CMA December, 2019 EXAMINATION
PROFESSIONAL LEVEL-II
SUBJECT: 201. ADVANCED FINANCIAL ACCOUNTING-I

MODEL SOLUTION

Solution of Question No. 1

(a) The loss carry back provision permits a company to carry a net operating loss back two years and receive refunds for income taxes paid in those years. The loss must be applied to the second preceding year first and then to the preceding year.

The loss carry forward provision permits a company to carry forward a net operating loss twenty years, offsetting future taxable income. The loss carryback can be accounted for with more certainty because the company knows whether it had taxable income in the past; such is not the case with income in the future.

(b)

(i)	(2)
(ii)	(1)
(iii)	(3)
(iv)	(1)

(c)

Required (i) Computation of Taxable Income for 2015

X (.40) = \$320,000 taxes due for 2015
X = \$320,000 ÷ .40
X = \$800,000 Taxable Income for 2015

Required (ii) Computation of Pretax Financial Income for 2015

	Amount (USD)
Taxable Income	8,00,000
(+) Excess Depreciation	120,000
(+) Governmental Interest	10,000
(-) Unearned Rent	40,000
Pretax financial Income	**8,90,000**

Required (iii)

	2015	
Income Tax Expense	\$348,000*	
Deferred Tax Asset (\$40,000 X .35)	\$14,000	
Income Taxes Payable (\$800,000 X .40)		\$320,000
Deferred Tax Liability (\$120,000 X .35)		\$42,000

***Calculation of Income Tax Expenses**

Current Tax Expenses (\$800,000 x 40%)	= \$320,000
Deferred Tax Expenses (\$120,000x35%-\$40,000x35%)	= \$ 28,000
	\$ 348,000

	2016	
Income Tax Expense	339,500**	
Deferred Tax Liability [($120,000 ÷ 4) X .35]	10,500	
Income Taxes Payable ($980,000 X .35)		343,000
Deferred Tax Asset [($40,000 ÷ 2) X .35]		7,000

****Calculation of Income Tax Expenses**

Current Tax Expenses ($980,000 x 35%)	= $343,000
Deferred Tax Expenses ($40,000/2x35% -$120,000/4x35%)	= ($ 3,500)
	$ 339,500

Required (iv)

Income before income taxes		$890,000
Less: Income tax expense		
Current	$320,000	
Deferred ($42,000 – $14,000)	28,000	348,000
Net income		**$542,000**

Solution of Question No. 2

(a) The distinction between a direct-financing lease and a sales-type lease is the presence or absence of a manufacturer's or dealer's profit. A sales-type lease involves a manufacturer's or dealer's profit, and a direct-financing lease does not. The profit is the difference between the fair value of the leased property at the inception of the lease and the lessor's cost or carrying value.

(b) Lessees and lessors should disclose the future minimum rental payments required as of the date of the latest statement of financial position presented, in the aggregate, and for the next year, for years 2-5, and thereafter.

(c)

Required (i)

This lease is a capital lease to the lessee because the lease term (six years) exceeds 75% of the remaining economic life of the asset (six years). Also, the present value of the minimum lease payments exceeds 90% of the fair value of the asset.

Required (ii)

€	124,798	Annual rental payment
X	4.60478	PV of an annuity due of 1 for n = 6, i = 12%
€	574,668*	PV of periodic rental payments
€	50,000	Guaranteed residual value
X	.50663	PV of 1 for n = 6, i = 12%
€	25,332	PV of guaranteed residual value
€	574,668*	PV of periodic rental payments
+	25,332	PV of guaranteed residual value
€	600,000	PV of minimum lease payments

Required (iii)

Lessee

Lease Amortization Schedule

Date	Annual Lease Payment Plus GRV	Interest (12%) on Liability	Reduction of Lease Liability	Lease Liability
1/1/15				€600,000
1/1/15	€124,798		€124,798	475,202
1/1/16	124,798	*€ 57,024	67,774	407,428
1/1/17	124,798	48,891	75,907	331,521
1/1/18	124,798	39,783	85,015	246,506
1/1/19	124,798	29,581	95,217	151,289
1/1/20	124,798	18,155	106,643	44,646
12/31/20	50,000	** 5,354	44,646	0
	€798,788	€198,788	€600,000	

*Rounding error is €1.
**Rounding error is €3.

Required (iv)

1/1/2015	Leased Equipment …………………………………………	600,000	
	Lease Liability…………………………………		600,000
1/1/2015	Lease Liability …………………………………………..	124,798	
	Cash ……………………………………………………...		124,798
During 2015 (at the time of payment of executory cost)			
	Lease Executory Expense …………………………………	5,000	
	Cash ……………………………………………………...		. 5,000
31/12/2015	Interest Expense …………………………………………..	57,024	
	Interest Payable ……………………………………………..		57,024
31/12/2015	Depreciation Expenses…………………………….	91,667	
	Accumulated Depreciation—Leased Equipment ……..		91,667
	([€600,000 – €50,000] ÷ 6)		
1/1/2016	Interest Payable…………………………………………	57,024	
	Interest Expense…………………………………… …		57,024
1/1/2016	Interest Expense……………………………..	57,024	
	Lease Liability …………………………………………..	67,774	
	Cash ………………………………………………………….		124,798
During 2016 (at the time of payment of executory cost)			
	Lease Executory Expense………………………	5,000	
	Cash …………………………………………………... ...		5,000
31/12/2016	Interest Expense ………………………………..	48,891	
	Interest Payable ……………………………………………		48,891

31/12/2016	Depreciation Expense …………………………	91,667	
	Accumulated Depreciation—Leased Equipment ……………		91,667

Note

The guaranteed residual value was subtracted for purposes of determining the depreciable base. The reason is that at the end of the lease term, hopefully, this balance can offset the remaining lease liability balance. To depreciate the leased asset to zero might lead to a large gain in the final years if the asset has a value at least equal to its guaranteed amount.)

Solution of the Question No. 3

(a) Receiver's Fees:

Subject to the approval of the court, Receiver shall be entitled a fee-

1. From the sale proceeds of assets realized:

On first Tk 1,000,000	@ 10%
From 1,000,001 to Tk 2 Crore	@ 5%
On excess of Tk 2 Crore	@ 1%

2. From the sale proceeds of Mortgaged Property:

Entitled to receive @ 4% of sales proceeds of mortgaged property.

Priority of debts for distribution

1. Realization expenses/ Administrative expenses (Auction, Advertisement, reward, case and law charge etc)
2. Receiver's fees
3. Secured creditors' claim
4. All taxes and other debts due to the Govt.
5. All wages or salaries, not exceeding Tk 2,000 due to any clerk, servant, labor, or workman in respect of service rendered to the debtor during the period of 6 months immediately before the date of filing the petition.
   (Excess of Tk 2,000 will be treated as unsecured debt)
6. All bank debts.
7. All unsecured claim
8. Any subordinate claim

(Items mentioned in number 4 and 5 together called preferential claim)

(b) A jointly controlled operation is where:

- No separate entity is set up.
- The parties to the transaction share the activities that are to be carried out.
- The contractual arrangement will normally set out how revenue and expenses are to be shared.

In such an operation the venture will:

- Pool their resources
- Provide their own expertise
- Use their own property, plant and equipment
- Incur their own expense
- Be responsible for raising their own finance

The **substance** of this type of joint venture is that each venture is carrying on its own activities as a separate part of its own business and the accounting procedures reflect this.

(c) The memorandum income statement for the joint venture and the calculation of A Ltd's share is as follows:

	A Ltd (Taka)	B Ltd (Taka)	Total (Taka)	A Ltd's share (50%)
Revenue	300,000	500,000	800,000	400,000
Expense	(280,000)	(420,000)	(700,000)	(350,000)
	20,000	80,000	100,000	50,000
Due to A Ltd	30,000	(30,000)	0	
Share (50:50)	50,000	50,000	100,000	

A Ltd should record a receivable due from B Ltd of Tk.30,000. In addition, it should amend its financial statements to record in full its share of the revenue and expenses as follows:

Receivable- B Ltd Dr………………………………………………….. Tk.30,000

Expense (350,000-280,000)………………………………………….. Tk.70,000

Revenue (400,000-300,000)……………………………………………….. Tk.100,000

Solution of Question # 4 (a)

Required (i) Inventory Value:

80 units shipped at cost of Tk.500 each	Tk.40,000
Freight	Tk.840
Total inventoriable cost	Tk.40,840
40 units on hand (Tk. 40,840/80*40)	Tk.20,420

Required (ii) Computation of Consignment Profit:

Consignment sales (Tk.750 X 40)	TK.30,000
Cost of units sold (Tk. 40,840/80*40)	(Tk.20,420)
Commission charged by consignee (6% X Tk.30,000)	(Tk.1,800)
Advertising cost	(Tk.200)
Installation costs	(Tk.320)
Profit on Consignment	Tk.7,260

Required (iii) Remittance of Consignee:

Consignment Sales	Tk.30,000
Less: Commissions	(TK.1,800)
Advertising	(Tk.200)
Installation	(Tk.320)
Remittance from Consignee	Tk.27,680

Solution of Question # 4 (b)

X Limited
Statement of Affairs

STATEMENT OF AFFAIRS ASSETS	BOOK VALUE	ESTIMATED TO PRODUCE	LIABILITIES	TAKA	EXPECTED TO RANK
Patents	70,000	45,000	Creditors Fully Secured	85,000	
Stock in Trade	80,000	60,000	Less: Fair Value of Free Hold		
Fixture and Fittings	12,000	8,000	Land 1,65,000		
Plant and Machinery	1,20,000	90,000	(-) Receiver's Fee		
Bill of Exchange	35,000	35,000	(1,65,000 * 4%) (6,600)		
Cash in Hand	2,000	2,000		(1,58,400)	
Calls in Arrear	4,000	2,000	Surplus After Meeting		
Debtors:			Secured Creditors		
Good	60,000	60,000	Less: Amount Paid to Partly	73,400	
Doubtful	15,000	5,000	Secured Creditors		
Bad	15,000	0		(90,000)	
			Amount to be shown as Unsecured Creditors	**16,600**	
	4,13,000	3,07,000	Debentures		
			Less: Deducted As per Contra	2,00,000	
				(2,00,000)	0
		(30,700)	Preferential Creditors:		
Less: Receiver's fee			Income Tax Due 25,000		
(3,07,000 * 10%)			Salary 40,000		
		2,76,300	Less: Deducted As per Contra	65,000	
Debentures Deducted as per Contra		(2,00,000)		(65,000)	0
		76,300	Bank Overdraft		
Preferential Creditors Deducted as per Contra		(65,000)	Unsecured Creditors:		20,000
			Trade Creditors	2,70,000	
			Unclaimed Dividends	6,000	
			Bills Payable	10,000	
Amount Available for Bank Overdraft and Unsecured Creditors		11,300	Bills Discounted	15,000	
			Amount Unsecured From Secured Creditors	16,600	3,17,600
Deficiency Account		**3,26,300**			
		3,37,600			3,37,600

DEFICIENCY ACCOUNT

Particulars	Taka	Particulars	Taka
Ordinary Share Capital	2,00,000	Calls in Arrear	2,000
6% Preference Share Capital	3,00,000	Bad Debt	25,000
		Bills Discounted	15,000
Deficiency Account (Balancing Figure)	**3,26,300**	Free hold Land	45,000
		Plant & Machinery	30,000
		Fixtures & Fittings	4,000
		Stock in Trade	20,000
		Patents	25,000
		Receiver's Fee (30,700 + 6,600)	37,300
		Business Loss	6,23,000
	8,26,300		8,26,300

Workings:

As the Available amount to pay the Bank Overdraft and 50% of Unsecured Creditors is not Enough, we have to perform the 100:50 test to make the distribution Schedule.

Bank Overdraft : 50% of Unsecured Creditors
= 20,000 : 1,58,800
= 1,78,800

So, Payment from the Available 11,300 will be distributed as follows:

Bank Overdraft = (11,300 / 1,78,800 * 20,000)
= 1264
Unsecured Creditors = (11,300 / 1,78,800 * 1,58,800)
= 10,036

NOTES:

1. Here Receiver's fee on Cash in Hand has been considered to be included.
2. The maximum amount of salary can be Tk,2000 for each employee and rest of the amount will be shown as Unsecured creditors.
3. Receiver's fee:

1st 10,00,000 = 10% ;
10,00,001- 2 core = 5% ;
Above 2 core =1%
For Selling any mortgage Assets – 4 % of the sale proceeds.

Solution of the Question No. 5

a. The major reasons why companies change accounting policies are:
   - Desire to show better profit picture.
   - Desire to increase cash flows through reduction in income taxes.
   - Requirement by International Accounting Standards Board to change accounting methods.
   - Desire to follow industry practices etc.

b. The three approaches suggested for reporting changes in accounting policies are:
   i. Currently- the cumulative effect of the change is reported in the current year's income as special item.
   ii. Retrospectively- the cumulative effect of the change is reported as an adjustment to retained earnings. The prior year's statements are changed on a basis consistent with the newly adopted policy.
   iii. Prospectively- no adjustment is made for the cumulative effect of the change. Previous reported results remain unchanged. The change shall be accounted for in the period of the change and in subsequent periods if the change affects future periods.

c. Retained earnings is correctly stated at December 31, 2018. Failure to accrue salaries in earlier years is a counter balancing error that has no effect on 2018 ending retained earnings.

d. December 31, 2018

1.

Equipment	Tk.6,000	
Accumulated Depreciation-Equipment		Tk.600
Retained Earnings		Tk.5,400

(To correct for the error of expensing installation costs on equipment acquired in January, 2017)

2.

Depreciation Expense	Tk,1620*	
Accumulated Depreciation-Equipment		Tk,1620

(To record depreciation on equipment for 2018 based on a 20 year useful life)

* [(Tk.36,000-Tk.3,600)/20]

e. Answer:

Required (i)

Cost of plant assets		Tk.2,400,000
Less: Depreciation prior to 2015		
2012 (2,400,000x25%)	Tk.600,000	
2013 (1,800,000x25%)	Tk.450,000	
2014 (1,350,000x25%)	Tk.337,500	Tk. 1,387,500
Book value at January 1, 2015		Tk.1,012,500

Depreciation for the year 2015 =(Tk.1,012,500-Tk.100,000)/5= Tk.182,500.

Depreciation Expense………………………… Tk.182,500
Accumulated Depreciation- Plant Assets……….. Tk.182,500

Required (ii)

Particulars	2015	2014
Income before depreciation expense	Tk.300,000	Tk.370,000
Depreciation expense	Tk.182,000	Tk.337,500
Net income	Tk.117,500	Tk.32,500

= THE END =