

FINANCIAL ACCOUNTING & REPORTING

Nov-Dec 2022

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) On 1st January 2016 an asset has a carrying amount of Tk. 140,000 and remaining useful life of ten years, with a nil residual value. The asset is revalued on that date to Tk. 60,000 and the loss is recognized in profit & loss.

The asset is depreciated straight-line over the next five years, giving a carrying amount of Tk. 30,000 at 31 December 2020. Then on 1st January 2021 when the remaining useful life is the unexpired five years, the asset is revalued to Tk. 72,000.

Requirement:

State how much of the revaluation gain on 1 January 2021 should be recognized in other comprehensive income and how much should be recognized in profit & loss.

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- b) An entity carries its land at fair value. One piece of land had a carrying amount of Tk. 600,000. On 1 January 2021 the asset was classified as held for sale, its fair value being estimated at Tk. 700,000 and the cost to sell the asset at Tk.20,000. The asset was sold on 30 June 2021 for Tk. 670,000.

Requirement:

Describe the accounting entries related to this transaction and show the journal entries needed.

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- c) Narrate the accounting treatment of the below situations:

5+5=10

- i) Cosmo Ltd issued a one year guarantee for faulty workmanship on a single item of specialist equipment that is delivered to a customer. At the company's year-end, the company is being sued by the customer for refusing to replace or repair the item of equipment within the guarantee period. Cosmo believes the fault is not covered by the guarantee, but instead has arisen because of the customer not following the operating instructions.

The company's lawyer has advised Cosmo that it is more likely than not that the company will be found liable. This would result in the company being forced to replace or repair the equipment plus pay court fees and damages amounting to approximately Tk. 20,000.

Based on past experience with similar items of equipment, the company estimates that there is a 70% chance that the control panel would need to be replaced which would cost Tk. 80,000 and a 30% chance that the repair would only cost about Tk. 30,000.

- ii) The company also manufactures small items of equipment which it sells via a retail network. The company sold 15,000 items of this type this year, which also have a one year guarantee if the equipment fails. Based on past experience, 5% of items sold are returned for repair or replacement. In each case, one third of the items returned are able to be repaired at a cost of Tk. 100, while the remaining two thirds are scrapped and replaced. The manufacturing cost of a replacement item is Tk. 300.

2. Modern Ltd went public 3 years ago. The Board of Directors will be meeting shortly after the end of the year to decide on a dividend policy. In the past, growth has been financed primarily through the retention of earnings. A share of cash dividend has never been declared. Presented below is a brief financial summary of Modern Ltd operations (BDT in thousands).

	2017	2018	2019	2020	2021
Sales revenue	20,000	16,000	14,000	6,000	4,000
Net income	2,400	1,400	800	700	250
Average total assets	22,000	19,000	11,500	4,200	3,000
Current assets	8,000	6,000	3,000	1,200	1,000
Working capital	3,600	3,200	1,200	500	400
Ordinary shares: Number of shares outstanding (in thousands)	2,000	2,000	2,000	20	20
Average market price	9	6	4	-	-

Requirements:

- a) Suggest factors to be considered by the board of directors in establishing a dividend policy.

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- b) Compute the return on assets, profit margin on sales, earnings per share, price earnings ratio and current ratio for each of the 5 years for Modern Ltd. 4
- c) Comment on the appropriateness of declaring a cash dividend at this time, using the ratios computed in part (b) as a major factor in your analysis. 4
3. a) Why does IFRS make a distinction between internally created intangibles and purchased intangibles? 5
- b) Dada Sporting Ltd has been experiencing growth in the demand for its products over the last several years. The last two Olympic games greatly increased the popularity of basketball around the world. As a result, a European sports retailing consortium entered into an agreement with Dada's Roundball Division to purchase basketballs and other accessories on an increasing basis over the next 5 years.

To be able to meet the quantity commitments of this agreement, Dada had to obtain additional manufacturing facility, and Dada agreed to purchase the factory and used machinery from Rupon Athletic Equipment company on October 1, 2020. Renovations were necessary to convert the factory for Dada's manufacturing use.

The terms of the agreement required Dada to pay Rupon Tk 500,000 when renovations started on January 1, 2021, with the balance to be paid renovations were completed. The overall purchase price for the factory and machinery was Tk 4,000,000. The building renovations were contracted to Concord Construction at Tk 1,000,000. The payments made, as renovations progressed during 2021, are shown below. The factory was placed in service on January 1, 2022.

Date	1/1/21	1/4/21	1/10/21	31/12/21
Rupon	Tk 500,000	Tk 900,000	Tk 1,100,000	Tk 1,150,000
Concord		Tk 300,000	Tk 300,000	Tk 400,000

On January 1, 2021, Dada secured a Tk 5,000,000 line of credit with a 12% interest rate to finance the purchase cost of the factory and machinery and the renovation costs. Dada drew down on the line of credit to meet the payment schedule shown above; this was Dada's only outstanding loan during 2021.

Safwan Ayan, Dada's controller, will capitalize the maximum allowable interest costs for this project. Dada's policy regarding purchases of this nature is to use the appraisal value of the land for book purposes and prorate the balance of the purchase price over the remaining items. The building had originally cost Rupon Tk 3,000,000 and had a net book value of Tk 500,000, while the machinery originally cost Tk 1,250,000 and had a net book value of Tk 400,000 on the date of sale. The land was recorded on Rupon's books at Tk 400,000. An appraisal, conducted by the independent appraisers at the time of acquisition, valued the land at Tk 2,900,000, the building at Tk 1,050,000 and the machinery at Tk 450,000.

Shabib Aaban, Chief engineer, estimated that the renovated plant would be used for 15 years, with an estimated residual value of Tk 300,000. Shabib estimated that the productive machinery would have a remaining useful life of 5 years and a residual value of Tk 30,000. Dada's depreciation policy specifies the 200% declining balance method for machinery and the 150% declining balance method for the plant. One-half year's depreciation is taken in the year the plant is placed in service and one-half year is allowed when the property is disposed of or retired. Dada uses a 360-day year for calculating interest costs.

Requirements:

- i) Determine the amounts to be recorded on the books of Dada sporting Limited as of December 31, 2021, for each of the following properties acquired from Rupon Athletic Equipment Company. 4
- 1) Land 2) Building 3) Machinery
- ii) Calculate Dada sporting Limited's 2022 depreciation expense, for book purpose, for each of the properties acquired from Rupon Athletic Equipment Company. 4
- iii) Discuss the arguments for and against the capitalization of interest costs. 3
- iv) Given the enhancements to the building, Dada thinks it would make its financial position look better if it used revaluation accounting. Advise Dada management on whether the company can use revaluation accounting for this building. Should Dada management use revaluation accounting? Briefly discuss some of the reasons for and against use of revaluation accounting. 4

4. a) During 2018, Robin Tool Company purchased a building site for its proposed research and development laboratory at a cost of Tk 600,000. Construction of the building was started in 2018. The building was completed on December 31, 2019, at a cost of Tk 3,200,000 and was placed in service on January 2, 2020. The estimated useful life of the building for depreciation purpose was 20 years. The straight-line method of depreciation was to be employed and there was no estimated residual value.

Management estimates that about 50% of the projects of the research and development group will result in long term benefits (i.e., at least 10 years) to the corporation. The remaining projects either benefit the current period or are abandoned before completion. A summary of the number of projects and the direct costs incurred in conjunction with the research and development activities for 2020 appears below.

	Number of Projects	Salaries and Employee benefits	Other expenses (Excluding building depreciation charge)
Completed projects with long term benefits (development costs incurred after achieving economic viability)	15	Tk 900,000	Tk 500,000
Abandoned projects or projects that benefit the current period	10	Tk 650,000	Tk 150,000
Projects in process – results indeterminate	5	Tk 400,000	Tk 120,000
Total	30	Tk 1,950,000	Tk 770,000

Upon recommendation of the research and development group, Robin Tool Company acquired a patent for manufacturing rights at a cost of Tk 880,000. The patent was acquired on April 1, 2019 and has an economic life of 10 years.

Requirement:

Under IFRS, how would the items above relating to research and development activities be reported on the following financial statements?

- i) The company's income statement for 2020 3
 - ii) The company's statement of financial position as of December 31, 2020. 3
- b) On first July 2021, Bee Limited entered into the following transactions which requires urgent attention. Management has requested your assistance for these transactions:

Bee has entered into a triparty agreement with its employees and Alpha Finance Limited for a car facility scheme. Under this scheme, Bee Limited plans to provide car to each of its 10 senior employees by taking loan from Alpha Finance Limited at 10% annual interest for 5 years. Estimated car purchase and registration cost is BDT 2,000,000 for each car. Loan will be taken in the employees account and car will be registered in the name of employees. However, ownership of the car will remain with the finance company until the loan is paid off. Bee Limited has agreed to provide the financial guaranty in favour of the employees. Bee Limited offered each of its 10 senior employees that Bee Limited will bear the interest and related annual financing expenses for each of these employees on the condition that they will stay with Bee Limited for next 5 years. At the end of the 5th year, ownership of the car will be transferred to the employees. However, if employees leave Bee Limited before 5th year, outstanding amount of loan will have to be paid by the employees. No employee left the Bee as of reporting date. Annual lease payment is BDT 4,796,318.

On first July 2021, Bee Limited entered into a rental agreement with Spider Limited for its office space. Rent agreement is for 1 year period but has option for renewal. Bee Limited has agreed to pay entire annual rent equal to 30,000,000 upfront as advance. Bee Limited has determined the annual discount rate at 10%. It has made significant investment for head office and doesn't plan to vacant the office space in next 5 years. It plans to renew the contract annually. As the lease contract is for 1 year only, Bee Limited is not sure whether it should be considered for lease accounting under IFRS 16.

Requirement:

Assist Bee Limited in recognition and presentation of these transactions at its annual financial statements.

5. a) On 31 December 2021, DFR Limited announced the sale of a building. A formal plan was approved on that date and the company is very confident that a buyer will be found by December 2022. DFR has not yet classified the building as held for sale. The building owned by DFR, which had originally cost BDT 500,000 on 1 January 2011, had been revalued on 31 December 2020 to BDT 700,000. The building was originally assessed as having a total useful life of 50 years and that estimate has never changed. On 31 December 2021, the building had a fair value of BDT 300,000 with a cost to sell estimated at BDT 2,000. Depreciation for the year ended 31 December 2021 has not yet been recorded. It is DFR Limited's policy to make an annual transfer between the revaluation surplus and retained earnings in accordance with best practices.

Requirement:

How the reclassification of the building would be made in the financial statements and how much amount will be charged to the profit or loss account? Pass necessary journal entries to record the transactions for the year ended 31 December 2021.

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- b) Finished goods inventories held by Alif Ltd have been valued at their cost. However, because of the imminent sale, DFR Limited expects to have to discount every product line by 30% and incur a selling cost of BDT 1 per unit. Costs and selling prices are as follows:

Product reference number	Number of units in inventory	Valued at cost (BDT)	Current selling price per unit (BDT)
PX98	1,000	5,500	8.00
DC76	1,500	10,500	12.00
BT52	5,000	22,500	3.00
	7,500	38,500	

Requirement:

What should be the value of inventory at the end of the year 31 December 2021? Pass the relevant journal entries for the year ended 31 December 2021.

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6. At January 2021 Alom Ltd held 80% of the ordinary share capital of Shajol Ltd, its sole subsidiary. On 1 April 2021 Taj Ltd acquired 30% of the ordinary share capital of Kajol Ltd, giving Alom Ltd significant influence over Kajol Ltd. The profits and losses of Kajol Ltd accrued evenly over the year ended 31 December 2021.

Extract from the draft financial statements of the three companies for the year ended 31 December 2021 are shown below:

Statement of profit or loss for the year ended 31 December 2021

	Alom Ltd.	Shajol Ltd.	<i>Amount in Taka</i> Kajol Ltd.
Revenue	1,105,000	864,900	763,200
Cost of sales	(353,600)	(389,200)	(305,300)
Gross profit	751,400	475,700	457,900
Operating expenses	(290,400)	(98,650)	(168,300)
Profit from operations	461,000	377,050	289,600
Investment income	96,000	-	-
Profit before tax	557,000	377,050	289,600
Income tax expenses	(167,000)	(110,000)	(85,000)
Profit for the year	390,000	267,050	204,600

Statement of financial position as at 31 December 2021 (extract)

	<i>Amount in Taka</i>		
	<u>Alom Ltd.</u>	<u>Shajol Ltd.</u>	<u>Kajol Ltd.</u>
Equity			
Ordinary share capital (Taka 1 shares)	3,000,000	1,100,000	500,000
Retained earnings	468,400	395,300	276,200
Total equity	3,468,400	1,495,300	776,200

Additional information:

- i) Alom Ltd acquired its holding in Shajol Ltd on 1 January 2019. The fair values of all assets and liabilities of Shajol Ltd at the date of acquisition were the same as their carrying amounts, with the exception of an intangible asset which was estimated to have a fair value of Taka 10,000 in excess of its carrying amount.

The intangible asset was assessed as having a remaining useful life of eight years at 1 January 2019. Amortization of intangible is presented in operating expenses.

Shajol Ltd's retained earnings at the date of acquisition were Taka 160,700. During the current year Shajol Ltd paid an interim dividend of Taka 50,000. The non-controlling interest and goodwill arising of the acquisition of Shajol Ltd were both calculated using the proportionate method.

- ii) At 1 April 2021, the date of acquisition by Alom Ltd, the fair value of Kajol Ltd's assets and liabilities were the same as their carrying amount.
- iii) Since 1 April 2021 Kajol Ltd has invoiced Taka 90,000 of sales of Alom Ltd, all at mark-up of 20%. One quarter of these goods were still in Alom Ltd's inventories at the year-end.
- iv) On 1 January 2021, Alom Ltd sold a machine to Shajol Ltd for Taka 120,000. The machine had a carrying amount in Alom Ltd's books of Taka 95,000 at the date of sale. The estimated remaining useful life of the machine was assessed at the date of sale as five years. Depreciation on plant and machinery is presented in cost of sales.
- v) At 31 December 2021 Shajol Ltd had received Taka 45,000 in deposits from customers to secure the purchase of its latest electronic game which went on sale on 1 February 2022. Shajol Ltd recognized the amount in revenue for the year ended 31 December 2021 and deposited the money in a separate deposit account.
- vi) At 31 December 2021 an impairment loss of Taka 15,000 in respect of goodwill arising on the acquisition of Shajol Ltd was recognised. An impairment loss of Taka 8,000 needs to be recognised in respect of Alom Ltd's investment in Kajol Ltd for the year ended 31 December 2021.

Requirements:

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| a) Prepare a consolidated statement of profit or loss for the year ended 31 December 2021. | 10 |
| b) An extract of its consolidated statement of financial position on the same date, presenting all figures that would appear as part of equity, including the no controlling interest. | 15 |

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