Advanced Accounting

Suggested

Roll No……………. **Maximum Marks - 100**

Total No. of Questions - 6 **Total No. of Printed Pages - 5**

Time Allowed - 3 Hours

Marks

Attempt all questions. Working notes should form part of the answer.

1. A, B and C are partners of M/s Sun Trading sharing profits and losses in the ratio of 3:3:2. Their balances as on July 16, 2015 is as under:

Particulars	Amount (Rs.)	Amount (Rs.)
Fixed Assets: Cost Less: Depreciation	 360,000 216,000	 144,000
Investment:Cost (Market Value Rs. 250,000)		120,000
Working Capital Total		400,000 664,000
Financed by: Loans from D E	 180,000 120,000	 300,000
Reserves		264,000
Capitals B C	240,000 120,000	
	360,000	
Less: A	260,000	100,000
Total		664,000

On that day, A retired from business. B and C decided to admit D as a partner and E, who is a minor, to benefits of partnership. B, C, D and E are to share profits in the ratio of 3:3:2:2. Losses, if any, are to be borne by B, C and D in the ratio of 3:3:2.

For the purpose of above retirement-cum admission, it is decided that:

a) Goodwill of the firm is valued at Rs. 250,000. However, no account is to appear for goodwill. Treatment of goodwill in relation to minor is to be deferred to the date when he opts to be a partner on attaining majority, when the value of goodwill will be deemed, for this purpose, to remain unchanged at Rs. 250,000.

b) A takes over: (i) Fixed Assets (cost Rs. 125,000; WDV Rs.55,000) for Rs.100,000; and (ii) Investments (cost Rs. 15,000) at their market value of Rs. 12,500.

c) The continuing partners take over the remaining assets at their book values, except investments which are taken over at their market values.

d) Loans are to be transferred to capital accounts.

e) The amount due to/from A is to be settled by Cheque immediately.

You are required to prepare: (a) the Revaluation / Adjustment Account; (b) the Capital Accounts; and, (c) the Balance Sheet of the firm after giving effect to all the above points of agreement. 20

Answer

a) Revaluation Account:

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Particulars	Amount	Particulars	Amount
To Investment A/c	2,500	By Fixed Assets A/c	45,000
To Partners Capital A/c		By Investment A/c	132,500
A	65,625		
B	65,625		
C	43,750		
	177,500		**177,500**

b) **Partners Capital Account:**

Particulars	A	B	C	D	E	Particulars	A	B	C	D	E
To Balance B/d	260,000					By Balance c/d		240,000	120,000		
To A's Capital			31,250	62,500		By C's Capital	31,250				
To Fixed Assets	100,000					By D's Capital	62,500				
To Investment	12,500					By Reserves	99,000	99,000	66,000		
To Balance c/d	-	404,625	198,500	117,500	120,000	By Revaluation	65,625	65,625	43,750		
						By Loan A/c	-	-	-	180,000	120,000
						By Bank A/c	114,125				
	372,500	**404,625**	**229,750**	**180,000**	**120,000**		**372,500**	**404,625**	**229,750**	**180,000**	**120,000**

c) Balance Sheet of the new firm as on 16.07.2015.

Liabilities	Amount	Assets	Amount
Capital Accounts		Fixed Assets (Cost Less Dep)	89,000
B	404,625	Investment (Market Value)	237,500
C	198,500	Working Capital	514,125
D	117,500		
E	120,000		
	840,625		**840,625**

Working Notes:

1. Adjustment of Goodwill:

Goodwill Value: Rs. 250,000

Particulars	A	B	C	D
A. Credited in the old Profit Sharing ratio (Rs.)	93,750	93,750	62,500	
B. Debited in the new profit sharing ratio (Rs.)	-	93,750	93,750	62,500
Required Adjustment (A-B)	93,750	-	(31,250)	(62,500)

Note: E's Account cannot be debited for writing – off goodwill since he is a minor.

2. Provision for Depreciation Account:

Particulars	Amount	Particulars	Amount
To Assets Account	70,000.00	By Balance b/d	216,000.00
To Balance c/d	146,000.00		
	216,000.00		**216,000.00**

3. Fixed Assets Account:

Particulars	Amount	Particulars	Amount

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To Balance b/d	360,000.00	By Prov for Depreciation	70,000.00
To Revaluation A/c	45,000.00	By A's Capital A/c	100,000.00
		By Balance c/d	235,000.00
	405,000.00		**405,000.00**

4. Investment Account:

Particulars	**Amount**	**Particulars**	**Amount**
To Balance B/d	120,000.00	By A's Capital	12,500.00
To Revaluation A/c	132,500.00	By Revaluation A/c	2,500.00
		By Balance c/d	237,500.00
	252,500.00		**252,500.00**

5. Ascertainment of Working Capital:

Opening working Capital: Rs. 400,000
Add: Cheque by A: Rs. 114,125
Closing Working Capital: Rs. 514,125

2.

a) A Commercial Bank has the following capital funds and assets. Segregate the capital funds into core capital (Tier I) and supplementary capital (Tier II). Find out the risk weighted asset and capital fund ratio.

Particulars	(Rs. in crores)
Equity share capital	500.00
Statutory reserve	270.00
Capital reserve (of which Rs. 16 crores were due to revaluation of assets and the balance due to sale of capital asset)	78.00
Assets: Cash balance with Nepal Rastra Bank (NRB)	10.00
Balance with other banks	18.00
Other investments	36.00
Loans and advances:	
(i) Guaranteed by the Government	16.50
(ii) Others	5,675.00
Premises, furniture and fixtures	78.00
Off-Balance Sheet items:	
(i) Advance Payment Guarantee	800.00
(ii) Contingent Liability in respect of Income Tax	4,800.00

10

b) On 31st Ashadh 2072 Varun Limited with an issued and subscribed capital of Rs.700,000 divided into 70,000 fully paid equity shares of Rs.10 each had net tangible assets of Rs.950,000 and Goodwill amounting to Rs.50,000. On this date Paul Limited took over Varun Limited's business for Rs.1,300,000 payable as to Rs.100,000 cash and Rs.1,200,000 in 100,000 equity shares of Rs.10 each valued at Rs.12 per share. However it was decided that the shares so allotted should be recorded by both the companies in the books at par value only.

On the date of purchase of business, Varun Limited's debtors included Rs.20,000 due from Paul Limited for goods sold to it at the profit of 25% on cost. Paul Limited had sold only 1/4th of these goods by the date of absorption, the remaining goods lying unsold in stock.

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You are required to pass necessary journal entries in the books of both the companies. **10**

Answer

a)

(i)		Rs in crores	Rs in crores
	Core Capital- Tier I		
	Equity share capital		500
	Statutory reserve		270
	Capital reserve (arising of sale of assets) (78-16)		62 832
	Supplementary Capital – Tier II		
	(Capital Reserve (arising out of revaluation of assets) As per NRB Directive- Capital Reserve relates with revaluation reserve of assets, upto 2% of total Supplementary Capital only allowed for the computation)	16	0.32
	Total Capital Fund		**832.32**

		Rs in crores	% of weight	Rs in crores
(ii)	**Risk Weighted Assets**			
	Funded Risk Assets			
	Cash balance with NRB	10	0	0
	Balance with other banks	18	20	3.60
	Other investments	36	100	36
	Loans and advances:			
	i) Guaranteed by the government	16.5	0	0
	ii) Others	5,675	100	5,675
	Premises, furniture and fixtures	78	100	78 5,792.60
		Rs in crores	Credit conversion factor	
	Off-Balance Sheet items:			
	Advance Payment Guarantees	800	100	800
	Contingent Liability in respect of Income Tax	4,800	100	4,800 11,392.60

Capital Fund Ratio:

$$\frac{\text{Capital fund}}{\text{Risk weighted assets}} \times 100$$

(832.32/11,392.60) x 100 =7.31%

b) **Working Note:**

Summarized Balance Sheet of Varun Limited as on 31st Ashad 2072:

Share capital		Goodwill	50,000
Issued and Subscribed		Net Sundry Tangible Assets	9,50,000
70,000 equity shares of Rs.10			
Each fully paid up	7,00,000		
Reserves	3,00,000		

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The consideration on the basis of par value of shares would be:

	Rs.
Cash	1,00,000
1,00,000 Equity shares of Rs.10 each	10,00,000
	11,00,000

In the books of VarunLimited
Journal Entries

Date	Particulars	Dr Amount	Cr Amount
2072 31/3	Realization A/c Dr. To Sundry Net Tangible Assets To Goodwill *(Being transfer of goodwill and other sundry tangible assets to realization account.)*	10,00,000	 9,50,000 50,000
31/3	Paul Limited A/c Dr. To Realisation A/c *(Being amount calculated on the basis of par value of shares due to Paul Limited for business sold to it.)*	11,00,000	 11,00,000
31/3	Bank. A/c Dr. Equity Shares in Paul Limited Dr. To Paul Limited A/c (*Being receipt of cash and equity shares in Paul Limited at [ar from Paul Limited in discharge of the purchase consideration for the business sold to it.*)	1,00,000 10,00,000	 11,00,000
31/3	Equity Share Capital A/c Dr. Reserves A/c Dr. Realization A/c Dr. To Equity Shareholders A/c *(Transfer of equity share capital account, Reserves and profit on realization to the Equity Shareholders A/c.)*	7,00,000 3,00,000 1,00,000	 11,00,000
31/3	Equity Shareholders A/c Dr. To Bank A/c To Equity Shares in Paul Ltd. A/c (*Being amount received from the insurance company less commission.*)	11,00,000	 1,00,000 10,00,000

In the books of Paul Limited
Journal Entries

Date	Particulars	Dr Amount	Cr Amount
2072 31/3	Business Purchase A/c Dr. To Liquidator of Varun Limited A/c *(Being amount calculated on the basis of par value of shares payable to liquidator of Varun Limited for the business purchased.)*	11,00,000	 11,00,000
31/3	Goodwill A/c Dr. Net Sundry Assets A/c Dr. To Realization A/c	1,50,000 9,50,000	 11,00,000

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	(Incorporation of the net sundry tangible assets taken over and the amount paid for goodwill..)		
31/3	Liquidator of Varun Limited A/c Dr. To Bank A/c To Equity Share Capital Account (*Payment of Cash and allotment of 1,00,000 equity shares of Rs.10 each (recorded at par) to the liquidators of Varun Limited in discharge of the consideration.)*	11,00,000	 1,00,000 10,00,000
31/3	Sundry Creditors Dr. To Sundry Debtors A/c *(Elimination of mutual owing.)*	20,000	 20,000
31/3	Goodwill A/c Dr. To Stock A/c (*Being elimination of unrealized profit in respect of 3/4th of goods purchased earlier from Varun Limited and remaining unsold on the date of absorption.)*	3,000	 3,000

3.

a) D Ltd., which operates a wholesale business, had a fire on premises on September 17, 2014, which destroyed most of the premises, although stock to the value of Rs. 3,960 was salvaged. The company has an insurance policy (with suitable average clauses) covering Stocks for Rs. 600,000, Building for Rs. 800,000, and Loss of Profits including standing charges for Rs. 250,000 with a six months period of indemnity.

The company's last Profit & Loss Account, for the year ended 16th July, 2014, showed the following position:

DR CR

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Opening Stock	412,500	By Sales	2,000,000
To Purchases	1,812,500	By Stock	525,000
To Insured Standing Charges	167,500	By Interest	5,000
To Other Expenses	80,000		
To Net Profit for the Year	57,500		
	2,530,000		2,530,000

The company's records show that the sales for period up to September 17, 2014 had been the same as for the corresponding months in the previous year at Rs. 100,000, payments made to trade creditors in October-November were Rs 106,680 and at the end of that month the balances owing to trade creditors had increased by Rs. 3,320. The company's business was disrupted until the mid of December 2015, during which period turnover fell by Rs. 180,000 compared with the same period in the previous year. It was agreed that three quarters of the value of the building had been lost and that at the time of the fire it had been worth Rs. 1,000,000.

Ascertain the amount of various claims to be lodged with the insurers. **10**

b) M/s Manakamna Limited has three department stores A, B & C. From the particulars given below the values of stock as on 31st December 2015 and the departmental trading result for the year ended 31st December 2015. **5**

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(a)

	A (Rs.)	B (Rs.)	C (Rs.)
Stock as on 1st January 2015	24,000	36,000	12,000
Purchases	146,000	124,000	48,000
Actual sales	172,500	159,400	74,600
G P on normal selling prices	20%	25%	33.33%

(b) During the year certain items were sold at a discount and these discounts were reflected in the values of sales shown above. The items sold at discount were:

Particulars	A (Rs.)	B (Rs.)	C (Rs.)
Sales at normal price	10,000	3,000	1,000
Sales at actual prices	7,500	2,400	600

Answer

a)

(i) Loss of Stock

Trading Account

(for the period ended September 17, 2014)

Dr **Cr**

Particulars	Amount	Particulars	Amount
To Opening Stock	525,000	By Sales	100,000
To Purchases	110,000	By Closing Stock	
To Gross Profit @ 15% Sales Rs. 100,000	15,000	*(Balancing Fig.)*	550,000
	650,000		**650,000**

Estimated Stock at the time of fire	Rs.550,000
Less: Salvaged Stock	Rs. 3,960
Loss of Stock:	***Rs. 546,040***

Working Notes:

1. ***Gross Profit*** shown by Last Year's Accounts is Rs 300,000 against Rs. 2,000,000 Sales i.e. **15%** of Sales. In absence, of any information; the same GP % is assumed for current year also.
2. ***Purchases*** = Payment to Creditors + Increase in Creditors Balance = 106,680 + 3,320 = ***110,000.***

(ii) Building

Loss: Three quarters of Rs. 1,000,000 : Rs. 750,000

The building was under-insured, as the insurance cover was for Rs. 800,000 only; Hence, Average Clause is applicable. Insured Covered = 800,000 / 1,000,000 X 100% = 4/5 0or 80%.

Therefore, the amount to be claimed= 4/5 of 750,000 =Rs. 600,000

(iii) Loss of Profit:

Indemnity Period: September 17 to December 15 i.e. 3 Months

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Profit Ratio for the year ending July 16, 2014

$$\frac{\text{Net Profit (Less Interest) + Insured Standing Charges}}{\text{Sales}} * 100$$

$$= \frac{(57{,}500-5{,}000) + 167{,}500}{2000000} * 100$$

= **11%.**

As Short Sales = Rs. 180,000,

Claim for Loss of Profit = 11% of 180,000 = Rs. 19,800.

b) **Departmental Trading Account**

For the year ending 31st December 2015

	A Rs.	B Rs.	C Rs.		A Rs.	B Rs.	C Rs.
To Opening Stock	24,000	36,000	12,000	By Sales	172,500	159,400	74,600
To Purchases	146,000	124,000	48,000	By Closing Stock	30,000	40,000	10,000
To Gross Profit	32,500	39,400	24,600				
	202,500	**199,400**	**84,600**		**202,500**	**199,400**	**84,600**

Working Note:

(i) Ascertainment of cost of sales	**A Rs.**	**B Rs.**	**C Rs.**
Sales at actual price	172,500	159,400	74,600
Less: Discounted sales price	(7,500)	(2,400)	(600)
	165,000	157,000	74,000
Add: Sales at normal selling price	10,000	3,000	1,000
Total Sales at normal price	175,000	160,000	75,000
Profit on normal prices	20%	25%	33.33%

4.

a) X Limited sells products on hire purchase terms, the price being cost plus 33 1/3%. From the following particulars for the year ended 31st Ashadh 2071, prepare the necessary accounts on stock-debtors system to reveal the profit earned: **10**

2070		
1st Shrawan	Stock out on hire at Hire purchase price	400,000
	Stock in hand at the shop	50,000
	Installments due (Customers still paying)	30,000
2071		
31st Ashadh	Stock out on hire at Hire Purchase price	460,000
	Stock in hand at the shop	70,000
	Installments due (Customers still paying)	50,000
	Cash received during the year	800,000

b) Butwal Hydro Power Company Ltd. came up with public issue of 3000,000 equity shares of Rs. 10 each at Rs. 15 per share. A, B and C took underwriting of the issue in 3: 2: 1 ratio.

Applications were received for 2,700,000 shares.

The marked applications were received as under:

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A	800,000 shares
B	700,000 shares
C	600,000 shares

Commission payable to underwriters is at 5% on the face value of shares.

i) Compute the liability of each underwriter as regards the number of shares to be taken up.

ii) Pass journal entries in the books of Butwal Hydro Power Company Ltd. to record the transactions relating to underwriters. **5**

Answer

Hire Purchase Debtors Account

Date	*Particulars*	*Amount*	*Date*	*Particulars*	*Amount*
2070 01/04 01/04 to 31/03/ 2071	To balance b/d To Hire Purchase stock account –total number of installments which become due (balancing figure 1)	30,000 8.20,000	2070 01/04 to 21/03 2071	By Cash By Balance c/d	8,00,000 50,000
		8,50,000			**8,50,000**

Hire Purchase Stock Account

Date	*Particulars*	*Amount*	*Date*	*Particulars*	*Amount*
2070 01/04 01/04 to 31/03/ 2071	To balance b/d To goods sold on hire purchase (balancing figure 2)	4,00,000 8,80,000	2070 01/04 to 31/03 2071 31/03	By Hire Purchase Debtors A/c (1) By Balance c/d	8,20,000 4,60,000
		12,80,000			**12,80,000**

Hire Purchase Adjustment Account

Date	*Particulars*	*Amount*	*Date*	*Particulars*	*Amount*
2071 31/03	To Hire purchase Stock Reserve A/c	1,15,000	2070 01/04	By Hire Purchase Stock Reserve A/c (opening balance)	1,00,000
31/03	To Profit and Loss A/c (transfer of profit)	2,05,000	2071 31/03	By Goods sold on hire purchase A/c (Loading 25% of Rs.8,80,000)	2,20,000
		3,20,000			**3,20,000**

b)

Computation of liability of underwriters in respect of shares

(In shares)

Particulars	**A**	**B**	**C**
Gross liability (Total Issue-Promoters etc) in agreed ratio of 3: 2: 1	15,00,000	10,00,000	5,00,000
Less: Unmarked applications (Subscribed shares-marked shares) in 3: 2: 1	(3,00,000)	(2,00,000)	(1,00,000)

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Marked shares as per agreed ratio	12,00,000	8,00,000	4,00,000
Less: Marked applications actually received	(8,00,000)	(7,00,000)	(6,00,000)
Shortfall / surplus in marked shares	4,00,000	1,00,000	(2,00,000)
Surplus of C distributed to A & B in 3:2 ratio	(1,20,000)	(80,000)	2,00,000
Net liability for underwriting shares	2,80,000	20,000	Nil

Journal Entries in the books of Butwal Hydro Power Company Ltd.

Particulars		**Rs**	**Rs**
A's Account B's Account To Share Capital Account To Securities Premium Account (Being the shares to be taken up by the underwriters)	Dr Dr	42,00,000 3,00,000	 30,00,000 15,00,000
Underwriting Commission Account To A's Account To B's Account To C's Account (Being the underwriting commission due to the underwriters)	Dr.	15,00,000	 7,50,000 5,00,000 2,50,000
Bank Account To A's Account (Being the amount received from underwriter A for the shares taken up by him after adjustment of his commission)	Dr.	34,50,000	 34,50,000
B's Account To Bank Account (Being the amount paid to underwriter B after adjustment of the shares taken by him against underwriting commission due to him)	Dr.	2,00,000	 2,00,000
C's Account To Bank Account (Being the underwriting commission paid to C)	Dr.	2,50,000	 2,50,000

Note: C had sold in excess of the underwriting obligation and hence he will not be required to purchase any shares but will get commission for underwriting.

5.

a) M/s. Zipee Traders sold a car to a customer on installment sales basis.

The sales price of the car is Rs. 6,000,000.
The customer was required to pay following:

Shrawan 01, 2072	Down Payment (At the time of delivery)	3,000,000	
Shrawan 01, 2073	At the end of Year 1	1,860,000	(includes Interest of Rs. 360,000)
Shrawan 01, 2074	At the end of Year 2	1,680,000	(includes Interest of Rs. 180,000)
	Total Amount	6,540,000	

M/s. Zipee Traders booked the entire Rs. 6,540,000 as sales on Shrawan 01, 2072. With reference to the applicable NAS, explain whether the accounting treatment of M/s. Zipee Traders is justifiable or not. **5**

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b) Discuss the meaning of Chart of Accounts in Computerized Accounting Environment and explain how you can improve the exiting chart of accounts so that it matches the organisations' requirement. **5**

c) State with reasons, how the following events would be dealt with in the financial statements of National Trading Ltd. for the year ended 31st Ashadh, 2072:

(i) An agreement to sell a land for Rs. 30 lakh to another company was entered into on 1st Ashadh, 2072. The value of land is shown at Rs. 20 lakh in the Balance sheet as on 31st Ashadh, 2071. However, the sale Deed was registered on 15th Shrawan, 2072.

(ii) The negotiation with another company for acquisition of its business was started on 2nd Magh, 2071. National Trading Ltd. invested Rs. 40 lakh on 12th Ashoj, 2072. **5**

Answer

a) As per *NAS 07, 'Nepal Accounting Standard on Revenue:* 'Revenue attributable to the sales price, exclusive of interest, is recognized at the date of sale. The sale price is the present value of the consideration, determined by discounting the installments receivable at the imputed rate of interest. The interest element is recognized as revenue as it is earned, using the effective interest method.'

In the given case:
The sale price of the car is Rs. 6,000,000
The interest portion is Rs. 360,000 in Year 1.
The interest portion is Rs. 180,000 in Year 2.

Since Rs. 6,000,000 is only attributable to the sales price, exclusive of interest, is recognized at the date of sale; M/s. Zipee Traders treatment of booking the entire amount Rs. 6,540,000 as sales on Shrawan 01, 2072 is ***WRONG.***

In the given case; Rs. 6,000,000 should only booked as Sales Revenue on Shrawan 01, 2072. Rs. 360,000 should be booked as interest income for F/Y 2072/73 and Rs. 180,000 should be booked as interest income for F/Y 2073/74.

b) Chart of Accounts in Computerized environment:

The chart of accounts is a listing of all accounts used in the general ledger of an organization. The chart is used by the accounting software to aggregate information into an entity's financial statements.

The chart is usually sorted in order by account number, to ease the task of locating specific accounts. The accounts are usually numeric, but can also be alphabetic or alphanumeric.

Accounts are usually listed in order of their appearance in the financial statements, starting with the balance sheet and continuing with the income statement. Thus, the chart of accounts begins with cash, proceeds through liabilities and shareholders' equity, and then continues with accounts for revenues and then expenses. Many organizations structure their chart of accounts so that expense information is separately compiled by department; thus, the sales department, engineering department, and accounting department all have the same set of expense accounts.

Typical accounts found in the chart of accounts are:

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Assets:	Liabilities:	Stockholders' Equity:	Revenue:
Cash Marketable Securities Accounts Receivable Prepaid Expenses Inventory Fixed Assets Accumulated Depreciation (contra account) Other Assets	Accounts Payable Accrued Liabilities Taxes Payable Wages Payable Notes Payable	Common Stock Retained Earnings **Expenses:** Cost of Goods Sold Advertising Expense Bank Fees Depreciation Expense Payroll Tax Expense Rent Expense Supplies Expense Utilities Expense Wages Expense Other Expenses	Revenue Sales returns and allowances (contra account)

The following points can improve the chart of accounts concept for a company:

- *Consistency*. It is of some importance to initially create a chart of accounts that is unlikely to change for several years, so that you can compare the results in the same account over a multi-year period. If you start with a small number of accounts and then gradually expand the number of accounts over time, it becomes increasingly difficult to obtain comparable financial information for more than the past year.
- *Lock down*. Do not allow subsidiaries to change the standard chart of accounts without a very good reason, since having many versions in use makes it more difficult to consolidate the results of the business.
- *Size reduction*. Periodically review the account list to see if any accounts contain relatively immaterial amounts. If so, and if this information is not needed for special reports, shut down these accounts and roll the stored information into a larger account. Doing this periodically keeps the number of accounts down to a manageable level.

c) (i) According to NAS 10 "Event after the reporting period", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st Ashadh, 2072 i.e. before the balance sheet date. Registration of the sale deed on 15th Shrawan, 2072, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of National Trading Ltd. for the year ended 31st Ashadh, 2072.

(ii) According to NAS 10 "Event after the reporting period" as those significant events, both favorable and unfavorable, those occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not after the determination and the condition of the amount stated in the financial statements for the year ended 31st Ashadh, 2072.

Applying provision of the standard which clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that

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represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 40 lakhs in Ashoj, 2072 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

6. Write short notes on: **(5×3=15)**

   a) Presentation of 'Government Grant related to Assets' in Financial Statement.
   b) Reserve for Outstanding Insurance Claim Payables
   c) Watch list in Loan loss provisioning
   d) 'Current Ratio' vs. 'Quick Ratio'.
   e) Fundamental Accounting Assumptions

Answer

a) Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

One method sets up the grant as deferred income which is recognized as income on a systematic and rational basis over the useful life of the asset.

The other method deducts the grant in arriving at the carrying amount of the asset. The grant is recognized as income over the life of a depreciable asset by way of a reduced depreciation charge.

b) As Per Rule15 of the Insurance Regulation 2049, every insurer shall provide an amount of one hundred fifteen percent (115%) of the remaining amounts of the payment against the claim made by the Insurer before the expiry of each fiscal year. Such amount shall be recognized as income in next year.

c) With effect from 2071/12/18, Nepal Rastra Bank has formulated a new category of loan for provisioning purposes. As per the Central Bank's Rule, all loans are required to be classified into 5 different categories including Watch List whereby 5% of the total loan is required to be kept as provisioning though the provision can be reversed when the loan becomes performing later. As per the circular issued by Central Bank, the loans having the following characteristics are to be classified as Watch List loans:

1. If interest and principal repayments are outstanding for more than a month.
2. Short term/Working Capital Loans that are not renewed on time and are renewed on temporary basis.
3. Loans and advances to customers/ group of customers who have been categorized as non performing by other banks and financial institutions.
4. Firms/Companies/Organizations having negative net worth or negative operating cash inflows though interest and principal are served on regular basis.

d) Current Ratio:

The current ratio is a financial ratio that investors and analysts use to examine the liquidity of a company and its ability to pay short-term liabilities (debt and payables) with its short-term assets (cash, inventory, receivables).

Current Ratio = Current Assets / Current Liabilities.

Quick Ratio:

The quick ratio, on the other hand, is a liquidity indicator that filters the current ratio by measuring the amount of the most liquid current assets there are to cover current liabilities (you can think of the "quick" part as meaning assets that can be liquidated fast). The quick

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ratio, also called the "acid-test ratio," is calculated by adding cash & equivalents, marketable investments and accounts receivables, and dividing that sum by current liabilities.
Quick Ratio = (Current Assets – Inventories) / Current Liabilities.

The main difference between the current ratio and the quick ratio is that the latter offers a more conservative view of the company's ability to meets its short-term liabilities with its short-term assets because it does not include inventory and other current assets that are more difficult to liquidate (i.e., turn into cash). By excluding inventory (and other less liquid assets) the quick ratio focuses on the company's more liquid assets.

e) Accounting has its own assumption to make it relevant and for the purpose of facility. The basic assumptions underlying accounts are as follows:

1. **Going concern:** The enterprise is normally viewed as a going concern, i.e. as continuing operations for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation.If an enterprise is not a going concern -Valuation of its assets and liabilities on historical cost becomes irrelevant and as a consequence its profit/loss may not give reliable information.
2. **Consistency:** It is assumed that accounting policies are consistent from one period to another. This adds the virtue of comparability to accounting data. It comparability is lost, the relevance of accounting data for users' judgment and decision making is gone.
3. **Accrual :** Revenues and costs are accrued, that is, recognized as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. This assumption is the core of accrual accounting system.

   Disclosure requirements If the fundamental accounting assumption, viz. going Concern, Consistency, and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

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Audit and Assurance
Suggested Answers

Roll No……………. **Maximum Marks - 100**

Total No. of Questions- 7 **Total No. of Pages- 10**

Time Allowed - 3 Hours

Marks

Attempt all questions.

1. As an auditor, give your opinion with explanations on the following cases: **(4×5=20)**

   a) M/s DC Limited signed an agreement with workers for increase in wages with retrospective effect. The outflow on account of arrears was for 2011-12 Rs. 10.00 lakhs, for 2012-13 Rs. 12.00 lakhs and for 2013-14 Rs. 12.00 lakhs. This amount is payable in September, 2014. The accountant wants to charge Rs. 22.00 lakhs as prior period charges in financial statement for 2014-15.

   b) X Ltd. sold theapartment to M Ltd. for Rs. 60 lakhs on 30.09.2014 and gave possession of the property to M Ltd. However, Malpotdocumentation and legal formalities are pending. Due to this, the company has not recorded the sale and has shown the amount received as an advance. The book value of the building is Rs. 25 lakhs as on March 31, 2014.

   c) Manu Manufacturing Limited acquired an asset which has been declared by municipality as not meeting the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at Rs. 6,00,000. The estimated cost of destroying the asset is Rs. 70,000. The accountant wishes to charge off net balance of Rs.5,30,000 in next 5 years.

   d) KP is Chartered Accountant Member of the Institute of Chartered Accountants of Nepal. He could not pay off the loan taken from one of the Commercial Bank. The Bank blacklisted and published the name in national daily newspaper. The Bank wrote a letter to ICAN for action.

Answer

a) The term prior period item refers only to income or expenses which arise in the current period as a result of errors or omission in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods are determined in the current period. The full amount of wage arrears paid to workers will be treated as an expense of current year and it will be charged to profit and loss account as current expenses and not as prior period expenses. It may be mentioned that additional wages is an expense arising from the ordinary activities of the company.

Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per NAS, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

b) Principles of prudence, substance over form and materiality should be looked into, to ensure true and fair consideration in a transaction. In the given case, the economic reality

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and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. Hence, X Ltd. should record the sale and recognize the profit of Rs. 35 lakhs in its financial statements for the year ended 31st March, 2015; value of building should be removed from the balance sheet.

Therefore the treatment given by the company is not correct.

c) As per NAS on Impairment of Assets, impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where, recoverable amount is the higher of an asset's net selling price and its value in use·. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price is also nil. Thus impairment loss will be the sum of Rs. 670,000 including the cost of disposable of the fixed assets.

Therefore, asset is to be fully impaired and impairment loss of Rs. 6,70,000 has to be recognized as an expense immediately in the statement of income as per NAS.

d) As per section 22 of Nepal Chartered Accountants Act, 1997 on provision of removal of names and re-instatement, the Council may issue an order to remove the name of any member from the Membership Register on any of the following circumstances:-

- If he is convicted by a court in a criminal offense involving moral turpitude and punished therefor,
- If he fails to pay any fees required to be paid to the Institute,
- If he fails to abide by the professional conduct referred to in this Act and the Rules framed under this Act,
- If he becomes unsound-minded, or
- If he is dead.

Based on the above provision, mere on the ground of loan defaulter, ICAN cannot initiate action.

2. Give your comments on the following cases: **(4×5=20)**

a) The auditor of a company is unable to obtain audit evidence relating to business promotion expenditures of Rs. 1 lakh. The company has earned net profit of Rs. 1 billion and has net asset base of Rs. 10 billion. The management explains that the expenditure is genuine although the said invoices are misplaced. However, auditor requests the management either not to charge the said promotional expenditure to profit or loss statement or he will qualify his audit report. The auditor does not have any issue raising question on the faithful presentation and preparation of the financial statements.

b) XYZ has trade receivable balance of Rs. 1 crore as on year end date. The cut off procedure indicates that cheque of Rs 25 lakhs received in the last week of the year was not entered in the books and it was entered in cheques in hand register. In the history of the company the cheques are never lost or misappropriated and the cheques are deposited within the first week of receipt. These cheques were also deposited and trade receivable balances were accordingly reduced in the next year.

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c) Quantity of an inventory item as per records was 4 lakhs units as on the year-end date. Auditor was present during the inventory count at the year-end date and he noticed that only 350,000 units were there during count. Management explains that there might be counting error because the record was correct and reconciled with opening stock, purchases and sales.

d) The audit report and the general purpose financial statements of XYZ Pvt. Limited for the year 2070/71 were signed by an auditor. The audited financial statements were submitted to tax authority along with the income tax return and to a Bank also for loan processing. It was noted that the profit of the company was Rs 1 crore in the financial statement submitted to tax authority and Rs 10 crores in the financial statements submitted to Bank in the same financial year which was audited by the same auditor. Please comment whether auditor shall be held responsible for professional misconduct.

Answer

a) As per NSA 705**,**"Modification to the opinion in the independent Auditor's Report', **t**he auditor shall express a qualified opinion when:

i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Rs 1 lakh expenses for a company which earns net profit of Rs 1 billion and having net assets base of Rs 10 billion seems to be immaterial/insignificant because omission or misstatement of expenditure by Rs 1 lakh in this case is unlikely to affect the decision of the users due to this omission/misstatement. Since the auditor does not have any other issue on faithful preparation and presentation of the financial statements, qualifying audit opinion for immaterial impact does not seem to be appropriate. The auditor should however communicate the finding through management letter with the recommendation to strengthen the system of proper maintenance and retention of supporting evidence.

b) Internal control procedure of the company seems to be appropriate to record all cheques which have not been deposited on the same date and keep it properly till deposited. However, at the year end all balances should also reflect the true and fair view. In the given case since no entries are made for cheques in hand, cash balance is understated and trade receivable balances are overstated by Rs 25 lakhs. So, the company should deduct the trade receivable balance in the current year itself thereby presenting cheques in hand under cash and cash equivalents. In the next year when cheques are deposited, cash in hand balance will be reduced and bank balance should be increased.

c) Certain audit evidences are more reliable than the other audit evidences. Stock quantity as recorded in the stock ledger was reconciled with opening stock, purchases and sales. But on physical verification, stock quantity was found to be short. Since the auditor himself has observed that stock quantity as per physical verification is lower than the quantity as per record, the evidence as per self-verification of the auditor should be considered as more reliable than the recorded information. The auditor should consider whether to conclude based on the evidence he/she has in hand or go further corrective evidence.

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d) In the given case it seems that either:
Sub section (11) of Section 34 of Nepal Chartered Accountants Act has clearly explained that no member shall knowingly or recklessly mention any false matter in any notice, explanation or statement required to be given to any office or department of Government of Nepal or any organization. In a given case the auditor has signed two balance sheets of different figures of the same organization of the same financial years to different party's purpose on the request or pressure of the client. This is a serious misconduct by the auditor. Hence disciplinary committee will take immediate action against him.

The auditor has signed both financial statements of the same company for the same year in which profits are different. It clearly indicates professional misconduct on the part of the auditor and hence he shall be liable for disciplinary action.

3. Answer the following: **(3×5=15)**

a) Knowledge of client business is important for effective and efficient conduct of the audit. Please explain the various sources from which the auditor can obtain such knowledge.

b) Audit evidences collected from different sources and of different nature are not equally reliable. Please explain.

c) It is not necessary to sign audit engagement letter every year in case of recurring/ongoing audits. Please explain the statement as per provisions of NSA 210.

Answer

a) **Sources for obtaining Knowledge of the client business:** The various sources from which the auditor can obtain knowledge of the client business are:

i) General economic factors and industry conditions affecting the client's business.
ii) Important characteristics of the client, its business, its financial performance and its reporting requirements including changes since the date of the prior audit.
iii) The general level of competence of the management.
iv) The clients annual report to shareholders.
v) Minutes of meetings of shareholders, board of directors and important committees.
vi) Internal financial management reports for current and previous periods, including budgets.
vii) The previous year audit working papers and other relevant files.
viii) Firm personnel responsible for non-audit services to the client who may be able to provide information on matters that may affect audit.
ix) Discussions with the client.
x) The client's policy and procedures manual.
xi) Relevant publications of ICAN and other professional bodies, industry publications, trade journals, magazines, newspapers etc.
xii) Consideration of state of economy and its effect on the client's business and
xiii) Visits to the client's premises and plant facilities.

b) **Reliability of audit evidences:** The reliability of audit evidence is influenced by its source and by its nature and is dependent on the individual circumstances under which it

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is obtained. Generalizations about the reliability of various kinds of audit evidence can be made; however, such generalizations are subject to important exceptions. ***(1)***

While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be useful:

- o Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- o Audit evidence that is generated internally is more reliable when the related controls imposed by the entity are effective.
- o Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- o Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- o Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles.

c) **Audit Engagement Letter in Recurring Audit:** As per NSA 210, on recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. The auditor may decide not to send a new audit engagement letter or other written agreement each period.

However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior management.
- A significant change in ownership.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

4. Answer the following: **(3×5=15)**

a) What is the requirement of Code of Ethics regarding use and disclosure of confidential information of client acquired by a professional accountant as a result of his service to the client?

b) What are the fundamental principles of the Code of Ethics issued by ICAN?

c) A Chartered accountant who is a member of ICAN is a full time employee of ABCD & Associates (a CA firm registered with ICAN). During the audit of an INGO from his firm (ABCD), he was requested by the client to audit a partner organization of INGO in his personal capacity. Shall he accept the appointment of auditor of Partner Organization of INGO?

Answer

a) Use and Disclosure of Confidential Information of Client: Code of Ethics requires that a professional accountant shall not use confidential information acquired as a result of his/her service to the client to his/her personal advantage or the advantage of third parties. Similarly, a professional accountant shall not disclose confidential information

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acquired as a result of his/her service to the client without proper and specific authority or unless there is a legal or professional right or duty to disclose such information.

b) Fundamental Principles of Code of Ethics: There are the following fundamental principles:

i. Integrity – to be straightforward and honest in all professional and business relationships

ii. Objectivity– to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

iii. Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service.

iv. Confidentiality– neither discloses any confidential information to third parties without proper and specific authority nor use the information for the personal advantage of the professional accountant or third parties.

v. Professional Behavior – to comply with relevant laws and regulations and avoid any action that discredits the profession.

c) Audit by a CA member in employment: As per decision of the council of ICAN, a CA member of ICAN who is in full time employment is not entitled to hold active Certificate of Practice. In other words, a CA member can either be in full time employment or in practice (also popularly known as one man one profession). So, in the give case the CA member should not accept the audit assignment in his personal name.

5. Answer the following: **(2×5=10)**

a) Write down the functions, duties and powers of audit committee Company Act, 2063.

b) Write down the disqualifications of the auditor as per Company Act, 2063.

Answer

a) Section 165 of the company act 2063 has prescribed the functions, duties and powers of audit committee: The functions, duties and powers of the audit committee formed pursuant to subsection (1) of Section 164 shall be as follows:

(a) To review the accounts and financial statements of the company and ascertain the truth of the facts mentioned in such statements;

(b) To review the internal financial control system and the risk management system of the company;

(c) To supervise and review the internal auditing activity or the company;

(d) To recommend the names of potential auditors for the appointment of the auditorof the company, fix the remuneration and terms and conditions of appointment of the auditor and present the same in the general meeting for the ratification thereof;

(e) To review and supervise as to whether the auditor of the company has observed such conduct, standards and directives determined by the competent body

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pursuantto theprevailing law as required to be observed in the course of doing auditing work;

(f) Based on the conduct, standard and directives determined by the competent body pursuant to the prevailing law, to formulate the polices required to be observed by the company in respect of the appointment and selection of the auditor;

(g) To prepare the accounts related policy of the company and enforce, or cause to be enforced, the same;

(h) Where any regulatory body has provided for the long term audit report to be set out in the audit report of the company, to comply with the terms required preparing such report;

(i) To perform such other terms as prescribed by the board of directors in respect of the accounts, financial management and audit of the company.

b) Section 112 (1) of the company act 2063 stated the disqualification of auditor. Accordingly none of the following persons or the firms or companies in which such persons are partners shall be qualified for appointment as auditor and shall, despite appointment as auditor, continue to hold office:

(a) A director, advisor appointed with entitlement to regular remuneration or cash benefit, a person or employee or worker involved in the management of the company or a partner of any of them or an employee of any of such partners or a close relative of a director or partner, out of them, or an employee of such relative;

(b) A debtor who has borrowed moneys from the company in any manner, or a person who has failed to pay any dues payable to the company within the time limit and is in such arrears or close relative of such person;

(c) A person who has been sentenced to punishment for an offense pertaining to audit and a period of five years has not elapsed thereafter;

(d) A person who has been declared insolvent;

(e) A substantial shareholder of the company or a shareholder holding one percent or more of the paid up capital of the company or his close relative;

(f) A person who has been sentenced to punishment for an offense of corruption, fraud or a criminal offense involving moral turpitude and a period of five years has not elapsed thereafter;

(g) A person referred to in Sub-section (3) of Section 111;

(h) In the case of a public company, any person who works, whether full time or part time, for any governmental body or anybody owned fully or partly by the Government of Nepal or any other company or a partner of such person or a person who is working as an employee of such partner or a person who is authorized to sign any documents or reports to be prepared by the management of the company;

(i) A company or corporate body with limited liability;

(j) A person having interest in any transaction with the company or his/her close relative or a director, officer or substantial shareholder of another company having any interest in any transaction with the company.

6. Write short notes on the following: **(4×2.5=10)**

a) Audit risk at the financial statement level

b) Competence and objectivity of the expert engaged by auditor

c) Competence of the audit engagement team

d) Financial indicators of going concern issue

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Answer

a) Audit risk is considered at the financial statement level during the audit planning process. At this time, the auditor should undertake an overall audit risk assessment based on his knowledge of the client's business, industry, management, control environment and operations. Such an assessment provides preliminary information about the general approach to the engagement, the auditor's staffing needs and the framework within which materiality and audit risk assessments can be made at the individual account balance or class of transactions level. As part of this overall risk assessment, the auditor should consider whether there is potential for pervasive problems, for example, liquidity or going concern problems.

b) i. When planning to use the work of an expert, the auditor should assess the professional competence of the expert which will involve considering the expert's:
a. Professional certification or licensing by, or membership in, an appropriate professional body;
b. Experience and reputation in the field in which the auditor is seeking audit evidence.
ii. The auditor should assess the objectivity of the expert. The risk that an expert's objectivity will be impaired increases when the expert is:
a. Employed by the entity; or
b. Related in some other manner to the entity, for example, by being financially dependent upon or having an investment in the entity. If the auditor is concerned regarding the competence or objectivity of the expert, the auditor needs to discuss any reservations with management and consider whether sufficient appropriate audit evidence can be obtained concerning the work of an expert.
The auditor may need to undertake additional audit procedures or seek audit evidence from another expert.

c) The appropriate capabilities and competence expected of the engagement team as a whole include the following:

- An understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- An understanding of professional standards and regulatory and legal requirements.
- Appropriate technical knowledge, including knowledge of relevant information technology.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- An understanding of the firm's quality control policies and procedures.

d) Financial Indicators

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawal of financial support by debtors and other creditors.
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.

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- Inability to comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.

7. Distinguish between: **(2×5=10)**
   a) Hot review & Cold Review in audit
   b) Accounting & Auditing

Answer

a) Hot file review or hot review is conducted usually conducted during the audit and/or audit work is completed but before the auditor's report is issued. This in nature is a detailed review that is conducted with an aim to find out if there s any weakness in application of audit procedures or if the results have been misinterpreted. Hot reviews are usually carried out usually by the senior the audit team or someone with the same authority who is not connected with the engagement. Such reviews mostly include meetings with audit team personnel and their individual work so that both work and the skills of members are improved by pointing out discrepancies and providing recommendations.

The purpose of a hot review is to identify any key areas that need to be addressed prior to signing the report. The categories for review which may be undertaken can be described as follows:

i. Comfort reviews
ii. High risk reviews
iii. Training reviews
iv. Independence reviews
v. NSQC reviews

To summarize, hot review is conducted during the audit work is conducted but before the auditor's report is issued with a prime objective to ensure compliance with relevant auditing standards and achieving engagement's objectives

Cold file review or cold review is an objective evaluation on the date of auditor's report and is performed by the auditor i.e. partner himself when all the audit work has been concluded and the required sufficient appropriate audit evidence has been obtained and conclusions drawn and reported. This review usually takes place when the auditor's report is signed off. The purpose of this review is to ensure compliance with relevant auditing standards and to analyze weaknesses in the way whole audit work is conducted and how it can be improved for next similar assignments by updating firm's quality control standards, training the staff etc.

Normally the cold file review would aim to:

- Identify whether the disclosure requirements had been properly met - incorrect disclosures are the largest subject of complaints to the Institute.
- Identify whether the Auditing Standards and Regulations have been properly complied with - each audit would be "scored" using a comprehensive file review checklist.
- Assess the effectiveness of any independent manager review and the partner review, looking for any points that should have been picked up by a manager but had not been, and likewise with the partner.

To summarize, cold review is conducted with a view to check for the weaknesses in the firm's quality control procedures and system, proficiency of audit team members and how they can be improved to make later audit assignment more effective and efficient.

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b) Distinction between Accounting and Auditing:

Point of difference	Accounting	Auditing
1. Meaning	It is recording of all the day to day transactions in the books of accounts leading to preparation of financial statements.	It is the critical examination of the transactions recorded in the books of accounts.
2. Nature	It is concerned with finalization of accounts.	It is concerned with establishment of reliability of financial statements.
3. Objects	Accounting commences when book keeping ends.	Auditing begins when accounting ends.
4. Commencement	It involves various financial statements. It involves maintenance of books of accounts.	It depends upon the agreement or upon the provisions of law.
5. Scope	It does not go beyond books of accounts.	It goes beyond books of accounts.

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Corporate and other Laws
Suggested Answer

Roll No……………. **Maximum Marks - 100**

Total No. of Questions - 7 **Total No. of Pages -12**

Time Allowed - 3 Hours

Marks

Attempt all questions.

1. Answer the following questions:

   a) Wild Fibers Pvt. Ltd. has intended to issue right shares but there was no unanimity within the Boards of Directors. Hence, the Directors who were opposed to issue right shares asked you for your opinion regarding the benefits of issuing of right shares. How can you give your opinion regarding the benefits of right shares? **(1+4=5)**

   b) Mr. XYZ was appointed as a director of a company in an Annual General Meeting. He took over the office and carried out his functions as director. Subsequently, it was found that there were some irregularities in the appointment and hence the appointment was declared invalid. Would the duties performed by Mr. XYZ, while in office as director, be binding upon the company?Also mention when a company be bound by the decision or action taken by its director under Companies Act, 2063? **(2+3=5)**

   c) Some of the shareholders of Transnational Works Pvt. Ltd. objected the resolution relating to issue bonus share forwarded by the Board of Directors stating that the resolution should be presented as a special resolution. Advise the directors on the following issues.

      i) What matters should be presented as a special resolution?

      ii) Whether the resolution to issue bonus share is special resolution.

   d) Who is the debenture trustee? What are the matters to be included in the agreement to be concluded between debenture trustee and company under Companies Act, 2063? **(1+4=5)**

   e) Mount Everest Ltd. has decided to appoint independent director(s) to the company. Advise the company on the following legal issues as to the appointment of independent director(s) pursuant to the Companies Act, 2063. **(2+3=5)**

      i) What is the legal provision of appointment of independent director(s)?

      ii) Who are the persons not eligible to be appointed as an independent director?

Answer:

a) Right Shares are those types of shares which are issued to existing shareholders only. The right shares help the company to raise its share capital without increasing the number of shareholders and the existing shareholders can get opportunity to increase their shares in the company.

   Benefits of Issuing Right Shares:

   1. More control on existing shareholders
   Because right shares are issued to existing shareholder, so there is no risk of losing of control of existing shareholders. Existing shareholders' share will increase in company

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and they can take decision without any compromise with the principles of company. It is very helpful to achieve the missions of company.

2. **No loss to existing shareholder**
   By issuing shares to existing shareholders, value of share will increase due to stability in controlling power of company. So, there will not be any loss to existing shareholders with right shares.

3. **No cost for issuing shares to public**
   Company has not to give any invitation to public, so advertising cost and other new issue cost will decrease with right shares.

4. **Capital formation**
   Company can get capital at any time without any delay because company can easily issue shares to existing shareholders just sending right shares offer notice. Further, it is also way to increase the goodwill and reputation of company in industry.

5. **More scientific**
   Distribution technique of right shares issue is more scientific. Not all shares will get by single shareholders but it will be in the proportion of existing shares which is in the hand of old shareholders at this time.

b) Section 106 of the Company Act, 2063 provides for the validity of acts already done by a director whose appointment comes to be invalid. According to it if it is afterwards discovered that any provision under this Act has not been complied with in respect of the appointment of any director, the acts already done by such director before the discovery of such fact does not become invalid by that fact.

Moreover, Section 104 prescribes the provision regarding company to be bound by the act done by a director. It states that any act done or action taken by or document signed by at least one director authorized by a company or any person authorized to act for the company shall be valid and binding for the company.

Where any person does any transaction with a company in good faith, such transaction shall be binding for the company; and nothing contained in memorandum of association, articles of association of the company or in any resolution adopted by the general meeting or in any agreement concluded between the company and its shareholder shall be deemed to have made any limitation in or restriction on the authority of the director or the authorized person to do such transaction.

Provided, however, that if any officer does any act or transaction mentioned above in excess of his/her authority, such officer shall be personally liable for such act or transaction unless such authority is ratified by the general meeting pursuant to this Act; and the company may also recover from him/her the loss or damage, if any caused to the company from such act or transaction.

c)

i) Regarding the special resolution, Section 83 of the Companies Act, 2063 mentions that the following matters shall be presented as special resolutions in the general meeting of a company:

1. Increasing the authorized capital of the company,
2. Decreasing or altering the share capital of the company,
3. Altering the name or main objectives of the company,
4. Amalgamating one company into another company,
5. Issuing bonus share,
6. Buying back of own shares by the company,

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7. Selling shares at a discount,
8. Converting a private company into a public company or vice versa,

Such other matter in respect of which the company is required by this Act or the articles of association to adopt a special resolution.

ii) As mentioned above, issuing a bonus share should be forwarded as a special resolution. Therefore, BoD has to present a special resolution to issue bonus share**.**

d) Section 2 (t) of the Companies Act 2063 defines Debenture-Trusteeas a body corporate undertaking the responsibility for the protection of interests of debenture-holders at the time of issuance of debentures by a company.

Section 36 of the Companies Act 2063 states the matters to be included in the agreement to be concluded between debenture trustee and company, which are as follows:

(a)That the debenture trustee is entitled to carry out, or cause to be carried out, valuation of the company's assets, project analysis or management analysis,

(b) The period of repayment of the principal and interest of debentures subscribed by the debenture-holder, interest rate, mode of repayment of the principal and interest, and matters of conversion of debentures into shares, if there is such provision,

(c)Matters relating to a provision made on the rights of other creditors over the assets of the company and liabilities that may arise there from in the future.

(d) A provision that, in the event of violation or non-fulfillment of the terms mentioned in the agreement or for any other reasonable reason, if it is required to take the control of financial transactions of the security as referred to in the agreement, the debenture trustee may take in his possession the assets or property that he has taken as the security or guarantee or hold the security or guarantee or hold the security or guarantee with himself or sell the same by auction or in any other appropriate manner,

(e)Procedures for payment by the company of the service charges and other direct expenses of the debenture trustee,

(f)That the debenture trustee shall not be liable to any loss or damage caused to the company or the debenture-holder from any act done by the trustee in the capacity,

(g) That, in the event of occurrence of any circumstance necessitating the liquidation of the company, the debenture trustee is entitled to take such legal action as may be taken on behalf of the debenture-holder and exercise the powers of the debenture-holder,

(h) Other necessary matters on the protection of interest of the debenture-holder.

e)

i) Section 86 of the companies Act 2063 provides provision regarding the appointment of the Directors of the company.

Pursuant to section 86 (2) of the companies Act 2063 every public company shall have a Board of Directors consisting of a minimum of three and maximum of eleven directors.

As per section 86(3) of Act, in forming the board of directors pursuant to sub-section (2) above, at least one independent director , in the case of the number of directors not exceeding seven, and at least two independent director , in the case of the number of directors exceeding seven, shall be appointed from amongst the persons who have the knowledge as prescribed in the articles of association of the company and gained knowledge and experience in the subject related to the business of the company concerned.

This legal provision should be considered by the Mount Everest Ltd. for the appointment of the independent director(s) depending upon the numbers of directors it appoints.

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ii) In pursuance to section 89(2) of the Companies Act, 2063 any of the following persons shall not be eligible to appointed to the office of independent director.

a. Who is a person disqualified to be appointed to the office of a director pursuant to sub-section(1) of section 89 of the Companies Act, 2063;
b. Who is the shareholder of the concerned company?
c. Who has not obtained at least bachelor degree in a subject that is related to the business to be carried on by the concerned company and gained at least ten years of experience in the related field or in the company management affairs or who has not obtained bachelor degree in finance, economics, management, accounts, statistics, commerce, trade or law and gained at least ten years of experience in the related field.;
d. Who is an officer, auditor or employee of concerned company or a period of three years has not lapsed after his/her retirement from any such office;
e. Who is close relative of the office of the concerned company;
f. Who is an auditor of the concerned company or his/her partner?

2. Answer the following questions:
   a) When Nepal Rastra Bank may cancel the license obtained by a licensed institution to carry on the financial transactions pursuant to BAFIA, 2063? Discuss.
   b) What are the objectives of Nepal Rastra Bank?
   c) Under what circumstances Bank & Financial Institutions are restricted from distributing dividends?

Answer:

a) As a regulating body, Nepal Rastra Bank shall have full authority to regulate and systematize the functions and activities of all licensed institutions. It is the bank of banks. Section 35 (2) of the Bank and Financial Institutions Act, 2063 has stated that the Rastra Bank may cancel the license obtained by a licensed institution to carry on the financial transactions pursuant to this Act in any of the following circumstances.

1. If the concerned licensed bank or financial institution requests for the cancellation of its license.
2. If it fails to carry on the financial transactions within six months from the date of receipt of the license.
3. If it stops carrying on the financial transactions since more than one month ago continuously.
4. If it carries on the financial transactions in such a manner as to be contrary to the rights and interests of depositors.
5. If it violates the Nepal Rastra Bank Act and its rules.
6. If it violates the conditions prescribed by the Rastra Bank.
7. If it fails to comply with the orders or directives issued by the Rastra Bank.
8. If it becomes insolvent.
9. If the bank or financial institution is found to have obtained the license by submitting false details.
10. If the licensed institution is merged with another bank or financial institution.

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b) As per the section 4 of Nepal Rastra Bank Act 2058 following are the objectives of Nepal Rastra Bank.

- To formulate necessary monetary and foreign exchange policies in order to maintain the stability of price and balance of payment for sustainable development of economy and manage it;
- To promote stability and liquidity required in banking and financial sector;
- To develop a secure, healthy and efficient system of payments;
- To regulate, inspect, supervise and monitor the banking and financial system and
- To promote entire banking and financial system of the Nepal and to enhance its public credibility and
- To extend co-operation in the implementation of the economic policies of the Government of Nepal.

c) Section 46 of Bank and Financial Institution Act 2063, states the circumstances under which Bank & Financial Institutions are restricted from distributing dividends.

As per the section 46 of the Act, Bank & Financial Institutions are restricted from distributing dividends till the following conditions are fulfilled.

- All preliminary expenses are recovered.
- Cumulative losses up to previous year is recovered.
- Capital fund is maintained.
- Risk bearing fund is adequately maintained.
- General Reserve as per section 44 of the Act is provided.
- Share capital for general public is issued and fully subscribed

3. Answer the following questions:
   a) State the various penalties imposed on insurance offences.
   b) Mr. Lekhapal wants to know the provision regarding the fund of Securities Board of Nepal under Securities Act, 2063.Advise him.

Answer:

a) The punishment to be imposed to any insurer or the Director of the insurer, employee or surveyor, broker or insurance agent who have knowingly violated the provisions of Insurance Act and rules made under the Act or order or directives is mentioned in Section 36 of the Insurance Act, 2049. The Insurance Board,in such cases, may punish to such insurer or the Director of the insurer, employee or surveyor, broker or insurance agent with a fine ranging from Rs.3000 to NRs. 10000. If such offense has been made frequently, he will be fined at the rate of extra NRs. 500 for each subsequent offense.

Similarly, sub-section (2) provides that if any insurer or insurance agent or broker has made any insurance business without following the procedures to be followed pursuant to this Act, the Board may fine him up to NRs. 10000. Further, if the accounts, records, register, details, information or any other documents has not maintained, prepared or submitted in time or made falsely, he may be punished with a fine up to NRs. 30000 or imprisonment up to two years or with both.

b) Section 22 of the Securities Act, 2063 prescribes the provision regarding fund of Securities Board.

1) The Board shall have a separate fund of its own.

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2) The following amount shall be credited to such fund.
   a. Amounts received from the Government of Nepal
   b. Amounts obtained as grants, assistance or loans from any national, foreign or international organizations, institutions or bodies.
      Provided that prior approval of the Government of Nepal shall be obtained in receiving such grants, assistance or loans.
   c. Amounts received by way of the license fees.
   d. Amounts received by way of the fees for registration of securities.
   e. Amounts received by way of fees, charges, dues for transactions in securities.
   f. Amounts received from any other sources.

3) All amounts to be obtained to the fund of Board as above shall be credited to an account to be opened with any commercial bank within Nepal.
4) All the expenditure to be made on behalf of Board shall be chargeable on such fund.
5) In making expenditure pursuant to above, such expenditure shall be made subject to the budget approved by the Board for the incomes and expenditures to be made in each fiscal year.
6) The operation of the fund of the Board shall be as prescribed.

4. Answer the following questions:
   a) In relation to the Labour Act, 2048, how this act prohibit in the engagement of non-Nepalese citizens at work? Briefly present your answer with legal provision and relevant case law.
   b) The workers of a company objected the decision of manager regarding the bonus to be distributed to them. The workers seek your advice about the action against the company. Advise them about the legal provisions for the settlement of disputes under the Bonus Act, 2030.

Answer:

a) After the decision in ***Balkrishna Neupane Vs. Parliamentary Secretariat, Nepal*** (Nepal KanoonPatrika 2050, Volume-8, Decision No. 4768, P-450) Labour Act has been amended with inserting restriction to engage Non-Nepalese citizen at work in Nepal. Formerly, its Section 4.1 has mentioned as "Nepali citizen shall be given priority in the recruitment in such manner". Supreme Court of Nepal had held that, this provision has adverse impact in the right to freedom conferred to the Nepali citizens by the Article 12.2.E and declared it as void. After the decision of the court, Government has amended the law byin sorting the restrictive provision to the Non-Nepalese Citizen at work Section 4A that is given as follows:

(1) Non-Nepalese citizens shall not be permitted to be engaged at work in any of the posts classified pursuant to Section 3.
(2) Notwithstanding anything contained in Sub-section (1), if a Nepalese citizen could not be available for any skilled technical post even after publishing an advertisement in national level public newspapers and journals, the Manager may submit an application to the Department of Labour along with the evidence of such fact for the approval to appoint a non-Nepalese citizen.
(3) If it is found, in conduction of an inquiry upon the submission of any application pursuant to Sub-section (2), that a Nepalese citizen would not be available for the skilled technical post mentioned in the application, the Department of Labour may,

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on the recommendation of the Labour Office, grant approval to engage a non-Nepalese citizen at work years for a maximum period of upto five years not exceeding two years at a time and, in the specialized kind of skilled technical post, for a period upto seven years.

(4) The Manager, who engages non-Nepalese citizens at work pursuant to Sub-section (3), shall have to make arrangements for making the Nepalese citizens skilled and for replacing the non-Nepalese citizens gradually by them.

b) The Bonus Act, 2030 assures the bonus to the employees out of the profits earned by an enterprise. The Act also has made legal provisions for the settlement of disputes which may rise between the employees and management. Section 16 (1) provides that if any dispute arises between employees and management with respect to the bonus, the Labour Office shall resolve such dispute by negotiations having invited both the parties. Similarly, if the dispute could not be resolved by negotiation the Labour Office shall ask to the concern enterprise and employees to produce necessary documents and statements of accounts and shall give a decision on the basis of such documents and statements. When the decision is given by the Labour Office, the party who is dissatisfied with the decision may appeal to the Labour Court within 35 day of receipt of such notice and the decision made by the Labour Court shall be final for the matter.

Therefore, the workers of the company shall have to follow the procedures as mentioned above to settle the dispute regarding the payment of bonus.

5. Suppose you are a Chartered Accountant practicing in Nepal, Mr. Alberto, an auditor from the USA, is interested to know the punishment provision under Nepal Chartered Accountants Act, 2053. Explain those disciplinary actions and punishment provision that ICAN can impose against auditor under Nepal Chartered Accountants Act, 2053?

Answer:

Section 14 and 35 of Nepal Chartered Accountants Act, 2053 has given power to the council of Institute of Chartered Accountants of Nepal to take different disciplinary action against an auditor.

Section 35 ofthis Act prescribe that a person or individual may lodge a complaint to the ICAN against the auditor (holding certificate of practice) for not upholding the conduct mentioned or for violation of this Act or Regulation framed under this Act. The Secretary shall, if he finds convincing information that proves any member or member holding certificate of practice is not observing the conduct, submit the proposal along with related facts to the council of the ICAN for further action against such member.

There shall be a Disciplinary Committee constituted by the ICAN council under section 14 of the Act, to inquire into a compliant and recommend the council for necessary action in cases where anyone lodges a compliant in the council that any member has done any act or action contrary to this Act or Rules or Code of Conduct framed under this Act, or where the Council receives such information.

The Disciplinary Committee shall make recommendation, along with its opinion and finding, to the Council for taking necessary action against a member found guilty from its investigation. The council may in view of such recommendation, impose any of the following penalties on the concerned member, according to the gravity of the offence:

a. Reprimanding

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b. Removing from membership for a period not exceeding Five years.
c. Prohibiting from carrying on the accountancy profession for any specific period,
d. Cancellation of the certificate of practice or membership.

Moreover, there is a provision of removal of names and re-instatement of membership in section 22 of the Act.

1. The Council may issue an order to remove the name of the auditor from the membership register for not abiding by the professional conduct referred to in this Act and Rules framed under 'this Act.
2. If his/her name has been removed from membership as above, he/ she can make an application, accompanied by a reasonable ground, to again obtain membership, and the council may decide to grant membership, by re-registering his / her name, upon receipt of the fees as prescribed.

6. Answer the following questions:

a) What are the special program relating to social welfare, as per Social Welfare Act, 2049?

b) What are the voidable contracts under Contract Act, 2056?

c) Can a bank or financial institution buy back its share? Discuss with relevant legal provisions.

d) Mention the punishment provision to be imposed while violating the Act, Rules or directives issued under Insurance Act,2049.

e) Mr.A, a Malaysian, endorsing it in the front, drew a Bill of Exchange (BoE) of MR. 50,000 to Nepalese person, Mr.B mentioning it is payable in Nepal only. Illustrate your answer in the following query.

i) Which law governs in the matters of dishonour?

ii) What is the validity of the BoE?

iii) In which condition law relating to negotiable instruments of foreign country is presumed to the same as that of Nepalese law?

Answer:

a) Section 4 of Social Welfare Act 2049, describes regarding Special program relating to Social Welfare.

Government of Nepal may operate special program relating to the social welfare activities and social service in the following matters

1. To serve interest and render welfare to the children, aged, helpless or disabled people.
2. To foster participation in development and to promote and protect the welfare, rights and interest of the women.
3. To rehabilitate and help to lead a life of dignity to the victims of social mischief and also to juvenile delinquency, drug addicts and similar type of people involved in other kind of addictions.
4. To help to lead a life with dignity to the jobless, poor and illiterate people.
5. To manage religious places and the activities of the trust Guthi institutions.

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6. To take effective management and actions for the welfare of the backward communities and classes.

b) Voidable contracts are such which are defective in the process of making it but not really void due to any defects in the essence of it.These contracts can be made void or may be made enforceable at the interest of an aggrieved party.

Section 14 of Nepal Contract Act has the following provisions regarding voidable contracts;

i) Contracts concluded through coercion

A person shall be deemed to have indulged in coercion if he, with the objective of compelling any person to accept any contract against his will, withholds or threatens to withhold his property or issues a threat to his life, body or prestige, or takes or threatens to take any other section i contravention of current law.

ii) Contracts concluded through undue influence

"Undue influence" means influence exercised by a person upon another person who is under his influence or is amenable to his wishes with the intention of deriving some undue advantage for personal benefit or to fulfil selfish interests.
Without prejudice to the generality of above, the following categories of persons shall be deemed to be under influence of any person or amenable to is wishes:

(a) Persons living under his guardianship, protection or custody.
(b) Persons who cannot take care of their interests temporarily or permanently by reason of old age, sickness or physical or mental weakness.
(c) Persons who can be subjected to economic pressure or pressure based on posts.

iii) Contracts by fraud

A party to the contract or is agent to believe, or takes any action which leads the latter to believe, that a particular matter is true, although he knows full well that it is false, or suppresses any information in his possession, or indulges in any other fraudulent act punishable under current law, with the intention of deceiving the opposite part or his agent.

iv) Contracts concluded through deceit

The following actions shall be taken as deceit:

(a) Submission of false particulars on any matter without a reasonable basis for doing so.
(b) Misleading any party so as to aggrieve him.
(c) Causing any mistake or error in respect to the particulars of the contract.

c) Section 10 (1) of the Bank and Financial Institutions Act, 2063 has imposed prohibition on buy back of shares by the bank or financial institutions. But Sub-section 2 of section 10 has mentioned the grounds on which the banks or financial institutions can buy back of their shares. In the following conditions a bank or financial institution may, with the approval of the Nepal Rastra Bank, buy back its shares out of its free reserves available for being distributed as dividends not exceeding the percentage prescribed by the Nepal Rastra Bank.

1. If the shares issued are fully paid up.
2. If the shares are already listed in the Securities Board.
3. If the buyback of shares is authorised by the articles of association.
4. If a special resolution has been adopted for the buyback of shares.
5. If the ratio of debt is not more than twice the capital and general reserve fund after such buyback.

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6. If the value of share bought back is not more than 20% of the total paid up capital general reserve fund.
7. If the buyback of share is not contravention to the directives issued by the Nepal Rastra Bank**.**

d) Section 36 of the Insurance Act prescribes the provision regarding the Punishment of concerned responsible persons as follows:

1. If any Insurer or the Director of the Insurer, employee or Surveyor, Broker or Insurance Agent knowingly violates this Act or the Rules made under this Act or order or directives or does not perform any function to be performed or does any act to be done, the Board may punish to such Insurer or the Director, employee or Surveyor, Broker or Insurance Agent with a fine ranging from three thousand rupees to ten thousand rupees. If such offense has been made frequently, he will be fined at the rate of extra five hundred rupees for each subsequent offense.
2. If any Insurer or Insurance Agent or Broker has made any Insurance Business within following the procedures to be followed pursuant to this Act, the Board may fine him up to ten thousand rupees.
3. If the accounts, records, register, details, information or any other documents to be maintained, prepared, formed or submitted pursuant to this Act or the Rules made under this Act has not maintained or submitted in time by knowingly or with malafied intention or has maintained or submitted the false details or documents by any-body, he may be punished with a fine up to thirty thousand rupees or imprisonment up to two years or with both.

Any person or corporate body dissatisfied with the decision made by the Board pursuant to this Act, may make an appeal in the concerned Appellate Court within thirty five days from the date of such decision under Section 37 of the Act.

e)

i) <u>Governing law in the matters of dishonor and its condition</u>: Sec 100

The Negotiable Instrument Act, 2034, in its section 100, provided about the matter of dishonor. Where a Negotiable Instrument is made payable in a different country from that in which it is made or endorsed, the law of the country where it is made payable determines what constitutes dishonour and what notice of dishonour is sufficient.

ii) <u>Validity of Bill of Exchange (BoE)</u> : Section 101

If a Negotiable Instrument is made drawn, accepted or endorsed outside Nepal, but in accordance with Nepalese Law, the circumstance that any agreement evidenced by such instrument is invalid according to the law of the country wherein it was entered into does not invalidate any subsequent acceptance or endorsement made thereon within Nepal.

iii) <u>Presumption of foreign law relating to Negotiable Instruments</u>: Sec 102

The law of any foreign country regarding Negotiable Instrument shall be presumed to be the same as that of Nepalese Law, unless and until the contrary is proved.

7. Write short notes on the following: **(2×5=10)**

a) Distinguish between Share and Stock

b) Fundamental principles of World Trade Organization (WTO).

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Answer:

a)

S.No.	Share	Stock
1.	Shares in physical form bear distinct numbers.	Stocks are the consolidated value of share capital.
2.	Shares may or may not be fully paid-up.	Stock is always fully paid-up.
3.	Shares have a nominal value.	Stock does not have any nominal value.
4.	All shares are of equal denomination.	Denomination of stocks varies.
5.	It is not possible to transfer shares into fraction.	Stock is divisible into any amount required. Thus, it is possible to transfer even into fractions.
6.	Shares come into existence before the stock and it is issued initially.	Stock comes into existence after conversion of shares into stock and on conversion of shares into stock, the provision of the Act governing the shares shall cease to apply to the share capital as it is converted into stock.

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b) The fundamental principles as embodied in the WTO Agreement in respect of multilateral trading system are derived from the GATT. Trade without discrimination is one of the basic principles included in the multilateral agreements on trade in goods in GATS, and in the TRIPs Agreements. It includes the following principles:

1. The Most-Favoured-Nations Treatment: It is the pillar of the system from the inception of the GATT in 1947. Members of the WTO have entered into similar commitments, under the GATT 1994 for trade in goods in relation to treatment of services, under the TRIPs agreement in regard to the protection of intellectual property.
2. Fair competition and Non discrimination: Principles of non-discrimination prohibit discrimination among WTO members while providing facilities and services i.e. information, dispute settlement , trade assistance, negotiation facilities. It includes two major components viz. national treatment and MFN treatment.
3. Transparency: Provisions on notification requirements and the Trade Policy Review mechanism are set out in the WTO Agreement and its Annexes, with the objective of guaranteeing the fullest transparency in trade policies of its members in goods, services and the protection of intellectual property rights.
4. Predictable and growing access to markets: Predictable and growing access to markets for goods and services is an essential principle of the WTO. This principle is fulfilled through various provisions so as to guarantee security, predictability and continued liberalization of trade.
5. Trade in goods: In case of goods, a basic GATT postulate is that tariffs should normally be the only instrument used to protect domestic industry.
6. Trade in services: GATS establishes a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency

and progressive liberalization, and a means to promote the economic growth of all countries and the development of developing countries.

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Financial Management
Suggested

Roll No……………. **Maximum Marks - 100**

Total No. of Questions – 7 **Total No. of Printed Pages –5**

Time Allowed – 3 Hours

Marks

Attempt all questions.

Working notes should form part of the answer. Make assumptions wherever necessary.

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1. Mr. X, an Agricultural Engineering graduate, is planning to set up a private limited commercial agriculture firm with registered office in Kathmandu Metropolitan City. During the initial days of the proposed company, it will focus on cultivating and harvesting a variety of premium apples and sell them in the ever increasing domestic market.

In order to set up his project, he has already reached agreements with the local government authority and the local communities through a cooperative society of one of the hilly districts suitable for farming. As such, the agreement has guaranteed minimum 25 years of lease of land property having a total area of 800 ropanis with a rent of Rs. 2.88 crore per annum. The rent will be paid on an annual basis with increment of 30% at the interval of every 5 years and the plantation properties (agricultural estate and the project office) will be transferred to the cooperative society at the end of 25th year. The rent accrual is agreed from the commercial operation date (COD), which tentatively is proposed from 1st of Shrawan, 2073. No incentive or residual value will be received by the proposed company at the end of project i.e. on Ashadh end 2098.

In order to operate the project successfully, you have been hired as his finance consultant and want you to assess the information properly. From the available research data adjusted with current inflation figures, you have been able to gather the following information in respect of annual operating cost and capital cost:

Operating costs (Amount in Rs.)

Particulars of operating expenses	Estimated annual cost	Annual growth (in every 5 years)
Orchard Activities (Pruning and Training, Thinning, Fertilizers, General Farm Labor, Irrigation and Electricity)		
Cost of activities starting from Year 1	1,88,10,000	15%
Cost of activities starting from Year 2	14,85,000	15%
Harvesting Activities (Picking Labor, Other Labor and Hauling of Apples)		
Cost of activities starting from Year 3	40,19,000	15%
Administration Expenses (except rent)		
Cost of activities starting from Year 3	54,00,000	15%

Capital cost

Particulars of Capital Expenses	Cost
Land Development and Ancillary Cost	5,00,00,000
Plantation Cost	12,00,00,000
Other capital investments (viz., quarters and project office set up in leased land)	2,00,00,000

Further, you have been informed that he expects to harvest 1,500 metric tons of apples during the 3rd year after COD, then 200 metric tons increase every year until

8th year after COD and steady production from 9th year onwards with no further growth or decline during the entire project period. In addition, he expects to fetch at least Rs.60 per kg during the first harvesting season, i.e. on 3rd year after COD and then 15% growth after every three years adjusted with inflation till 10th year (consider price rounding in nearest rupee).

Consider:

- tax rate as 20%;
- no tax outflows during the accumulated loss period;
- useful life of all initial investments as equivalent to the project period (lease term) and depreciation method as SLM basis
- All assets accounted as leasehold asset and categorised under Class "E", hence no deferred tax and temporary differences; and
- cost of capital as 10% (3 decimal places) as given below

Year	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
PV Factor @ 10%	1.000	0.909	0.826	0.751	0.683	0.621	0.565	0.514	0.467	0.425	0.386

Required: **(14+6=20)**

a) Based on the NPV & IRR from the aforementioned information, would you suggest him to take up this project based on the 10 years cash flow, at least from financial perspective? Consider carrying amount of initial capital investment at the end of 10th year as its terminal value for your computation. (Calculate in nearest thousand).

b) What three factors other than the financial should an investor look into before taking up the project? Your answer should present factors in connection to the above apple farming case study.

Answer

a)

Calculation of Initial Investments, Annual Depreciation and Terminal Value

Particulars	**Rs. In 000**
Initial Investment	
Land Development and Ancillary Cost	50000
Plantation Costs	120000
Other Capital Investments	20000
Total Initial Investments	**190000**
Useful Life of Initial Investments	25 years
Annual Depreciation	**7600**
Total Depreciation on 10 years	76000
Terminal Value after 10 years	**114000**

Year	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Production in Tons		0	0	1500	1700	1900	2100	2300	2500	2500	2500
Price per Kg				60	60	60	69	69	69	79	79
											Rs. In 000
Sales		**0**	**0**	**90000**	**102000**	**114000**	**144900**	**158700**	**172500**	**197500**	**197500**
Orchard Activities		18810	18810	18810	18810	18810	21632	21632	21632	21632	21632
			1485	1485	1485	1485	1485	1708	1708	1708	1708
Harvesting Activities				4019	4019	4019	4019	4019	4622	4622	4622
Administration Expenses (except rent)				5400	5400	5400	5400	5400	6210	6210	6210

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Total Costs Except Rent and Depreciation		**18810**	**20295**	**29714**	**29714**	**29714**	**32536**	**32759**	**34172**	**34172**	**34172**
Rent		28800	28800	28800	28800	28800	37440	37440	37440	37440	37440
Depreciation		7600	7600	7600	7600	7600	7600	7600	7600	7600	7600
Total Costs		**55210**	**56695**	**66114**	**66114**	**66114**	**77576**	**77799**	**79212**	**79212**	**79212**
Profit Before Tax		**-55210**	**-56695**	**23886**	**35886**	**47886**	**67324**	**80901**	**93288**	**118288**	**118288**
Accumulated Profit		**-55210**	**-111905**	**-88019**	**-52133**	**-4247**	**63077**	**143978**	**237266**	**355554**	**473842**
Tax		0	0	0	0	0	12615	16180	18658	23658	23658
Profit After Tax		**-55210**	**-56695**	**23886**	**35886**	**47886**	**54709**	**64721**	**74630**	**94630**	**94630**
Add: Depreciation		7600	7600	7600	7600	7600	7600	7600	7600	7600	7600
Cash Profit		**-47610**	**-49095**	**31486**	**43486**	**55486**	**62309**	**72321**	**82230**	**102230**	**102230**
Initial Investments	-190000										
Terminal Value											114000
Net Cash Flow	**-190000**	**-47610**	**-49095**	**31486**	**43486**	**55486**	**62309**	**72321**	**82230**	**102230**	**216230**
PV Factor @ 10%	1.000	0.909	0.826	0.751	0.683	0.621	0.565	0.514	0.467	0.425	0.386
Discounted Cash Flow	**-190000**	**-43277**	**-40552**	**23646**	**29701**	**34457**	**35205**	**37173**	**38401**	**43448**	**83465**
Net Present Value	**51667**										

At discount rate of 10%, the project has a positive NPV of Rs.51,667K hence a much higher discount rate (15%) is considered to compute IRR.

Net Cash Flow	**-190000**	**-47610**	**-49095**	**31486**	**43486**	**55486**	**62309**	**72321**	**82230**	**102230**	**216230**
PV Factor @ 15%	1.000	0.870	0.757	0.658	0.572	0.497	0.432	0.376	0.327	0.284	0.247
Discounted Cash Flow	-190000	-41421	-37165	20718	24874	27577	26917	27193	26889	29033	53409
Net Present Value	-31976										

Thus IRR shall be

$$= +\text{Low} \times \frac{\text{NPV at Low Rate}}{\text{NPV at Low Rate} - \text{NPV at High}} \quad (\text{High Rate} - \text{Low}$$

= 10%+ (51,667 / (51,667 - (-31,976))) × 5%
= 13.09%

From the above calculation of NPV & IRR, the project can be undertaken.

b) The financial assessment of the project is indeed very important to ascertain its viability. Nevertheless, the investors should also look into other factors such as political, social and technological in order to determine whether these factors complement to its progression.

In addition, there is also a growing trend of examining the factors like environmental and legal / regulatory that could influence the feasibility of the project. As far as assessment is concerned, all these components are indispensable and interrelated.

The political factors have significant bearing in the investment of the project. These include law and order situation, stability of the government and its policies, availability and development of adequate infrastructures, tax regime and subsidies to the investors, transportation facilities, adequate law for free flow of goods and services within the region etc. Any disorder in the factors mentioned above would discourage the investors to put in their hard earned money as there will be severe uncertainty on economic rewards they expect from the project.

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Besides political, social factors also have important bearing on the feasibility assessment. For instance, the proposed project is planned to be implemented in one of the hilly regions and it is important for Mr. X to understand the behaviors, attitudes, education, population, age group and employment status of the local community. If the district lacks youth force, the project may find difficulty in getting workers and labors and consequently the cost of production may shoot up making the project less attractive.

In addition to the two factors mentioned above, the technology bestows several advantages to the investors of the present world. The process automation and the more use of technology eventually contribute in reducing the cost of operations thereby assisting the project to achieve the goal of long term sustainability. Again, the research and development plays a crucial role in developing and fine tuning the product which would lead innovating to a unique product. Like any other product researches, the apple fruit research cannot be ignored at all.

2.

a) The Samriddhi Ltd. propose to raise its turnover from Rs. 6,00,000 to Rs. 8,40,000 next year and to Rs. 9,60,000 in the succeeding year. It is expected that the purchases will go up from Rs. 1,80,000 to Rs. 2,40,000 and then to Rs. 2,70,000 in the next two years.

A steady profit of 10% on turnover is estimated over the years; and the materials, labour and factory overheads are expected uniformly to be 30%, 20% and 30% respectively of the total cost of goods sold.

At the end of each year the raw materials stock would amount to two months' consumption, work-in-progress to one month's factory cost and finished goods to half a month's total cost. There is a two months' credit period allowed to customers and received from suppliers.

The company has a policy of carrying cost equivalent to one month's requirement for payment of labour and other overhead cost. Ignoring prepayments and accrued charges as they normally offset each other, please work out an estimate of working capital requirement for all the three years separately. State assumptions, if any. **10**

b) A firm has a total sales of Rs. 200 lakhs of which 80% is on credit. It is offering credit terms of 2/40, net 120. Of the total, 50% of customers avail discounts and the balance pay in 120 days. Past experience indicates that bad debt losses are around 1% of credit sales. The firm spends about Rs. 2,40,000 per annum to administer its credit sales. These are avoidable as a factor is prepared to buy the firm's receivables. He will charge 2% commission. He will pay advance against receivables to the firm at an interest rate of 18 % after withholding 10% as reserve. **5**

i) What is the effective cost of factoring? Consider year as 360 days.

ii) If bank finance for working capital is available at 14% interest, should the firm avail of factoring service?

Answer

a) Workings:

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Particulars		Year 1	Year 2	Year 3
Estimated sales		600,000	840,000	960,000
Less: Profit (@10% on sales)		60,000	84,000	96,000
Cost of goods sold	**(a)**	**540,000**	**756,000**	**864,000**
Factory costs				
Material cost	(30% of total cost)	162,000	226,800	259,200
Labour cost	(20% of total cost)	108,000	151,200	172,800
Overhead cost	(30% of total cost)	162,000	226,800	259,200
	(b)	**432,000**	**604,800**	**691,200**
Administration, selling and distribution expenses	**(a-b)**	**108,000**	**151,200**	**172,800**
Purchase estimation		**180,000**	**240,000**	**270,000**

Estimation of Working Capital requirement

Particulars		Year 1	Year 2	Year 3
Current Assets:				
Raw material stock	2 months raw material cost	27,000	37,800	43,200
Work in Progress	1 month factory cost	36,000	50,400	57,600
Finished goods	1/2 month of cost of goods sold	22,500	31,500	36,000
Sundry debtors	2 months of credit sales	100,000	140,000	160,000
Cash	1 month of labour cost, factory overhead, administration selling and distribution expenses	31,500	44,100	50,400
	a	**217,000**	**303,800**	**347,200**
Current Liabilities:				
Sundry Creditors	2 months of purchase estimation	30,000	40,000	45,000
	b	**30,000**	**40,000**	**45,000**
Estimated Working Capital	**(a-b)**	**187,000**	**263,800**	**302,200**

b) Total sales = Rs. 200 Lakhs
Credit Sales (80%) = Rs. 160 lakhs
Receivable for 40 days = Rs. 80 lakhs
Receivable for 120 days = Rs. 80 lakhs
Average collection period [(40x0.5) + 120x0.5)] = 80 days
Average level of receivables (Rs. 1,60,00,000x80/360)=Rs. 35,55,556
Factoring Commission= Rs. 35,55,556 x 2% = Rs.71,111
Factoring Reserve = Rs. 35,55,556 x 10% = Rs.3,55,556
Amount available for advance = Rs. 35,55,556 – (3,55,556+71,111)=Rs.31,28,889
Factor will deduct his interest at 18%,
So, interest = Rs.31,28,889 x 18% x 80/360= Rs. 1,25,156
Advance to be paid = Rs.31,28,889 – 1,25,156=Rs.30,03,733

(i) Calculation of effective cost of factoring

Annual cost of factoring to the firm:
Factoring Commission (Rs.71,111 x 360/80) = Rs. 3,20,000
Interest Charges (Rs.1,25,156 x 360/80) = Rs. 5,63,200
Sub Total Rs. 8,83,200

Firm's saving on using Factoring services
Cost of credit administration saved Rs. 2,40,000
Bad debts (Rs.1,60,00,000 x 1%) avoided Rs. 1,60,000
Sub Total Rs. 4,00,000

Net Cost to the firm = Rs,8,83,200 – Rs. 4,00,00 = Rs. 4,83,200

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Effective cost of factoring = Rs.4,83,200 / Rs. 30,03,733 x 100 = 16.09 %

(ii) If bank finance for working capital is available at 14%, the firm should not avail factoring services as 14% is lower than effective cost of factoring service i.e. 16.09%

3.

a) Following are the financial details of two farmers Mr. M and Mr. N, who belongs to the same area at the end of financial year 2071-72:

Income Statement

	Rs. in Lakhs	
	M	N
Gross Revenue (Value from farm production)	125	80
Cost of Production	64	56
Gross Farm Income	61	24
Operating Expense attributable to agriculture	24	12
Interest Expense on Agricultural Loans	4	1
Net Farm Income from Operations	33	11
Tax	-	-
Net Farm Income	33	11

Balance Sheet

	Rs. in Lakhs	
	M	N
Assets		
Biological Asset (harvested paddy)	49	22
Non Current Asset	75	40
Current Asset	9	3
Total Assets	133	65
Previous Year Total Assets	97	48
Equity and Liabilities		
Equity	63	37
Non Current Liability (full debt)	14	8
Current Liability (80% renewable debt)	56	20
Total Equity and Liabilities	133	65

The increase in total assets of Mr. M owed to increase in non current asset (80% of total assets increment), whereas increase in total assets of Mr. N owed to increase in biological asset (75% of total asset increment). Furthermore, the current asset of Mr. M and Mr. N grew by Rs.2 lakhs and Rs.1 lakh respectively.

Required **(2+2+4=8)**

i) Calculate profit margin ratio, asset turnover and debt-equity ratio.

ii) Calculate return on equity using Du Pont formula.

iii) Analyse the ratios from calculation parts (i and ii) with reference to the information given above and make apt suggestions. You may consider suitable assumptions / calculations and subsidies on interest rates and insurance for your justification.

b) The Board of Z Ltd. is seeking an improvement plan on the company's working capital management. Currently, the Company has total turnover (credit sales) of Rs. 23,09,00,000 per year and has a policy of providing 30 days credit to its customers. Per facts furnished to the Board by the management, the average

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collection period is more than the prescribed limit and it is estimated that around 1% of the turnover turn into bad that are not recoverable. The company has around Rs. 5,07,00,000 in accounts receivables and has a cost of short-term finance at 8% per annum.

The CFO has invited for a proposal from a factoring company, D Ltd., to manage the receivables/sales account of the company on a with-recourse basis. Per proposal submitted to the company, the D Ltd. has committed to use its expertise to reduce average trade receivables days to 27 days, cutting bad debts by 60% and reducing administration costs by Rs. 15,00,000 per year.

In addition, D Ltd. shall also advance Z Ltd. 70% of the value of invoices raised at an interest rate of 9% per year. The D Ltd. shall charge an annual fee of 1% of credit sales.

Assume 365 days for a year.

Required: **7**

Is the factor's offer financially viable to Z Ltd?

Answer

a)

i. Calculation of Profit Margin Ratio, Asset Turnover and Debt-Equity Ratio

		Mr. M	Mr. N
Net Farm Income (Rs. in Lakh)	A	33	11
Gross Revenue (Value from farm production) (Rs. in Lakh)	B	125	80
Profit Margin Ratio	**A/B**	**26.40%**	**13.75%**
Gross Revenue (Value from farm production) (Rs. in Lakh)	C	125	80
Average Farm Assets (Rs. in Lakh)	D	115	56.5
Asset Turnover	**C/D**	**1.09**	**1.42**
Debt (Full Debt + Renewable Debt)	E	59	24
Equity	F	63	37
Debt - Equity Ratio	**E/F**	**0.93**	**0.65**

ii. Calculation of Return on Equity using Du Pont formula

		Mr. M	Mr. N
Profit Margin Ratio	**G**	**26.40%**	**13.75%**
Asset Turnover	**H**	**1.09**	**1.42**
Calculation of Equity Multiplier			
Average Farm Assets (Rs. in Lakh)	I	115	56.5
Equity	J	63	37
Equity Multiplier	**K(I/J)**	**1.83**	**1.53**
Return on Equity	**G × H × K**	**52.66%**	**29.87%**

iii. The profit margin ratio of Mr. M is very strong (26.40%) vis-à-vis Mr. N who has almost of half at 13.75%; however the asset turnover of Mr. M is lower than the Mr. N (1.09 versus 1.42). The equity multiplier and debt equity ratio of the Mr. M is higher than the Mr. N indicating that Mr. M has higher financial leverage ratios than Mr. N.

As per given information, Mr. M has acquired non-current assets of Rs.28.8 lakhs (Rs.36 lakhs × 80%), whereas Mr. N has acquired non-current assets of mere Rs.3.25 lakhs (Rs.17 lakhs × 25% - Rs.1 lakh). This resembles that Mr. M is expanding its business the consequences of which may be evident in the years to come when he uses his infrastructure at the optimum.

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On the contrary, the increment of biological asset of Mr. N is Rs.12.75 lakhs (Rs.17 lakhs × 75%) as against Rs.5.20 lakhs (Rs.36 lakhs × 20% - Rs.2 lakhs) of Mr. M. The inventory turnover ratio of Mr. M and Mr. N is 1.31 and 2.09 times respectively which coupled with asset turnover ratio reflects that Mr. N had better performance during the year and was more efficient in terms of infrastructures.

The debt equity ratio of both farmers is below 1 and therefore can be increased ideally to the extent of 2:1 in order to improve their profitability ratios giving due consideration to the subsidies available to the farmers on interest rates (as low as 5% on agricultural credit) and crop insurance (50% waiver).

Considering the asset and inventory turnovers, which seem quite low assuming that there is no seasonal storing at the end of the financial year, both need to improve their production efficiency or price levels. In addition, they may reduce biological assets through regular disposal thereby reducing financing and inventory handling cost and also focusing to integrate the paddy farming with animal husbandry, dairy farming, beekeeping, vegetable farming etc.

Working Note:

1. Calculation of Inventory Turnover Ratio

Cost of production	64	56
Biological Asset	49	22
Inventory Turnover	**1.31**	**2.55**

b) The offer of factor will be financially viable only if there is net benefit from the arrangement.

Current accounts receivables		5,07,00,000	
Revised accounts receivables	23,09,00,000 × 27/365	1,70,80,274	
Reduction in receivables		**3,36,19,726**	
Reduction in financing costs of receivables @ 8%	3,36,19,726 × 8%	26,89,578	
Saving in bad debts	23,09,00,000 × 1% × 60%	13,85,400	
Reduction in administration costs	(given)	15,00,000	
Total Savings			**55,74,978**
Factor's annual fee	23,09,00,000 × 1%	23,09,000	
Increase in financing cost on advance	23,09,00,000 × 70% × (9% - 8%)	16,16,300	
Total Cost			**39,25,300**
Net Benefit from the arrangement			**16,49,678**

The factor's offer is financially viable to Z Ltd. since it saves Rs.16,49,678 annually from the arrangement.

4.

a) The Capital structure of the company is as below:

Particulars	Amount in (Rs.)
Equity share capital of Rs.10 each	8,00,000
8% preference share capital of Rs.10 each	6,25,000
10% Debenture of Rs.100 each	4,00,000
Total	18,25,000

Additional information:
Profit after tax (tax rate 30%) Rs. 1,82,000
Operating expenses (including depreciation Rs. 90,000) being 1.50 times of EBIT.
Assume all operating expenses excluding depreciation are variable.

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Equity dividend paid 15%
Market price per equity share Rs.20

Required: **(2+2+2+2=8)**

i) Operating and financial leverage
ii) Cover for the preference and equity share of dividends
iii) The earning yield and price earnings ratio
iv) The net fund flow

b) A company requires Rs. 25,00,000 for a new plant. This plant is expected to yield earnings before interest and taxes of Rs. 5,00,000. While deciding about the financial plan, the company considers the objective of maximizing earning per share. It has three alternatives to finance the project as below:

i) Raise debt of Rs. 2,50,000 and balance by issuing equity shares,
ii) Raise debt of Rs. 10,00,000 and balance by issuing equity shares
iii) Raise debt of Rs. 15,00,000 and balance by issuing equity shares

The company's share is currently selling at Rs. 150, but is expected to decline to Rs. 125 in case the funds are borrowed in excess of Rs. 10,00,000. Assume that company can raise cash from issue of equity at these market prices.
The funds can be borrowed at the rate of 10% up to Rs. 2,50,000, at 15% over Rs. 2,50,000 and up to Rs. 10,00,000 and at 20% over Rs. 10,00,000. The tax arte applicable to the company is 50%.
Required: **7**

Which form of financing should the company choose?

Answer

a) Working Notes:

Net profit after tax	Rs. 1,82,000
Tax @30%	78,000
Earning Before tax	**2,60,000**
Interest on Debenture@10%	40,000
EBIT	**3,00,000**
Operating Expenses 1.5 times	4,50,000
Sales	**7,50,000**

(i) **Operating Leverage**= Contribution/EBIT=(7,50,000-3,60,000)/3,00,000=1.30 times

Financial Leverage $= \dfrac{\text{EBIT}}{\text{EBIT-Int-}\dfrac{\text{PD}}{\text{1-Tax}}}$

$= \dfrac{3,00,000}{3,00,000-40,000-\dfrac{5,000}{1-0.30}}$

= 1.59 times

(ii) **Preference Dividend Cover =** PAT/Preference share dividend
= Rs. 1,82,000/(6,25,000 x 8%) = 3.64 times
Equity dividend cover = (PAT – Preference share dividend)/equity dividend
=(Rs.1,82,000 – 50,000)/ (8,00,000 x15%)=1.10 times

(iii) **Earning yield =** (EPS/ Market price) x 100 = [(1,32,000/80,000)/20] = 8.25%
Price Earning ratio = Market price/EPS = 20/1.65=12.12 times

(iv) **Net Fund flow = Net profit after tax + depreciation – total dividend**
= 1,82,000 + 90,000 – (50,000 + 1,20,000)
= 2,72,000 – 1,70,000
= Rs. 1,02,000

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b) Calculation of Earning Per Share for three alternatives to finance the project

Particulars	**Alternatives**		
	I	**II**	**III**
	Raise debt of Rs.2,50,000 and equity of Rs.22,50,000	Raise debt of Rs.10,00,000 and equity of Rs.15,00,000	Raise debt of Rs.15,00,000 and equity of Rs.10,00,000
EBIT Expected	5,00,000	5,00,000	5,00,000
Less: Interest on Debt at rates given in question	25,000	1,37,500	2,37,500
Earnings Before Tax	4,75,000	3,62,500	2,62,500
Less: tax at 50%	2,37,500	1,81,250	1,31,250
Earnings After Tax	2,37,500	1,81,250	1,31,250
Number of shares in each alternative (Equity/Market Price per share)	15,000	10,000	8,000
Earning Per Share	15.833	18.125	16.406

The company should raise Rs.10,00,000 from debt and Rs.15,00,000 by issuing equity shares as this alternative gives highest EPS.

5.

a) Determine the market value of equity shares of the company from the following information as per Walter`s Model:

Earnings of the company	Rs. 5,00,000
Dividend paid	Rs. 3,00,000
Number of the shares outstanding	1,00,000
Price-earning ratio	8
Rate of return on investment	15%

Are you satisfied with the current dividend policy of the firm? If not what should be the optimal dividend payout ratio? **5**

b) The following data relating to two securities, A and B.

	A	B
Expected return	22%	17%
Beta factor	1.5	0.7

Assume Risk Free Interest (Rf)=10% and Return Market (Rm)=18%. Find out whether the securities A and B are correctly priced? **5**

c) Calculate the value of equity share from the followings: **5**

Particulars	Amount in Rs.
Equity Share Capital (Rs. 20 each)	50,00,000
Reserve and Surplus	5,00,000
15% Secured Loans	25,00,000
12.5% Unsecured Loans	10,00,000
Fixed Assets	30,00,000
Investments	5,00,000
Operating Profit	25,00,000
Tax Rate	50%
P/E Ratio	12.5

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Answer

a) Price earning ratio= Market Price/EPS
8= Market Price/5
So, Market Price=Rs. 40
EPS= 500,000/100,000=Rs.5
DPS=300,000/100,000=Rs. 3
Dividend payout ratio=DPS/EPS*100=3/5*100=60%

Walter's Formula

As the P/E ratio is given 8, and the cost of capital (Ke) is also defined as the reciprocal of P/E ratio, therefore the Ke may be taken as 1/8=.125 i.e.12.5%

Since, this is a growth firm having rate of return (15%) more than cost of capital(12.5%), therefore, the company will maximize its market price if it retains its 100% of its profits. The current market price of Rs. 40 (based on P/E Ratio can be increased by reducing the payout ratio. If the company opts for 100% retention (i.e. 0% payout), the market price of the share as per Walter's formula should be as follows;

P=D/Ke+((r/Ke)(E-D))/Ke
P=0/.125+((.15/.125)(5-0))/.125
= Rs. 48

So, the firm can increase the market price of the share up to Rs. 48 by increasing the retention ratio to 100% or in other words, the optimal dividend payout for the firm is 0.

b) Calculation of return under CAPM
Company A=Rf+B(Rm-Rf)
=10+1.5(18-10)
=22%
Company B=Rf+B(Rm-Rf)
=10+0.7(18-10)
=15.6%

Security	E(R) Expected Return	Return under CAPM	Position
A	22%	22%	Correctly Priced
B	17%	15.6%	Under Priced

The return from security A exactly equal to the calculated return under CAPM hence it is correctly priced securities.

The return from security B is better than the return under CAPM. It indicates a favorable position .i.e. the security is currently traded at underpriced position.

c) In the given situation, the value of the share can be ascertained on the basis of earnings of the firm and the price-earnings multiple as follows:
Value = EPS* P/E Ratio
The P/E Ratio is given and the EPS may be ascertained as follows:

	Amount in Rs.
Operating Profit i.e. EBIT	2,500,000
Less: Interest on 15% secured loans	375,000
Interest on 12.5% Unsecured loans	125,000
Profit before Tax(PBT)	2,000,000
Tax@50%	1,000,000
Profit after Tax	1,000,000
Number of Equity Shares(Rs. 5000000/20)	250,000
Therefore, EPS(Rs.1000000/250000)	4.00
P/E Ratio(given)	12.5

Therefore,
Value of equity shares= EPS*P/E Ratio

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=4*12.5= Rs. 50

6. Write Short Notes on: **(4×2.5=10)**

   a) Debt Securitisation
   b) NEPSE Index
   c) Risk and Uncertainty
   d) Basic functions of financial management

Answer

a) Debt securitisation is a method of recycling of funds. It is especially beneficial to financial intermediary to support the lending volumes. Assets generating steady cash flows are packaged together and against this assets pool, market securities can be issued, e.g. housing finance, auto loans and credit cards receivables. The process of securitization is generally without recourse i.e. investors bear the credit risk and issuer is under an obligation to pay to investors only if the cash flows are received by him from the collateral. The benefits to the originator are that assets are shifted off the balance sheet, thus the originator recourse to off-balance sheet funding.

b) The Nepal Stock Exchange is a value weighted index of all shares listed at the Nepal Stock Exchange and calculated on a daily basis (for the days market remain open) at the closing price. The calculation of the NEPSE index is based on the concept of the market capitalization which is the sum of the market capitalization of all the company listed in the Nepal Stock Exchange. If the ratio of current period market capitalization to the base period market capitalization is multiplied by the multiplier 100, we get NEPSE index. This method of index calculation is called value weighted method.

$$\text{NEPSE Index} = \frac{\text{Total Market Capitalization of all the Companies Listed}}{\text{Total Base Year`s Market Capitalization}} * 100$$

However in reality, the number of the listed companies keeps on changing, and the number of the outstanding shares also keeps on changing as the company issues right shares or bonus shares or common shares at the time of capital needs. The actual practice to adjust the base period is as follows:
Adjusted Base Period =(New Market Capitalization including new listing/New Market Capitalizations excluding new listing)* Base Year's Market Capitalization.

c) In common parlance, the terms Risk and Uncertainty have synonymous meaning. However, they differ from each other. Risk may be defined as the chance of future loss that can be foreseen. In other word, in case of risk an estimate can be made about the degree of happening of the loss. This is usually done by assigning to the probabilities of risk on the basis of past data and the probable trends.
Uncertainty may be defined as “the unforeseen chance for future loss or damages.” In case of uncertainty, since the firm cannot anticipate the future loss, and hence it cannot directly deal with it in its planning process, as is possible in the case of risk. For example, a firm cannot foresee the loss which may be due to destruction of its plant in account of earthquake.

d) The basic functions of the financial management are as discussed below:
- i) Procurement of funds – identifying the source of financing considering the risk, costs and control.
- ii) Effective utilization of funds – funds are used for beneficial ventures and not kept idle.
- iii) Generation of reports for decision makers
- iv) Preparation of financial reports
- v) Ensure proper financial accountability

7. Distinguish between: **(4×2.5=10)**

   a) Preference share and Debenture

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b) Horizontal analysis Vs. Vertical analysis
c) Financial lease and Operating lease
d) Euro convertible bonds Vs. Euro convertible zero bonds.

Answer

a) Preference share is a special kind of share whose holders enjoy priority both as regard to the payment of a fixed amount of dividend and also towards repayment of capital in case of winding up of a company. Preference shares are a hybrid form of financing with some characteristics of equity shares and some attributes of debt capital.

A debenture is a type of loan which can be raised from the public. It carries fixed percentage of interest. Debentures are instruments for raising long term capital with a period of maturity. Some debenture can be convertible to equity.

b) Horizontal analysis: this technique is also known as comparative analysis. It is conducted by setting consecutive balance sheet, income statement or cash flow side by side and reviewing changes in individual categories on year to year or multi year basis. The most important item revealed by comparative financial statement analysis is trend. A comparison of statements over several years reveals direction speed & extents of a trends. The horizontal financial statement is done by restating amount of each item or group of items as a percentage.

Vertical analysis: Vertical/Cross sectional/Common size statements came from the problems in comparing the financial statements of firms that differ in size. The vertical analysis represents the relationship of different items of financial statements which some common items by expressing each item as a percentage of common item. In common size income statements, each item is stated as percentage of net sales. The percentage of different items are computed by dividing the absolute item by the common base (i.e. the balance sheet total or net sales as the case may be), and multiplying by hundred.

c) In Financial lease, the risk and reward incident to ownership are passed on to the lessee. The lessor only retains the legal ownership of the assets. The lessor does not bear the cost of repairs, maintenance or operations. The lease is usually full payout.

In operating lease, the lessee is only provided the use of the assets for a certain time. Risk incident to ownership belongs to the lessor. Usually, the lessor bears the cost of repairs, maintenance and operations. The lease is usually non-payout.

d) Euro convertible bond is a Euro bond, a debt instrument which gives the bond holders an option to convert them into a pre determined number of equity shares of the company. Usually the price of the equity shares at the time of conversion will have a call option (where the issuer company has the option of calling/buying the bonds for redemption prior to the maturity date) or a put option (which gives the holder the option to put/sell his bonds to the issuer company at a predetermined date & price).

Euro convertible zero bonds are structured as convertible bond. No interest is payable on the bonds. But conversion of bonds takes place on maturity at a predetermined price. Usually there is a five years maturity period and they are treated as deferred equity issue.

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Cost & Management Accounting
Suggested

Roll No……………. **Maximum Marks - 100**

Total No. of Questions: 6 **Total No. of Printed Pages - 5**

Time Allowed - 3 Hours

Marks

All questions are compulsory. Working notes should form part of the answer. Make assumptions wherever necessary.

1. PQR Limited produces two joint products P and Q together with a by-product R, from a single main process (process 1). Product P is sold at the point of separation for Rs.5 per kg., whereas product Q is sold for Rs.7 per kg. after further processing into product Q2. By- product R is sold without further processing for Rs.1.75 per kg. Process 1 is closely monitored by a team of chemists, who planned the output per 1000 kg of input materials to be as follows:

Product P	500 kg.
Product Q	350 kg.
Product R	100 kg.
Toxic waste	50 kg.

The toxic waste is disposed of at a cost of Rs.1.50 per kg, and arises at the end of processing.Process 2, which is used for further processing of product Q into product Q2, has the following cost structure:

Fixed costs	Rs.6,000 per week
Variable costs	Rs.1.50 per kg. processed

The following actual data relate to the first week of accounting period 10:

Process 1		
Opening work in process	Nil	
Materials input 10,000 kg.costing	Rs.15,000	
Direct labour	Rs.10,000	
Variable overhead	Rs.4,000	
Fixed overhead	Rs.6,000	
Outputs:		
Product P	4,800 kg.	
Product Q	3,600 kg.	
Product R	1,000 kg.	
Toxic waste	600 kg.	
Closing work in progress	Nil	
Process 2		
Opening work in process	Nil	
Input of product Q	3,600 kg.	
Output of product Q2	3,300 kg.	
Closing work in progress	300 kg,	50% converted

Conversion costs were incurred in accordance with the planned cost structure.

Required: **(7+7+6=20)**

a) Prepare the main process account for the first week of period 10 using the final sales value method to attribute pre-separation costs to joint products.

b) Prepare the toxic waste accounts and process 2 accounts for the first week of period 10.

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c) Advise the management of PQR Limited whether or not, on purely financial grounds, it should continue to process product Q into product Q2:

i) if product Q could be sold at the point of separation for Rs.4.30 per kg; and

ii) if 60% of the weekly fixed costs of process 2 were avoided by not processing product Q further.

Answer

a) Normal loss (toxic waste) = 50 kg per ,000 kg of input (i.e. 5%)
Actual input = 10,000 kg
Abnormal loss = Actual toxic waste (600) less normal loss (500) = 100 kg

By-product R net revenues of Rs.1750 are credited to the joint (main) process account and normal and abnormal losses are valued at the average cost per unit of output:

Net cost of production (35,750-1,750)/ Expected output of the joint products (8,500 kg) = Rs.4

The cost of the output of the joint products is Rs.33,600 (8,400 kg ×Rs.4) and this is to be allocated to the individual products on the basis of final sales value (i.e. 4,800 kg ×Rs.5 = Rs.24,000 for P and 3600 kg ×Rs.7 = Rs.25 200 for Q):

P = Rs.24 000/Rs.49 200 ×Rs.33 600 = Rs.16 390
Q = Rs.25 200/Rs,49 200 ×Rs.33 600 = Rs.17 210

The main process account is as follows:

Main process account

	Kg	Rs.		Kg	Rs.
Materials	10,000	15,000	P Finished goods	4,800	16,390
Direct Labor		10,000	Q Process 2	3,600	17,210
Variable Overhead		4,000	By-Product R	1,000	1,750
Fixed Overhead		6,000	Normal Toxic Waste	500	
Toxic Waste disposal A/c		750	Abnormal Toxic Waste	100	400
	10,000	**35,750**		**10,000**	**35,750**

b)

Normal Waste A/c

	Rs.		*Rs.*
Bank	750	Main Process Account	750
	750		**750**

Abnormal toxic waste account

	Rs.		*Rs.*
Main Process Account	400	Profit and Loss Account	550
To bank (100 ×1.50)	150		
	550		**550**

Process 2 account

	Kg	Rs.		Kg	Rs.
Main Process Q	3,600	17,210	Finished Goods Q (Note 2)	3,300	26,465
Fixed Cost		6,000	Closing Work in Progress	300	1,920

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			(Note 2)		
Variable Cost (Note 1)		5,175			
	3,600	**28,385**		**3,600**	**28,385**

Notes:

Note1. 3300 + (50% * 300) * Rs.1.50 = Rs.5175

Note2.

	Rs.	Completed Units	WIP Equivalent Units	Total Equivalent Units	Cost Per Unit
Previous Process Cost	17,210	3,300	300	3,600	Rs.4.78
Conversion Cost	11,175	3,300	150	3,450	Rs.3.24
					Rs.8.02

Therefore,

	Rs.
Completed Units (3,300 × Rs.8.02)	26,465
WIP (300×Rs.4.78 + 150×Rs.3.24)	1,920
Total	**28,385**

(c)

Incremental sales revenue per kg from further processing (Rs.7 – Rs.4.30)	Rs.2.70
Incremental (variable) cost per kg of further processing	Rs.1.50
Incremental contribution per kg from further processing	**Rs.1.20**
At an output of 3600 kg the incremental contribution is	Rs. 4320
Avoidable fixed costs	Rs.3600
Net benefit	**Rs.720**

Since the net benefit increased by Rs. 720 under further processing, it should be further processed.

2.

a) The annual demand for an item of raw material is 4,000 units and the purchase price is expected to be Rs. 90 per unit. The incremental cost of processing an order is Rs. 135 and the cost of storage is estimated to be Rs. 12 per unit. **(2+4+4=10)**

i) What is the optimal order quantity and total relevant cost of this order quantity?

ii) At the commencement of the year a supplier offers 4,000 units at a price of Rs. 86.The materials will be delivered immediately and placed in the stores and the incremental cost of placing the order is zero. Should the order be accepted?

iii) At the time of annual cost audit it was revealed that Rs. 135 as estimated to be the incremental cost of processing an order is incorrect and should have been Rs. 80. All other estimates are correct. What is the difference in cost on account of this error?

b) The following standards have been set to manufacture a product:

		Rs.
Direct material		
2 units of A @ Rs.4 per unit		8.00
3 units of B @ Rs.3 per unit		9.00
15 units of C @ Re. 1 per unit		15.00
		32.00
Direct labour 3 hrs. @ Rs.8 per hour	24.00	

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Total standard prime cost 56.00

The company manufactured and sold 6,000 units of the product during the year.

Direct material costs were as follows:

12,500 units of A at Rs.4.40 per unit

18,000 units of B at Rs.2.80 per unit

88,500 units of C atRs.1.20 per unit

The company worked 17,500 direct labour hours during the year. For 2,500 of these hours the company paid at Rs.12 per hour while for the remaining the wages were paid at standard rate.

Calculate materials price variances and usage variances and labour rate and efficiency variances. **8**

c) State the objectives of standard costing technique? **2**

Answer

a)

i) Optimum order quantity (EOQ) = $\sqrt{\frac{2AO}{C}}$

Where

A = Total Annual requirements of raw materials in units

O = Ordering cost per order

C = Raw materials carrying cost per unit per annum

$= \sqrt{\frac{2\times 4{,}000 \text{ units} \times \text{Rs.}135}{\text{Rs. }12}}$

= 300 units

Total relevant cost when order quantity is 300 units

= Ordering cost + Carrying cost

= No. of orders × ordering cost per order + ½ Order size × carrying cost per unit per annum

$= \frac{4{,}000 \text{ units}}{300 \text{ units}} \times \text{Rs. } 135 + \frac{1}{2} \times 300 \text{ units} \times \text{Rs. } 12$

= Rs. 1,800 + Rs. 1,800

= Rs. 3,600

ii) Comparision of cost at Special offer and EOQ

	Order Size (units)	Total units purchased	Price per unit (Rs.)	Total cost of purchase (Rs.)	Ordering Cost (Rs.)	Carrying Cost (Rs.)	Total Cost (Rs.)
Special Offer	4,000	4,000	86	3,44,000	Nil	24,000	3,68,000
EOQ	300	4,000	90	3,60,000	1,800	1,800	3,63,600
Difference in cost							4,400

Since the special offer of Rs. 86 per unit on the initial purchase of 4,000 units imposes an additional cost of Rs.4,400, the offer should not be accepted.

iii)

Revised optimal order quantity = $\sqrt{\frac{2\times 4{,}000 \text{ units} \times \text{Rs.}80}{\text{Rs. }12}}$

= 231 units

Revised relevant cost when order quantity is 231 units

$= \frac{4{,}000 \text{ units}}{231 \text{ units}} \times \text{Rs. } 80 + \frac{1}{2} \times 231 \text{ units} \times \text{Rs. } 12$

= Rs. 1,385.28 + Rs. 1,386

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= Rs. 2,771.28

Difference in the relevant cost on account of wrong estimation of ordering cost
= Rs. 3600 – Rs. 2,771.28
= Rs. 828.72

b)

For material cost variances
Actual cost of material used

A	12,500 units x Rs. 4.40 =	Rs.55,000
B	18,000 units x Rs. 2.80 =	Rs.50,400
C	88,500 units x Rs. 1.20 =	Rs 1,06,200
		Rs. 2,11,600

Standard cost of material used

A	12,500 units x Rs. 4.00 =	Rs. 50,000
B	18,000 units x Rs. 3.00 =	Rs.54,000
C	88,500 units x Rs. 1.00 =	Rs. 88,500
		Rs. 1,92,500

Standard material cost of production 6,000 units x Rs. 32 = Rs. 1,92,000
Variances:
Material price variance = Actual cost of material used – Standard cost of material used
= Rs. 2,11,600 – Rs. 1,92,500
= Rs. 19,100 (A)
Material usage variance = Standard cost of material – Standard material cost of production = Rs. 1,92,500 – Rs. 1,92,000
= Rs. 500 (A)

For labour cost variance
Actual wages paid to workers
2,500 hrs.xRs. 12 = Rs.30,000
15,000 hrs.xRs. 8 = Rs. 1,20,000
Rs. 1,50,000
Payment involved, if workers had been paid at standard rate = 17,500 hrs. xRs. 8
= Rs. 1,40,000

Standard labour cost of output achieved = 6,000 units x Rs 24 = Rs. 1,44,000
Variances:
Labour rate variance = Rs.1,50,000 – Rs.1,40,000 = Rs.10,000 (A)
Labour efficiency variance = Rs. 1,40,000 – Rs. 1,44,000 = Rs. 4,000 (F)

c)

The objectives of standard costing technique are as follows:
(i) To provide a formal basis for assessing performance and efficiency.
(ii) To control costs by establishing standards and analysis of variances.
(iii) To enable the principle of 'Management by exception' to be practiced at the operational level.
(iv) To assist in setting budgets.
(v) The standard costs are readily available substitutes for actual average unit costs and can be used for stock and work-in-progress valuations, profit planning and decision making and as a basis of pricing where 'cost-plus' systems are used.
(vi) To assist in assigning responsibility for non-standard performance in order to correct deficiencies or to capitalize on benefits.
(vii) To motivate staff and management.
(viii) To provide a basis for estimating.
(ix) To provide guidance on possible ways of improving performance.

3.
a) Calcutta Company Ltd. manufactures and sells four types ofproducts under the

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brand name ACE,UTILITY,LUXURY and SUPREME.The sales mix in value comprises:

Brand	Percentage
ACE	33-1/3%
UTILITY	41-2/3%
LUXURY	16-2/3%
SUPREME	8-1/3%
	100%

The total budgeted sales(100%) are Rs. 6,00,000 per month .The operating cost are:

ACE60% of the selling priceLUXURY 80 % of the selling price.

UTILITY 68%of the selling priceSUPREME 40 % of the selling price.

The fixed costs are Rs.1,59,000 per month. Calculate the break even point for the products on an overall basis.

It has been proposed to change the sales mix as follows, the total sales per month remaining Rs. 600,000:

Brand	Percentage
ACE	25%
UTILITY	40%
LUXURY	30%
SUPREME	5%
	100%

Assuming that this proposal is implemented, calculate the new break- even point. **8**

b) The boilerhouse is one of the service departments of a company. Steam is raised and then transferred to production departments and other service departments as required.

The basic monthly budget figures for 2016 are as follows:

Boiler operating hours:	480
Steam raised:	80,00,000 kg.
Costs:	
Fuel (V)	Rs.19,200
Chemicals (V)	Rs. 960
Wages(F)	Rs. 2,400
Sundry overheads(F)	Rs. 3,000

The actual figures for February 2016 are as follows:

Boiler operating hours:	432
Steam raised:	67,50,000kg.
Costs:	
Fuel (V)	Rs. 18,000
Chemicals (V)	Rs. 990
Wages(F)	Rs. 2,200
Sundry overhead (F)	Rs. 3,000

It is expected that the price of chemicals for all output will fall by 2% where the boiler operates in excess of 480 hours per month. Sundry fixed(F) costs are expected to fall by Rs. 200 where the boiler is operated for less than 425 hours and to increase from the normal level by Rs. 250 where the boiler is operated for more than 480 hours.

Variable(V) costs vary in proportion to boiler hours.

Required: **(4+4=8)**

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i) Prepare a budget summary which shows the cost of the boilerhouse in total and per '000 kg steam for boiler operating levels of 400, 432, 480,and 540 hours

ii) Prepare a control statement which compares budget with actual cost of the boilerhouse for February where a flexible budgeting system is in operation. Comment on the variances in the statement.

c) What are the ways for the treatment of defective work? **4**

Answer

a)

Computation of the overall break even point

Particulars	ACE	UTILITY	LUXURY	SUPREME	TOTAL
Sales Mix	33-1/3%	41-2/3%	16-2/3%	8-1/3%	100%
	Rs	Rs	Rs	Rs	Rs
Sales	200,000	2,50,000	1,00,000	50,000	6,00,000
Less:VariableCosts	1,20,000	1,70,000	80,000	20,000	3,90,000
Contribution	80,000	80,000	20,000	30,000	2,10,000

Composite P/V Ratio =Total Contribution/Total Sales×100

=Rs 2,10,000/Rs 6,00,000×100=35%

Break -even Point(sales value)=Total Fixed Costs/Composite P/V Ratio

=Rs 1,59,000/35%=Rs4,54,286

COMPUTATION OF NEW BREAK EVEN POINT(after change in sales mix)

Particulars	ACE	UTILITY	LUXURY	SUPREME	TOTAL
Revised Sales Mix	25%	40 %	30%	5%	100%
Rs.RsRsRsRs					
Sales Mix	1,50,000	2,40,000	1,80,000	30,000	6,00,000
Less: Variable Costs	90,000	1,63,200	1,44,000	12,000	4,09,200
Revised Contribution	60,000	76,800	36,000	18,000	1,90,800

New Composite P/V ratio =Rs 1,90,800/Rs 6,00,000×100 =31.8%

New Break -even Point (Sales value) =Rs 1,59,000/31.8% = Rs 5,00,000

b)

(a) Flexible Budget Summary

Boiler operating hours:	400	432	480	540
Steam raised('000kg)	6667	7200	8000	9000
Costs				
Fuel	Rs. 16,000	Rs. 17,280	Rs. 19,200	Rs. 21,600
Chemicals(v)	800	864	960	1,058.4
Wages(F)	2400	2400	2400	2,400.0
Sundry overheads	2800	3000	3000	3,250.0
Total	22,000	23,544	25,560	28,308.4
Cost/'000 kg	3.30	3.27	3.195	3.145

(b) Control statement for the month

	Budget	Actual	Variances	
Boiler operating hours	432	432		
Steam raised ('000kg)	7,200	6,750	450	(Adverse)
Costs:	Rs	Rs	Rs.	
Fuel(V)	17,280	18,000	720	(Adverse)
Chemical(V)	864	990	126	(Adverse)
Wages(F)	2,400	2,200	200	(Favourable)
Sundry overhead(F)	3,000	3,000	nil	nil

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23,544	24,190	646	(Adverse)

c)

The possible ways for the treatment of defective work are as below:

i) Defectives that are considered inherent in the process and are identified as normal can be recovered by using the following methods:

a. Charged to good products-The loss is absorbed by good units .This method is used when seconds or first are normal:

b. Charged to general overheads-When the defectives caused in one department are reflected only on further processing,the rework costs are charged to general overheads;

c.Charged to Department overheads-If the department responsible for defectives can be identified then the rectification costs should be charged to that department.

d.Charged to Costing Profit and loss Account-If defectives are abnormal and are due to causes beyond the control of organization, the rework cost should be charged to Costing Profit and Loss Accounts.

ii) Where defectives are easily identifiable with specific jobs, the work costs are debited to the job.

4.

a) A manufacturing company disclosed a net loss of Rs. 3,47,000 as per their Cost Accounts for the year ended March 31,2016. The financial accounts however disclosed a net loss of Rs. 5,10,000 for the same period. The following information was revealed as a result of scrutiny of the figures of both the sets of accounts.

	(Rs.)
Factory overheads under-absorbed	40,000
Administration overheads over-absorbed	60,000
Depreciation charged in financial accounts	3,25,000
Depreciation charged in cost accounts	2,75,000
Interest on investments not included in cost accounts	96,000
Income-tax provided	54,000
Interest on loan funds in financial accounts	2,45,000
Transfer fees (credit in financial books)	24,000
Stores adjustment (credit in financial books)	14,000
Dividend received	32,000

Prepare a memorandum reconciliation account. **5**

b) From the following particulars make out a monthly cost sheet or production account of ABC manufacturing company showing cost per ton and percentage of cost used in each item of output:

January 2015:

	Tons	Rate Per ton (Rs.)	Amount (Rs.)
Coal used	5,000	12.50	
Coke produced	3,500	25.00	
Tar Produced	210	50.00	
Sulphate of ammonia produced	49	150.00	
Benzolproduced	48	65.00	
Raw materials used			8,750

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Wages paid			3,585
Repairs and renewals			2,815
General charges			4,050

5

c) The following information is related to the Himalayan Coffee House located at City Centre, Kathmandu:

No. of coffee cups sold in January 2015	Average cost for making a cup of coffee
1,000	5.50
1,200	5.00

You have just been appointed as an accountant of the Himalayan Coffee House. The Coffee House sold 1500 cups of coffee in February, 2015 at the average selling price of Rs.5.00 per cup. One of the board member said that there is a loss in February month. Do you agree? 5

Answer

a) **Memorandum Reconciliation Account**

Dr, **Cr.**

	(Rs.)		**(Rs.)**
To net loss as per Costing books	3,47,000	By Administration overheads over recovered in cost accounts	60,000
To Factory overheads under absorbed in Cost Accounts	40,000	By Interest on investment not included in cost accounts	96,000
To Depreciation under charged in Cost Accounts	50,000	By Transfer fees in financial books	24,000
To income-Tax not provided in cost accounts	54,000	By Store adjustment (Credit in financial books)	14,000
To Interest on loan funds in financial accounts	2,45,000	By Dividend received in financial books	32,000
		By Net loss as per financial books	5,10,000
	7,36,000		**7,36,000**

b)

1. **<u>Calculation of Joint Cost:</u>**

Particulars	Amount
Coal used (5,000x12.5)	62,500
Raw Material used	8,750
Wages Paid	3,585
Repair & Renewals	2,815
General Charges	4,050
	81,700

2. **<u>Statement showing Segregation of Joint Cost</u>**

(Sales Value Method)

Joint Product	Selling Price/ton	Qty (Ton)	Sales Value	Joint Cost
	(a)	(b)	(a x b)	
Coke	25	3,500	87,500	65,905.3
Tar	50	210	10,500	7,908.7
Sulphate of Amonia	150	49	7,350	5,536
Benzol	65	48	3,120	2,350
Total			1,08,470	81,700

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3. Statement showing Cost Sheet:

Product	Amt (a)	Qty (b)	Cost/ton(a/b)	Percentage of Cost
Coke	65,905.3	3,500	18.63	80.67%
Tar	7,908.7	210	37.66	9.68%
Sulphate of Amonia	5,536	49	112.98	6.78%
Benzol	2,350	48	48.96	2.88%
	81,700			100%

Note:
Alternative Physical Output Method can be used for segregation of joint cost.

c) Total Cost at 1,000 cups = No. of cups x Average Cost
= 1,000 x 5.50 = Rs. 5,500
Total Cost at 1,200 cups = No. of cups x Average Cost
= 1,200 x 5.00 = Rs. 6,000
Variable Cost per unit = Difference in Cost / Difference in Units
= 6,000-5,500/ 1,200-1,000
=500/200 = Rs. 2.50 per unit
Fixed Cost = Total Cost- Variable cost per unit x No. of Cups
= 6,000 - (2.50x 1,200) = 6,000-3,000 = Rs. 3,000
Total Cost at 1,500 coffee cups = Fixed Cost + Variable cost
= 3,000+(1500 x 2.5)
= Rs. 6,750
Sales Value of 1,500 coffee cups = 1500 x 5 = Rs 7,500
Profit on sales of 1500 cups of Coffee = 7,500- 6,750 = Rs. 750
Conclusion: I do not agree with the board member since there is a profit of Rs. 750.

5.

a) In an engineering company, the factory overheads are recovered on a fixed percentage basis on direct wages and the administration overheads are absorbed on a fixed percentage basis on factory cost.
The company has furnished the following data relating to two jobs undertaken by it in a period:

	Job 101 (Rs.)	Job 102 (Rs.)
Direct materials	54,000	37,500
Direct wages	42,000	30,000
Selling price	1,66,650	1,28,250
Profit percentage on total cost	10%	20%

Required: **7**

i) Computation of percentage recovery rates of factory overheads and administrative overheads.

ii) Calculation of the amount of factory overheads, administrative overheads and profit for each of the two jobs.

b) What role does a management accountant have in cost control and cost reduction? **4**

c) Fixed costs are irrelevant for decision-making. What are the exceptions? **4**

Answer

a)

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i. Let factory overhead recovery rate, as percentage of direct wages be F and administrative overheads recovery rate, as percentage of factory cost be A.

Factory Cost of Jobs:

Job 101 = Rs. 96,000 + Rs. 42,000F
Job 102 = Rs. 67,500 + Rs. 30,000F

Total Cost of Production of Jobs:

Job 101 = (Rs. 96,000 + Rs. 42,000F) + (Rs. 96,000 + Rs. 42,000F)A
= Rs. 1,51,500…..(i)
Job 102 = (Rs. 67,500 + Rs. 30,000F) + (Rs. 67,500 + Rs. 30,000 F) A
= Rs. 1,06,875…..(ii)
(refer to Working Note)
42,000 F + 96,000 A + 42,000 FA = 55,500……………………. (iii) x 5
30,000 F + 67,500 A + 30,000 FA = 39375…………………….(iv) x 7

On solving above relations

2,10,000 F + 4,80,000 A + 2,10,000 FA = 2,77,500
2,10,000 F + 4,72,500 A + 2,10,000 FA = 2,75,625
7,500 A = 1,875
A = 0.25

Putting the value of 'A' in equation no. (iv) above to get the value of 'F'
30,000 F + 67,500 * 0.25 + 30,000 * 0.25 F = 39,375
37,500 F = 39,375 – 16,875
Or, F = 0.60

Hence percentage recovery rates of factory overheads and administrative overheads are 60% and 25% respectively.

Working Note:

	Job 101	**Job 102**
Total cost of production Rs. Selling price / (100% + Percentage of profit	1,51,500 (Rs. 1,66,650/110%)	1,06,875 (Rs. 1,28,250/120%)

ii. Statements of jobs, showing amount of factory overheads, administrative overheads and profit

	Job 101 (Rs.)	**Job 102 (Rs.)**
Direct Materials	54,000	37,500
Direct Wages	42,000	30,000
Prime Cost	96,000	67,500
Factory Overheads (60% of Direct Wages*)	25,200	18,000
Factory Cost	1,21,200	85,500
Administrative Overheads (25% of Factory Cost*)	30,300	21,375
Total Cost	1,51,500	1,06,857
Profit (difference figure)	15,150	21,375
Selling Price	1,66,650	1,28,250

*As calculated in requirement (i) above.

b) Management Accountants role in cost control and cost reduction is perhaps central to his role as amember of the management team. Indeed, for effective cost control, it may be necessary to spend more onthe items which will reduce waste and scrap, improve quality, increase productivity or conserve energy. Inany large organization the points at which costs are incurred are usually numerous and relatively fewline managers have the mechanism of collating and analyzing all the costs they incur, with a view toimplementing cost control measures. The Management Accountant is uniquely placed in this respect andit usually falls on him to play a catalytic role in getting the management team to work together to

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achievespecific cost control objectives. It is also upto the Management Accountant to channelize the cost control and cost reduction efforts intoareas which will give the greater results. Without this direction, cost control and cost reduction can toooften degenerate into symbolic actions like reusing envelopes or downgrading the class of air travel,which generally have little impact on the overall cost structure but can substantially harm morale andmotivation. It is important for the Management Accountant to guide the company's cost control and costreduction programme into productive lines and not let it degenerate into a morale damaging axing ofpetty expenditure.

c) Fixed costs are unrelated to output and are generally irrelevant for decision-making purpose. However, inthe following circumstances, Fixed Costs become relevant for decision-making.

(i) When fixed costs are specifically incurred for any contract.
(ii) When fixed costs are incremental in nature.
(iii) When the fixed portion of semi-variable cost increases due to change in level of activity consequentto acceptance of a contract.
(iv) When fixed costs are avoidable or discretionary.
(v) When fixed costs are such that one cost is incurred in lieu of another (the difference in costs willbe relevant for decision-making).

6. Write short notes on: **(4×2.5=10)**

a) How flexible budget can help in management decision making?
b) Enumerate the essential pre-requisites of integrated accounting system.
c) Explain 'Cost Centre' and 'Cost Unit'.
d) Discuss how you would treat the shortage in stock taking.

Answer

a) Flexible budget is a budget which, by recognizing the difference in behavior between fixed and variablecosts in relation to fluctuations in output, turnover, or other variable factors, etc. is designed to change inrelation to the level of activity actually attained.A flexible budget is one that takes account of a range of possible volumes. It is sometimes referred to asa multi-volume budget. The range of possible outputs may be known as the relevant range. Flexing abudget takes place when the original budget is deliberately amended to take account ofchange in activitylevels.Flexible budget enable an organization to predict its performance and income levels at a given range ofsales levels and activity levels. It can be seen the impact of changes in sales and production levels onrevenue, expenses and ultimatelyincome. It enables more accurate assessment of managerial and organizational performance. So, Flexible budget is an important aid to management to decision making.

b) The essential pre-requisites for integrated accounts include the following steps.
(i) The management's decision about the extent of integration of the two sets of books, some concerns find it useful to integrate upto the stage of primary cost or factory cost, while others prefer full integration of the entire accounting records.
(ii) A suitable coding system must be made available so as to serve the accounting purposes of financial and cost accounts.
(iii)An agreed routine, with regard to the treatment of provision for accruals, prepaid expenses, other adjustment necessary for preparation of interim accounts.
(iv) Perfect coordination should exist between the staff responsible for the financial and cost aspects of the accounts and an efficient processing of accounting documents should be ensured.

c) CIMA defines Cost Centre as "a production or service, function, activity or item of equipment whose costs may be attributed to cost units. A cost centre is the smallest organisational sub-unit for which separate cost allocation is attempted". A cost centre is an individual activity or group of similar activities for which costs are accumulated. For example in production departments, a machine or group of machines within a department or

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a work group is considered as cost centre. Any part of an enterprise to which costs can be charged is called as 'cost centre'.

A cost centre can be:

(i) Geographical i.e. an area such as production department, stores, sales area.

(ii) An item of equipment e.g. a lathe, forklift, truck or delivery vehicle.

(iii) A person e.g. a sales person.

CIMA defines Cost Unit as "a quantitative unit of product or service in relation to which costs are ascertained". A 'cost unit' is a unit of product or unit of service to which costs are ascertained by means of allocation, apportionment and absorption. It is a unit of quantity of product, service or time or a combination of these in relation to which costs are expressed or ascertained. For example, specific job, contract, unit of product like fabrication job, road construction contract, an automobile truck, a table, 1000 bricks etc. The cost units which pass through the cost centre, the direct and indirect costs of the cost centre are charged to the units of production by means of an absorption rate. The unit of output in relation to which cost incurred by a cost centre is expressed is called 'cost unit'. Cost units can be developed for all kinds of organizations, whether manufacturing, commercial or public utility services.

d) At the time of stock taking generally discrepancies are found between physical stock shown in the bin card and store ledger. These discrepancies are in the form of shortages or losses. The causes for these discrepancies may be classified as unavoidable or avoidable.

Losses arising from unavoidable causes should be taken care of by setting up a standard percentage of loss based on the study of the past data. The issue price may be inflated to cover the standard loss percentage. Alternatively, issues may be made at the purchase price but the cost of the loss or shortage may be treated as overheads.

Actual losses should be compared with the standard and excess losses should be analyzed to see whether they are due to normal or abnormal reasons. If they are attributable to normal causes, an additional charge to overheads should be made on the basis of the value of material consumed. If they arise from abnormal causes, they should be charged to the costing profit and loss account.

Avoidable losses are generally treated as abnormal losses. These losses should be debited to the costing profit and loss account. Losses and surpluses arising from errors in documentation, posting etc. should be corrected through adjustment entries.

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Business Communication
Suggested Answer

Roll No……………. **Maximum Marks – 100**

Total No. of Questions - 10 **Total No. of Printed Pages -2**

Time Allowed – 3 Hours

Marks

All questions are compulsory.

Section -'A'

1. Read the following case carefully and answer the questions given below: **(4×5=20)**

Dr. Aditya Sharma, a consultant business researcher primarily works in the organizational management sector, and has conducted varieties of research including case study, action research, business surveys, and so on about varieties of organizational issues such as auditing, business administration, conflict management, marketing, advertising, international relationships, etc. Dr. Sharma is asked by one of the multinational companies based on Kathmandu, Nepal to conduct a comprehensive study and submit the report about the business problems seen in the changing context of Nepal. Nepal's Regional Office of the company has investigated from the preliminary study that the company is bearing 12% loss every year for the recent three years. The new executive director of the company has decided to conduct an intensive study about the potential causes and problems of the company's loss, and has appointed Dr. Sharma as the chief researcher who is expected to lead a task force.

Mr. Sharma has recently started the preliminary activities and procedures of the research. The research is problem based, and immediate solutions are expected. The TOR has mentioned that the report must include practice related and policy related recommendations. The research team of Mr. Sharma has organized a meeting, and conceptualized the design and procedures of the research. They have prepared the time framework, and have planned about the tools and procedures for data collection.

Questions:

a) Which type of report is Mr. Sharma asked to prepare: analytical or investigative? What are the major components of this type of report? Describe each in brief.

b) What would be the highly efficient tools for gathering information for this report? Discuss any two of them in brief.

c) How can data be analyzed and interpreted?

d) Write statement of problem and objectives of Mr. Sharma's report.

Answer:

a) Since Mr. Sharma is asked to carry out a critical analysis of a particular business situation with an aim at investigating the major problems and recommending the effective solutions, this report is investigative in nature. Unlike informative reports, this type of report is more focused to a specific problem of the organization. The major components of investigative report include:

- Introduction
- Statement of problem
- Objectives
- Methodology (sampling, data collection tools and procedures, …)
- Analysis and interpretation of data

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- Findings, Conclusion and Recommendations
- Bibliography

b) The major tools for data collection for the research report of Mr. Sharma may include:

- interview
- questionnaire
- observation
- focused group discussion
- interactions with clients and retailers

Among them, the highly effective tools for gathering information can be 'interview' and 'focused group discussion' which are explained below in brief:

Interview: it is a face to face interaction of the researcher with the sampled subjects such as clients, retailers, dealers, and other stakeholders. Interview can be of two types: structured and unstructured. Structured interview involves systematic planning about the questions to be asked to the subjects. For this report, the questions can be structured within the framework or the contents such as popularity of the brand, marketing strategies, prices, consumer satisfaction, delivery process, dealership model, and so on. The unstructured interviews are open in nature. The questions are not set before the interview. Interaction is often context dependent.

Focused group discussion: this technique is really worth talking for the particular case of the given report. The representatives of the stakeholders such as staff, clients, retailers, dealers, etc. can be put together in a meeting or a discussion session. Their opinions, reflections and reactions can be recorded as the data for detecting the problems.

c) The data collected by different tools can be analyzed by using different strategies and procedures. The qualitative information is gathered and analyzed by categorizing it into different themes, titles and options. The common tendencies of the data are elaborated, and verified with the previously defined theories and facts. The quantitative data are analysed in terms of different statistical tools such as mean, standard deviation, correlation coefficient, and so on. The data are presented in the tables, charts, graphs, etc. The analysis is done in line with the objectives set for the research. Report is produced on the basis of the findings attained by analysis and interpretation of the data.

d) *Statement of problem :* The present report is prepared focusing basically on the problems that are implicitly and explicitly associated with the business strategies adopted by the regional office of Anuradha International Company (Kathmandu Branch). The research emerges out of the basic problem related to the decreasing financial growth of the company. The causes of consistent loss seen in the recent annual reports are the primary issues that this report deals with. The latest audit report shows that the company is bearing gross loss of 12%. The research question is: what is the factor that affects the financial status of the company?

Objectives

The report has the following specific objectives:

- to study and analyze managerial efficiency of the company
- to find out the marketing strategies of the company
- to analyze consumer responses of the products
- to explore the problems related to management, marketing, sales and public dealing
- to recommend potential solutions of the identified problems.

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2. Prepare a persuasive cover letter in response to the advertisement given below: **10**

Assistant Product Manager: We are currently seeking an assistant product manager for our fast-paced organization. S/he must possess as sound knowledge of marketing related activities such as making a marketing plan; executing, monitoring, & evaluating it. S/he should be very good at computer use and must have very good interpersonal communication skills. Please send your application to Ms. Courtney L. Donahue, director of Del Rio Enterprises.

Answer:
Satdobato, Lalitpur
May 23, 2016

Ms. Courtney L. Donahue
Director, Human Resources
Del Rio Enterprises
Denver, CO 82511

Dear Ms. Donahue:

Your advertisement for an assistant product manager, appearing May 22 in Section C of the Denver Post, immediately caught my attention because my education and training closely parallel your needs. According to your advertisement, the job includes "assisting in the coordination of a wide range of marketing programs as well as analyzing sales results and tracking marketing budgets." A recent internship at Ventana Corporation introduced me to similar tasks. Assisting the marketing manager enabled me to analyze the promotion, budget, and overall sales success of two products Ventana was evaluating. My ten-page report examined the nature of the current market, the products' life cycles, and their sales/profit return. In addition to this research, I helped formulate a product merchandising plan and answered consumers' questions at a local trade show.

Intensive course work in marketing and management, as well as proficiency in computer spreadsheets and databases, has given me the kind of marketing and computer training that Del Rio probably demands in a product manager. Moreover, my recent retail sales experience and participation in campus organizations have helped me develop the kind of customer service and interpersonal skills necessary for an effective product manager.

After you have examined the enclosed résumé for details of my qualifications, I would be happy to answer questions. Please call me at 9851133333 to arrange an interview at your convenience so that we may discuss how my marketing experience, computer training, and interpersonal skills could contribute to Del Rio Enterprises.

Sincerely,

Kendra A. Hawkins

3.

a) Effective listening is one of the important determinants for the successful business interactions. Listening becomes more complex in many contexts because of many

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different barriers to it. Explain in brief how barriers to effective listening can be overcome, and success in business interactions can be enhanced. 5

b) State the contents of a persuasive resume, and write the resume head and objective statement of your resume. 5

Answer:

a) Listening is a very common receptive skill which often becomes far more complex than most people think. Complexity in effective and successful listening is mostly caused by many different factors such as content, channel, etc. of communication. Listening becomes complex because of various barriers to it, too. Good listeners always look for ways to overcome potential barriers throughout the listening process.

Barriers to effective listening may vary from physical reception to listener's mental conditions. The physical barriers such as room acoustics, phone rings and other noises, background music etc. can be serious when the listener has to extract particular information or content from listening. Similarly, lack of attention, interruption, schema, prejudgment etc. can be the examples of mental barriers to effective listening. Some of the strategies for overcoming the barriers to effective listening can be:

- try to minimize the sources of physical barriers such as noises and poor acoustics
- avoid selective listening and focus on the speaker
- keep an open mind and avoid prejudgment
- try to interpret the message from the context of the speaker
- do not interrupt the speaker
- write, record or try to capture the information
- try to associate, categorize and visualize the information
- pay proper attention

b) The contents of a persuasive resume:

- Resume head (Name, address,..)
- Objective Statement
- Academic details
- Professional details
- Experience record
- Special skills & involvement
- Referees
- Signature & date

Suman Bista
Kathmandu 13, Kalanki
9841xxxxxx
discover.xxxxxx@gmail.com

Objective statement:
To serve the nation and the organization where I work with consistent dedication and hard work, and to enhance the business environment of my organization, focusing on business ethics and standard.

4. Briefly explain any FOUR of the following: **(4×2.5=10)**

a) Disadvantages of grapevine in an organization

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b) Ethics in business communication
c) Parts of a formal report
d) Group dynamics
e) Follow up letter

Answer:

a) A grapevine is more like a rumor. It doesn't come straight from the horse's mouth and is usually not fact. These rumors can cause distrust or mutiny within an organization. It is important for managers of a marketing team to address these issues to all personnel before the rumors get out of hand. Monthly mandatory meetings with employees can help quench this bomb fuse. It is important to create constant communication between the hierarchy reinforced with internal newsletters to keep information factual.

b) Any company that aims to be socially and ethically responsible must make a priority of ethical communication both inside the company and in its interactions with the public. In theory, many consumers prefer to do business with companies they believe are ethical which gives those ethical businesses an advantage in the market. Ethical issues of business communication are one such issue. Some of the vital characteristics of ethical communication are discussed below.

While communicating to the audience, conveying the desired message to them in a significant manner is of primary importance. For instance, the employees in a company can be asked to increase their efficiency in a demanding manner whereas managers and executives will feel offended if the same tone is used on them.
Maintaining the same wavelength with the audience is very important for a communicator to ensure the audiences feel at home. Experienced communicators immediately build a relationship based on trust with the audience as soon as they start speaking.

c) These are three major parts of a formal report:

1. Prefatory parts
   - Title fly
   - Title page
   - Letter of authorization
   - Letter of transmittal/preface/ foreword
   - Table of content
   - Executive summary
2. Report Proper
   - Introduction
   - Report findings
   - Summary, recommendation
3. Appended parts
   - Bibliography
   - Appendix
   - Index

d) Strength of team work is always appreciated in the sector of business and organizational management. The role of each member in the team or group is important in order to accomplish

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group tasks and get success in business. To accomplish the business goals successfully, team members constantly contact with one another. The interactions and processes that take place between the members of a team are called group dynamics. Some teams are more effective than others simply because the dynamics of the group facilitate member input and the resolution of differences. Group dynamics are affected by several factors: the role that team members assume, the current phase of team development, the team's success in resolving conflict, and its success in overcoming resistance. Group dynamics promote understanding and cooperation among the members.

e) Follow-up letters are different than thank you letters. The purpose of thank you letters is to thank someone for meeting with you and to reaffirm your interest in the position or industry at hand. Thank you letters are, in turn, sent immediately. A follow-up letter is sent several weeks after sending a thank you letter in order to touch base once again with your contact and to reintroduce yourself. A follow-up letter provides you with the opportunity to restate your interest and to check for new job leads or information. Another type of follow-up letter may be sent after submitting your resume and cover letter. If after several weeks, you have not heard from the employer, you should send a follow-up letter to reemphasize your interest in the company and the position. Follow-up letters can be sent by post or email. You should make your letter as formal or as informal as your relationship with the contact dictates.

Follow- up letter shows:

- That you appreciated your initial meeting
- Where you stand in your current job search
- Anything relevant that has occurred between the initial meeting and now
- What type of help you now need

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Marketing
Suggested Answer

Roll No……………. **Maximum Marks – 100**

Total No. of Questions - 4 **Total No. of Printed Pages -2**

Time Allowed – 3 Hours

Marks

All questions are compulsory.

Section -'B'

5. Read the following case carefully and answer the questions given below:

Kanchhi Balami and her husband migrated to Kathmandu from Nuwakot few years ago. Her husband Kumar Balami works as a driver in a private firm. She is 25 years old and has one son Krishna and one daughter Bimala. Both the children are enrolled in a government school.

Kanchhi has been working as a cook in a private house while working as a domestic service worker in a private house; so she has adequate knowledge in cooking. During the period, she had obtained from her house-owner the 'pastry making' skill, where she works. So pastries baked by her are delicious. Once she expressed her interest with her husband, instead of working at a private house, to open a pastry shop near by the SANN and CAB College to put her talent in practice, because sometime she felt lonely and bored staying home alone, especially at day time, and at the same time, their income was not sufficient to meet their children's expenses. Her husband understood her problem and interest, so he gave her wife permission to do according to her interest and also assured to support her in this effort. So she was impressed by the support of her husband and decided to open a small pastry shop near by these colleges. She rented a small shop near by the College, hoping that a large number of students may come to the shop for varieties of pastry, coffee and tea. She bought the necessary equipments for kitchen and shop with a cash outlay of Rs.50, 000. She managed for furniture and furnishings. Now, Kanchhi decided to name her shop as "Bhatbhateni Bakery Shop". Kanchhi maintained neat and clean in the shop to satisfy the customers. Beside it, her treatment with the customers was also impressive.

The business has been operating for the last ten months. Sales are slowly increasing. The major customers are college students, who drop in for a pastry and coffee. Occasionally, professors come by with their friends for pastry and cup of tea. Shopkeepers and offices in the nearby area are also her regular clients who send orders for shop delivery. With the passes of time, a large number of travellers also come to the shop for tea, coffee and pastries. Local households also come to purchase pastries over the counter. Customers are satisfied with her services and treatment. But many customers frequently asked for Momo and Chow-Min dishes. During the vacation period, Kanchhi has noticed considerable drop in the sales. Though she has knowledge about cooking Momo and Chow-Min, she needs to make additional investment of about Rs. 50, 000 for managing Momo and Chow-Min in the shop, for which she has to take loan from financial institution or somebody else. This money is necessary not only to purchase necessary equipments and furniture but also needs to hire more space in the rented house. She is confident that, if additional dishes could be managed in the shop, the loan would be repaid within six months and then afterwards she would be able to earn handsome profit from the business. She discussed with her husband on this issue. Her husband was impressed by her proposal

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and permitted to do accordingly. However, she wants to change neither the existing business name nor the location.

Actually, Kanchhi Balami hesitates to keep additional items like Momo and Chow-Min dishes, because of limited managerial capacity and limited financial capacity. She was satisfied with the existing business flow and profit margin. But if the demanded items could be added, she is confident that she will be able to earn more money. On the other, if she avoids keeping the demanded items and insists only in the current items, it becomes difficult for her to expand volume and value of business in future.

Kanchhi Balami is now in a big problem because she does not know about the modern marketing concept and marketing techniques; so she is searching for persons, who can provide her an expert advice in this connection. You as a marketing student, she puts the following questions and issues on you for providing her reasonable solutions, which can promote her business in the days to come.

Questions:

a) Why did Kanchi Balami decide to open a pastry shop near by the SANN and CAB colleges? **5**

b) State the target market and customers of Kanchi Balami. **5**

c) What factors compelled Kanchi Balami to think for adding Momo and Chowmin dishes? **5**

d) Explain the reasons, whether Kanchi Balami should add these two dishes or not. **5**

Answer1(a)

The main intention of Kanchhi Balami to open the pastry shop was to help her husband financially, because the income of single person was not adequate to feed and educated her children properly.

However, the main objective of opening the pastry shop near by the SAAN and CAB colleges was that the colleges have many students who may come to her pastry shop and drink tea & coffee and eat pastry items.

Answer1(b)

She decided to open her pastry shop in that area thinking that Kanchhi Balami may have a large target market and can earn adequate income from students. Her customers include college professors, travelers, nearby shop-keepers, local house-owners, and students as well.

Answer1(c)

When the classes were off during the vacation period, Kanchhi Balami noticed considerable drop in sales. Similarly, many customers demanded for momo and chowmin items. Due these situations, Kanchhi Balami was compelled to think for keeping the most demanded additional dishes in her shop.

Answer1(d)

Since she does not have good knowledge about marketing, she decided to take the suggestions of marketing students. If she really wants to be a marketer, she should add the two dishes as demanded by most of the customers; because marketing is a customer-oriented philosophy of business, so she as a marketer should go ahead as per the demand of customers. The sustainability of her business is dependent on how she perceives the customers' sentiment and work accordingly.

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6. What is marketing? Explain the selling concept and new marketing concept. **(4+6=10)**

Answer2

Most people think that marketing is only about the advertising and selling of goods and services. Advertising and selling, however, are just two of the many marketing activities. In other words, selling and advertising are only the tip of the marketing iceberg. Although they are important, they are only two of many marketing functions and are often not the most important ones.

Today, marketing must be understood not in the old sense of making a sale- "telling and selling"- but in the new sense of satisfying customer needs. If a marketer does good job of understanding customer needs; develops products that provide superior value; and prices, distributes and promotes them effectively, these products will sell very easily. Thus selling and advertising are only part of a marketing mix.

In general, marketing activities are all those associated with identifying the particular wants and needs of a target market of customers, and then going about satisfying those customers better than the competitors. This involves doing marketing research on customers, analyzing their needs and then making strategic decisions about product design, pricing, promotion, and distribution. Thus, marketing deals with identifying and meeting human and social needs.

According to Philip Kotler & Kevin Lane Keller, "Marketing is a societal process by which individuals and groups obtain what they need and want through creating, offering, and freely exchanging products and services of value with others."

According to American Marketing Association, "Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organizational objectives.

According to Stanton, Etzel & Walker, "Marketing is a total system of business activities designed to plan, price promote and distribute want satisfying products to target markets in order to achieve organizational objectives."

From the above definitions what we can say is customers' wants must be recognized and satisfied. Entire system of business activities should be customer oriented. Marketing should start with an idea about a want-satisfying product and should not end until the customers' wants are completely satisfied, which may be some time after the exchange is made.

Thus, in conclusion, marketing is meeting needs profitably.

The selling Concept:

Selling concept holds that consumers and businesses, if left alone, will ordinarily not buy enough of the organization's products unless it undertakes a large-scale selling and promotion effort. Therefore, the organization must undertake an aggressive selling and promotion effort. The selling concept is practiced most aggressively with unsought products, products that buyers normally do not think buying, such as insurance and encyclopedias. Most firms practice the selling concept when they have overcapacity. Their aim is to sell what they make rather than make what the market wants. Such marketing carries high risks. It focuses on creating sales transactions rather than on building profitable relationships with customers. It assumes that consumers who are coaxed into buying the product will like it. Or if they don't like it, they will possibly forget their disappointment buy it again later. These are usually poor assumptions to make about buyers. Most studies show that dissatisfied customers do not buy it again. Worse yet, whereas the average satisfied customer tells three others about good experiences, the average dissatisfied customer tells ten others about his or her bad experiences.

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The New Marketing Concept

The new marketing concept holds that achieving organizational goals depends on determining the needs and wants of target markets and delivering the desired satisfactions more effectively and efficiency than competitors do. The marketing concept starts with a well-defined market, focuses on customer needs, coordinates all marketing activities affecting customers, and makes profit by creating long term customer relationship based on customer value and satisfaction.

Thus, under marketing concept, customer focus and the value are the paths to sales and profits. This concept is based on "*we make what we can sell*."

7.

a) Explain the meaning and objectives of promotion. **(2+3=5)**

b) What is a new product for a marketing firm? Explain briefly the reasons for product failure in the market. **(2+3=5)**

Answer3(a)

Promotion is one of the major element of marketing mix which provides various valuable information to consumers about product, its price, availability, utilities and benefits. Promotion consists of various activities that facilitates exchanges with target customers through persuasive communication which stimulates the demand of the product.

According to Philip Kotler, "Promotion includes all the activities the company undertakes to communicate and promote its products to the target market."

Promotion includes various types of activities such as advertising, sales promotion, personal selling, publicity and public relation to inform, persuade, remind and reinforce the target market about the company's offerings. These activities influence the customer's feelings, belief or behavior for buying.

The major objectives of promotion are informing, persuading, reminding and reinforcing or reassuring the customer about the product.

1. Informing:

The main objective of promotion is to inform the market about product, price, availability, utilities and benefits. It helps to develop awareness about the product It also provides alternatives to the customers for purchase decision.

2. Persuading:

Promotion persuades customers to make the purchase decision in favor of the promoted brand. Promotion is persuasive communication. It stimulates product demand through appealing ads, incentives and benefits. Promotion influence buyer behavior. Promotion also persuades middlemen to carry such product.

3. Reminding:

Customer normally have very short-lived memory. It is impossible to customers to remember all advertised brand. So, marketer reminds customers about the product by using various promotional tools. The marketer assumes that customer may forget unless they are constantly reminded.

4. Reinforcing:

Promotion is equally important in post purchase stage of the buying process. Consumer may feel anxiety after their purchase decision. Marketer often provides reinforcing message to increase customer's satisfaction level. Repeated reinforcement also leads to brand loyalty. By the

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reassurance to customer, marketer tries to reduce cognitive dissonance and build brand and corporate image.

Answer3(b)

A product is anything, tangible or intangible, that can satisfy the expected need of the target customers. People generally think that a new product should be completely a new and innovative product which is new for the customers. But for a marketer, a product may be the following products –

i. Imitating product – It is a new product copied by an organization from an original firm;

ii. Improved product – It is an existing product of the firm which is modified with a view to increase sale of expand market;

iii. Innovative product – It is completely a new product, which is developed through the research and development activities;

Each year, certain products become failure and are dissuaded from the market. The main reasons for product failure in the market may include –

i. Lack of differentiation with the existing competitive product;
ii. Due to poor positioning strategy of the marketer;
iii. Poor value of the product compared to their prices;
iv. Due to small size of the market or fragmented markets;
v. Due to the increased rate of product imitation in the market by the competitors;
vi. Due to ineffective and poor distribution system;
vii. Due to high level of unhealthy competition In the market;
viii. Due to lack of adaptation ability of the new product to the changed needs of the markets, etc.

8. Briefly explain the following: **(5×2=10)**

a) Market entry pricing strategy
b) Niche marketing
c) Product line
d) Importance of understanding consumer behavior
e) Marketing mix

Answer4 (a)

(a) Market-entry pricing decision is a pricing strategy that a marketer follows while entering to the market for the first time. Under this circumstance, there may be two alternative pricing strategies – market penetration pricing and market skimming pricing.

i. Market penetration pricing strategy: Market penetration pricing involves setting low price for the new product in the initial period with a view to penetrate the mass market immediately and thus obtain a large sales volume and larger market share. After the market for the product is established, price will gradually be increased.

ii. Market-skimming pricing strategy: Market-skimming pricing involves setting high price for a new product in the initial stage assuming that the customers will pay high price for the new product. But with an increase in competition, the initial price will be lowered to meet competition and the changed demand.

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Answer 4(b)

A niche is more narrowly defined group seeking a distinctive mix of benefits. Marketers usually identified niches by dividing a segment into sub-segments. For example, the segment of heavy smokers includes two niches: those who are trying to stop smoking and those who don't care.

In an attractive niche, customers have a distinct set of needs; they will pay a premium to the firm that best satisfies their needs: the niche is not likely to attract other competitors; the nicher gains certain economies through specialization and the niche has size, profit and growth potential.

Answer4 (c)

Product line is a group of closely related products. They perform similar functions, are sold to the same customer groups, are marketed through the same channels and fall within given price ranges. Product line strategy includes product line length, product line modernization and line featuring strategies. For example, if any bakery shop offers verities of bakery product that is called product line strategy.

Answer4 (d)

Buyer behavior refers to the activities and actions expressed by the buyer or potential buyer while selecting, buying and using the product. Understanding buyer behavior is a difficult task for the marketer because it involves, to a great extent, the psychological phenomenon. which is difficult to understand. Though it is difficult to understand, the marketers need to understand the buyer behavior properly to formulate a suitable marketing program. The reasons behind the need of understanding buyer behavior are –

i. Different persons and communities have different needs because they live in different environment.
ii. Their needs go on changing and may demand different goods and services in different situations;
iii. different persons may demand different goods and services at the same time;
iv. Some needs are fulfilled while some are not.
v. Degree of need fulfillment, by and large, depends upon the marketing environment that exists in the market;

Answer 4(e)

The term marketing mix was coined by Professor Neil Borden. Marketing mix is the set of marketing tools that the firm uses to pursue its marketing objectives in the target market. Marketing mix is a blend of product, price, place and promotion tools. Thus, it is popularly known as four Ps' of marketing which was popularized by Professor McCarthy. Nowadays, four P's has expended to seven Ps' by adding people process and physical evidence especially for service marketing.

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