

**CMA JANUARY 2022 EXAMINATION  
INTERMEDIATE LEVEL - I  
FR222. INTERMEDIATE FINANCIAL ACCOUNTING**

**Model Solution**

**Section A**

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

- (i) (a) decision usefulness.  
(ii) (c) materiality ingredient.  
(iii) (c)

*Cost per widget*

	CU
Raw materials (CU100,000 ÷ 10,000)	10
Direct labour (CU50,000 ÷ 10,000)	5
Variable overheads (CU40,000 ÷ 10,000)	4
Fixed overheads (CU120,000 ÷ 12,000)	10
	<b>29 * 1,000 widgets = CU29,000</b>

- (iv) (a) 65,000  
(v) (a) Current liabilities  
(vi) (d)

	CU
Original purchase price	50,000
Depreciation for 20X1 ((50,000 – 5,000) ÷ 5)	(9,000)
Depreciation for 20X2	(9,000)
Upgrade 31 December 20X2	<u>15,000</u>
NBV at end of 20X2	47,000
Depreciation for 20X3 ((47,000 – 5,000) ÷ 5)	<u>(8,400)</u>
NBV 1 January 20X4	38,600
Disposal proceeds	<u>(7,000)</u>
<b>Loss on disposal</b>	<b>31,600</b>

- (vii) (b)  
Borrowing over ten quarters (since paying in arrears)  
Therefore SOTD = (10 \* 11) ÷ 2 = 55

	CU
Deposit	6,000
Instalments (10 * CU2,600)	26,000
Cash price	(24,000)
Total interest	8,000

Allocated to 4th repayment = 7/55 \* CU8,000 = CU1,018

- (viii) (c)  
Recoverable amount is the higher of fair value less costs to sell (CU18,000) and value in use (CU22,000)

	CU
Development costs	300,000
Depreciation on equipment used for development (100,000 ÷ 5)	20,000
	<b>320,000</b>

- (x) (c) An installment sale accounted for on the accrual basis for financial reporting purposes and on the installment (cash) basis for tax purposes.

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

- (a) False. The objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers.
- (b) False. While comparability does pertain to the reporting of information in a similar manner for different companies, it also refers to the consistency of information, which is present when a company applies the same accounting treatment to similar events, from period to period. Through such application the company shows consistent use of accounting standards and this permits valid comparisons from one period to the next.
- (c) True
- (d) False. To be classified as PPE, the building:
  - 1) must be acquired for use in operations and not for resale;
  - 2) be long-term in nature and generally subject to depreciation; and
  - 3) possession physical substance.
- (e) FALSE. Costs incurred internally to create intangible assets are generally expensed as incurred.

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

- (1) (d) Historical cost principle
- (2) (j) Expense recognition
- (3) (h) Economic Entity assumption
- (4) (f) Cost constraint
- (5) (b) Revenue and expense recognition

**SECTION B**

**Solution of the Q. No. 4**

(a)  
No.

Revaluation of non-current assets during the year will **not** be shown under cash flows from operating activities. A revaluation of non-current assets during the year will **be entirely excluded**. Revaluations have no cash flow implications.

(b)

VICARIO CORPORATION  
Partial Statement of Financial Position  
December 31, 2017

Equity		
Share capital—preference, \$100 par value 10,000 shares authorized, 5,000 shares issued & outstanding .....	\$500,000	
Share capital—ordinary, \$50 par value 15,000 shares authorized, 8,000 shares issued 7,700 shares outstanding .....	<u>400,000</u>	\$ 900,000
Share premium—preference.....	65,000	
Share premium—ordinary.....	49,000*	
Share premium—treasury (preference).....	<u>4,700</u>	118,700
Retained earnings.....		247,400**
Less: Treasury shares (300 shares—ordinary).....		<u>19,200</u>
Total equity .....		<u>\$1,246,900</u>

\*[(\$57 – \$50) X 7,000]

\*\*\$610,000 – \$312,600 – (\$50 X 1,000 shares)

(c) (i)

XYZ GROUP  
Statement of Cash Flows  
For the Year Ended December 31, 2020

Cash flows from operating activities	
Net income .....	67,000
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation expense .....	22,000
Gain on sale of equity investments .....	(15,000)
Loss on sale of equipment .....	3,000
Increase in accounts receivable (net) .....	(23,000)
Increase in inventory .....	(14,000)
Increase in accounts payable .....	6,000
Increase in income taxes payable .....	2,000
	<u>(19,000)</u>
Net cash provided by operating activities .....	48,000
Cash flows from investing activities	
Purchase of equity investments [55,000 – (85,000 – 35,000)] .....	(5,000)
Purchase of equipment [70,000 – (48,000 – 10,000)] .....	(32,000)
Sale of equity investments (35,000 + 15,000) .....	50,000
Sale of equipment [10,000 – (10,000 X 60%)] – 3,000 .....	1,000
Net cash provided by investing activities .....	14,000
Cash flows from financing activities	
Payment of long-term notes payable .....	(8,000)
Cash dividends paid [(95,000 + 67,000) – 92,000] .....	(70,000)
Issuance of ordinary shares .....	35,000*
Net cash used by financing activities .....	<u>(43,000)</u>
Net increase in cash .....	19,000
Cash, January 1, 2020 .....	51,000
Cash, December 31, 2020 .....	<u>70,000</u>
*310,000 – 260,000 = 50,000; 50,000 – (40,000 – 25,000) = 35,000	

Non-cash investing and financing activities\*\*

    Issuance of ordinary shares for land .....

15,000

\*\*Presented in the notes to the financial statements.

(ii) Net Cash Provided by Operating Activities

Cash receipts from customers	925,000 (1)
Cash payments:	
Cash payments to suppliers	608,000(2)
Cash payments for operating expenses	226,000(3)
Cash payments for income taxes	43,000(4)
Net cash provided by operating activities	<u>877,000</u> <u>48,000</u>

(1) (Sales Revenue) less (Increase in Accounts Receivables)  
950,000 – 25,000 = 925,000

(2) (Cost of Goods Sold) plus (Increase in Inventory) less  
(Increase in Accounts Payable)  
600,000 + 14,000 – 6,000 = 608,000

- (3) (Operating Expenses) less (Depreciation Expense) less  
(Bad Debt Expense)  
250,000 – 22,000\* – 2,000 = 226,000
- (4) (Income Taxes) less (Increase in Income Taxes Payable)  
45,000 – 2,000 = 43,000

$$*21,000 - [14,000 - (10,000 \times .60)] = 13,000 \text{ Equipment depreciation}$$

$$37,000 - 28,000 = \begin{array}{r} 9,000 \\ \hline 22,000 \end{array} \text{ Building depreciation}$$

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

(a)

**£1,827,360**

The signing of the lease is a past event that creates a legal obligation to pay for the property under the terms of the contract and is an obligating event (IAS 37.14). The company should therefore create a provision for the onerous contract that arises on leaving the premises (IAS 37.66). This is calculated as the excess of unavoidable costs of the contract over the economic benefits to be received from it. The unavoidable cost is the lower of the cost of fulfilling the contract and the penalty that arises from failing to fulfil it (IAS 37.68).

The effect of the time value of money over six years is material, so the provision should be discounted to its present value (IAS 37.45). The present value of the sub-lease arrangement is £1,827,360 ((£480,000 - £120,000) \* 5.076). As this is less than the £2.2m compensation payable, it should be used to measure the provision.

(b)

Premium Puppet	60,000	
Cash		60,000
(To record purchase of 40,000 puppets at 1.50 each)		
Cash	1,800,000	
Premium Expense	57,600	
Premium Liability (See Schedule A)		57,600
Sales Revenue (480,000 boxes at 3.75 each) (To record sale and related premium expense)		1,800,000

Schedule A		
Total boxes sold	480,000	
Estimated redemptions	<u>40%</u>	
Total estimated redemptions	<u>192,000</u>	
Cost of estimated redemptions (192,000 boxes ÷ 5) X 1.50		<u>€57,600</u>
Premium Liability	34,500	
Premium Puppets (115,000 ÷ 5) X 1.50 (To record redemption of puppets)		<u>34,500</u>

(c)

Peking Duck Co. (Lessee)\*

1/1/15	Cash .....	510,000.00	
	Equipment .....		450,000.00
	Unearned Profit on Sale Leaseback .		60,000.00

Leased Equipment .....	510,000.00	
Lease Liability		
(¥83,000.11 X 6.14457).....		510,000.00

Throughout 2015

	Insurance (Tax, Maintenance and Repairs) Expense	9,000.00	
	Accounts Payable or Cash .....		9,000.00
12/31/15	Unearned Profit on Sale Leaseback .....	6,000.00	
	Depreciation Expense**		
	(¥60,000 ÷ 10) .....		6,000.00
12/31/15	Depreciation Expense .....	51,000.00	
	Accumulated Depreciation—Leased Equipment		
	(¥510,000 ÷ 10) .....		51,000.00
	Interest Expense .....	51,000.00	
	Lease Liability .....	32,000.11	
	Cash.....		83,000.11

\*The lease should be treated as a finance lease because the present value of minimum lease payments equals the fair value of the computer. Also, the lease term is greater than 75% of the economic life of the asset, and title transfers at the end of the lease.

\*\*The credit could also be to a revenue account.

Note:

The present value of an ordinary annuity at 10% for 10 periods should be used to capitalize the asset. In this case, Peking Duck Co. would use the implicit rate of the lessor because it is known to Peking Duck Co. The unearned profit on the sale-leaseback should be amortized on the same basis that the asset is being depreciated.

Partial Lease Amortization Schedule

Date	Annual Lease Payment	Interest (10%)	Amortization	Balance
1/1/15				¥510,000.00
12/31/15	¥83,000.11	¥51,000.00	¥32,000.11	477,999.89
Liquidity Finance Co. (Lessor)*				
1/1/15	Equipment.....		510,000.00	
	Cash.....			510,000.00
	Lease Receivable.....		510,000.00	
	Computer.....			510,000.00
12/31/15	Cash .....	83,000.11		
	Lease Receivable.....			32,000.11
	Interest Revenue .....			51,000.00

\*Lease should be treated as a direct-financing lease because the present value of the minimum lease payments equals the fair value of the computer, and the cost to the lessor equals the fair value of the asset at the inception of the lease.

**Solution of the Q. No. 6**

(a) This is a contingent asset because the amount to be received will be in excess of the book value of the plant. Contingent assets are not recorded and are disclosed only when the probabilities are high (virtually certain) that a contingent asset will become reality.

(b)

1.	Land .....	375,000	
	Buildings .....	1,125,000	
	Equipment.....	750,000	
	Share Capital—Ordinary (12,500 X Tk. 100).....		1,250,000
	Share Premium—Ordinary..... (Tk. 2,250,000 – Tk. 1,250,000)		1,000,000

The cost of the property, plant and equipment is Tk. 2,250,000 (12,500 X Tk. 180). This cost is allocated based on appraised values as follows:

$$\text{Land} \quad \frac{\text{Tk. 400,000}}{\text{Tk. 2,400,000}} \times \text{Tk. 2,250,000} = \text{Tk. 375,000}$$

$$\text{Buildings} \quad \frac{\text{Tk. 1,200,000}}{\text{Tk. 2,400,000}} \times \text{Tk. 2,250,000} = \text{Tk. 1,125,000}$$

$$\text{Equipment} \quad \frac{\text{Tk. 800,000}}{\text{Tk. 2,400,000}} \times \text{Tk. 2,250,000} = \text{Tk. 750,000}$$

2.	Buildings (Tk. 105,000 plus Tk. 161,000) .....	266,000	
	Equipment .....	135,000	
	Land Improvements .....	122,000	
	Land .....	18,000	
	Cash.....		541,000
3.	Equipment .....	284,900	
	Cash.....		284,900
	(Tk. 10,500 plus Tk. 274,400, which is 98% of Tk. 280,000.)		

c) Ending inventory:

	Cost	Retail
Beginning inventory.....	Tk. 149,000	Tk. 283,500
Purchases .....	1,400,000	2,160,000
Freight-in.....	<u>70,000</u>	<u>—</u>
Totals .....	1,619,000	2,443,500
Add net markups .....	<u>—</u>	<u>92,000</u>
	<u>Tk. 1,619,000</u>	<u>2,535,500</u>
Deduct net markdowns.....		<u>48,000</u>
		2,487,500
Deduct sales .....		<u>2,175,000</u>
Ending inventory, at retail.....		<u>Tk. 12,500</u>

$$\text{Ratio of cost to selling price} \quad \frac{\text{Tk. 1,619,000}}{\text{Tk. 2,535,500}} = 64\%$$

Ending inventory estimated at cost = 64% X Tk. 312,500 = Tk. 200,000.

The retail method, above, showed an ending inventory at retail of Tk. 312,500; therefore, merchandise not accounted for amounts to Tk. 17,500 (Tk. 312,500 – Tk. 295,000) at retail and Tk. 11,200 (Tk. 17,500 X .64) at cost.

**Solution of the Q. No. 7**

**(a)**

	June 30, 2016		
(i)			
	Bonds Payable (Tk. 600,000 – Tk. 78,979) .....	521,021	
	Loss on Extinguishment of Debt .....	102,979	
	Cash .....		624,000
	Reacquisition price (Tk. 600,000 X 104%).....		Tk. 624,000
	Net carrying amount of bonds redeemed:		
	(Tk. 600,000 – Tk. 78,979).....		<u>(521,021)</u>
	Loss on extinguishment.....		<u>Tk. 102,979</u>
	Cash (Tk. 800,000 X 112.5513%) .....	900,410	
	Bonds Payable .....		900,410
(ii)	December 31, 2016		
	Interest Expense .....	22,510*	
	Bonds Payable .....	1,490	
	Cash .....		24,000**

\*(Tk. 900,410 X 5% X 6/12)

\*\*(.03 X Tk. 800,000 = Tk. 24,000)

**(b)**

The futures contract was intended to protect the company from a fall in oil prices (which would have reduced the profit when the oil was eventually sold). However, oil prices have actually risen, so that the company has made a loss on the contract.

**(i) Without hedge accounting**

The futures contract is a derivative and therefore should be remeasured to fair value under IAS 39. The loss on the futures contract should be recognised in profit or loss:

Dr Profit or loss (40,000 * [£24 – £22])	£80,000	
Cr Financial liability		£80,000

**(ii) With hedge accounting**

The loss on the futures contract should be recognised in profit or loss, as before.

There is an increase in the fair value of the inventories:

	£
Fair value at 31 December 20X3 (40,000 * £22.25)	890,000
Fair value at 1 December 20X3 = cost	(800,000)
	Gain 90,000

The gain should also be recognised in profit or loss and adjusted against the carrying amount of the inventories:

Dr Inventory	£90,000
Cr Profit or loss	£90,000

The net effect on profit or loss is a gain of £10,000, compared with a loss of £80,000 without hedging.

**Note:** The hedge is highly effective: 80,000/90,000 = 89% which is within the 80% – 125% range.

**(c)**

- (i)  $X (.40) = \$320,000$  taxes due for 2015  
 $X = \$320,000 \div .40$   
 $X = \$800,000$  taxable income for 2015

(ii)

Pretax financial Income	910,000
(-) Excess Depreciation	160,000
(-) Governmental Interest	10,000
(+) Unearned Rent	60,000
Taxable Income	8,00,000

(iii)

2015

Income Tax Expense		
(\$320,000 + \$48,000 – \$18,000) .....	350,000	
Deferred Tax Asset (\$60,000 X .30) .....	18,000	
Income Taxes Payable (\$800,000 X .40) .....		320,000
Deferred Tax Liability (\$160,000 X .30) .....		48,000

2016

Income Tax Expense		
(\$294,000 + \$9,000 – \$12,000) .....	291,000	
Deferred Tax Liability [(\$160,000 ÷ 4) X .30] .....	12,000	
Income Taxes Payable (\$980,000 X .30) .....		294,000
Deferred Tax Asset [(\$60,000 ÷ 2) X .30] .....		9,000

**= THE END =**