SUGGESTED ANSWERS TO

THE QUESTIONS SET AT

CHARTERED ACCOUNTANCY PROFESSIONAL (CAP)-II LEVEL

December 2021 EXAMINATIONS

Group-II

The Institute of Chartered Accountants of Nepal (ICAN)

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Paper 4: Financial Management

Attempt all questions.

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

1. Shrawan Chemicals Ltd. supplies chemicals to various industries located in Kathmandu valley. The onsite delivery of chemicals every month is 2,000 units. The unit sale price is Rs. 200. The cost per unit is Rs. 100. It is using a small delivery truck which can carry a maximum of 100 units. Total distance covered in one trip is 500 kms. The cost of diesel is Rs. 100 per litre. The average consumption of diesel is 10 kms per litre.

   Due to increase in demand for chemicals for industrial use, Shrawan Chemicals Ltd. has an opportunity to make and deliver 3,000 units per month. To cater to the increased demand, the company required a larger truck with a capacity to carry 200 units. The required truck is available at Rs. 20 lacs with 25% down payment and 5 year's payment term in equal annual principal amount along with interest at 10% p.a. The truck will have salvage value of Rs. 10 lacs at the end of 5^{th} year. The small delivery truck being currently used has a book value of Rs. 5 lacs and it can be sold for Rs. 2 lacs. The salary of the small delivery truck driver is Rs. 10,000 per month. If larger truck is acquired the salary costs will increase to Rs. 15,000 per month. The consumption of diesel by larger truck would average 5 kms per litre. The annual tax and maintenance cost of the larger truck would be Rs. 100,000 as compared to Rs. 60,000 that of small delivery truck. Shrawan Chemicals Ltd. is availing straight line method of depreciation for tax purposes. The small delivery truck has remaining useful life of 5 years. The applicable tax rate is 25%. Assume that the loss on sale of existing truck can be claimed as short-term capital loss at the end of current year itself.
   The equity share holders of Shrawan Chemicals Ltd. are asking for rate of return of 15% p.a. As financial advisor to Shrawan Chemicals Ltd. you are required to make appropriate suggestion based on your calculations. (**20 Marks)**

Answer:

1) WN- 1: Calculation of incremental initial cash outlay

Down payment on cost of new truck (25% of 2,000,000)	500,000
Less: Sale proceeds of old truck	200,000
Net initial cash outlay	**300,000**

WN- 2: Calculation of tax benefit from old truck:

Tax benefit on sale of old truck = (Book value-sale proceeds)*tax rate
= (500,000-200,000)*25% = **75,000**

WN-3: Calculation of interest and total payment to bank:

Total financing of new truck (75% of 2,000,000)	1,500,000
Equal principal payment p.a. (1,500,000/5)	300,000

Year	Principal balance	Interest @ 10%	Principal repayment	Total payment
1	1,500,000	150,000	300,000	450,000
2	1,200,000	120,000	300,000	420,000
3	900,000	90,000	300,000	390,000
4	600,000	60,000	300,000	360,000
5	300,000	30,000	300,000	330,000

WN- 4: Calculation of incremental depreciation:

Cost of new truck	2,000,000
Less: Salvage value at the end	1,000,000
Depreciable value	1,000,000
Less: Depreciable value of old truck	5,00,000
Incremental depreciable value	5,00,000
Incremental depreciation p.a. for 5 years (500,000/5)	1,00,000

WN- 5: Calculation of incremental fuel cost:

	New Truck	**Old Truck**
Annual trip made	180	240
	(3,000/200*12)	(2,000/100*12)
Kms run	90,000	120,000
	(180*500)	(240*500)
Fuel consumed in litre @ 5 km and 10 km	18,000	12,000
Fuel cost @ Rs. 100	1,800,000	1,200,000
Incremental fuel cost	**600,000**	

WN- 6: Calculation of annual incremental profit before interest and tax:

Incremental revenue ((3,000-2,000)*12*200)	2,400,000
Less: Incremental direct cost (1,000*12*100)	1,200,000
Less: Incremental fuel cost (WN 5)	600,000
Less: Incremental salary cost (15,000-10,000)*12	60,000
Less: Incremental maintenance & tax cost (100,000-60,000)	40,000
Less: Incremental depreciation cost (WN 4)	100,000
Annual incremental profit before interest and tax	**400,000**

Calculation of incremental Net Present Value (NPV) from replacement of truck:

Year	**1**	**2**	**3**	**4**	**5**
Annual incremental PBIT	400,000	400,000	400,000	400,000	400,000
Less Interest	150,000	120,000	90,000	60,000	30,000
PBT	250,000	280,000	310,000	340,000	370,000
Less : Tax @25%	62,500	70,000	77,500	85,000	92,500
PAT	187,500	210,000	232,500	255,000	277500
Add: Depreciation	100,000	100,000	100,000	100,000	100,000
Less: Principal repayment	(300,000)	(300,000)	(300,000)	(300,000)	(300,000)
Cash flow after tax (CFAT)	(12,500)	10,000	32,500	55,000	77,500
Tax benefit of old truck	75,000				
Salvage value of new truck					1,000,000
Final Cash Flow	62,500	10,000	32,500	55,000	1,077,500
PVIF @ 15%	0.870	0.756	0.658	0.572	0.497
Present Value of CF	54,375	7,560	21,385	31,460	535,518
Total PV of Cash Inflows Less: Initial Outflow	650,298 300,000				
Net Present Values	**350,298**				

Note:

There is no profit/loss from new truck at the end of 5th year as salvage value equals book value.
The salvage value of old truck at the end of 5th year is assumed to be nil.

Suggestion:
Since there is incremental NPV of Rs. 350,298 from increased sales made possible by replacement of new larger truck, the firm should replace the truck.

2.

a) A Proforma cost sheet of a company provides the following data:

Particulars	Cost per unit (NPR)
Raw Materials	52
Direct Labour	19.5
Overheads (including Depreciation @ NPR 0.5)	39.5
Total Cost (per unit)	111
Profit	19
Selling Price	130

The following is the additional information available:
Average raw material in stock: one month; average materials in process: half a month; Finished goods stock: one month; Credit allowed by suppliers: one month; credit allowed to debtors: two months. Time lag in payment of wages: one and a half weeks; overheads: one month. One-fourth of sales are on cash basis. Cash balance is expected to be NPR 120,000.

Required:
Prepare a statement showing the cash cost of working capital needed to finance a level of activity of 70,000 units of output. You may assume that production is carried on evenly throughout the year and wages and overheads accrue similarly. (**10 Marks)**

b) ABC Ltd. has expected EPS of Rs. 10 each on its equity shares which are currently quoted in the market at Rs. 100 each. It has policy of providing 25% of its earnings as dividend and is expected to grow at the rate of 10%. Recently, it has planned expanding its operations which is expected to cost Rs. 4 million. The company intends to finance the 50% of expansion through rising of equity shares and rest equally with 8% preference shares and debt. Debts are available at interest rate of 10% per annum upto an amount of Rs. 0.5 million above which the rate of interest will rise to 15%. Applicable corporate tax rate is 30%.
Calculate cost of each source of capital and weighted average cost of capital.

(5 Marks)

Answer

2 a) Statement showing the requirements of working capital:

Particulars	Computation	NPR
A. Current Assets:		
Stock of Raw Material	NPR 36,40,000×1/12	3,03,333
Stock of Work in Progress	As per working note (II)	2,36,980
Stock of Finished goods	As per working note (I)	6,44,583
Debtors	Rs 77,35,000×2/12^{x} 3/4	966,875
Cash in Hand		120,000
Total Current Assets		**22,71,771**
B. Current Liabilities:		
Creditors for Raw Materials	NPR 36,40,000×1/12	3,03,333
Creditors for Wages	NPR 13,65,000×1.5/52	39,375
Creditors for Manufacturing Expenses (overhead)	NPR 27,30,000×1/12	227,500
Total Current Liabilities		**5,70,208**
C. Net Working Capital (A-B) (Cash cost)		**17,01,563**

Working Notes:

(I) CALCULATION OF STOCK OF FINISHED GOODS AND COST OF SALES:

Particulars	Amount (NPR)
Direct Material Cost (70,000×NPR 52)	36,40,000
Direct Labour Cost (70,000×NPR 19.5)	13,65,000
Manufacturing Overheads (excluding Depreciation) (70,000×39)	27,30,000
Total Cash Cost of Goods produced	77,35,000
Add: Opening Stock of Finished Goods (77,35,000×1/12)	6,44,583
Total Cash Cost of Goods available	83,79,583
Less: Closing Stock of Finished Goods	(644,583)
Total Cash cost of Goods Sold	77,35,000
Selling and Distribution Expenses	Nil
Total Cash Cost of Sales	77,35,000

(II) CALCULATION OF STOCK OF WORK IN PROGRESS:

Particulars	Amount (NPR)
Raw Materials (36, 40,000 ×0.5/12×100%)	151,667
Wages (13, 65,000×0.5/12*50%)	28,438
Manufacturing Expenses (27, 30,000×0.5/12×50%)	56875
Total	236,980

Since, it is an existing company and no specific information regarding opening stock has been given, it has been assumed that stock level is uniform throughout the year. Hence, opening stock equals closing stock.

2 b)

i. **Calculation of costs of sources of capital:**

Cost of Equity shares (K_e) = $\frac{D}{P_0}$ + g = $\frac{25\%\ of Rs.10}{100}$ + 0.10 = $\frac{2.5}{100}$ + 0.10 = or **12.50%**

Cost of Preference shares (K_p) = $\frac{DPS}{Net\ Proceeds}$ **= 8%** in the absence of other information

Cost of Debt (K_d) = $\frac{Interest\ Expenses}{NetProceeds}$ × (1-t) = $\frac{500{,}000*10\%+500{,}000*15\%}{1000{,}000}$ × (1-0.30)

= $\frac{125{,}000}{1000{,}000}$ × 0.7 = 0.0875 or **8.75%**

ii. **Calculation of Weighted Average Cost of Capital (WACC):**

Source of Capital	Amount (Rs.)	Weight	Cost of Capital %	WACC %
Equity shares	2,000,000	0.50	12.50	6.25
Preference shares	1,000,000	0.25	8.00	2.00
Debt	1,000,000	0.25	8.75	2.19
Total	4,000,000			**10.44**

3.

a) United Company's present annual sales amounts to Rs. 30 lakhs and sales price is Rs. 12 per unit. Variable cost is Rs 8 per unit and fixed costs amount to Rs. 2.5 lakhs per annum. It is considering various policies. The following estimates are made for the purpose:

Particulars	Present Policy	Proposed Policy I	Proposed Policy II
Debtor Turnover Ratio	12	6	4
Increase in Sales (%)	-	8	30
% of Bad debt to sales	1	2	6

Fixed cost will increase by Rs. 50,000 annually after any increase in sales above 25% over the present level. The company requires a pre-tax return on investment of at least 20% for the level of risk involved.

Required:

What will be the most rewarding credit policy in case of United Company under the above circumstances? Present your answer in a tabular form. **(8 Marks)**

b) Following data is available in respect of two companies having same business risk.
Capital employed = NRs 200,000 and EBIT = NRs 30,000

Sources	P Ltd. (amount in NRs)	Q. Ltd (amount in NRs)
Debt @ 10%	100,000	Nil
Equity	100,000	200,000
Ke	20%	12.5%

Investor A is holding 15% shares in Q Ltd Company. Calculate increase in return of investor A if he switches his holding from Q Ltd to P Ltd Company**. (7 Marks)**

Answer:

3 a) **STATEMENT SHOWING THE EVALUATION OF DEBTORS POLICIES:**

Particulars	**Present Policy (1 month) (Rs)**	**Proposed Policy I (2 month) (Rs)**	**Proposed Policy II (3 month) (Rs)**
A. Expected Profit:			
a) Credit Sales	30,00,000	32,40,000	39,00,000
b) Total Cost other than Bad Debts			
i) Variable Cost	20,00,000	21,60,000	26,00,000
ii) Fixed Cost	250,000	250,000	300,000
c) Bad Debt	30,000	64,800	234,000
d) Expected Profit (a-b-c)	720,000	765,200	766,000
B. Opportunity cost of Investment in Receivables	37,500	80,333	145,000
C. Net Benefits (A-B)	682,500	684,867	621,000

Recommendation:

The Proposed policy I should be adopted since the net benefits under this policy are higher than those under other policies.

Working Note:

Calculation of Opportunity Cost of Average Investments:

Opportunity Cost = Total cost × Collection Period/12 X Required Rate of Return/100

Present policy = Rs. 22,50,000 X 1/12 X 20% = Rs. 37,500

Policy I = Rs. 24,10,000 X 2/12 X 20% = Rs. 80,333

Policy II = Rs. 29,00,000 X 3/12 X 20% = Rs. 145,000

3 b)

i. Valuation of Firm

Particulars	**P Ltd**	**Q Ltd**
EBIT	30,000	30,000
Less Interest	10,000	Nil

Earnings available for equity (NI)	20,000	30,000
Return on Equity (Ke)	20%	12.5%
Value of equity (NI/Ke)	100,000	240,000
Debt	100000	Nil
Value of Firm	200,000	240,000

Value of Q Ltd is more than that of P Ltd therefore investor will sell his share in Q Ltd. and buy shares in Levered Company P Ltd. Market value of debt and equity of P. Ltd. are in the ratio of NRs 100,000: 100,000 i.e. 1:1. To maintain the level of risk, investor will lend proportionate amount (50%) and invest balance amount 50% in share of P Ltd.

ii. Investment and borrowings

Particulars	**Amount in NRs**
Sell shares in Q Ltd (240,000 * 15%)	36,000
Lend money (36,000 * 50%)	18,000
Buy shares in P. Ltd.	18,000
Total	36000

iii. Change in return

Particulars	**Amount in NRs**
Income from shares in P. Ltd (18,000*20%)	3,600
Interest on money lent (18,000* 10%)	1,800
Total income after switch over	5,400
Income from Unlevered Firm (36,000*12.5%)	4,500
Incremental income due to arbitrage	900

4.

a) A company is planning to set up a new project which is estimated to cost Rs. 100 lacs. The financing of project can be done with various mix of equity, debt and hybrid financial instruments. Most appropriate financing plans with their options are as follows:

Rs. In lacs

Particulars	**Plan A**	**Plan B**	**Plan C**
Option I : Equity shares	100	100	100
Option II :			
Equity Shares	50	50	50
12% Preference shares	50	Nil	25
10% Non-convertible debentures	Nil	50	25

Corporate tax rate is 25% and the face values of all the shares and debentures are Rs. 100 each.

You are required to calculate the indifference points and earnings per share for each of the financing plan in order to suggest best plan along with reasons.

(8 Marks)

b) Given below the Profit and Loss Statement of Kathmandu Ltd. for the year ended Ashadh 31, 2078 and Balance Sheet as on that date.

Profit and Loss Statement

	Rs. In lacs
Sales	10,000
Less: Cost of goods sold	6,500
Gross profit	3,500
Less: Administrative expenses	400
Less: Selling and distribution expenses	600
Less: Depreciation	500
Less: Interest expenses	300
Profit before tax	1,700
Less: Income tax	700
Net profit	1,000

Balance Sheet:

Liabilities	Rs. In lacs	Assets	Rs. In lacs
Share capital (Rs. 10 each)	5,000	Fixed assets	6,000
Reserve & surplus	2,000	Investments	2,000
Secured loans	2,500	Inventory	1,000
Unsecured loans	1,000	Sundry debtors	2,000
Sundry creditors	1,500	Other current assets	500
Provisions	1,000	Bank balance	1,500
	13,000		13,000

Proposed dividend 500

Average market price of the company is Rs. 50.

You are required to calculate the following ratios from above information.

i. Return on capital employed, return on equity, debt equity and interest coverage ratios.

ii. Dividend yield, market value to book value ratio, price earning ratio and market price to cash flows ratio. **(2+5=7 Marks)**

Answer:

4 a) Let X be the EBIT in all cases, then we know the indifference point will be

For Plan A X(1-t)/N1 = [(X-Interest)(1-t)-D_p]/N2

Or, X(1-0.25)/100,000 = [(X-0)(1-0.25)-5,000,000×12%]/50,000

Or, 0.75X/100,000 = (0.75X-600,000)/50,000

Or, 0.75X = 1.5X-1,200,000

Or, X = 1,200,000/0.75

Or, X = 1,600,000

For Plan B X(1-t)/N1 = (X-Interest)(1-t) /N2

Or, X(1-0.25)/100,000 = (X-5,000,000×10%)(1-0.25)/50,000

Or, 0.75X/100,000 = (X-500,000)0.75/50,000

Or, 0.75X = 1.5X-750,000

Or, X = 750,000/0.75

Or, X = 10,00,000

For Plan C X(1-t)/N1 = [(X-Interest)(1-t)-D_p]/N2

Or, X(1-0.25)/100,000 = [(X-2,500,000*10%)(1-0.25)-2,500,000*12%]/50,000

Or, 0.75X/100,000 = [(X-250,000)0.75-300,000]/50,000

Or, 0.75X = 1.5X-375,000-600,000

Or, X = 975,000/0.75

Or, X = 1,300,000

Calculation of EPS under different plans

Particulars	Plan A		Plan B		Plan C	
	Option I	Option II	Option I	Option II	Option I	Option II
EBIT	1,600,000	1,600,000	1,000,000	1,000,000	1,300,000	1,300,000
Less: Interest	-	-	-	500,000	-	250,000
EBT	1,600,000	1,600,000	1,000,000	500,000	1,300,000	1,050,000
Less: Tax@25%	400,000	400,000	250,000	125,000	325,000	262,500
EAT	1,200,000	1,200,000	750,000	375,000	975,000	787,500
Less: Pref. Div.	-	600,000	-	-	-	300,000
Earnings available to equity shareholders	1,200,000	600,000	750,000	375,000	975,000	487,500
No. of equity shares	100,000	50,000	100,000	50,000	100,000	50,000
EPS	**12**	**12**	**7.5**	**7.5**	**9.75**	**9.75**

Advice: The Company is advised to go for Plan A of financing the project since it results in highest number of EPS. However, as pointed by different indifference points under each plan the potential to earn EBIT is to be considered to have a best financing plan for the project.

4 b) Return on capital employed $= \frac{EBIT}{Total\ capital\ employed}$

$= \frac{1700+300}{5000+2000+2500+1000} = \frac{2000}{10500} = 19.05\%$

Return on equity $= \frac{Net\ profit\ after\ tax}{Total\ equity} = \frac{1000}{5000+2000} = 14.29\%$

Debt equity $= \frac{Total\ debt}{Total\ equity} = \frac{2500+1000}{5000+2000} = 0.5$

Interest coverage $= \frac{EBIT}{Total\ interests} = \frac{1700+300}{300} = 6.67$ times

Total number of shares $= \frac{Share\ capital}{Face\ value\ per\ share} = \frac{5000}{10} = 500$ lacs shares

Dividend per share $= \frac{Proposed\ dividend}{Total\ number\ of\ shares} = \frac{500}{500} =$ Rs. 1 each

So, Dividend yield $= \frac{Dividend\ per\ share}{Average\ market\ value\ per\ share} = \frac{1}{50} = 2\%$

Book value per share $= \frac{Net\ worth\ or\ Total\ equity}{Total\ number\ of\ shares} = \frac{7000}{500} =$ Rs. 14 each

So, Market value to book value ratio $= \frac{Market\ value\ per\ share}{Book\ value\ per\ share} = \frac{50}{14} = 3.57$

Earnings per share $= \frac{Net\ profit\ after\ tax}{Total\ number\ of\ shares} = \frac{1000}{500} =$ Rs. 2 each

So, Price earnings ratio $= \frac{Market\ value\ per\ share}{Earning\ per\ share} = \frac{50}{2} = 25$

Cash flow per share $= \frac{Net\ profit\ per\ share+Depreciation+Amortization}{Total\ number\ of\ shares} = \frac{1000+500}{500} =$ Rs. 3 each

Market price to cash flow ratio $= \frac{Market\ value\ per\ share}{Cash\ flow\ per\ share} = \frac{50}{3} = 16.67$

5.

a) Price per share of B & B Ltd on 01/04/2073 is Rs. 50. Dividend for 2073-74 is Rs. 9. Dividend is growing annually by 3%. Determine the expected equilibrium price per share on 01/04/2074 and 01/04/2075. (**5 Marks)**

b) Alpha Capital is managing an open-ended mutual fund and following are the position of portfolio of the fund :

Company	No. of units	Market Price as of Ashwin 10, 2078	Market Price as of Ashwin 12, 2078
ABC shares	10,000	120	110
MNO shares	15,000	150	160
XYZ shares	20,000	200	220
IJK debentures	1,000	1,050	1,100

There are 500,000 units of the scheme as of Ashwin 10, 2078. On Ashwin 11, 2078 the Capital launched Dashain offer for sale of further 100,000 units at NAV of Ashwin 10, 2078 all of which were subscribed and allotted on the same day. On Ashwin 12, 2078 the Capital purchased 5,000 units of NLK shares at Rs. 200 each from such sale proceeds.

You are required to calculate NAV of the fund as on Ashwin 12, 2078 from above information. (**5 Marks)**

c) PM Ltd. undertakes large turnkey projects. It is situated in Delhi and receives large payments on contracts as and when works progresses. The cheques received from are deposited in a local branch of a nationalized bank and the money becomes available after 10 days. The cheques are mostly drawn on a bank in Chennai. The company is thinking of collecting the funds sooner by sending an accounts executive to Chennai, so money becomes available immediately. A visit to Chennai may cost Rs.15,000. If company's opportunity cost of capital is 15%, what minimum amount of cheque will justify sending a person to Chennai. [Assume 360days in a year].(**5 Marks)**

Answer

5 a) Given that,

Price on 01/04/2073 (P0) = Rs. 50
Next Dividend 2073-74 (D1) = Rs. 9
Growth rate (g) = 3%

Now, to calculate cost of equity (Ke);

$$P0 = \frac{D1}{Ke - g}$$

$$Ke = \frac{D1}{P0} + g$$

Ke = 9/50 + 0.03 = 0.21 i.e. **21%**

Now,
Expected Price on 01/04/2074 (P1);

$$P1 = \frac{D2}{Ke - g} = \frac{9\,(1.03)}{0.21 - 0.03} = \textbf{Rs. 51.50}$$

Expected Price on 01/04/2075 (P2);

$$P2 = \frac{D3}{Ke - g} = \frac{9\,(1.03)^2}{0.21 - 0.03} = \textbf{Rs. 53.05}$$

5 b) Calculation of NAV of fund as on Ashwin 10, 2078:

Investments	No. of units	Market price	Total value
ABC shares	10,000	120	1,200,000
MNO shares	15,000	150	2,250,000
XYZ shares	20,000	200	4,000,000
IJK debentures	1,000	1,050	1,050,000
Total			**8,500,000**

NAV = $\frac{Total\ value}{Number\ of\ unts} = \frac{8{,}500{,}000}{500{,}000}$ = Rs. 17 each

Calculation of NAV of fund as on Ashwin 12, 2078:

Proceeds from sale of mutual funds = 100,000×17 =	1,700,000
Less: purchase of NLK shares 5,000×200 =	1,000,000
Cash/Bank balance	700,000

Total number of units now = 500,000+100,000 = **6,00,000**

Investments	No. of units	Market price	Total value
ABC shares	10,000	110	1,100,000
MNO shares	15,000	160	2,400,000
XYZ shares	20,000	220	4,400,000
IJK debentures	1,000	1,100	1,100,000
NLK shares	5,000	200	1,000,000
Cash/Bank			700,000
Total			**10,700,000**

Now, NAV = $\frac{Total\ value}{Number\ of\ unts} = \frac{10{,}700{,}000}{600{,}000}$ = Rs. 17.83 each

5 c)

Here,
Cost of sending to Chennai = Rs. 15,000
Time saved in collection from visit = 10 days
Opportunity cost of capital (interest rate) = 15%
Now,
Let the minimum amount of cheque will justify sending a person to Chennai be Rs. P
At justifiable point;
Cost of sending to Chennai = Interest saved from collecting the funds soon
Rs. 15,000 = (Rs. P x Time saved from visit/ 360 x Rate of interest)/ 100
Rs. 15,00,000 = P x 10/360 x 15
P = 15,00,000 x 360/(10 x 15)
P = 36,00,000
Therefore, the minimum amount of cheque that will justify to sending a person to Chennai is Rs. 36,00,000.

6. Write short note/ answer on: **(4×2.5 =10)**
   a) Capital rationing
   b) Portfolio management
   c) Perpetuity
   d) Limitations of using Retained Profit

Answer:

6 a) **Capital rationing** is the decision process used to select capital projects when there is a limited amount of funding available. Rationing may also be imposed when there is enough funding, but management is restricting it from certain parts of the business in order to emphasize investments in other areas.

Capital rationing means the utilization of existing funds in most profitable manner by selecting the acceptable projects in the descending order or ranking with limited available funds. The firm must be able to maximize the profits by combining the most profitable proposals. Capital rationing may arise due to.

i) The imposition of internal constraints, which are often imposed when managerial resources are limited, known as soft capital rationing.

ii) Hard capital rationing occurs when external limits are set, perhaps because of scarcity of financing, high financing costs or restrictions on the amount of external financing an organization can seek.

IRR or NPV are the best basis of evaluation even under Capital Rationing situations. The objective is to select those projects which have maximum and positive NPV. Preference should be given to interdependent projects. Projects are to be ranked in the order of NPV (Profitability Index). Where there is multi-period Capital Rationing, Linear Programming Technique should be used to maximize NPV. In times of Capital Rationing, the investment policy of the company may not be the optimal one.

In nutshell, Capital Rationing leads to:

a) Allocation of limited resources among ranked acceptable investments.

b) This function enables management to select the most profitable investment first.

c) It helps a company use limited resources to the best advantage by investing only in the projects that offer the highest return.

d) Either the internal rate of return method or the net present value method may be used in ranking investments.

6 b) **Portfolio** is a collection of investment instruments like shares, debentures, mutual funds, fixed deposits etc. Portfolio management is the art of selecting the right investment instruments in right proportion to generate optimum return with a balance of risk from the investment made. Composition of instruments in a portfolio gives an opportunity to diversify risk which is risk reduction not elimination. By reduction of risk in a portfolio the variability of return is reduced. Portfolio management starts with the objective of investor on a portfolio. Investor's profile in terms of income, investment budget, investment horizon and risk appetite is taken based on which expected rate of return is set as target. The portfolio is built and managed accordingly to achieve the target by making selection of suitable investment instruments.

6 c) **Perpetuity** is a stream of payments or type of annuity that starts payment on fixed date and such payments continue forever or perpetually. Often preference share which pays a dividend is considered as a form of perpetuity. However, one must assume that the firm does not go bankrupt or is otherwise impended for making timely payments. Specifically fixed coupon payments on permanently invested (irredeemable) sums of money are the core examples of perpetuities. The value of the perpetuity is finite because receipts that are anticipated far in the future have extremely low present value. Further, because the principal is never repaid, there is no present value for the principal. Therefore, the value of perpetuity is simply the coupon amount over the appropriate discount rate. The formula for calculating value of perpetuity is:

Present value of perpetuity = C/i

Where, C = the interest/cash payment each period

I = the interest rate per payment period

6 d) **Limitation of Using Retained Profits**

The major limitations of using retained profits as a source of financing are as follows:

1) Available only to Profitable Companies—This source of financing is available only to profitable companies.
2) Concentration of Economic Power—Growth of companies through accumulation of reserves leads to concentration of economic power.
3) Involves Opportunity Cost—It involves opportunity cost (i.e. the return which the shareholders could have earned if the profits were distributed). The management sometimes does not consider this cost while declaring dividend to equity shareholders.
4) Danger of Over-capitalisation—There is always a danger of over-capitalisation if the company retains profits on continuous basis year after year without requirements of funds for profitable investments.

7. Distinguish between: **(4×2.5 =10)**
   a) Business risk and financial risk
   b) Risk and Uncertainty
   c) Depository and depository participant
   d) Bank Overdraft and Clean Overdraft

Answer

a) **Business risk** refers to the risk associated with a Company's operations. It is unavoidable risk because of the environment in which the Company has to operate. Business risk is represented by the variability of earnings before interest and taxes (EBIT). Such variability in EBIT is influenced by revenues and expenses which are affected by demand of the Company's products, variations in prices and proportion of fixed cost in total cost.

Financial risk refers to the additional risk placed on a Company's shareholders as a result of use of debt in financing investment in business. Companies that use more of debt instruments would have higher financial risk than Companies that use more of equity in financing its operations. Financial risk is measured by ratios such as financial leverage, debt equity ratio etc.

7 b)

Basis of Comparison	Risk	Uncertainty
Meaning	The probability of winning or losing something worthy is known as risk.	Uncertainty implies a situation where the future events are not known.
Ascertainment	It can be measured.	It cannot be measured.
Outcome	Chances of outcomes are known.	The outcomes are unknown.
Control	Controllable	Uncontrollable
Minimization	Yes	No
Probabilities	Assigned	Not assigned

7 c) **Depository** is a service provider which takes custody of listed securities from security owners and performs the job of maintaining their securities account, clearing and settlement of the securities transactions, transfer and transmission of securities etc. Depository renders its services directly and indirectly via depository participants (DPs). Depository takes membership and other fees from those DPs. CDS and Clearing Ltd. is the only depository in Nepal as of now.

Depository participant is a company having membership of a depository who is authorized by the depository to provide depository services to security owners. Accordingly, it provides services to investors in securities by opening an account termed as Beneficial Owner ID (BOID) and taking certain fees from them. Currently banks and financial institutions, merchant banks, security brokerage companies etc. are provided with membership as depository participant by CDS and Clearing Ltd.

7 d) **Bank Overdraft**

Bank Overdraft refers to an arrangement whereby the bank allows the customers to overdraw from its current deposit account within a specified limit. The overdraft facility is granted against the securities of assets or personal security as in case of cash credit. Interest is charged only on the amount actually overdrawn (i.e. debit balance) for the actual period of use (i.e., for the period the debit balance in current deposit account remains outstanding). The cost of raising finance by this method is the interest charged by the bank.

Clean Overdraft

Banks may entertain clean advances from those customers, which are financially, sound and reputed for their integrity. The Banks in this case rely upon the personal security of borrower. Banks are responsible for ensuring customer's credit worthiness before providing them with clean overdraft as there is no asset securing the amount of advance. The Banks normally take guarantee from the persons whom they believe to be credit worthy.

Paper 5: Cost and Management Accounting

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

1. A Chemical Company carries on production operation in two processes. The material first pass through Process I, where Product 'A' is produced. Following data are given for the month just ended:

Material input quantity	200,000 kg
Opening work in progress quantity (Material 100% and Conversion 50% Complete)	40,000 kg
Work completed quantity	160,000 kg.
Closing work in progress quantity (Material 100% and conversion two-third complete)	30,000 kg.
Material input cost	Rs. 75,000
Processing Cost	Rs. 102,000
Opening work in progress cost	
Material Cost	Rs. 20,000
Processing Cost	Rs. 12,000

Normal process loss in quantity may be assumed to be 20% of material input. It has no realizable value.

Any quantity of Product 'A' can be sold for Rs. 1.60 per kg.

Alternatively, it can be transferred to Process II for further processing and then sold as Product 'AX' for Rs. 2 per kg. Further materials are added in Process II, which yield two kg. of product 'AX' for every kg. of Product 'A' of Process I.

Of the 160,000 kg. per month of work completed in Process I, 40,000 kg. are sold as Product 'A' and 120,000 kg. are passed through Process II for sale as Product 'AX'. Process II has facilities to handle up to 160,000 kg. of Product 'A' per month, if required.

The monthly costs incurred in Process II (other than the cost of Product 'A') are:

	120,000 kg. of Product 'A' input (Rs)	160,000 kg. of Product 'A' input (Rs)
Materials Cost	132,000	176,000
Processing Costs	120,000	140,000

Required: **20**

a) Determine, using the weighted average cost method, the cost per kg. of Product 'A' in Process I and value of both works completed and closing work-in-progress for the month just ended.

b) Is it worthwhile processing 120,000 kg. of Product 'A' further?

c) Calculate the minimum acceptable selling price per kg., if a potential buyer could be found for additional output of Product 'AX' that could be produced with the remaining Product 'A' quantity.

Answer

1)

Process -I

Statement of Equivalent Production

Inputs		Output		Equivalent Output			
Particulars	**Kg.**	**Particulars**	**Kg.**	**Material**		**Conversion**	
				(%)	**Kg.**	**(%)**	**Kg.**
Opening WIP	40,000	Normal loss	40,000	-	-	-	-
New material introduced	200,000	Units introduced & completed	160,000	100	160,000	100	160,000
		Abnormal loss	10,000	100	10,000	100	10,000
		Closing WIP	30,000	100	30,000	2/3rd	20,000
	240,000		240,000		200,000		190,000

Process-I

Statement of Cost for each element

Element of Cost	Cost of opening WIP in Rs.	Cost in process in Rs.	Total Costs in Rs.	Equivalent Units in Kg	Cost per kg. in Rs.
Material	20,000	75,000	95,000	200,000	0.475
Conversion cost	12,000	102,000	114,000	190,000	0.60
	32,000	177,000	209,000		1.075

Statement of Apportionment of Cost

Units completed	Elements	Equivalent units in kg	Cost per kg in Rs.	Cost in Rs.	Total Cost in Rs.
Work Completed	Material	160,000	0.475	76,000	
	Conversion	160,000	0.60	96,000	172,000
Closing WIP	Material	30,000	0.475	14,250	
	Conversion	20,000	0.60	12,000	26,250

ii) Statement showing comparative data to decide whether 1,20,00 kg of Product 'A' should be processed further into 'AX'.

<u>Alternative I</u>

To Sell product 'A' after Process-I	Rs.
Sales 1,20,000 kg*Rs. 1.60	192,000
Less: Cost from Process-I (1,20,000 kg*Rs. 1.075)	<u>(129,000)</u>
Profit	63,000

<u>Alternative II</u>

Process further into 'AX'	Rs.
Sales 240,000 kg*Rs. 2	480,000
Less: Cost from Process -I (120,000 kg*Rs. 1.075)	(129,000)
Material in Process-II	(132,000)
Processing costs in Process II	<u>(120,000)</u>
Profit	99,000

Hence, the company should process further. It will increase profit by Rs. 36,000

iii) Calculation of minimum selling price per kg:

Cost of processing remaining 40,000 kg further	Rs.
Material (Rs. 176,000-Rs. 132,000)	44,000
Processing Cost (Rs. 140,000-Rs. 120,000)	20,000
Cost from Process-I (40,000 kg*Rs. 1.075)	43,000
Benefit foregone if 40,000 kg 'A' are further processed	
40,000 kg * (Rs. 1.60-Rs.1.075)	21,000
Total Cost	128,000
Additional quantity of Product 'AX' (40,000 kg*2)	80,000

Minimum Selling Price (Rs. 128,000/80,000 kg) = Rs.1.6 per kg

2.

a) Nepal Adarsha Nirman Company Ltd. has entered into a big contract at an agreed price of Rs. 15,000,000 subject to an escalation clause for material and labour as spent out on the contract and corresponding actual are as follows:

Material:	Standard		Actual	
	Quantity	Rate per ton	Quantity	Rate per ton
	Tons	Rs.	Tons	Rs.
A	3,000	1,000	3,400	1,100
B	2,400	800	2,300	700
C	500	4,000	600	3,900
D	100	30,000	90	31,500
Labour:	Hours	Hourly Rate Rs.	Hours	Hourly Rate Rs.
L1	60,000	15	56,000	18
L2	40,000	30	38,000	35

You are required to: **10**

(i) Analyse admissible escalation claim and determine the final contract price payable.

(ii) Prepare the contract account, if the all expenses other than material and labour related to the contract are Rs. 1,345,000.

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

The basic monthly budget figures for 2020 are as follows:

Boiler operating hours:	480
Steam raised:	8,000,000 kg
Costs:	
Fuel (V)	Rs.19,200
Chemicals (V)	Rs. 960
Wages (F)	Rs. 2,400
Sundry overheads (F)	Rs. 3,000

The actual figures for February 2020 are as follows:

Boiler operating hours:	432
Steam raised:	6,750,000 kg
Costs:	
Fuel (V)	Rs. 18,000
Chemicals (V)	Rs. 990

Wages (F) Rs. 2,200
Sundry overhead (F) Rs. 3,000

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

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

Required:

a) Prepare a budget summary which shows the cost of the boiler house in total and per '000' kg steam for boiler operating levels of 400, 432, 480, and 540 hours. **6**

b) Prepare a control statement which compares budget with actual cost of the boiler house for February where a flexible budgeting system is in operation. Comment on the variances in the statement. **4**

Answer

2 a) In case of escalation clause in a contract, a contractor is paid for any increase in price of material and rate of labour which are beyond the control of the contractor. Any increase in the cost due to inefficiencies in usage of the materials and labour are not admissible. Thus, any increase in cost due to usage in excess of standard quantity or hours is not paid.

(i) **Statement showing additional claim due to escalation clause**

Particulars	Std. Qty/Hours	Std. Rate Rs.	Actual Rate Rs.	Variation in Rate Rs.	Escalation claim Rs.
Material:	A	B	C	D=C-B	E=A*D
A	3,000	1,000	1,100	+100	+300,000
B	2,400	800	700	-100	-240,000
C	500	4,000	3,900	-100	-50,000
D	100	30,000	31,500	+1,500	+1,50,000
Material escalation claim					1,60,000
Labour:					
L1	60,000	15	18	+3	+1,80,000
L2	40,000	30	35	+5	+2,00,000
Labour escalation claim					3,80,000

Statement showing final contract price

Particulars	Amount Rs.	Amount Rs.
Agreed Contract Price		1,50,00,000
Add: Agreed escalation claim:		
Material Cost	1,60,000	
Labour Cost	3,80,000	5,40,000
Final Contract Price		1,55,40,000

(ii) **Nepal Adarsha Nirman Company Ltd.**

Contract Account

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Material:		By Contractee's A/c	1,55,40,000

A- (3,400* Rs. 1,100)	37,40,000		
B- (2,300* Rs. 700)	16,10,000		
C- (600* Rs.3,900)	23,40,000		
D- (90* Rs. 31,500)	28,35,000		
To Labour:			
L1- (56,000* Rs. 18)	10,08,000		
L2- (38,000* Rs. 35)	13,30,000		
To Other expenses	1,345,000		
To Estimated Profit	13,32,000		
	1,55,40,000		1,55,40,000

2 b)

(a) Flexible Budget Summary

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

(b) Control statement for the month of February

	Budget	Actual	Variances	
Boiler operating hours	432	432		
Steam raised (‘000kg)	7,200	6,750	450	(Adverse)
Costs:	Rs.	Rs.	Rs.	
Fuel (V)	17,280	18,000	720	(Adverse)
Chemical (V)	864	990	126	(Adverse)
Wages (F)	2,400	2,200	200	(Favorable)
Sundry overhead (F)	3,000	3,000	nil	
	23,544	24,190	646	(Adverse)

3.

a) KOSMOS Ltd. executes customer-based job orders. Following information has been extracted from cost records of the company for FY 2077/78:

Particulars	**Amount in Rs.**
Material Consumed	400,000.00
Direct Labour	330,000.00
Factory Overheads	228,000.00
Administrative Overheads	107,600.00
Sales	1,200,000.00

A potential customer has approached the company seeking quotation for a job. It is estimated that job requires material of Rs. 80,000.00. For completion of the job order, 500 direct labour hours is required and currently direct labour rate is Rs. 100 per hour.

Required: **8**

Cost sheet for the job showing quotation price.

b) The following information has been obtained from the records of a manufacturing unit:

Particulars	Rs.	Rs.
Sales 80,000 units @ Rs. 50		4,000,000
Material Consumed	1,600,000	
Variable Overheads	400,000	
Labour Charges	800,000	
Fixed Overheads	720,000	3,520,000
Profit		480,000

Calculate: **8**

i) The number of units by selling which the Company will neither lose nor gain anything.
ii) The sales needed to earn a profit of 20% on sales.
iii) The extra units which should be sold to obtain the present profit if it is proposed to reduce the selling price by 20% and 25%.
iv) The selling price to be fixed to bring down its breakeven point to 10,000 units under present conditions.

c) What are the implications of Economic Order Quantity in proper inventory management? **4**

Answer

3 a) KOSMOS Ltd.

Cost sheet for the job order

Particulars	**Amount**
Material Consumed	80,000.00
Direct Labour	50,000.00
Prime Cost	**130,000.00**
Factory Overheads (50,000×69.091%)	34,545.5
Work Cost	**1,64,545.5**
Administrative Overheads (164,500×11.23%)	18,478.5
Total Cost	**1,83,024**
Profit (182,973.35×12.61%)	23,084
Sales Price	**2,06,108**

Working Notes:
Computation of Relevant Overhead Absorption rate

i) **Factory Overhead Absorption rate based on direct labour**
(228,000/330,000) 69.091%

ii) **Admin overhead absorption rate based on work cost**

(107,600/958,000)	11.23%
Work Cost:	
Material Consumed	400,000.00
Direct Labour	330,000.00
Factory Overheads	228,000.00
Work Cost:	**958,000.00**

iii) **Profit to be added on cost of Job**

(134,400/1,065,600)	12.61%
Total Cost:	
Material Consumed	400,000.00
Direct Labour	330,000.00
Factory Overheads	228,000.00
Administrative Overheads	107,600.00
	1,065,600.00
Profit	134,400.00

3 b)

Workings

a) Contribution per unit= Selling price per unit-Variable Cost per unit

=Rs. 50-{Rs. (1,600,000+400,000+800,000)/80,000 units}
= Rs. 50- Rs. 35= Rs. 15

b) Profit Volume (P/V) Ratio = Contribution per unit/Selling Price per unit
=Rs. 15/Rs. 50×100% = 30%

Calculation

i) The number of units to be sold for neither loss nor gain i.e. breakeven units
Fixed Overheads/Contribution per unit = Rs. 720,000/Rs. 15 = 48,000 units

ii) The sales needed to earn a profit of 20% on sales

We know, Sales= Variable Cost+ Fixed Cost+ Profit

Suppose sales units are X then, Rs. 50X= Rs. 35X+720,000+ Rs. 50X×$\frac{20}{100}$

50X= Rs. 35X+720,000+ Rs. 10X

Or, 50X-45X=720,000
Or, 5X= 720,000
Or, X= 144,000

Therefore, sales needed= 144,000 Units* Rs. 50= Rs. 7,200,000 to earn a profit of 20% on sales.

iii) Calculation of extra units to be sold to earn present profit of Rs. 480,000 under the following proposed selling price:

Particulars	When selling price is reduced by	
	20%	25%
Selling Price Per unit (Rs.)	40	37.5
Less: Variable Cost per unit (Rs.)	35	35

Contribution per unit (Rs.)	5	2.5
Desired Contribution		
Fixed Overheads (Rs.)	720,000	720,000
Desired Profit (Rs.)	480,000	480,000
Total Desired Contribution	1,200,000	1,200,000
Sales Unit for Desired Contribution = Desired Contribution/Contribution per unit (A)	Rs.1,200,000/Rs.5 = 240,000 unit	Rs.1,200,000/Rs.2.5 =480,000 unit
Units presently sold (B)	80,000	80,000
Extra Units to be sold (A-B)	160,000	400,000

iv) Sales price to bring down BEP to 10,000 units

New BEP (Units) = Fixed Cost/Contribution per unit
New Contribution Per unit= Fixed Cost/New BEP Units
= Rs. 720,000/10,000
= Rs. 72
So, Sales price per unit = Variable Cost per unit+ Contribution per unit
= Rs. 35 + Rs. 72 = Rs. 107

3 c) The prime objective of inventory management is to find out and maintain optimum level of investment in inventory to minimize the total costs associated with it. Economic Order Quantity is the size of the order for which both ordering and carrying costs are minimum. Economic Order Quantity forms the very basis of inventory management. It refers to the size of each purchase order quantity for each item, which gives the maximum economy in purchase of that raw material or finished goods or stores materials. While placing any order for purchase of any item, it must be ensured that the order quantity is neither too large nor too small. A large order, no doubt, shall also mean the lower ordering cost but it shall mean a higher and sometimes prohibitive carrying costs. On the other hand, a small order may reduce the inventory carrying cost but the ordering costs would increase as the company may have to place a new order every now and then, besides, it may result in occasional production halts also. Therefore, a proper balance has to be struck between these two factors and the Economic Order Quantity shall be fixed at a point, where the aggregate cost of the two is minimum i.e., the total cost associated with the inventory management is minimum.

4.

a) Textile Ltd. pays following overtime premium for its labour beside normal wages of Rs. 100 per hour.

Before and after normal working hours	80% of basic wage rate
Sundays and holidays	150% of basic wage rate

During the previous year 2019-20, the following hours were worked:

Normal time	300,000 hrs.
Overtime before and after normal working hours	60,000 hrs.
Overtime on Sundays and holidays	15,000 hrs.
Total	375,000 hrs.

During the current year 2020-21, the following hours have been worked on job ‘spinning’:

Normal	4,000 hrs.
Overtime before and after normal working hours	400 hrs.
Overtime on Sundays and holidays	100 hrs.

Total 4,500 hrs.

You are required to calculate the labour cost chargeable to Job 'spinning' and overhead in each of the following instances: **5**

1) Where overtime is worked regularly throughout the year as a policy due to labour shortage.
2) Where overtime is worked irregularly to meet the requirements of production.
3) Where overtime is worked at the request of the customer to expedite the job.

b) PPC Company had following transaction during Ashad 2078:

Transaction		**Amount in Rs.**
i.	Material Purchase	
	Credit Purchase	10,000.00
	Cash Purchase	8,000.00
ii.	Purchase return out of credit purchase	500.00
iii.	Direct Materials issued to Job	4,000.00
iv.	Indirect Materials issued to Job	400.00
v.	Material transfer from Job 73 to 37	500.00

Prepare journal entries to record above transaction in the cost book. **5**

c) From the following data for the year ended 31st December, 2020 calculate the inventory turnover ratio of the two items and put forward your comment on them: **5**

	Material P (Rs.)	Material Q (Rs.)
Opening Stock 1/1/2020	20,000	18,000
Purchase during the year	104,000	54,000
Closing stock 31/12/2020	12,000	22,000

Answer

4 a) Workings:

Basic wage rate= Rs. 100 per hour

Overtime wage rate before and after normal working hours= Rs. 100+Rs. 100*80%
= Rs. 180 per hour

Overtime wage rate for Sundays and holidays = Rs. 100+Rs. 100*150%
= Rs. 250 per hour

Computation of average inflated wage rate including overtime premium:

Particulars	**Amount Rs.**
Annual wages for the previous year for normal time (300,000 hrs. * Rs. 100)	30,000,000
Wages for overtime before and after normal working hours (60,000 hrs. * Rs. 180)	10,800,000
Wages for overtime on Sundays and holidays (15,000 hrs. * Rs. 250)	3,750,000
Total wages for 375,000 hrs.	44,550,000

Average inflated wage rate= 44,550,000/375,000 hrs. = 118.80

1) Where overtime is worked regularly as a policy due to labour shortage

The overtime premium is treated as a part of employee cost and job is charged at an inflated wage rate. Hence, employee cost chargeable to job 'spinning'

Total hrs.* Inflated wage rate= 4,500 Hrs. * Rs. 118.80 = Rs. 534,600

2) Where overtime is worked irregularly to meet the requirements of production.

Basic wage rate is charged to the job and overtime premium is charged to factory overheads as under

Employee cost chargeable to job 'spinning'= 4,500 hrs. * Rs. 100 per hour
= Rs. 450,000

Factory Overhead= {400 hrs.*(Rs.100*80%)}+{100 hrs.* (Rs.100*150%)}
= Rs. 32,000+ Rs. 15,000
= Rs. 47,000

3) Where overtime is worked at the request of the customer, Overtime premium is also charged to the job as under

Job 'spinning' employee cost:	4,500 hrs. @ Rs. 100	= Rs. 450,000
Overtime Premium	: 400 hrs.*(Rs.100*80%)	= Rs. 32,000
	: 100 hrs.* (Rs.100*150%)}	= Rs. 15,000
Total		**= Rs. 497,000**

4 b)

Journal Entries
In the Books of PPC Company

Date	Particulars		Amount	Amount
Ashad 2078	Stores Ledger Control A/c	Dr	10,000.00	
	General Ledger Adjustment A/c	Cr		10,000.00
	(Being material purchased on credit)			
Ashad 2078	Stores Ledger Control A/c	Dr	8,000.00	
	General Ledger Adjustment A/c	Cr		8,000.00
	(Being material purchased on cash)			
Ashad 2078	General Ledger Adjustment A/c	Dr	500.00	
	Stores Ledger Control A/c	Cr		500.00
	(Being purchase returned)			
Ashad 2078	WIP Ledger Control A/c	Dr	4,000.00	
	Stores Ledger Control A/c	Cr		4,000.00
	(Materials issued to Job)			

Ashad 2078	Overhead Ledger Control A/c	Dr	400.00	
	Stores Ledger Control A/c (Indirect materials issued)	Cr		400.00
Ashad 2078	Job no 37	Dr	500.00	
	Job no 73 (Material transfer from Job 73 to 37)	Cr		500.00

4 c)

First of all it is necessary to find out the cost of material consumed.

Cost of material consumed	Materials P (Rs.)	Materials Q (Rs.)
Opening stock	20,000	18,000
Add:Purchases	1,04,000	54,000
	1,24,000	72,000
Less: Closing stock	12,000	22,000
Material consumed	1,12,000	50,000
Average inventory (Op. Stock+Cl. Stock) ÷2	16,000	20,000
Inventory Turnover ratio (Consumption÷Avg. inventory)	7 times	2.5 times
Inventory Turnover (No. of days): (No of days in a year ÷ I.T.Ratio)	52 days	146 days

Comment: Material P is more fast moving than Material Q.

5.

a) The following figures are available from financial accounts of X Ltd. for the 1st year of its operations:

Particulars	Rs.
Direct Material consumption	250,000
Direct wages	100,000
Factory Overheads	380,000
Administration Overheads	250,000
Selling and Distribution Overheads	480,000
Bad Debts	20,000
Preliminary expenses written off	10,000
Legal Charges	5,000
Divided Received	50,0000
Interest on Deposit received	10,000
Sales 120,000 units	700,000
Closing Stock:	
Finished Goods 40,000 units	120,000
Work in progress	80,000

The cost accounts reveal:
Direct material consumption: Rs. 280,000
Factory Overhead recovered at 20% on prime cost.
Administrative overhead at Rs. 3 per unit of production.
Selling and distribution overhead at Rs. 4 per unit.
Prepare: **7**

i. Costing profit and loss account.
ii. Financial Profit and loss account

iii. Reconciliation statement of profit shown by cost and financial accounts.

b) What is Budgetary control system? Discuss limitations of Budgetary control system. **4**

c) How continuous stock taking is complementary to the perpetual inventory system? **4**

Answer

5 a) **Profit and Loss Account as per Cost Accounts**

For the year ended 31 Ashad 2078

Particulars	Amount	Particulars	Amount
To Direct Material	280,000	By Sales	700,000
To Direct wages	100,000	By Loss	422,000
Prime Cost	380,000		
To factory Overhead (20% on Prime Cost)	76,000		
Gross Factory Cost	456,000		
Less: Work in progress	(80,000)		
Factory Cost	376,000		
To Administration Overhead (Rs. 3 per units produced)	480,000		
To cost of production (160,000 units)	856,000		
Less: Closing stock (40,000 units)	(214,000)		
Cost of production of goods sold	642,000		
To Selling Overheads	480,000		
Total	**1,122,000**		**1,122,000**

Profit and Loss Account as per Financial Accounts

For the year ended 31 Ashad 2078

Particulars	Amount	Particulars	Amount
To Material consumed	250,000	By Sales	700,000
To Direct wages	100,000	By Dividend Received	50,000
To factory Overhead	380,000	By Interest on Deposit	10,000
To Administration Overhead	250,000	By Closing Stock:	
To Selling and Distribution Expenses	480,000	Finished Goods	120,000
To Legal Charges	5,000	Work in Progress	80,000
To Bad Debts	20,000	By Loss	535,000
To Preliminary Expenses	10,000		
Total	**1,495,000**		**1,495,000**

Reconciliation Statement

Particulars	Amount	Amount
Loss as per Cost accounts		*(422,000)*
Add: Over charging materials in cost accounts	30,000	
Over absorption of admin Overhead	230,000	
Dividend received not included in cost accounts	50,000	
Interest received on deposit not included in cots accounts	10,000	320,000
Less: under absorption of factory overheads	304,000	
Bad Debts	20,000	
Preliminary expenses	10,000	

Legal Charges Overvaluation of Closing Stock	5,000 94,000	 (433,000)
Loss as per Financial Accounts		*(535,000)*

5 b) Budgetary control system can be defined as the establishment of budgets relating the responsibilities of executives to the requirements of a policy and the continuous comparison of actual with budgeted results, either to secure by individual action the objective of that policy or to provide a basis for its revision.

Limitation of Budgetary Control System

1. Budgets are considered as rigid document.
2. Budgets cannot be executed automatically
3. Staff co–operation is usually not available during budgetary control exercise.
4. Its implementation is quite expensive.

5c) Perpetual Inventory System is a system of stock control followed by the stores department. Under this system, a continuous record of receipt and issue of material is maintained by the stores department. In other words, in this system, stock control cards or bin cards and the stores ledger show clearly the receipts, issues and balance of all items in stock at all times. This system facilitates planning of production and ensures that production is not interrupted for want of materials and stores.

Continuous Stock taking means physical verification of stores items on a continuous basis to reveal the position of actual balances. Such a verification is conducted round the year, thus covering each item of store twice or thrice. Any discrepancies, irregularities or shortages brought to the notice, as a result of continuous stock verification are reported to the appropriate authorities for initiating necessary rectification measures. This system works as a moral check on stores staff and acts as a deterrent to dishonesty.

A perpetual inventory system is usually supported by a programme of continuous stock taking. That is, continuous stock taking is complementary to the perpetual inventory system. Sometimes the two terms are considered synonymous but it is not so. The success of the perpetual inventory system depends upon the maintenance and updated writing up of (i) the stores ledger and (ii) bincards/stock control cards. Continuous stock taking ensures the veracity of figures shown by the above records.

6. Write short notes: **(4×2.5=10)**
   a) Uniform Costing
   b) Assumptions underlying break even analysis
   c) Operation Costing
   d) Idle capacity and its treatment in cost accounts

Answer

6 a) Uniform costing is not a distinct method of costing. It is adoption of common accounting principles and in some cases common methods by member companies in the same industry so that their cost figures may be comparable. Uniform costing can be defined as the 'use by several undertakings of the same costing principle and practices'. Uniform costing can be adopted if certain pre-conditions exist. The success of a uniform costing system depends primarily on the cooperation extended by different units or firm towards the working of the system. Every unit should agree to supply required accounting and costing information without reservation to a central body formed by them for implementation of the uniform costing scheme. This body has to correlate, analyze and consolidate the information received from the different units.

6 b) The assumptions underlying break even analysis are as below:

(i) All costs can be easily classified into fixed and variable components.

(ii) Both revenue and cost functions are linear over the range of activity under consideration.

(iii) Prices of output and input remain unchanged.

(iv) Productivity of the factors of production will remain the same.

(v) The state of technology and the process of production will not change.

(vi) There will be no significant change in the levels of inventory.

(vii) The company manufactures a single product.

(viii) In the case of a multi-product company, the sales mix will remain unchanged.

6 c) Operation costing is defined as the refinement of process costing. It is concerned with the determination of the cost of each operation rather than the process. In those industries where a process consists of distinct operations, the method of costing applied or used is called operation costing. Operation costing offers better scope for control. It facilitates the computation of unit operation cost at the end of each operation by dividing the total operation cost by total input units. It is the category of the basic costing method, applicable, where standardized goods or services result from a sequence of repetitive and more or less continuous operations, or processes to which costs are charged before being averaged over the units produced during the period. The two costing methods included under this head are process costing and service costing.

6 d) It is that part of the practical capacity which cannot be utilised due to lack of demand, non-availability of materials, skilled labour, shortage of power, fuel or supplies, seasonal nature of product and lower sales expectancy. Idle capacity in fact is the difference between the practical capacity and the capacity based on sales expectancy. In brief, idle capacity is unused capacity of a plant, equipment or department which cannot be used gainfully. It usually arises due to factors which the management of a business concern considers beyond its control.

Idle capacity is associated with costs which are represented mostly by fixed charges such as depreciation, repairs and maintenance, insurance premium, rent, rates, management supervisory costs, which cannot be absorbed or recovered due to under-utilisation of plant capacity.

Treatment of Idle Capacity in cost accounts:

Idle capacity costs may be normal or abnormal. These costs may be treated in the following ways in cost accounts.

(i) Normal Idle capacity cost due to unavoidable reasons may be included in works overheads and be absorbed into the cost of production either by inflating the overhead rate or by means of a supplementary overhead rate.

(ii) Abnormal Idle Capacity cost due to avoidable reasons such as lack of proper planning and control should be charged to costing profit and loss account.

(iii) Idle Capacity cost due to trade depression is abnormal in nature and thus it should be charged to costing profit and loss account

Paper 6: Business Communication and Marketing

Business Communication

All questions are compulsory.

Section -'A'

1. Read the following case and answer the questions that follow. **(4×5=20)**

   Sunlight Publications and Distributers Pvt. Ltd. is an established publication house in Kathmandu, and it publishes books and other reading materials on business and management. This company has recently conducted a public auditing regarding their goods/ published materials and services. Particularly, they conducted a research project focusing on the readers' opinions on the quality of their books and the services that they are delivering through publication and distribution. Specific objectives were set and tools were developed to lead the project successfully.

   After they carried out the project, they offered you as an expert of business communication an assignment to write an effective report on the project. The nature of the study was survey. At least 1,000 readers including students, professors and professionals of the management field were sampled. They were given a short close-ended questionnaire, and their opinions and perceptions were collected. These data are expected to be analyzed and interpreted in the research report.

   Questions

   a) Write an introduction paragraph and at least three objectives of the research report.
   b) What would be their questionnaire like? Develop a close-ended questionnaire with at least five items.
   c) Write a sample paragraph of the analysis of data that you may include in your report. Mention statistical figures such as percentage too.
   d) What would be the major components of the report? Introduce them very briefly.

Answers:

a) Sunlight Publications and distributers Pvt. Ltd. is an established and successful publication house in Kathmandu that publishes books and materials on business and management. We are satisfied with the current trends of our business growth, transaction and promotion. However, our way of understanding our business and our clients has always been too traditional and clumsy. After the consultation with an expert on business communication, we have identified the urgency of knowing the reactions of our own clients or consumers who are obviously the readers of our books about our publications and service delivery. This project was conducted after the realization of this kind of gap or urgency.

   OBJECTIVES

   The major objectives of the project were:

   1) To find out the reactions of the readers about the quality of the publication;
   2) To explore their opinions about the quality of services that we are providing;
   3) To recommend some useful strategies for better delivery of quality products and services from the publication house.

b) The questionnaire used in this project would be more or less like the following.

Statements	**Strongly Agree**	**Agree**	**Disagree**	**Strongly Disagree**
The quality of our publication is of international level particularly for citation and references.				

Materials published from our house are purely academic and worthy of consultation by scholars.				
Books published from this organization are thoroughly revised and well edited.				
Books and other published materials are easily available in the Nepalese market.				
The e-copies of books and materials can be bought online.				

c) Most of the university graduates graded the quality of the publications as of the international standard. 40% of them responded that they strongly agree to this fact, while 35% simply agreed to the statement. Other 25% graduates were not ready to agree the international quality of the publications. Similarly, more than 80% professors agreed that the materials published from this house were of the international level. Nearly 18% professors disagreed this idea. In the same way, 72% graduates mentioned that the publications were worth of consultation and 81% professors found the materials worth of consultation for their academic purposes.

d) The major components of the survey report are:

- Introduction with general background, statement of problem, objectives, limitations, etc.
- Methodology with sources of data, tools for data collection, samples, data analysis procedures, etc.
- Discussion with analysis of data
- Conclusion with findings and recommendations.

2. You work for a company named Software.com. The company wants to hold its next company-wide meeting in a resort. The CEO has asked you to find a conference location for your 80 engineers, product managers, and marketing staff. He wants the company to host a four-day combination sales conference/vacation/retreat at some spectacular spot. He suggests that you start by inquiring at Hotel Marigold, Butwal. You check its Web site and discover interesting information. However, you decide to write a letter so that you can have all information that you need.

   You estimate that your company will require about 80 rooms. You will also need three conference rooms for one and a half days. You want to know room rates, conference facilities, and entertainment options for families. You have two periods that would be possible: April 20-24 or July 10-14. Write a letter to the manager of Hotel Marigold, Butwal. **10**

Software.com
Mid-Baneswor, Kathmandu
Devkota Street
45/456

January 20, 2021

John Kaka
Marigold Hotel
Butwal Municipality
Faketown-08

Dear Mr. Kaka

Would you please provide me with the following information regarding your resort? We are planning to hold a four-day conference in your resort if it meets our basic requirements. Please answer the following questions:

a. Could you provide us with about 80 rooms for four days?
b. Does your resort have 3 conference rooms to accommodate around 120 staff members?
c. Would you be able to provide us with facilities like food and entertainment? We may need a disco hall for the evenings after 8 pm.
d. What are the standard room rates and what would be the room rates if we used it at an off-peak time?

We would be much obliged if we receive the reply within a week. Looking forward to using your location for our conference. Thank you.

Sincerely
Amdhan Rai
Managing Director

3. Answer the following questions briefly. **(5+5=10)**

a) What should management do to improve intercultural communication in the workplace?

Answer

Improving intercultural communication is a management responsibility which extends over a range of activities listed below. These are just some of the areas in a business which may have cultural assumptions built into them, including:

- company policy and working conditions;
- training;
- industrial relations and the work of the personnel or human resources department;
- the house journal and other publications;
- customer relations.

The organization must set up effective consultation procedures. The managers should get out of their ivory towers and sample the real world. They should work to change the perception of the staff. They should realize that there is not a quick-fix solution to intercultural communication, but do identify problem areas and provide an agenda for consultation. Each organization must identify its own problems and set its own agenda. The management should enter the process of improving cross-cultural communications with as few preconceptions as possible. The company must be committed to improving intercultural relationships through genuine consultation and negotiation. The ultimate aim is to build a corporate culture to which all employees can subscribe.

b) How do you explain the fact that ambiguity may be a primary source of misunderstanding in nonverbal communication? Discuss.

Answer

Nonverbal communication is the transfer of information through the use of body language including eye contact, facial expressions, gestures, and more. For example, smiling when you meet someone conveys friendliness, acceptance, and openness. Everyone uses nonverbal communication all the time whether they know it or not. But nonverbal signs can be ambiguous. They may differ from place to place or even context to context. We can never be sure that others understand the meanings we intend to express with our nonverbal behavior. The ambiguity of nonverbal communication also arises because meanings change over time.

Nonverbal communication is also learned and guided by rules. These rules reduce the ambiguity of nonverbal communication by telling us how certain behaviors are to be understood, and when and where certain behaviors are appropriate and inappropriate. For example, most of us understand that people take turns speaking and that we should whisper in libraries but it’s appropriate to yell at ball games. We know that we are supposed to raise our hands if we want to ask a question during a lecture but don’t need to raise our hands to speak when interacting with friends. We dress differently for religious services, classes, dates, and job interviews. These agreed-upon rules reduce but don’t completely eliminate the ambiguity of nonverbal communication. In order to avoid such miscommunications, one must be aware of nonverbal cues, and contexts.

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

a) The grapevine

Answer

The grapevine is the communication that develops among organization members and is not necessarily prescribed by the formal structure and hierarchy of the organization but grows out of organization members’ curiosity, interpersonal attraction, and social interaction. It is that mixture of leaks, conjecture, educated guesses and gossip that circulates in an organization.

b) Meta-perception

Answer

As well as directly perceiving our own behaviour and the behaviour of others, we can also reflect on how those other people are perceiving us. This has been called ‘meta-perception’ and has been shown to be an important factor in determining how people react to one another.

c) Technical and financial proposals

Answer

A technical proposal is a document where the writer introduces the product, explains how it can help solve the recipient's issues, identifies the company's plan for execution, and provides technical details of the deal. A financial proposal is a written report that details the future of a business's economy by addressing its monetary needs and budget. In these reports, we must follow the rules of good technical writing as it can be very difficult for readers if it is not written in the proper format and the proper style.

d) Information overload

Answer

Information overload is known as the excess of information available to a person aiming to complete a task or make a decision. This hinders the decision-making process, resulting in a poor or even no decision being made. Information overload is usually caused by the existence of multiple sources of information, over-abundance of information, difficulty in managing information, and irrelevant or unimportant information. This is particularly important because people may experience stress due to information overload. This stress is also described as “information anxiety.” Most of the time, information anxiety isn’t caused by a large amount of information in itself, but rather by a large amount of irrelevant information. Therefore, we, as communicators, must be careful enough while sharing information with our readers.

Marketing

All questions are compulsory.

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

Dabur Nepal

Beauty forms one of the biggest consumer industries in today's economies due to increasingly uniform yet competitive standards of good looks worldwide. With the rising popularity of all things healthy and natural, it is a little surprising that Dabur Vatika beauty, hair, and skincare products are one of the most vied for in the South Asian market.

Dabur Nepal Pvt. Ltd (DNPL) started its operation in Nepal in 1992, in association with Dabur India Ltd, which is one of the leading "manufacturers in Ayurveda-based consumer goods." The Dabur Nepal factory, which was first set up at Parwanipur launched its Vatika range of cosmetic products in the year 1999. Cutting-edge technology, highly trained personnel, and the most rigorous manufacturing processes ensure that Dabur Nepal's products meet the highest international standards. With an investment of Rs. 150 million Dabur Nepal Pvt. Ltd established a state-of-the-art greenhouse facility at Banepa, about 25 km from Kathmandu in 1988. This greenhouse facility can produce 4-5 million trees of medicinal saplings every year. All the requisite climate parameters for uniform growth of trees like temperature, humidity, etc. are controlled by automatic computer systems. The company has planted more than one million trees at different locations so far. A total of more than 70 hectares of land area has been used for the cultivation of medicinal plants.

Vatika from Dabur is the leading brand of herbal beauty products. The Vatika range of hair care and skin care products includes Vatika Hair Oil, Vatika Shampoos, Vatika Fairness Face Pack, and Vatika Honey & Saffron Soap. Each of these Vatika products has natural herbs as their active ingredients, which promise the best nourishment and beauty.

The market for the Vatika product range is regularly growing. The product has been able to respond to the demands of consumers. The size of its consumers has reached about 3 million. The products are sold through 25,000 outlets throughout the country. The marketing proposition of the brand has always been to produce a premium up-market product that focuses on individual needs rather than on collective" says SK Das, unit head of the Dabur Nepal.

Vatika with its pioneering efforts across categories has various achievements to its record since the launch of the mother brand. Initially, Vatika Hair Oil used to come in blue packs with coconut oils in it, later the color of the pack was changed into a green with a mushroom-like cap. The cap design was changed to a flip-open style with the launch of Vatika Shampoo in 1999. The shampoo was launched as a premium natural offering that would condition the hair with the ingredients from traditional recipes such as henna, green almonds, and shikakai. The success of Vatika Shampoo forced the larger competitor to also introduce natural ingredient-based products. Vatika anti-dandruff shampoo was another successful launch of Dabur Nepal. The shampoo has lemon as the natural cure for the dandruff problem.

a) What are the main issues of the case?
b) Why has Dabur Nepal been able to achieve a competitive advantage in the Nepalese market?
c) Analyze and evaluate the company's marketing strategies.
d) Why Nepalese consumers are attracted to natural products?

Answer

1 a) The main issues of the case are the following:

- Beauty forms one of the biggest consumer industries in today’s economies.
- Global competition has led the companies to constantly update their products as the consumer’s demand.
- Consumers these days are extremely conscious about their health and are inclined towards organic and natural products.
- Dabur Vatika beauty, hair, and skincare products are one of the most vied for in the South Asian market.
- Dabur Nepal has strategically planted its greenhouse facility at Banepa, which can produce 4-5 million saplings of medicinal plants every year.
- Vatika’s range of hair care and skin care products has natural herbs and its active ingredients promise the best nourishment and beauty.
- Dabur Nepal has a total of 25,000 outlets throughout the country.
- Dabur Vatika with its pioneering effort across categories has various achievements to its record since the launch of the mother brand.
- Dabur minutely cares about the consumer’s demands like Vatika changed the pack color to green with a mushroom-like cap.
- Dabur’s next premium successful product is Vatika ‘anti-dandruff shampoo’.

1 b) Dabur Nepal started its operation in Nepal in 1992 in association with Dabur India Ltd, which is one of the leading “Manufacturers in Ayurveda-based consumer goods”. The following points can be considered for its success in Nepal:

- **Strategic location:** The company’s location is based at Parwanipur, which is near the border of India, and the company's greenhouse is situated at Banepa, only 25 km from the capital city Kathmandu.
- **Advanced Technology:** The Company uses highly advanced technology in the production and operation process which increases manufacturing efficiency.
- **Trained Personnel:** The Company has recruited trained employees who are less likely to make manual errors during the manufacturing process which in turn increases its production efficiency.
- **Huge Investment:** The Company has established a greenhouse facility at Banepa with a total investment of 150 million rupees which can produce 4-5 million trees of medicinal saplings every year. This greenhouse facility has all the requisite climate

parameters for uniform growth of trees like temperature, humidity, etc. are controlled by automatic computer systems.

- **Pricing:** The Company also has a competitive advantage for pricing as most of their products have premium prices as the company follows the product line concept in marketing.
- **Products as per the customer's demand:** The company's range of hair care and skin care products such as Vatika hair oil, Vatika Shampoos, Vatika fairness cream, Face pack, and Vatika Honey and Saffron Soap consists of natural ingredients which are liked by the modern sophisticated customers.

1 c) Marketing is the creating, communicating, and delivering goods and services to the target groups. Dabur Nepal researched setting up the company and found that the nature of geography and the health-conscious customer, that also applies the same situation of any customer around the world about the sensitivity of health. By this statement, the company has applied the following marketing strategies:

- Dabur Nepal did research and selected beauty and skin products, which is necessary for each individual
- Dabur Nepal followed a product line approach by including hair care and skin care products, such as Vatika Hair Oil, Vatika Shampoos, Vatika Fairness Face Pack, and Vatika Honey & Saffron Soap. Each of these Vatika products has natural herbs and active ingredients which promises the best nourishment and beauty.
- Dabur Nepal follows a strategic distribution policy throughout the nation with more than 25,000 outlets.
- Dabur Nepal follows a premium pricing policy.
- Psychological treatment with the local people through huge investment for herbal product plantations.

1 d) If we look at the recent trends, not just Nepalese customers but customers all around the world are more attracted to natural and organic products. Following are some of the reasons why Nepalese customers are attracted to natural products:

a. They are eco-friendly
By using products made up of natural ingredients, the customers can choose to live a lifestyle that respects the earth and doesn't harm the environment. It gives them the "moral satisfaction" that they have done something good for themselves and the world.
b. They are Chemical Free:
Customers nowadays are very health conscious and are aware of the side effects of different chemicals used as major ingredients in various products. By using natural products with no pesticides, chemicals, or processed additives and picking organic products means a smaller risk of disease, illness, and disorders.
c. They are Sustainable:

By using natural products, customers power their economic and social development and many 'ecosystem services' to ensure an uninterruptedly healthy planet - from a clean supply of air, water, food, and raw materials, to disease regulation and space for recreation.

2. What do you know about new marketing concept? Discuss the fundamental principles of new marketing concept. **(3+7=10)**

Answer

2) The marketing concept, based on central doctrines crystallized in the mid-1950s, challenges the three business orientations. The marketing concept holds that the key to achieving organizational goals consists of the company being more effective than its competitors in creating, delivering, and communicating customer value to its chosen target markets.

The marketing concept starts with a well-defined market, focuses on customer needs, coordinates all marketing activities affecting customers, and makes profit by creating long-term customer relationship based on customer value and satisfaction.

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

The marketing concept takes an outside-in perspective. It starts with a well-defined market, focuses on customer needs, coordinates activities that affect customers, and produces profits by satisfying customers.

Target Market

No marketer can satisfy the needs of all customers by offering single product. Thus, market segmentation is essential to implement new marketing concept. Market segmentation is customer-oriented philosophy where total heterogeneous market is divided into common homogeneous small groups under specific criteria. Selected market segment is called target market. Companies do best when they choose their target market(s) carefully and prepare tailored marketing programs. For example, junior Horlicks for Children, Lux soap for beauty, Liril soap for freshness, Pepsodent for strong teeth, Close up for fresh breath etc.

Customer Needs

A company can carefully define its target market yet fail to correctly understand the customers' needs. Clearly, understanding customer needs and wants is not always simple. Some customers have needs of which they are not fully conscious; some cannot articulate these needs or use words that require some interpretation. We can distinguish among five types of needs: (1) stated needs, (2) real needs, (3) unstated needs, (4) delight needs, and (5) secret needs.

Responding only to the stated need may shortchange the customer. For example, if A customer enters cosmetics shop and asks for a lipstick, she is not asking for lip color or chemicals, she is going to buy beauty. If the salesperson suggests another alternative product that would provide a better solution, the customer may appreciate that the salesperson met her need and not her stated solution.

A distinction needs to be drawn between responsive marketing, anticipative marketing, and creative marketing. A responsive marketer finds a stated need and fills it, while an anticipative marketer looks ahead to the needs that customers may have in the near future. In contrast, a creative marketer discovers and produces solutions that customers did not ask for, but to which they enthusiastically respond. Sony exemplifies a creative marketer because it has introduced many successful new products that customers never asked for or even thought were possible: Walkmans, VCRs, and so on. Sony goes beyond customer-led marketing: It is a market-driving firm, not just a market-driven firm. Akio Morita, its founder, proclaimed that he doesn't serve markets; he creates markets.

Why is it supremely important to satisfy the needs of target customers? Because a company's sales come from two groups: new customers and repeat customers. One estimate is that attracting a new customer can cost five times as much as pleasing an existing one. And it might cost 16 times as much to bring the new customer to the same level of profitability as that of the lost customer. Customer retention is thus more important than customer attraction.

Integrated Marketing

When all of the company's departments work together to serve the customers' interests, the result is integrated marketing. Integrated marketing takes place on two levels. First, the various marketing functions—sales force, advertising, customer service, product management, marketing research—must work together. All of these functions must be coordinated from the customer's point of view.

Second, marketing must be embraced by the other departments. According to David Packard of Hewlett-Packard: "Marketing is far too important to be left only to the marketing department!" Marketing is not a department so much as a company-wide orientation.

To foster teamwork among all departments, the company must carry out internal marketing as well as external marketing. External marketing is marketing directed at people outside the company. Internal marketing is the task of hiring, training, and motivating able employees who want to serve customers well. In fact, internal marketing must precede external marketing. It makes no sense to promise excellent service before the company's staff is ready to provide it.

Managers who believe the customer is the company's only true "profit center" consider the traditional organization chart—a pyramid with the CEO at the top, management in the middle, and front-line people and customers at the bottom—obsolete. Master marketing companies invert the chart, putting customers at the top. Next in importance are the front-line people who meet, serve, and satisfy the customers; under them are the middle managers, who support the front-line people so they can serve the customers; and at the base is top management, whose job is to hire and support good middle managers.

Profitability

The ultimate purpose of the marketing concept is to help organizations achieve their objectives. In the case of private firms, the major objective is profit; in the case of non-profit and public organizations, it is surviving and attracting enough funds to perform useful work. Private firms should aim to achieve profits as a consequence of creating superior customer value, by satisfying customer needs better than competitors.

How many companies actually practice the marketing concept? Unfortunately, too few. Only a handful of companies stand out as master marketers: Procter & Gamble, Disney, Wal-Mart, Milliken & Company, McDonald's, Marriott Hotels, American Airlines, and several Japanese (Sony, Toyota, Canon) and European companies (IKEA, Club Med, ABB, Marks & Spencer). These companies focus on the customer and are organized to respond effectively to changing customer needs. They all have well-staffed marketing departments, and all of their other departments—manufacturing, finance, research and development, personnel, purchasing— accept the customer as king.

Most companies do not embrace the marketing concept until driven to it by circumstances. Various developments prod them to take the marketing concept to heart, including sales declines, slow growth, changing buying patterns, more competition, and higher expenses. Despite the benefits, firms face three hurdles in converting to a marketing orientation: organized resistance, slow learning, and fast forgetting.

Some company departments (often manufacturing, finance, and research and development) believe a stronger marketing function threatens their power in the organization. Resistance is especially strong in industries in which marketing is being introduced for the first time—for instance, in law offices, colleges, deregulated industries, and government agencies. In spite of the resistance, many companies manage to introduce some marketing thinking into their organization. Over time, marketing emerges as the major function. Ultimately, the customer becomes the controlling function, and with that view, marketing can emerge as the integrative function within the organization.

3.

a) Explain the meaning and objectives of distribution. **5**

b) Describe the concepts of product levels. **5**

Answer

3 a) All marketing activities which make the product accessible and available to target market is distribution. In another words, various activities performed for supplying the products to the target markets on the whole is distribution. Distribution creates time utility, place utility, ownership utility of products. Management of product storing creates time utility whereas exchange creates ownership utility. Management of good transport system creates place utility. Distribution management satisfies customers' wants by supplying necessary goods to them and heightens their lifestyle.

Products have no utility at production place. Their utility increases immediately after they have been taken to consumption places. For example, publishers have no use of books, but when they reach among readers and students their utility increases. Similarly, suppliers provide means of productions and work as bridge between producers and target markets by supplying products. Distribution includes the tasks of distribution channels and physical distribution.

The main objectives of distribution which discharges such important responsibility are as follows:

1. *Minimization of total cost*

Producers produce various goods. A lot of expense is needed to distribute them. The producers may give responsibility to any channel to distribute. Channel management may deliver products to a certain place at minimum cost for distribution. While distributing products in such way, many channels may be involved in it. The function of distribution can be completed at minimum cost calculating the average labor of persons or groups spent on it. So, distribution channel sets the objective to minimize the total cost.

2. Making the goods available

Effective distribution channel makes arrangements for easy availability of any goods. Any goods or services demanded by customers become available at any place and any time. If goods are available when demanded, sale quantity of such goods increases on the one hand and healthy competition with competitors can be easily faced on the other. In this way, distribution channels always have the objective to maintain the availability of the products regularly.

3. Regular supply of goods

Any business firm or producer can give the responsibility of distribution for channels. Then the distribution channel manages regular supply of goods. In other words, distribution channel delivers right product at the right time and right place to buyers. So, all the customers of target market do not feel the lack of goods. Thus, distribution channel sets objective to render crucial services of regular supply of goods.

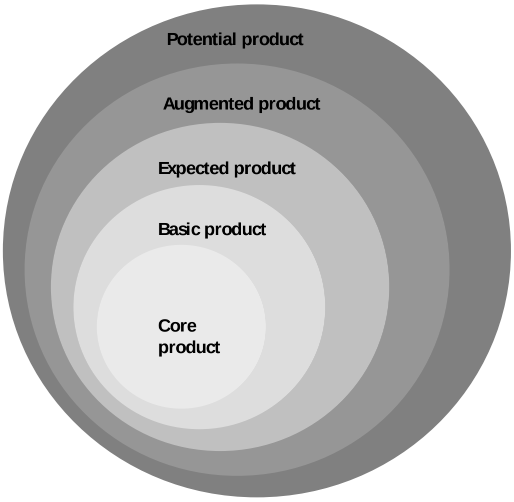
4. Transfer of product ownership

The distribution function also fulfills the process of ownership transfer. For any product documents/papers should also be given together with product by signing a contract. Ownership of some other goods should be handed over, in presence of government authority, with documents by completing every legal process and requirement. Only after formally transferring ownership, the goods belong to the buyer or customer. So, distribution channels also take responsibilities to transfer ownership of goods.

5. Promotion of goods and services

Effective distribution channel also promotes goods or services. Distributor reaches target market taking goods from production center. After reaching target market, the distributor gets chances to show the goods to customers. Customers become very happy to see and know about the goods. They also can ask about the product if anything unclear. They become acquainted with the product after the distributor gives true information and answers to them about the products. In this way, distributor has the target to promote the product or service of the producer.

3 b) Product can be seen from various angles. There are five levels of a product also known as five product concepts, they are core product, basic product, expected product, actual product and augmented product.



Levels of Product

1. **Core product:** Core product concept sees product as benefit it provides. Core product is benefits or services consumers seek from the product. For example, lipstick as beauty product, medicine as health product, book as education product, etc.
2. **Actual (basic/formal) product:** Actual product concept sees product as it is visible. Elements of actual product could be materials, parts, features, design, quality, brand name, packaging etc. For example, Revlon red lipstick, Honeytus Cough Syrup medicine, Principles of Marketing book by Philip Kotler are products from actual product concept.
3. **Augmented products:** Augmented products are additional services & benefits like warranty/guaranty, use instruction, repair services, toll free number, delivery, free items with the main bought product. For example, lip liner may be augmented when lipstick is bought. Bag, information, return facility, discount, credit may be augmented when medicine is bought. CD, book cover might be augmented when book is bought. Each level adds more value to the product. Actual product must be according to core (need) product.
4. **Potential product concept:** Potential product concept see product in future scenario that is in the form of total future augmentation possible in the product. For example, lipstick with torchlight attached, potential product could be e-book that you carry on mobile not in your bag.
5. **Expected product concept:** Expected product is product that is expected by customer (many times product does not meet the expectations and fails). Many customers expect lipstick to be non-sticky to others but some lipstick stick. Medicine may not cure disease in two days as we expected, book might not cover all syllabus as expected, mobile phone may not pick the network as you expect. Product must meet the customer expectations.

Manufacturing product should not be just concerned with materials and parts. Product should be manufactured on the foundation of core product (benefits desired by customer). Product must augment some additional benefits to win the competition. Company must always plan ahead (proactive marketing) for what customer may need in future. If you ask what customers want and then start developing it, by the time you finish developing product customer may have fulfilled his/her need from other company.

4. Write short notes on: **(5×2=10)**

a) Green Marketing
b) Warehousing
c) Price determinants
d) Industrial Product
e) Distribution Channel

Answer

4 a) Green Marketing

Green marketing refers to the process of selling products and/or services based on their environmental benefits. Such a product or service may be environmentally friendly in itself or produced in an environmentally friendly way.

4 b) Warehousing

A warehouse is a fixed facility in which products are stored until demand arises for them in the market. Warehousing is a major physical distribution function that affects the level of customer service of an organization. The concept of warehousing has undergone significant changes over the years. It is no more viewed as the traditional go-down where products are stored for months. The distribution warehouses have replaced go-downs. The distribution warehouse stores products for a minimum of time before they are delivered to the target markets. The emphasis is on product movement rather than product storage.

4 c) Price determinants

Factors that affect pricing are called price determinants. Price determinants are objectives of the organization, marketing mix strategy, costs, product differentiation, business efficiency, market demand of the product, economic condition, market competition, government rules and regulations, market intermediaries, political condition, pressure groups.

4 d) Industrial Product

Industrial products are those intended for use in making other products or operating a business or institution. Thus, industrial products are differentiated from consumer products based on their ultimate use. The types of Industrial goods are raw materials, component parts, major equipment, accessory equipment, operating supplies, and business services.

4 e) Distribution channel

Distribution channel is path made up of various persons and institutions (agent, wholesaler (dealer, distributor), retailer) that help transfer ownership of product while products being physically distributed. They help product movement, transfer ownership of products and facilitating exchanges. Channel of distribution is also known as financial function (due payments for product) or legal function (due transfer of ownership) of marketing.

Paper 7: Income Tax and VAT

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

1. ABC P. Ltd. is a special industry as per Industrial Enterprise Act 2076. Relevant extracts related to income and expenditure for income year 2077/78 are as follows:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Opening Stock	4,500,000.00	Sales	18,000,000.00
Purchase of raw materials	8,500,000.00	Closing stock	4,800,000.00
Freight Inwards	400,000.00	Gain on sale of business assets	600,000.00
Direct wages	800,000.00	Prize from display competition	200,000.00
Manufacturing Expenses	1,200,000.00	Miscellaneous Income	750,000.00
Administrative Expenses	400,000.00	Bad debts recovered	300,000.00
Interest Expenses	700,000.00	Dividend received	950,000.00
Repair Expenses	500,000.00		
Depreciation	1,200,000.00		
Entertainment Expenses	200,000.00		
Miscellaneous Expenses	100,000.00		
Audit Fee	400,000.00		
Pollution control cost	500,000.00		
Donation	300,000.00		
Research and Development Cost	200,000.00		

Additional Information: **20**

1. Out of bad debts recovered, 20% was not allowed previously.
2. The opening stock and closing stock has been recorded 45,000 pieces and 50,000 pieces respectively. The opening stock includes factory fixed overhead Rs. 15 per piece and repair and maintenance Rs. 10 per piece (related to machinery). During the year, the company produced 200,000 pieces of garments and the overhead cost includes equal rate of previous years fixed overhead and repair and maintenance cost.
3. Administration expenses include a cash payment of Rs. 75,000 to a constitutional body
4. Additionally, administrative expenses includes payment made to wages amounting to Rs. 250,000 The breakup of these payments are as: Rs. 2,500 paid to 60 workers and Rs. 5,000 paid to 20 workers, each.
5. Opening WDV of assets are: Building Rs. 30,000,000, land 5,000,000, Plant & Machinery Rs. 4,000,000, Vehicle 1,000,000, Office Equipment Rs. 1,000,000.
6. Machinery worth 6,000,000 was purchased on the Month of Jestha, 2078, while vehicle purchased 3 years ago with a cost of 3,000,000 and WDV of 1,000,0000, as per accounts was disposed off for value of Rs. 1,500,000 in the month of Baisakh, 2078.
7. Repair and maintenance cost includes Rs. 200,000 for repairs of building and 300,000 for repairs of machinery
8. Donation includes Rs. 100,000 donated to Covid relief fund and Rs. 200,000 donated to tax exempt organization.
9. The Company employees 400 Nepalese citizen throughout the year and was set up in less developed area five years ago.

Answer

1)

Income from Business	Rs.	Note	Section
Sales	18,000,000.00		7
Net gain on sale of business assets	600,000.00		7
Prize from display competition	200,000.00		7
Miscellaneous Income	750,000.00		7
Bad debts recovered (80%)	240,000.00	(W.N.1)	7
Gain on disposal of depreciable assets	500,000.00	(W.N. 4)	7
Dividend Received (Final Withholding)	-		92
Less: Allowable Deductions			
Cost of trading stock u/s 15	12,225,000.00	(W.N.2)	15
Administration expenses	300,000.00	(W.N.3)	13
Depreciation	35,33,333.00	(W.N.4)	19
Repair & improvement expenses	500,000.00	(W.N.5)	16
Entertainment expenses	200,000.00		13
Miscellaneous expenses	100,000.00		13
Audit Fee	400,000.00		13
Interest Expenses	700,000.00		13
Assessable Income before PCC, R& D, Donation	**23,31,667.00**		
Less: Pollution control cost	500,000.00	(W.N.6)	17
Less: R & D Cost	200,000.00	(W.N.7)	18
Assessable Income from Business			
Less: Donation	181,583.35	(W.N.8)	12
Taxable Income	**1,450,083.65**		
Effective Tax Rate	6%	(W.N.)	Multiple sections
Tax Liability	87,005.02		

W.N. 1

80 % of Bad Debts was allowed previously, therefore, on recovery 80% of the recovery is only taxable.

W.N. 2	
Calculation of Cost of trading stock **Alternative 1**	
Particulars	Amount
Opening Stock	4,500,000.00
Less: Adjustment for Repair & Maintenance Expense (10*45,000)	450,000.00
Value of Adjusted Opening Stock (A)	**4,050,000.00**
Add: Cost of Production	
Purchase of Raw Materials	8,500,000.00
Freight inwards	400,000.00
Direct Wages	800,000.00
Manufacturing Expenses	1,200,000.00
Total Manufacturing Cost (B)	**10,900,000.00**
Production Unit	200,000.00

Production Cost Per Unit (Using FIFO Method)	**54.50**
Value of Closing Stock (50,000*54.50) (C)	**2,725,000.00**
Cost of Trading Stock (D=A+B-C)	**12,225,000.00**

W.N. 2	
Calculation of Cost of Trading Stock **Alternative 2**	
Particulars	**Amount**
Opening Stock	4,500,000.00
Less: Adjustment for Repair & Maintenance Expense (10*45,000)	450,000.00
Value of Adjusted Opening Stock (A)	**4,050,000.00**
Add: Cost of Production	
Purchase of Raw Materials	8,500,000.00
Freight inwards	400,000.00
Direct Wages	800,000.00
Manufacturing Expenses	1,200,000.00
Total Manufacturing Cost (B)	**10,900,000.00**
Value of Closing Stock (Given)	**4,800,000.00**
Less: Repair and Maintenance Expense (Machinery) 50,000*10	(500,000.00)
Adjusted Closing Stock (C)	**4,300,000.00**
Cost of Trading Stock (D=A+B-C)	**10,650,000.00**

W.N. 3: Administrative Expenses

(Given)	400,000.00
Cash Paid to Constitutional Body	-
Cash paid in excess of Rs. 3000, paid to a worker (5,000*20)	(100,000.00)
Cash paid for amounts up to Rs. 3,000	**-**
Allowed Expenses	**300,000.00**

As per section 21(2) of the act, if a person, having annual turnover of Rs. 20 lacs, makes an expenditure by cash for amount more than Rs.50,000, then the expenditure is not deductible. But the exception is for constitutional body, hence it is allowable

W.N. 4
Calculation of Depreciation Expense

Particulars	**Pool A**	**Pool B**	**Pool C**	**Pool D**	
I. Depreciation Rate	5.00%	25.00%	20.00%	15%	
Additional: (1/3)	1.67%	8.33%	6.67%	5%	
	6.67%	33.33%	26.67%	20%	
II. Opening Depreciation Base	30,000,000.00	1,000,000	1,000,000.00	4,000,000.00	
III. Absorbed Additions				2,000,000.00	
IV. Disposals			1,500,000.00		
V. Depreciation Base	30,000,000.00	1,000,000	-500,000.00	6,000,000.00	
VI. Depreciation Expenses	2,000,000.00	3,33,333.33	Balancing Charge	1,200,000.00	

Total Depreciation Expenses: NRs. 35,33,333

Land is a non-depreciable asset
Additional 1/3rd depreciation is provided to special industries.
Rs. 500,000 is included income (sales proceeds less WDV)

W.N. 5
Calculation of Eligible Repair & Improvement Cost

Particulars	**Pool A**	**Pool B**	**Pool C**	**Pool D**
I. Depreciation Base	30,000,000.00	1,200,000	0	6,000,000.00
II. 7% of Depreciation Base	2,100,000.00	84,000.00	0	420,000.00
III. Actual Repair & Improvement Cost	200,000.00	0	0	300,000.00
IV. Eligible (Lower of II or III)	200,000.00	0	0.00	300,000.00

Total Eligible Repair and Maintenance Expenses: 500,000

W.N. 6
Pollution Control Expenses

Taxable income without giving effect to sec 12, 14(2), 17, 18	23,31,667.00	
Less: Actual PCC	500,000.00	
ATI for the purpose of Sec. 17	18,31,667.00	
Actual PCC [A]	500,000.00	
50% of ATI [B]	915,833.50	
Allowable PCC	500,000.00	

W.N. 7
Research and Development cost

Taxable income without giving effect to sec 12, 14(2), 17, 18	23,31,667.00	
Less: Actual R&D Cost	200,000.00	
ATI for the purpose of Sec. 18	21,31,667.00	
Actual R & D Expenses	200,000.00	
50% of ATI	10,65,833.50	
Allowable R & D expenses	200,000.00	

W.N. 8
Donation

Taxable income without giving effect to sec 12, 14(2), 17, 18	23,31,667.00
Less: Actual PCC	500,000.00
Less: Actual R&D	200,000.00
ATI for the purpose of Sec. 12	16,31,667.00
Actual Donation (300,000-100,000)	200,000.00
5% of ATI	81,583.35
Maximum	100,000.00
Allowable Donation u/s 12	81,583.35

Donation made to Covid Relief fund is fully allowable without any limits.

W.N. 9

Effective Tax Rate

Tax Rate- Special Industry (11(2b)(c)) - 20% exempt	20%
Concession to industry providing employment to more than 300 Nepalese citizen throughout the year(Section 11(3(a))- 80% of applicable tax	16%
Tax rate of Special industry set up at less developed area, within 10 years of its incorporation 30% of the tax levied (Section 11(3)(b))	6%

Hence, 6% effective tax rate shall be chosen because it is beneficial to the taxpayer among the available concession.

2. Laxmi Bank Limited declared a Voluntary Retirement Scheme (VRS) for its staffs during 2077.78. Man Bahadur Tamang 56 years old widower looking after 2 kids and working as junior assistant decided to opt for VRS scheme announced by the bank with effective from Chaitra end 2077 who had completed 16 years of bank service. Bank has got approval from IRD to maintain its staff retirement fund. The following details are available for income of Man Bahadur for the year:
   - Basic Salary till Chaitra 2077 Rs. 50,000 per month.
   - Monthly Allowance Rs. 30,000 per month.
   - Retirement Fund contributed by employer 10% of basic salary an equal amount was contributed by employee.
   - Life Insurance premium paid by Man Bahadur for himself Rs. 25,000
   - Remote area allowance for working in branch situated in Category C district for 3 months Rs. 5,000 per month
   - Provident Fund paid by retirement fund maintained by the bank on 15th Baishakh 2078 Rs. 12,00,000.
   - Additional retirement payment paid by Bank under Voluntary Retirement Scheme was Rs. 20,00,000.
   - He was nominated by the bank for 35 days banking training in Singapore and received allowance at the rate of 75 USD per day.
   - He was availing the subsidized staff housing loan from the bank for which he was paying interest @ 3% per annum whereas the prevailing interest rate of similar loan was 9% per annum. Average outstanding principal amount of the loan at the time of retirement was 1,326,200.
   - Mr. Man Bahadur has maintained 9% recurring FD account with the bank where he used to deposit 15000 per month from his salary and total interest earned during the year was 17,560.
   - While going to Nepalgunj on bank duty, he suffered from road accident and treated in Kohalpur hospital and cost of treatment amounting Rs. 156,500 was paid by the bank.

   Based on the information provided above, you are required to calculate the tax liability of Mr. Man Bahadur for the income year 2077.78. **10**

Answer:

Particulars	Amount	Remarks
1. Basic Salary	450,000.00	9 months @ Rs. 50000
2. Allowances	270,000.00	9 months @ Rs. 30000
3. Employers contribution to retirement fund	45,000.00	10% of basic salary
4. Remote area allowances	15,000.00	3 months @ Rs. 5000
5. Provident Fund paid by the bank's retirement fund	-	Retirement payment from approved retirement fund, 5% final withholding on retirement payment less high amount of 5 lakhs or 50% of the payment
6. Retirement payment by the bank under VRS Scheme	-	Retirement payment from non-contributory retirement fund, 15% final withholding
7. DSA for banking training in Singapore	-	DSA not to be included in remuneration income
8. Interest on subsidized housing loan	59,679.00	Included under section 27, quantification (6% of Rs. 13,26,200 for 9 months)
9. Interest on recurring FD	-	Final withholding @ 5%
10. Medical Compensation	-	Reimbursement of Medical Expenses (Treatment for accident on duty) not to be included in remuneration income
Assessable Income from employment	839,679.00	
Reduction		
Contribution to Approved Retirement Fund	90,000	Lower of below three: A. 1/3rd of Assessable Income (839679/3), i.e. Rs. 279,893 B. Max. Rs. 300,000 C. Actual Rs. 90,000
Taxable Income	749,679	
Deduction for Insurance premium (Lower of below two)	25,000.00	Rs. 25000 or actual which is lower
Deduction as the person resided in remote area	7,500.00	Category C, maximum allowed Rs. 30,000 per year, pro-rata basis for 3 months
Tax Applicable Income	717,179.00	
Tax Calculations		
First 450,000 @ 1 % (SST)	4,500.00	Widower having dependent to look after are treated as couple under section 50
Next 100,000 @ 10%	10,000.00	
Balance 167,179 @ 20%	33,436	
Total Tax Liability	**47,936**	

3.

a) Nepal Electricity Authority (NEA) hired Mr. Peter, a UK Citizen as Infrastructure Expert with effect from September 17, 2020. He came to Nepal, 7 days before his joining date on September 10, 2020. He left Nepal on December 20, 2020 and came back to Nepal after Christmas leave on January 9, 2021, and continued his service for the contract period. After the expiry of contract, he converted his visa category into Tourist Visa, and went to Annapurna Base Camp for 17 days, and returned to his home country on April 2, 2021. Comment about the residential status of Mr. Peter. **5**

b) As per provisions of Income Tax Act, 2058, mention the applicable withholding tax rate and classify them as final or advance withholding tax in case of the following transaction of the financial year 2077/78 as per the provision of Income Tax Act 2058. Assume that transactions are between person resident in Nepal unless clearly mentioned in the question: **5**

i) RST Limited paid Rs. 100,000 as sales commission to PQR Ltd., a company not resident in Nepal.

ii) PQR a commercial bank paid interest of Rs. 1,000,000 on deposit to a Life Insurance Company.

iii) ABC college of Kathmandu paid Rs. 900,000 to University of Philippines for registration, education fee and exam fee of 9 students studying course offered by that university.

iv) Tax incentive amount for consumer who paid their bill through electronic payment instruments like payment card, e-money (wallet), mobile banking on their purchase.

v) CP Pvt. Ltd. paid annual office space rent Rs. 1,500,000 to PT Ltd.

Answer

3 a) As per Section 2(Ka Nga), a natural person is resident for an Income Year if he stayed for 183 days or more in 365 consecutive days. As per the clarification of Income Tax Directive, 365 consecutive days should be read as Income Year. [1 mark]

Determination of Residential Status of Mr. Peter for an Income Year 2020-21 (2077-78)

Income Year	Period of Stay	Number of Days
2020-21 (2077-78)	10.09.2020 to 20.12.2020,	(30 - 10 + 1) + 31 + 30 + 20 = 102
	09.01.2021 to 02.04.2021	(31 - 9 + 1) + 28 + 31 + 2 = 84
Total		186

Since Mr. Peter, a UK Citizen has stayed in Nepal for 186 days i.e. more than 183 days in 365 consecutive days, he is resident for income year 2020-21 (2077-78).

Note: Date of arrival and date of departure shall be inclusive.

3 b) As per provisions of IT Act, 2058, applicable withholding tax rate and its classification as final or advance withholding tax in case of the following transaction are as follows:

	TDS or Not	Rate	Final withholding or not
i)	Yes	15%	Final
ii)	Yes	15%	Not final
iii)	Yes	5%	Final
iv)	No		
v)	Yes	10%	Not final

4.

a) Mr. Udit, a resident natural person, is a musician deriving income from concerts performed from various countries outside Nepal. During Financial Year 2077/78, he performed concerts in India and received remuneration of Rs. 1,000,000 where he paid Rs. 300,000 tax. Mr. Udit also earned Rs. 5,00,000 in Nepal during the financial year 2077/78. Assuming that he has chosen to be couple, find his tax liability on his total income and amount for foreign tax credit available to him under section 71(1) for the income year 2077/78. **5**

b) Quantify the value of perquisite as per the provision of Income Tax Act, 2058 provided by RST Ltd. to employees and others as under: **5**

i) RST Ltd. provides luxury car with market value of Rs. 1.26 crore to Mrs. Rosy Poudel, manager of production for both personal and official use. During FY 2077/78, RST Ltd. incurred expenditure of Rs. 300,000 being cost of driver, fuel, repairs etc. in relation to car provided to Mrs. Poudel. RST Ltd. pays Basic salary of Rs. 50,000/month, Grade of Rs. 3,000/month and other allowances of Rs. 30,000/month to Mrs. Poudel.

ii) Mrs. Rupa Gurung, manager- sales of RST Ltd. owns personal car. The company provides fuel as per employee benefit policy. During FY 2077/78, RST Ltd. Provided 165 Ltr. fuel for car owned by Mrs. Gurung and its cost was Rs. 190,000.

iii) RST Ltd. provides luxury car with market value of Rs. 1 crore to Mrs. Rojina Rungta, marketing consultant for both personal and official use. During FY 2077/78, RST Ltd. incurred expenditure of Rs. 300,000.00 being cost of driver, fuel, repairs etc in relation to car provided to Mrs. Rungta. RST Ltd. pays consulting fees of Rs. 8 Lakh to Mrs. Rungta during FY 2078/79.

iv) RST Ltd. sold luxury car, depreciable assets owned by the company to its employee Mr. Deepak Pradhan, manager of finance at price of Rs. 50 Lakh. The depreciated value of the car is Rs. 70 Lakh whereas its market value is Rs. 60 Lakh.

v) Mrs. Rama Rungta, manager- administration of RST Ltd. owns personal car. The company provides driver for vehicle owned by Mrs. Rungta. Cost to company on account of driver provided to Mrs. Rungta is Rs. 9

Lakh which includes basic salary of Rs. 50,000/month and remaining Rs. 300,000 being other allowances.

c) Mr. Basant Bohara resident in Nepal during FY 2077/78 provides following details of his income during FY 2077/78:

i) Assessable income from Nepal 2,500,000 Advance tax paid in Nepal was Rs. 400,000

ii) Income from Germany Rs. 500,000 tax paid in Germany was Rs. 150,000

iii) Income from Switzerland Rs. 500,000 tax paid in Switzerland was Rs. 50,000

Required:

Calculate amount of Income tax liability and amount of any unrecovered foreign tax credit of Mr. Bohara for FY 2077/78 assuming that he opted to be assessed as couple and adopted Credit Method for availing foreign tax credit. **5**

d) M/s Hanuman Pvt. Ltd. having registered office at Kathmandu, exclusively deals in computer trading wholesale business. It recently extended its branches to all 77 districts of Nepal. The Company imports computers for wholesale business @ Rs. 85,000 per computer. After opening the branches, the Company sent the imported computers for office use one piece to each branch. Is there any tax implication for the above transaction as per the provision of Income Tax Act, 2058? **5**

Answer

4 a)

Assuming there is no employment income

Step 1:	Calculation of Tax Liability before Foreign Tax Credit		
	Assessable Income from Nepal		500,000
	Assessable Income from India		1,000,000
	Total Assessable Income		
	(Taxable/Balance Taxable Income)		1,500,000
	Tax Liability		
	1st Rs. 450,000	0%	
	Next Rs. 100,000	10%	10,000
	Next Rs. 200,000	20%	40,000
	Next Rs. 750,000	30%	225,000
	Tax Liability before FTC		275,000
Step 2:	Calculation of Average Tax rate in Nepal		
	Tax Liability before Foreign Tax Credit (A)		275,000
	Taxable Income in Nepal (B)		1,500,000
	Average Tax Rate in Nepal [A/B * 100]		18.33%

Step 3: Calculation of Eligible Foreign Tax Credit and excess, if any

		India
A	Foreign Assessable Income	1,000,000
B	Average Rate of Tax in Nepal	18.33%
C	Average Tax liabilities in Nepal (A * B)	183,333.33
D	Actual Tax Paid in Foreign Country	300,000
E	Excess Taxes of Previous Income Year (s)	-
F	Sum of D & E	300,000
G	Eligible Amount [Lower of "C" or "F"]	183,333.33
H	Excess to be carried forward [F- G]	116,666.67

Step 4: Calculation of Tax Liability after Tax Credit

Tax Liability before Foreign Tax Credit	275,000
Less: Eligible Credit from Step 3	(183,333)
Tax Liability after Foreign Tax Credit	91,667

4 b) Quantification of perquisite/benefits as per the provision of Income Tax Act, 2058 are as follows:

i) Rs. 3,180 being 0.5% of basic salary and grade of Mrs. Poudel [((50000+3000)*12)*0.5%)]

ii) Rs. 190,000 being cost of fuel provided.

iii) Rs. 100,000 being 1% p.a. of market value of car

iv) Rs. 10 Lakh being market value of car less consideration paid

v) Rs. 9 Lakh being cost incurred by company

4 c)

Computation of Income tax liability of Mr. Bohara (assuming him as couple) after claiming foreign tax credit under Credit Method for 2077/78:

Taxable Income	Tax Rate	Tax (Rs)
Up to Rs. 450,000	0 %	0.00
Next Rs. 100,000	10%	10,000.00
Next Rs. 200,000	20%	40,000.00
Next Rs. 1,250,000	30%	375,000.00
Bal. Rs. 1,500,000	36%	540,000.00
Total Tax Liability before FTC		965,000.00
Less: Advance tax paid in Nepal		(400,000.00)
Less: Foreign tax Credit available (W.N. 3)		(187,850.00)
Net tax Liability after claiming foreign tax credit		**377,150.00**

Working Note: 1

Calculation of Tax Liability before Foreign Tax Credit

Assessable Income from Nepal	2500,000
Assessable Income from Germany	500,000
Assessable Income from Switzerland	500,000
Total Assessable Income (Taxable/Balance Taxable Income)	3,500,000

Working Note: 2

Average Income Tax Rate:

Nepal Average Income tax rate =	$\frac{965,000}{3,500,000}$ x100	= 27.57%

Working Note-2:

Computation of average IT Rate and eligible foreign tax credit available to Mr. Bohara by using Credit Method for the FY 2077/78:

Country	Taxable Income	Tax Paid (1)	Average tax (2)	Available Foreign tax Credit (3) min of 1 or 2
i) Germany	500,000	150,000	137,850	137,850
ii)Switzerland	500,000	50,000	137,850	50,000
Total	**1,000,000**	**200,000**	**275,700**	**187,850**

Mr. Bohara can avail foreign tax credit of Rs. 187,850 and his unrecovered tax credit from Germany is Rs. 12,150 (Rs. 150,000-Rs. 137,850), and it will be available for set off from his future income of Germany.

4 d) When the trading stock of M/s Hanuman Pvt. Ltd. is changed to depreciable assets, it is deemed as disposal as per Section 40 (3) (Gha) of IT Act where the person begins to use the assets in such a way that it ceases to be an asset of the type it was immediately before that use.

So, the company shall consider the disposal of trading stock and ensure that there is inclusion u/s 7.

Further, the cost of computers shall also be treated as part of cost of trading stock u/s 15.

In addition to this, the company shall treat the computer as Pool B depreciable asset and compute depreciation based on date of put to use of computer as per Schedule 2 of Income Tax Act, 2058.

5. Write short notes of the following with reference to Income Tax Act, 2058.

(4×2.5=10)

a) Tax Payer‘s Rights
b) General rule against tax avoidance
c) Tax assessment notice
d) Departmental action against tax officer

Answer

5 a) As per the Section 74(2) of Income Tax Act 2058, the following rights are available to the tax payers:

i) Right to get respectful behavior
ii) Right to receive any information related to tax as per the prevailing laws
iii) Right to get an opportunity of submitting a proof in one‘s own favor as regards tax matter
iv) Right to appoint lawyers or auditors for defense, and
v) Rights to secrecy in respect of tax matters and to keep it inviolable.

5 b)

As per Section 35 of Income Tax Act 2058, for purposes of ascertaining the tax liability pursuant to this Act, the Department may carry out the followings:

(a) To re-characterize any arrangement or any part of such arrangement made or attempted to be made as a part of a tax avoidance scheme,

(b) To disregard any arrangement or any part of such arrangement that does not show any substantial effect, or

(c) To re-characterize any arrangement or any part of such arrangement that does not show any substantial element.

Explanation: For purposes of this Section, "tax avoidance scheme" means any arrangement with a main objective to have avoidance of tax liability or to lessen the tax liability.

5 c) The Department shall give the person, whose tax is assessed, a written notice of tax assessment made pursuant to sub-section (2) of Section 100 or Section 101 setting out the following matters:

(a) The assessed tax to be paid and due and payable by the person mentioned in clauses (a) and (b) of Section 3 for the income year or period related with assessment of tax,
(b) The method of computation of tax in the tax assessment as mentioned in clause (a),
(c) The reason why the Department has to assess the tax,
(d) The time for payment of the assessed tax due and payable, and
(e) The time, place and mode for making a petition if one is not satisfied with the assessment of tax.

5 d) As per section 133 of Income Tax Act, 2058 Director General of IRD can take a departmental action against such Tax Officer who has, negligently, assessed any tax liability and there-by, the tax liability of an assessee either increased or decreased or the tax officer has not completed the amended assessment within the time limit prescribed by section 101(3).

However, section 136 of Income Tax Act provides relaxation to the tax officer by saying that an officer, who takes any action with good intention in course of performing duties, shall not be personally liable to the action.

6. MM Pvt. Ltd. had the following transactions in Baishakh 2078. Calculate the VAT payable/receivable from the information below: **10**

Particulars	
Sales:	
Local	5,000,000.00
Export	15,000,000.00
Purchases:	
Raw materials	7,200,000.00
Special packing for export	500,000.00
Consultancy charges purchased from abroad	800,000.00
Bus for staff transportation	200,000.00
Motorcycle hire purchase	500,000.00
Telephone expenses	750,000.00
Diesel for generator	100,000.00
Diesel for bus	250,000.00
Petrol for motorcycle	300,000.00
Computers	150,000.00
Soft drinks	25,000.00

Additional information:

Opening VAT receivable for the month was Rs. 100,000. Diesel for bus for Rs. 20,000 and soft drinks for Rs. 10,000 was purchased through abbreviated tax invoice. Items above are exclusive of VAT.

Staff quarter of Rs. 6,000,000/- was constructed by the company in Month of Baisakh from builders not registered in VAT and without payment of VAT.

Answer

Particulars	Amount (Rs.)	VAT (Rs.)	Remarks
Output VAT			
Local Sales	5,000,000.00	650,000.00	Full
Export Sales	15,000,000.00	-	0% for Export
Total Output VAT (A)		650,000.00	
Less: Input VAT			
Raw materials	7,200,000.00	936,000.00	Full
Special packing for export	500,000.00	65,000.00	Full
Payment of consultancy charges abroad	800,000.00	104,000.00	Reverse Charging, assuming VAT already paid
Purchase of bus for staff transportation	200,000.00	10,400.00	Only 40% Allowed
Purchase of motorcycle hire purchase	500,000.00	65,000.00	Full
Telephone expenses	750,000.00	97,500.00	Full
Purchase of diesel for generator	100,000.00	13,000.00	Full
Purchase of diesel for bus	230,000.00	29,900.00	Abbreviated Tax not allowed

Purchase of petrol for motorcycle	300,000.00	-	No credit
Purchase of computers	150,000.00	19,500.00	Full
Purchase of soft drinks	25,000.00	-	VAT on Beverages not allowed
Total Input tax credit (B)		1,340,300.00	
Opening VAT Receivable (C)		100,000.00	
Excess Input VAT (A-B-C) to be carried forward		-790,300.00	

As per section 8(3) of Value Added Tax Act, 2052, if a construction of commercial purpose building or apartment or shopping complex or similar other structure as specified by the Department, of which value is more than Five Million Rupees, has been made from a person who is not registered, it shall be deemed as it has been constructed from registered person and shall deposit the tax. In case tax is not deposited, it shall be assessed and collected from the owner of such structure.
So, VAT needs to be paid in Staff quarter construction, as it is not done through VAT registered persons

VAT payable =Rs. 6000,000*13%= Rs.7,80,000

7.

a) ABC Ltd. provides you the following transaction during Ashwin to Mangsir, 2078:

Amount (Rs.)

Particulars	Ashwin	Kartik	Mangsir
Sales:			
Taxable Sales	100,000	200,000	300,000
Zero Rated Sales	300,000	100,000	200,000
Exempted Sales	200,000	300,000	100,000
Total Sales (A)	600,000	600,000	600,000
VAT paid/payable on purchases related to :			
Taxable Sales	13,000	26,000	39,000
Zero Rated Sales	12,000	3000	6,000
Exempted Sales	12,000	24000	6,000
Total VAT paid (B)	37,000	53,000	51,000
VAT paid/payable on expenses:			
Overhead expenses	12,000	12,000	12,000
Motor Car	26,000	0	0
No credit (goods/services)	8,000	8,000	8,000
Total VAT paid (C)	46,000	20,000	20,000

Required: **5**

Compute the amount of eligible VAT credit available to the company for each month?

Assume there was opening VAT credit of Rs. 1,500 at the beginning of Ashwin, 2078.

b. Global Visa Support Service Pvt. Ltd. is operating as approved education consultancy at Dillibazar. The Occupation English Test (OET) facilitation is done by the company to the Nepal service seekers. The cost of OET is 250 USD and need to be paid to US based Global Services Centre. Each Nepali who wish to appear on the test should go through the Nepali company for the exam appearance. The company further collects Rs. 15,000 as test preparation and facilitation services. Discuss the impact of VAT on above transaction. **5**

7 a) Computation of eligible VAT credit available to ABC Ltd for each month:

Particulars	**Ashwin**	**Kartik**	**Mangsir**
Percentage of Taxable and Exempted Sales	**66.67**	**50.00**	**83.33**
Input tax credit (VAT receivables):			
Opening VAT credit	1,500	28,433	37,433
Input tax credit related to taxable sales	13,000	26,000	39,000
Input tax credit related to Zero Rated Sales	12,000	3000	6,000
Input tax credit related to Exempted Sales	0	0	0
Input tax credit on Overhead Exp. (Note -2)	8,000	6,000	10,000
Input tax credit on Motor Vehicle (W.N.-3)	6,933	0	0
Input tax credit on No credit (goods/Services)	0	0	0
Total eligible VAT credit available (A)	**41,433**	**63,433**	**92,433**
Output Tax (VAT Payable):			
Total Taxable Sales	13,000	26,000	39,000
Zero Rate Sales	0	0	0
Exempted Sales	0	0	0
Total output VAT payable (B)	**13,000**	**26,000**	**39,000**
Net VAT credit Receivable/ (Payable) to be carried forward to next month A-B	**28,433**	**37,433**	**53,433**

Note 1:

Particulars	**Ashwin**
Taxable Sales (Taxable + Zero Rated Sales) (a)	400,000
Exempted Sales	200,000

Total Sales	(b)	600,000
% of Taxable Sales (a/b*100)		66.67

Note 2:

Computation of VAT credit allowed on overhead expenses

Particulars	**Ashwin**
Overhead Expenses	12,000
% of Taxable Sales as per Note 1	66.67
Credit Allowed	8,000

Note 3:

Computation of VAT credit allowed on Motor Car

Particulars	**Ashwin**
VAT paid on purchase of Motor Car	26,000
Credit Allowed @ 40%	10,400
% of Taxable Sales as per Note 1	66.67
Credit Allowed	6,933

7 b) As per the Schedule 1 of VAT Act, 2052, The educational services by the Universities and Schools are exempted from VAT, but the case above mentioned for OET test is not exempted.

Thus, the Nepali company Global Visa Support Service Pvt. Ltd. need to collect VAT on exam fee 250 USD (equivalent NRs) from each Nepali service seeker, and on the Rs. 15,000 test preparation and facilitation fee is also VAT attractive.

On payment to US based company by Nepali Company, reverse VAT is applicable.

8. **Write short notes on:** **(5×2=10)**

a) Collection of tax from other than registered person
b) Jeopardy assessment
c) Circumstances under which Tax Officer can assess tax
d) Valuation of Closing Stock
e) Power to suspend Permanent Account Number

Answer

8 a)

In general, VAT is collected from registered person but in the following cases it is also collected from other than registered person:
i) Taxable goods purchased from Government/International organizations and public entities dealing in VAT exempt goods ii) Wood purchased from community forest.

8 b) **Jeopardy assessment:** If there is reason to believe that collection of tax is in jeopardy by way of person leaving Nepal or transferring property or removing or concealing

assets tax officer with approval from the DG may immediately assess and collect the tax due, or about to become due.

8 c)

A Tax Officer may make an assessment in any of the following circumstances:

(a) If the tax return is not filed within the time limit;
(b) If an incomplete or erroneous tax return is filed;
(c) If a fraudulent tax return is filed;
(d) If the Tax Officer has a reason to believe that the amount of tax is understated or otherwise incorrect.
(e) If the Tax Officer has a reason to believe that the price of supply is under-invoiced.
(f) If supply is made within the group company by under-invoicing,
(g) If a person with obligation to register, transacts without registration,
(h) If sale is made without issuing invoice,
(i) If tax is collected by unregistered person,
(j) If tax is not filed pursuant to Sub-section (2) or (3) of Section 8,
(k) If conditions under Sub-section (4) of Section 17 are prevalent.

8 d)

Valuation of Closing stock

Valuation of closing stock of a business for income year is done at a lower of the following:

i) Cost of closing stock that remains at the end of year or
ii) Market price of the closing stock at the end of year;

Where identification of each items stock is not possible IT Act permit first in first out (FIFO) OR weighted average method for valuation of closing stock.

8 e)

Power to suspend Permanent Account Number

As per section 78Ka of Income Tax Act, 2058, the Inland Revenue Department may suspend PAN in any of the following circumstances:

i) If the taxpayer ceases carrying out transaction,
ii) In case of entities, if an entity is closed, sold or transferred or is no longer in existence in whatsoever way,
iii) In case of a business owned by a natural person, if the person dies,
iv) If the taxpayer was registered in error.

Examiner’s Commentary on Students' Performance in December 2021 Examinations

Subject: Financial Management

List of Questions	Specific Comments on the Performance of the Students
Question no. 1	Not attempted well, lack of conceptual knowledge
Question no. 2	Satisfactory performance
Question no. 3	Satisfactory performance
Question no. 4	Satisfactory performance
Question no. 5	Question was simple but not attempted by most of the students.
Question no. 6	Average performance; lack of conceptual clarity
Question no. 7	Average performance; lack of conceptual clarity

Subject: Cost and Management Accounting

List of Questions	Specific Comments on the Performance of the Students
Question no. 1	Very poor performance, few students answered the question.
Question no. 2	Satisfactory performance
Question no. 3	Satisfactory performance
Question no. 4	Satisfactory performance
Question no. 5	Average performance; lack of conceptual knowledge
Question no. 6	Students were confused on operation costing and operating costing

Subject: Business Communication

List of Questions	Specific Comments on the Performance of the Students
Question no. 1	Confused on report writing, students have not understood close ended questionnaire.
Question no. 2	Problem with proper format of enquiry letter.
Question no. 3	Satisfactory performance
Question no. 4	Poor performance; students should focus on communication terms.

Subject: Marketing

List of Questions	Specific Comments on the Performance of the Students
Question no. 5	Case related question were not answered by most of the students
Question no. 6	Lack of knowledge about the subject matter of questions
Question no. 7	Students were confused about level of product.
Question no. 8	Satisfactory performance

Subject: Income TAX and VAT

List of Questions	Specific Comments on the Performance of the Students
Question no. 1	Very few students attempted full question.
Question no. 2	Students failed to capture the knowledge of widower.
Question no. 3	Satisfactory performance
Question no. 4	Poor performance; mistake was on computing Taxable income, slab rate and assumption.
Question no. 5	Lack of knowledge on theoretical concept of Anti Avoidance Rule.
Question no. 6	Satisfactory performance
Question no. 7	Most of the students were confused in calculation of VAT
Question no. 8	Poor performance; lack of conceptual knowledge.