

**CMA DECEMBER, 2020 EXAMINATION  
PROFESSIONAL LEVEL - I  
SUBJECT: 101. INTERMEDIATE FINANCIAL ACCOUNTING**

**Model Solutions**

**Solution of the Q. No. 1**

(a)

Mar.	1	Petty Cash .....	100	
		Cash.....		100
		15 Postage Expense .....	39	
		Freight-Out.....	21	
		Miscellaneous Expense.....	11	
		Travel Expense .....	24	
		Cash Over and Short.....	3	
		Cash.....		98
		20 Petty Cash .....	75	
		Cash.....		75

(b)

Cash and cash equivalents should be reported at \$88,500.

Cash in bank .....	\$42,000
Cash on hand .....	12,000
Petty cash .....	500
Highly liquid investments .....	<u>34,000</u>
	<u>\$88,500</u>

(c)

i.

PHILLIPS COMPANY

Bank Reconciliation  
November 30, 2014

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Cash balance per bank statement .....	\$ 9,100
Add: Deposits in transit .....	<u>2,541</u>
	11,641
Less: Outstanding checks	
No. 2451 .....	\$700
No. 2472 .....	270
No. 2478 .....	300
No. 2482 .....	350
No. 2484 .....	460
No. 2485 .....	525
No. 2487 .....	210
No. 2488 .....	<u>635</u>
	<u>3,450</u>
Adjusted cash balance per bank.....	<u>\$ 8,191</u>
Cash balance per books .....	\$ 5,958
Add: Note collected by bank	
(\$2,300 note plus \$91 interest	
less \$16 fee).....	<u>2,375</u>
	8,333
Less: Check printing charge .....	\$ 34
Error in recording check No. 2479 .....	90*
Error in 11-21 deposit	

(\$1,642 – \$1,624).....	18	142
Adjusted cash balance per books .....		<u>\$ 8,191</u>
*\$980 – \$890		

ii.

Nov. 30	Cash .....	2,375	
	Miscellaneous Expense	16	
	Notes Receivable .....		2,300
	Interest Revenue .....		91
30	Miscellaneous Expense .....	34	
	Accounts Payable	90	
	Accounts Receivable	18	
	Cash		142
	Or		
30	Miscellaneous Expense .....	34	
	Cash .....		34
30	Accounts Payable .....	90	
	Cash.....		90
30	Accounts Receivable.....	18	
	Cash.....		18

**Solution of the Q. No. 2**

(a)

Cost per widget

Taka

Raw materials (Taka 100,000 ÷ 10,000)	10
Direct labour (Taka 50,000 ÷ 10,000)	5
Variable overheads (Taka 40,000 ÷ 10,000)	4
Fixed overheads (Taka 120,000 ÷ 12,000)	10
29 * 1,000 widgets = TAKA 29,000	

(b)

	Taka
Revenue ((10,000 – 3,000) *45)	315,000
Costs	(352,500)
Closing inventory at NRV* (3,000 *29)	87,000
Net profit	49,500
*Cost per unit = 312,500/10,000 = 31.25 therefore NRV of Taka 29 (35 – 6) is lower	

(c)

	Taka
Raw materials (7,000*20)	= 140,000
Work in progress at NRV [2,500*{(35*80%) – 2 – 2.50}]	=58,750
Finished goods at NRV [1,000 *{(35*80%) – 2}]	<u>= 26,000</u>
	<u>224,750</u>

(d)

Costs applicable to normal levels of production = 100,000 + 50,000 + 40,000 + (120,000\*2/3)  
= 270,000  
Closing inventory 1,000/10,000 \*270,000 = Taka 27,000  
Charged to IS in year (270,000 – 27,000) + (120,000 \*1/3) = Taka 283,000

**Solution of the Q. No. 3**

(a)

(i) **Exchange has commercial substance**

		<u>B Company</u>	
Equipment .....		15,500*	
Accumulated Depreciation—Equipment .....		19,000	
Equipment .....			28,000
Cash .....			2,000
Gain on Disposal of Equipment .....			4,500**

\*Cost of new equipment:

Cash paid	Tk. 2,000
Fair value of old equipment	<u>13,500</u>
Cost of new equipment	<u><u>R15,500</u></u>

\*\*Computation of gain on disposal of equipment:

Fair value of old equipment	Tk. 13,500
Book value of old equipment	
(R28,000 – R19,000)	<u>(9,000)</u>
Gain on disposal of equipment	<u><u>Tk. 4,500</u></u>

		<u>N Company</u>	
Cash		2,000	
Equipment .....		13,500*	
Accumulated Depreciation—Equipment (Old) .....		10,000	
Loss on Disposal of Equipment .....		2,500**	
Equipment .....			28,000

\*Cost of new equipment:

Fair value of equipment	Tk. 15,500
Less: Cash received	<u>2,000</u>
Cost of new equipment	<u><u>Tk. 13,500</u></u>

\*\*Computation of loss on disposal of equipment:

Book value of old equipment	
(R28,000 – R10,000)	Tk. 18,000
Fair value of equipment (Old)	<u>15,500</u>
Loss on disposal of equipment	<u><u>Tk. 2,500</u></u>

(ii) **Exchange lacks commercial substance**

		<u>B Company:</u>	
Equipment .....		11,000	
Accumulated Depreciation—Equipment .....		19,000	
Equipment .....			28,000
Cash .....			2,000

Valuation of equipment

Book value of equipment given	Tk. 9,000
Cash paid	<u>2,000</u>
New equipment	<u><u>Tk. 11,000</u></u>

OR

Fair value received	Tk. 15,500
Less: Gain deferred	<u>4,500*</u>
New equipment	<u>Tk. 11,000</u>

*Fair value of old equipment	Tk. 13,500
Book value of old equipment	<u>(9,000)</u>
Gain on disposal	<u>Tk. 4,500</u>

N Company:

Cash	2,000	
Equipment .....	13,500	
Accumulated Depreciation—Equipment.....	10,000	
Loss on Disposal of Equipment.....	2,500*	
Equipment.....		28,000

\*Computation of loss:

Book value of old equipment	Tk. 18,000
Fair value of old equipment	<u>(15,500)</u>
Loss on disposal of equipment	<u>Tk. 2,500</u>

(b)

Avoidable Interest

Weighted-Average Accumulated Expenditures	X	Interest Rate	=	Avoidable Interest
<u>2,000,000</u>		12%		240,000
<u>1,800,000</u>		10.38%		<u>186,840</u>
<u>3,800,000</u>				<u>426,840</u>

Capitalization rate computation	<u>Principal</u>	<u>Interest</u>
10% short-term loan	1,600,000	160,000
11% long-term loan	<u>1,000,000</u>	<u>110,000</u>
	<u>2,600,000</u>	<u>270,000</u>

$$\frac{\text{Total Interest}}{\text{Total Principal}} = \frac{270,000}{2,600,000} = 10.38\%$$

Actual Interest

Construction loan	2,000,000 X 12% =	240,000
Short-term loan	1,600,000 X 10% =	160,000
Long-term loan	1,000,000 X 11% =	<u>110,000</u>
	Total	<u>510,000</u>

Because avoidable interest is lower than actual interest, use avoidable interest.

Cost	5,200,000
Interest capitalized	<u>426,840</u>
Total cost	<u>5,626,840</u>

$$\text{Depreciation Expense} = \frac{5,626,840 - 300,000}{30 \text{ years}} = 177,561$$

(c) To record the sale of the automobile and related warranties: January 2, 2014

Cash (Taka 30,000 + Taka 900)	30,900	
Warranty Expense	700	
Warranty Liability		700
Unearned Warranty Revenue		900
Sales Revenue		30,000

To record warranty costs incurred in 2014: January 2–December 31, 2014

Warranty Liability	500	
Cash, Inventory, Accrued Payroll		500

To record revenue recognized in 2017 on the service-type warranty: January 1–December 31, 2017

Unearned Warranty Revenue (Taka 900 ÷ 3)	300	
Warranty Revenue		300

#### Solution of the Q. No. 4

(a) The seller normally uses trade discounts to avoid frequent changes in its catalogs, to quote different prices for different quantities purchased, and to hide the true invoice price from competitors. Trade discounts are not recorded in the accounts because the price finally quoted is generally an accurate statement of the fair market value of the product on that date. In addition, no subsequent changes can occur to affect this value from an accounting standpoint. With a cash discount, the buyer receives a choice and events subsequent to the original transaction dictate that additional entries may be needed.

(b)

(i) **Allowances and charge-offs.** Method (a) is recommended. In the case of this company which has a large number of relatively small sales transactions, it is practicable to give effect currently to the probable bad debt expense. Whenever practicable, it is advisable to accrue probable bad debt charges and apply them in the accounting periods in which the related sales are credited. If the percentage is based on actual long-run experience, the allowance balance is usually adequate to bring the accounts receivable in the balance sheet to realizable values. However, the method does not preclude a periodic review of the accounts receivable for the purpose of estimating probable losses in relation to the allowance balance and adjustment for an inadequate or excessive allowance. Therefore method (b) is technically not wrong, but perhaps could be used in conjunction with method (a). Method (b) does not seem as appropriate here because of the probable large number of accounts involved and therefore a percentage-of-sales basis should provide a better “matching” of expenses with revenues.

(ii) **Collection expenses.** Method (a) or (b) is recommended. In the case of this company, one strong argument for method (a) is that it is advisable to have the Bad Debt Expense account show the full amount of expense relating to efforts to collect and failure to collect balances receivable. On the other hand, an argument can be made to debit the Allowance account on the theory that bad debts (including related expenses) are established at the time the allowance is first established. As a result, the allowance account already has anticipated these expenses and therefore as they occur they should be charged against the allowance account. It should be noted that there is no “right answer” to this question. It would seem that alternatives (c) and (d) are not good alternatives because the expense is not identified with bad debts, which it should be.

(iii) **Recoveries.** Method (c) is recommended. This method treats the recovery as a correction of a previous write-off. It produces an allowance account that reflects the net experience with bad debts. Method (a) might be acceptable if the provision for bad debts were based on experience with losses without considering recoveries, but in this case it would be advisable to use one account with a specific designation rather than the broad designation “other revenue.” As indicated in the textbook, recoveries are usually handled by reestablishing the receivable and allowance account and then payment recorded. Method (c) is basically that approach.

**Solution of the Q. No. 5**

**Requirement i:**

An associate is a company over which an investor has significant influence. Therefore, if the investment in SUN is to be classified as an investment in an associate, it must be demonstrated that MS has significant influence over the financial and operating policies of SUN. Normally, if an investor holds 20% or more of the voting equity of the investee, significant influence is assumed to exist. However, it is important to examine other factors to determine whether the 20% holding is sufficient for significant influence. Other factors that would be examined to assess whether significant influence exists would include

- composition of remaining share ownership (for example, whether one shareholder own the remaining 80% of the shares or ownership is widely held)
- representation of MS on Board of directors
- participation in policy making processes
- significant transactions between MS and SUN
- transfer of executive personnel between MS and SUN

If these factors suggested significant influence over the financial and operating policies of SUN, the investment would be classified as an investment in an associate. If significant influence does not appear to exist, the investment would be classified as an available-for-sale investment, as long as the intent of MS is to hold the investment for a long period.

If the investment is classified as an investment in an associate it will be reported by MS using the equity method of accounting.

**Requirement ii:**

**January 1, 20X7**

Investment in MOON .....	358,140	
Discount on note payable <sup>1</sup> .....	61,860	
Cash .....		120,000
Note payable .....		300,000

[To record investment in 20% of shares of MOON]

<sup>1</sup> (Tk.300,000 – (Tk.300,000 × 0.7938))

**December 31, 20X7**

Interest expense <sup>1</sup> .....	19,051	
Discount on note payable .....		19,051

To record interest expense on note payable for 20X7

<sup>1</sup> Tk.238,140 × 8%

**Requirement iii: (a)**

If the investment is recorded in the accounting records of MOON using the cost method of accounting, the following additional entry would be made in 20X7:

Cash <sup>1</sup> .....	20,000	
Investment income .....		20,000

[To record receipt of dividends from MOON]

<sup>1</sup> Tk.100,000 × 20%

**b)** If the investment is recorded in the accounting records of MOON using the equity method of accounting, the following additional entries for 20X7 are required:

Cash <sup>1</sup> .....	20,000	
Investment in MOON.....		20,000

[To record receipt of dividends from MOON]

<sup>1</sup> Tk.100,000 × 20%

Investment in MOON <sup>1</sup> .....	48,000	
Investment income .....		48,000

[To record AZN's share of MOON's adjusted profit]

<sup>1</sup> The investment income earned by AZN from its investment in MOON in 20X7, under the equity method, is calculated as follows:

AZN's share of MOON reported profit ( $20\% \times \text{Tk.}250,000$ )	Tk. 50,000
Extra depreciation expense ( $\text{Tk.}200,000 \times 20\% \times \frac{1}{20}$ )	<u>(2,000)</u>
AZN's adjusted investment income from MOON	<u>Tk. 48,000</u>

**Requirement iv:**

**a) (1 mark)**

The balance in the Investment in MOON account at December 31, 20X7, under the cost method is Tk.358,140, the original cost amount.

**b) (3 marks)**

The balance in the Investment in MOON account at December 31, 20X7, under the equity method is Tk.386,140 ( $\text{Tk.}358,140 + \text{Tk.}48,000 - \text{Tk.}20,000$ ).

**= THE END =**