REVISION TEST PAPER

"ADVANCED FINANCIAL REPORTING"

CAP III

(December 2010)

The Institute of Chartered Accountants of Nepal
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QUESTIONS

Consolidated Financial Statements

Question No. 1
From the following Balance Sheets of a group of companies and the other information provided, draw up the Consolidated Balance Sheet as on 31. 3. 2066. Figures give are in Rupees Thousand:

Balance Sheet as on 31.3.2066

Particulars	Shree Ltd.	Raja Ltd.	Ram Ltd.
Equity and Liabilities			
Share Capital (In Shares of Rs. 100 each)	300	200	100
Reserves	50	40	30
Profit and Loss Balance	60	50	40
Bills Payable	10	-	5
Creditors	30	10	10
Raja Ltd.	-	-	15
Ram Ltd.	50	-	-
Total	**500**	**300**	**200**
Assets			
Property Plant and Equipment	130	150	100
Investment in Raja Ltd.	180	-	-
Investment in Ram Ltd.	40	-	-
Investment in Ram Ltd.	-	80	-
Cash and Cash Equivalent	30	20	10
Inventories	50	20	20
Debtors	70	10	20
Bills Receivable	-	10	20
Ram Ltd.	-	10	-
Shree Ltd.	-	-	30
Total	**500**	**300**	**200**

- Shree Ltd. holds 16,000 shares and 3,000 shares respectively in Raja Ltd. and Ram Ltd.; Raja Ltd. holds 6000 shares in Ram Ltd. These investments were made on 1.7.2065 on which date the provision was as per below:

Particulars	Raja Ltd.	Ram Ltd.
Reserves	20	10
Profit and Loss Account	30	16

- In Chaitra 2065 Raja Ltd. invoices goods to Shree Ltd. for Rs. 40 thousand at cost plus 25%. The closing stock of Shree Ltd. includes such goods valued at Rs. 5 thousand.
- Ram Ltd. sold to Raja Ltd. an equipment costing Rs. 24 thousand at a profit 25% on selling price on 1.1.2066. Depreciation at 10% per annum was provided by Raja Ltd. on this equipment.

- Bills payables of Ram Ltd. represent acceptances given to Raja Ltd. out of which Raja Ltd. had discounted bills worth Rs. 3 thousand.
- Debtors of Shree Ltd. include Rs. 5 thousand being the amount due from Raja Ltd.
- Shree Ltd. proposes dividend at 10%.

Goodwill Valuation

Question No. 2
Given below is the balance sheet of XYZ Ltd. as on 31.3.2066.

Balance Sheet as on 31.3.2066

(Rs. in Millions)

Equity and Liabilities	Rs.	Assets	Rs.
Share Capital	750	Property Plant and Equipment	
General Reserve	150	Cost	750
18% Term Loan	400	Less: Accumulated Depreciation	250
Sundry Creditors	217		500
Provision for Tax	4	Investment:	
Proposed Dividend	225	Non-Trade	150
		Trade	45
		Stock	225
		Debtors:	
		Foreign Currency ($1 = Rs. 73.50)	211
		Others	350
		Cash and Bank	265
Total	1,746	Total	1,746

Other Information:
Year end exchange rate was $1 = Rs. 75. Non trade investment earned 32% gross. Current depreciation was Rs. 500,000. Current cost of fixed assets as on 1.4.2064 was determined as Rs. 800 million. Also the current cost of opening stock was assessed as Rs. 190 million (historical cost being Rs. 138 million) and current cost of closing stock was assessed as Rs. 242 million. Market value of non trade investment as on 31.3.2066 was Rs. 180 million. Foreign currency debtors were receivable in dollars.
Industry average rate of return (on current cost value of capital employed) is 20% on long term fund and 24% on equity fund. General reserve balance as on 1.4.2065 was Rs. 40 million. Tax rate for 2065/66 is 30% and expected future tax rate 25%.

Determine the value of goodwill of XYZ Ltd. Show the leverage effect on goodwill.

Business Take-over

Question No. 3

The following is the Balance Sheet of Sita Ltd. as on Asadh 31, 2066:

Equity and Liabilities	Rs.	Assets	Rs.
Share Capital (2,000 shares of Rs.100 each)	200,000	Goodwill	35,000
		Land and Building	85,000
Reserve Fund	20,000	Plant and Machinery	160,000
5% Debentures	100,000	Stock	55,000
Loan from A	40,000	Debtors	65,000
Sundry Creditors	80,000	Cash at Bank	34,000
		Preliminary Expenses	6,000
Total	440,000	Total	440,000

The business of the company is taken over by Ram Ltd. as on that date, on the following terms:

a) Ram Ltd. to take over all assets except cash; to value the assets at their book value less 10 percent except goodwill which was to be valued at 4 years' purchase of the excess of average (five years) profits over 8 percent of the combined amount of share capital and reserves;

b) Ram Ltd. to take over trade creditors which were subject to a discount of 5 percent. Other outside liabilities were discharged by Ram Ltd. at their book values.

c) The purchase consideration was to be discharged in cash to the extent of Rs. 10,000 and the balance in fully paid equity shares of Rs. 10 each valued at Rs. 12.50 per share.

d) Ram Ltd. purchased 10 percent shares of Sita Ltd. for Rs. 18,000 sometime before it took over the business of Sita Ltd.

The average of the five years' profits was Rs. 30,100. The expense of liquidation amounted to Rs. 4,000. Sita Ltd. had sold prior to Asadh 31, 2066, goods costing Rs. 30,000 to Ram Ltd. for Rs. 40,000. Debtors include Rs. 20,000 still due from Ram Ltd. on the date of absorption, Rs. 25,000 worth of the goods were still in stocks of Ram Ltd.

Show the important ledger accounts in the books of Sita Ltd. and journal entries in the books of Ram Ltd.

<u>Amalgamation (Inter company holding)</u>

Question No. 4
The balance sheets of Momento Ltd. and Sacramento Ltd., as at Asadh 31, 2066 are given below:

(Figures in NRs.)

Particulars	Momento Ltd.	Sacramento Ltd.

Equity and Liabilities		
Share Capital – Equity shares of Rs.10 each	6,000,000	2,000,000
Security Premium	300,000	0
General Reserve	300,000	300,000
Profit and Loss A/c	840,000	140,000
13% Debentures	0	1,200,000
Trade Payables	700,000	360,000
Outstanding Expenses	260,000	100,000
	8,400,000	4,100,000
Assets		
Land and Buildings	2,000,000	800,000
Plant and Machinery	1,200,000	400,000
Furniture	800,000	200,000
Investments		
40,000 shares in Sacramento Ltd	600,000	0
1,20,000 shares in Momento Ltd.	0	2,000,000
Inventories	1,800,000	400,000
Trade Receivables	1,300,000	250,000
Cash and Cash Equivalent	700,000	50,000
	8,400,000	4,100,000

Momento Ltd. depends on Sacramento Ltd. for supply of a particular category of raw material it needs in production. Inventories of Momento Ltd. include Rs.400,000 for purchases made from Sacramento Ltd.

It is the practice of Sacramento Ltd. to sell goods to Momento Ltd. at a profit of 25% on cost. Momento Ltd. owes Rs.280,000 for goods purchased in Asadh 2066.

Momento Ltd. is to absorb Sacramento Ltd. on the basis of the intrinsic value of shares of the two companies. Before absorption Momento Ltd. declares a dividend of 10%. Ignore dividend distribution tax. Momento Ltd. also decides to revalue shares in Sacramento Ltd. before it records entries relating to absorption.

Show the Journal entries in the books of Momento Ltd. and prepare its balance sheet immediately after the absorption. Assume that Momento Ltd. has paid in cash for any fractional share.

Value Added Statement

Question No. 5

From the following Profit & Loss account of Magic Ltd., prepare a gross value added statement for the year ended Asadh 31, 2066.
Show also the reconciliation between gross value added and profit before taxation.

Profit & Loss Account
for the year ended Asadh 31, 2066

	Notes	(Rs. '000)	(Rs. '000)
Income:			
Sales			6,240
Other income			55
			6,295
Expenditure:			
Production and operational expenses	1	4,320	
Administration expenses (factory)	2	180	
Interest & other charges	3	624	
Depreciation		16	5,140
Profit before tax			1,155
Provision for tax			55
Profit after tax			1,100
Balance as per last Balance Sheet			60
			1,160
Transferred to fixed assets replacement reserve		400	
Dividend paid		160	560
Surplus carried to Balance Sheet			600

Notes:

1. Production & Operation Expenses:

	(Rs. '000)
Consumption of raw materials	3,210
Consumption of stores	40
Local tax	8
Salaries to staffs	620
Other manufacturing cost	442

47,320

2. Administration expenses include salaries & commission to directors.

3. Interest & other charges include:

a.	Interest on Bank overdraft	Rs. 109
b.	Fixed loan from Nepal Bank	Rs. 51
c.	Working capital loan	20

d. Excise duties amounts to one-tenth of total value added by manufacturing and trading activities.

Human Resource Accounting

Question No. 6
From the following information in respect of Sun Ltd., calculate the total value of human capital by following Lev and Schwartz model.

Age	Unskilled		Semiskilled		Skilled	
	No	Average annual earnings (Rs. '000)	No	Average annual earnings (Rs. '000)	No	Average annual earnings (Rs. '000)
30-39	70	3	40	3.5	30	5
40-49	20	4	15	5	15	6
50-54	10	5	10	6	5	7

Apply 15% discount factor. 10

Consolidated Cash Flow Statement

Question 7
The condensed balance sheets of One Ltd. and Two Ltd. as on Asadh 31, 2065 and the condensed Consolidated Balance Sheet of One Ltd. as on 31.12.2006 are as follows:

	One Ltd. (Rs.) Asadh 31, 2066	One Ltd. (Rs.) Asadh 31, 2065	Two Ltd. (Rs.) Asadh 31, 2065
Land	400,000	75,000	575,000
Building	423,000	345,000	128,000
Machinery	975,000	650,000	550,000
Current Assets	2,217,000	1,061,000	1,125,000
Deposit on purchase of shares of Two Ltd.	Nil	50,000	Nil
Total	4,015,000	2,181,000	2,378,000
Issued share capital: 5,000 equity shares of Rs. 100 each			500,000
6% Preference shares (Rs. 100 each)	250,000		
Equity shares of Rs. 100 each	500,000	500,000	

Profit & loss account	498,000	250,000	120,000
Minority Interest in Two Ltd.	187,000		
Long-term Debt:			
7% Debentures (due on 30.6.2006)		500,000	450,000
8% Debentures (issued on 1.7.2006)	500,000		
Current liabilities – Creditors	1,605,000	746,000	964,000
Provision for Depreciation:			
Building	135,000	75,000	69,000
Machinery	340,000	110,000	275,000
Total	4,015,000	2,181,000	2,378,000

The following additional information for the year 2065/66 is available:

1. One Ltd. owns 4,000 equity shares of Two Ltd. These shares were acquired on Srawan 1, 2066 for Rs. 550,000.
2. Land cost Rs. 250,000 owned by Two Ltd. was sold for Rs. 275,000.
3. Sales of fixed assets of One Ltd. were as follows:
   Building costing Rs. 50,000, accumulated depreciation Rs. 29,000 was sold for Rs. 31,000. Machinery costing Rs. 250,000, accumulated depreciation Rs.125,000 was sold for Rs. 100,000.
4. One Ltd. issued 2,500 preference shares at par and the dividend on these shares was paid for the full year.
5. Goodwill on consolidation has been charged to consolidated P & L account.
6. Two Ltd. paid Rs. 100,000 dividend on its equity shares for the year 2064/65.
7. Two Ltd. is the only subsidiary of One Ltd.

Prepare consolidated Cash Flow Statement for the year 2065/66.

Corporate Social Reporting

Question No. 8
From the following information taken from the books of Radhe Ltd. relating to staff and community benefits, prepare a statement classifying the various items under the appropriate heads.

Particulars	Rs.
Environmental Improvements	2,010

Medical Facilities	4,500
Training Programs	1,025
Generation of Job Opportunities	6,075
Municipal Taxes	1,070
Increase in cost of living in the vicinity due to thermal power station	1,655
Concessional transport, water supply	1,125
Extra work put in by staff and officers for drought relief	1,850
Leave Encashment and leave travel benefits	5,200
Educational facilities for children of staff members	2,160
Subsidized Canteen Facilities	1,440
Generation of Business	2,500

Questions on Nepal Accounting Standards

NAS 13- Construction Contract

Question 9
X ltd won a contract for constructing a bridge at an initial price of Rs. 55 million to be completed in two years. It incurred following expenses and worked out additional revenue as per below:

(Rs. in Thousand)

Particulars	Year 0 (Actual)	Year 1 (Actual)	Year 2 (Budgeted)
Expenses			
Tender Cost	180		
Site Staff Cost		4,000	3,700
Transport Charges		120	110
Depreciation		800	800
Materials		15,100	19,000
Contract Overhead (Allocated to Contract @ 10%)			
Insurance	2,000	2,200	
Design and Technical Assistance	1,000	1,200	
Contract Administration	2,000	2,400	
Additional Revenue			
Claims	350	500	
Variations	700	200	
Incentives		500	

Material Inventory at the end of year 1 was Rs. 100 thousand.

Required:

Contract Profit and Loss for Year 1 assuming that the contract outcome can be reliably measured

NAS 07- Revenue

Question 10

XYZ limited sold a vehicle that has a cash sales price of Rs. 125,000 on arrangement of deferred payment as per below:

Year	Installments
0	30,000.00
1	40,000.00
2	40,000.00
3	40,000.00

Internal Rate of Return of the company is 10%.

Required

Calculate the amount of Revenue to be recognized by the Company from the sales of the vehicle and the finance income to be recognized over the period.

NAS 27 Intangible Assets

Question 11

A patent right is acquired by R Ltd. from K Ltd. in exchange of mineral right. The mineral right is carried at Rs.400 lacs in the book of R. Ltd.? K Ltd. has recorded the value of Patent right in its book at Rs.10 lacs, which is not fair value.

The fair value of Patent right is 520 lacs and that of mineral right is 500 lacs.
What is the value of Intangible Asset that should be recognized by R Ltd. and K Ltd.

NAS 05 Events After the Balance Sheet Date

Question No. 12

Fholex Ltd. has announced on Asadh 31, 2066 that the company was raising Rs. 500 million before expenses by the issue of share for cash. The paid up capital of the company as on Aswin 15, 2066 is Rs. 5 billion. The issue took place on Kartik 15, 2066. Now you are required to state your view on appropriate treatment in the financial statement as at Kartik 15, 2066 and draft the appropriate note to the account if required with reason for requirement or not. 4

NAS 16 Related Party Disclosures

Question No. 13
Explain why the disclosure of related party relationships and transactions is an important issue.

NAS 06 Property Plant and Equipment

Question No. 14
A company is in the process of setting up a production line for manufacturing a new product. Based on trial runs conducted by the company it was noticed that the production lines output was not of the desired quality. However, company has taken a decision to manufacture and sell the sub standard product over the next one year due to the huge investment involved.

In the background of the relevant Nepal Accounting Standard, advise the company on the cut-off date for capitalization of the project cost.

NAS 04 Inventories

Question No. 15
A dealer purchased 1,000 cars on deferred payment basis for @ Rs.25,000 per month per car. The cash price of each car was Rs. 280,000. Amount to be paid in 12 monthly equal installments. At the year end 2008, 20 cars were in the stock. The company found cost of inventory at Rs. 6million.
Was the company correct in its inventory valuation approach?

NAS 15 Leases

Question No. 16
What are the situations that individually or in combination would normally lead to a lease being classified as a finance lease? Also state the indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease.

NAS 21 Business Combination

Question No. 17
Discuss the accounting treatment for the resultant difference between Cost of Business Combination and Acquirer's Interest?

NAS 24 Accounting and Reporting By Retirement Benefit Plans

Question No. 18

XYZ limited has a separate fund for making retirement payments to its retiring staffs. The position of assets and liabilities of the fund on 32.3.2065 is as per below:

	Rs.	Rs.	Actuarial Value
Retirement Liabilities			
Provident Fund	100		
Gratuity Fund	50		50
Pension Fund	80		80
Lump sum	15	245	15
Surplus		5	
Total Liability		**250**	
Fixed Deposit		100	
Equity Investment		50	
Debt Investment		70	
Cash Balance		20	
Property Plant and Equipment		10	
Total Assets		**250**	

During FY 2065/66, Following Events Took Place

Contribution By Employer

Particulars	Rs.
PF	10
Gratuity	10
Pension	8
Lumpsum	2

Retirment Payments

Particulars	Rs.
PF	5
Gratuity	7
Pension	3
Lumpsum	2

Contribution By Employee

Particulars	Rs.
PF	10

Inome

Particulars	Rs.
Interest and Dividends	12
Appreciation in Fair Value of Equity	5

Expenses

Particulars	Rs.
Depreciation	1
Admin Charges	1

Prepare :

1. Statement of Net Assets as at Asadh 31, 2066.
2. Statement of Changes in Net Assets for the year ended Asadh 31, 2066.

NAS 09 Income Taxes

Question No. 19

The following information related to a company for 2065 Asadh end:

Particulars	Carrying Value (Rs.)	Tax Base (Rs.)
Non Current Assets	460,000	320,000
Tax Losses	90,000	

The company has backlog in finalizing its accounts for several years. As such the management is trying to finalize its accounts of FY 2064/65 on 2067 Baisakh.

Further information:

1. Tax rates enacted by the finance bill for the various Income Years are as per below:

2064/65	2065/66	2066/67
20%	25%	30%

2. The loss above is the tax loss incurred in IY 2064/65. The company is very confident about the profitability of the company which shall be revealed once the accounts will be finalized. The company expects to recoup the tax losses equally in the following two Income Years.

3. The temporary difference in respect of Non Current Assets is expected to grow each year until beyond 2066/67.

Required:

Calculate the deferred tax provision that is required at 2065 Asadh end the Tax expenses for that year.

NAS 19 Investment Property

Question No. 20
How is fair value of investment property determined?

NAS 18 Impairment of Assets

Question No. 21
Discuss Impairment of Asset and its application to inventory.

ANSWERS/ HINTS

Answer to Question No. 1

Consolidated Balance Sheet of Shree Ltd.
and its subsidiaries Raja Ltd. and Ram Ltd.
as at 31. 3. 2066

(Rs. in thousand)

Particulars	Amount	
Equity and Liabilities		
Share Capital		300.00
Minority Interest		
Raja Ltd.	63.08	
Ram Ltd	16.22	79.30
Capital Reserve		13.40
Other Reserves		81.60
Profit and Loss Account		56.90
Bills Payables		
Shree Ltd.	10.00	
Raja Ltd.	5.00	
Less: Mutual in-debtness	(2.00)	13.00
Creditors		
Shree Ltd.	30.00	
Raja Ltd.	10.00	
Ram Ltd	10.00	
Less: Mutual in-debtness	(5.00)	45.00
Current Account Balances		
Shree Ltd.	50.00	
Ram Ltd	15.00	
Less: Mutual in-debtness (10+30)	(40.00)	25.00
Proposed Dividend		30.00
	Total	**644.20**
Assets		
Property Plant and Equipment		
Shree Ltd.	130	
Raja Ltd.	150	
Ram Ltd	100	
Less: Unrealised Profit	(7.8)	372.20
Cash and Cash Equivalent		60.00
Inventories		
Shree Ltd.	50.00	
Raja Ltd.	20.00	
Ram Ltd	20.00	
Less: Unrealised Profit	(1.00)	89.00
Debtors		

Shree Ltd.	70.00	
Raja Ltd.	10.00	
Ram Ltd	20.00	
Less: Mutual indebtness	(5.00)	95.00
Bills Receivable		
Raja Ltd.	10.00	
Ram Ltd.	20.00	
Less: Mutual indebtness	(2.00)	28.00
	Total	**644.20**

Working Notes

(Rs. in Thousands)

(1) Analysis of Profits of Ram Ltd.

Particulars	Capital Profit	Revenue Reserve	Revenue Profit
Reserves as on 1.7.2065	10.00		
Profit and Loss A/c on 1.7.2065	16.00		
Increase in Reserves		20.00	
Increase in Profit			24.00
	26.00	20.00	24.00
Less : Minority Interest (10%)	2.60	2.00	2.40
	23.40	18.00	21.60
Share of Shree Ltd.	7.80	6.00	7.20
Share of Raja Ltd.	15.60	12.00	14.40

(2) Analysis of Profits of Raja Ltd.

Particulars	Capital Profit	Revenue Reserve	Revenue Profit
Reserves as on 1.7.2065	20.00		
Profit and Loss A/c on 1.7.2065	30.00		
Increase in Reserves		20.00	
Increase in Profit			20.00
	50.00	20.00	20.00
Share in Ram Ltd.		12.00	14.00
	50.00	32.00	34.00
Less: Minority Interest (20%)	10.00	6.40	6.88
Share of Shree Ltd.	40.00	25.60	27.52

(3) Cost of Control

Particulars	Amount		
Investment in Raja Ltd.			180.00
Investment in Ram Ltd.			120.00
			300.00
Less: Paid up Value of			

Investment			
In Raja Ltd.	160.00		
In Ram Ltd.	90.00	250.00	
Capital Profit			
In Raja Ltd.	40.00		
In Ram Ltd.	23.40	63.40	313.40
		Capital Reserve	13.40

(4) Minority Interest

Particulars	Raja Ltd.	Ram Ltd.
Share Capital	40.00	10.00
Capital Profit	10.00	2.60
Revenue Reserves	6.40	2.00
Revenue Profits	6.88	2.40
	63.28	17.00
Less: Unrealised profit on stock (20% of 1)	(0.20)	
Unrealised profit on equipment (10% of 7.8)		(0.78)
	63.08	16.22

(5) Unrealised profit on equipment sale

Particulars	Amount
Cost	24.00
Profit	8.00
Selling Price	32.00
Unrealised Profit = 8-8*10/100*3/12 = 8.00-0.2 = 7.8	

(6) Profit and Loss Account – Shree Ltd.

Particulars	Amount
Balance	60.00
Less: Proposed Dividend	(30.00)
	30.00
Share in Raja Ltd.	27.52
Share in Ram Ltd.	7.20
	64.72
Less: Unrealised profit on equipment (90% of 7.8)	(7.02)
	57.70
Less: Unrealised profit on stock (5*25/125*80%)	(0.80)
	56.90

(7) Reserves – Shree Ltd.

Particulars	Amount
Balance	50.00
Share in Raja Ltd.	25.60
Share in Ram Ltd.	6.00
	81.60

Answer to Question No. 2

XYZ Ltd.

Valuation of Goodwill

Goodwill = Capitalized Value of FMP – Average Capital Employed
= 1211.92 – 1128.08
= Rs. 83.92 million

Leverage effect on Goodwill refers to the difference on value of Goodwill based on Equity or shareholders' fund approach and long term fund approach.

	Rs. in million
Value of Goodwill based on	
Shareholders' Fund Approach	83.92
Long Term Fund Approach	302.62
Leverage effect on Goodwill	**218.45**

Working Notes:

A) Future Maintainable profit (FMP) / Average profit

		Rs. in million
Net Profit After Tax earned during the year*		335.00
Add: Provision for tax for the year 2003 (335 × 30/70)		143.57
Net Profit Before Tax		**478.57**
Add: Foreign Exchange gain {211/73.5 × (75 – 73.5)}	4.30	
Increase in closing stock	17.00	21.30
Less: Income from Non-trade investment (150×32%)	48.00	
Additional Depreciation (0.8 – 0.5, refer Note C)	0.30	
Increase in opening stock (190 – 138)	52.00	(100.30)
		399.57
Less: Tax @ 25%**		108.71
		209.86

* Calculation of Net Profit After Tax earned during the year

	Rs. in million
Closing Balance of General Reserve	150.00
Add: Proposed Dividend	225.00
Less: Opening Balance of General Reserve	40.00
Net Profit After Tax earned during the year	**335.00**

**Calculation of Tax for FMP

Tax will be paid on real profit only and the profit or loss arise from the conversion of historical cost to current cost will not attract tax liability. Hence tax will be payable on profit that arise after adjustment of foreign exchange gain and income from non trade investment for the purpose of FMP.

Profit for Tax = 478.57 + 4.30 – 48
= 434.87

Tax =434.87 × 25% = 108.71

B) Capitalized Value of FMP
Average rate of return of industry = 24%

Capitalised Value of FMP $= 290.86 \times \frac{100}{24}$
= Rs. 1211.92 million

C) Current Cost of Property Plant and Equipment

The capital employed has to be calculated with reference to the current cost, which is the cost that would be incurred in the similar type of assets are purchased. Accordingly, the property plant and equipment would have to be included in the capital employed at its current cost as on 31-12-2003. However, current cost as given is as on 1-1-2003. Hence, the current cost as on 31-12-2003 would be current cost as on 1-1-2003 as reduced by the depreciation.

Current cost of fixed assets = 800 – 0.8***
= Rs. 799.20 million

***Calculation of Depreciation

	Rs. in million
Closing book value of fixed assets as on 31-12-2003	500.00
Add: Current year depreciation	0.50
Opening book value of fixed assets as on 1-1-2003	500.50

Depreciation = 0.5/500.50 × 100% = 0.10% on opening book value

Depreciation on current cost = 800 × 0.10%
= Rs. 0.8 million

D) Average Capital Employed
= Closing Capital Employed – 50% of (Profit Retained – Profit Distributed)
= 1,070.50 – 50% of {(335 – 225) – 225}

= 1,070.50 + 57.5
= Rs. 1,128 million

Calculation of Closing Capital Employed

Particulars	Rs in million	
	Rs.	Rs.
Assets		
Property Plant and Equipment (Refer Note C)	799.20	
Trade investment	45.00	
Stock	242.00	
Debtors - Foreign (211 + 4.30)	215.30	
Other	350.00	
Cash & Bank	265.00	1,916.50
Less: Liabilities		
Term Loan	400.00	
Sundry Creditors	217.00	
Provision for tax	4.00	
Proposed dividend	225.00	
		(846.00)
Closing Capital Employed		1,070.50

E) Long Term Fund Approach for Valuation of Goodwill
Average Capital Employed:

	Rs. in million
Average Capital Employed (refer Note D)	1128.00
Term Loan	400.00
Average Capital Employed	1512.00

Further Maintainable Profit:
Since the capital employed includes term loan, the FMP should be before interest.

Hence,
FMP = 290.86 + (400 × 18%) = Rs. 362.86 million

Capitalized Value of FMP $= 362.86 \times \frac{100}{20}$
= Rs. 1814.30 million

Goodwill = Capitalised value of FMP – Average Capital Employed
= 1814.30 – 1512
= Rs. 302.30 million

Answer to Question No. 3

In the books of Sita Ltd.

Realisation Account

Dr. Cr.

Particulars	Amount	Particulars	Amount
To Goodwill	35,000	By 5% debentures	100,000
To Land and Building	85,000	By Loan from A	40,000
To Plant and Machinery	160,000	By Sundry Creditors	80,000
To Stocks	55,000	By Ram Ltd.	162,500
To Debtors	65,000	By Shareholders A/C (Loss)	21,500
To Cash and Bank	4,000		
Total	404,000	Total	404,000

Dr. Cash and Bank Account Cr.

Particulars	Amount	Particulars	Amount
To Balance b/d	34,000	By Realisation account(Expenses)	4,000
To Strong Ltd	6,000		
		By shareholders account	36000
Total	40,000	Total	40,000

Dr. Shareholders Account Cr.

Particulars	Amount	Particulars	Amount
To Preliminary expenses	6,000	By Share Capital account	200,000
To Realisation account	21,500	By Reserve fund	20,000
(loss)	36,000		
To Cash and Bank	137,250		
To Shares in Ram Ltd	19,250		
To Ram Ltd. Account			
Total	**220,000**	**Total**	**220,000**

Dr. Ram Ltd. Account Cr.

Particulars	Amount	Particulars	Amount
To Realisation Account	162,500	By Cash and Bank	6,000
		By Share in Ram Ltd.	137,250
		By Shareholders account	19,250
	162,500		**162,500**

In the books of Ram Ltd.

1.	Goodwill Account -	Dr.	50,000
	Land and Building Account	Dr.	76,500
	Plant and Machinery Account	Dr.	144,000
	Stocks Account	Dr.	49,500
	Debtors Account	Dr.	65,000

	Reserve for Discount on creditors a/c	Dr.	4,000	
	To Provision for Doubtful debt account			6,500
	To Liability for loan from A			40,000
	To Liability for 5% Debentures			100,000
	To Trade Creditors			80,000
	To Liquidator for Sita Ltd.			162500
	(For Assets and liabilities taken over)			
2.	Liquidator of Sita Ltd. Account	Dr.	162,500	
	To Cash and Bank Account			6,000
	To Share Capital Account			109,800
	To Share Premium Account			27,450
	To Investment Account			18,000
	To Capital Reserve Account			1,250
	(Being discharge of purchase consideration and cancellation of investment)			
3.	Sundry Creditors Account	Dr.	20,000	
	To Debtors Account			20,000
	(Being cancellation of Intra-company owings)			
4.	Capital Reserve Account	Dr.	6,250	
	To Stock Reserve			6,250
	(Being creation of stock reserve for unrealized profit)			

Working Notes:

1. Determination of Purchase Consideration

Agreed Value of Assets taken over:			
Goodwill	(30,100-220,000*8%)*4 years	=	50,000
Land and Building	(85,000*90%)	=	76,500
Plant and Machinery	(160,000*90%)	=	144,000
Stock	(55,000*90%)	=	49,500
Debtors net of 10% provision		=	58,500
			378,500
Less: Agreed Value of liabilities taken over			
Trade Creditors net of reserve for discount @ 5%			76,000
Loan from A (Director)			40,000
Liability for 5% Debenture			100,000
Total Purchase Consideration			162,500

2. Mode of discharge of purchase consideration

Particulars	Payable as a purchasing company	Receivable as a shareholder of vendor company	Net Payable
For net assets taken over other than cash			
Cash	10,000	4,000*	6,000
Shares in Ram Ltd.	152,500	15,250	137,250
Total	162,500	19,250	143,250

*Note: **

Ram Ltd. is entitled to receive Rs. 4,000 in cash as a 10% shareholder of Sita Ltd. (i.e. 10% share in PC receivable in cash 10,000*10% = Rs.1,000 plus 10% in Rs. 30,000 not taken over by purchasing company reversing in Sita Ltd.

Answer to Question No. 4

(i) Calculation of Intrinsic Value of Shares

(Rs.)

Particulars	Momento Ltd.	.Sacramento Ltd.
Assets as per Balance Sheet	8,400,000	4,100,000
Add: 10% Dividend Receivable on 1,20,000 shares of Momento Ltd.		120,000
	8,400,000	4,220,000
Less: Investment	(600,000)	(2,000,000)
Assets excluding Investments (a)	7,800,000	2,220,000
Liabilities		
13% Debentures		1,200,000
Trade Payables	700,000	360,000
Outstanding Expenses	260,000	100,000
Dividend Payable (60,00,000 x 10%)	600,000	
Total Liabilities (b)	1,560,000	1,660,000
Net Assets (a)-(b)	6,240,000	560,000
No. of shares	600,000	200,000
Shares held by		
Grass Ltd. in Momento Ltd. (20%)	120,000	

Momento Ltd. in Sacramento Ltd. (20%)	40,000

Let the Net assets of Momento Ltd. be 'M' and the Net assets of Sacramento Ltd. 'S'. Then-
M = 6,240,000 + 0.2S….(i)
S = 560,000 + 0.2 M…..(ii)

Now putting the value of 'G' in equation (i) we get:
M = 6,240,000 + 0.2(560,000 + 0.2 M)
M = 6,240,000 + 112,000+0.04M
0.96M = 6,352,000

M = 6,352,000/0.96 =Rs.6,616,667

S = 560,000 + 0.2 (6,616,667)
S = Rs.1,883,333

Intrinsic value of shares of:
Momento Ltd. = Rs.6,616,667/600,000 =Rs. 11.0277
Sacramento Ltd. = Rs.1,883,333/200,000 =Rs. 9.4166

Value of 40,000 shares in Sacramento Ltd.
= 40,000 × Rs.9.4166 = Rs. 376,664
= Rs.600,000 - Rs.3,76,664 = Rs. 223,336

(ii) Purchase consideration

Intrinsic value of 160,000 shares (i.e 200,000 – 40,000)	=160,000 × Rs.9.4166	= Rs.1,506,656
No. of shares to be issued by Momento Ltd.	=Rs.1,506,656/Rs.11.0277	=136,624.68
Shares already held as investments	=120,000	
Net shares to issued	=136,624.68 – 120,000	= 16,624.68
Cash to be paid per share to avoid fraction	=.68	

No. of shares to be issued to Sacramento Ltd. for its outside shareholders =16,624

	(Rs.)	
Value of shares to be issued (16,624 × Rs.11.0277)	183,324	
Nominal value	166,240	
Share Premium	17,084	
Cash to be paid to avoid fraction (Balancing Figure)	12	
Net purchase consideration payable to outside shareholders		1,83,336
Amount to be set off for 40,000 shares (40,000 × Rs.9.4166)		3,76,664
Total purchase consideration		5,60,000

Journal of Momento Ltd.

Particulars	Debit (Rs.)	Rs. Credit(Rs.)
Profit and Loss A/c Dr.	600,000	
To Dividend Payable A/c		600,000
(Being declaration of 10% equity dividend)		
General Reserve A/c Dr.	223,336	
To Investment inSacramentoLtd. A/c		223,336
(Being adjustment of loss of investment value)		
Land and Building A/c Dr.	800,000	
Momento and Machinery A/c Dr.	400,000	
Furniture A/c Dr.	200,000	
Stocks A/c Dr.	400,000	
Sundry Debtors A/c Dr.	250,000	
Cash and Bank A/c Dr.	50,000	
Dividend Receivable A/c Dr.	120,000	
To 13% Debentures A/c		1,200,000
To Sundry Creditors A/c		360,000
To Outstanding Premium A/c		100,000
To Liquidator of Sacramento Ltd. A/c		560,000
(Being assets and liabilities of Sacramento Ltd. taken over)		
Liquidator of Sacramento Ltd. A/c Dr.	560,000	
To Cash A/c		12
To Share Capital A/c		166,240
To Security Premium A/c		17,084
To Investment in Sacramento Ltd. A/c		376,664
(Being purchase consideration satisfied)		
Sundry Creditors A/c Dr.	280,000	
To Sundry Debtors A/c		280,000
(Being Inter company debt set-off)		
Goodwill A/c Dr.	80,000	
To Stocks A/c		80,000
(Being unrealized profits on stocks eliminated)		
Dividend Payable A/c Dr.	600,000	
To Cash and Bank A/c		480,000
To Dividend Receivable A/c		120,000
(Being payment of dividend and adjustment of inter company dividend)		

Balance Sheet of Momento Ltd. as on Asadh 31, 2066

Equity and Liabilities	Rs.	Assets	Rs.
Share Capital		Property Plant and Equipment	
Issued and Subscribed			
616,624 Equity share of Rs.10 each	6,166,240	Land and Buildings	2,800,000
(of which 16,624 Equity shares have		Plant and Machinery	1,600,000
been issued for consideration other than cash)		Furniture	1,000,000
		Intangible Assets	
		Goodwill	80,000
Reserve and Surplus			
Security Premium	317,084		
General Reserve	76,664	Current Assets	
Profit and Loss A/c	240,000	Inventories	
		(Less: Unrealised profit)	2,120,000
Secured Loan		Trade Receivable	1,270,000
13% Debentures	1,200,000	Cash and Cash Equivalent	269,988
Current Liabilities & provisions		(750,000 – 480,000-12)	
Trade Payables	780,000		
Outstanding Expenses	360,000		
	9,139,988		9,139,988

Answer to Question No. 5

Magic Ltd.
Value Added Statement for the year ended Asadh 31, 2066

	Rs. ('000)	Rs. ('000)	%
Sales		6,240	
Other Income		55	
		6,295	
Less:			
Cost of material & services:			
Production & operation expenses (4,320-8-620)		3,692	
Cost of services:			
Administrative expenses	180		
Interest on bank overdraft	109		
Interest on working capital loan	20		
Excise duties (refer to working note)	180.50		
Other charges (444-180)	263.50	753	
Gross Value Added		1,850	

Application of Value Added:
Payment to Employees:

Salaries to office staffs		620	33.51
Payment to Government:			
Local tax	8		
Income tax	55	63	3.41
Payment to Provider of Capital:			
Interest on fixed loan	51		
Dividend	160	211	11.40
To Maintenance & Future Expansion:			
Depreciation	16		
Fixed Assets Replacement Reserve	400		
Profit Retained (600-60)	540	956	51.68
		1,850	100.00

Reconciliation between Gross Value Added and Profit before Tax:

	Rs. ('000)	Rs. ('000)
Profit before tax		1,155
Add: Depreciation	16	
Salaries to office staffs	620	
Interest on fixed loan	51	
Loan tax	8	695
Gross Value Added		1,850

Working Notes:
Calculation of Excise Duty

	Rs. ('000)	Rs. ('000)
Interest and other charges		624
Less: Interest on bank overdraft	109	
Interest on loan from Nepal Bank	51	
Working Capital loan	20	180
Excise duty and other charges		444

Assuming that the other charges are part of expense to be taken for arriving at Gross Value Added, the excise duty will be computed as follows:

Let excise duty be x; then other charges = 444 - x

Thus x = 1/10 X [6,240 - {3,692 + 180 + 109 + 20 + x + (444 - x}]
= 180.50

Other charges = 444 - 180.50 = 263.50

Answer to Question No. 6

(A) Unskilled employees

Age group 30 - 39

Assume that all 70 employees are just 30 years old

	Present Value Rs.
Rs 3,000 p.a. for next 10 years	15,057
Rs. 4,000 p.a. for years 11 to 20	4,960
Rs. 5,000 p.a. for years 21 to 25	1,025
Total earning of a single employee	21,042
Number of employee	70
Total earning	1,472,940

Age group 40 – 49

Assume that all 20 employees are just 40 years old

	Rs.
Rs 4,000 p.a. for next 10 years	20,076
Rs. 5,000 p.a. for years 11 to 15	4,140
Total earning of a single employee	24,216
Number of employee	20
Total earning	484,320

Age group 50 - 54

Assume that all 10 employees are just 50 years old

	Rs
Rs. 5,000 p.a. for next 5 years	16,760
Number of employees	10
Total earning	167,600

(**B**) Semi - skilled employees

Age group 30 - 39

Assume that all 40 employees are just 30 years old

	Present Value Rs.
Rs 3,500 p.a. for next 10 years	17,567
Rs. 5,000 p.a. for years 11 to 20	6,200
Rs. 6,000 p.a. for years 21 to 25	1,230
Total earning of a single employee	24,997
Number of employee	40

Total earning	999,880

Age group 40 - 49
Assume that all 15 employees are just 40 years old

	Rs.
Rs 5,000 p.a. for next 10 years	25,095
Rs. 6,000 p.a. for years 11 to 15	4,968
Total earning of a single employee	30,063
Number of employee	15
Total earning	450,945

Age group 50 - 54
Assume that all 10 employees are just 50 years old

	Rs
Rs. 6,000 p.a. for next 5 years	20,112
Number of employees	10
Total earning	201,120

(**C**) Skilled employees
Age group 30 - 39
Assume that all 30 employees are just 30 years old

	Present Value Rs.
Rs. 5,000 p.a. for next 10 years	25,095
Rs. 6,000 p.a. for years 11 to 20	7,440
Rs. 7,000 p.a. for years 21 to 25	1,435
Total earning of a single employee	33,970
Number of employee	30
Total earning	1,019,100

Age group 40 - 49
Assume that all 15 employees are just 40 years old

	Rs.
Rs. 6,000 p.a. for next 10 years	30,114
Rs. 7,000 p.a. for years 11 to 15	5,796
Total earning of a single employee	35,910
Number of employee	15
Total earning	538,650

Age group 50 - 54

Assume that all 5 employees are just 50 years old

	Rs
Rs. 7,000 p.a. for next 5 years	23,464
Number of employees	5
Total earning	117,320

Total Value of Human Capital

Age	Unskilled		Semi - skilled		Skilled		Total	
	No.	Average annual earnings	No.	Average annual earnings	No.	Average annual earnings	No.	Average annual earnings
30 - 39	70	1,472,940	40	999,880	30	1,019,100	140	3,491,920
40 - 49	20	484,320	15	450,945	15	538,650	50	1,473,915
50 - 54	10	167,600	10	201,120	5	117,320	25	486,040
	100	2,124,860	65	1,651,945	50	1,675,070	215	5,451,875

Answer to Question No. 7

1. Consolidated Balance Sheet of One Ltd.
As on Srawan 1, 2066

Assets	Rs.	Rs.
Goodwill (W.N. 2)		54,000
Land		650,000
Building		473,000
Machinery		1,200,000
Current Assets	2,186,000	
Less: purchase of share	500,000	1,686,000
Total		**4,063,000**
Equity and Liabilities		Rs.
Issued equity share capital		500,000
Profit and loss A/C		250,000
7% debenture		950,000
Creditors		1,710,000
Provision for depreciation		
Building		144,000
Machinery		385,000
Minority Interest (W.N. 3)		124,000
Total		**4,063,000**

2. Cost of Control

Particulars	Rs.
Cost of shares	550,000
Less:	
Paid up capital	400,000.00
Pre acquisition dividend (80% of Rs. 100,000)	80,000
Capital Profit (120,000-100,000)×80%	16,000.00
Goodwill	**54,000**

3. Minority Interest

Particulars	Rs.
Share Capital	100,000
Pre acquisition profit (120,000 × 20%)	24,000
	124,000

4. Building A/C

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Balance b/d	473,000	By Build disposal A/C	50,000
	-	By Balance c/d	423,000
	473,000		**473,000**

5. Accumulated Depreciation (Building)

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Building disposal A/C	29,000	By Balance b/d	144,000
To balance c/d	135,000	By P/L A/C	20,000
	164,000		**164,000**

6. Building Disposal A/C

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Building A/C	50,000	By Accum. Dep. A/C	29,000
To Profit on sale	10,000	By Bank A/C	31,000
	60,000		**60,000**

7. Machinery A/C

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,200,000	By Mech. Disposal A/C	250,000
To Bank A/C	25,000	By Balance c/d	975,000
	1,225,000		**1,225,000**

8. Accumulated Depreciation A/C

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Mach. Disposal A/c	125,000	By Balance b/d	385,000
To Bal c/d	340,000	By P/L A/C	80,000
	465,000		**465,000**

9. Machinery Disposal A/C

Dr Cr

Particulars	Rs.	Particulars	Rs.
To Machinery A/C	250,000	By Accumulated. Depreciation	125,000
		By Bank A/C	100,000
		By Loss on sale	25,000
	250,000		**250,000**

Consolidated Cash Flow statement of One Ltd. for the year 2065/66

Cash flow from Operating Activities

Particualrs	Rs.	Rs.
Increase in Profit and Loss A/C		248,000
Add:		
Goodwill written off	54,000	
Depreciation on Building & Machinery	100,000	
Loss on sale of machinery	25,000	
Changes in Minority interest	63,000	
Interest on Debenture	53,250	
Dividend paid on Pref. & Equity shares	115,000	410,250
Less:		
Profit on sale of Land	25,000	
Profit on sale of Building	10,000	
Increase in current assets	531,000	
Decrease in creditors	105,000	671,000
Cash Flow from Operating Activities		**(12,750.00)**

Cash flow From Investing Activities

Particulars	Rs.
Sale of Land	275,000
Sale of Building	31,000
Sale of Machinery	100,000
Purchase of Machinery	(25,000.00)
Cash Flow from Investing Activities	**381,000**

Cash flow from financing Activities

Particulars		Rs.
Issue of preference shares		250,000
Redemption of debenture		(950,000.00)
Issue of debenture		500,000
interest on debenture paid		(33,250.00)
		(20,000.00)
Dividend paid	Preference Capital	(15,000.00)
	Equity Capital	(100,000.00)
	Cash Flow from Financing Activities	**(368,250.00)**

Consolidated Cash Flow Statement

Particulars	Rs.
Cash flow From Operating Activities	(12,750.00)
Cash flow From Inverting Activities	381,000
Cash flow From financing Activities	(368,250.00)
Net Cash flow From All Activities	NIL
Add:	
Opening Cash and Cash Equivalent	-
Closing Cash and Cash Equivalent	NIL

Answer to Question No. 8

In the books of M/s Radhe Ltd.
Statement relating to Staff and Community Benefits

1. Social Benefits and Cost to Staff

	Particulars	Rs.
A.	Social Benefits to Staff	
	Medical Facilities	4,500
	Training Programs	1,025
	Concessional transport, water supply	1,125
	Leave encashment and leave travel benefits	5,200
	Educational facilities for children of staff members	2,160
	Subsidized Canteen Facilities	1,440
	Total Social Benefits	15,450
B.	Social Costs to Staff	
	Extra work put in by staff and officers for drought relief	1,850
C.	**Net Social Benefits to Staff (A-B)**	**13,600**

2. Social Benefits and Cost to Company

	Particulars		Rs.
A.	Social Benefits to Community		
	Environmental Improvements		2,010
	Generation of Job Opportunities		6,075
	Municipal Taxes		1,070
	Generation of Business		2,500
		Total Social Benefits	11,655
B.	Social Costs to Community		
	Increase in cost of living in the vicinity due to thermal power station		1,655
C.	**Net Social Benefits to Staff (A-B)**		**10,000**

3. Net Social Benefit to Staff and Community (1+2) 23,600

Answer Question No. 9

Estimated Revenue

Particulars	Rs.
Initially Agreed Price	55,000
Variations	900
Claims	850
Incentives	500
Total	**57,250**

Estimated cost

Particulars	Year 1	Year 2	Total
Direct Cost			
Tender Cost	180		180
Site Staff Cost	4,000	3,700	7,700
Transport Charges	120	110	230
Depreciation	800	800	1,600
Materials	15,000	19,100	34,100
Overheads			
Insurance	200	220	420
Design and Technical Assistance	100	120	220
Contract Administration	200	240	440
Total	20,600	24,290	44,890
Stage of Completion (By ratio of cost	45.89	54.11	

incurred) %			100.00

Hence, Profit for Year 1

Particulars	Rs.
Revenue (45.89% of 57,250)	26,272.00
Less: Expenses	20,600.00
Profit for Year 1	**5,672.00**

Answer to Question No. 10

Sales: Rs. 129,474 to be recognized immediately upon incurrence of the transaction.

Finance Income to be recognized over the period as per below:

Year	Finance Income
0	-
1	3,636.36
2	6,942.15
3	9,947.41
	20,525.92

Working Note

Year	Installments	Discounting Rate at 10%	Present Value	Finance Income
0	30,000.00	1.00	30,000	-
1	40,000.00	0.91	36,364	3,636.36
2	40,000.00	0.83	33,058	6,942.15
3	40,000.00	0.75	30,053	9,947.41
	150,000.00		129,474	20,525.92

Answer to Question No. 11

In the books of R Ltd.:

Patent Right	Dr.	Rs. 520	
To Mineral Right			Rs. 400
To Gain on Exchange			Rs. 120

In the books of K Ltd.:

Mineral Right	Dr.	Rs. 500	
To Patent Right			Rs. 10
To Gain on Exchange			Rs. 490

Working Note:
The intangible assets should be measured at its fair value. If its fair value can not be reliably measured, the entity shall measure the fair value of assets given up

Answer to Question No. 12

This is a non-adjusting post balance sheet item. Although the decision was made within the financial year ended Asadh 31, 2066 it was not put into effect until the following year i.e. receipt or entitlement to the receipt of cash was not a condition that existed at the date of balance sheet.

Disclosure is required because it is an event of such materiality that its non-disclosure would affect the ability of the users of the financial statements to reach a proper understanding of the financial position as the 10% of paid up share capital has been increased.

The appropriate note would read as:

"On Asadh 31, 2066 it was announced that the company was raising fund by Rs. 500 million (before expense) by an issue of shares in cash, which amounts to 10% of existing paid up capital. The issue was completed on Kartik 15, 2066 and proceed will be used towards the intended purpose."

Answer to Question No. 13
Related party relationships are part of normal business process. Entities operate the separate parts of their business through subsidiaries and associates and acquire interest in other enterprises for investment or commercial reasons. Thus, control or significant influence can be exercised over the investee by the investing company. These relationships can have a significant effect on the financial position and operating results of the company and lead to transactions, which would not normally be undertaken. For example, a company may sell a large proportion of its production to its parent/subsidiary company because it cannot and could not find a market elsewhere. Additionally the transactions may be affected at prices, which would not be acceptable to unrelated parties.

In the absence of contrary information, it is assumed that the financial statements of an entity reflects transactions carried out on an arm's length basis and that the entity has independent discretionary power over its actions and pursues its activities independently. If these assumptions are not justified because of related party transactions, then disclosure of the fact should be made. Even if transactions are at arm's length, the disclosure of related party transactions is useful because it is likely that future transactions may be affected by such relationships. The main issues in determining such disclosures are the identification of related parties, the types of transactions and arrangements and the information to be disclosed.

Note: Students may support by real corporate scandals with link to related party transactions.

Answer to Question No. 14

As per NAS 06, the purpose of trial production is to ascertain whether the Plants and Machinery and other relevant facilities, as installed, give the intended output in terms of quality and quantity. If during the trial run, the production standards are not met, normally, the production is stopped and necessary alternations/modification in the P&M are made. It may be necessary to carry out trial runs further until the output of desired quality and quantity is obtained.

In the given case, the company did not do so, but continued the sub-standard production, in view of the fact that it had invested huge sums in the project. Due to commercial reasons, this decision was taken. Accordingly, capitalization should cease in the given case at the end of the trial run, since the cut-off date would be the date when the trial run was completed.

Answer to Question No. 15

As per NAS 04 Inventories "An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expenses over the period of the financing."

Deferred Payment Price (Rs. 25,000*12)	=	Rs. 300,000
Less: Cash Price	=	Rs. 280,000
Interest Expenses		Rs. 20,000

The company valued the stock at cost Rs. 300,000 per car. However, it should have excluded the interest element. So the cost of inventory should be Rs. 5.6 million.

Answer to Question No. 16

As per Para 11 of NAS 15 Leases, the situations that individually or in combination would normally lead to a lease being classified as a finance lease are as per below:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

As per Para 12, the indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and

(c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

Answer to Question No. 17

Where the Cost of Business Combination is in excess of Acquirer's Interest in the net fair value of the identifiable assets, liabilities and contingent liabilities, the difference should be treated as Goodwill upon initial recognition. After initial recognition, the acquirer shall not amortize such goodwill. Instead it should be tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

On the other hand, where Acquirer's Interest the net fair value of the identifiable assets, liabilities and contingent liabilities is in excess of Cost of Business Combination, the acquirer shall reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination. After reassessment if any surplus still remains then immediately recognize such amount in Profit or Loss.

Answer to Question No. 18

Statement of Net Assets as at Asadh 31, 2066

Assets	Rs.
Fixed Deposit	100
Equity Investment	55
Debt Investment	70
Cash Balance	54
Property Plant and Equipment	9
Total	**288**
Liabilities : *(Other than Actuarial Promised Value)*	
Provident Fund	115
Surplus	20
Total	**135**
Net Asset	153
Actuarial Value	145
Surplus	**8**

Statement of Changes in Net Assets for the year ended Asadh 31, 2066

Particulars		2066/67 (Rs.)	2065/66 (Rs.)
Contributions			
Gratuity		10	
Pension		8	
Lumpsum		2	
Total Contributions		20	
Benefit payments			
Gratuity		7	

Pension		3	
Lumpsum		2	
Total Deductions		12	
Net Increase		**8**	
Net Assets Available for Benefits			
At the Beginning		145	
At the End of the Year		153	

Answer to Question No. 19

Statement of Calculation of Deferred Tax Provision:

Particulars	Rs.
Taxable Temporary Difference	
Non Current Assets (460,000- 320,000)	140,000
(A)Deferred Tax Liability (140,000*30%)	42,000
Unused Tax Losses	
Reversal in FY 2065/66 = (90,000/2* 25%)	11,250
Reversal in FY 2066/67 = (90,000/2* 30%)	13,500
(B)Deferred Tax Asset	24,750
Deferred Tax Expenses (A-B)	17,250

Total Tax Expenses = Current Tax + Deferred Tax Expenses
= Rs. 0 + 17,250
= Rs. 17,250

(Note: The tax rate that should be used is the rate that is expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted at the time of reporting.)

Answer to Question No. 20

The fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. Fair value is not an estimated price inflated or deflated for special terms and conditions. It is measured at gross basis without deduction of transaction cost which an entity may incur for sale or other disposal of the investment property. Fair value should reflect market conditions on the balance sheet date.

The terms knowledgeable, willing parties means well informed buyer and seller who have knowledge about the nature and characteristics of the investment property, its actual and potential uses and market condition as on the balance sheet date. The "willing seller" is not eager seller who is prepared to sell at any price. He is rather motivated to sell at market terms for the best probable price.

The term arm's length transaction means the transaction is not influenced by special relationship that makes price uncharacteristic of the market conditions.

Answer to Question No. 21

The objective of NAS 18 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale or the assets. If this is the case the asset is described as impaired and this statement requires the enterprise to recognize an impairment loss. This standard should be applied in accounting for the impairment of assets, other than

(a) inventories (NAS 04 Inventories);
(b) assets arising from construction contracts (see NAS 13 Construction Contracts);
(c) deferred tax assets (NAS 09 Income Taxes);
(d) assets arising from employee benefits (NAS 14 Employee Benefits);
(e) financial assets;
(f) investment property that is measured at fair value;
(g) biological assets related to agricultural activity that are measured at fair value less estimated point-of-sale costs;
(h) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts; and
(i) non-current assets (or disposal groups) classified as held for sale.

Reference to above exclusion NAS 18 Impairment Asset does not apply to inventories because NAS 04 Inventories already contain specific requirements for recognizing and measuring the impairment related to inventories.