Corporate Sector

Model Solutions

Winter Exam-2016

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Business Economics

(Level-2)

Solutions – Business Economics
Winter 2016

Q.1

Economic Resources: Economic resources are the goods or services available to individuals and businesses used to produce valuable consumer products. The four economic resources are land, labor, capital and entrepreneurship. These economic resources are also called the factors of production.

Land: Land is the economic resource encompassing natural resources found within an economy. This resource includes timber, land, fisheries, farms and other similar natural resources.

Labor: Labor represents the human capital available to transform raw or national resources into consumer goods. Human capital includes all able-bodied individuals capable of working in the economy and providing various services to other individuals or businesses.

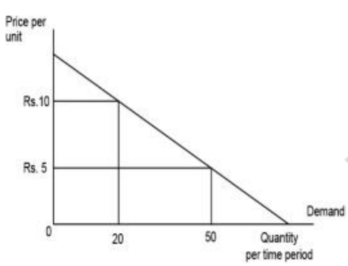
Capital: Capital has two economic definitions as a factor of production. Capital can represent the monetary resources companies use to purchase natural resources, land and other capital goods. Capital also represents the major physical assets individuals and companies use when producing goods or services. These assets include buildings, production facilities, equipment, vehicles and other similar items.

Entrepreneur: Entrepreneurs usually have an idea for creating a valuable good or service and assume the risk involved with transforming economic resources into consumer products.

Total Marks 10

Q.2 a)

Demand curve shows the inverse relationship between price of a good and its quantity demanded.



b)

When the price of particular changes, its quantity demanded will change. That is a movement along the same demand curve. When factors other than price changes, demand curve will shift. These are the determinants of the demand curve.

Solutions – Business Economics
Winter 2016

1. **Income:**
   A rise in a person's income will lead to an increase in demand (shift demand curve to the right), a fall will lead to a decrease in demand for normal goods. Goods whose demand varies inversely with income are called inferior goods.

2. **Consumer Preferences:**
   Favorable change leads to an increase in demand, unfavorable change lead to a decrease.

3. **Number of Buyers:**
   The more buyers lead to an increase in demand; fewer buyers lead to decrease.

4. Price of related goods:

a) Substitute goods (those that can be used to replace each other): price of substitute and demand for the other good are directly related. For example, if the price of coffee rises, the demand for tea should increase.

b) Complement goods (those that can be used together): price of complement and demand for the other good are inversely related. For example, if the price of ice cream rises, the demand for ice-cream toppings will decrease.

5. Expectation of future:

a. Future price: consumers' current demand will increase if they expect higher future prices; their demand will decrease if they expect lower future prices.

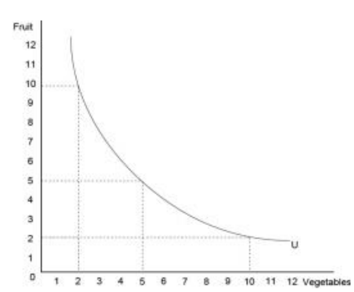
b. Future income: consumers' current demand will increase if they expect higher future income; their demand will decrease if they expect lower future income.

Total Marks 10

Q.3

a)

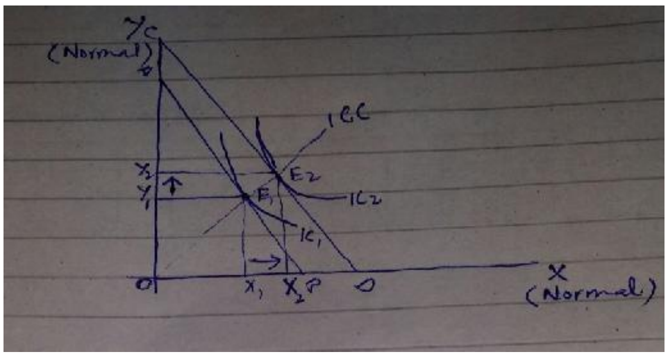
An indifference curve is one that shows the different combinations of two goods which give an equal level of utility or satisfaction to the consumer.



b)

i. If income increases and X and Y are Normal goods.

Normal good: Regarding income, *a good is said to be a normal good if a consumer purchases its more quantity by increasing the income and purchases its less quantity by decreasing the income (Income effect of normal good is positive).*



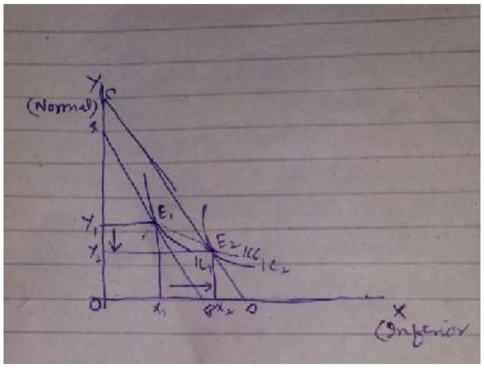
The initial equilibrium is at E1, where the AB budget line is tangent to IC1.At E1, a consumer is purchasing OX1 of X good and OY1 of Y good. When income of a consumer increases, he is able to purchase more of X & Y good, in result of which BL shifts from AB to CD. Since both goods are normal, he purchases more quantity of both goods at higher level of income. In result of increase in income, a new equilibrium establishes at E2 where CD budget line is tangent to IC2 (a higher level of satisfaction); At E2, he purchases OX2 of X good and OY2 of Y good. The movement from E1 to E2 is called income effect.

By joining the different points of equilibrium in result of change in income, we get another curve which is called *Income Consumption Curve*.

Income Consumption Curve: A curve that shows the purchasing pattern of consumer in response of change in income is called Income Consumption Curve.

ii. If income increases and X is an inferior good.

Inferior good: Regarding income, *a good is said to be a inferior good if a consumer purchases its less quantity by increasing the income and purchases its more quantity by decreasing the income (Income effect of inferior good is negative).*



The initial equilibrium is at E1, where the AB budget line is tangent to IC1.At E1, a consumer is purchasing OX1 of X good and OY1 of Y good. When income of a consumer increases, he is able to purchase more of X & Y good, in result of which BL shifts from AB to CD. Since X is an inferior good, he purchases its less quantity at higher level of income whereas he purchases more of a normal good 'Y'. In result of increase in income, a new equilibrium establishes at E2 where CD budget line is tangent to IC2 (a higher level of satisfaction); At E2, he purchases OX2 of X good (a smaller quantity) and OY2 of Y good (a larger quantity). The movement from E1 to E2 is called income effect. By joining the different points of equilibrium in result of change in income, we get Income *Consumption Curve (ICC)*.

Total Marks 10

Q.4 a)

Devaluation of currency: If government or relevant monetary authority deliberately decreases the value of its currency with respect to other currencies, it is called devaluation of currency.

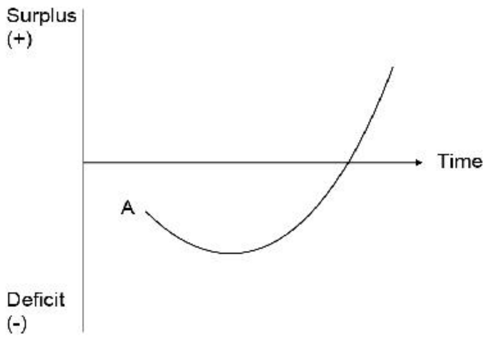
b)

The decision of ABC country will affect the exports, imports and balance of payments in the following way.

Exports cheaper: A devaluation of the exchange rate will make exports more competitive and appear cheaper to foreigners. This will increase demand for exports. Also, after devaluation, assets become more attractive; for example devaluation in the Pound can make UK property appear cheaper to foreigners.

Imports more expensive: A devaluation means imports, such as petrol, food and raw materials will become more expensive. This will reduce demand for imports.

Improvement in balance of payment: The effect on BOP would be an improvement in the current account. With exports more competitive and imports more expensive, there will be higher exports and lower imports, which will reduce the current account deficit.



This curve shows the effect of devaluation of currency; starting from Point A, the deficit increases before swinging up and going into a surplus as time goes on.

Total Marks 10

Q.5 a)

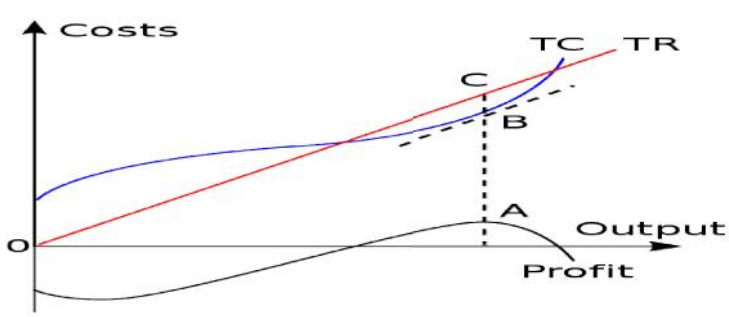
A firm's profit maximizing output is that where the slope of profit function is zero.

$d\pi/dQ=0$ Profit=TR-TC

$d\pi/dQ$= dTR-dTC=0 , MR-MC=0

It means at profit maximizing point MC=MR

The profit-maximizing output is the one at which this difference reaches its maximum In the accompanying diagram, the linear total revenue curve represents the case in which the firm is a perfect competitor in the goods market, and thus cannot set its own selling price. The profit-maximizing output level is represented as the one at which total revenue is the height of C and total cost is the height of B; the maximal profit is measured as CB. This output level is also the one at which the total profit curve is at its maximum.



Winter 2016

b)

Quantity of Output	Price ($)	Total Revenue ($)	Marginal Revenue ($)	Total Costs ($)	Marginal Cost ($)	Profit or Loss ($)
1	14	14	-	16	-	-2
2	12	24	10	20	4	4
3	**10**	**30**	**6**	**26**	**6**	**4**
4	8.5	34	4	33	7	1
5	7	35	1	41	8	-6
6	5.5	33	-2	50	9	-17

- The profit maximizing point of a firm is that where MC=MR, Firm will produce three units to maximize the profit.
- At profit maximizing profit, the firm will charge Rs. 10; at this price total profit is Rs. 4.

Total Marks 10

Q.6a)

Gross Domestic Product (GDP): It is the monetary value of all final goods and services produced during a year within the geographical boundaries of a country.

- In GDP income/production of foreign firms working in the country is included.
- In GDP income/production of external resources of the country is not included.

Or

It is the aggregate of expenditures incurred during a year in the economy.

GDP= C+I+G+(X-M)

- **Gross National Product (GNP):** It is the monetary value of all final goods and services produced during a year by internal and external resources of the country.
  - In GNP income/production of foreign firms working in the country is not included.
  - In GNP income/production of external resources of the country is included.

GNP= GDP+ Net foreign income

b)

- GDP=C+I+G+(X-M)
  = 219.1+52.1+59.4+ (17.8-16.5)=331.9 billion dollars
- GNP=GDP+Net Foreign Income
  = 331.9+2.2= 334.1 billion dollars
- NNP= GNP-Depreciation of Capital
  = 334.1-11.8=322.3 billion dollars

Total Marks 10

Q.7 a)

Demand Pull Inflation: Demand-pull Inflation is asserted to arise when aggregate demand in an economy outpaces aggregate supply. It involves inflation rising as real gross domestic product rises and unemployment falls, as the economy moves along the Phillips curve. This is commonly described as "too much money chasing too few goods".

Cost Push Inflation: Cost push inflation is inflation caused by an increase in prices of inputs like labor, raw material, etc. The increased price of the factors of production leads to a decreased supply of these goods.

b) Income redistribution: Higher inflation can have a regressive effect on lower income families, and elderly people in society. Especially if the price of food and utilities increases drastically.

1. **Fall in real incomes:** If wages are cut (to help tackle inflation) then this means that real incomes have reduced.
2. **Negative real interest rates:** If the savings interest rate is lower than inflation, than those who rely on savings as their income will become poorer.
3. **Cost of borrowing:** In response to high inflation, governments may increase the interest rates. This will increase the cost of businesses getting a loan, which may stifle investment.
4. **Business competitiveness:** if prices in one country are higher than another, then when selling comparable goods, the country with lower inflation will have a lower price and therefore have much better international competitiveness.
5. **Business uncertainty:** with high and volatile inflation, businesses are less likely to commit to big projects, as they are uncertain as to the economic future.

Total Marks 10

Q.8

Economic growth: Economic growth is a long-term expansion of a country's production potential.

Advantages of Economic Growth

1. **Higher living standards**: an increase in the real income of the individuals in an economy.
2. **Employment effects**: with economic growth, the capacity in an economy increases and therefore there is more opportunity for employment within society.
3. **Fiscal benefits**: with higher GDP growth, firms and individuals will increase the amount of taxes that they pay. This gives government better opportunity to meet their objectives.
4. **Economic Development**: Economic growth is a necessary condition of economic development. Negative economic growth does not bring the economic development in the economy.

Disadvantages of Economic Growth

Despite seeming obvious that long-term growth in an economy is beneficial, we should also consider some of the downsides that come with this growth.

1. **Environmental concerns:** fast growth may be at the expense of the natural environment. This has been attributed to the swathes of deforestation in many rural areas of the world, as the wood has been used to fuel economic growth.
2. **Inequality:** there is also an argument that economic growth merely exacerbates inequality that is present in an economy. Whilst it might reduce absolute poverty, the level of relative poverty in countries may increase dramatically with a drive for economic growth.
3. **Inflation risk:** if demand outstrips supply due to rising incomes then, there is the risk that demand-pull inflation will set in, causing the general price level to increase to an unsustainable level.
4. **Working hours:** with an increased economic output, there are concerns that workers may be exploited, working longer hours than they should. This might upset work-life balance, leading to social problems.

Total Marks 10

Q.9 a)

Financial Intermediary: An institution, such as a bank, building society, or unit-trust company, that holds funds from lenders in order to make loans to borrowers.

b)

New Deposit= Rs.1000 Reserve Requirement= 20%

Operation of banking system up to five rounds:

Banks/Time Rounds	New Deposits	New Loans	Cash Reserves
Bank A	Rs. 1000	Rs.800	Rs.200
Bank B	Rs.800	Rs. 640	Rs. 160
Bank C	Rs. 640	Rs. 512	Rs. 128
Bank D	Rs.512	Rs. 409.6	Rs. 102.4
Bank E	Rs. 409.6	Rs. 327.68	Rs. 81.92

Total credit creation=initial deposit/ Reserve Requirement

= Rs.1000/20%= Rs. 5000

Total Marks 10

Q.10

(i) **Multiplier effect:** The multiplier effect refers to the increase in final income arising from any new injection of spending. The size of the multiplier depends upon household's marginal decisions to spend, called the marginal propensity to consume.

(ii) **Economic Growth:** Economic growth is an increase in the capacity of an economy to produce goods and services, compared from one period of time to another. It can be measured in nominal or real terms, the latter of which is adjusted for inflation.

(iii) **Foreign exchange rate:** In finance, an exchange rate (also known as a foreign-exchange rate, forex rate, or FX rate) between two currencies is the rate at which one currency will be exchanged for another. It is also regarded as the value of one country's currency in terms of another currency

(iv) **Commodity backed money:** Commodity-backed money is also known as "representative money". Many currencies have consisted of bank-issued notes which have no inherent physical value, but which may be exchanged for a precious metal, such as gold.

(v) **Structural unemployment:** Structural unemployment is a longer-lasting form of unemployment caused by fundamental shifts in an economy and exacerbated by extraneous factors such as technology, competition and government policy. Reasons why structural unemployment occurs include workers' lack of requisite job skills or that workers live too far from regions where jobs are available and cannot move closer. Jobs are available, but there is a serious mismatch between what companies need and what workers can offer.

Total Marks 10

Business Laws

(Level-2)

Solutions – Business Law
Winter 2016

Q.1 a) INTRODUCTION

It is generally said that by way of delegated legislation, chances of arbitrary decisions increase. Before commenting on this, one needs to know the concept of delegated legislation. In delegated legislation, power is given to an Executive (a minister or public body to make subordinate or delegated legislation for specified purposes only). For instance, local authorities are given statutory powers to make bye-laws which apply within a specific locality.

IS DELEGATED LEGISLATION ARBITRARY?

Though, the local authorities are empowered to legislate yet some measures have been taken to ensure the checks and balances on theses authorities.

1. Parliament has some control over delegated legislation by restriction and defining the power to make rules.
2. Rules made under delegated power to move legislation may be challenged in the courts on the grounds that it is ultra vires. In other words that it exceeds the prescribed limits or has been made without due compliance.
3. If the objection is valid, the court declares it void.

So, one can safely say while analyzing the wisdom behind delegated legislation that it cannot be arbitrary and irrational as a system of checks and balances is in place.
Business Law-Study Text, p.13

b) X may file a writ of Mandamus against the police official before the court of law. Mandamus requires the public official/body to carry out a public duty; e.g. a tribunal may be ordered to hear an appeal which it has wrongly refused to do. Similarly, the police official may be given orders to register the case.

Total Marks 10

Q.2 ADVICE TO JANNAT BIBI

Jannat Bibi can avoid the contract on the ground of 'Undue Influence'.
Section 16 read with section 10 of The Contract Act 1872 says that any contract which is under undue influence or pressure is not sustainable in the eye of law.

WHAT NEEDS TO BE PROVED BEFORE A CONTRACT CAN BE SAID TO BE INDUCED BY UNDUE INFLUENCE?

1. That the relation subsisting between the parties is such that one of the parties is in a position to dominate the will of the other party.
2. That he uses that position.
3. That an unfair advantage over the other has been obtained by the use of that position.

EXPLANATION

If a person has some influence over the other and by means of that influence reduces the will of the other to his subjection whatever may be the nature of the influence spiritual, moral, social or any other then it such coercion as is sufficient to constitute undue influence. The question whether a party was in a position to dominate the will of the other is largely a question of fact.

Total Marks 10

Q.3 a) As per Section 4 of the Contract Act 1872, the communication of an acceptance is complete as against the proposer when it is in a course of transmission to him so as to be out of the power of the acceptor.

b) When the Promisee accepts performance by a third person, he cannot afterwards enforce it against the Promisor. (Section 41 of the Contract Act, 1872)

c) Section 31 of the Contract Act 1872 deals with this type of contracts. It is a valid contingent contract. It will be enforceable if house is burnt.

d) A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a Bailee. (Section 71 of the Contract Act, 1872)

Total Marks 09

Q.4 AUDITOR - POSITION OF

An auditor is a servant of the shareholders whose duty is to examine the affairs of the company on their behalf at the end of the year and report to them what he has found. The auditor holds the position of trust and he is duty bound honor that trust by being candid with the shareholders and telling them frankly and fully everything with regard to the affairs of the company which has come to his knowledge and which is material for the shareholders to know.

BUYING SHARES OF XYZ COMPANY

Kamran cannot buy shares of XYZ Company as Proviso to Section 254(3) states that If a person holds shares prior to his appointment as auditor, whether as an individual or a partner in a firm, the fact shall be disclosed on his appointment as auditor and such person shall disinvest such shares within 90 days of such appointment.

POSITION OF KAMRAN

As per Section 254(5) of the Companies Ordinance, Kamran shall be deemed to have vacated his office as auditor with effect from the date on which he becomes disqualified.

DUTY OF KAMRAN BEING AUDITOR OF XYZ LTD - SECTION 255 (3)

It was the duty of Kamran that he shall make a report to the members of the company on the account and books of account of the company and on every balance sheet and profit and loss account or income and expenditure account and on every other document forming part of the balance sheet and profit and loss account or income and expenditure account, including notes, statement or schedules appended thereto, which are laid before the company in general meeting during his tenure of office. He violated the duty by disclosing the report to a person who is not a member of a company.

PENALTY

The auditor's report must be in conformity with the requirements of the Ordinance. In case of non-compliance with the legal requirements, a fine may be imposed which may extend to one hundred thousand rupees, Where such a report is made with intent to derive profits, either by the auditor himself or by any other person, in addition to fine, the auditor shall be punished with imprisonment for a term which may extend to one year.

Total Marks 10

Q.5 a) The directors of a company by resolution passed by not less than three-fourths of the total number of directors for the time being, or the company by a special resolution, may remove a chief executive before the expiration of his term of office notwithstanding anything contained in the articles or in any agreement between the company and such chief executive. (Section 202)

b) The copies of the financial report and the audit repot should be sent to every member of the company at least 21 days before meeting".

c) As per Section 66 of the Ordinance, Any person making any statement which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting shares or debentures; or any agreement the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or debentures shall be punishable with imprisonment of either description for a term which may extend to three years or with fine which may extend to twenty thousand rupees, or with both.

Total Marks 10

Q.6 As per Section 214 of the Ordinance, every director of a company who is in any way, whether directly or indirectly, concerned or interested in any contract or arrangement entered into, or to be entered into, by or on behalf of the company shall disclose the nature of his concern or interest at a meeting of the directors. A director shall also be deemed to be interested or concerned if any of his relatives is so interested or concerned.

The disclosure required to be made by a director:

a. in the case of a contract or arrangement to be entered into, at the meeting of the directors at which the question of entering into the contract or arrangement is first taken into consideration or, if the director was not, on the date of that meeting, concerned or interested in the contract or arrangement, at the first meeting of the directors held after he becomes so concerned or interested; and
b. in the case of any other contract or arrangement, at the first meeting of the directors held after the director becomes concerned or interested in the contract or arrangement.

For the purposes, a general notice given to the directors to the effect that a director is a director or a member of a specified body corporate or a member of a specified firm and is to be regarded as concerned or interested in any contract or arrangement which may, after the date of the notice, be entered into with that body corporate or firm, shall be deemed to be a sufficient disclosure of concern or interest in relation to any contract or arrangement so made.

Any such general notice shall expire at the end of the financial year in which it is given, but may be renewed for further period of one financial year at a time, by a fresh notice given in the last month of the financial year in which it would otherwise expire.

No such general notice, and no renewal thereof, shall be of effect unless either it is given at a meeting of the directors, or the director concerned takes reasonable steps to ensure that it is brought up and read at the first meeting of the directors after it is given.

A director, who fails to comply with these provisions, shall be liable to a fine which may extend to five thousand rupees.

Total Marks 10

Solutions – Business Law
Winter 2016

Q.7 RELEVANT PROVISION

Section 37 of the Companies Ordinance, 1984

NAMES WHICH ARE PROHIBITED:

INAPPROPRIATE OR DECEPTIVE NAMES

No company shall be registered by a name which in the opinion of the commission is inappropriate or deceptive.

OFFEND THE RELIGIOUS SUSCEPTIBILITIES OF THE PEOPLE

No company shall be registered by a name which in the opinion of the Commission is designed to offend the religious susceptibilities of the people.

IDENTICAL NAMES

A company shall not be registered by a name identical with that by which a company in existence is already registered.

IN RESEMBLANCE TO OTHER COMPANY'S NAME

A company shall not be registered by a name identical with that by which name in existence is already registered, or so nearly resembling that name as to calculate to deceive.

PATRONAGE OF ANY PAST OR PRESENT PAKISTANI OR FOREIGN HEAD OF STATE

Except with the prior approval in writing of the Commission, no company shall be registered by a name which contains any words suggesting or calculated to suggest the patronage of any past or present Pakistani or foreign head of State.

NAME IS IN CONNECTION WITH THE FEDERAL GOVERNMENT ETC

Except with the prior approval in writing of the Commission, no company shall be registered by a name which contains any words suggesting or calculated to suggest any connection with the federal government or provincial government or any department or commission of any such government.

NAMES IN CONNECTION WITH ANY CORPORATION SET UP BY OR UNDER ANY FEDERAL OR PROVINCIAL LAW

Except with the prior approval in writing of the Commission, no company shall be registered by a name which contains any words suggesting or calculated to suggest any connection with any corporation set up by or under any federal or provincial law.

NAMES IN CONNECTION WITH ANY FOREIGN GOVERNMENT OR ANY INTERNATIONAL ORGANIZATION

Except with the prior approval in writing of the commission, no company shall be registered by a name which contains any words suggesting or calculated to suggest the patronage of, or any connection with any government or any international organization.

QUESTION REGARDING THE VIOLATION OF SECTION 37
Whenever a question arises as to whether or not the name of the company is in violation of sec 37, the decision of the Commission shall be final.

Total Marks 10

Q.8 a) The relation of partnership arises from the contract and not from the status. (Section 4)

b) An act of a firm means any act or omission by all the partners, or by any partner or agent of the firm which gives rise to a right enforceable by or against the firm. [Section 2 (a)]

c) Subject to the provisions of this act, a partner is the agent of the firm for the purposes of the business of the firm. (Section 18). So, the agreement would be binding on the firm.

d) The mutual rights and duties of the partners of a firm may be determined by the contract between the partners as per Section 11 and subject to the provisions of the Partnership Act. Someone implied nights & duties & authorities.

Total Marks 10

Q.9 a) As per Section 15 of the Contract Act 1872, in a contract for the sale of goods by description, there is an implied condition that goods shall correspond with the description; and if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

b) Section 30 of the Sale of Goods Act deals with this situation. Where a person, having sold goods, continues or is in possession of the goods or of the documents of title to the goods, the delivery or transfer by that person or by mercantile agent acting for him, of the goods or documents of title under any sale, pledge or other disposition thereof to any person receiving the same in good faith and without notice of the previous sale shall have the same effect as if the person making the delivery or transfer were expressly authorized by the owner of the goods to make the same.
Where a person, having bought or agreed to buy goods, obtains, with the consent of the seller, possession of the goods or the documents of title to the goods, the delivery or transfer by that person or by a mercantile agent acting for him, of the goods or documents of title under any sale, pledge or other disposition thereof to any person receiving the same in good faith and without notice of any lien or other right of the original seller in respect of the goods shall have effects as if such lien or right did not exist.

Total Marks 10

Cost Accounting

(Level-2)

Solutions – Cost Accounting
Winter 2016

Ans. 1 (i) **Economic order quantity (EOQ)** **08**

$$EOQ = \frac{\sqrt{2 \text{ x Annual Requirement x Cost Per Order}}}{\text{Carrying Cost}} = \frac{\sqrt{2 \text{ x } 360.000 \text{ x } 100}}{2} = 6{,}000 \text{ units}$$

Ans. 1 (ii) **Optimum Number of Orders**: **03**

$$\frac{\text{Annual Requirement}}{\text{EOQ}} = \frac{360{,}000}{6{,}000} = 60 \text{ Number of Order}$$

Ans. 1 (iii) **04**

$$\text{Carrying Cost} = \frac{6{,}000}{2} \text{ x } 2 = \text{Rs.}6{,}000$$

$$\text{Ordering Cost} = \frac{360{,}000}{6{,}000} = 60 \text{ x } 10 = \text{Rs.}6{,}000$$

Total = 6,000 + 6,000 = Rs.12,000

Total Marks 15

Ans. 2a **Employees Earnings:**

	Saturday	Sunday	Monday	Rs.
Hours x hourly rate	600.00	600.00	600.00	
Units above standard	-0-	10.00	15.00	
Hours saved	-0-	0.50	0.75	
Value of time saved	-0-	37.50	56.25	
80% of value of time saved	-0-	30.00	45.00	
(A) Earnings	600.00	630.00	645.00	1,875.00

03

Earnings = 110 % x Rs.75 hourly rate x 40 hours = **Rs.3,300** **03**
(Efficiency rate = 880 + 800 x 100 = 110%)

Earnings = (Rs.75 hourly rate x 5% rate increase) x 24 hours **03**
= Rs.78.75 x 24 hours =**Rs.1,890**

Ans. 2b **Per unit Labor Cost:**
1,875 ÷ 505 =**Rs.3.71 per unit** **02**
(No. of units 160 + 170 + 175 = 505)

Earning Rs.3,300 ÷ No. of units 880 =**Rs.3.75 per unit** **02**
Earning Rs.1,890 ÷ No. of units 503 =**Rs.3.76 per unit** **02**

Total Marks 15

Solutions – Cost Accounting
Winter 2016

Ans. 3

		Production Departments				Service Departments			
Actual Expenses	**Total**	**Grinding**	**Forming**	**Machining**	**Finishing**	**Building**	**Health**	**Repair**	
Dist. of service dept. exp	300,000	60,000	84,000	24,000	48,000	36,000	30,000	18,000	02
Building service		9,000	4,500	7,500	3,000	(36,000)	6,000	6,000	02
Health Recreation		10,800	7,200	10,800	3,600		(36,000)	3,600	02
Repair Maintenance		12,000	6,000	7,200	2,400			(27,600)	02
Actual Exp. Inc. Service Dept. O/H		91,800	101,700	49,500	57,000	---	---	---	02

Distribution Rates:

Building Service = $\frac{\text{Rs.36,000}}{\text{12,000 sq.ft}}$ = Rs.3.00 per Sq.ft 02

Health & Recreation = $\frac{\text{36,000}}{\text{100 Employees}}$ = Rs.360 per Employee 02

Repair / Maintenance = Rs.0.10 Per rupees investment 01

Total Marks 15

Ans. 4a **Statement of Actual & Standard Cost:** 03

	Actual (Rs.)		Standard (Rs.)
Material (10,510 x 6.96)	73,150	(10,300 x 6.80)	70,040
Labor (15,276 x 7.52)	114,876	(14,832 x 7.36)	109,164
Fixed O/H	9,600		9,600
Variable O/H	26,700	(4,120 x 412x6)	24,720
Total Cost	224,326		213,524
Total Variance			(U.F)10,802
	224,326		224,326

Breakup of Total Variance:

	Rs.
Material Price Variance	1,682
Material Quantity Variance	1,428
Labor Rate Variance	2,445
Labor hour variance	3,267
FOH variance	1,980
Total	**(U.F) 10,802**

(2)

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Ans. 4b

Material price variance:					
Actual Qty x Actual Rate	=10,510 x 6.96	=	73,150	1,682 (U.F)	(2)
Actual Qty x St. Rate	=10,510 x 6.80	=	71,468		
Material Quantity variance:					
Actual Qty x St. Rate	=10,510 x 6.80	=	71,468	1,428 (U.F)	(2)
Standard Qty x St. Rate	=10,300 x 6.80	=	70,040		
Labor Rate variance:					
Actual Hours x Actual Rate	=15,276 x 7.52	=	114,876	2,445 (U.F)	(2)
Actual Hours x St. Rate	=15,276 x 7.36	=	112,431		
Labor Hour/Efficiency variance:					
Actual Hours x St. Rate	=15,276 x 7.36	=	112,431		
Standard Hours x St. Rate	=14,832 x 7.36	=	109,164	3,267 (U.F)	(2)
Factory Overhead variance:					
Actual Fixed O/H	9,600				
Actual variable O/H	26,700	=	36,300		
Standard fixed O/H	9,600				
Standard variable O/H (4,120 x 6)	24,720	=	34,320	1,980 (U.F)	(2)

Total Marks 15

Ans. 5

Assembly Department
Cost of Production Report
For the Month of October, 2014

Quantity Schedule:

Units received from preceding department		60,000	(1)
Units transferred to next department	50,000		(1)
Units still in process (all materials – 2/3 labor and factory overhead)	9,000		(1)
Units lost in process (abnormal – ½ materials, labor, and factory overhead)	1,000	60,000	(1)

Cost charged to the Department:

	Total Cost (Rs.)	Unit Cost (Rs.)	
Cost from preceding department			
Transferred in during the month (60,000 units x Rs.3.54)	212,400	3.54	(1)
Cost added by department			
Materials	41,650		(1)
Labor	101,700		(1)
Factory overhead	56,500		(1)
Total cost added by the department	199,850		(1)
Total cost to be accounted for	412,250	7.04	(1)

Cost accounted for as Follows:

Transferred to next department (50,000 x Rs.7.04)		Rs.352,000	(1)
Transferred to factory overhead			
From preceding department (1,000 x Rs.3.54)	Rs.3,540		
Materials (1,000 x ½ x Rs.0.70)	350		
Labor (1,000 x ½ x Rs.1.80)	900		
FOH (1,000 x ½ Re.1)	500	5,290	(1)
Work in process – ending inventory:			
From preceding department (9,000 x Rs.3.54)	31,860		
Materials (9,000 x Rs.0.70)	6,300		
Labor (9,000 x 2/3 x Rs.1.80)	10,800		
Factory overhead (9,000 x 2/3 x Re.1.00)	6,000	54,960	(1)
Total cost accounted for		Rs.412,250	(2)

Working Notes:

Equivalent Production:

Materials $= 50{,}000 + 9{,}000 + \frac{1{,}000}{2}$ lost unit $= 59{,}500$ units **(1)**

Labor and factory overhead $= 50{,}000 + (9{,}000 \text{ x } 2/3) + \frac{1{,}000}{2}$ lost units $= 56{,}500$ units **(1)**

Units Costs:

Material $= \frac{\text{Rs.}41{,}650}{59{,}500} = $ Re.0.70 per unit **(1)**

Labor $= \frac{\text{Rs.}101{,}700}{56{,}500} = $ Rs.1.80 per unit **(1)**

Factory overhead $= \frac{\text{Rs.}56{,}500}{56{,}500} = $ Re.1.00 per unit **(1)**

Total Marks 20

Ans. 6

MUNEEB TRUCKS LIMITED
JOB COST SHEET

Date Started October 3, 2006
Date Finished November 2, 2006

Date	Department	Material Rs.	Labor Rs. W-1	F.O.H Rs. W-2	Total Rs.
---	Assembly Dept.	150,000	81,000	108,000	339,000
---	Painting Dept.	75,000	18,000	30,000	123,000

---	Finishing Dept.	45,000	7,200	9,000	61,200	
	Total	**270,000**	**106,200**	**147,000**	**523,200**	(3)

a) Total cost = Rs.523,200

b) Cost per Unit $= \dfrac{523,200}{150}$ = Rs. 3,488 **(2)**

c) Total Gross Profit = 523,200 x 20% = Rs.104,640 **(3)**

Workings:

W-1: Labor Cost **(3)**

	Hour	Rate	Amount
Assembly	4500	18	81,000
Painting	1200	15	18,000
Finishing	600	12	7,200

W-2: FOH Cost **(3)**

	Hour	Rate	Amount
Assembly	4500	24	108,000
Painting	1200	25	30,000
Finishing	600	15	9,000

	FOH Cost / Labor Hour	Payroll / Labor Hour Rate	Labor Hours	
Assembly	$\dfrac{1,296,000}{54,000} = 24$	$\dfrac{972,000}{18}$	= 54,000 Hours	**(2)**
Painting	$\dfrac{375,000}{15,000} = 25$	$\dfrac{225,000}{15}$	= 15,000 Hours	**(2)**
Finishing	$\dfrac{105,000}{7,000} = 15$	$\dfrac{84,000}{12}$	= 7,000 Hours	**(2)**

Total Marks 20

Financial Accounting

(Level-3)

SOLUTION PAPER - FINANCIAL ACCOUNTING
WINTER - 2016

Ans -1 -

CANDY LAND (PRIVATE) LIMITED
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED JUNE 30, 2015

Sales	W-01	8,800,000	0.5
Less Cost of Goods Sold	W-02	6,053,000	0.5
Gross Profit		2,747,000	
Less : Administrative Expenses	W-03	2,647,500	0.5
Less : Financial Charges	W-04	(48,000)	0.5
		5,346,500	
Other Income (40,000)		40,000	0.5
Net Profit for the period		5,386,500	0.5

CANDY LAND (PRIVATE) LIMITED
BALANCE SHEET
AS ON JUNE 30, 2015

EQUITY AND LIABILITIES				
EQUITY				
Paid-up Capital		5,500,000		1
Net Profit		5,386,500		1
Total Equity			10,886,500	
Current Liabilities				
Sundry Creditors		1,160,000		0.5
Accrued Expenses (124,500+8,000)		132,500		1
Short Term Bank Loan		400,000		0.5
Total Current Liabilities			1,692,500	
TOTAL EQUITY AND LIABILITIES			**12,579,000**	1
ASSETS				
Non-current assets	W-05		3,855,000	1
Current Assets				
Closing Stocks		425,000		0.5
Debtors (2,400,000-120,000)		2,280,000		1
Short Term Investments		400,000		0.5
Prepaid Expenses		60,000		1
Cash at Bank		210,000		0.5
Cash in Hand		54,000		0.5
Total Current Assets			3,429,000	
Total Assets			**7,284,000**	1

Workings

Working - 01 (SALES)

Gross Sales	9,600,000	0.5
Less Sales Return	(800,000)	0.5
	8,800,000	
TOTAL SALES	**17,600,000**	

Working - 02 (COST OF GOODS SOLD)

Opening Stock		400,000	0.5
Add Purchases	6,640,000		0.5
Add Carriage Inward	278,000		0.5
Less Purchase Return	(840,000)		
Net Purchases		6,078,000	
Less Closing Stocks		425,000	0.5
Cost of Goods Sold		**6,053,000**	0.5

Working - 03 (ADMINISTRATIVE EXPENSES)

	Disc Allowed	40,500	
	Disc Allowed	28,000	
Salaries (1,375,500+124,500)		1,500,000	0.5
Rent and Taxes		120,000	0.5
Travelling Expenses		22,000	0.5
Insurance Premium		24,000	0.5
Audit Fees		54,000	0.5
Bad Debts		20,000	0.5
Advertisement Expenses (240000-60000)		180,000	0.5
Depreciation (W-05)		595,000	0.5
Provision for Doubtful Debts (2,400,000*5%)		120,000	0.5
Total Administrative Expenses		**2,647,500**	

(*Both Discounts should be treated as settled Discounts)

Working - 04 (FINANCIAL CHARGES)

Total Financial Charges @ 12% on 400,000	48,000	0.5
As Per Trial Balance	40,000	0.5
Accrued Financial Charges	8,000	

Working - 05 (NON-CURRENT ASSETS)

	Furniture	Building	Plant	Total	
Opening Balance as on July 01, 2014	450,000	2,500,000	1,500,000	4,450,000	
Depreciation Rate	10%	10%	20%		
Depreciation for the Year	45,000	250,000	300,000	595,000	1
Written Down Value as on June - 30 -2015	**405,000**	**2,250,000**	**1,200,000**	**3,855,000**	

Total Marks 25

SOLUTION PAPER - FINANCIAL ACCOUNTING
WINTER - 2016

Ans -2 -

GALAXY BROTHERS
STATEMENT OF CASH FLOW
FOR THE YEAR ENDED DECEMBER 31, 2013

CASH FLOWS FROM OPERATING ACTIVITIES				
Profit before Taxes	W - 01		13,200,000	1
Adjustments for :				
Depreciation (9,000,000 + 6,250,000)		15,250,000		0.5
Finance Charges		2,500,000		0.5
Provision for Doubtful Debts		900,000		0.5
Loss on Settlement of total Loss Claim		350,000	19,000,000	0.5
Operating Profit before Working Capital Changes			32,200,000	0.5
Closing Balance Accounts Receivable		(18,000,000)		0.5
Closing Balance Inventories		(10,000,000)		0.5
Closing Balance Accounts Payable		14,000,000	(14,000,000)	0.5
Cash Generated from Operations			18,200,000	
Finance Charges Paid (2,500,000 - 1,200,000)		(1,300,000)		1
Income Taxes Paid (6,000,000 - 1,000,000)		(5,000,000)	(6,300,000)	1
Net Cash from Operating Activities			11,900,000	
Cash Flow from Investing Activities				
Purchase of Fixed Assets		(103,650,000)		1
(128,250,000 - 25,000,000 - 1,400,000) + 1,800,000				
Proceeds from the Settlement of total loss claim (1.8 - .25 - .35)		1,200,000	(102,450,000)	1
Cash used in Investing Activities			(90,550,000)	
Cash Flow from Financing Activities				
Contribution by partners		50,000,000		0.5
Drawing Partners (73,950,000 -25,000,000 - 1,400,000-50,000,000)		2,450,000		0.5
Proceeds from Long Term Loan		25,000,000	72,550,000	0.5
Net Cash from Financing Activities			(18,000,000)	0.5
Cash and Cash equivalent at beginning of the Period			-	
Closing Balance of Cash and Cash Equivalents (23,000,000 - 5,000,000)			**(18,000,000)**	1
W - 01 Profit before Taxation			136,000,000	
Sales			(83,500,000)	
Cost of Sales			(37,300,000)	
Operating and Selling Expenses			500,000	
Miscellaneous Income			(2,500,000)	
Finance Expenses			**13,200,000**	
Profit before Taxation				

Total Marks 12

Ans -3-

FIFO Method

Opening Inventory	300	Units	0.5
Transferred to Finished Products	1,200	Units	0.5
Total available	1,500	Units	0.5
Less Sold during the period	1,100	Units	0.5
	400	Units	

Closing Inventory		
300 Units @ Rs. 12.00 Each	3,600	0.5
200 Units @ Rs. 12.50 Each	2,500	0.5
200 Units @ Rs. 12.50 Each	2,500	0.5
300 Units @ Rs. 14.00 Each	4,200	0.5
100 Units @ Rs. 14.00 Each	1,400	0.5
Cost of Sales FIFO Method	14,200	

AVEARGE COST METHOD				
November 01, 2015 Opening Inventory	300	12.00	3,600	0.5
November 10, 2015 Finished Goods Produced	400	12.50	5,000	0.5
	700	12.29	8,600	
November 14, 2015 Sales	500	12.29	6,143	0.5
	200	12.29	2,457	
November 20, 2015 Finished Goods Produced	400	14.00	5,600	0.5
	600	13.43	8,057	
November 21, 2015 Sales	500	13.43	6,714	0.5
	100	13.43	1,343	
November 25, 2015 Finished Goods Produced	400	15.00	6,000	0.5
	500	14.69	7,343	
November 28, 2015 Sales	100	14.69	1,469	0.5
Closing Stock Cumulative Average	400	14.69	5,876	1

	FIFO	Average	
Opening Stock	3,600	3,600	0.5
Cost of Production	16,600	16,600	0.5
	20,200	20,200	
Less Cost of Sales	14,200	14,329	1
Closing Stock	6,000	5,876	1
Sales	22,000	22,000	1
Gross Profit	7,800	7,671	1

Total Marks 14

Ans -4-a

(a) An entity shall disclose the Accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;

(b) The amount of each significant category of revenue recognized during the period, including revenue arising from:

(i) The Sale of goods;
(ii) The rendering of services;
(iii) Interest;
(iv) Royalties
(v) Dividends; and

(c) The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

Ans -4-b

December 31, 2013			
Accounts Receivable	80,000		1
Sales		80,000	1
(To record Sales at Cash Price as Fair Value Consideration).			
December 31, 2014			
Cash	100,000		1
Accounts Receivable		80,000	1
Interest / Mark-up Income		20,000	2
(To record Cash received from Debtors)			

Total Marks 06

Ans -5-

BALANCE SHEET OF NEW FIRM
AS ON APRIL 01, 2011

Partners Capital - A	1,070,340		0.5
Partners Capital - B	528,740		0.5
Partners Capital - C	1,070,000		0.5
Partners Capital		2,669,080	
Current Liabilities			
Creditors (296,000 + 24,000)		320,000	1

Total Capital and Liabilities		**2,989,080**	1
Assets			
Furniture and Fittings	600,000		0.5
Add Brought by C	120,000		0.5
Add Adjustment (8,000 - (800 x 2))	6,400	726,400	1
Office Equipment		300,000	0.5
Motor Vehicle		375,000	0.5
Current Assets			
Inventory (250,000 + 800,000)	1,050,000		0.5
Sundry Debtors (190,000 - 11,400)	178,600		0.5
Cash and Bank Balances	359,080	1,587,680	1
(118,000 + 150,000 + 91,080)			
Total Assets		**2,989,080**	1

WORKING NOTES

COMPUTATION OF GOODWILL

Profit for the last Three years before adjustments		712,100	1
Add Furniture wrongly written to revenue	8,000		0.5
Less Depreciation on Furniture for Two Years	(1,600)		0.5
Less Purchase Invoice Omitted	(24,000)		0.5
Less Provision for Doubtful Debts	(11,400)	(29,000)	0.5
Adjusted total profits for last three years		683,100	1
			0.5
Goodwill = (Rs. 683,100 x 2) / 3		455,400	1
Share of C in Goodwill = (Rs. 455,400 x 20%)		91,080	1
Cash to be Contributed by A for Goodwill		45,540	0.5
Cash to be Contributed by B for Goodwill		45,540	0.5

Total Marks **22**

SOLUTION PAPER - FINANCIAL ACCOUNTING
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IN THE BOOKS OF THE HEAD OFFICE (AKHTAR LIMITED - KARACHI)
LAHORE BRANCH ACCOUNT

Debit		**Credit**		
Particulars		**Particulars**		
Opening Balance Stock	24,000	Bank Account - Cash Sales	17,500	3
Opening Balance Debtors (Note # 01)	6,060	Bank Account - Rcvd from Debtors	37,900	2
Bank Account (Expenses)	10,400	Closing Balance Stock	18,000	2
Goods Sent to Branch	33,600	Closing Balance Debtors	9,160	2
General Profit and Loss Account	8,500			2
	82,560		82,560	

MEMORANDUM BRANCH ACCOUNT - DEBTORS ACCOUNT

Debit		**Credit**		
Particulars		**Particulars**		
Opening Balance	6,060	Cash Received from Debtors	37,900	2
Credit Sales	41,000	Closing Balance - Debtors	9,160	2
	47,060		47,060	

Total Marks 15

Business Commn. & Report Writing

(Level-3)

Solutions – Business Communication & Report Writing
Winter 2016

Ans. 1 (a) **06**

- **Acquiring information**- collecting, analyzing, checking and processing numerous types of communication both internal and external to an organization. This often involves initiatives to generate ideas and solutions.
- **Disseminating information**- sharing information with those who need it to perform their job, make a decision or solve a problem. This might involve coordinating plans and communicating goals and structures.
- **Maintaining relationships**- relationships between co-workers and both with suppliers and customers need effective and appropriate communication to ensure continuity of operations and ultimate profitability of the organization.

Ans. 1 (b) **03**

1. Generate a message
2. Transmitter encodes the message
3. The encoded message is transmitted
4. Encoded message is received
5. Receiver decodes the message
6. Receiver provides feedback

Total marks 09

Ans. 2

Barriers might include:

- Issues in the relationship between the sender and receiver that can lead to bias.
- Noise - physical interference that damaged the message while it was being communicated.
- Confusing and conflicting messages leading to distortion.
- Selecting the wrong channel, for example trying to explain a complicated concept with words when a diagram and logical written explanation would be more effective.
- Suffering interruptions and distractions during transmission of the message.
- Receiver does not provide feedback.
- Lack of information - for example contextual information that is critical to understanding how to interpret a message.
- Faulty systems - e.g. weak mobile phone signal.
- Stereotyping assumptions that the recipient has a particular level of understanding.
- Use of technical jargon or complicated language.
- Poor listening skills of the receiver - lack of attention, inability to absorb information or selective hearing.
- Non-verbal signs that contradict a verbal message.
- Information overload.
- Differences in education and/or social background leading to cultural differences and varying interpretations of the same message.

- Sender and receiver speak different languages.
- Sender and receiver dislike each other and do not trust each other.
- The recipient of the information may be biased either due to personal or cultural differences.
- Physical distance between sender and recipient making videoconference difficult.
- Filtering of Information - this refers to the sender's deliberate suppression or manipulation of information so that it may be seen in a more favorable perspective by the receiver.
- Selective Perception - this describes the process by which the sub-conscious mind subjectively 'decides' which stimuli relating to an object, person or event are relevant and accepts only such stimuli which do not contradict the interests, experience, background and attitude of the recipient and confirm the individual's viewpoint. All other stimuli are considered irrelevant by the recipient and ignored and reject d by the sub-conscious mind.

(2 marks each for any five points)

Total marks 10

Ans. 3

a) Your admission statement has been received.
b) Your last response was helpful.
c) The list you requested is attached.
d) Such refreshing comments are scarce.
e) Mr. Smith knew we must reduce inventory.

Total marks 05

Ans. 4a **04**

- **Meetings** range between the more formal board meetings and annual general meetings with shareholders to much more informal team meetings, problem solving and brainstorming meetings. Delegates need to be conscious of adopting the appropriate style and tone depending on the type of meeting.

- **Committees** - Many organization constitute committees with specific responsibilities for example:
  - New product committee — responsible for analyzing and assessing suggestions for new products.
  - Remuneration committee — a sub-committee of the board of directors responsible for advising on and setting executive remuneration.
  - Executive committee — the board of directors or trustees responsible for governing and leading organizations.

  Committees benefit from the consolidation of power and authority and the ability to share responsibility for making decisions. Brainstorming should be more effective particularly when the committees bring together different abilities and skills.

- **Team briefings** are common in the modern working environment as an aid to increasing commitment and understanding of the workforce. They are also used to control disruption and limit rumors with respect to policies, plans, progress personnel issues.
- **Conferences** are useful as a way for bringing together a large membership spread over a wide area such as a trade union, professional body or accountancy network.
- **Interviews** are another form of face-to-face business communication commonly employed for uses such as grievance and disciplinary interviews, staff appraisal meetings and recruitment and selection.

Ans. 4b Non-verbal communication describes the conveyance of a message without using words or symbols. It may be completely independent of any verbal message (e.g. the slamming of a door, shaking of a head or simply remaining silent) or linked to words (e.g. a particular tone of voice). **06**

Non-verbal communication can be used to give a message when used effectively. For example:

- Creating a particular impression- smile, firm handshake, punctuality, smart dress.
- Reinforcing spoken message indicating seriousness, interest and engagement e.g. an emphatic gesture, sparkling eyes, disapproving frown.
- Providing feedback- applause, fidgeting, and yawn.
- Establishing desired atmosphere- informal dress, respectful distance, friendly smile.

Total marks 10

Ans. 5 There are generally three natural listening styles that evolve. You need to be aware of your natural style so that you can modify it to balance with the other styles and objectives in order to maximize the effectiveness of your listening.

- **Results-oriented** — Typically low on patience, these listeners are focused on achieving their goals as quickly and efficiently as possible. Speakers who like listeners to demonstrate empathy and logical thought often see results-oriented listeners as arrogant and impatient. Conversely results-oriented listeners would see many speakers as unfocused and become frustrated at speakers taking too long to make their point.
- **Information-oriented** — These listeners like to build a full picture, collect and consolidate all relevant information in order to take the right decision. The risk is that an overly analytical approach can overlook emotional attitudes and appear unsympathetic to some speakers.
- **People-focused** — The priority of this type of listener is not the business outcome or a technical solution, but rather a focus on supporting the speaker and being attentive to their feelings and needs. People-focused listeners have lots of patience and are naturally gifted at providing feedback and reflective questions that make the speaker feel good and confident about themselves. The speaker really feels listened-to although a results-oriented or information-oriented speaker may feel that a people-focused listener is vague and inconclusive with too much of an emphasis on feelings.

Total marks 06

Solutions – Business Communication & Report Writing
Winter 2016

Ans. 6

a) **Sales letter:** Sent from an organization to a potential customer to prompt them into ordering goods or services.

b) **Adjustment letter:** Usually sent in response to a claim or complaint and includes the final outcome.

c) **Letter of recommendations:** Sent by a previous employer or other referee to support some kind of application. Normally refers to a job (reference letter) application but could be submitted as part of other applications such as an application for bank funding.

d) **Cover letter:** Accompanies something such as a package or report. It describes the enclosed and why it being sent.

Total marks 04

Ans. 7

Answers will vary but must contain following characteristics:

- Get the reader's attention by mentioning benefits of the message to the reader.
- Build the reader's interest by emphasizing relevance of the message to the reader.
- Increase the reader's desire by supporting the viewpoints stated in the message with relevant evidence.
- Motivate the reader to take action and state the positive result of the action.
- Present emotional and logical appeals in a balanced manner. Substantiate the appeal by presenting facts and evidence for complex ideas and recommendations.

Total marks 12

Ans. 8

The answer will vary but must contain the following:

- Specific order numbers the goods relate to.
- The date they were originally delivered and details of the damage identified.
- The cover letter would also describe the contents and specify the quantity of each type of good that is included in the consignment.

Total marks 10

Ans. 9

Free Web hosting cost zero to the user. The Web host covers their costs (and profit) through selling advertising that is added automatically to Web pages through pop-ups, frames and scripts.

Standard Web hosting is a broad term covering the most common form of paid Web hosting. A standard fee would secure a specific amount of server space on a Web hosting system that provides high-speed servers and quality software.

Solutions – Business Communication & Report Writing
Winter 2016

Ecommerce is required when a business sells goods on the Web. Ecommerce Web hosting describes when an SSL (secure socket layer) has been added to different types of Web hosting to protect customers when paying for goods.

Reseller Web hosting is when a company wants to become a Web hosting business. A reseller purchases Webhosting facilities of another Web host, and then sells them on to other clients acting as their Web host - i.e. operating as a wholesaler.

Total marks 10

Ans. 10 Answers will vary but must reflect following points.

- Clarity of Purpose and need of the proposal.
- Solution offered in the proposal is workable and is in the best interests of the recipient.
- Proposal is honest, factual and objective.
- Benefits to be derived from the proposal outweigh the costs.
- Proposal contains a time schedule including the milestones and any checklists of the projects.
- Contains a list of the costs and resources involved in completion of the project.

Total marks 12

Ans. 11 Answers will vary but must reflect following structure.

- Introduction
- Problem details
- Reasons
- Impact on organizations
- Conclusion
- Recommendations

Total marks 12

Taxation

(Level-3)

Solutions – Taxation
Winter 2016

Ans-1

1. **Foreign Source Income** – "foreign-source income" means any income that is not Pakistan-source income. "Pakistan –Source income" means any income, which is eared, accrued or arisen in Pakistan, for rendering an income as a 'Pakistan-source income'

2. **Fast Moving Consumer goods –** "fast moving consumer goods" means consumer goods which are supplied in retail marketing as per daily demand of a consumer;

3. **Principal Officer** – "Principal Officer" used with reference to a company or association of persons includes-
   - (a) a director, a manager, secretary, agent, accountant or any similar officer; and;
   - (b) any person connected with the management or administration of the company or association of persons upon whom the Commissioner has served a notice of treating him as the principal officer thereof;

4. **Taxpayer** – "taxpayer" means any person who derives an amount chargeable to tax under this Ordinance, and includes –
   - (a) any representative of a person who derives an amount chargeable to tax under the Ordinance;
   - (b) any person who is required to deduct or collect tax under Part V of Chapter X and Chapter XII;

Total Marks 08

Ans-2

(a) Manufacturer and Producer

Manufacture' or 'producer means a person who engages whether exclusively or not, in the production or manufacture of goods whether or not the raw material of which the goods are produced or manufactured are owned by him; and shall include-

a) A person who by any process or operation assembles, mixes, cuts, dilutes, bottles, packages, repackages or prepares goods by any other manner;
b) An, assignee or trustee in bankruptcy, liquidator, executor, or curator or any manufacturer or producer and any person who disposes of his assets in any fiduciary capacity; and
c) Any person, firm or company which owns, holds, claims or uses any patent, proprietary, or other right to goods being manufactured, whether in his or its name, or on his or its behalf, as the case may be, whether or not such person, firm or company sells, distributes, consigns or otherwise disposes of the goods:

   Provided that for the purpose of refund under this Act, only such person shall be treated as manufacturer-cum-exporter who owns or has his own manufacturing facility to manufacture or produce the goods exported or to be exported;

(b) Supply

"Supply" means a sale or other transfer of the right to dispose of goods as owner, including such sale or transfer under a hire purchase agreement, and also includes-

a) Putting to private, business or non-business use of goods produced or manufactured in the course of taxable activity for purposes other than those of making a taxable supply;
b) Auction or disposal of goods to satisfy a debt owed by a person: and
c) Possession of taxable goods held immediately before a person ceases to be a registered person: Provided that the Federal Government ,May by notification in the official Gazette, specify such other transactions which shall not constitute supply;
d) In case of manufacture of goods belonging to another person, the transfer or delivery of such goods to the owner or to a person nominated by him;

(c) Input tax

"input tax", in relation to a registered, means-

1. Tax levied under this Act on supply of goods to the person;
2. Tax levied under this Act on the import of goods by the person;
3. In relation to goods or services acquired by the person, tax levied under the Federal Excise Act, 2005 in sales tax mode as a duty of excise on the manufacture or production of the goods, or the rendering or providing of the services
4. Provincial sales tax levied on services rendered or provided to the person; and
5. Levied under the sales Tax Act, 1990 as adapted in the state of Azad Jammu and Kashmir, on the supply of goods received by the person;

Total Marks 06

Ans-3

Output tax

Taxable supplies	(1,500,000+3,750,000) * 17%	892,500
Exempt supplies	(1,800,000+750,000)	Nil
		892,500
Less: input tax allowed as credit:		
Goods to be used for taxable supplies	(600,00*17%)=102,000	
Goods for taxable as well as exempt supplies		
Input tax / Value of taxable + exempt supplies	*Value of taxable supplies	
3,00,000*17% / 3,750,000 *750,000	*3,750,000	425,000
		527,000
Net tax liability		365,500

Total Marks 10

Solutions – Taxation
Winter 2016

Ans-4

Records

1. Every person registered for the purposes of this Act shall maintain and keep for a period of 6 [six] years at his business premises or registered office in English or Urdu language the following records of excisable goods purchased, manufactured and cleared (including those cleared without payment of excise duty) by him or by his agent acting on his behalf in such form and manner as would permit ready on his liability of duty, namely:-
   a) Records of clearances and sales made indicating the description, quantity and value of goods, name and address of the person to whom sales were made and the amount of the duty charged;
   b) Records of goods purchased showing the description, quantity and value of goods, name, address and registration number of the supplier and the amount of the duty, if any on purchases;
   c) Records of goods cleared and sold without payment of duty;
   d) Records of invoices, bills , accounts, agreements, contracts, orders and other allied business matters;
   e) Records of production, stocks and inventory;
   f) Records of imports and exports; and
   g) Such other records as may be specified by the Board.
2. For any person or class of persons registered under this Act, or for any goods or class of goods the boards may specify or prescribe,-
   a) To keep any other records for the purposes of this Act;-
   b) To use such electronic fiscal cash registers as may be approved by the Boards

      and
   c) The procedure or software for electronic maintenance of records and filing of statements, documents or information by any person or class of persons.
3. Provisions of sub-sections (1) and (2) shall apply mutatis mutandis on service provided or rendered by a person registered under this Act.

Total Marks 10

Ans-5

Intangibles:

1) A person shall be allowed an amortization deduction in accordance with this section in a tax year for the cost of the person's intangibles-

   a) That are wholly or partly used by the person in the tax year in deriving income from business chargeable to tax; and

b) That has a normal useful life exceeding one year.

2) No deduction shall be allowed under this section where a deduction has been allowed year in which the intangible is acquired.

3) Subject to sub-section (7), that amortization deduction of a person for a tax year shall be computer according to the following formula , namely:-

$$\frac{A}{B}$$

Where-

Is the cost of the intangible; and

Is the normal useful life of the intangible in whole years?

4) An intangible

a) With a normal useful life of more than ten years; or

b) that does not have an ascertainable useful life,

Shall be treated as if it had a normal useful life of ten years,

5) Where an intangible is used in a tax year partly in deriving income from business chargeable to tax and partly for another use, the deduction allowed under this section for that year shall be restricted to the fair proportional part of the amount that would be to tax.

6) where an intangible is not used for the whole of the tax year in deriving income from business chargeable to tax, the deduction allowed under this section shall be computed according to the following formula, namely:-

A x B/C

where-

a) Is the amount of amortization computer under sub-section (3) or (5), as the case may be;
b) is the number of days in the tax year the intangible is used in deriving income from business chargeable to tax; and
c) Is the number of days in the tax year?

7) The total deductions allowed to a person under this section in the current tax year and all previous tax years in respect of an intangible shall not exceed the cost of the intangible.

8) Where, in any tax year a person disposes of an intangible, no amortization deduction shall be allowed under this section for that year and –

a) if the consideration received by the person exceeds the written down value of the intangible at the time of disposal, the excess shall be income of the person chargeable to tax in that year under the head "income from Business"; or

b) if the consideration received is less than the written down value of the intangible at the time of disposal, the difference shall be allowed as a deduction in computing the person's income chargeable under the head 'income from Business" in that year.

9) for the purposes of sub-section (8)

a) the written down value of an intangible at the time of disposal shall be the cost of the intangible reduced by the total deduction allowed to the person under this section in respect of the intangible or, where the intangible is not wholly used to derive income chargeable were wholly so used ;and
b) The consideration received on disposal of an intangible shall be determined in accordance with section 77.

10) For the purposes of this section, an intangible that is available for use on a day (including a non-working day) is treated as used on that day.

11) In this section,-

"cost" in relation to an intangible, means any expenditure incurred in acquiring or creating the intangible, including any expenditure incurred in improving or renewing the intangible: and

"intangible" means any patent, invention, design or model, secret formula or process, copyright, trade mark, scientific or technical knowledge, computer software, motion picture film, export quotas, franchise, licence, intellectual property], or other like property or right, contractual right and expenditure that provides an advantage or benefit for a period of more than one year (other than expenditure incurred to acquire a depreciable asset or unimproved land)

Total Marks 15

Ans-6

Pre-commencement expenditure.-

1. A person shall be allowed a deduction for any pre-commencement expenditure in accordance with this section.
2. Pre-commencement expenditure shall be amortized on a straight-line basis at the rate specified in part III of the third Schedule @20%.
3. That total deductions allowed under this section in the current tax year and all previous tax years in respect of an amount of pre-commencement expenditure shall not exceed the amount of the expenditure.
4. No deduction shall be allowed under this section where a deduction has been allowed under another section of this ordinance for the entire amount of the pre-commencement expenditure in the tax year in which it is incurred.

5. In this section, "pre-commencement expenditure'' means any expenditure incurred before the commencement of a business wholly and exclusively to derive income chargeable to tax, including the cost of feasibility studies, construction of prototypes, and trial production activities, but shall not include any expenditure which is incurred in acquiring land, or which is depreciated or mortised under section 22 or 24.

Total Marks 10

Ans-7

a) The rate of deduction of withholding tax under clauses (a) and (b) of sub-section (1) of section 153shall be one per cent on local sales, supplies and services provided or rendered to the taxpayers falling in the]following categories namely

   I. Textile and articles thereof:
   II. Carpets;
   III. leather and articles thereof including artificial leather footwear;
   IV. surgical goods; and
   V. sports goods;

   Provided that withholding tax under clauses (a) and (b) of sub-section (1) of section 153 shall not be deducted from sales, supplies and services made by traders of yarn to the above mentioned categories of taxpayers.. such traders of yarn shall pay minimum tax @ 0.1 % on their annual turnover on monthly basis on 30th day of each month and monthly withholding tax statement shall be e-filed

b) provisions of clause (a) of sub-section (1) of section 111 of this ordinance shall not apply to the amounts credited in the books of accounts maintained for the period ending on the 30th June 2011, by the sellers, suppliers, service providers to the categories of sale tax zero – rated taxpayers, as mentioned in sub-clause (a); and

c) provisions of sub-clauses (a) and (b) shall be applicable only to the cases of sellers, supplies, service providers of the above mentioned categories of sales of sales tax zero-rated tax payers who get themselves registered by the 30th June,2011`

Total Marks 12

Ans-8

Tax Year 20X8
Computation of Taxable Income and Tax Liability

Salary	**Rs.**	**Rs.**
Basic Salary	8,800,000	
Bonus	5,000,000	
Utility Allowance	880,000	

Relocation Allowance	200,000	
Accommodation:45% of Basic Salary	3,960,000	
Car:5 % of Rs.2 million	100,000	
Children Education Fee	100,000	
House Servant Salaries	105,000	
Tax Born by the employer(working note) [Grossing up]	230,000	
Taxable income	1,883,571	
	21,158,571	
Income From Property		
Chargeable rent 7*50,000	350,000	
Tax liability (salaried case)		
Income tax on Rs.7,000,000		1,422,000
income tax on Rs.14158571 @ 30%		4247571
Total tax liability		5,669,571
Less: Tax Paid by The employer so, no deduction	1,883,571	
Tax withheld from salary is allowed	3,786,000	
	20,000	5,689,571
Tax payable		53,500
Tax Payable on income from property [150000 x 5%]		
Note for tax borne by the employer:		7,500
taxable perquisites on which tax shall be borne the employer:		
Accommodation:45% of basic salary	3,960,000	
car: 5% of Rs. 2 million	100,000	
children Education Fee	105,000	
House Servant Salaries	230,000	
As taxable salary exceeds Rs. 7 Million, Applicable tax rate would be 30%		
Tax @ 30 % on Rs.4,395,000	1,318,500	
		1,883,571

Note for income covered under FTR: Bank profit is taxable under FTR @ 10%

Total Marks 15

Ans-9

The law of insurance, except as respects insurance undertaken by a province, and the regulation of the conduct of insurance business, except as respects business undertaken by a province: Government insurance, except so far as undertaken by virtue of any matter within the legislative competence of the provincial Assembly.

Stock exchange and future markets with objects and business not confined to one province.

corporations, that is to say, the incorporation, regulation and winding-up of trading corporations, including banking, insurance and financial corporation, but not including corporations owned or cooperative societies, and of corporations, whether trading or not, with objects not confined to a province, but not including universities.

Total Marks 08

Ans-10

a) Where any person violates any embargo pleased on removal of goods in connection with recovery of tax.

Such person shall pay a penalty of twenty five thousand rupees or ten per cent of the amount of the tax involved, whichever is higher. He shall, further be liable, upon conviction by a special judge, to imprisonment for term which may extend to one year, or with fine which may extend to amount equal to the amount of tax involved, or with both

b) any person who fails to make payment in the manner prescribed u/s 73 of this act (4) such person shall pay a penalty of five thousand rupees or three per cent of the amount of tax involved, whichever is higher .

c) Where any person fails to furnish a return within the due date.

such person shall pay a penalty of five thousand rupees:

Provided that in case a person files a return within fifteen days of the due date, he shall pay a penalty of one hundred rupees for each day of default.

Total Marks 06

Financial Reporting

(Level-4)

Solutions – Financial Reporting
Winter 2016

Ans-1

a) The free samples fall in the definition of inventory under IAS -2. The IAS -2 (Inventory) requires that inventory should be measured at lower of cost or net realizable value, as the cost of free samples is zero therefore, the free samples will be recognized at nil value in the financial statements.

b) The goods sent on sale or return basis cannot be recognized as revenue unless the customer accepts the goods. As the confirmation of goods have been received after the year end therefore, no revenue will be recognized. The company should the reveres the revenue and recognized the goods as inventory lying at customer's premises.
The respective reversal entries will be as under: -

Revenue	550,000	
Receivables		550,000
Inventory	440,000	
Cost of goods sold		440,000

c) The repair services are to be performed over two years, therefore revenue relating to repair services can only be recognized up to the period of services rendered. Therefore, the revenue relating to un-expired period of one and half year will be recognized as advance income and not revenue.
The respective double entry for reversal will be as under: -

Revenue from services	37,500	
Advance income		37,500

d) The revenue relating to extended period is only up to the fair value of goods sold (PV of future cash flows at effective rate). The respective double entries for reversal of revenue will be as under:

Revenue	(w-1)	8,680	
Receivable			8,680
Receivable	(w-2)	3,100	
Interest income			3,100

(W-1)
50,000 - PV of 50,000
= 50,000-50,000(1+0.10)
=50,000-41322
=8,678

(W-2)
413,22 x 10% x $\frac{9}{12}$ = 3,100

Total Marks 12

Solutions – Financial Reporting
Winter 2016

Ans-2

Profit or loss account			2015 Rs. (m)
Tax expense			
Current tax	W-1		2,504.96
Deferred tax	W-2	52.8-25.74	27.06
Net tax expense			2,532.02

Statement of financial position		2015 Rs. (m)	2014 Rs. (m)
Deferred tax liability	W-2	52.8	25.72

Notes to accounts

Reconciliation of tax on accounting profit and tax expense		Marks
Tax expense	2,532.02	
Tax on accounting profit (7,950x32%)	2,544	1
Effect of capital gain (35x32%)	(11.2)	1
Effect of change in tax rate (78x1%)	(0.78)	1
	2,532.02	

W-1	Calculation of current tax		
Profit before tax		7,950	
Add:	Provision for taxation (15-25+7)	10	1
	Provision for gratuity (35+10-25)	20	1
	Accounting depreciation (1,580-1365)	215	1
		8,195	
Less:	Bad debts written off	(7)	1
	Gratuity paid	(10)	1
	Capital gain	(35)	1
	Tax depreciation (1,465-1,150)	(315)	1
Taxable profit		7,828	
Current tax @32%		2,504.96	

W-2	Calculation of deferred tax	TTD/(DTD)	TTD(DTD)	
	Property plant and equipment	215	115	1
	Provision for doubtful debts	(15)	(12)	1
	Provision for gratuity	(35)	(25)	1
	Net taxable temporary differences	165	78	1
	Deferred tax liability 2015 @32%, 2014 @33%	52.8	25.74	1

Total Marks 15

Ans-3

PCL GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2015

	Rs. (m)	Rs. (m)	Marks
Assets			
Noncurrent assets			
Tangible assets(1,358+503-30+5)	1,836		3
Intangible assets (150+52-52)	150		3
Goodwill (275-5)	270	2,256	4
Current assets (515+465)		980	1
		3,236	0.5
Equity and liabilities			
Equity-Ordinary share capital of Rs. 10 each	1,500		1
Retained earnings	451.60	1,951.60	4
Non-controlling interest		269.40	4
		2,221	
Noncurrent liabilities (350+310)		660	1
Current liabilities (250+105)		355	1
		3,236	0.5

W- 1 Group structure

	%
Group	**70**
NCI	**30**
	100

W-2 Cost of control account

Cost of investment		600
Share of share capital	280	
Share of pre-acquisition reserves	157.50	437.50
		162.50

W-3 Non-controlling interest (NCI)

Share capital	120	
Pre-acquisition reserves	67.50	
Post-acquisition reserves	(29.10)	
Impairment loss on goodwill (5x30%)	(1.50)	
Goodwill	112.50	269.40

W-4 NCI goodwill

Fair value of NCI		300
Share capital	120.00	
Pre-acquisition reserves	67.50	(187.50)

Goodwill		112.50
W-6 Consolidated retained earnings		
B /f	523	
Impairment loss on goodwill (5x70%)	(3.5)	
Share of loss from subsidiary company	(67.90)	451.60
W-7 Subsidiary retained earnings	Pre	Post
B /f	225	(50)
Extra depreciation		5
Intangible assets		(52)
	225	(97)
Group share 70%	157.50	(67.90)
NCI share 30%	67.50	(29.10)

Total Marks 23

Ans-4

		Rs.	Rs.	Marks
Cost	01-01-2013		150,000	
Depreciation	30-06-2013	150,000x20%x12	15000	
Depreciation	30-06-2014	150,000x20%	(30,000)	
Carrying value	30-06-2014		105,000	1
Revaluation surplus			65,000	1
Revalued amount			170,000	1
Depreciation	01-01-2015	170,000x15% x $\frac{6}{12}$	12,750	1
Carrying value			157,250	1
Adjustment against revaluation surplus			65,000	1
Adjustment against profit or loss account			47,250	1
			112,250	1
Recoverable value			45,000	1
Value in sale		45,000		
Value in use		40,000		
Depreciation	30-06-2015	(45,000/1.5)x0.5	(15,000)	1
Varying value of asset	30-06-2015		30,000	

Total Marks 10

Solutions – Financial Reporting
Winter 2016

Ans-5

Particulars			Debit Rs.	Credit Rs.	Marks
01-07-2012	Asset		50,000		
		Bank		50,000	1
Recognition of asset					
30-06-2013	Depreciation		6,250		
		Asset		6,250	1
Depreciation of first year					
30-06-2013	Asset		5,250		
		Revaluation surplus		5,250	1
Recognition of revaluation surplus					
30-06-2014	Depreciation		7,000		
		Asset		7,000	1
Depreciation of second year					
30-06-2014	Revaluation surplus		750		
		Retained earnings		750	1
Transfer of revaluation surplus to retained earnings					
30-06-2014	Revaluation surplus		4,500		
	Profit or loss account		1,500		
		Asset		6,000	2
Recognition of deficit					
30-06-2015	Depreciation		6,000		
		Asset		6,000	1
Depreciation of third year					
30-06-2015	Asset		15,000		
		Revaluation surplus		13,750	2
		Profit or loss		1,250	
Recognition of revaluation surplus and reversal of deficit					

Working 1	**Calculation of carrying value**	**Rs.**	**Rs.**
01-07-2012	Cost		50,000
30-06-2013	depreciation (50,000/8)		(6,250)
30-06-2013	Revaluation surplus		5,250
30-06-2013	Revalued amount		49,000
30-06-2014	Depreciation (49,000/7)		(7,000)
30-06-2014	Deficit		(6,000)
30-06-2014	Revalued amount		36,000
30-06-2015	Depreciation (36,000/6)		(6,000)
30-06-2015	Revaluation surplus		15,000
30-06-2015	Revalued amount		45,000

Working 2	**Calculation of revaluation surplus**		
30-06-2013	Surplus		5,250
30-06-2014	Transfer on account of extra depreciation	5,250/7	(750)
30-06-2014	Adjustment against deficit		(4,500)
30-06-2015	Revaluation surplus	(15,000-1,250)	13,750

Total Marks 10

Solutions – Financial Reporting
Winter 2016

Ans-6

a) **02**

Depreciation Expense =500*37%=185

Carrying Volume=cost –Acc Depreciation

=1250-(750+185)

=1250-935 **03**

=315

b) **05**

This scenario should be coved under IAS-10-"Events after reporting period the given situation is an example of an adjusting event. So a provision for taxation of 2 million should be made at the year end and it should be reported under current liability in statement of Financial Position as well.

Total Marks 10

Ans-7

ABC Limited
Statement of Cash Flows
For the year ended June 30, 2016

	Rs. (000)	Rs. (000)	Marks
Cash flows from operating activities			
Profit before interest and tax		100,050	0.5
Effect of:			
Interest expense	12,225		1
Gain on disposal of fixed assets	(25)		1
Depreciation expense	50,350	62,550	1
Operating profit before working capital changes		162,600	0.5
Working capital changes			
(Increase)/decrease in current assets			
Inventory	86,940		1
Receivables	9,707		1
Increase /(decrease) in current liabilities			
Trade creditors	(107,865)	(11,218)	1
Cash generated from operations		151,382	
Interest paid		(12,010)	1
Taxes paid		(76,927)	1
		(88,937)	

Solutions – Financial Reporting
Winter 2016

Net cash inflow/(outflow) from operating activities		62,445	
Cash flows from investing activities			
Investment acquired	(200)		1
Disposal proceeds	5,275		1
Property, plant and equipment acquired	(63,330)		1
Net cash out flow from investing activities		(58,255)	
Cash flows from financing activities			
10% TFC's	175		1
Dividend paid	(12,500)		1
Share capital issued (7000+15000) W.7	22000		2
Lease liability paid	(14,530)		1
		(4,855)	
Increase/(decrease) in cash and cash equivalents		(665)	1
Opening balance of cash and cash equivalents		233	1
Closing balance of cash and cash equivalents		(432)	1

		Debit	Credit
W-1	Interest expense		
	Opening balance		350
	Expense		12,225
	Dismantling liability	65	
	Cash paid (Balancing)	12,010	
	Closing balance	500	
		12,575	12,575
W-2	Disposal account		
	Gain on disposal	25	
	Property, plant and equipment	5,250	
	Cash (balancing)		5,275
		5,275	5,275
W-3	Retained earnings		
	Opening balance		175,320
	Profit after tax		59,795
	Dividend	12,500	
	Bonus issued	18,750	
	Closing balance	203,865	
		235,115	235,115
W-4	Tax account		
	Opening balance		71,205
	Expense for the year		40,255
	Cash (Balancing)	76,927	
	Closing balance	34,533	
		111,460	111,460

W-5	Revaluation surplus		
	Opening balance		550
	Deficit for the year	120	
	Closing balance	430	
		550	550
W-6	Investments	450	
	Gain on investment	25	
	Cash (Balancing figure)	200	
	Closing balance	675	675
		675	675
W-7	Property, plant and equipment		
	Opening balance	350,750	
	Deficit		120
	Disposal		5,250
	Depreciation		50,350
	Lease liability	16,000	
	Provision for dismantling	1,000	
	Cash (Balancing)	63,330	
	Closing balance		375,360
		431,080	431,080
W-7	Share capital		
	Opening balance		125,000
	Bonus issued		18,750
	Cash (Balancing)		7,000
	Closing balance	150,750	
		150,750	150,750
W-8	Lease liability		
	Opening balance		40,780
	Property, plant and equipment		16,000
	Cash (Balancing)	14,530	
	Closing balance	42,250	
		56,780	56,780
W-9	provision for dismantling		
	Opening balance		650
	Property, plant and equipment		1,000
	Interest expense		65
	Closing balance	1,715	
		1,715	1,715

Total Marks 20

Management Accounting

(Level-4)

Solutions – Management Accounting

Winter 2016

Ans. 1-a

	NPV					
Year	0	1	2	3	4	**marks**
Sales Volume		350	380	420	430	
Price		5.25	5.25	5.25	5.25	
Revenue		**1837.5**	**1995**	**2205**	**2257.5**	**2**
Variable Cost		1050	1140	1260	1290	**2**
Fixed Cost		145	145	145	145	**1**
Operating Profit		642.5	710	800	822.5	
Tax @ 30%		192.75	213	240	246.8	**1**
Machine Cost	**(1500)**					**0.5**
Scrap Value					200	**0.5**
Net Cash Flows	(1500)	449.7	497	560	775.7	
Discount factor @ 10%	1	0.909	0.826	0.751	0.683	**1**
Present Value	(1500)	408.78	410.52	420.56	529.80	
NPV	269.66					**1**

Company should accept the project because it will generate positive NPV and will increase shareholders wealth. **1**

Ans. 1-b

3 marks for calculation and 2 for acceptability discussion

IRR					
discount factor @ 20%	1	0.833	0.694	0.579	0.482
PV	1500	374.6	344.9	324.2	373.9
	-123.30175	- 82.4			
IRR	0.1766				
	17.66 %	10%			

AS IRR of the project is higher than Cost of capital, company should accept the project.

Ans. 1-c **5**

SIMPLE PAY BACK

Years	**Cash flows**	**Cumulative Cash flows**
0	-1500	-1500
1	449.7	1050.3
2	497	-553.3
3	560	6.7
4	775.7	782.4

3 years Approximately

Total Marks 20

Solutions – Management Accounting

Winter 2016

Ans. 2-a

The **relevant costs** are the differential costs between making and buying, and they consist of **differences in unit variable costs plus differences in directly attributable fixed costs**. Subcontracting will result in some **fixed cost savings**.

	A	B	C	D	
	Rs	Rs	**Rs**	**Rs**	
Unit variable cost of making	14	17	7	12	
Unit variable cost of buying	12	21	10	14	
Excess/(Saving) if buy	(2)	4	3	2	**4**
Annual requirements (units)	2,000	1,500	4,000	3,000	
	Rs	Rs	Rs	Rs	
Extra variable cost of buying (per annum)	(4,000)	6,000	12,000	6,000	
Fixed costs saved by buying	(1,000)	(5,000)	(6,000)	(8000)	
Extra total cost of buying	**(5000)**	**(1000)**	**(6000)**	**(2000)**	**4**

The company would save Rs. 5,000pa by sub-contracting, component A (Where the purchase cost would be less than the marginal cost per unit to make internally) and would save Rs2,000 pa by sub-contracting component D (because of the saving in fixed costs of Rs8,000). **4**

In this Question, relevant costs are the variable costs of in-house manufacture, the variable costs of sub-contracted units, and the saving in fixed costs.

Further considerations (3 marks)

(i) If components A and D are sub-contracted, the company will have **spare capacity**. How should that spare capacity be profitably used? Are there hidden benefits to be obtained from sub-contracting? Would the company's workforce resent the loss of work to an outside sub-contractor, and might such a decision cause an industrial dispute?

(ii) Would the sub-contractor be **reliable** with delivery times, and would he supply components of the same **quality** as those manufactured internally?

(iii) Does the company wish to be flexible and maintain better **control over** operations by making everything itself?

(iv) Are the **estimates** of fixed cost savings reliable? In the case of Product A, buying is clearly cheaper than making in-house. In the case of product D, the decision to buy rather than make would only be financially beneficial if it is feasible that the fixed cost savings of Rs 8,000 will really be delivered by management. All too often in practice, promised savings fail to materialize!

Total Marks 15

Solutions – Management Accounting

Winter 2016

Ans. 3-a

Incremental (or Differential) Approach calculates the difference between the additional revenues and the additional costs of further processing. If the difference is positive the product must be processed further, otherwise not. **1.5**

Opportunity Cost Approach calculates the difference between net revenue from further processed product and the opportunity cost of not selling the product at split-off point. If the difference is positive, further processing will increase profits. **1.5**

Total Project Approach (or the comparative statement approach) compares the profit statements of both options (i.e. selling or further processing) separately for each product. The option generating higher profit is chosen. **02**

Ans. 3-b

Incremental approach:

Incremental revenue (15000x5)	75,000	
Incremental costs	(50,000)	
Incremental profits due to further processing	25,000	**01**

Opportunity cost approach:

Sales in case of further processing (15000x10)	150,000	
Costs		
Additional costs	(50,000)	
Opportunity cost of not selling at split-off	(75,000)	
Gain on further processing	25,000	**02**

Total project approach:

	Split-off point	**further processed**	
Revenue	75,000	150,000	
Costs	0	(50,000)	
Net revenue	75,000	100,000	
Gain from further revenue		25,000	**02**

Total Marks 10

Solutions – Management Accounting

Winter 2016

Ans. 4-a

Khan Co. (1 mark for each definition)

(a) Purchase price the supplier's price or the offer of a discount for bulk purchases will need to be considered.

(b) Holding cost this includes costs such as warehousing, insurance, financing the inventory and costs of deterioration.

(c) Ordering cost this consists of delivery costs, and staffing, stationery and telephone charges etc in the procurement department.

(d) Shortage costs these costs include the loss of sales revenue, the loss of customer goodwill and the cost of paying labor even when there are no raw materials to work with.

Ans. 4-b

$$\sqrt{2 \times \frac{200 \times 40{,}000}{0.15 \times 5}}$$

New supplier

The EOQ should first be calculated: EOQ = [(2 x Rs200 x 40,000)/0·15 x Rs5]1/2 = 4,619 units.

1) Order size = EOQ			
Purchase price	40,000 x Rs.5	200,000	**0.75 mark**
Ordering Cost	40,000/4,619 x Rs.200	1,732	**1 mark**
Holding cost	(4,619/2) x 0.15 x Rs.5	1,732	**1 mark**
		203,464	
2) Order Size 7,000 or above			
Purchase price	40,000 x Rs.5 x 0·92	184,000	**0.75 mark**
Ordering Cost	40,000/7,000 x Rs.200	1,143	**0.75 mark**
Holding cost	(7,000/2) x 0.15 x Rs.5 x 0.92	2,415	**0.75 mark**
		187,558	

The total cost needs to be calculated at this level and if the order size is increased to obtain the bulk buy discount. On the basis of these calculations, the new supplier should be used. **1**

Total Marks 10

Solutions – Management Accounting

Winter 2016

Ans. 5

Cash budget					marks
	August	**September**	**October**	**November**	
Cash inflows	**Rupees**				
cars Washed (working 1)	**1,300**	**1,700**	**2,000**	**2,000**	
Doctor's surgery (rec'd one month in arrears)	**-**	**50**	**50**	**50**	
Cars association (rec'd one month in arrears) Total cash inflows	**-**	**-**			
	1,300	**1,750**	**2,125**	**2,125**	**3**
Cash Outflows					
Equipment (two equal installments)	**-**	**1,200**	**1,200**	**-**	**2**
Salary	**1,000**	**1,000**	**1,000**	**1,000**	**1**
Costs- Cars Washed (5% of income)	**65**	**85**	**100**	**100**	**1**
Costs – doctor's surgery (5% of income)	**3**	**3**	**3**	**3**	**1**
Costs- Cars association (5% of income)	**-**	**4**	**4**	**4**	**1**
Total cash outflows	**1,068**	**2,292**	**2,307**	**1,107**	
Net cash flow	**232**	**(542)**	**(182)**	**1,018**	
Cash b/fwd	**200**	**432**	**(110)**	**(292)**	
Cash b/fwd	**432**	**(110)**	**(292)**	**726**	**3**

Working 1 : income from households	**July**	**August**	**September**	**October**	**November**	**3**
Number of cars (increasing at 30 % per month to maximum of 100)	**50**	**65**	**85**	**100**	**100**	
income (x Rs.20 per cars	**1,000**	**1,300**	**1,700**	**2,000**	**2,000**	

Total Marks 10

Solutions – Management Accounting

Winter 2016

Ans. 5

Fabric: **02**

Since the fabric is regularly used, it will have to be bought from the market at the price of Rs 18.5 per m^2. The total cost will be 400 x Rs 18.5 = Rs7400.

Wood: **03**

The company has 1000 m in inventory, but 980 is needed for a project. 20 m of it can be used and a cost of Rs 8.2 can be charged to it. The rest 80 m can be bought from the new supplier who can supply immediately at the price of Rs 8.5. The total price would be, (20 x Rs 8.20) + (80 x 8.50) = 844

Skilled Labor: **03**

Skilled labor is needed for 400 hours. Idle time is available for 300 hours for which no extra cost is relevant. For overtime of 100 hours, time and half rate will be charged. The time and half rate is 20 + 20 x 50 % = Rs 30. For 100 overtime hours, the relevant cost will be, 100 x 30 = Rs.3,000.

Semi-skilled Labor: **03**

As there is no spare capacity for semi-skilled labor, they would need to be over time at time and half, which is 16 + 16 x 50% = 24. But another agency can provide the labor for Rs 20 per hour. Therefore, we will hire labor from the agency at Rs 20 per hour and our relevant cost will be 600 x 20 = Rs12000.

Supervisor salary: **02**

Supervisor will work 20 hours overtime and will be paid Rs 16 per hour for that, a total of 20 x 16 = 320.

Factory OHS **02**

Factory OHs are not relevant costs, neither are administration OHs, and will not be included in the cost estimate. The reason is that the decision of this order does not affect the incurrence of these costs.
The total cost estimate will be:

Fabric	Rs. 7,400
Wood	Rs. 844
Skilled Labor	Rs. 3,000
Semi-Skilled Labor	Rs. 12,000
Supervisor salary	Rs. 320
TOTAL	Rs. 23,564

Total Marks 10

Ans. 7-a

Weighted Average C/S ratio

Per unit	A		B		C		
	Rs	**Rs**	**Rs**	**Rs**	**Rs**	**Rs**	
Selling price		1,600		1,800		1,400	
Material	(430)		(500)		(360)		
Variable labor	(88)		(96)		(76)		
Variable OHS	<u>(110)</u>		<u>(120)</u>		<u>(95)</u>		
Total Variable cost		<u>(628)</u>		<u>(716)</u>		<u>(531)</u>	
Contribution		<u>972</u>		<u>1,084</u>		<u>869</u>	
							1.5
Sales units		420		400		380	
Total sales revenue		672,000		720,000		532,000	
Total contribution		408,240		433,600		330,220	
							1.5

WA C/S ratio = (408,240 + 433,600 + 330,220) / (672,000 + 720,000 + 532,000)

= 1,172,060/ 1,924,000 = 60.92 % **03**

Ans. 7-b

Margin of safety

Margin of safety = budgeted sales – breakeven sales

Budgeted sales revenue = Rs 1,924,000

Fixed labor cost = ((420 x Rs.220) + (380 x Rs.190) + (400 x 240)) x 0.6 = Rs 156,360.

Total fixed cost = Rs 156,360 + Rs 55,000 = 211,360 **02**

Breakeven sales revenue = fixed cost / weighted average C/S ratio

= 211,360 / 60.92

= 34,6947 **02**

Therefore; margin of safety = 1,924,000 – 346,947 = Rs. 1,577,053. **02**

Ans. 7-c

If the more profitable products are sold first, this means that the company will cover its fixed costs more quickly. Consequently, the breakeven point will be reached earlier, i.e. fewer sales will need to be made in order to break even. So, the breakeven point will be lower. **03**

Total Marks 15

Solutions – Management Accounting

Winter 2016

Audit, Assurance & Ethics

(Level-4)

Solutions – Audit, Assurance & Ethics
Winter 2016

Ans. 1 **Up to 2 marks each for clearly describing each**

Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.

Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based

Total Marks 04

Ans. 2 **3 marks for explaining why revenue recognition policy of company is not correct.**
4 mark for stating what assertions of revenue, cost of sales and trade receivable which are compromised.
½ mark for calculating the materiality and relating it to the items affected.
½ mark for suggesting the management to adjust the financials

a **Recognition Policy:**

As per IAS 18, revenue should be recognized when all risks and rewards (rights and obligations) pertaining to the ownership of the goods are transferred to customers. In this scenario,

- It is SKL responsibility to deliver goods and
- The customers have the right to not accept delivery if goods do not meet quality and other specifications.

Hence the risks and rewards are transferred at the premises of customers not at the dispatch of goods from the warehouse of SKL.

Therefore, the revenue recognition policy of the management is not correct.

Assertions

As a result of this incorrect policy following assertions of revenue, cost of sales, inventory and trade receivables are called into question:

Occurrence and cut-off (Revenue): As sales of next period may be booked in this year, revenue may be over-stated.

Occurrence and cut-off (cost of sales): As sales of next period may be booked in this year the relevant cost will also be recorded, resulting in over statement of cost of sales as well.

Existence (Receivables): As revenue will be overstated consequently receivables will also be overstated.

Completeness (Inventory): As SKL still owns the inventory but due to the recognition policy the inventory will be understated.

Materiality: Since SKL is in profits, we may use Net profit for determining materiality. Say we take 10% of net profits of Rs. 540 million, the materiality comes as Rs. 54 million.

Alternative action

We should ask the management of SKL to not to record this excess revenue and change its revenue recognition to "When the goods are delivered at customer" RATHER than on dispatch of goods.

Impact outside sampled transactions

Since the Rs. 160 million error has been identified only from a sample and the whole population of sales has not been tested, as auditors we are facing a much higher risk which needs to be addressed by performance of extended substantive procedures.

We would therefore have to increase the sample size and based on the results may extend our testing to the entire week or last two weeks of the reporting year. This would give us an idea of the quantum of misstatement in order to conclude on the reporting implications.

b **2 marks for quantification of effect on each balance sheet item**
1 mark for explaining that effect is both material and pervasive.
1 mark for stating the adverse opinion should be given.

Impact on report for marking scheme please refer Annex A
If management does not agree to reverse the sales recorded.

- Receivables and sales will be overstated by 160 million. This is 29.6% of net profit and 5.06% of revenue.
- Assuming that the profit margin on each sales transaction is similar (i.e. 17.09%), Cost of sales will be overstated by Rs. 106 million and net profit will be overstated by Rs. 27.3 million. This is 5.05% of net profit.
- Trade receivables are overstated by Rs. 160 million which is 6.4% of total assets.
- Inventory is understated by Rs. 106 million which is 4.24% of total assets.
- There may be tax implications as well which cannot be quantified due to absence of information in the question.

Further, the impact of this revenue recognition policy on opening balances also needs to be ascertained. In the absence of information in the question, this has been ignored.

Note: these calculations are made on the basis at assumption that all relevant figures include affect of 160 million. Except where specially stated otherwise.

Taking into account all factors, the impact of the incorrect revenue recognition policy is not restricted to one or two items but extends to a lot of areas in the financial statements, in particular, revenue, trade receivables, inventory, cost of sales, taxation, net profit etc. Therefore the audit report would have to be modified. Since the impact if widespread it may be argued that the misstatement is not just material but also pervasive to the financial statements. Therefore, an adverse opinion should be given on this matter.

Total Marks 12

Ans. 3 **½ mark for identification / heading of relevant section up to maximum of 2½ marks in total; up to of 2 marks per point in each heading if well-explained. Limit to 1 mark each for vague / unclear explanations.**

Industry, Regulatory and Other External Factors

- Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological development
- Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment.
- Examples of other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation

Nature of the Entity

- Business operations
- Investments and investment activities
- Financing and financing activities
- Financial reporting

The Entity's Selection and Application of Accounting Policies

- The methods the entity uses to account for significant and unusual transactions
- The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.
- Changes in the entity's accounting policies
- Financial reporting standards and laws and regulations that are new to the entity and when and how the entity will adopt such requirements.

Objectives and Strategies and Related Business Risks

- Industry developments (a potential related business risk might be, for example, that the entity does not have the personnel or expertise to deal with the changes in the industry).
- New products and services (a potential related business risk might be, for example, that there is increased product liability).
- Use of IT
- The effects of implementing a strategy, particularly any effects that will lead to new accounting requirements (a potential related business risk might be

Measurement and Review of the Entity's Financial Performance

- Key performance indicators (financial and non-financial) and key ratios, trends and operating statistics.
- Period-on-period financial performance analyses.
- Budgets, forecasts, variance analyses, segment information and divisional, departmental or other level performance reports.
- Employee performance measures and incentive compensation policies.
- Comparisons of an entity's performance with that of competitors.

Total Marks 10

Ans. 4a **1 mark for identifying the threat involved, 1 mark for defining the threat identified, 1 for explaining the threat and linking it to the scenario, 1 marks for each safeguard given with maximum of 20.**

The threat involved in this scenario is self-interest threat as audit manager owns the share of RSL.

A financial interest exists where an audit firm or any member of audit has a financial interest in a client's affairs.

In this case, the audit partner has no shareholdings in the client company and so he could be seen as giving an objective audit opinion. However, the audit manager does have a shareholding in RSL which is not material to the company (at 1% of issued share capital), could be material to the audit manager. This may impair his ability to give object opinion and thus compromise his independence. As the partner will be relying on the work of audit manager, this could be seen to impair the objectivity of the audit opinion to be given on financial statements of RSL.

Following safeguards may be available:

- Asking the manager to dispose of the shares
- Removing the manager from the audit of RSL
- Having a quality review of the work already performed by the manager
- Informing the Audit Committee about the situation

of the above safeguards the most practical and the one likely to reduce the threat to an acceptable level is to remove the manager from the audit of RSL and depute him to other engagements.

Ans. 4b **1 mark for identifying the threat involved, 1 mark for defining the Lowballing, Up to 1 for explaining the threat and linking it to the scenario, 1 marks for each safeguard given with max upto 2**

The threat involved in this scenario is self-interest threat as the firm is intending to engage in what may be perceived by the public or stakeholders as 'Lowballing'.

Lowballing is when a firm quotes a significantly lower fee level for an assurance service than would have been charged by the predecessor firms or as compared to actual budgeted cost of that service.

Lowballing is in itself not prohibited. However, code of Ethics for Chartered Accountants issued by ICAP prohibits quoting fee which is less than the predecessor's auditor fee.

There is a significant self-interest threat if the firm's tender is successful, the firm must apply safeguards such as:

i. Maintaining records such that the firm is able to demonstrate that appropriate staff and time are spent on the engagement.

ii. Complying with all applicable assurance standards, guidelines and quality control procedures. E.g. ensure that fee quoted is not less than predecessor auditor's fee.

Total Marks 10

Ans. 5 **½ mark for stating each element, 1½ mark for explaining each element.**

a) Three party relationship
The three parties are the intended user (e.g. Shareholders), responsible party (e.g. management) and the practitioner (auditor).

b) Subject matter
This is the data/information to be evaluated by the practitioner that has been prepared by the responsible paty. E.g. Annual financial statements, interim financial information etc.

c) Suitable Criteria
The above subject matter is evaluated or measured against criteria in order to reach an opinion

d) Evidence
Practitioner needs to obtain sufficient and appropriate audit evidence needs to obtain in order to support the level of assurance to be given.

e) Assurance Report
A written report containing the practitioner's opinion is issued to the intended user. The assurance report may contain reasonable or limited level of assurance depending on terms of engagement.

Total Marks 10

Ans. 6

2 Marks for the format of memo, up to 2 marks for each factor explained.

Date: ____________

The Partners
Hussain Kirmani, Chartered Accountant

Subject: Factors the firm needs to consider if the firm is unable to continue the audit of PWL

As concluded by senior partners the fraud in WPL has brought into question the firm's ability to continue performing the audit.

As per ISA 240 *The Auditor's Responsibilities Relating To Fraud In An Audit Of Financial*

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and

c) If the firm/auditor withdraws:

- Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
- Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Regards
Mr. ABC
Audit Manager
Hussain Kirmani, Chartered Accountant

Total Marks 10

Ans. 7

2 marks for stating each benefit correctly; limit to 1 mark each of not adequately explained.

a) Helping the auditor to devote appropriate attention to important areas of the audit.

b) Helping the auditor identify and resolve potential problems on a timely basis.

c) Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.

d) Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.

e) Facilitating the direction and supervision of engagement team members and the review of their work.

f) Assisting, where applicable, in coordination of work done by auditors of components and experts.

Total Marks 10

Ans. 8

Up to two marks for each definition

Significant risk: An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

Audit evidence: Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Population: The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

Statistical sampling: An approach to sampling that has the following characteristics:

- Random selection of the sample items; and
- The use of probability theory to evaluate sample results, including measurement of sampling risk.

Tolerable rate of deviation: A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

Total Marks 10

Ans. 9

1 mark for explaining that company will not be able to sell the inventory due to ban.
2 marks for using the legal advisor statement and linking it to the scenario
3 marks for explaining the issue in inventory,
2 marks for explaining the issue in fixed assets and license
2 marks for explaining the issue related to license (intangible)
1 marks for calculating materiality
3 marks for explaining the impact on audit report.

The Health regulators has banned the GPS and revoked the license, consequently NFL will not be able to sell the finished goods and cannot produce any further items of GPS until the ban is removed and license is reinstated.

The fact that legal advisor does not know that whether the Company has good chances to win this case and cases of such nature are usually decided in favor of the regulator, this may indicate provisions/write off may be required in financial statements despite the fact that case is still in case.

Inventory:
In case of inventory, IAS 2 states that inventory should be stated at lower of cost of net realizable value. Since NFL will not be able to sell GPS anymore, NRV is zero. Which means that inventory should be written off by Rs. 300 million.

Machinery:
IAS 16 states that fixed assets should be stated at cost less cost accumulated depreciation less accumulated impairment loss. Impairment loss is the difference between net book value and recoverable amount (i.e. higher of value in use and fair value less cost to sell).

Value in use is zero as license has been revoked. Whereas fair value less cost to sell is Rs. 800million. So the impairment loss should be recognized by Rs. 1,200 million and machinery should be written down by Rs. 1,200 million.

License:
Similar is the case with license, IAS 38 states that intangible should be stated at cost less accumulated amortization less accumulated impairment loss. Impairment loss is the difference between net book value and recoverable amount (i.e. higher of value in use and fair value less cost to sell).

Both value in use and fair value is zero as license has been revoked. Consequently all amount of license should be charged as impairment loss i.e. impairment loss of Rs. 200 million with respect to license should be booked.

Materiality
Since the Company is in profits we may use net profit as base for determining materiality. Taking 10% of net profits, the materiality comes out to be Rs. 300 million.

Impact on audit Report
If management does not agree on either one of above issues then:

Net Assets of the Company will be overstated by Rs. 1,700 million (Inventory 300+machinery 1,200+ license 200) and net profits will be overstated by same amount.

The impact of this misstatement is way above materiality of Rs. 300 million and is not restricted one or two elements of financial statement. Consequently the impact of this misstatement will be both material and pervasive. The audit opinion will be modified in this case. An adverse opinion should be given on this matter.

Total Marks 14

Ans. 10a

1 Mark for stating that it is a non-adjusting event. 1 mark for explaining why it is non adjusting?
1 Mark for stating the disclosure requirements.
2 Mark for stating the impact on audit report

This is a non-adjusting event. The Board of directors has approved the dividend subsequent to the year end and as at 30 September 2016 the Company does not declared the dividends

An additional note should be given stating the approval of dividends and stating that the financial statements do not reflect the effect of this event.

If the management does not agree to disclose this in the financial statements, the auditor will consider the significance of this note to the understanding of users. Since declaring 100% dividend has the potential of impacting the decisions of financial users. Auditor may modify the audit opinion depending upon the significance for intended users.

Ans. 10b

1 Mark for stating that it is an adjusting event. 1 mark for explaining why it is adjusting?
1 Mark for stating the impact on Financial Statements.
2 Mark for stating the impact on Audit Report.

This is an adjusting event. Since the conditions existed at balance sheet date i.e. the Company has the liability to pay the tax authorities at year end which was later confirmed by the order of the Supreme Court.

A provision and an expense amounting to Rs. 500 million should be recorded in the financial statements for the year ended 30 September 2016.

If the management does not agree the auditor will modify the audit opinion because tax provision is 5% of net asset (material and pervasive) and 80% of the net profits (material and pervasive) of the Company and its impact is not restricted to one or two elements of Financial Statements.

Total Marks 10

Gateway Examinations

(Level-4)

Solutions – GATEWAY Financial Reporting
Winter 2016

Ans. 1

Statement of Profit or Loss for year ended 31 March 2016

	Rs. '000	
Revenue recognized ((60% x 28,000) – 7,000)	9,800	1
Contract expenses recognized (balancing figure)	(4,400)	1
Profit recognized ((60% x 11,000) – 1,200)	5,400	1

Statement of Financial Position as at 31 March 2016

	Rs. '000
Current assets	
Amounts due from customers (2,600 + 1,400)	4,000

1

Amounts due from customers:		
Contract costs incurred to date	12,800	
Recognized profits (11,000 x 60%)	<u>6,600</u>	
	19,400	
Progress billings	<u>(16,800)</u>	
Amounts not yet billed	<u>2,600</u>	1
Amounts billed to date	16,800	
Cash received to date	<u>(15,400)</u>	
	1,400	1

Workings (in Rs.'000)

(i) Percentage complete:
Agreed value of work completed at year end (16,800/28,000)*100= 60%

(ii) Estimated profit = Total revenue – total cost
= 28,000,000 – 17,000,000 1
= Rs. 11,000,000

Total Marks 07

Ans. 2

IAS 37 Provisions, contingent liabilities and contingent assets defines provisions as liabilities of uncertain timing or amount that should be recognized where there is a present obligation (as a result of past events), it is probable (assumed to be more than a 50% chance) that there will be an outflow of economic benefits (to settle the obligation) and the amounts can be estimated reliably. The obligation may be legal or constructive. 2

A contingent liability has more uncertainty in that it is a possible obligation (assumed to be less than a 50% chance) whose existence will be confirmed only by one or more future uncertain events that are not wholly within the control of the entity. 2
An existing obligation where the amount cannot be reliably measured is also treated as a contingent liability.

A contingent liability should be disclosed related to the court case. 1

Total Marks 05

Solutions – GATEWAY Financial Reporting
Winter 2016

Ans. 3 **Airbest – Statement of Profit or Loss**
For the year ended 31 December 2015

	Rs. million	
Depreciation	5.3	**1**
Exterior painting	1.5	
	6.8	

Airbest - Statement of Financial Position
As at 31 December 2015

	Rs. million	
Exterior structure [24 – (1.2 x 4)]	19.2	**1**
Interior cabin fittings	6	**0.5**
Engine (5 – 2.5 – 1.1)	1.4	**0.5**

Depreciation for the year

	Rs. Million	
Exterior cabin (24/20)	1.2	**1**
Interior cabin fittings	3	**2.5**
Engine (5 x 7,920/36,000)	1.1	**1.5**
	5.3	

Cabin fittings – at 1 January 2015 the accumulated depreciation of cabin fittings is Rs. 4 million (8/6 x 3) and the carrying amount of the cabin fittings is Rs. 4 million (8 – 4). The cost of improving the cabin facilities of Rs. 5 million should be capitalized as it led to enhanced future economic benefits in the form of substantially higher fares. The cabin fittings would then have a carrying amount of Rs. 9 million (4 + 5) and an unchanged remaining life of 3 years. Thus depreciation for the year ended 31 December 2015 is Rs. 3 million (9/3) and its carrying value is Rs. 6 million

Engine - at 1 January 2015 the accumulated depreciation of engine is Rs. 2.5 million (5 x18,000/36,000) and the carrying value is also Rs. 2.5 million.

Total Marks 08

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Winter 2016

Ans. 4

	Rs. Million	
Carrying value of property plant and equipment (650 + 312)	962	**1**
Fair value gain	16	
Additional depreciation (3*16/8)	(6)	**1**
Brand	18	**1**
Accumulated amortization (3*18/10)	(5.4)	**1**
	984.6	**1**

Total Marks 05

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Solutions – GATEWAY Management Accounting
Winter 2016

Ans. 1 **Calculation of Factory A & C in total after shutting down B**

Factory	A	C	
Operating Profit	80	130	01
Apportioned Head office cost (150/2)	(75)	(75)	1.5
Net Divisional Profit	5	55	1.5

Total Divisional Profit after shutting down = 5 + 55 = $60,000

Total Divisional Profit before shutting down = 30 - 20 + 80 = $90,000 **02**

Comparison with total before shutting down B

Difference = 60000 - 90000 = -30000 ($30000 decrease)

(Note: Discussion is necessary, only calculations are not enough)

Other Factors: **02**

- Reputation of company
- Effect on Sales of other factories

Total Marks 08

Ans. 2 **Sales Budget** **0.5**
Budgeted Sales x Selling Price = 100,000 x 50 = $5,000,000

Finished Goods Inventory Budget **1.5**
Production Units
= Budgeted Sales - Opening Inventory + Closing Inventory
= 100,000 - 10,000 + 12,000 = 110,000 units

Production Budget (kgs)
Production Requirement (kgs)
= Production Units - Opening Inventory + Closing Inventory **01**
= (110,000 x 10) = 1,100,000 kgs

Material Inventory Budget
Material Purchase Budget
= Production Requirement - Opening Inventory - Closing Inventory
= 1,100,000 - 150,000 + 120,000 = 1,070,000 kgs **02**

Total Marks 05

Solutions – GATEWAY Management Accounting
Winter 2016

Ans. 3

Product	Roya	Echo	Vox	
Variable Cost per unit	10	11	12	
Buy in cost	13	15	20	**01**
Excess buy in cost	3	5	8	
Birset usage per unit	2.5	3	3.5	**1.5**
	(5 / 2)	(6 / 2)	(7 / 2)	
Excess cost per limiting factor	1.2	1.67	2.23	**1.5**
	(3 / 2.5)	(5 / 3)	(8 / 3.5)	
Make / Buy	Buy	Make	Make	**03**

Discussion about:

- Contingency Plans
- Another Supplier
- Demand of Raw material rising could be anticipated

Total Marks 07

Solutions – GATEWAY Management Accounting
Winter 2016

Ans. 4

Simple Payback Period
2 years = $150,000 **0.5**
6 months = 50/100 x 12 **0.5**

2 years and 6 months

Discounted Payback Period

Year	Cash Flows
1	50 x 0.909 = 45.45
2	100 x 0.826 = 82.6
3	100 x 0.751 = 75.1

2 years = $128,050 **0.5**
11 months = 71.95 / 75.1 x 12

2 years and 11 months **1**

Net Present Value
PV of inflows
= 45.45 + 82.6 + 75.1 + 0.683 x (25 / 0.1) **1**
= 203.15 + 170.75 **0.5**
= 373.9 = $374,000 (rounding up) **0.5**

[4 - ∞ (perpetuity applied)]

Net Present Value
= 374,000 - 200,000
= $174,000 **0.5**

Total Marks 05

Solutions – GATEWAY Audit, Assurance & Ethics
Winter 2016

Ans. 1a

Information is said to be material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. **01**

Materiality depends upon the size and nature of the item. The onus is on the auditors themselves to decide, using their skill and judgment, what is material is and what is non-material. The same item and of the same magnitude may be material to one concern and non-material to another. **01**

Sometimes the auditor becomes aware of some piece of information (like knowledge of significant amounts of material costs not reported), which could have caused the auditor to set a different amount as materiality during the planning stage. Therefore the level of materiality (determined at the time of preparing the audit strategy) may change during the course of audit. **01**

Ans. 1b

Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. The main reason for an incorrect audit opinion is that the auditors receive and rely upon fraudulent or inaccurate information to base their findings and conclusions on. **01**

Consequently the main reason why an auditor ends up using such information is because of the three different types of risks all organizations (and subsequently their audits face). These risks are inherent risks, control risks and detection risks. **01**

The auditor's assessment of the risks identified at the assertion level provides a basis for considering the appropriate audit approach such as the nature, timing and extent of audit procedures.

- Nature: may prefer substantive procedures rather than tests of control
- Timing: may prefer to perform audit procedures at the period end (e.g. attending physical verification at the period end rather than at the interim period)
- Extent: may prefer to perform extensive audit procedures and try to obtain more extensive audit evidence (e.g. including deciding to visit more client locations)

1 mark per valid point.

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Solutions – GATEWAY Audit, Assurance & Ethics
Winter 2016

Ans. 1c

Audit Risk	Explanation
Adam Co has recently spent a substantial amount on repairing its main production plant in order to modernize it.	There is a risk that revenue expenditure may be misclassified as capital expenditure leading to overstatement of assets and profit.
To raise finance for these repairs, a 5-year loan was raised from a bank and the entire amount has been booked in non-current liabilities	There is a risk that loan is misclassified since the portion of loan payable within 12 months should be classified as a current liability. This would lead to errors in current and non-current liabilities.
Red Co has identified several items in inventory that were expired and have not been provided for in financial statements.	There is a risk that inventory may not be written down leading to overstatement in assets and profit. This is because expired inventory needs to be written down to Net Realizable Value.
Since competition has increased in recent years, revenue has fallen drastically over the past year leading to doubts about the company being a going concern.	There is a risk that management has not given adequate disclosures regarding uncertainty of going concern. This could mislead shareholders and other stakeholders.

0.5 marks for identification
0.5 marks for explanation

Total Marks 10

Ans. 2a

Depreciation has been understated by Rs.180,000 (Rs.750,000-Rs.570,000). This would result in an Overstatement in Assets and Profit.

1 mark for calculation of impact, 1 mark for impact on Financial Statements.

Ans. 2b

- Confirm the depreciation policy communicated by management with the policy in the Non-Current asset register.
- Check whether depreciation policy is consistently applied by comparing it with policy used in previous years.
- Review Non-Current register for fully depreciated assets still in use to identify errors in depreciation estimates.
- Re-cast the list of depreciation charge of individual assets
- Agree the total charge with the trial balance

1 mark per valid procedure

Ans. 2c

The amount of understatement is material as the understatement is 6% of PBT. (180,000/2,975,000*100) **01**

Since the misstatement is material but not pervasive, if unresolved, would require an except for qualification on the auditors opinion. **01**

Total Marks 06

Ans. 3a

- Inspection of bank documents and cash receipt documents for the period after the date of the financial statements, but before the date of the audit report and agree it with the receivables ledger.
- Inspect the correspondence with customers and confirm whether specific invoices have been confirmed. If so verify the validity of the confirmations.
- Verify the file for information on any disputes with the customers on accounts receivables. If correspondence is available, verify whether allowance for doubtful debts is required.
- In case subsequent payments are made before making payments of earlier overdue invoices, inquire with management the reasons for the same. Verify correspondence with customers in this connection.

1 mark for each valid procedure

Ans. 3b

- Verify vouchers of additions to non-current assets with purchase bills, architect's / solicitor's certificates.(Completeness and rights and obligations)
- Confirm that the board has approved the capital purchases. (Completeness and rights and obligations)
- Confirm that the expenditure which is capitalized is allocated to the appropriate account head i.e. maintenance expenses, capital expenses. The capitalization should be in accordance with the accounting policies of the entity and the accounting standards. (Valuation and allocation)
- Cast the schedule containing the additions to non-current assets and tally the total to the general ledger. (Completeness and valuation)

1 mark for each valid procedure

Ans. 3c The following factors are to be considered in order to determine the sufficiency of evidence:

- Source and reliability of available information (explained above)
- Experience of earlier audits (the auditor would increase the quantity of evidence on period end balances and transactions where misstatements on account of fraud or error were noticed in the previous audits)
- Results of audit procedures (if the physical count of assets indicates anomalies, the auditor will have to increase the quantum of evidence)
- Risk assessment (areas where the risk of material misstatement is high need to be supported with greater quantity of evidence)
- Nature of accounting and internal control systems (if the results of tests of control show efficient controls, the auditor can reduce the quantum of evidence)
- Materiality (the quantitative and qualitative factors which determine materiality need to be considered)

1 mark for each valid procedure

Total Marks 09