Corporate Sector

Model Solutions

Winter Exam-2015

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Business Economics

(Level-2)

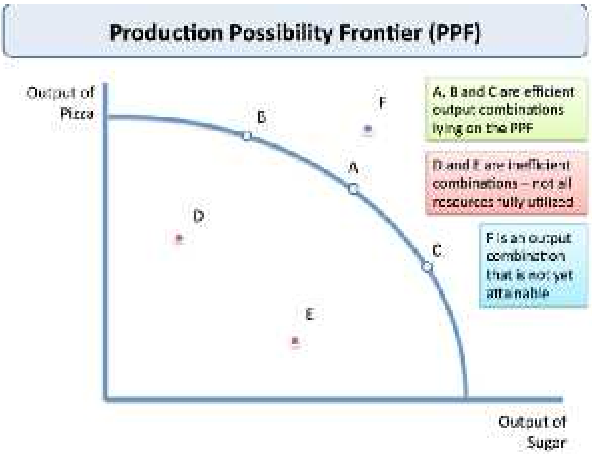
Pakistan Institute of
Public Finance Accountants

Winter Exam-2015

Economics

Ans. 1. **a)** Production possibility Frontier: A production possibility frontier (PPF) shows the maximum possible output combinations of two goods or services an economy can achieve when all resources are fully and efficiently employed. It is negatively sloped and concave to origin. **02**

b) **04**



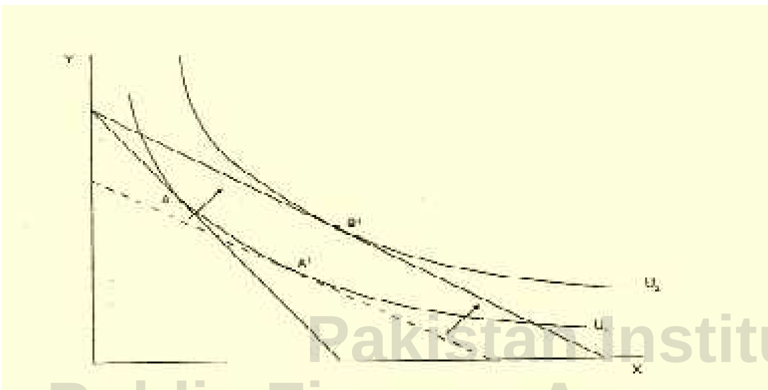
c) **(i)** The reason of downward sloping PPF is that in order to increase the production of one good, resource must be diverted from the other, hence decreasing the production of that good. **04**

(ii) The lack of perfect substitutability, or interchangeability, on the part of resources, and the resulting increase in the amount of one good that must be sacrificed in order to acquire more and more units of another good, is the reason of increasing opportunity costs or concavity of PPC. Determinants of the Elasticity of Demand.

Total Marks 10

Ans. 2. **a)** When consumer's equilibrium changes because of change in relative prices of goods it is called price effect and if price changes but consumer's income also changes in such a way as to leave their total utility unchanged the quantities of goods consumed will still change; because consumer will buy more of goods whose relative price, has fallen and less the goods whose relative price, has risen. When a consumer purchases more of the good whose price has fallen and has become even cheaper to relative good although increase in real income because of fall in price of good 'X' has been with drawn is known as Substitute Effect or Sliding over the same I.C.. The Substitute effect can be shown with the help of a diagram: **06**

Remaining on the same indifference curve, moving from one place to another is called substitution.



The movement from A to A' reflects the substitution effect

b) (i) Complementary Goods: **02**

These are the goods that tend to be bought and used together.
An increase in the price of one good decreases the demand for the other.

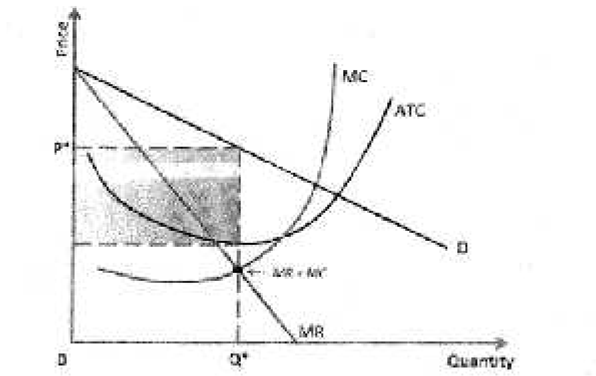
(ii) Cross Price elasticity of demand: **02**

Cross elasticity of demand (X.E.D) measures the responsiveness of demand for good **A** to a given change in the price of good **B.**

Total Marks 10

Ans. 3. **a)** ABC company is a monopoly. since it the only supplier of electricity in country X. The company's demand curve is also the industry/market demand curve and will be downward sloping. In this situation, it can decide on the price to charge or the quantity to supply, but not both. **08**

As it is a profit maximizing firm, ABC would choose the output where MC"'MR. Referring to the diagram below, profit is maximized at output Q. This output will be somewhere over the price range where demand is price elastic and will be sold at the price P.



It can be seen, at output Q, AR > AC. This means ABC would make abnormal profits and is shown by the shaded area. Since there are high barriers to entry, these supernormal profits will not be competed away in the long run. This will be a permanent feature i.e. in both the short and long run. However, it is important to note that regardless of neither maximizing profits, ABC company would neither be technically nor allocatively efficient.

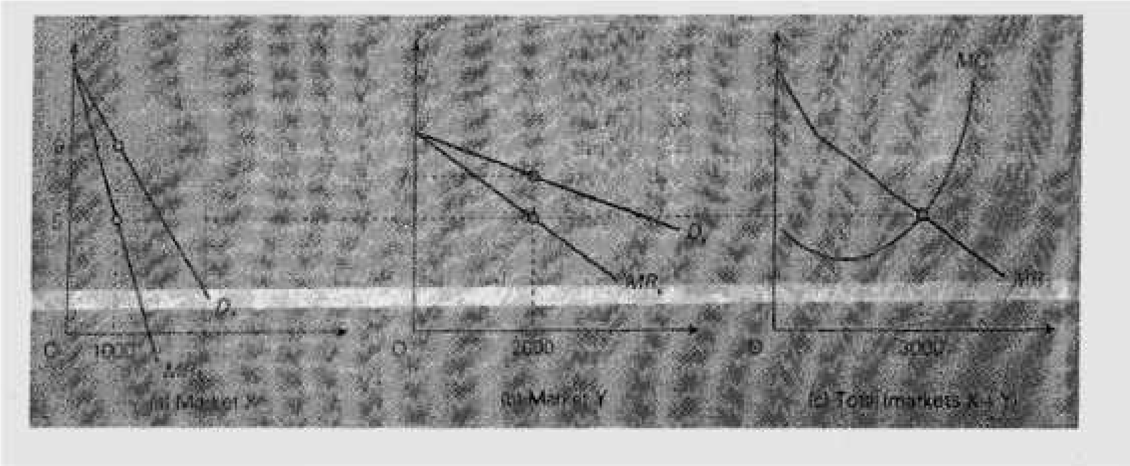
b) Monopolistic Competition: **02**

Monopolistic competition is a situation where there are many firms competing but where each firm does nevertheless have some degree of market power. The focus is primarily on product differentiation.

Total Marks 10

Ans. 4. **a)** Price discrimination is where a firm sells the same product at different prices in different markets. It can be explained with the help of an example. Assume that a firm wishes to maximize profits and that it sells an identical product in two separate markets X and Y with demand and MR curves as shown in the diagrams 'a' and 'b'. Diagram 'c' shows the MC and MR curves for the firm as a whole. **05**

Total profit is maximized where MC=MR i.e. at an output of 3000 units in total. This output must then be divided between the two markets so that MC=MR=$5 in each market. MR must be same in both markets otherwise true price discrimination won't take place. The profit maximizing price in each market will be given by the relevant demand curve. Thus, in market X 1000 units will be sold at $9; in market Y, 2000 units will be sold at $7 each. This is how a price discriminating firm would operate.



There are four main assumptions under which price discrimination can exist. These are;

1. the quality of the product must be identical in all markets
2. the firm must be able to set its price i.e price maker
3. the markets must be separate and no seepage should occur
4. demand elasticity must differ in each market

b) There are 3 conditions under which price discrimination can exist. These are; **04**

1. Market segregation.
2. Market sealing.
3. Multiple demand elasticities.

Total Marks 09

Ans. 5.

(i) Gross Domestic Product (GDP): GDP= GNP – IMPORTS + EXPORTS **03**
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.

(ii) Gross National Product (GNP): **03**
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.

(iii) Net National Product (NNP): **03**
If we deduct depreciation of capital from GNP, it becomes Net National Product(NNP)
NNP= GNP- Depreciation of capital

Depreciation of capital:
Reduction in the value of capital over the period of one year.

Total Marks 09

Ans. 6.

a) Autonomous Investment: **03**
This type of investment is independent of the level of income and aggregate demand. This type of investment is ordinarily undertaken by public bodies, or private organizations not pursuing profit. Examples of autonomous investment include: construction of highways, street lighting and other infrastructure projects.

Induced Investment:
Conversely, investment that is dependent on the level of income is known as induced investment. This type of investment is associated with private enterprise in pursuit of maximizing profit.

b) The government can influence the level of private investment in several ways: **07**

(i) Control interest rates: By keeping interest rates low, for example, the government might encourage a higher volume of investments, whereas by allowing interest rates to rise, the government would probably cause the volume of investment to fall. Government can influence interest rates.

(ii) Provide direct encouragement to investing firms: By offering investment grants, perhaps directed at particular regions, by lowering the cost of investment i.e. cost of doing business, by improving the rule of law, by providing tax incentives etc.

(iii) Seek to stimulate business confidence: By developing and announcing an economic policy for continued growth which should be consistent with the stated goals. Frequent and sudden changes in economic policy results in loss of business confidence.

(iv) Encourage technological developments: By financing research schemes of its own as well as those of private firms. In the long run, investment in education might be significant for the strength of innovative research and development by the count y's industries.

(v) Influencing the volume of consumption: Sometimes the government indirectly influence the level of investment, for instance a policy to control the growth in the money supply, would help in credit control and would in turn affect consumer spending, especially in consumer durable goods. Changes in consumption affects investment levels, with the influence of the accelerator.

(vi) Government spending: Higher government spending in infrastructure cerates demand which stimulates investment by the private sector.

Total Marks 10

Ans. 7. **a)** The number by which a change in investment must be multiplied to result in the final change of total output. **02**

K = Change in output(Y)/ change in Investment(I)

b) Initial investment=Rs. 100 MPC=0.7 **06**

Time Rounds	Change in 'Y'	Change in 'C'	Change in 'S'
1st	Rs. 100	100*0.7=70	30
2nd	70	70*0.7=49	21
3rd	49	49*0.7= 34.3	14.7
4th	34.3	34.3*0.7=24.01	10.29

The volume of total income generated depends upon the value of multiplier.

K = 1/1-MPC = 1/1-0.7= 3.33
K = change in 'Y'/change in 'I'
3.33 = Change in y/Rs. 100

Thus, Final amount of income generated= Rs. 333.33

c) **Limitations of Multiplier Effect: (Any 2 points are correct)** **04**

1. **Leakages:**
Leakages from the circular flow of income would make the value of multiplier very low and extra spending in the economy would have nominal effect, particularly where there is high marginal propensity for imports.

2. **Time Lag:**
Time Lag exists between when the initial investment will be made and when the full effects of the multiplier will be felt.

3. **Change in MPC.**

4. **Continuous increase in Investment.**

Total Marks 12

Ans. 8. **<u>Money Market:</u>** **10**

The financial market which is used to raise short-term credit.

<u>Instruments of Money Market:</u>

1) **Treasury Bills:** Treasury bill is short term instrument of finance. It is issued for a period of less than a year, mostly for 90 days. They are sold at discounted value and purchased by government at par value.
2) **Commercial Paper:** an unsecured, short-term loan issued by a corporation, typically for financing accounts receivable and inventories. It is usually issued at a discount, reflecting current market interest rates. Maturities on commercial paper are usually no longer than nine months, with maturities of between one and two months being the average.

<u>Capital Market:</u>

The financial market which is largely used to raise long-term finance and capital.

<u>Instruments of Capital Market:</u>

1) **Share Stock:** Share stock is an ownership certificate issued by the corporate sector. It can be divided into the following types.
   - **i)** Common share
   - **ii)** Preferential share
2) **Debentures:** A debenture is a loan certificate issued by the corporate sector for period of more than a year. A debenture holder gets fixed rate of interest. He cannot interfere in the affairs of company. He has no liability whatsoever.

Total Marks 10

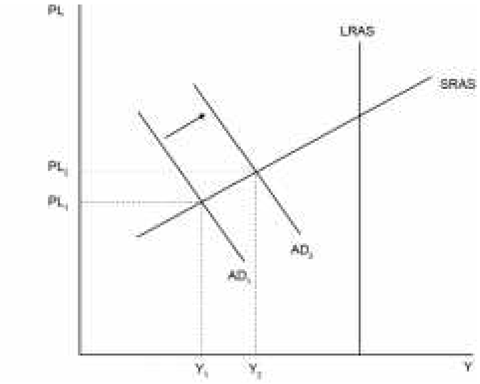
Ans. 9. An expansionary monetary policy will be used when the central bank wishes to stimulate the level of aggregate demand and economic growth in the economy. If the level of output is low, meaning central bank objective of economic growth is not being met, then they will look at ways of stimulating aggregate demand through one, or a combination of, monetary policies. **10**

To stimulate economic growth central bank expands the money supply by using one or more tools. Central bank can increase the money supply and aggregate demand by

- Decreasing the discount rate/bank rate
- Purchasing the bonds and securities from open market

- Decreasing the reserve ratio
- Increasing the credit limit

The central bank is concerned that the level of output in the economy is too low, and therefore decides to try and increase the level of aggregate demand in the economy. For example, It does so through buying government bonds in a round of open market operations.



By purchasing government bonds from commercial banks, the central bank transfers money to the banks, increasing the cash reserves that they hold. The commercial banks, with their bolstered reserves, will look to then loan out these additional reserves, to the level of the reserve rate. Doing so increases the reserve level for second-generation banks, which do the same. Consequently the initial increase in cash reserves to the first bank translates to a multiplied effect across the wider economy. This increases the level of money supply in the economy, and brings down the market rate of interest. Consequently firms and consumers then increase their investment and consumption respectively, and the level of aggregate demand increases. This is shown in the diagram by an increase in output from Y1 to Y2, and the price level from PL1 to PL2.

Total Marks 10

Ans. 10.

(i) <u>Balance of payment</u> **02**

It is the systematic record of economic transaction of a country with the rest of the world of all goods & services in a given period of time.

(ii) <u>Terms of trade</u> **02**

This is defined as the ratio of export prices to import prices. It is the amount of import goods an economy can purchase per unit of export goods. The terms of trade are said to improve when export prices rise faster than import prices and to worsen when import prices rise faster than export prices.

(iii) <u>Devaluation of Currency</u> **02**

Devaluation describes a policy of deliberately weakening the domestic currency against others; usually by reducing its parity value within a fixed rate system.

(iv) <u>Direct Tax</u> **02**

Tax whose burden cannot be shared with others is called direct tax. For example, income and property tax.

(v) <u>Barter system</u> **02**

It is system of exchange in which goods are traded with goods without using money. For example exchange of copy with pen.

Total Marks 10

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Business Laws

(Level-2)

Winter Exam-2015

Business Laws

Ans 1 (a)

The Federal Shariat Court consists of not more than eight Muslim Judges including the Chief Justice who are appointed by the President of Pakistan. 2.5

The Judges hold office for a period of three years. However, The President may, extend such period. 1.5

Ans 1 (b)

Distinction between Civil law and Criminal Law

Civil Law deals with disputes between individual and organization whereas Criminal Law is where the conduct which states unacceptable and which it wishes to prevent. 0.5

In Civil Laws legal proceeding are initiated by an individual or private individual or private person against another whereas criminal prosecution is brought to court by the state.

The Civil Law proves for remedies for civil wrong (tort) but there does not include imprisonment and /or time.
In criminal cases the burden of proof is much greater than in Civil Laws.

Civil Law

- Property Disputes
- Work related disputes
- Accusations of negligence
- Claims by consumers
- Commercial Disputes
- Copy right Disputes
- Claims of defamation
- Disputes for Breach of Contract

(0.5 marks for any two correct examples)

Criminal Law

- Fraud
- Money laundering
- Robbery
- Terrorist Activities
- Murder
- Theft, dacoity

(0.5 marks for any two correct examples)

Total Marks 10

Ans 2 (a)

The consideration or object on an agreement is lawful unless:

- It is forbidden by law. 01
- Is of such a nature that if permitted would defeat the provisions of any law . 01

	- It is fraudulent	0.5
	- It involves an injury to the person or property of another.	01
	- The court regards it as immoral, or opposed to public policy.	01
Ans 2 (b)-i	The first set for reciprocal promises, namely to sell the house and to pay Rs.2,000,000 for it, is a contract.	02
	The second set is for an **<u>unlawful object</u>**, namely, that B may use the house as a gambling house and is a **<u>void agreement and illegal</u>**.	02
Ans2 (b)-ii	It was held that A could not recover anything from B because the agreement was in restraint of trade and was thus void.	02
	Every agreement by which anyone is restricted from exercising a lawful profession, trade or business of any kind is to the extent void. [Section 27].	01

Total Marks 11

Ans 3 **Duties of agent**

The duties of an agent are as follow:

- Duty to carry out mandate
- Duty to follow instructions
- Duty to reasonable carefulness and proficiency
- Duty to maintain and render true & fair accounts.
- Duty to communicate
- Duty not to deal personally
- Duty to pay sums received.
- Duty in case of principal's death or insanity.
- Duty not to use critical information.
- Duty not to delegate authority.
- Duty in selecting sub-agent and substituted agent.
- Duty in case of emergency.

(01 mark each for any of the 10 correct points)

Total Marks 10

Ans 4 (a)

Condition	Warranty	
A condition is a stipulation which is essential to the main purpose of the contract.	A warranty is a stipulation which is collateral to the main purpose of the contract.	02
The aggrieved party can repudiate the contract of sale in case there is a breach of a condition.	The aggrieved party can claim damages only in case of breach of a warranty and cannot repudiate.	01

A breach of condition may be treated as a breach of a warranty. This would happen where the aggrieved party is contended with damages only.	A breach of a warranty can not be treated as a breach of a condition.	02

Ans 4 (b)

The following are the exceptions to the general Rule.
- Sale by mercantile agent. 01
- Sale by one of the joint owners. 01
- Sale by person in possession under voidable contract. 01
- Seller or buyer in possession after sale. 01
- Sale by estoppel. 01
- Sale by unpaid seller after exercising his right of lien or stoppage in transit. 01

Total Marks 11

Ans 5 (a)

Position of Choto on attaining majority
On attaining majority Choto has to decide within six months whether he shall continue in the firm or leave it. 01
- of his attaining majority or 01
- when he first comes to know that he had been admitted to the benefits of partnership, 01 whichever **<u>is later</u>**. 01

Within this period he should give a public notice of his choice: 01
- to become or 01
- not to become a partner in the firm. 01

If he fails to give a public notice, he is deemed to have become a partner in the firm on the expiry of the six months after obtaining majority. 01

Ans 5 (b)

Restrictions on the implied authority of a partner 05
Following acts are not included in the implied authority of partner unless there is any usage Or custom of trade:

<u>Arbitration</u>
Submit a dispute relating to the business of the firm to arbitration.

<u>Bank Account</u>
Open a banking account on behalf of the firm in his own name.

<u>Compromise</u>
Compromise or Relinquish any claim or portion of a claim by the firm.

Withdrawal of suit
Withdraw a suit or proceeding filed on behalf of the firm.

Acceptance of liability
Admit any liability in a suit or proceeding against the firm.

Transfer
Transfer immovable property belonging to the firm.

Partnership
Enter info partnership on behalf of the firm.

(01 mark for five correct point. For Heading only give 0.5 marks)

Total Marks 13

Ans 6 (a) Companies are required to hold the statutory meeting **after three month** and **before six months** From the date of entitlement to commence the business. 03

Ans 6 (b) **Certification & Filing of Report.**
Report shall be certified by the chief executive of the company and at least two directors. 03

Ans 6 (c) Direction of every company shall make out and attach to the accounts, Direction' repost containing Following particular namely 03

Statements regarding the state of the affairs of the company
Particulars of any amount recommended as dividend
Particulars of any amount transferred or proposed to be transferred to any reserve account.

Statement regarding the state of the affairs of the company.
Particulars of any amount recommended as dividend
Particulars of any amount transferred or proposed to be transferred to any reserve account.

Total Marks 09

Ans 7 (a) The Ordinance provides that unless a larger number is fixed by the articles, the minimum quorum shall be:

- In case of a public listed company - Ten members, present personally in the meeting, representing 25% voting powers, either on their own account or as proxies. 02
- In case of single member company - The single member present in person or proxy. 02
- In case of any other company - two members, present personally in the meeting, representing 25% of total voting powers, either on their own account or as proxies. 02

Ans 7 (b) **Timing, place and notice period for conduct of AGM.**

- The first annual general meeting of a company shall be held within **18 months** from the date of its incorporation and thereafter at least **once in a calendar year.** 02
- Subsequent annual general meeting shall be held **within four months** from closure of its financial year and **15 months from** the last meeting, whichever is earlier. 02
- At **least 21 days' notice** shall be given to members for holding of a meeting. Further in case of listed companies such notice shall also be **published in an Urdu and an English daily newspapers** having circulation in the **province in which the stock exchange,** on which the company is listed, is situated. 03
- AGM of a listed company is **held in the town** in which the registered office is situated, however **SECP may allow to hold any particular AGM elsewhere** than the town or registered office. 03

Total Marks 16

Ans 8 (a) The directors elected in a general meeting are entitled to hold the office of the **directors for three years** however; in listed companies, there may be a case when the elections of directors are held on **such time before the expiry of the three years** period **on orders of Commission**. 02

Where a person acquires **12.5% or more** voting shares in a listed company in his own name, he may apply to the **Commission for ordering** the company to hold fresh election of directors in the forthcoming annual general meeting of the company. The commission may, if it deems appropriate in the **interest of the company,** its **minority shareholders** or the **capital markets** generally, direct the company to hold the election of directors in the manner provided as above and the **company shall comply with such directions** of Commission. 06

The person on **whose request fresh elections of directors is held shall not sell or otherwise** dispose of the shares acquired by him for at **least one year from the date** of election of directors. 02

Ans 8 (b) **Qualification and disqualification of auditors [Section 254]** 02

For a public company and its subsidiaries and a private company having paid up capital of more than or equal to Rupees 3 million, the qualification of auditors is a chartered Accountant shall be appointed by its firm name as auditors of a company and may act in its firm name.

Disqualification of auditors:

The following named persons cannot act auditors of the company.

a person who is a director, other officer or employee of the company or held such a position at any time during the preceding three years. 1.5

A person who is a partner of a director, officer or employee of the company is in the employment of any of these person; 1.5

The spouse of a director of the company and a person who is indebted to the company however a person is not considered as indebted if the company is a utility provider and the auditor's credit card bill for not more than Rupees five hundred thousand are payable. 1.5

A person or his spouse or minor children, or in case of a firm, all partners of such firm who holds any share of an audit client or any of its associated companies: 02

However, as an exception if such a person holds shares prior to his appointment as auditor, the fact shall be disclosed on his appointment as auditor and such person shall disinvest such shares within ninety days of such appointment.

A person shall also not be qualified for appointment as auditor of a company if he is, by virtue of above stated disqualifications, disqualified for appointment as auditor of any other company which is that company's subsidiary or holding company or a subsidiary of that holding company. 1.5

Total Marks 20

Cost Accounting

(Level-2)

Ans. 1. Purchase price per unit of each grade in direct proportion to selling price of grades of material purchased is:

		Rs.	
A-5,000 Units	@ Rs.1.20	6,000	**(1)**
B-3,000 Units	@ Rs.1.00	3,000	**(1)**
C-2,000 units	@ Rs.0.50	1,000	**(1)**
Total selling price of all grade		10,000	

Cost of material i.e. Rs.9,000 is divided in proportion to 6,000 ; 3,000 ; 1,000 i.e. 6:3:1,

Cost of purchase of grade A $= 9{,}000 \times \frac{6}{10} = \text{Rs.}5{,}400$ **02**

Cost per unit $= \frac{5{,}400}{5{,}000} = \text{Rs.}1.08$ **02**

Cost of purchase of grade B $= 9{,}000 \times \frac{3}{10} = \text{Rs.}2{,}700$ **02**

Cost per unit $= \frac{2{,}700}{3{,}000} = \text{Re.}0.90$ **02**

Cost of purchase of grade C $= 9{,}000 \times \frac{1}{10} = \text{Rs.}900$ **02**

Cost per unit $= \frac{900}{2{,}000} = \text{Re.}0.45$ **02**

Total Marks 15

Ans. 2.

Calculation of contribution per Labour Hour

Direct labour hours worked	20,300	**(1)**
Less: Un-production hours pertaining to the new workers on training (60% of 500 hours)	300	**(1)**
Productive hours	20,000	**(1)**
Contribution for 20,000 hours	Rs.70,000	**(1)**
Contribution per labour hours $\left(\frac{70{,}000}{20{,}000}\right)$	Rs.3.50	**(1)**
Calculation of Productive Hours Lost		
Hours lost due to training of the new workers (i.e. 60% of 500 hours)	300	**(1)**
Hours lost because of delayed replacement	600	**(1)**
Productive hours lost	900	**(1)**

Calculation of profit foregone on account of Labour Turnover

		Rs.	
Contribution foregone on account of labour turnover (i.e. contribution for 900 producting hours lost @ Rs.3.50 per hours)		3,150	**(1)**
Add: Separation Cost	Rs.2,000		**(1)**
Selection Costs	Rs.3,000		**(1)**
Training Costs	Rs.5,000		**(1)**

	10,000	(1)
Profit foregone on account of labour turnover	13,150	(2)

Total Marks 15

Ans. 3.

Activity level Hours	Differential Hours	Budget Overhead Allowance	Differential	
	Rs.	Rs.		
3,000	--	10,000		(1)
7,000	4,000	18,000	8,000	(1)
11,000	4,000	26,000	8,000	(1)

Hence for a change of 4,000 hours in the level of activity, there is change of Rs.8,000 in the budget overhead allowance. Thus the budget rate of variable overhead

$= \frac{\text{Rs.8,000}}{4,000} = \text{Rs.2 per hour}$ **02**

Final cost= Total budget over head allowance – (Variable over head rate x activity level)

= Rs.18,000 – (2 x 7,000) = Rs.4,000 **03**

Standard overhead rate.	= Rs.2.50
Less variable overhead rate	= Rs.2.00
Fixed overhead rate	0.50 **02**

Standard activity level $= \frac{\text{Rs.4,000}}{\text{Re.0.50}} =$ 8,000 hrs **02**

Therefore budget overhead allowances both for fixed and variable for the standard level is Rs.4,000 + (8,000 x 2) = Rs.20,000 **02**

Total Marks 11

Ans. 4.

APPORTIONMENT OF JOINT COST (on the basis of weight)

Product	Yield	Apportionment of Joint Cost		
P	63	1,400	$(\frac{63}{900}$ x 20,000$)$	**02**
Q	117	2,600	$(\frac{117}{900}$ x 20,000$)$	**02**
R	180	4,000	$(\frac{180}{900}$ x 20,000$)$	**02**
S	540	12,000	$(\frac{540}{900}$ x 20,000$)$	**02**
Total out put	900	20,000		
Normal wastage (Bal. fig)	100	Nil		**01**
Input	1,000	20,000		**01**

Total Marks 10

Ans. 5. **Calculation of contribution per unit under FIFO System:**

		Rs.	
a)	Selling price of 1 unit of opening stock	10	
	Less: variable cost per unit of opening stock	5	02
	Contribution per unit of opening stock	5	
b)	Selling price per unit of current year's production	10	
	Less: Variable cost per unit of current year's production	6	
	Contribution per unit of current year's production	4	02

Break Even Volume in Units:

$$= \text{units from opening stock} + \frac{\text{Total fixed cost - Total contribution from units from opening stock}}{\text{Contribution per unit of current year's production}}$$ 02

$$= 6{,}000 \text{ units} + \frac{\text{Rs.}86{,}000 - (6{,}000 \times \text{Rs.}5)}{\text{Rs.}4}$$ 02

= 6,000 units + 14,000 units = 20,000 units 02

Break Even volume in Rs.= 20,000 units @ Rs.10 per unit = Rs.200,000 01

Total Marks 14

Ans. 6.(i) **Material price variance**

Actual quantity of material used (St. unit price – Actual unit price) 01

$$2300 \text{ kgs} \left(\text{Rs.}4 - \frac{\text{Rs.}9{,}800}{2{,}300 \text{ kgs}}\right) = \text{Rs.}600 \text{ Adverse}$$ 02

Ans. 6.(ii) **Material Usage Variance**

St. Unit price (St. usage – Actual usage) 01

Rs.4 (2,425 kgs – 2,300 kgs) = Rs.500 Favourable 02

(St. usage for actual production of 4,850 units @ 0.5 kg per unit = 2,425 kgs) 01

Ans. 6.(iii) **Labour Rate Variance**

Actual time (St. rate – Actual rate) 01

$$8{,}500 \text{ hours} \left(\text{Rs.}2 - \frac{\text{Rs.}16{,}800}{8{,}500 \text{ hours}}\right) = \text{Rs.}200 \text{ favourable}$$ 02

Ans. 6.(iv) **Labour Efficiently Variance**

St. rate (St. time – Actual time) 01

Rs.2 (9,700 hours – 8,000 hours) = Rs.3,400 Favourable 02

Ans. 6.(v) **Variable Overhead Expenditure Variance**

Actual hours worked (St. Variable overhead rate – Actual variable overhead rate) 02

or

Actual hours worked x St. variable overhead rate – Actual variable overheads

8,000 x Re. 0.30 – Rs.2,600 = Rs.200 Adverse 02

Ans. 6.(vi)	**Variable Overhead Efficiently Variance**	
	St. Variable overhead rate (St. hours produced – Actual hours)	**02**
	Re. 0.30 (9,700 – 8,000) = Rs.510 Favourable	**02**
Ans. 6.(vii)	**Fixed Overhead Expenditure Variance**	
	Budgeted fixed overhead – Actual fixed overheads	
	=5,100 units x Rs.7.40 – Rs.42,300	**02**
	=Rs.37,740 – Rs.42,300 = Rs.4,560 Adverse	**02**
Ans. 6.(viii)	**Fixed Overhead Volume Variance**	
	St. fixed overhead rate pr unit (Actual output – Budgeted output)	**02**
	Rs.7.40 (4,850 units – 5,100 units) = Rs.1,850 Adverse	**02**
Ans. 6.(ix)	**Sales Margin Variance due to Selling Price**	
	Actual quantity of sales (Actual Selling Price – St. Selling Price)	**01**
	$4{,}850 \text{ units} \left(\frac{\text{Rs.}95{,}600}{4{,}850} - \text{Rs.}20 \right) = \text{Rs.}1{,}400 \text{ Adverse}$	**02**
Ans. 6.(x)	**Sales Margin Variance due to Volume**	
	St. profit per unit (Actual quantity of sales – Budgeted quantity of sales)	**01**
	Rs.6 (4,850 units – 5,100 units) = Rs.1,500 Adverse	**02**

Total Marks 35

Financial Accounting

(Level-3)

Winter Exam-2015
Financial Accounting

Ans. 1

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

		Rs.	
Sales	W-01	2,600,000	
Less Cost of Goods Sold	W-02	2,010,800	
Gross Profit		589,200	0.50
Less : Administrative Expenses	W-03	(703,200)	
		(114,000)	
Less Finance Cost (1,500,000 * 10%) /2		(75,000)	1
		(189,000)	
Other Income	W-04	40,000	
Profi/(Loss) Before Taxes		(149,000)	0.50
Provision for Taxation		-	
Profit/(Loss) after Taxation		(149,000)	
Unapropriated Profit Brought Forward		(262,500)	0.50
Unapropriated Profit Carried Forward		**(411,500)**	0.50

GREEN ACRES (PRIVATE) LIMITED
BALANCE SHEET
AS ON JUNE 30, 2015

EQUITY AND LIABILITIES

EQUITY		**Rs.**	**Rs.**	
Paid up Capital		2,000,000		0.50
Unappropriated Profit		(411,500)		0.50
Total Equity			1,588,500	
Long Term Loan			900,000	1
Current Liabilities				
Current Portion of Long Term Loan		600,000		1
Bank Overdraft		173,000		0.50
Accounts Payable		350,000		0.50
Accrued Expenses and Other Liabilities		147,500		1
Total Current Liabilities			1,270,500	
TOTAL EQUITY AND LIABILITIES			**3,759,000**	1
ASSETS				
Non-current assets	W-05		196,000	1
Current Assets				
Closing Stocks		100,000		0.50
Accounts Receivables		3,243,000		0.50
Prepaid Expenses		20,000		0.50
Cash in Hand		200,000		0.50
Total Current Assets			3,563,000	
Total Assets			**3,759,000** #	1

Working Notes

Working - 01 (SALES)

Gross Sales			2,800,000	0.25
Less Sales Return			(150,000)	0.25
Purchase Return wrongly Credited			(50,000)	0.25
TOTAL SALES			**2,600,000**	0.25

Working - 02 (COST OF GOODS SOLD)

Opening Stock			120,000	0.25
Add Purchases		2,050,000		0.25
Add Transporation In		50,000		0.25
Less Purchase Return wrongly Credited to Sales		(50,000)		0.25
Less Purchase Return		(80,000)		0.25
Net Pruchases			1,970,000	
			2,090,000	0.25
Less Closing Stocks			100,000	
			1,990,000	
Depreciation on Plant and Equiptment	W-05		20,800	0.25
Cost of Goods Sold			**2,010,800**	0.25

Working - 03 (ADMINISTRATIVE EXPENSES)

Salaries (200,000 + 100,000)			300,000	0.25
Advertisement and Publicity			50,000	0.25
Stationary and Supplies			30,000	0.25
Utilties Expenses			30,000	0.25
Insurance Expenses			60,000	0.25
Sundry Expenses			50,000	0.25
Rent Expenses (180,000 - 20,000)			160,000	0.25
Depreation Expenses	W-05		23,200	0.25
Total Administrative Expenses			**703,200**	

Working - 04 (OTHER INCOME)

Commission Income			50,000	0.25
Un-earned Commission			(10,000)	0.25
			40,000	

Working - 05 (NON-CURRENT ASSETS)

	Furniture	Vehicles	Plant	Total	
Opening Balance as on January 01, 2013	50,000	120,000	130,000	300,000	
Less Accumulated Depreciation	10,000	24,000	26,000	40,000	
Written Down Value	40,000	96,000	104,000	240,000	
Depreciation Rate	10%	20%	20%		
Depreciation for the Year	4,000	19,200	20,800	44,000	0.75
Accumulated Depreciation as On Dec-31-2013	14,000	43,200	46,800	104,000	
Written Down Value as on June-30-2015	**36,000**	**76,800**	**83,200**	196,000	0.75

Total 20 marks

Ans. 2

ABDUL REHMAN & SONS
STATEMENT OF CASH FLOW
FOR THE YEAR ENDED JUNE 30, 2015

CASH FLOWS FROM OPERATING ACTIVITIES	Working	**Rs.**	**Rs.**	
Profit before Taxes			3,161,000	
Adjustments for :				
Depreciation	W-02	2,498,000		1
Gain and disposal of Fixed asset	W-03	(417,000)		1
Provision for Bad Debts (484,000 - 385,000)		99,000	2,180,000	0.50
Operating Profit before Working Capital Changes			5,341,000	
Increase in Debtors	W-04	(1,944,000)		1
Decrease in Stocks (14,950,000 - 12,178,000)		2,772,000		0.50
Increase in Creditors (3,457,000 - 2,850,000)		607,000	1,435,000	0.50
Cash from Operating Activities			6,776,000	
Cash Flow from Investing Activities				
Sale Proceeds of Fixed Assets		1,284,000		1
Purchase of Fixed Assets	W-05	(6,191,000)		1
Purchase of Investments		(4,911,000)		0.50
Cash used in Investing Activities			(9,818,000)	
Cash Flow from Financing Activities				
Capital Contributed	W-01	5,450,000		1
Increase in Short Term Finance		929,000		0.50
Drawings		(3,120,000)		0.50
Net cash flow from Financing Activities			3,259,000	
Net Increase in Cash and Cash Equivalents			217,000	
Opening Balance of Cash and Cash Equivalents			225,000	
Closing Balance of Cash and Cash Equivalents			**442,000**	1

WORKING NOTES

W-01 (CAPITAL ACCOUNT)

Balance Brought Forward	27,942,000
Balance Carried Forward	33,433,000
Increase in Captial Account	5,491,000
Profit for the year	(3,161,000)
Drawings	3,120,000
Capital contributed by owner	5,450,000

W-02 - DEPRECIATION

Balance Brought Forward	5,605,000
Balance Carried Forward	7,470,000
Increase in Depreciation	1,865,000
Depreciation on Disposal	633,000
Depreciaiton for the year	2,498,000
Total Depreciation	

W-03 - GAIN ON SALE OF FIXED ASSETS	**Rs.**
Cost	1,500,000
Less Accumulated Depreciation	633,000
Net Book Value of Equipmet	867,000
Sold	1,284,000
Gain on Sale of FIXED ASSETS	417,000

W-04 - INCREASE IN DEBTORS

Closing Balance Debtors (6,732,000 + 484000)	7,216,000
Opening Balance Debtors (4,887,000 + 385,000)	5,272,000
Increase in Debtors	**1,944,000**

W-05 - FIXED ASSETS

Balance Brought Forward (12,346,000 + 5,605,000)	17,951,000
Balance Carried Forward (15,172.000 + 7,470,000)	22,642,000
Increase in Fixed Assets	4,691,000
Assets Disposed Off	1,500,000
Total Increase in Fixed Assets	6,191,000

Total 10 marks

Ans. 3a

a. Ray Pharma	Units
Quatitative Data	1,200
Inventory as April 01, 2015 (as given in question)	5,200
Purchases for the quarter (3,200 + 2,000)	6,400
Inventory available for sale	(4,000)
Sales for the quarter (800 + 2,000 + 1,200)	2,400
Inventory as at June 30, 2015	

i) Computation of cost of goods sold and ending inventory as June 30, 2015	Rupees	
(a) Under FIFO method using periodic inventory system	3,000	0.50
Cost of goods sold	8,400	0.50
1200 @ Rs. 2.50/unit	**11,400**	
2800 @ Rs. 3.00/unit		
Ending Inventory		
400 @ Rs. 3.00/unit	1,200	0.50
2,000 @ Rs. 3.25/unit	6,500	0.50
	7,700	
(b) Under LIFO method using periodic inventory system		
Cost of goods sold		
2,000 @ Rs. 3.00/unit	6,000	0.50
2,000 @ Rs. 3.25/unit	**6,500**	0.50
	12,500	
Ending Inventory		
400 @ Rs. 3.00/unit	3,000	0.50
2,000 @ Rs. 3.25/unit	3,600	0.50
	6,600	

ii). Reason of higher Inventory Value under FIFO than LIFO

The prices of commodities and services, it is commonly observed, usually increase with the passage of time due to inflation and other reasons. Hence, the prices of inventory items purchased at the end of particular period are usually greater than the prices of inventory items purchased at the begining of the period. 03

The characteristic of FIFO method is that it values inventory at the latest purchase price (which is usually higher price than the previous purchase price) whereas the characteristics of LIFO methods is that it values inventory at oldest purchase price (which is usually lower than latest price). Due this reason the value if inventory under FIFO method is higher than LIFO method.

Ans. 3b

(A). Net Realisable Value

Net Realisable Value is the estimated selling price in the ordrinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

(B). Fair Value

Fair Value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Total 15 marks

Ans. 4

(A). Sale of Goods

Revenue from the sale of goods shall be recognised when all the following condition have been satisfied:

(a). The entity has transferred to the buyer the significant risks and rewards of ownership of the goods; 1

(b). The entity retains neither contining managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; 1

1

(c). The amount of revenue can be measured reliably; 1

(d). It is probable that the economic benefit associated with the transaction will flow to the entity; and 1

(e). The costs incurred or to be incurred in respect of the transaction can be measured relaibly.

(B). Interest, Royalities and Dividends

Revenue arising from the use by others of entity assets yielding interest, royalities and dividends shall be recognised on the bases set out when:

(a). It is probable that the economic benefits associated with the transaction will flow the entity; and 1

(b). The amount of the revenue can be measured relaibly. 1

Revenue shall be recognized on the following bases:

(a). Interest shall be recognized unsing the effective interest method as set out in IAS 39; 1

(b). Royalities shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and 1

(c). Dividends shall be recognised when the shareholder's right to receive payment is established. 1

Total 10 marks

Ans. 5a

JOURNAL ENTRIES IN THE BOOK OF ALI

Particualrs		Debit	Credit	
		Rs.	Rs.	
Realisation Account		276,250		
Stock in Trade			170,000	
Sundry Debtors			89,000	
Cash at Bank			13,000	
Cash in Hand			987	
Furniture and Fixture			2,750	
Investments			513	
(Being the transfer of different assets to Realisation Account				1
Sundry Creditors		110,000		
Accrued Expenses		750		
Bills Payable		12,500		
Realisation Account			123,250	
(Being the transfer of different Liabilities to Realisation Account)				1
New Firm Account (Note 01)		118,987		
Realisation Account			118,987	
(Being the Purchase consideration due from the new firm).				1
Realisation Account		750		
Capital Account			750	
(Being the accrued expenses not taken over by the new firm trfd to Capital A/c)				1
Capital Account		34,763		
Realisation Account			34,763	
(Being the Realisation Loss transferred to Capital Account).				1
Capital in New Firm A/c		118,967		
New Firm Account			118,967	
(Being the Settlement of Purchase consideration).				1
Capital Account		118,967		
Capital in New Firm			118,967	
(Being the Final Adjustment to close the books of accounts).				1

Ans. 5b

JOURNAL ENTRIES IN THE BOOK OF SALEEM

Particualrs		Debit	Credit	
		Rs.	Rs.	
Realisation Account		144,500		
Stock in Trade			98,000	
Sundry Debtors			37,000	
Cash at Bank			7,500	
Cash in Hand			234	
Furniture and Fixture			1,766	
(Being the transfer of different assets to				
Realisation Account				1
Sundry Creditors		47,000		
Accrued Expenses		2,000		
Realisation Account			49,000	
(Being the transfer of different Liabilities				
to Realisation Account)				1
New Firm Account (Note 01)		101,750		
Realisation Account			101,750	
(Being the Purchase consideration due				
from the new firm).				1
Realisation Account		2,000		
Capital Account			2,000	
(Being the accrued expenses not taken				
over by the new firm trfd to Capital A/c)				1
Realisation Account		4,250		
Capital Account			4,250	
(Being the Realisation Profit transferred				
to Capital Account).				
Capital in New Firm A/c		101,750		1
New Firm Account			101,750	
(Being the Settlement of Purchase				
consideration).				1
Capital Account		101,750		
Capital in New Firm			101,750	
(Being the Final Adjustment to close the				
books of accounts).				1

Winter Exam-2015
Financial Accounting

Note # 01

PURCHASE CONSIDERATION

Particulars		Rs. Ali	Rs. Saleem
Stock in Trade		144,500	107,800
Sundry Debtors		80,000	31,450
Cash at Bank		13,000	7,500
Cash in Hand		987	234
Furniture and Fixture		2,000	1,766
Investments		1,000	-
		241,487	148,750
Less Sundry Creditors		(110,000)	(47,000)
Bills Payable		(12,500)	
Net Assets taken over by the New Firm		**118,987**	**101,750**
Capital as per Agreement		200,000	100,000
(Cash to be Inducted) / Cash Withdrawn		**(81,013)**	**1,750**

BALANCE SHEET OF NEW FIRM
AS ON JULY 01, 2014

Partners Capital - Ali	200,000		0.50
Partners Capital - Saleem	100,000		0.50
		300,000	
Current Liabilities			
Creditors	157,000		0.50
Bills Payable	12,500	169,500	0.50
Total Capital and Liabilities		**469,500**	
Assets			
Non-current Assets - Furniture		3,766	1
Current Assets			
Debtors	252,300		0.50
Stock in Trade	111,450		0.50
Investments	1,000		0.50
Cash at Bank	99,763		0.50
Cash in Hand	1,221	465,734	
Total Assets		469,500	1

Total 20 marks

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Ans. 6

A - BRANCH STOCK ACCOUNT

IN THE BOOKJS OF THE HEAD OFFICE (ALPHA LIMITED - KARACHI) - HEAD OFFICE
BRANCH STOCK ACCOUNT

Debit Particulars	Rs.	Credit Particulars	Rs.	
Opening Balance Stock	2,400	Cash Sales by Branch	3,000	0.50+0.50
Goods Sent to Branch	72,000	Credit Sales by Branch	60,000	0.50+0.50
		Balance C/d	11,400	
	74,400		74,400	

B - BRANCH ADJUSTMENT ACCOUNT

IN THE BOOKJS OF THE HEAD OFFICE (ALPHA LIMITED - KARACHI) - HEAD OFFICE
BRANCH ADJUSTMENT ACCOUNT

Debit Particulars	Rs.	Credit Particulars	Rs.	
Closing Stock Reserve (Note # 03)	2,850	Opening Stock Reserve (Note #	600	01 + 01
Gross Profit Trfd to Profit and Loss Account	15,750	Goods Sent to Branch (Note # C	18,000	01 + 01
	18,600		18,600	

C - BRANCH DEBTORS ACCOUNT

IN THE BOOKJS OF THE HEAD OFFICE (ALPHA LIMITED - KARACHI) - HEAD OFFICE
BRANCH DEBTORS ACCOUNT

Debit Particulars	Rs.	Credit Particulars	Rs.	
Opening Balance	6,000	Cash Receipt from Branch	57,600	0.50+0.50
Credit Sales	60,000	Discounts by Branch	1,400	0.50+0.50
		Branch Bad Debts	300	01
		Balance C/d	6,700	01
	66,000		66,000	

D - BRANCH PROFIT AND LOSS ACCOUNT

IN THE BOOKJS OF THE HEAD OFFICE (ALPHA LIMITED - KARACHI) - HEAD OFFICE
BRANCH PROFIT AND LOSS ACCOUNT

Debit Particulars	Rs.	Credit Particulars	Rs.	
Discount Allowed	1,400	Gross Profit B/f.	15,750	01 + 01
Bad Debt Expenses	300	Net loss of Branch	950	01 + 01
Cash Expenses	15,000			01
	16,700		16,700	

Note # 01 - Opening Stock

Opening Stock (Invoice Value) = 2,400
Branch Margin = Cost Plus 33.333%

Branch Stock at Cost	1,800
Opening Stock Invoice Value	2,400
Opening Stock Reserve - Branch	600

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Note # 02 - Goods sent to Branch

Goods sent to Branch (Invoice Value) = 72,000

Branch Margin = Cost Plus 33.333%

Branch Goods sent at Cost	54,000
Goods sent at Invoice value	72,000
Goods sent Reserve - Branch	18,000

Note # 03 - Branch Closing Stock

Branch Closing Stock (Invoice Value) = 11,400

Branch Margin = Cost Plus 33.333%

Branch Goods sent at Cost	8,550
Branch Closing Stock at Invoice Value	11,400
Goods sent Reserve - Branch	2,850

Total 15 marks

Ans. 7

A. Elements of Costs

The cost of an item of property, plant and equipments comprises:

(a). Its purchase price, including import duties and non refundable purchase taxes, after deducting trade discounts and rebates. 1

(b). Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. 1

(c). The initial estimates of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquied or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. 2

B. Cost of the Machine

Invoice Price	2,500,000	0.5
Delivery (Frieght)	180,000	0.5
Installation	245,000	0.5
Start-up Costs	210,000	0.5
Total Machine Cost	**3,135,000**	0.5

Calculation of Net Residual Value

Estimated Residual Value	180,000	0.5
Less Costs to dismantle	(125,000)	0.5
Net Residual Value	**55,000**	0.5

Calculation of Depreciation for the year ended December 31, 2014

Cost of Machine	3,135,000	
Less Net Residual Value	(55,000)	
Depriciable Value	3,080,000	
Estimated Useful Life	14	
Annual Depreciation	**220,000**	1
Depreciation for the year ended December 31, 2014 = 220,000 x 9 / 12	**165,000**	1

Total 15 marks

Business Commn. & Report Writing

(Level-3)

Ans. 1 The Choice of a particular medium entirely depends upon the situations. Each of the following media is an appropriate choice for certain situations as discussed below:

Teleconference

This medium is appropriate:

- When there is a need of the real-time exchange of information between people who are not in the same physical space.
- When time- saving and high- travel cost saving measures are taken.
- When communication between the home office and the field staff is frequently required.

Advertisements

Advertisements are an integral part of marketing. They are the best choice when:

- Information needs to be disseminated to large audience.
- The objective is to change the thinking pattern (or buying behavior) of the recipients, so that they are persuaded to take the action desired by the advertiser.

Memoranda

Memos are often informal, with less attention to structure, formatting, and quality of paper.

- Memos are the best medium for internal correspondence.
- They may be used to notify staff members about-a meeting or new policy the company feels is important enough to merit more than a verbal message.

E-mail

- E-mail is a good channel for the routine communication to the concerning individuals or groups. It is suitable mainly for up-to-date and simple messages and where there is no risk of misunderstanding
- E-mail is an important supplement to weekly meetings and the Intranet.
- If saved, the email can function as proof of a message sent or received, and is easily accessible to remind the recipient of pertinent message.

Total Marks 08

Ans. 2 The information being communicated must possess the following qualities:

Appropriateness: The information must be appropriate - according to subject, needs of the receiver and environment.

Reliability: Reliable information is the information that one can rely on as being correct. It will be from a valid and trusted source.

Timeliness: Timely information is information that is from the correct time period. If a company wants to analyze current profit and loss, they will need to access current sales figures and not the sales figures from past years. We can say that timely information is information that is available as and when needed

Cost Effectiveness: Cost effective information is information that is worth investing the time and money to get to help make business decisions. As an example, if a survey cost Rs.100,000 and we used that information to increase our profits by Rs.250,000 in the next month, then this could be seen as cost effective information.

Accuracy: Accurate information helps businesses make the correct decisions. As an example, if a sales department sent inaccurate sales figures to the finance department, this might result in incorrect tax calculations for the company that would put them in risk.

Relevance: Relevant information is information that is directly related to your business need. If a business was looking to cut costs they might look at their utility bills, travel costs, etc. and try to see where they could save money.

User friendly: Information that is used for a business purpose needs to be understandable by the end user. As an example, if a non -financial person wanted information about the sales for the last 3 years, the information for him should not be a complex set of figures taken from a database. It must an easy to read graph with clear instructions on the totals sales for each of the last 3 years.

Total Marks 07

Ans. 3a Emphatic listening means to listen with the objective of understanding the speaker's emotions, feelings, needs and wants. **2.5**

Emphatic listening assists the listener in appreciating more fully the speaker's perspectives regardless of whether the listener agrees with the speaker.

Ans. 3b Techniques involved in emphatic listening include: **7.5**

- **Focus –** provide the speaker with undivided attention and avoid multitasking and interruptions.
- **Don't judge** – the listener must not minimize or trivialize the speaker's issue. The listener should understand the perspectives of the speaker and should not be judgmental.
- **Read the speaker** – this involves being alert to the emotions behind the words such as anger, fear, frustration or resentment. The emphatic listener should respond to the emotion as well as words.
- **Be quiet** – pauses and silences are often as powerful as the words themselves. The listener should not interrupt and let speaker finish his message. The listener should reflect sensitivity to the emotions being expressed.
- **Assure -** the listener should ask questions and restate what they perceive the speaker to have said in order to clarify their understanding. Once again this process will often prompt the speaker to identify their own solution.

Total Marks 10

Ans. 4 Answers will vary but it must focus on the following:

1. Get the reader's attention by mentioning benefits of the message to the reader.
2. Build the reader's interest by emphasizing relevance of the messages to the reader.
3. Increase the reader's desire by supporting the viewpoints stated in the message with relevant evidence.
4. Motivate the reader to take action and state the positive result of the action. The action should have clarity and be easy to adopt.
5. Present emotional and logical appeals in a balanced manner. Substantiate the appeal by presenting facts and evidence for complex ideas and recommendations.
6. Reinforce the Request by providing additional evidence of the benefits of the message and establish the sender's credibility in presenting the message.
7. Anticipate objections from the reader and be prepared to offer convincing replies, with the necessary pros and cons of the original message.

Total Marks 15

Ans. 5 The axioms of communication attempt to explain how miscommunication can occur if the communicators are not subconsciously aligned. Axiom theory argues that if one axioms is disturbed, communication may fail.

- **Content and relationship dimensions of communication** – In certain situations, aside from the content of the message, an understanding of the difference in the nature of the relationship between the sender of the message and the recipient could lead to a better understanding of the message.

  A lack of understanding of the relationship dimension of communication could give rise to conflict and misunderstanding in spite of the fact that the content dimension of the communication may essentially be the same in similar situations.

  The communication has a relationship dimension which exists between the parties in terms of family ties, status and nature of association. This needs to be kept in mind when interpreting the message and understanding the message that is actually communicated.

- **Irreversibility of communication –** It means that what has once been said or communicated cannot be retrieved, withdrawn or called back.

  However, the adverse impact of the message can subsequently be mitigated by sending a qualified message or an apology – for example adding "only joking" after having criticized someone.
  The irreversibility of communication imposes an obligation on the sender to exercise care and abstain from stating something which may later cause embarrassment or regret.

Total Marks 05

Ans. 6

i. Physical noise

Physical noise is any external or environmental stimulus that distracts us from receiving the intended message sent by a communicator." The disturbance in the theatre was a physical noise which was external to both the speaker and the listener and distracted from receiving the complete message.

ii. Filtering

Filtering implies willful distortion of information. This problem usually arises in upward communication. In upward communication, employees tend to pass only those messages that create positive impression about them." The given scenario represents that the regional manager sent the information deliberately suppressed/ manipulated to make it attractive enough to earn appreciation from the head office.

iii. Differences in Perceptions and Differences in language register

Perceptions are based on individuals' experiences, knowledge, and background. The Differences in perception can influence the receiver draw different conclusions. The language register is the language we use for a particular purpose or in a particular context. Since we have different language registers, we interpret messages differently. The internee with a different perception and language register could not interpret the message as intended by the supervisor.

Total Marks 03

Ans. 7

Within the business context there are a number of key factors that will drive the most appropriate selection of media and channel. Some of them are as under:

- **Time** : Urgency and time available to prepare and transmit.
- **Complexity** : Use of diagrams and combination of media.
- **Written Record** : Consider the need for an audit trail.
- **Sensitivity** : How would a letter be received compared to face-to-face discussion, particularly when delivering bad news.
- **Cost** : Employee time is expensive.
- **Interaction** : Is there a need for instant feedback and spontaneity?

Total Marks 06

Ans. 8

The answers will vary but it must contain the following:

1. Introduction
2. Problem details
3. Industry background
4. PEST analysis
5. SWOT analysis
6. Competitor analysis
7. Conclusions and recommendations

Total Marks 16

Ans. 9 **Benefits of video conferencing.**

1. A video conference is the best solution, when face-to-face meeting is not possible and a live conversation is needed.
2. Reduced travel costs and ability to be in several places without leaving your office.
3. Increased productivity across dispersed workforces and teams.
4. A real-time exchange of information with an advantage of picking nonverbal cues which essentially supplements verbal communication.
5. Short-notice meetings: Enable individuals in distant locations to participate in meetings at short notice.
6. Telecommuting: Greatly assists the facilitation of telecommuting (home working) enabling businesses to embrace workforce diversity and flexible working. This helps improve work-life balance, particularly with the reduction in lengthy commutes.
7. Competitive advantage: Sustained competitive advantage from:
   - Improved sharing of knowledge;
   - Faster and more informed decisions that reduce time to market for new products and services;
   - Improved relationships with suppliers and customers; and
   - Good public relations through promoting video conferencing as proof of environmental initiatives.

Total Marks 10

Ans. 10 A circular letter provides information to a large group of people. Circular letters should get straight to the point and not bury news amongst lots of other points which would run the risk of readers losing interest and missing the main point.

Answers will vary but must contain the following:

- Opening : Explain the situation.
- Body : Main idea first followed by extra explanatory information as necessary. One topic per paragraph.
- Closing : End positively including offers of help and more information (with contact details) if needed.

Total Marks 10

Ans. 11 **Answers will vary but the report must outline the progress of the tasks including:**

1. Work completed and work remaining,
2. Costs incurred and remaining cost to complete the project
3. Schedule of original and anticipated time for completion of the project
4. Problems faced

Total Marks 10

Taxation

(Level-3)

Winter Exam-2015

Taxation

Ans. 1 **(a) Direct Taxes:**

Direct taxes are such taxes which are borne by the person who is charged to tax[01mark] under the law. Generally, the taxpayer cannot shift the burden of tax[01mark] to other persons.

Indirect Taxes:

Indirect taxes are such taxes which are ultimately borne by and shifted to the end consumer[02marks] of the goods.

Kinds of Taxes in Force in Pakistan:

Following are different kinds of taxes in Pakistan:

1. Income tax;	Direct
2. Capital value tax;	Direct
3. Zakat and Ushr;	Direct
4. Customs duty;	Indirect
5. Sales tax; and	Indirect
6. Federal excise duty.	Indirect

(1/2 mark for each kind of tax)

(b) **Federal Consolidation Fund** is a fund which consists of all revenues received[01mark], all loans raised[01mark] and all monies received by the Federal Government in repayment of any loan[01mark].

Public Account of the Federation is an account in which all monies (other than those which are part of Federal Consolidation Fund) received by or on behalf of the Federal Government[01mark]

OR

received by or deposited with the Supreme Court[0.5mark] or any other court established under the authority of the Federation are credited[0.5mark].

Total Marks 12

Ans. 2 '**Company'** includes the followings:

1. A company as defined in the Companies Ordinance, 1984;
2. A body corporate formed by or under any law in force in Pakistan;
3. A modaraba;
4. A company incorporated outside Pakistan;
5. A co-operative society;
6. A finance society;
7. Any other society;
8. A non-profit organization;
9. A trust, an entity or body of persons established under any law;
10. A foreign association declared by Board as company;
11. A Provincial Government;
12. A Local Government in Pakistan; or
13. A Small Company as defined in section 2 (59A).

(1/2 mark for each point subject to a maximum of 06 marks)

Total Marks 06

Winter Exam-2015

Taxation

Ans. 3

Name of Taxpayer	:	**Mr. Khanjee**
National Tax Number	:	**XXX**
Tax Year Ended on	:	**30th June,**
Tax Year	:	**2016**
Personal Status	:	**Individual-Salaried**
Residential Status	:	**Resident**

TAXABLE INCOME AND TAX PAYABLE

Salary Income:		**Rs.**	
Salary		1,550,000	**0.5**
Bonus		144,000	**1.0**
Performance award		56,000	**1.0**
Employer's contribution to Provident Fund **155,000-100,000] - [N-5]**		55,000	**2.0**
House rent **[N-1]**		697,500	**3.0**
Conveyance **[N-4]**		80,000	**2.0**
Total salary income		2,582,500	
Income from Business (poultry farm)		50,000	**0.5**
Total income		2,632,500	
Less: Zakat (2,500 + 20,000)		(22,500)	**1.0**
Total taxable income		**2,610,000**	
Tax Liability			
Tax on Rs. 2,500,000		259,500	
Tax @ 20%		22,000	
Total Rs. 110,000 @ 20% (2,610,000 – 2,500,000)		281,500	**2.0**
Less: Tax credits for:			
Donation **[N-2]**	2,157		**3.0**
Life Insurance premium **[N-3]**	2,157	(4,314)	**3.0**
Total tax liability		277,186	
Less: Tax deducted at source		(50,000)	**0.5**
Tax payable		**227,186**	**0.5**

Note: Dividend (Gross) amount to be shown as FTR & Tax deducted as well.

N-1 Where accommodation is provided by the employer, the following amount shall be included in salary income:

- 45% of the MTS/Basic Salary (i.e., 45% of Rs. 1,550,000) Rs. 697,500

N-2 Tax credit on donation will be computed at average rate of tax.

281,500 ÷ 2,610,000 x 20,000 = 2,157

While computing tax credit on donation it is assumed that donations were given to such institution which are not included in Clause (61) of Part-I of Second Schedule. Had it been part of Clause (61), a straight deduction form total income would have been allowed.

N-3 Tax credit for life insurance premium: 281,500 ÷ 2,610,000 x 20,000 = 2,157

N-4 10% of the cost of the car exclusively used for family is included in taxable salary income of an employee. Other one shall have no tax treatment.

N-5 It is assumed the same amount is contributed by employer and PF is also recognized. So, employer's contribution is exempt up to $^{1}/^{10\ th}$ of salary or Rs. 100,000 whichever is less

Total Marks 20

Winter Exam-2015

Taxation

Ans. 4 **Section 56, 57 and 59 of Income Tax Ordinance 2001**

Business Loss

(i) Where a person sustains a loss for a tax year under the head "income from business", the said loss can be fully offset against the person's income, if any, chargeable to tax under any other head of income. **2.0**

(ii) Where such loss cannot be fully offset against the income of any other head for that year, so much of the loss that has not bee offset fully, may be carried forward to the following tax year and set off against the person's chargeable income under the head "income from business" for that year. **2.0**

(iii) No loss can be carried forward for more than six years immediately succeeding that tax year for which the loss was first computed. **2.0**

(iv) Where the business loss includes deductions allowed under depreciation and amortization that have not been set off against income, the amount not set off, may be added to the deductions allowed under these heads in the subsequent years and so on without any limit. **2.0**

Capital Loss

(i) Where a person sustains a loss for a tax year under the head "capital gains", the loss cannot be offset against the person's income under any other head of income for that tax year. **2.0**

(ii) The capital loss may be carried forward to the subsequent tax year and offset against the capital gains of subsequent years. **2.0**

(iii) No such loss can be carried forward for more than six tax years immediately succeeding the tax year in which the loss was first computed. **2.0**

Neither a Business Loss nor a Capital Loss can be set off or carried forward if the related gain is exempt from tax. **1.0**

Total Marks 15

Ans.5 **(a) FILING OF RETURN OF TOTAL INCOME [114(1) & (1A)]**

Subject to this ordinance, the following persons are required to furnish a return of income for a tax year, namely:-

(i) every company;

(ii) every person (other than a company) whose taxable income for the year exceeds the maximum amount that is not chargeable to tax under this Ordinance for the year;

(iii) any non-profit organization as defined in clause (36) of section 2;

(iv) any welfare institution approved under clause (58) of Part I of the Second Schedule;

(v) Any person who:

- Has been charged to tax in respect of any of the two preceding tax years;
- claims a loss carried forward under this Ordinance for a tax year;
- owns immovable property with a land area of two hundred and fifty square yards or more or owns any flat located in areas falling within the municipal limits existing immediately before the commencement of Local Government Laws in the provinces; or areas in a cantonment; or the Islamabad Capital Territory
- owns immovable property with a land area of five hundred square feet or more located in a rating area;
- owns a flat having a covered area of two thousand square feet or more located in a rating area;
- owns a motor vehicle having engine capacity above 1000CC;
- has obtained National Tax Number; or
- is the holder of commercial or industrial connection of electricity where the

amount of bill exceeds rupees five hundred thousand; or

- Is a resident person registered with any chamber of commerce and industry or any trade or business association or any market committee or any professional body including Pakistan Engineering Council, Pakistan Medical and Dental Council, Pakistan Bar Council, Institute of Chartered Accountants of Pakistan or Institute of Cost and Management Accountants of Pakistan.

(1/2 mark for each point subject to a maximum of 05 marks)

(b) (Legal Procedure Where Return of Income is Not Complete)

The following procedure shall be adopted in a case where a person has filed an incomplete return.

1. The Commissioner shall issue a notice to the taxpayer pointing therein the deficiency in the return and the due date of removing the deficiency. **2.0**
2. The notice shall not be issued after the expiry of one hundred and eighty (180) days from end of the financial year in which return was furnished. **1.0**
3. Where the taxpayer has fully complied with the requirements of the notice issued by Commissioner, the return furnished by the taxpayer shall be treated as complete on the date of filing of return. **1.0**
4. A return shall be treated as invalid and not furnished with the tax authorities if the taxpayer fails to fully comply with the notice within the due date. **1.0**

Total Marks 10

Ans. 6.

KARWAN LIMITED
Computation of Sales Tax Liability
For the Month of October 2015

Input tax			
(a)	Local purchase of raw material from:		
			Sales Tax @17%
	Registered persons	Rs. 160,000,000	27,200,000
	Unregistered persons	Rs. 50,000,000	-
(b)	Import of raw material:		
	C & F value	Rs. 40,000,000	
	Add: Customs duty @ 10%	Rs. 4,000,000	
		Rs. 44,000,000	7,480,000
	Total Input Tax for the Month		34,680,000
	(-) Input Tax on Exempt Goods not to be claimed (N-1)		(3,015,652)
	(-) Input Tax on export to be refunded (N-1)		(4,523,478)
	Total input tax for the month to be claimed		27,140,000

Output tax:		**Rs.**
Export Sales	30,000,000	-
Local Sales of exempt goods.	20,000,000	-
Taxable supplies– Registered persons	180,000,000	30,600,000
Total output tax for the month		30,600,000
(-) Input Tax may be claimed against output lower of: 90% of output 27,540,000 or 2,714,000		(27,140,000)
Sales tax payable with Return		3,460,000
Sales Tax on exports claimed for refund		4,523,478

Winter Exam-2015

Taxation

N-1 **Total Supplies**

Export + Exempt + Taxable	230,000,000
Input on Exempt Supplies = $\frac{20,000,000}{230,000,000} \times 34,680,000$	3,015,652
Apportionment of input tax on raw material $\frac{30\ M}{230\ M} \times 34,680,000$	4,523,478

Total Marks 13

Ans. 7 **(a)** **BASIS OF THE DUTY [3(1) & (3)]**

The duty may be charged on any of the following basis:

1. Percentage to the value of the goods or services *(ad valorem)*; **1.0**
2. Percentage to the retail price of the goods or services; **1.0**
3. Production capacity of the plant, machinery, installations, etc.; or **1.0**
4. Fixed duty. **1.0**

(b) **MANUFACTURER** [2(16)]

'Manufacturer' <u>includes</u> the following persons: **1.0**

1. A person who employs hired labour in the production or manufacture of excisable goods. **1.0**
2. A person, who is engaged in production or manufacture of his own goods, provided that the goods are intended for sale. **1.0**
3. Any person who, whether or not carries out any process of manufacture himself or through his employees, gets any process of manufacture carried out on his behalf by any person who is not in his employment. Under this case it shall be deemed that he has manufactured the goods in which he deals in any capacity. **1.0**

Total Marks 08

Ans. 8 **(a)** 'Goods' means <u>every kind of movable property excluding</u> the following: **0.5**

1. Actionable claims; **0.5**
2. Money; **0.5**
3. Stocks; **0.5**
4. Shares; and **0.5**
5. Securities. **0.5**

(b) Under the following cases 'open market price' shall be taken as value of the supply:

1. Where the consideration of supply is in kind or partly in kind and partly in money; **1.0**
2. Where the supplies are made to an associated person against no consideration or for a consideration, which is lower than the open market price; and **1.0**
3. Where for any special nature of a transaction it is difficult to ascertain the value of a supply. **1.0**

(c) Rule 11 of Sales Tax Rules 2006

(i) The following registered person may apply for deregistration. **1.0**

- Who ceases to carry on his business **1.0**
- Whose supplies become exempt from tax **1.0**
- Whose total taxable turnover during the last twelve months remain below the limit **1.0**

(ii) The local Registration Office may de-register a person if that person fails to file tax return for six months. **1.0**

(iii) Where a person is de-registered then the said person:

1. Does not have to maintain sales tax record. However, the previously maintained record has to be kept in tact for a period of six (6) years; **1.0**
2. Cannot charge sales tax to his customers after de-registration; **1.0**
3. Cannot claim the credit for input tax; **1.0**
4. Cannot claim the refund on zero-rated basis even if the goods are exported; and **1.0**
5. Has to account for sales tax on any taxable stocks in hand. **1.0**

Further, the obligations and liabilities relating to the period when a person conducted business as a registered person shall not be affected by the fact that he ceased to be a registered person or his registration has been cancelled. **1.0**

(Subject to maximum of 10 marks)

Total Marks 16

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Financial Reporting

(Level-4)

Parent Company Limited
Consolidated statement of financial position
As at June 30, 2015

Ans. 1.

	Rs.	Rs.
Assets		
Non current assets		
Tangible assets (150,400+150,050+25,000-12,500)	312,950	
Intangible assets (150,250+200,000-200,000)	150,250	
Goodwill (150,000-30,000) (W-2)	120,000	583,200
Current assets (550,350+250,350)		800,700
		1,383,900
Equity and liabilities		
Equity –ordinary share capital	500,000	
Consolidated retained earnings (W-4)	131,112.50	631,112.50
Non controlling interest (W-3)		51,937.50
		683,050
Noncurrent liabilities (350,450+125,000-125,000)		350,450
Current liabilities (250,250+100,150)		350,400
		1,383,900

Working Notes

	%
W-1 Group structure	75
Group	25
NCI	**100**

W-2 Goodwill

Investment (600,000 – 125,000)	475,000	
NCI at fair value(5000 shares x Rs 25/share)	125,000	
Share capital		200,000
Pre-acquisition reserves		225,000
Fair value gain		25,000
Goodwill (Balancing Figure)		150,000
	600,000	600,000

W-3 Non controlling interest	**Rs.**
Faire value of NCI	125,000
Post-acquisition loss [(W-5) 262,250 ×25%]	(65,562.50)
Impairment loss on goodwill (25% of 30,000)	(7,500)
	51,937.50

W-4 Consolidated retained earnings	(Rupees)
Parent company	350,300.00
Impairment loss on goodwill (30,000x 75%)	(22,500.00)
Subsidiary retained earnings [(W-5) 262,250 ×75%]	(196,687.50)
	131,112.50

W-5 Subsidiary post acquisition profit	**Post**
Balance (175,250-225,000)	(49,750)
Extra depreciation (25,000/4)x2	(12,500)
Intangible asset wrongly capitalized now corrected	(200,000)
	(262,250)
Group share 75%	(196,687.50)
NCI share 25%	(65,562.50)

Total Marks 25

Ans. 2a. The provision is only required for the redundancy to be paid, as IAS 37 only permits the provision to be recognized for present obligation resulting from past event which results in probable out flow of entity resources. IAS 37 does not allow provision for any future event relating to future activity. Therefore, only expense and provision will be recognized for Rs. 5 million.

Ans. 2b. The stock should be written down to net realizable value of Rs. 2.5 million and loss should be recognized for Rs. 8 million by lowering the value of closing stock. This is an adjusting event because the sale of inventories after the reporting period provide evidence about the NRV at the end of the reporting period (IAS 10(9)(b)(ii).

Ans. 2c. The following costs may be capitalized if the improvement in the production process meets the criteria for recognizing an expenditure as intangible asset as has been given in IFRS.

	Rs. (millions)
Designing cost of pilot plant	0.5
Manufacturing of pilot plant	1.5
Total	2.0

<u>Expense incurred to be charged to P & L A/c:</u>

Even if the criteria is met as discussed above the following expenses would be recognized in the profit and loss account as research expenses:

	Rs. (millions)
Feasibility study expenses	2.5
Identification of various alternatives	1.2
Identification of best alternative	0.2
Total	3.9

Total Marks 12

Ans. 3.

		Rs.	Rs.
a)	**Tax expense**		
	Current tax **(W-1)**	44,632.5	
	Deferred tax **(W-2)**	(8,121)	36,511.5
b)	**Deferred tax liability**		
	Closing balance		211,879

W-1 Current tax

Profit before tax		115,250
Add: donation	25,000	
Accounting depreciation	30,000	55,000
Less: capital gain	(10,000)	
Tax depreciation	(25,000)	(35,000)
Taxable profit		135,250
Current tax @33%		44,632.5

W-2 Deferred tax

Opening deferred tax		220,000
Deferred tax (credit)	**(balancing)**	(8,121)
Closing deferred tax [(220,000/0.34)- 5,000] x 0.33		211,879

Total Marks 08

Ans. 4.

Statement of financial position	**2015 Rs.**	**2014 Rs.**
Non-current Assets		
Leased asset-cost **(W-2)**	195,930	195,930
Accumulated depreciation	(70,372)	(35,186)
	125,558	160,744
Non-current liabilities		
Lease liability **(W-1)**	87,816	123,990
Current liabilities		
Lease liabilities **(W-1)**	36,175	32,195
Interest payable **(W-1)**	7,439	9,371

Statement of comprehensive income		
Depreciation (195,930-20,000)/5	35,186	35,186
Interest expense	15,873	19,627
	51,059	54,813

W-1

Date	Installment	Interest	Principal	Balance
01-07-13				195,930
01-07-13	25,000	-	25,000	170,930
01-01-14	25,000	10,255.8	14,744.2	156,185.8
01-07-14	25,000	9,371.148	15,628.85	140,556.9
01-01-15	25,000	8,433.417	16,566.58	123,990.4
01-07-15	25,000	7,439.422	17,560.58	106,429.8
01-01-16	25,000	6,385.787	18,614.21	87,815.57
01-07-16	25,000	5,268.934	19,731.07	68,084.51
01-01-17	25,000	4,085.071	20,914.93	47,169.58
01-07-17	50,000	2,830.175	47,169.83	-0.24634
	250,000	54,069	195,929	

W-2 Present value of minimum lease payments

PV=25,000 + Annuity factor x 25,000 + discount factor x 50,000

PV=25,000 + (25,000 x 5.5824) + (50,000 x 0.6274)

PV=25,000 + 139,560 + 31,370

$\left.\begin{array}{l}\text{PV=195,930}\\ \text{FV=200,250}\end{array}\right\}$ whichever is lower 195,930

Total Marks 15

Ans. 5.

Identification of reportable segment

Reportable segment	Basis
A	Rev/profit/assets
B	Rev/profit/assets
C	Profit
D	Rev/profit/assets
F	Profit/assets

W-1 Identification of reportable segment 10% threshold (Para 13 of IFRS- 08)

Segment	Revenue	Profit/ (loss)	Assets
A	(230/1,063)x100=22%	(42/115)x100=37%	(1,500/7,205)x100=21%
B	(148/1,063)x100=14%	(08/115)x100=7%	(650/7,205)x100=9%
C	(74/1,063)x100)=7%	(10/115)x100=9%	(425/7,205)x100=6%
D	(430/1,063)x100=40%	(19/115)x100=17%	(2,500/7,205)x100=35%
E	(77/1, 063)x100=7%	(7/115)x100=6%	(630/7,205)x100=9%
F	(104/1,063)x100=10%	(29/115)x100=25%	(1,500/7,205)x100=21%

Reportable segment under 10% thresholds are segments A, B, D & F

W-2 Identification of reportable segment 75% threshold (Para 15 of IFRS- 08)
External revenue of reportable segments under 10% threshold/entity external revenue is 83% (737/888 x 100), therefore no need to identify additional reportable segment as the external revenue of reportable segment is greater than 75% of entity revenue.

Total Marks 08

Ans. 6.

Interest to be capitalised	Alternative 1 Rupees	Alternative 2 Rupees
Gross on Rs. 50,000,000 @ 12% per annum for 5 months	2,500,000	2,500,000
Less: Interest earned on unused funds	500,000	750,000
Net interest to be capitalised	2,000,000	1,750,000

Alternative 1

Date	Balance of unused funds	Interest for the month
01-09-2014	40,000,000	200,000
01-10-2014	30,000,000	150,000
01-11-2014	20,000,000	100,000
01-01-2015	10,000,000	50,000
01-02-2015	0	
		500,000

Alternative 2

Date	Balance of unused funds	Interest for the month
01-09-2014	50,000,000	250,000
01-10-2014	40,000,000	200,000
01-11-2014	30,000,000	150,000
01-01-2015	20,000,000	100,000
01-02-2015	10,000,000	50,000
		750,000

Total Marks 10

Ans. 7.

			Rs.	Rs.
Cost	01-07-2012			150,000
Depreciation	30-06-2013		150,000x20%	(30,000)
Depreciation	30-06-2014			(30,000)
Carrying value	30-06-2014			90,000
Revaluation surplus	30-06-2014			80,000
Revalued amount	30-06-2014			170,000
Depreciation	30-06-2014 to 01-01-2015		(170,000×30%÷2)	(25,500)
Carrying value	01-01-2015			144,500
Adjustment against revaluation surplus			80,000-(80,000×30%÷2)	(68,000)
Adjustment against profit or loss account				(31,500)
				(99,500)
Recoverable value (higher of value in sale / use)				45,000
	Value in sale		45,000	
	Value in use		40,000	
Depreciation	01-01-2015 to 30-06-2015		(45,000/1.5)x0.5	(15,000)
Carrying value of asset	30-06-2015			30,000

Total Marks 12

Ans. 8.

Rising Star Limited
Statement of Financial Position
As at June 30, 2015

		2015 Rs. (m)	2014 Rs. (m)
Assets			
Fixed assets			
Property, plant and equipment	2015 (3,750+250-12.5-25+75-37.5)	4,000	2,937.5
	2014 (2,700+250-12.5)		
Equity and liabilities			
Equity –retained earnings	2015 (3,400+958.50-950+161.5)	3,570	2,261.5
	2014 (2,100+1661.5-1,500)		
Noncurrent liabilities			
Deferred tax liability	2015 (850+4+76)	930	576
	2014 (500+76)		

Rising Star Limited
Statement of Comprehensive Income
For the year ended June 30, 2015

		2015	2014
		Rs. (m)	Rs. (m)
Profit before tax	2015 (1,590-25+75-37.5) 2014 (2,300+250-12.5)	1,602.50	2,537.5
Tax expense	2015 (12.5x32%)+640 2014 (237.5x32%)+800	(644)	(876)
Profit after tax		**958.50**	**1,661.5**

Total Marks 10

Management Accounting

(Level-4)

Ans 1

Budgeted results					Mrks
	Year 1	Year 2	Year 3	Total	
	Rs.	Rs.	Rs.	Rs	
Sales revenue	240,000	480,000	120,000	840,000	**0.5**
Variable cost (W)	40,000	80,000	20,000	140,000	**0.5**
Fixed cost(W)	80,000	120,000	80,000	280,000	**0.5**
Marketing cost	60,000	40,000		100,000	**0.5**
Profit	60,000	240,000	20,000	320,000	**0.5**

Working		Mrks		Mrks
	Units		Cost	
	Rs.		Rs.	
Highest activity level	14,000	**0.5**	150,000	**0.5**
Lowest activity level	10,000	**0.5**	130,000	**0.5**
	4000		20,000	

Variable cost per unit = Rs. 20,000/4000 units =Rs. 5 **01 mrk**

Fixed cost= Total cost - Variable cost

= 150,000 – (14,000 x 5)

=Rs. 80,000 **01 mrk**

If volumes exceed 15,000 units, fixed costs = Rs.80,000 x 1.5 =Rs.120,000 **02 mrks**

Assessment

The stealth will make a profit in each of the three year with the highest profit in Year 2. In total, the net profit margin 38% (320,000/840,000 x100%) which is also above the target 35%. **0.5 mrk**

The contribution rate is 83% (30 -5/30 x100%) which is also above the expected 75%. This indicates that the production process is expected to be under control and reliable. **0.5 mrk**

Aman may therefore be satisfied that using traditional performance measures, the Stealth will be successful. However, this falls to take into account the design and development costs of Rs.300,000. If this is incorporated into the profit forecast, the profit is the only Rs.20,000. This may still be acceptable but it does illustrate the importance of looking at costs throughout the entire lifecycle. **0.5 mrk**

Total Marks 10

Ans. 2

Month Wise Cash Budget						
	Rs. In '000					
	March	Mrks	April	Mrks	May	Mrks
Opening balances	100,000		109,204		104,828	
Collections	83,800	**01**	68,800	**01**	59,400	**01**
Payments:						
Purchases	(47,250)	**0.5**	(44,250)	**0.5**	(48,000)	**0.5**
Selling expenses	(13,200)	**0.5**	(14,400)	**0.5**	(15,600)	**0.5**
Administrative expenses	(8,800)	**0.5**	(9,600)	**0.5**	(10,400)	**0.5**
Packing machinery	(3,000)	**0.5**	(3,000)	**0.5**		
Tax withheld by 80% of customers	(2,346)		(1,926)		(1,663)	
@ 3.5%						
	(74,596)		(73,176)		(75,663)	
Closing balance	109,204	**0.5**	104,828	**0.5**	88,565	**0.5**
Working Notes:						
W-1: Collections – Jan Sales					85,000	
Feb Sales					95,000	

	Mar	Apr	May
Sales Gross	55,000	60,000	65,000
Collections:			
Cash Sales	11,000	12,000	13,000
1st month after sales	45,600	26,400	28,800
2nd month after sales	27,200	30,400	17,600
	83,800	68,800	59,400
W-2 Purchases:			
Sales Gross (June)			75,000

		Feb	Mar	Apr	May
Sales Gross		95,000	55,000	60,000	65,000
Cost of Sales [75% of sales]	A	71,250	41,250	45,000	48,750
Less: Opening stock		(57,000)	(33,000)	(36,000)	(39,000)
[80% of cost of sales]	B				
Add: Closing stock		33,000	36,000	39,000	45,000
[80% of next cost of sales]	C				
Purchases (A+C-B)		47,250	44,250	48,000	54,750
Payment to creditor			47,250	44,250	48,000

Total Marks 10

Ans. 3

Relevant cost - Material K

Since the material is regularly used by the company, the relevant cost of material K is the current price of the material.

		Mrks
Cost last month	Rs. 19,600	
	2,000kg	
	= Rs. 9.80	0.5
Revised cost (=5%)	Rs. 9.80 x 1.05	
	= Rs. 10.29	0.5
Relevant cost of material **K**	3,000kg x Rs. 10.29 per-kg	
	= Rs. 30,870	0.5

Relevant cost- Material L

Mrks

Since the material is not required for normal production, the relevant cost of this material is its net reasonable value if it were sold.

Relevant cost of material L	200kg x Rs. 11 per-kg	1
	Rs. 2,200	

Relevant cost- skilled Labour

Skilled labour is in short supply and therefore the relevant cost of this labour will include both the actual cost and the opportunity cost of the labour employed.

	Rs.	Mrks
Cost of skilled labour (800 hours x Rs. 9.50)	7,600	0.5
Opportunity cost of skilled labour (see working)	8,000	0.5
Relevant cost- skilled labour	15,600	0.5

Working

Skilled labour cost per unit of Product P	Rs. 38	
	Rs. 9.50	
	4 hours	
Contribution per unit of product P	Rs. 40	
Contribution per skilled labour hour	Rs. 40	
	4 hours	0.5
	Rs. 10 per hour	
Opportunity cost of skilled labour	800 hours x Rs. 10 per hour	
	Rs. 8,000	0.5

Financial Viability of the common process

Product	Selling price after common process	Litres	Total revenue	
	Rs./Litre			
M	6.25	25,000	156,250	05 mrks
N	5.2	15,000	78,000	
P	6.8	45,000	306,000	

Less costs at the end of common process

Net revenue at the end of the common process

Therefore the common process is viable as net revenue is positive

Optimal processing plan for each product

Product	Further revenues	Further costs	Incremental net revenue from further processing	Mrks
M	Rs. 2.15 x 25,ooo = 53,750	Rs. 1.75 x 25,000 = 43,750	10,000	**01**
N	Rs. 1.25 x 15,000 = 18,750	Rs. 0.95 x 15,000 = 14,250	4,500	**01**
P	Rs. 0.65 x 45,000 = 29,250	Rs. 0.85 x 45,000 = 38,250	9,000	**01**

Therefore products M and N make additional profit and so should be processed further.
Product P should not be processed beyond the common stage as net revenue is negative. **02**

Total Marks 20

Ans. 4

Make or Buy	Component A	Mrks	Component B	Mrks
	Rs.		Rs.	
Cost of making internally	10.0	**01**	17.0	**01**
Cost of buying	12.5	**01**	23	**01**
Extra Variable cost of buying	2.5	**01**	6.0	**01**
Quantities required next year	30,000		20,000	
Total extra cost of buying	75,000	**0.5**	120,000	**0.5**
Fixed cost saved by closure	40,000	**0.5**	50,000	**0.5**
Net extra costs of buying	35,000	**0.5**	70,000	**0.5**

It appears that it would cost the company more each year to shut down internal production of either component and switch to external purchasing **01**

Production Hours required	Hours	Mrks
Component A(30,000*0.25 hrs)	7500	**0.5**
Component B(20,000*0.75hrs)	15000	**0.5**
Total Hours required	22500	**0.5**
Total hours available	19500	**0.5**
Shortfall	3000	**0.5**
There are insufficient hours available to manufacture everything internally. Some components must be purchased externally.		

	Component A	Mrks	Component B	Mrks
	Rs/unit		Rs/unit	Cost of making
Internally	10		17	
Cost of buying	12.5	**0.5**	23	**0.5**
Cost saved by making	2.5	**0.5**	6	**0.5**
Hours required to make internally	0.25hrs	**0.5**	0.75hrs	**0.5**
(Rs. 3/Rs.12 per hour : Rs. 9/ Rs.12 per hour)				
Costs saved per hour by making	Rs.10	**0.5**	Rs.8	**0.5**
(Rs. 2.50/0.25 hours: Rs.6/0.75 hours)				
It is better to make component **A** internally than Component **B**				**01**

Component	Unit	Hours	Cost/unit(Rs)	Cost(Rs)	Mrks
A	30,000	7500	10	300,000	**0.25**
B(balance)	16,000	12,000	17	272,000	**0.25**
Variable cost of internal manufacture		19,500		572,000	**0.5**
Cost of external purchase-		4000	23	92000	**0.5**
balance if units required					
Fixed cost				120,000	**0.5**
Total costs				784,000	**0.5**

Total Marks 20

Ans. 5

Project Appraisal

(a) Depreciation must first be added back to the annual profits figure, to arrive at the annual cash flows.

Depreciation = initial investment 46,000 – scrap value Rs.4,000 = Rs.10,500

4Years

Adding Rs. 10,500 per annum to the profits figure produces the cash flows for each proposal.

Year	Proposal A		Proposal B	
	Annual Cash flow Rs.	Cumulative Cash flow Rs.	Annual Cash flow Rs.	Cumulative Cash flow Rs.
0	(46,000)	(46,000)	(46,000)	(46,000)
1	17,000	(29,000)	15,000	(31,000)
2	14,000	(15,000)	13,000	(18,000)
3	24,000	9,000	15,000	(3,000)
4	9,000	18,000	25,000	22,000
5	4,000	22,000	4,000	26,000

1. **Proposal A**

2 & 0.5 Marks

Payback period = $2 + \frac{15,000 \times 1 \text{ year}}{24,000}$ = 2.6 years

Proposal B

2 & 0.5 Marks

Payback period = $3 + \frac{3,000 \times 1 \text{ year}}{25,000}$ = 3.1 years

2. The return on capital employed (ROCE) is calculated using the accounting profits given in the question.

Average investment = $\frac{46,000 + 4,000}{2}$ =25,000 **02 mrks**

Proposal A

Average profit = $\frac{\text{Rs. }(6,500 + 3,500 + 13,500 - 1,500)}{4} = \frac{\text{Rs. }22,000}{4}$ = Rs. 5,500 **01 mrk**

ROCE on average investment = $\frac{\text{Rs. }5,500 \times 100\%}{\text{Rs. }25,000}$ = 22% **0.5 mrk**

Proposal B

Average profit = $\frac{\text{Rs. }(4,500 + 2,500 + 4,500 + 14,500)}{4} = \frac{\text{Rs.}26,000}{4}$ = Rs. 6,500 **1 mrk**

ROCE on average investment = $\frac{\text{Rs. }6,500 \times 100\%}{\text{Rs. }25,000}$ = 26% **0.5 mrk**

(b) Two advantages of the methods of appraisal can be selected from the following Payback period

1. It is simple to calculate
2. It preserves liquidity by referring early cash flow
3. It uses cash flows instead of more arbitrary accounting profits.
4. It reduces risk by referring early cash flows

(0.5 Marks for each relevant point)

Return on capital employed

1. It uses readily available accounting profits.
2. It is understood by non-financial managers.
3. It is a measure used by external analysts which should therefore be monitored by the company.

(0.5 Marks for each relevant point)

Total Marks 15

Ans. 6 There has been a growing emphasis on NFPIs for a number of reasons.

(a) Concentration on too few variables. If performance measurement systems focus entirely on those items which can be expressed in monetary terms, managers will concentrate on only those variables and ignore other important variables that cannot be expressed in monetary terms. **01**

(b) Lack of information on quality. Traditional responsibility accounting systems fail to provide information on the quality or importance of operations. **01**

(c) Changes in cost structures. Modern technology requires massive investment and product lifecycles have got shorter. A greater proportion of costs are sunk and a large proportion of costs are planned, engineered or designed into a product/service before production/delivery. At the time the Product/service is produced/delivered, it is therefore too late to control costs. **01**

(d) Changes in competitive environment. Financial measures do not convey the full picture of a company's performance, especially in a modern business environment. **01**

(e) Changes in manufacturing environment. New manufacturing techniques and technologies focus on minimizing throughput times, inventory levels and set-up times. But managers can reduce the costs for which they are responsible by increasing inventory levels through maximizing output. If a performance measurement system focuses principally on costs, managers may concentrate on cost reduction and ignore other important strategic manufacturing goals. **0.5**

(f) NFPIs are a better indicator of future prospects. Financial performance indicators tend to focus on the short term. They can give a positive impression of what is happening now but problems may be looming. For example, falling quality will ultimately damage profitability. **0.5**

Total Marks 05

Ans. 7a

	20X8		20X7	
Current ratio	572.3/501.0 = 1.14	**01**	523.2/420.3 = 1.24	**01**
Quick ratio	453.3/501.0 = 0.90	**01**	414.2/420.3 = 0.99	**01**
Receivables' payment period	329.8/2,065.0 x 365 = 58 days	**01**	285.4/1,788.7 x 365 = 58 days	**01**
Inventory turnover period	119.0/1,478.6 x 365 = 29 days	**01**	109.0/1,304.0 x 365 = 31 days	**01**
Payables' turnover period	236.2/1,478.6 x 365 = 58 days	**01**	210.8/1,304.0 x 365 = 59 days	**01**

As a manufacturing group serving the construction industry, the company would be expected to have a comparatively lengthy receivables' turnover period, because of the relatively poor cash flow in the construction industry. It is clear that the company compensates for this by ensuring that they do not pay for raw materials and other costs before they have sold their inventories of finished goods (hence the similarity of receivables' and payables' turnover periods). **2 mrks**

2 mrks

The company's current ratio is a little lower than average but its quick ratio is better than average and very little less than the current ratio. This suggests that inventory levels are strictly controlled, which is reinforced by the low inventory turnover period. It would seem that working capital is tightly managed, to avoid the poor liquidity which could be caused by a high receivables' turnover period and comparatively high payables.

Ans. 7b

The objectives of working capital management are usually taken to be profitability and liquidity. Profitability is allied to the financial objective of maximising shareholder wealth, while liquidity is needed in order to settle liabilities as they fall due. A company must have sufficient cash to meet its liabilities, since otherwise it may fail. However, these two objectives are in conflict, since liquid resources have no return or low levels of return and hence decrease profitability. **3 mrks**

Working capital management is central to financial management for several reasons. First, cash is the life-blood of a company's business activities and without enough cash to meet short-term liabilities, a company would fail. Second, current assets can account for more than half of a company's assets, and so must be carefully managed. Poor management of current assets can lead to loss of profitability and decreased returns to shareholders. Third, for SMEs current liabilities are a major source of finance and must be carefully managed in order to ensure continuing availability of such finance. **3 mrks**

Total Marks 20

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Audit, Assurance & Ethics

(Level-4)

Ans. 1a Fraud is an intentional act by an individual or group of individuals involving the use of deception to obtain an unjust or illegal advantage; error on the other hand, is a mistake which is unintentional in nature and does not involve an in individual or group of individuals engaged in deceptive activity. Fraud would therefore, include the three elements of an incentive/pressure, opportunity and attitude; all three being required for a person to commit a fraudulent activity. An error could be made any individual and would likely occur in the course of business being carried out in good faith. In short, it is the mal-intention which differentiates a fraud from an error. **04**

Ans. 1b ISA 240 describes the following two types of fraud: **02**

1. Misappropriation of assets - Embezzling receipts, stealing physical assets or intellectual property, causing an entity to pay for goods and services not received, using an entity's assets for personal use
2. Fraudulent financial reporting - Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation, misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information and intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Ans. 1c **Fraudulent Financial Reporting - Risk Factors** (Any six out of the following are required) **06**

Incentives/Pressures

a) **Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):**

- High degree of competition or market saturation, accompanied by declining margins.
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.
- Significant declines in customer demand and increasing business failures in either the industry or overall economy.
- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.
- New accounting, statutory, or regulatory requirements.

b) **Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:**

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example; overly optimistic press releases or annual report messages.
- Need to obtain additional debt or equity financing to stay competitive including financing of major research and development or capital expenditures.
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.

c) **Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:**
- Significant financial interests in the entity.
- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow.25
- Personal guarantees of debts of the entity.

d) **There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.**

Opportunities

a) **The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:**
- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.
- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.
- Use of business intermediaries for which there appears to be no clear business justification.
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

The monitoring of management is not effective as a result of the following:
- Domination of management by a single person or small group (in a non owner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.

b) **There is a complex or unstable organizational structure, as evidenced by the following:**
- Domination of management by a single person or small group (in a non owner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.

c) **There is a complex or unstable organizational structure, as evidenced by the following:**
- Difficulty in determining the organization or individuals that have controlling interest in the entity.
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority.
- High turnover of senior management, legal counsel, or those charged with governance.

d) Internal control components are deficient as a result of the following:
- Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of staff in accounting, information technology, or the internal audit function that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations
- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards, those are not effective.
- Nonfinancial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the-basis of materiality.
- The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:
  - Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.
  - Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.
  - Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.
  - Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

Total Marks 12

Ans. 2.

Audit engagement letter is issued by an auditor to the client or its management. In this letter the auditor specifies the agreed terms of the audit. Key contents of **Audit** engagement letter:

- The objective and scope of the audit of financial statements; **01**
- The responsibilities of the auditor; **01**
- The responsibilities of management; **01**
- Identification of the applicable financial rep otting framework for the preparation of the financial statements; **01**
- Reference to the expected form and content of any reports to be issued by the auditor and; **01**
- A statement that there may be circumstances in which a report may differ from its expected form and content. **02**

Total Marks 07

Ans. 3(a)

Professional, skepticism means that the auditor should recognize the fact that circumstances may exist that may cause the financial statements to be materially misstated. Consequently, he should make a critical assessment with a questioning mind of the validity of audit evidence obtained. He should remain alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and the reliability of other information obtained from management and those charged with governance. **03**

Ans. 3(b)

Risk assessment is a key feature of the audit planning process as on the basis of risk assessment the auditor will determine: **02**

- The amount of audit work to be performed in general, and
- The areas on which the auditor will focus his attention

Total Marks 05

Ans. 4

Recalculation

- Calculating depreciation expense by applying the depreciation rate and comparing with the amount recorded by the client.
- Calculating the amount of sales tax or excise duty based on the value of an invoice.
- Calculating exchange gain/loss on a foreign currency balance receivable or payable.
- Calculating amortization of an intangible asset based on its life.
- Calculating rent expense for a year by applying escalation as listed in the rent agreement

Inspection of records

- Examination of a legal agreement Review of an invoice to ensure recognition at appropriate amount.
- Reading of minutes of meetings of board of directors to identify significant events and conditions.
- Review of last month's electricity bill to obtain information about the bills for the last 12 months

Inspection of assets

- Physical verification of inventories
- Physical count of cash in hand
- Examination of fixed assets
- Examination of physically-held investments

Analytical Review

- Preparation of a trend analysis of revenue and comparison with marketing expense
- Comparison of payroll expense with number of employees at each month end
- Calculation of ratios and comparison with industry averages or prior periods
- Computation of debtors days to identity changes in credit limit or pattern of receipt from customers.

Total Marks 12

Ans. **2 marks for each valid action point if appropriately explained.**

5(a) First of all it needs to be ascertained whether this event which has happened after the reporting date for Flash Lights current financial year, is an adjusting or non-adjusting event in terms of IAS 10 Events after the balance sheet date.

As per the terms of the letter received, it appears that the customer was facing a tough financial time since over a year. This implies that the events or circumstances indicating the risk of non-recovery already existed on the date of Balance Sheet. **1.5**

The receipt of the letter us therefore an adjusting subsequent event and requires the adjustments of Rs. 10 million in the financial statements (please see note 1) **1.5**

From a materiality point of view, the Rs. 10 million receivable from this customer is 22% of total trade receivables, 5% of total assets and over 19% of profit for the year. By all means, this is a material amount and we as auditors need to persuade management to record the amount as an adjusting event. **1.5**

We should first discuss the matter with management and try to obtain further information about the customer. We would need to ask:

Whether any other correspondence exists with this customer which points out to the non-recovery of the amount.

Whether there is any other amount in addition to the Rs. 10 million owed by the customer which may also need to be considered for charging to the income statement. **1.0**

Whether the company has any security deposit of the customer which can be adjusted against the receivable balance **1.0**

Whether management believes any amount is likely to be recovered after having applied pressure on the customer by litigation or other means of recovering the amount. **1.0**

We also need to review the significant transactions with this customer during the year and the correspondence with him so as to obtain the complete picture with regard to this receivable. **1.0**

In terms of ISA 560, a review of events after the date of this letter also needs to be carried out to ascertain what action management has undertaken in respect of the recovery. **1.0**

Reading of the minutes of meetings of board of directors or other senior management committees should be done to find out what discussion has taken place with regard to recovery of amount from this customer. **1.0**

We need to find out whether any further sales were made to the customer other than the Rs. 10 million as those would also be subject to recovery risk. **1.0**

Obtain written representations from the management of the client. **1.0**

If management accounts for the adjustment in the financial statements we need to ensure that these have been properly applied and disclosed as considered necessary, in the financial statements. **1.5**

Note 1:
If the student treats it as a non-adjusting event and gives appropriate reasons, the marks may still be granted.

Note 2:
Some students may cover points on reporting in this part of the questions whereas those have been asked in part (b). However, in such case these points would be considered while marking part (b).

<u>Subject to maximum of 10 marks.</u>

Ans. 5b. If the adjustment of Rs. 10 million is not made in the financial statements of Flash Lights Limited, there appears to be a non-compliance with the requirements of IAS 10 as this is an adjusting event after the balance sheet which has not been accounted for. **01**

As discussed already, the item is material to the financial statements as a whole there by implying that non-adjustment may be a Significant item requiting the attention of the shareholders. **01**

In such a case, the auditor would not be able to issue an unmodified audit opinion since the financial statements are materially misstated. **01**

However, the financial statements are not pervasively misstated since the item is confined to a single or few items in the financial statements and does not distort the view of the entire financial statements. **01**

In this case, the item Can be considered material but not pervasive and hence a qualified opinion should be issued. **01**

The matter should also be highlighted to those charged with governance. **01**

Subject to maximum of 05 marks

Ans. 6. **1 mark for each step/procedure**

Ensure all stock listings are generated from the system in your presence

Identify the appropriate personnel from your team and the client's side who would be present prior to the count start time.
Request the client to ensure stoppage of production and sale activity during the time of the count; if this is not possible, request for adequate and appropriate help in ensuring all documentation is available as regards movement during the count

Assess whether client's audit staff is appropriately trained to conduct the count and planning is done to ensure all stock is counted.

During the count, remain alert for any changes/movement in stock and ensure that these are appropriately accounted for.

Ensure that stock is properly counted in terms of the number of units in which it is reported in the accounting System i.e. ml, tones, number, kg, etc.

Ensure that proper procedure is following like marking items to avoid double counting of stock which have been counted.

Doing a two-way count i.e. floor to stock list and stock list to floor to ensure existence as well as completeness.

Identifying, reconciling and reporting any discrepancies 111 the number of stock as per records and physical quantities
Ensuring arithmetical accuracy of the stock listing

Ensuring numerical sequence for any tags or item codes are proper

If inventories are held by third parties, ensuring we either have a confirmation from them or there is access to count that inventory as well

Ensuring appropriate cut-off by noting the last documents in respect of dispatches and issuances.
Marks to be awarded for other valid and distinct procedures as well.

Total Marks 10

Ans. 7.

- A lawyer in case of an ongoing legal-case for an -audit client **01**
- A professional value in case of a client that revalues its land and building in the balance sheet **01**
- An actuary for estimating the value of employee benefit liability such as gratuity **01**
- A tax consultant for assessing the tax impact of tax regulation or assisting in tax computation **01**
- An oil and gas expert for measuring the quantities of oil inventory in pipeline **01**
- A mining and exploration engineering expert for valuing the coal or diamond in a mined area **01**
- An architect who estimates the condition of a building **01**

Subject to a maximum of 5 marks.

The following matters should be considered in order to determine the degree of reliance to be placed on the report of the expert:

(a) Professional competence, capabilities and objectivity of the expert including his professional qualifications, credentials in the relevant field and exposure. **01**

(b) Whether that expert is subject to the auditor's firm's quality control policies and procedures for example whether the auditor can review the working paper or files of the expert in arriving at the conclusion. **01**

(c) Adequacy and appropriateness of the expert's work in relation to the assertion being addressed. **01**

(d) Whether assumptions used by expert appear to be reasonable. **01**

(e) Relevance and reasonableness of findings, and source data. **01**

(f) The auditor's knowledge of and experience with previous work performed by the expert. **01**

Subject to a maximum of 5 marks

Ans. 8a. A self-interest threat to independence arises when an auditor's interest conflicts with the interest and objective to provide an impartial opinion on the .truth and fairness of the financial statements. In other words, it is any situation where the auditor's duty to provide an impartial, unbiased view comes into conflict with his personal or business concerns. Such an interest can arise from the personal or business situation / position of the auditor such as a family or business relationship.

Due to the close family relationship between the audit partner and the CFO, it would not appear that Mr. Abdul Raheern or the firm Eternity would be classified as independent. This is because in all likely cases, in the event of a disagreement between the client and the auditor, the father-daughter relationship could playa part and result in independence and objectivity being compromised. The situation is more serious since the daughter is at the position of CFO, hence directly affected by any issue relating to the financial reporting process. A case may have been made had she been in some other department and at a lower position

Ans. 8b. Following are some situations where a self-interest threat may arise:

a) Financial interest - where an audit firm has a financial interest in a client's affairs by way of, for example, the audit firm owns shares in the client or is a trustee ofa trust that holds shares in the client.

b) Close business relationships - between a firm or an audit team member or a member of that individual's immediate family, and the audit client (or its management); these could arise from commercial relationships or common financial interests.

c) Employment with assurance client - staff transfers between the firm and the client, or possible, chance of employment also create threat to independence.

d) Partner on client board - the partner being involved in management affairs would create a threat to the level of objectivity demonstrated.

e) Gifts and hospitality - unless clearly trivial, undue gifts and hospitality measures may be a hindrance to independence.

£) Loans and guarantees - a loan or guarantee given to or from the audit client would be a business relationship that could jeopardize the independent position of the auditor.

g) Overdue fees - such fee may be treated as a loan and despite independence of mind, would hinder independence in appearance.

h) Percentage fees - fee based on percentage of certain financial or non- financial numbers may not let the auditor exercise independence, especially in areas of subjectivity such as audit of accounting estimates.

i) Contingent fees - fee that is dependent upon the occurrence or occurrence of certain events, transactions or achievement of a certain task I number would also create a threat similar to percentage fee.

j) High percentage of fees - if a significant percentage of revenue of an audit firm comes from a single audit client, independence as auditor may be jeopardized in order not to displease a significant client and lose a major source of revenues for the firm.

k) Low balling - a fee quote significantly lower than the competition or a generally estimated amount (in order to get the client) may create a threat in current and future audit periods.

1) Recruitment - hiring of staff would also lead to self-interest threat if, for example, a recommended person from the audit firm was hired by an audit client.

There may be other situation also.

Total Marks 15

Ans. 9.

a) Preparation of annual, quarterly and monthly budgets (and approvals of the same) to plan the intended production and purchase of raw cotton and chemicals;

b) Budget vs Actual analysis performed on a monthly basis to keep track of cotton and chemical purchases and action upon any significant variances.

c) A purchase requisition is filled for each cotton purchase based on production requirements, this is approved by Head of Purchase Department and also by Factory Operations head.

d) Selection of cotton and chemical vendors from list of approved vendors maintained in the system; selection being done by purchase department and approved by a high official such as head of operations etc.

e) Preparation of Purchase Order based on final selection and approval of purchase order by purchase head and CFO.

f) Upon receipt of goods at factory, inspection by the Store or Gate In Charge

g) Preparation of Goods Receipt Note (GRN) and forwarding a copy of the Same to
a. 'purchase department and accounts department for further processing.

h) Entry of goods received in the company's cost accounting books and updation of weighted average cost of inventory held.

i) If inventory is not as per specification, preparation of Rejection Letter and return of inventory items to vendor.

j) Communication by Store In Charge to factory operations head I controller that goods have been received and are ready for use.

k) Upon approval of GRN, matching with Purchase Order and Invoice.

l) Entry in the books of account by the accounts department based on matched invoice, purchase order and GRN.

m) For urgent/ emergency chemical purchases, an online I email requisition being raised by purchase department.

n) Automatic/system-based approval of purchases.

Note:
Other controls listed may be accepted provided they relate to the scenario of purchases for a textile company.

Total Marks 10

Ans. 10.

Up to 1 mark for each advantage if properly described

- Documentation is neat, easy to read and in standard format.
- Risk of errors in processing audit adjustments, amendments, corrections, updates is reduced.
- Review can be carried out remotely without the need for physical presence at client premises
- Significant time saving may result from the automatic processing of adjustments and generation of lead schedules.

Total Marks 04