplus to retained earnings in the statement of changes in equity in years 1 to 6. 10

3. East Golf Ltd. was formed on July 1, 2020, when Mahbub Hossain, owner of East Golf purchased the Old Master Golf Company. Old Master provides video golf instruction at kiosks in shopping malls. Mahbub plans to integrate the instructional business into his golf equipment and accessory stores. Mahbub paid Tk. 770,000 cash for Old Master. At the time, Old Master's statement of financial position reported assets of Tk. 650,000 and liabilities of Tk 200,000 (thus equity was Tk 450,000). The fair value of Old Master's assets is estimated to be Tk 800,000. Included in the assets is the Old Master trade name with a fair value of Tk. 10,000 and a copyright on -some instructional books with a fair value of Tk. 24,000. The trade name has a remaining life of 5 years and can be renewed at nominal cost indefinitely. The copyright has a remaining life of 40 years.

Instructions

- Prepare the intangible assets section of East Golf Ltd. at December 31, 2020. How much amortization expense is included in East Golf's income for the year ended December 31, 2020? Show all supporting computations.
- Prepare the journal entry to record amortization expense for 2021. Prepare the intangible assets section of East Golf Ltd. at December 31, 2020 (No impairments are required to be recorded in 2021.)
- At the end of 2022, Mahbub is evaluating the results of the instructional business. Due to fierce competition from online and television (e.g., the Golf Channel), the Old Master cash-generating unit has been losing money. Its book value is now Tk 500,000. The recoverable amount of the Old Master reporting unit is Tk 420,000. Mahbub has collected the following information related to the company's intangible assets.

Intangible Asset	Value-in-Use
Trade names	Tk. 3,000
Copyrights	Tk. 25,000

Requirement:

Prepare the journal entries required, if any, to record impairments on East Golf Ltd's intangible assets. (Assume that any amortization for 2022 has been recorded.) Show supporting computations.

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4. Concord Corporation sold an investment on an installment basis. The total gain of Tk 60,000 was reported for financial reporting purposes in the period of sale. The company qualifies to use the installment-sales method for tax purposes. The installment period is 3 years; one-third of- the sale price is collected in the period of sale. The tax rate was 40% in 2020, and 35% in 2021 and 2022. The 35% tax rate was not enacted in law until 2021. The accounting and tax data for the 3 years is shown below.

	Financial Accounting (BDT)	Tax Return (BDT)
<u>2020 (40% tax rate)</u>		
Income before temporary difference	70,000	70,000
Temporary difference	<u>60,000</u>	<u>20,000</u>
Income	<u>130,000</u>	<u>90,000</u>
<u>2021 (35% tax rate)</u>		
Income before temporary difference	70,000	70,000
Temporary difference	<u>0</u>	<u>20,000</u>
Income	<u>70,000</u>	<u>90,000</u>
<u>2022 (35% tax rate)</u>		
Income before temporary difference	70,000	70,000
Temporary difference	<u>0</u>	<u>20,000</u>
Income	<u>70,000</u>	<u>90,000</u>

Requirements:

- Prepare the journal entries to record the income tax expense, deferred income taxes, and the income taxes payable at the end of each year. No deferred income taxes existed at the beginning of 2020.
- Explain how the deferred taxes will appear on the statement of financial position at the end of each year.
- Draft the income tax expense section of the income statement for each year, beginning with "Income before income taxes."

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5. Nixon Corporation, in preparation of its December 31, 2022, financial statements, is attempting to determine the proper accounting treatment for each of the following situations.
- As a result of uninsured accidents during the year, personal injury suits for Tk 350,000 and Tk 60,000 have been filed against the company. It is the judgment of Nixon's legal counsel that an unfavorable outcome is unlikely in the Tk 60,000 case but that an unfavorable verdict approximating Tk. 250,000 will probably result in the Tk. 350,000 case.
 - Nixon Corporation owns a subsidiary in a foreign country that has a book value of Tk. 5,725,000 and an estimated fair value of Tk. 9,500,000. The foreign government has communicated to Nixon its intention to expropriate the assets and business of all foreign investors. On the basis of settlements other firms have received from this same country, it is virtually certain that Nixon will receive 40% of the fair value of its properties as final settlement.
 - Nixon's chemical product division consisting of five plants is uninsurable because of the special risk of injury to employees and losses due to fire and explosion. The year 2022 is considered one of the safest (luckiest) in the division's history because no loss due to injury or casualty was suffered. Having suffered an average of three casualties a year during the rest of the past decade (ranging from Tk. 60,000 to Tk. 700,000), management is certain that next year the company will probably not be so fortunate.
 - Nixon operates profitably from a factory it has leased. During 2022 Nixon decides to relocate these operations to a new factory. The lease of the old factory continues for the next 5 years. The lease cannot be cancelled, and the factory cannot be subleased. Nixon determines that the cost to settle the old lease is Tk. 950,000.
 - Litigation is being pursued for the recovery of Tk. 1,300,000 consulting fees on a failed project. The directors believe it is more likely than not that their claim will be successful.

Requirements:

- Prepare the journal entries that should be recorded as of December 31, 2022, to recognize each of the situations above. 5
 - Indicate what should be reported relative to each situation in the financial statements and accompanying notes. Explain why. 10
6. On 1 June 2021, K & Sons Ltd (KSL) acquired 80% of the equity share capital of L & Sons Ltd (LSL). The consideration consisted of two elements: a share exchange of three shares in KSL for every five acquired shares in LSL and the issue of a Tk. 100, 6% loan note for every 500 shares acquired in LSL. The share issue has not yet been recorded by KSL, but the issue of the loan notes has been recorded. At the date of acquisition, shares in KSL had a market value of Tk. 5 each and the shares of LSL had a stock market price of Tk. 3.50 each. Below are the summarized draft financial statements of both companies.

Statements of comprehensive income for the year ended 30 September 2021

	KSL	LSL
	Tk. '000	Tk. '000
Revenue	92,500	45,000
Cost of sales	(70,500)	(36,000)
Gross profit	22,000	9,000
Distribution costs	(2,500)	(1,200)
Administrative expenses	(5,500)	(2,400)
Finance costs	(100)	-
Profit before tax	13,900	5,400
Income tax expenses	(3,900)	(1,500)
Profit for the year	10,000	3,900
Other comprehensive income:		
Gain on revaluation of land (note (i))	500	-
Total comprehensive income	10,500	3,900

Statements of financial position as of 30 September 2021

	KSL Tk. '000	LSL Tk.'000
Assets		
Non-current assets		
Property, plant & equipment	25,500	13,900
Investments	1,800	-
	<u>27,300</u>	<u>13,900</u>
Current assets	12,500	2,400
Total assets	<u>39,800</u>	<u>16,300</u>
Equity and liabilities		
Equity		
Equity shares of Tk. 1 each	12,000	5,000
Land revaluation reserve – 30 September 2021 (note (i))	2,000	-
Other equity reserves – 30 September 2020 (note (iv))	500	-
Retained earnings	12,300	4,500
	<u>26,800</u>	<u>9,500</u>
Non-current liabilities		
6% loan notes	3,000	-
Current liabilities	<u>10,000</u>	<u>6,800</u>
Total equity and liabilities	<u>39,800</u>	<u>16,300</u>

The following information is relevant:

- (i) At the date of acquisition, the fair values of LSL assets were equal to their carrying amounts with the exception of its property. This had a fair value of Tk. 1.2 million below its carrying amount. This would lead to a reduction of the depreciation charge (in cost of sales) of Tk. 50,000 in the post-acquisition period. LSL has not incorporated this value change into its entity financial statements.

LSL group policy is to revalue all properties to their current value at each year's end. On 30 September 2021, the value of LSL property was unchanged from its value at acquisition, but the land element of KSL property had increased in value by Tk. 500,000 as shown in other comprehensive income.

- (ii) Sales from LSL to KSL throughout the year ended 30 September 2021 had consistently been Tk. 1 million per month. KSL made a markup on the cost of 25% on these sales. KSL had Tk. 2 million (at the cost to LSL) of inventory that had been supplied in the post-acquisition period by LSL as of 30 September 2021.
- (iii) KSL had a trade payable balance owing to LSL of Tk. 350,000 as of 30 September 2021. This agreed with the corresponding receivable in LSL's books.
- (iv) KSL's investments include some available-for-sale investments that have increased in value by Tk. 300,000 during the year. The other equity reserve relates to these investments and is based on their value as of 30 September 2020. There were no acquisitions or disposals of any of these investments during the year ended 30 September 2021.
- (v) KSL's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, LSL's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.
- (vi) There has been no impairment of consolidated goodwill.

Requirements:

- a) Prepare the consolidated statement of comprehensive income for KSL for the year ended 30 September 2021. 10
- b) Prepare the consolidated statement of financial position for KSL as at 30 September 2021. 15

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