SUGGESTED ANSWERS TO

THE QUESTIONS SET AT

CHARTERED ACCOUNTANCY PROFESSIONAL (CAP)-II LEVEL

December 2022 EXAMINATIONS

Group-I

The Institute of Chartered Accountants of Nepal (ICAN)

ICAN Marg, Satdobato, Lalitpur

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Paper 1: Advanced Accounting

Marks

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

1. The following is the Balance Sheet of M/s P and Q as on 31st March 2012:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capital Accounts:		Machinery	54,000
P	50,000	Furniture	5,000
Q	30,000	Investment	50,000
Reserves	20,000	Stock	20,000
Loan Account of Q	15,000	Debtors	21,000
Creditors	40,000	Cash	5,000
	155,000		155,000

It was agreed that Mr. R is to be admitted for a fourth share in the future profits from 1st April 2012. He is required to contribute cash towards goodwill and Rs. 15,000 towards capital.

The following further information is furnished:

a) P & Q share the profits in the ratio 3:2.

b) P was receiving salary of Rs. 750 per month from the very inception of the firm in 2005 in addition to share of profit.

c) The future profit ratio between P, Q & R will be 2:1:1. P will not get any salary after the admission of R.

d) It was agreed that the value of goodwill of the firm shall appear in the books of the firm. The goodwill of the firm shall be determined based on 3 years' purchase of the average profits from business of the last 5 years. The particulars of the profits are as under:

Year Ended	Profit/(Loss)
31st March 2008	25,000
31st March 2009	12,500
31st March, 2010	(2,500)
31st March, 2011	35,000
31st March, 2012	30,000

The above Profits and Losses are after charging the Salary of P. The Profit of the year ended 31st March 2008 included an extraneous profit of Rs. 40,000 and the loss for the year ended 31st March 2010 was on account of loss by strike to the extent of Rs. 20,000.

e) The cash trading profit for the year ended 31st March 2013 was Rs. 50,000 before depreciation.

f) The partners had drawn each Rs. 1,000 per month as drawings.

g) The value of other assets and liabilities as on 31st March 2013 were as under:

Particulars	Amount (Rs.)
Machinery (before depreciation)	60,000
Furniture (before depreciation)	10,000
Investment	50,000
Stock	15,000
Debtors	30,000
Creditors	20,000

h) Provide depreciation @ 10% on Machinery and @ 5% on Furniture on the Closing Balance and interest is accumulated @ 6% on Q's loan. The loan along with interest would be repaid within next 12 months.

i) Investments are held from inception of the firm and interest is received @ 10% p.a.

j) The partners applied for conversion of the firm into a Private Limited Company. Certificate was received on 1st April 2013. They decided to convert Capital A/cs of the partners into share capital in the ratio of 2:1:1 based on a total Capital as on 31st March 2013. If necessary, partners must subscribe to fresh capital or withdraw.

Prepare the Profit and Loss Account of the firm for the year ended 31st March 2013 and the Balance Sheet of the Company on 1st April 2013. **20**

Q1.Answer:

M/s P, Q and R

Profit and Loss Account for the year ending on 31st March 2013

Particulars	Amount	Particulars	Amount
To Depreciation on Machinery	6,000	By Trading Profit	50,000
To Depreciation on furniture	500	By Interest on Investment	5,000
To Interest on Q's loan	900		
To Net Profit to: P's Capital A/c 23,800 Q's Capital A/c 11,900 R's Capital A/c 11,900	47,600		
	55,000		55,000

Balance Sheet of the PQR Pvt. Ltd. as on 1st April 2013

Particulars	Notes	Amount
I. Equity and Liabilities		
Shareholders' funds		
Share capital		1,41,600
Current liabilities		
Short term borrowings	1	15,900
Trade payables		20,000
	Total	**1,77,500**
II. Assets		
Non-current assets		
Fixed assets		
Tangible assets	2	63,500
Non-current investments		50,000
Current assets		
Inventories		15,000
Trade receivables		30,000
Cash and cash equivalents		19,000
	Total	**1,77,500**

Notes to Accounts

Particulars	Amount	Amount
1. Short term borrowings		
Loan from Q		15,900
2. Tangible assets		

Machinery	54,000	
Furniture	9,500	63,500

Working Notes:

1. Calculation of goodwill

	2007-08	2008-09	2009-10	2010-11	2011-12
	Rs	**Rs**	**Rs**	**Rs**	**Rs**
Profits/(Loss)	25,000	12,500	(2,500)	35,000	30,000
Adjustment for extraneous profit of 2007-08 and abnormal loss of 2009-10	(40,000)	-	20,000	—	—
	(15,000)	12,500	17,500	35,000	30,000
Add: Salary of P (750 x12)	9,000	9,000	9,000	9,000	9,000
	(6,000)	21,500	26,500	44,000	39,000
Less: Interest on non-trading investment*	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
	(11,000)	16,500	21,500	39,000	34,000
Total Profit from 2008-09 to 2011-12					1,11,000
Less: Loss for 2007-08					(11,000)
					1,00,000
Average Profit					20,000
Goodwill equal to 3 years' purchase					60,000
Contribution from R for ¼ share					15,000

* Investments are assumed to be non-trading investments.

* Alternatively, Investment can be assumed as trading investment

2. Calculation of sacrificing ratio of Partners P and Q on admission of R

	Old share	New share	Sacrificing share	Gaining share
P	3/5	1/2	3/5-1/2= (6-5)/10=1/10	
Q	2/5	1/4	2/5-1/4=3/20	
R		1/4		1/4

3. Goodwill adjustment entry∗ through Partners' capital accounts (in their sacrificing ratio of 2:3)

Particulars	**Amount**	**Amount**
R' s capital A/c Dr	15,000	
To P's capital A/c		6,000
To Q' s capital A/c		9,000
(R's share in goodwill adjusted through P and Q)		

4. Partners' Capital Accounts

Particulars	**P**	**Q**	**R**	**Particulars**	**P**	**Q**	**R**
	Rs	**Rs**	**Rs**		**Rs**	**Rs**	**Rs**
To Drawings (1,000 x 12)	12,000	12,000	12,000	By Balance b/d	50,000	30,000	—
To P			6,000	By General Reserve	12,000	8,000	—
To Q			9,000	By R	6,000	9,000	—

To Balance c/d	79,800	46,900	14,900	By Bank (15,000 + 15,000)	—	—	30,000
				By Profit & Loss A/c	23,800	11,900	11,900
	91,800	58,900	41,900		91,800	58,900	41,900

5. Balance Sheet of the firm as on 31st March 2013

Liabilities	**Amount**	**Assets**	**Amount**
P's Capital 79,800		Machinery 60,000	
Q's Capital 46,900		Less: Depreciation (6,000)	54,000
R's Capital 14,900	1,41,600	Furniture 10,000	
		Less: Depreciation (500)	9,500
Q's Loan 15,000		Investments	50,000
Add: Interest due 900	15,900	Stock-in-trade	15,000
Creditors	20,000	Debtors	30,000
		Cash (W.N.6)	19,000
	1,77,500		**1,77,500**

6. Cash balance as on 31.3.2013

Particulars	**Amount**	**Amount**
Cash trading profit		50,000
Add: Investment Interest		5,000
Add: Decrease in Stock Balance		5,000
		60,000
Less: Increase in Debtors	9,000	
Less: Decrease in Creditors	20,000	(29,000)
		31,000
Add: Opening cash balance	5,000	
Add: Cash brought in by R	30,000	35,000
		66,000
Less: Drawings (12,000 +12,000 +12,000)	36,000	
Less: Additions to Machine (60,000 - 54,000)	6,000	
Furniture (10,000 - 5,000)	5,000	(47,000)
Closing cash balance		**19,000**

7. Distribution of shares – Conversion into Company

Particulars		**Amount**
Capital:	**P**	79,800
	Q	46,900
	R	14,900
Share Capital		**1,41,600**
Distribution of shares:	P (1/2)	70,800
	Q (1/4)	35,400
	R (1/4)	35,400

P and Q should withdraw capital of Rs 9,000 (Rs 79,800 – Rs 70,800) and Rs 11,500 (Rs 46,900 – Rs 35,400) respectively and R should subscribe shares of Rs 20,500 (Rs 35,400 – Rs 14,900).

Question No 1. (With both alternatives if students assume:

i. Cash Trading Profit as Total Trading Profit (No adjustments for credit sales) (Strike through figures)
ii. Adjusted for deriving accrual Trading Profit Due to growth in debtors. (Normal Figures)

Answer:

M/s P, Q and R

Profit and Loss Account for the year ending on 31st March 2013

Particulars	Amount	Particulars	Amount
To Depreciation on Machinery	6,000	By Trading Profit	~~50,000~~ 59,000
To Depreciation on furniture	500	By Interest on Investment	5,000
To Interest on Q's loan	900		
To Net Profit to: P's Capital A/c ~~23,800~~ 28,300 Q's Capital A/c ~~11,900~~ 14,150 R's Capital A/c ~~11,900~~ 14,150	~~47,600~~ **56,600**		
	~~55,000~~ **64,000**		~~55,000~~ **64,000**

Balance Sheet of the PQR Pvt. Ltd. as on 1st April 2013

Particulars	Notes	Amount
II.Equity and Liabilities		
Shareholders' funds		
Share capital		~~1,41,600~~ **1,50,600**
Current liabilities		
Short term borrowings	1	15,900
Trade payables		20,000
	Total	~~1,77,500~~ **1,86,500**
II. Assets		
Non-current assets		
Fixed assets		
Tangible assets	2	63,500
Non-current investments		50,000
Current assets		
Inventories		15,000
Trade receivables		30,000
Cash and cash equivalents		~~19,000~~ 28,000
	Total	~~1,77,500~~ **1,86,500**

Notes to Accounts

Particulars	Amount	Amount
1. Short term borrowings		
Loan from Q		15,900
2. Tangible assets		

Machinery	54,000	
Furniture	9,500	63,500

Working Notes:

8. Calculation of Trading Profit

Cash Trading Profit		50,000
Changes due to Growth in Debtors	Add	9,000
Total Trading Profit		**59,000**

*As there is reduction in sundry creditors, so there is no adjustment for accruals. This only impacts the cash position.

9. Calculation of goodwill

	2007-08	2008-09	2009-10	2010-11	2011-12
	Rs	**Rs**	**Rs**	**Rs**	**Rs**
Profits/(Loss)	25,000	12,500	(2,500)	35,000	30,000
Adjustment for extraneous profit of 2007-08 and abnormal loss of 2009-10	(40,000)	-	20,000	—	—
	(15,000)	12,500	17,500	35,000	30,000
Add: Salary of P (750 x12)	9,000	9,000	9,000	9,000	9,000
	(6,000)	21,500	26,500	44,000	39,000
Less: Interest on non-trading investment*	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
	(11,000)	16,500	21,500	39,000	34,000
Total Profit from 2008-09 to 2011-12					1,11,000
Less: Loss for 2007-08					(11,000)
					1,00,000
Average Profit					20,000
Goodwill equal to 3 years' purchase					60,000
Contribution from R for ¼ share					15,000

* Investments are assumed to be non-trading investments.

10. Calculation of sacrificing ratio of Partners P and Q on admission of R

	Old share	New share	Sacrificing share	Gaining share
P	3/5	1/2	3/5-1/2= (6-5)/10=1/10	
Q	2/5	1/4	2/5-1/4=3/20	
R		1/4		1/4

11. Goodwill adjustment entry∗ through Partners' capital accounts (in their sacrificing ratio of 2:3)

Particulars	**Amount**	**Amount**
R' s capital A/c Dr	15,000	
To P's capital A/c		6,000
To Q' s capital A/c		9,000
(R's share in goodwill adjusted through P and Q)		

12. Partners' Capital Accounts

Particulars	**P**	**Q**	**R**	**Particulars**	**P**	**Q**	**R**
	Rs	**Rs**	**Rs**		**Rs**	**Rs**	**Rs**
To Drawings	12,000	12,000	12,000	By Balance b/d	50,000	30,000	—

(1,000 x 12)							
To P			6,000	By General Reserve	12,000	8,000	—
To Q			9,000	By R	6,000	9,000	—
To Balance c/d	~~79,800~~ **84,300**	~~46,900~~ **49,150**	~~14,900~~ **17,150**	By Bank (15,000 + 15,000)	—	—	30,000
				By Profit & Loss A/c	~~23,800~~ **28,300**	~~11,900~~ **14,150**	~~11,900~~ **14,150**
	~~91,800~~ **96,300**	~~58,900~~ **61,150**	~~41,900~~ **44,150**		~~91,800~~ **96,300**	~~58,900~~ **61,150**	~~41,900~~ **44,150**

13. Balance Sheet of the firm as on 31st March 2013

Liabilities	**Amount**	**Assets**	**Amount**
P's Capital ~~79,800~~ 84,300		Machinery 60,000	
Q's Capital ~~46,900~~ 49,150		Less: Depreciation (6,000)	54,000
R's Capital ~~14,900~~ 17,150	~~1,41,600~~ 1,50,600	Furniture 10,000	
		Less: Depreciation (500)	9,500
Q's Loan 15,000		Investments	50,000
Add: Interest due 900	15,900	Stock-in-trade	15,000
Creditors	20,000	Debtors	30,000
		Cash (W.N.6)	~~19,000~~ 28,000
	~~**1,77,500**~~ **1,86,500**		~~**1,77,500**~~ **1,86,500**

14. Cash balance as on 31.3.2013

Particulars	**Amount**	**Amount**
Cash trading profit		50,000
Add: Investment Interest		5,000
Add: Decrease in Stock Balance		5,000
		60,000
~~Less: Increase in Debtors~~	~~9,000~~	
Less: Decrease in Creditors	20,000	~~(29,000)~~ **(20,000)**
		~~**31,000**~~ **40,000**
Add: Opening cash balance	5,000	
Add: Cash brought in by R	30,000	35,000
		~~**66,000**~~ **75,000**
Less: Drawings (12,000 +12,000 +12,000)	36,000	
Less: Additions to Machine (60,000 - 54,000)	6,000	
Furniture (10,000 - 5,000)	5,000	(47,000)
Closing cash balance		~~**19,000**~~

		28,000

- **Cash Trading Profit is taken as given in question, hence adjustment of growth in debtors is not required.**

15. Distribution of shares – Conversion into Company

Particulars		**Amount**
Capital:	**P**	~~79,800~~ 84,300
	Q	~~46,900~~ 49,150
	R	~~14,900~~ 17,150
Share Capital		**~~1,41,600~~ 150,600**
Distribution of shares:	P (1/2)	~~70,800~~ 75,300
	Q (1/4)	~~35,400~~ 37,650
	R (1/4)	~~35,400~~ 37,650

P and Q should withdraw capital of Rs 9,000 (Rs ~~79,800~~ 84,300 – Rs ~~70,800~~ 75,300) and Rs 11,500 (Rs ~~46,900~~ 49,150 – Rs ~~35,400~~ 37,650) respectively and R should subscribe shares of Rs 20,500 (Rs ~~35,400~~ 37,650 – Rs ~~14,900~~ 17,150).

2.

a) X Ltd. and Y Ltd. amalgamate to form a new company XY Ltd. The Financial Position of these two companies on the date of amalgamation was as under

Equity and Liabilities	X Ltd. (Rs.)	Y Ltd. (Rs.)	Assets	X Ltd. (Rs.)	Y Ltd. (Rs.)
Share Capital			Goodwill	80,000	
Equity Share of Rs. 100 each	800,000	300,000	Land and Building	450,000	300,000
7% Preference Share of Rs. 100 each	400,000	300,000	Plant & Machinery	620,000	500,000
5 % Debenture	200,000	-	Furniture and Fittings	60,000	20,000
General Reserve	-	100,000	Sundry Debtors	275,000	175,000
Retained Earnings	431,375	97,175	Stores and Stock	225,000	140,000
Sundry Creditors	100,000	210,000	Cash at Bank	120,000	55,000
Secured Loan	-	200,000	Cash in Hand	41,375	17,175
			Preliminary Expense	60,000	
Total	1,931,375	1,207,175	Total	1,931,375	1,207,175

The terms of amalgamation are as under:

i) The assumption of liabilities of both companies.
Issue of 5 preference share of Rs. 20 each in XY Ltd. @ Rs. 18 paid up at premium of Rs. 4 per share for each preference share held. Issue of 6 Equity shares of Rs. 20 each in XY Ltd. @ Rs. 18 paid up at a premium of Rs. 4 per share for each equity share held in both companies. In addition, necessary cash should be paid to equity shareholders of both companies as is required to adjust the rights of shareholder of both the Companies in accordance with intrinsic value of the share of both the companies.
Issue of such amount of fully paid 6% debenture in XY Ltd. as is sufficient to discharge the 5% debenture in X Ltd. at a discount of 5% after takeover.

ii) The assets and liabilities are to be taken at book values stock and debtors for which provision at 2% and 2.5% respectively to be made. The XY Ltd. to issue 15,000 new equity shares of Rs. 20 each Rs. 18 paid up at a premiumof Rs. 4 per share so as to have sufficient working capital.

Required: **10**

Prepare realization accounts in the books of X Ltd. and Y Ltd. to close their books.

2a.Answer:

Books of X Ltd.

Realization Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Goodwill	80,000	By 5% debenture	200,000
To land and Building	450,000	By Sundry Creditors	100,000
To Plant and machinery	620,000	By XY Ltd (purchase Consideration)	1,560,000
To Furniture and Fitting	60,000	By Equity Shareholders A/c(Loss)	51,375
To sundry debtors	275,000		
To stores and stock	225,000		
To cash at bank	120,000		
To Cash in Hand	41,375		
To preference shareholder (excess payment)	40,000		
Total	**1,911,375**	**Total**	**1,911,375**

Books of Y Ltd

Realization Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To land and Building	300,000	By Sundry Creditors	210,000
To Plant and machinery	500,000	By Secured Loan	200,000
To Furniture and Fitting	20,000	By XY Ltd (purchase Consideration)	790,000
To sundry debtors	175,000		
To stores and stock	140,000	By Equity shareholder A/c (loss)	37,175
To cash at bank	55,000		
To Cash in Hand	17,175		
To preference shareholder	30,000		
	1,237,175		**1,237,175**

Working note 1

<u>**Purchase consideration**</u>	<u>**X Ltd (Rs.)**</u>	<u>**Y Ltd (Rs.)**</u>
Payable to preference shareholder		

Preference share @ 22 per share	440,000	330,000
Equity Shares at Rs 22 per share	1,056,000	396,000
Cash (WN 2)	64,000	64,000
	1,560,000	790,000

Working note 2

Value of Net Assets	**X Ltd**	**Y Ltd**
Goodwill	80,000	
land and Building	450,000	300,000
Plant and machinery	620,000	500,000
Furniture and Fittings	60,000	20,000
Debtor Less 2.5%	268,125	170,625
Stock less 2 %	220,500	137,200
Cash at Bank	120,000	55,000
Cash In Hand	41,375	17,175
	1,860,000	1,200,000
Less		
Debenture	200,000	-
Creditors	100,000	210,000
Secured Loan	-	200,000
	1,560,000	790,000
Payable in Shares	1,496,000	726,000
Payable in cash	64,000	64,000

b) Rajan (Pvt.) Ltd. is a Kathmandu based trading company having its Branch Office in Chitwan. As per the policy of the company, goods are sent from the Head Office to Branch at cost plus 10%. Head Office makes a uniform gross profit of 33.33% on selling price on all its other sales. The Branch sells goods at a uniform gross profit to Branch of 25% on selling price. The following transactions have taken place during the financial year ended on 31st Ashad, 2079.

i) Head Office purchases amounted to Rs. 1,464,000, purchase returns were Rs. 61,650 and discount allowed by suppliers amounted to Rs. 30,090.

ii) Sales by Head Office amounted to Rs. 1,080,000, Goods sent to Branch were Rs. 544,500 (at invoice price) and discount allowed to customers amounted to Rs. 9,180.

iii) Goods sent to Branch for Rs. 66,000 in Jestha 2079 were not received at the Branch until Ashad end.

iv) Branch purchased goods locally for Rs. 187,500, discount allowed by suppliers amounted to Rs. 4,875.

v) Overhead expenses of Head Office were Rs. 280,260 and of Branch Rs. 80,475.

vi) Sales by the Branch amounted to Rs. 720,000, discount allowed to customers amounted to Rs. 5,640 and cost of goods lost in-transit was Rs. 8,010.

vii) Branch Stock as on 31st Ashad, 2079 included Stock invoiced by Head Office at Rs. 115,500.

You are required to prepare memorandum Trading, Profit and Loss Account of the Head Office and Branch for the year ended 31st Ashad, 2079 in columnar form. **10**

2b.Answer:

Trading and Profit and Loss Account (In Columnar Form)
For the year ended 31st Ashad, 2079

Particulars	Head Office	Branch Office	Total	Particulars	Head Office	Branch Office	Total
To Purchase (Less: Return)	14,02,350	1,87,500	15,89,850	By Sales	10,80,000	7,20,000	18,00,000
To Goods Received	-	4,78,500		By Goods Sent	5,44,500	-	
To Gross Profit	4,09,500	1,80,000	5,89,500	By goods lost in transit		8,010	8,010
				By goods in Transit			66,000
				By Closing Stock	1,87,350	1,17,990	3,05,340
Total	**18,11,850**	**8,46,000**	**21,79,350**	**Total**	**18,11,850**	**8,46,000**	**21,79,350**
To Expenses	2,80,260	80,475	3,60,735	By Gross Profit c/d	4,09,500	1,80,000	5,89,500
To Discount Allowed	9,180	5,640	14,820	By Discount Received	30,090	4,875	34,965
To Goods lost in transit		8,010	8,010				
Less: Unrealized Profit	(16,500)		(16,500)				
To Net Profit	133,650	90,750	224,400				
Total	**4,39,500**	**1,84,875**	**5,89,500**	**Total**	**4,39,500**	**1,84,875**	**5,89,500**

Working Notes

1. **Calculation of Closing Stock of Head office:**

Purchase During the year	14,02,350
Less: Sales at cost price (10,80,000 x 2/3)	7,20,000
Less: Goods sent to branch (5,44,500 x100/110)	4,95,000
Closing Stock	1,87,350

2. **Calculation of Closing Stock of Branch Office:**

Purchase During the year	1,87,500
Add: Goods Received from HO	4,78,500
Less: Sales at cost price (7,20,000*3/4)	5,40,000
Less: Goods lost in Transit	8,010
Closing stock	1,17,990

3. **Calculation of unrealized profit on on stock**
   a) Goods in Transit = 66000×10/110 = 6000
   b) Closing stock of branch = 115,500×10/110 = 10500
   Total Unrealized Profit = 16,500

3.

a) From the following Trial Balance of proprietorship firm XYA, prepare a Trading and Profit and Loss Account for the year ending on 31st December, 2016 and a Balance Sheet as on that date after taking into consideration the necessary adjustments: **10**

Particulars	Debit (Rs.)	Credit (Rs.)
Capital and Drawings	10,200	95,000
Stock (1-1-2016)	18,900	
Purchases and Sales	138,600	202,000
Printing and Stationery	2,600	
Debtors and Creditors	22,800	16,020
Freehold Premises	39,000	
Deposit with Damodar at 10% (since 30-6-2016)	18,000	
Salaries (including advance Rs. 3,500)	28,200	
Returns	890	1,580
Provident Funds		6,550
Interest on Deposit with Damodar		450
Furniture and Fixture	8,600	
Trade Expenses	12,650	
Outstanding Trade Expenses		1,600
Provision for Doubtful Debts		2,200
Bad Debt Recovered		700
Income Tax	7,900	
Bank Balance	6,950	
Cash in Hand	6,310	
Patent Right	5,400	
Suspense Account		900
Total	327,000	327,000

Adjustments:

i) Last year's closing stock was valued at 10% below cost. It has to be reverted to cost. Stock as on 31-12-2016 was valued at Rs. 16,400 (at cost).

ii) Goods costing Rs. 650 pilfered by a dishonest employee and furniture (book value on 1-1-2016 Rs. 700) destroyed by an accidental fire on 31-12-2016.

iii) Bhaskar is included in both debtors and creditors - the amount due from him is Rs. 430 and the amount due to him is Rs. 200.

iv) New furniture costing Rs. 1,200 was purchased on 31-12-2016 on credit but not yet recorded.

v) Suspense Account represents a cheque received from a debtor in full settlement of a claim of Rs. 1,000. The cheque was deposited into bank and duly collected also.

vi) The employer's contribution to provident fund Rs. 1,240 is yet to be paid.

vii) Write-off Rs. 400 as bad and maintain provision for doubtful debts @ 5% on debtors.

viii) Depreciate all tangible fixed assets @ 10% p.a. Patent was acquired in 2015 and annual amortization equal to 1/10th of the cost started last year.

ix) Creditors include suppliers of stationery Rs. 200.

3a) Solution:

M/s XYA
Trading and Profit and Loss Account for the year ended 31st December, 2016

Particulars	Amount	Amount	Particulars	Amount	Amount
To Opening Stock (W.N. 1)		21,000	By Sales	202,000	
To Purchases	138,600		Less: Sales Returns	890	201,110
Less: Purchase Returns	1,580		By Closing Stock		16,400
Less: Goods Pilfered	650	136,370			
To Gross Profit c/d		60,140			
		217,510			**217,510**
To Goods Pilfered		650	By Gross Profit b/d		60,140
To Printing and Stationery		2,600	By Interest on Deposit	450	
To Salaries	28,200		Add: Accrued Interest	450	900
Less: Advance Salary	3,500		By Provision for Doubtful Debts:		
	24,700		Old	2,200	
Add: Employers' contribution to PF	1,240	25,940	Less: New (W.N.2)	1,060	1,140
To Trade Expenses		12,650	By Bad debts recovered		700
To Loss on Furniture Destroyed (W.N. 3)		630			
To Discount Allowed (1000-900)		100			
To Bad debts		400			
To Depreciation on:					
Freehold Premises	3,900				
Furniture & Fixture (W.N. 4)	860	4,760			
To Amortization of Patent Right (5,400/9)		600			
To Net profit c/d		14,550			
		62,880			**62,880**
To Income Tax		7,900	By Net Profit b/d		14,550
To Net profit c/d (Transferred to Capital A/c)		8,750	By Opening Stock		2,100
		16,650			**16,650**

Alternatively, Opening stock can be added to capital

M/s XYA
Balance Sheet as at 31st December, 2016

Liabilities	Amount	Amount	Assets	Amount	Amount
Capital			Freehold Premises	39,000	
Opening Balance	95,000		Less: Depreciation	3,900	35,100
Add: Net Profit	8,750		Furniture & Fixture (W.N. 4)	9,100	
	103,750		Less: Depreciation	790	8,310
Less: Drawings	10,200	93,550	Patent Right	5,400	

Provident Fund	6,550		Less: Amortization	600	4,800
Add: Employers' Contribution	1,240	7,790	Debtors (W.N. 2)	21,200	
Creditors for:			Less: Provision for Doubtful Debts	1,060	20,140
Goods	16,020		Deposit with Damodar	18,000	
Less: Mutual Indebtness	200		Add: Accrued Interest	450	18,450
Less: Creditors for stationery	200		Closing Stock		16,400
	15,620		Advance Salaries		3,500
Add: Furniture	1,200		Bank Balance		6,950
Add: Stationery	200	17,020	Cash in hand		6,310
Outstanding Trade Expenses		1,600			
		119,960			**119,960**

Working Notes:

(1) Last year's closing stock is this year's opening stock, which is valued at 10% below cost. Therefore, it appears in the Trial Balance at 90%. In effect, the actual cost of opening stock = Rs 18,900 / 90% = Rs 21,000. Assuming that the market value of opening stock is more than Rs 21,000, the value of opening stock is to be increased by Rs 2,100 (Rs 21,000 - 18,900).

(2) Closing Value of Debtors

	Rs
Debtors as per Trial balance	22,800
Less: Received from a Debtor	1,000
	21,800
Less: Mutual Indebtedness	200
	21,600
Less: Bad Debts	400
Closing Value of Debtors	21,200
Provision is required (5% on Rs 21,200)	1,060

(3) Loss on Furniture Destroyed

Book value of furniture destroyed Rs 700. Depreciation @ 10% p.a. for 1 year = 10% of Rs 700 = Rs 70.

Therefore, loss on furniture destroyed = Rs (700 - 70) = Rs 630.

(4) Closing Value of Furniture and Fixture and Depreciation Thereon

	Rs
Book value as per trial balance	8,600
Less: Book value of furniture destroyed on 31.12.1998	700
	7,900
Add: Purchase of furniture	1,200
	9,100
Depreciation @ 10% p.a. on Rs 700	70
On Rs (8,600 - 700)	790
On Rs 1,200	-
	860

b) From the following particulars, calculate: **5**

i) Agreed value of two plants taken back by the hire vendor.
ii) Book value of plant left with the hire purchaser.
iii) Profit or loss to hire purchaser on two plants taken back by the hire vendor.
iv) Profit or loss on plants repossessed, when sold by the hire vendor.

Particulars:

X purchased three plants from Y on hire purchase basis, the cash price of each plant being Rs. 100,000. The hire purchaser charged depreciation @ 20% on diminishing balance method.

Two plants were seized by the hire vendor when second installment was not paid at the end of the second year. The hire vendor valued the two plants at cash price less 30% depreciation annually charged at diminishing balance method.

The hire vendor spent Rs. 40,000 on overhauling of the plants and then sold them for a total sum of Rs. 160,000.

3b) Solution:

i. Agreed value of two plants taken back by the hire vendor

Price of two plants = Rs. 100,000 x 2=200,000
Less: Depreciation for the first year @ 30%=60,000
Less: Depreciation for the second year Rs. 140,000 x 30/100 =42,000
Agreed value of two plants taken by the hire vendor= 98,000

ii. Book value of the plant left with the hire purchaser

Cash purchase price of one plant=100,000
Less: Depreciation on Rs. 100,000 @ 20% for first year=20,000
Written down value of the plant at the end of first year=80,000
Less: Depreciation on Rs. 80,000 @ 20% for the second year=16,000
Book value of the plant left with the hire purchaser=64,000

iii. Profit or loss to hire purchaser

Book Value of one plant (b)=64,000
Book Value of two plants=128,000
Agreed Value=98,000
Loss=30,000

iv. Profit or loss on plants repossessed

Sale proceeds of plants repossessed=160,000
Less: Agreed Value=98,000
Less: Overhauling Charges= 40,000
Profit on resale=22,000

4.

a) You are given the following particulars:

Current Ratio=2
Working Capital Rs. 400,000
Capital Block to Current Asset 3:2
Fixed Assets to Turnover 1:3
Sales Cash /Credit 1:2
Creditors Velocity 2 Months
Stock Velocity 2 Months
Debtors Velocity 3 Months
Net Profit 10% of Turnover
Reserve 2.5% of Turnover
Debentures/Shares Capital 1:2
Gross Profit 25%

Required: Prepare the Financial Position based on above information. **10**

4a.Answer:

Financial Position

Capital & Liabilities	**Rs**	**Assets**	**Rs.**
Share Capital	600,000	Non-Current (Fixed) Assets	800,000

Net Profit (P/L)	240,000	Stock	300,000
Reserves	60,000	Debtors	400,000
Debenture	300,000	Other Current Assets	100,000
Sundry Creditors	300,000		
Other Current Liabilities	100,000		
	1,600,000		**1,600,000**

Working Notes:

1. Current Ratio = Current Assets (CA)/Current Liabilities (CL)

Or, 2 = CA/ CL
Or, CA = 2 CL
Again, WC = CA- CL
Or, 400,000= 2CL- CL
Or, CL = Rs. 400,000
& CA = 2* Rs.400,000
CA = Rs.800,000

2. Capital Block: Current Assets = 3:2

If Current Assets = 8,00,000
Capital Block = 12,00,000

3. Debenture: Share Capital = 1:2

Debentures = Share Capital/2

4. Capital Block = Share Capital + Profit + Reserve + Debenture

Let Share Capital be X
Let Sales be Y
Net Profit = 10% of Y = 0.1Y
Reserve = 2.5% of Y = 0.025Y
Capital Block = X+0.1Y+0.025Y+0.5X
or, 1.5X+0.125Y=12,00,000-------------------(I)

5. Fixed Assets: Turnover= 1:3

or Fixed Assets = Turnover/ 3
Fixed Assets = Y/3
We know, Capital funds - fixed assets = working capital and
Capital funds = Capital Block
or, 1.5X+0.125Y- Y/3 = 4,00,000
or, 4.5X -0.625Y= 12,00,000 ------------------(ii)
Solving the equation (i) and (ii) we get
X= Share Capital = 6,00,000
Y= Sales = 24,00,000

6.
   a. Fixed Assets = Y/3= 2,400,000/3 = 800,000
   b. Cash Sales = 1/3 X 2,400,000 = 800,000
   c. Credit Sales = 2/3 X 2,400,000= 1,600,000
   d. Net Profit = 10/100 X 2,400,000= 240,000
   e. Reserve = 2.5/100 X 2,400,000= 60,000

f. Gross Profit = 25/100 X 2,400,000 = 600,000
g. Debentures = Share Capital/2 = 300,000
h. Cost of Goods Sold = 2,400,000- 600,000 = 1,800,000

7. Stock Velocity = Average Stock/ Cost of goods sold x 12 = 2
   therefore, Closing Stock = 300,000
   In the absence of information here it is assumed that average stock = closing stock

8. Debtor Velocity = Average Debtors/ Credit Sales x 12 = 3
   Therefore, Closing debtors = 400,000
   In the absence of information here it is assumed that average debtors = closing debtors
   Other current Assets = 800,000-400,000 -300,000 = 100,000

9. Creditors Velocity= Average Creditors/ Credit Purchases x 12 = 2
   Therefore, Closing Creditors = 300,000
   In the absence of information regarding cash and credit purchase and opening and closing stock, cost of goods sold is considered.
   Other current liabilities = 400,000-300,000 = 100,000

b) The available cash with the liquidator of a Company after realizing all Assets and paying all Liabilities is Rs. 330,000.

The issued Capital of the company is made up of:

30,000 10% Preference Shares of Rs. 10 each fully paid.
30,000 Equity Shares of Rs. 10 each fully paid.
30,000 Equity Shares Rs. 10 each Rs. 8 paid up per share.
30,000 Equity Shares of Rs. 5 each Rs. 3 paid up per share.

Preference dividend has been paid to date.

Prepare Liquidators' Statement of Account assuming that the required calls were made and the amounts due were received in full. **5**

4b.Answer:

Liquidator's Final Statement of Accounts

Receipt	Amount	Payment	Amount
To Balance b/d	3,30,000	By Preference Capital	3,00,000
To Equity Share III (30,000 x 1)	30,000	By Equity Share I (30,000 x 2)	60,000
Total	**3,60,000**	**Total**	**3,60,000**

Working Notes:

1. Amount available after call

Amount Available to equity shareholders	30,000
Add: Notional Calls	
30000 x 2	60,000
30,000 x 2	60,000
Total Fund Available after call	1,50,000

2. Calculation of Deficiency to shareholders:

30,000 x 10	3,00,000
30,000 x 10	3,00,000

30,000 x 5	1,50,000
Total Face value of shares	7,50,000
Less: Available Amount	1,50,000
Deficiency to shareholder	6,00,000
Percentage of Deficiency (6,00,000/7,50,000)	80%

Alternatively, per rupee calculation will also be acceptable

3. Calculation of Refund and Call from shareholders

Class of Shares	Face Value	Deficiency	Paid	Call	Refund
Equity Share I	10	8	10	-	2
Equity Share II	10	8	8	-	-
Equity Share III	5	4	3	1	-

5.

a) Shree Ganesh Ltd. is a manufacturing company produces durable consumer goods with an annual turnover of Rs. 100 crores. The company receives orders from its commission agents all over the country, but goods are dispatched directly to the customers. The documents including transport bills are sent through the bank for collection. At the end of the 6th year, it is found that documents covering the dispatch of goods worth Rs. 10 crores were still lying with the banks not cleared by the customers even though the normal collection period of 15 days from the date of dispatch has expired. Should revenue be recognized in the above case? **5**

5a.Answer:

According to NAS - 18 on Revenue, revenue from the sale of goods shall be recognized when the seller of goods has transferred to the buyer the significant risks and rewards of ownership of the goods;

a. the seller retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
b. the amount of revenue can be measured reliably.
c. It is probable that the economic benefits associated with the transaction will flow to the entity; and
d. The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Since the transport bills were sent through the bank for collection, it may be said that the seller entity has retained effective control over the ownership of goods. Further since the documents were not cleared by the customer even after the expiry of the normal period of collection, there is an uncertainty in the realization of sale proceeds. Hence, revenue should not be recognized in this case.

(Altenatively, NFRS – 15, may be used)

b) Nepal Trading gives the following information relating to items forming part of inventory as on 31-3-2079. His factory produces Product X using Raw material A.

i) 600 units of Raw material A (Produce @ Rs. 120). Replacement cost of raw material A as on 31-3-2079 is Rs. 90 per unit.

ii) 500 units of partly finished goods in the process of producing X and cost incurred till date Rs. 260 per unit. These units can be finished next year by incurring additional cost of Rs. 60 per unit.

iii) 1500 units of finished product X and total cost incurred Rs. 320 per unit. Expected selling price of Product X is Rs. 300 per unit.

Determine how each item of inventory will be valued as on 31-3-2079. Also calculate the value of total inventory as on 31-3-2079. **5**

5b.Answer:

As per NAS, 2 'Inventories' are valued at lower of cost and net realizable value. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at cost or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. In the given case, selling price of product X is Rs. 300 and total cost per unit for production is Rs.320.

Hence the valuation will be done as under:

i 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence value at Rs. 90 per unit.

ii 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost Rs. Rs. 260 or Net estimated selling price Rs. 240(Estimated selling price Rs. 300 per unit less additional cost of Rs. 60)

iii 1500 units of finished product X will be valued at NRV of Rs. 300 per unit since it is lower than cost Rs. 320 of product X.

Valuation of Total Inventory
As on 31-03-2079

Types of Inventory	**Qty**	**Cost**	**NRV**	**Value**
Raw Material A	600	120	90	54,000
Partly Finished Goods	500	260	240	1,20,000
Finished Goods	1,500	320	300	4,50,000
Total Value of Inventory				6,24,000

c) AD Limited exported good for $10,000 on 20.2.2078 and the amount was settled on 20.5.2078. Give the necessary journal entries and account treatment in the books of AD Limited (on transaction date, year end and settlement date). **5**

Given

Date	Exchange Rate
20.2.2078	110
31.3.2078	115
20.5.2078	112

5c.Answer:

<u>20.2.2078- Spot Rate @ Rs.110</u>

Debtors/Receivables A/c Dr.	11,00,000	
To Sales A/c		11,00,000

<u>31.3.2078 -Closing rate @ 115 (Debtor is Monetary item)</u>

It will result in exchange gain of Rs 50,000 (115-110=5*10,000), will be recognized as profit.

Debtors/Receivables A/c Dr.	50,000	
To Exchange Gain A/c		50,000

<u>20.5.2078 -settlement rate @ 112</u>

Bank A/c Dr.	11,20,000	
Exchange Loss A/c Dr.	30,000	
To Debtors/ Receivable A/c		11,50,000

6. Write short notes on: **(5×3=15)**
   a) Off Balance Sheet Items
   b) Capital Fund in Banks
   c) Held for Trading Investments
   d) Recognition of Premium Income by Insurance Companies
   e) Inter-departmental transfers in the context of departmental accounts.

Answers:

6 a) Off balance sheet items are those which do not appears in the balance sheet & usually comprises of disclosure of contingent assets and contingent liabilities. It involves only those items which need disclosure and are not accounted for in the balance sheet.
Some of the examples of off balance sheet items include:

- Letters of credit
- Bank guarantee
- Irrevocable credit commitments
- Pending income tax liabilities
- Pending legal cases
- Sale & repurchase arrangements

6 b) As per the section 2(y) of the Bank and Financial Institution Act, 2073 capital fund means the total of the primary and supplementary capital of a bank or financial institution and this term includes any other fund of the institution as prescribed as such by the Nepal Rastra Bank from time to time. As per directive relating to the Capital Accord core capital is also known as Tier- I Capital and Supplementary capital also known as Tier- II capital.

6 c) **Held for Trading Investments:** Trading generally reflects active and frequent buying and selling, and investment held for trading generally are used with the objective of generating a profit from short term fluctuation in price or dealer’s margin. Hence, an investment that is made for the purpose of generating a profit from short term fluctuations in price should be classified under this category. An asset should be classified as held for trading even if it is a part of a portfolio of similar assets for which there is a pattern of trading for the purpose of generating a profit from short term fluctuations in price. Examples for held for trading investments are investment in securities like treasury bills of Nepal government, bonds of Nepal government, debentures or shares of an entity held with a motive of short term fluctuation gain and entity has not invention to hold the securities till their maturity.

6 d) **Recognition of Premium Income by Insurance Companies:** As per directives issued by Insurance Board, the insurer shall account the premium received on Cash Basis. However, if the premium received is relating to the risk covered for later period, then premium income shall be recognized on later. Premium received in advance shall not recognized as income and shall be kept under “Premium received in Advance” account. Gradually, the advance premium shall be recognized as income on pro-rata basis over the period of risk covered. However, one-time premium received shall be recognized as income whenever, the premium received. The Re-insurance premium income shall be recognized on accrual basis.

6 e) The basic objective of departmentalization is to make each department a responsibility center. The departments are also profit centers. When one responsibility center renders service or supplies goods to another center, the price used is known as 'transfer price'. Such price may be the market price if available. The transfer price may be adjusted for cash discount and

selling costs that do not arise in internal transfers to make it more accurate and equitable to both the buying and the selling centers. Alternatively, one might take cost plus certain margin as transfer price. This is generally set as a standard to ensure that the selling departments do not transfer their inefficiencies as a part of the cost in transfer price. Thus, it can be concluded that transfer price is a good mechanism to record inter-departmental transfers. Among others, this helps the management in setting up profit centers and fixing responsibility on departmental managers. This also ultimately helps the management in efficiency and productivity evaluation.

Paper 2: Audit and Assurance

Marks

Attempt all questions.

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

   a) Subhakamana Sugar Mills Limited is closed from last 11 months due to outdated technology and has no sales as old technology produces inferior products. The company will take minimum 2 years' time with substantial modification of technology to restart production and make sales. Cost is very substantial for upgrading technology. Due to factory closure, company defaults in loan repayment and bank have issued notice for auction if loan is not repaid within 3 months' time. Management is doubtful that funding can be arranged.

      CFO is of view that financial statements shall be prepared in going concern basis as there is little hope that funding will be received.

   b) In the books of Palpa Limited, it is found that inventory costing Rs. 8,500 of item was accidentally destroyed in Bhadra 2078, inventory costing Rs. 7,000 which was given to local NGO for free in Mangsir 2078 and inventory costing Rs. 5,400 which relates to the cost of damaged inventory which can be reworked at a cost of Rs. 900, and which can then be sold for Rs. 4,300. These events were not considered by the accountants in the books of accounts.

   c) Dharan Limited has acquired a machine in Shrawan 2071 for Rs. 80,000. Useful life of the machine was estimated for 8 years and straight line method is used to depreciate the machine. In the reporting date of FY 2078/79, as per technical examination of the machine useful life of the machine is expected to be for next 5 years. However, the accountant of Dharan Limited has argued that machinery has been fully depreciated in this year and no depreciation will be charged from the next fiscal year.

   d) You are the auditor of Himalaya Fashion Pvt. Ltd. (the company) for the FY 2075/76. Total number of shareholders of the company since FY 2074/75 is 115 which include 11 employees.

Answer:

1 a) As per NAS 1 Presentation of Financial Statements, an entity shall prepare its financial statements on a going concern basis unless management intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so. When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. In making assessment, if management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When financial statements are not prepared on going concern basis, it shall disclose the fact, together with the basis on which it prepared the Financial Statements and the reasons of doing so.

NSA 570 "Going Concern" requires that the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In the given case, entity's inability to operate the business for more than 11 months' time, substantial time to be required for upgrading technology and significant doubt on availability of the fund are the examples of conditions casting uncertainties. If the financial statements have been prepared on a going concern basis but, in the auditor's judgment, management's use of the going concern assumption in the financial statements is inappropriate, the auditor shall express a modified opinion. In the given case, as there is significant doubt that entity will be operational and going concern assumptions is questionable, The auditor shall evaluate the data on which basis the management has made assessment and come to the conclusion of the appropriateness of use of going concern assumption. Based on evaluation, the auditor should form an appropriate opinion of the Financial Statements.

1 b) As per NAS 2: Inventories, any amount of write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period when write down or losses occurs. Since the accountant of Palpa Limited did not record these write offs and losses in the books of account, following amount should be recorded as expenses in FY 2078-79;

S.N.	Particulars	Amount	Expenses (Rs.)
1	Accidentally destroyed inventory		8,500
	Cost Price	8,500	
	Net Realisable Value	-	
2	Inventories given to Local NGO for free of cost		7,000
	Cost Price	7,000	
	Net Realisable Value	-	
3	Damaged Inventories		2,000
	Cost Price	5,400	
	Net Realisable value (4300-900)	3,400	
	Total Expenses		17,500

Hence, Palpa Limited shall recognise NPR 17,500 as expense in FY 2078-79 in accordance with the Nepal Accounting Standards -2: Inventories. If this is not corrected in financial statements the auditor should consider the impact of such audit observations to the fairness of financial statements and form an appropriate opinion.

1c) As per Nepal Accounting Standards 16: Property, Plant and Equipment; para 51, the residual value and the useful life of an asset should be reviewed at least each financial year-end. If expectations differ from previous estimates, the changes shall be accounted for as a change in an accounting estimate in accordance with NAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. In the given case, useful life is being revised, so resultant impact should be accounted for prospectively as follows.

S.N.	Particulars	Amount (Rs.)
1	Cost of Machinery	80,000
2	Initial Useful Life	8
3	Accumulated Depreciation till 2077-78 (7 years)	70,000
4	Carrying amount as on Ashad end 2077-78	10,000
5	Revised useful life of machinery	5
6	Revised Depreciation in FY 2078-79	2,000

In FY 2078-79, Dharan Limited shall charge Rs. 2,000 as depreciation based on revised useful life of 5 years. Therefore, contention of the accountant that no deprecation will be charged from the next fiscal year on the asset is not correct as per Nepal Financial Reporting Standards.

1d) Pursuant to Section 9(1) of the Companies Act (with amendment 2074), a private company cannot have more than One Hundred one shareholders. The threshold of maximum number of the shareholders does not apply in case of the existing Transportation Business Committees forming a private company within given period (Section 9(1ka)) and employee shareholders getting shares under defined scheme (Section 9(3)).

In the light of foresaid changes of Companies Act 2063(amended 2074), The maximum shareholders to be maintained for FY 2074/075 & 2075/76 is 101 (excluding employee shareholders). The shareholders of the company excluding employee shareholders for FY 2074/75 and 2075/76 are 104. Accordingly, the company has breached the provision of amended Company's Act 2063. As an auditor, I would like to suggest the company to regularize it without any further delay. Otherwise, it shall imply non-compliance with laws.

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

   a) After the completion of statutory audit of Rara Holidays Ltd., a fraud was detected at the office of the auditee. The management of the company alleged that there is a failure on the part of the auditor to detect fraud and that auditor would be responsible for not detecting fraud in the company.

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

   c) CA. K is reappointed as the auditor of B Ltd. He wants to re-confirm certain matters relating to responsibility of management regarding preparation of financial statements and has asked the management to give written representations for the same. Under what circumstances can an auditor ask the management to reconfirm its acknowledgement and understanding of responsibilities in written representations?

   d) During the audit of FY 2078-79, the auditor has requested the client to pay 70% of the overdue fee of previous audit before signing the audit report. The client has lodged complaint against the auditor for disciplinary action.

Answer:

2 a) As per NSA 240, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. Such a system reduces but does not eliminate the possibility of fraud and error. An auditor conducting an audit in accordance with NSAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the NSAs. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts of concealment may be even more difficult to detect when accompanied by collusion.

The subsequent discovery of material misstatement of the financial information resulting from fraud or error existing during the period covered by the auditor's report does not, in itself, indicate that whether the auditor has adhered to the basic principles governing an audit. The question of whether the auditor has adhered to the basic principles governing an audit (such as performance of the audit work with requisite skills and competence, documentation of important matters, details of the audit plan and reliance placed on internal controls, nature and extent of compliance and substantive tests carried out, etc.) is determined by the adequacy of the procedures undertaken in the circumstances and the suitability of the auditor's report based on the results of these procedures.

The liability of the auditor for failure to detect fraud exists only when such failure is clearly due to not exercising reasonable care and skill.

Thus, in the instant case, after the completion of the statutory audit, if a fraud has been detected, the same by itself can not mean that the auditor did not perform his duty properly. If the auditor can prove with the help of his papers (documentation) that he has followed adequate procedures necessary for the proper conduct of an audit, he cannot be held responsible for the same. If however, the same cannot be proved, he would be held responsible.

2 b) As per NSA 705, “Modification to the opinion in the independent Auditor’s Report’, the auditor shall express a qualified opinion when:

i. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate are material, but not pervasive, to the financial statements; or
ii. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

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

2c) NSA 580 Written Representations governs the provisions about written representations from management. Written Representations are written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Other NSAs also require the auditor to request written representations. If in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations.

The written representations draw on the agreed acknowledgement and understanding of management of its responsibilities by requesting confirmation that it has fulfilled them. The auditor, CA. K of B Ltd, may also ask management of B Ltd to reconfirm its acknowledgement and understandingof those responsibilities in written representations. This is particularly appropriate when:

- Those who signed the terms of the audit engagement on the behalf of the entity no longer have the relevant responsibilities
- The terms of audit engagement were prepared in a previous year
- There is any indication that management misunderstands those responsibilities or
- Changes in circumstances make it appropriate to do so.

2 d) As per subsection 410.7: Fees – Overdue, of Handbook of Code of Ethics for Professional Accountants, overdue of previous professional service fee might create self-interest threat for the audit of following year. Therefore, it is generally expected to clear the overdue amount before the issuance of audit report of following year. In order to safeguard from the self-interest threat, the auditor can obtain partial payment of overdue fee or have appropriate reviewer who did not take part in the audit engagement review the work performed. In the given case, contention of the auditor is correct as per code of ethics for professional accountants that the previous year due should be paid by the client before the signing of audit report of current period to safeguard of self-interest threat to independence for audit. In case the client refuses to pay the overdue audit fee. auditor can take other safeguard measure or withdraw the appointment as an auditor. Therefore, the complaint against the auditor for not singing the audit report is not valid.

3. Answer the following: **(3×5=15)**
   a) Explain the circumstances when the work of the internal audit function can be used by External Auditor.
   b) Define error. Briefly discuss the types of errors.
   c) Define external confirmation as audit evidence and its type.

Answer:

3a) The external auditor's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, the level of competence of the internal audit function, and whether it applies a systematic and disciplined approach may provide a basis to the external auditors as to whether to use the work of internal auditors. In cases where external auditor cannot obtain reliable evidences as to effective internal audit function, that indicates the risks to the quality of the work of the internal audit functions. Therefore, it is not appropriate to use any of the work of the function as audit evidence in such cases.

Consideration of the factors of NSA 610 individually and in aggregate is important because an individual factor is often not sufficient to conclude that the work of the internal audit function cannot be used for purposes of the audit. For example, the internal audit function's organizational status is particularly important in evaluating threats to the objectivity of the internal auditors.

If the internal audit function reports to management, this would be considered a significant threat to the function's objectivity.

This is because of the possibility that the engagement team will use the results of the internal audit service without properly evaluating those results or without exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm.

So, the external auditors should evaluate the organizational status of internal audit function, competence and the approach that internal audit function applies in conducting quality internal audits before deciding whether to use the work of internal audit for his external audit purposes.

3b) NSA 240 on 'The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements' provides that misstatements in the financial statements can arise from fraud or error.

Error refers to an unintentional misstatement in financial statements, including the omission of an amount or a disclosure, such as:

- A mistake in gathering or processing data,
- An incorrect accounting estimate arising from oversight or misinterpretation of facts and
- A mistake in the application of accounting principles relating to measurement, recognition etc.

Errors can be classified as:-

i. **Self-revealing and not self-revealing**:- These are such errors the existence of which becomes apparent in the process of compilation of accounts. Unrecorded cheque details are apparent while preparing bank reconciliations. If errors could not be noticed during normal course, such errors are not self-revealing errors. If an item of expense which should have been charged to repairs account has been charged by mistake to the building account or if the amount of depreciation is calculated incorrectly, there is nothing in the book-keeping system which will bring the error to notice. Such errors are not self-revealing errors.

ii. **Unintentional and intentional**: - Errors are normally considered as unintentional. It may be due to human errors, lack of knowledge or lack of guidance. However, Fraud is the word used to mean intentional act. This is done deliberately which implies that there is intent to deceive, to mislead or at least to conceal the truth. It follows that other things being equal, they are more serious than unintentional errors because of the implication of dishonesty which accompanies them.

iii. **Unconcealed and concealed**: - Mistakes are unconcealed but frauds are deliberately concealed. Mistakes become concealed if compensated by another or more mistakes in the opposite direction. Mistakes may as well be concealed for wrong arithmetical calculations or for a faulty process of verification.

3 c) External confirmation is a process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for the information about a particular item affecting assertions made by management in the financial statements. External confirmations are frequently used in relation to account balance and their components but need not be restricted to these items. External confirmation may be of following two types;

i) Positive confirmation

Positive external confirmation request asks the respondent to reply to the auditor in all case either by indicating the respondent's agreement with the given information or by asking the respondent to fill in the information. A response to a positive conformation request is ordinarily expected to provide reliable audit evidence.

ii) Negative confirmation

Negative external confirmation request asks the respondent to reply only in the event of disagreement with the information provided in the request. However, when no response has been received to a negative confirmation request, the auditor remains aware that there will be no explicit evidence that indented third party have received the confirmation request and verified that the information contained therein is correct.

4. Answer/Comment on the following: **(3×5=15)**

a) Lalita sports club is organizing a sports event and has approached a Chartered Accountants firm for sponsorship of the event. Is the firm allowed to sponsor as per ICAN Code of Ethics?

b) PRR & Associates published its website with client portfolio details which illustrates various clients, testimonial of client regarding the service provided by the firm and variety of services it serves.

c) Kriti Associates, Chartered Accountants has been appointed by Big Bank Ltd to provide Risk Management Service. The Bank has agreed to pay fee of Rs. 32 Lakh if consultant can fix the operational risk below 5 out of rank 10. Comment on this in the light of ICAN Code of Ethics.

Answer:

4 a) ICAN Code of Ethics, 2018 and Guidelines on Marketing Professional Services by professional accountants in public practice provides guidance to the professional accountants as to what is expected and what not.

When undertaking marketing or promotional activities, a professional accountant shall not bring the profession into disrepute. A professional accountant shall be honest and truthful and shall not make:

(a) Exaggerated claims for the services offered by, or the qualifications or experience of, the accountant; or

(b) Disparaging references or unsubstantiated comparisons to the work of others.

Marketing, publicity or advertisement may create threat to compliance with the fundamental principles of the Code of Ethics.

Publicity is meant to reach out to the potential or even not potential clients to make them known that a particular professional accountant seeks clients to provide them her or his professional services. The guidelines in regards to publicity includes the provision for sponsoring charitable events/ organizations that engage in social welfare e.g. health organizations, sports clubs and displaying simple banner during such event. In the given case, Lalita sports club is an organization that is engaged in social welfare and sponsoring the sports event is a publicity activity so sponsoring the event and displaying a simple banner during the event is permissible according to the Code of Ethics and related Guidelines. If a firm is in doubt about whether a form of advertising or marketing is appropriate, the firm is encouraged to consult with the relevant professional body.

4 b) As per provision specified in the Code of Ethics and related Guidelines on marketing professional services issued by the ICAN prohibits solicitation of client or professional work either directly or indirectly by circular, advertisement, personal communication, or interview or by any other means because it shall constitute professional misconduct. However, in the given case PRR & Associates published its website with client portfolio, detail of its clients and testimonial of client regarding the service provided by the firm and other services the firm provides which is not permitted by the Code of ethics. Hence, PRR & associates in way to promote its services and quality being offered to client is considered as misconduct by PRR & Associates and the firm shall be liable for disciplinary action.

4 c) In the given case, Bank is offering contingent fees which are calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm.

As per section 34 (10), the member holding COP should not base his remuneration as a percentage of profit or any uncertain results.

Further, the case is examined as follows in the light of the provisions of Code of Ethics.

A contingent fee charged directly or indirectly, for example through an intermediary, by a firm in respect of an audit engagement creates a self-interest threat that is so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm shall not enter into any such fee arrangement.

A contingent fee charged directly or indirectly, for example through an intermediary, by a firm in respect of a non-assurance service provided to an audit client may also create a self-interest threat. The threat created would be so significant that no safeguards could reduce the threat to an acceptable level if:

(a) The fee is charged by the firm expressing the opinion on the financial statements and the fee is material or expected to be material to that firm;

(b) The fee is charged by a network firm that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or

(c) The outcome of the non-assurance service, and therefore the amount of the fee, is dependent on a future or contemporary judgment related to the audit of a material amount in the financial statements.

In the given case, the accountant should not accept such engagements that will result in non-compliance with code of ethics.

5. Answer/Comment on the following: **(2×5=10)**

a) Kohalpur Limited having substantial investment (more than 50 percent) of the Government of Nepal and has completed its AGM for FY 2078-79 in Asoj 2079, however the company fails to appoint the auditor through AGM because the company has not received the consultation from the office of Auditor General. As a professional accountant, please suggest how the company can appoint the auditor.

b) CBB & Associates has issued the audit report of Butwal Limited on 15th Bhadra 2079; however later it was revealed that the auditor has not renewed the membership and the certificate of practice of the firm on 30th Asoj 2079.

Answer:

5 a) As per Section 11 of Audit Act, 2075, corporate bodies having substantial investment (more than 50 percent) of the Government of Nepal should appoint the auditor after taking consultation from the Auditor General and have its accounts audited subject to the principles specified by the auditor General. Corporate bodies should forward the report presented by the auditor to the office of Auditor General. Similarly, as per section 113 of Companies Act, 2063 states that if a company fails to appoint an auditor due to any reason or the appointed auditor discontinues the appointment, the office of the company registrar may appoint an auditor upon request of board of directors of the company.

In the given case, Kohalpur Limited has completed its AGM for FY 2078-79 in Asoj 2079; however the appointment of auditor could not be done by the AGM due to unavailability of consultation from the office of Auditor General. Therefore, the company should obtain the consultation from the Auditor General regarding appointment of the auditor and the board of directors of the company should sent a request letter to the Office of the Company registrar under section 113 for the appointment of the auditor specifying the reason.

5 b) As per section 29 of Nepal Chartered Accountants Act, 2053, no member shall provide auditing service without obtaining certificate of practice. As per the clause, person appointed as an auditor shall be a member of Institute of Chartered Accountants of Nepal and having valid certificate of practice.

At the time when audit report was issued, the COP has already expired but there was time left for renewal of membership and certificate of practice. But, for issuance of any reports in the capacity of a member holding COP, the auditor should be careful whether it has made all renewal in time and ensure that the Certificate of Practice remains valid

In the given question, the auditor of Butwal Limited has signed the audit report on 15th Bhadra 2079 when he has no valid certificate of practice which is contrary to the clause of the act. Therefore, the auditor shall be liable for disciplinary action.

6. Write short notes on the following: **(4×2.5=10)**
   a) Examination in Depth
   b) Peer Review
   c) Government Audit
   d) Tolerable misstatement

Answer:

6 a) It implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction, i.e., from initiation to the completion of the transaction by receipt of payment of cash and delivery or receipt of the goods. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure. For example, if payment to a creditor is to be verified "in depth", it would be necessary to examine the following documents:

- The invoice and statements of accrual from the supplier
- The entry in stock register showing the goods were received
- Goods received Note and inspection certificate showing that goods on receipt were verified and inspected.
- The copy of original order and authority showing that the goods in fact were ordered by an authority which was competent to do so.

6 b) Peer review means an examination and review of the system and procedures to determine whether they have been put in place by the practice unit for ensuring the quality of attestation service as envisaged and implied/mandated by the Technical Standards and whether these were effective or not during the period under review.

Peer review is directed towards maintenance as well as enhancement of quality of attestation services and to provide guidance to members to improve their performance and adhere to various statutory and other regulatory requirements. Essentially, through a review of attestation services engagement records, peer review identifies the areas where a practicing member may require guidance in improving the quality of his/her performance and adherence to various requirements as per applicable Technical Standards.

The main objective of Peer Review is to ensure that in carrying out their attestation services assignments; the members of the Institute (a) comply with the Technical Standards made mandatory for application by the Institute and (b) have in place proper systems (including documentation systems) for maintaining the quality of the attestation services they perform. The Council has issued the Statement on Peer Review which provides guidance on scope and authority of the Technical Standards to be complied with while performing audit and assurance services. However, of late, the Quality Assurance for Audit has been replacing the concept and practice of Peer Review in many jurisdictions.

6 c) Government Audit is the audit of government offices to promote good governance through an independent, efficient and effective audit service and it is governed by Audit Act, 2075. Office of Auditor General is responsible to carry out the audits of all receipt, expenditure and other matters as specified in mandate from various aspects such as regularity, economy, efficiency and effectiveness and propriety.

The auditor general is empowered and made independent through constitutional provisions. Government audit not only include financial audit but includes other audits such as performance and compliance audits. It may also include special audits such as IT audit, environmental audit.

6 d) Tolerable misstatement is a monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

When designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements.

7. Distinguish between: **(2×5=10)**

a) Batch Processing and Online Real Time Processing System in computerized environment
b) Accounting policies and accounting estimate.

Answer:

7 a) The major differences between Batch Processing and online real time processing system in computerized environment is as follows:

Batch Processing	**On-Line Real Time (OLRT) Processing**
♦ Transactions are accumulated and processed in group	♦ Transactions are processed as on when they occur
♦ Two types of files are maintained master file is updated when batch processing is run	♦ Only master file is maintained. It keeps updating
♦ Updating does not take place as quickly as in On-Line Real time system	♦ Though updating takes place immediately the processing becomes complex.
♦ Not useful when instant and updated results are required	♦ Useful for immediate reporting system
♦ Generally provides Audit trail	♦ Generally, does not provide audit trail and hence requires more attention of auditor

7 b) Accounting policies and accounting estimate

Particulars	**Accounting Policies**	**Accounting Estimate**
1. Nature	**Accounting policies** are the specific principles, rules, bases, conventions and practices	Accounting **estimate** relates to judgments made based on most up to date information

	adopted by an entity for preparation and presentation of financial statements.	available at the time of preparation and presentation of financials. So, estimates having inherent uncertainties
2. Changes under NAS 8	The change in accounting policies should be made only if: a) The change is required by NFRS standard b) The changes will results into more appropriate presentation of financials. i.e. more reliable and relevant	The changes in Accounting estimates are applicable if the changes will results into more reliable preparation and presentation of information.
3. Application of Change	Change accounting policy is accounted for retrospectively	change in accounting estimate is accounted for prospectively
4. Example	Example of change in accounting policy is change in valuation of inventory from FIFO to weighted average cost	Example of change in accounting estimate is change in depreciation method by the company

Paper 3: Corporate and Other Laws

Marks

Attempt all questions.

1. Answer the following questions: **(5×5=25)**

   a) Mr. Madan, a director of Manakamana Limited unable to attend the 7th AGM of the company and in his place appoints Mr. Lila Raj, proxy to attend the AGM in the capacity of the director. Is the appointment of proxy valid? Explain with reference to the Companies Act,2063.

   b) Rita Pradhan, a director of Astra Engineering Ltd. was involved in preparing prospectus and with some reservations she signed on it. The prospectus is approved and registered to the Office of Company Registrar and accordingly published. When she knew that the director signing on the prospectus with false contents shall liable personally for loss caused to the investors, she want to be freed from such obligation and asked you. Advise her referring the relevant provision of the Companies Act, 2063.

   c) CA Expert Rawal was appointed as auditor of FY 2078-79 of National Ltd. During the courses of audit the detail of the fixed assets of the Company was not provided and auditor proceeded for the audit report with disclaimer opinion. Board of Directors unsatisfied with the decision wants to proceed for the change in auditor on the ground of disclaimer opinion. Examine the validity proceedings mentioning the relevant provisions as per the Companies Act, 2063.

   d) Board of Director of National Insurance Company is in the opinion to increase their capital with the medium of Further Public Offering (FPO) in premium price. Advise the BOD of the insurance company regarding the pre-conditions of and the procedures for issuing FPO at premium price citing the relevant provision of the Companies Act, 2063.

   e) Namaste telecom company is a leading telecom public company with notable profits. The majority of shareholders have intended to convert their company into a private limited company, but they have no idea what the legal requirements are; therefore, the company wants your advice. Assist them with the conversion of a public limited company to a private limited company under the Companies Act, 2063.

Answer

1 a) A proxy is an instrument in writing executed by a shareholder authorizing another person to attend a meeting and to vote on his behalf in his absence. Section 71 of the Companies Act, 2063 provides every shareholder, who is entitled to attend and vote, a statutory right to appoint another person as his proxy to attend and vote for him.

But in this case, the issue is related to Mr. Madan's directorship, but not to his shareholder ship, because he cannot exercise both rights at a time. He is entitled to exercise his authority of director once he is elected as a director from shareholders for the term. As a director he can only exercise his legal rights or authority to perform only right valid functions conferred by the Companies Act, 2063.

Section 68 of the Companies Act, 2063 provides that - Every director of a company shall be present in the general meeting as far as possible.

The appointment of proxy as Director is invalid pursuant to section 68 of the Companies Act, 2063, because this section requires every director of a company shall be present at the AGM as far as possible.

In the above case, Mr. Madan as a director of Manakamana Limited is unable to attend the AGM, he cannot appoint his proxy to attend AGM in his behalf in the capacity of Director.

1 b)

As per Section 24(1) of the Companies Act, 2063 it shall be the duty and obligation of the concerned company to abide by the matters contained in the prospectus published. And the directors who have signed the prospectus as referred to in Subsection (1) shall be liable for the matters mentioned in that prospectus.

Similarly, Subsection (3) states that if any published prospectus contains false statements made maliciously or deliberately and any person sustains any loss or damage by reason of his/her subscription of securities on the faith of that prospectus, the directors who have signed that prospectus shall be personally liable to pay compensation for the actual loss or damage so sustained.

A Director who resigns before the decision made by the company to publish the prospectus or whom on becoming aware of any false statement in the prospectus, publishes a notice of that matter to the information of the general public prior to the sale or allotment of securities or who proves that he/she did not know that the prospectus contained any false statement shall not be liable to bear such compensation.

Hence, Rita Pradhan by publishing a notice regarding false statement as stated above can be freed from her obligation.

1 c)

Issue:

Section 119 “Provision relating to removal of appointed auditor” of the Companies Act, 2063 mentions about the removal of appointed auditor. They are:

Section 119(1) states that no auditor appointed pursuant to this Act shall be removed pending the completion of audit of accounts of any financial year for which he/she was appointed as the auditor.

Section 119(2) states that if any auditor breaches the code of conduct of auditors or does any act against the interest of the company which has appointed him as the auditor or commits any act contrary to the prevailing law, such auditor may be removed through the same process whereby he/she was appointed as auditor, by giving prior information to the Nepal Chartered Accountants Institute, and with the approval of the regulatory authority, if any authorized by the prevailing law for the regulation of business of the company concerned, and failing such authority, with the approval of the Office of Company Registrar.

Section 119(3) states that while removing an auditor with valid reasons, the auditor shall be provided with a reasonable opportunity to defend him/herself.

Conclusion:

Based on the above legal provisions the Plan of the Board of Directors of the National Ltd. to remove of auditor appointed for FY 2078-79, CA Expert Rawal on ground of issue of audit report with disclaimer opinion is not valid as per the provisions of the Provisions of the Companies Act, 2063.

1 d)

Section 29 (1) of the Companies Act, 2063 any company fulfilling the following conditions may, with the prior approval of the Office, issue shares at a premium:

a) The company has been making profits and distributing dividends for three consecutive years,
b) The company's net worth exceeds its total liabilities,
c) The company's general meeting has decided to issue shares at a premium.

Further, as per the sub section (2) of the section 29, where the shares are sold at a premium pursuant to Sub-section (1), a sum in excess of the face value, out of the proceeds thereof, shall be deposited in a premium account to be opened to that effect.

Sub section (3) of the section provides that the company may use the moneys in the account as referred to in Sub-section (2) in the following acts:

a) Paying up un-issued share capital to be issued to the shareholders as fully paid bonus shares,
b) Providing for the premium payable on redemption of any redeemable preference shares,
c) Writing off the preliminary expenses made by the company,
d) Bearing or reimbursing the expenses of, or the commission paid or discount allowed on, any issue of shares of the company.
   In making a request for approval of the Office to issue shares at a premium pursuant to Sub-section (1), the audited financial statements for three years shall be provided to the Office.

1 e)

Namaste telecom company wants to convert it into a private company, must proceed with Section 14 of the Companies Act, 2063. As this Section 14 under different clauses has stated the provisions for the conversion of a public company into a private company. Sub-section 1 of section 14 of this Act reads thus:

In the following circumstance, a public company shall be converted into a private company:

- If the number of shareholders of the public company becomes less than seven,
- If the public company fails to maintain its paid-up capital under section 11 or the paid-up capital as referred to in section 11 is not maintained because of reduction in capital pursuant to section 57. Provided, however, that this provision shall not apply to the company as referred to in sub-section (2) of section 11.

In the event of occurrence of a circumstance as reffered to in sub-section (1) above, the concerned public company shall make necessary amendments to its memorandum and articles of association and convert it into a private company within 6 months. After making the necessary amendments in the memorandum and articles, the company, within 30 days after the making of such amendment, shall make an application to the office of the Company Registrar (CRO) with the prescribed fees for being converted into a private company. The CRO on the receipt of an application shall mention in the company register the contents of conversion of such company into a private company and give a company conversion certificate with 60 days. Prusuant to section 14 (5) of this Act, all the assets and liabilites of the public company so converted shall devolve on the successor Namaste Pvt. Ltd. Company.

2. Answer the following questions: **(3×5=15)**

a) Taranath Rai was appointed as a director of Nepal Rastra Bank for the term of 4 years. An application filed to the ministry of finance to remove the director as he was expelled from the post of CEO of Dharan Bikas Bank 5 years back in a charge of over valuation of security that was resulted huge loss to the bank. The ministry wants your opinion to the following matters:

i) What are the conditions when a director of Nepal Rastra Bank can be removed?

ii) Can he be removed from his post on the above ground?

b) Mr. Shisir Chand is appointed as the Auditor of Manaslu Bank Ltd, as he has been appointed as Auditor of the Bank for first time. He asked you what are the matters that he should include in his Auditor's Report as per Bank and Financial Institution Act ,2073.

c) Mr. Dhakal has spent five years working as the CEO of a Nepal Commercial Bank Ltd. He learned that NRB offers the bank this kind of loan and refinancing. You are serving as an economic advisor there. Make recommendations about the Nepal Rastra Bank Act, 2058 of lending and refinancing provisions.

Answer:

2 a) i

Pursuant to Section 22(1) of the Nepal Rastra Bank Act,2058 the Government of Nepal, the Council of Ministers shall remove the Governor, Deputy Governor and Director on conditions stipulated under Section 22(5) which provides that the Governor, Deputy Governor and Director shall be removed from the office on any of the following grounds:-

1. If one is disqualified to become a Director pursuant to section 21.
2. The lack of capability to implement or cause to implement the functions which the Bank has to carry out in order to achieve the objectives of the Bank under this Act.
3. If one has committed any act causing loss and damage to the banking and financial system of the country.
4. If one is found to have acted dishonestly or with mala-fide intention in any transaction related to the business of the Bank.
5. If professional license is revoked or prohibited from carrying out any profession rendering disqualified to be engaged in any trade or profession on the ground of gross misconduct.
6. If one is absent for more than three consecutive meeting of Board without a genuine reason.

ii.

As the act and punishment before the appointment is not a ground to remove the Governor, Deputy Governor and Director as per Section 22(5) as mentioned above, the Government of Nepal cannot remove Taranath from his post.

2 b)

As per the section 66 (3) of Bank and Financial Institution Act 2073 the auditor shall have to include the following matters in his/her report clearly:-

(a) Whether or not replies to the queries as per the demand were provided,

(b) Whether or not the balance sheet, off-balance sheet transactions, profit and loss account, cash flow statement and other financial statements, as well, have been prepared in such format and in accordance with such procedures as prescribed by the Rastra Bank, and whether or not they actually matched with the accounts, records, books and ledgers maintained by the bank and financial institution,

(c) Whether or not the accounts, records, books and ledgers have been maintained accurately in accordance with prevailing laws,

(d) Whether or not any official of the bank or financial institution has committed any act contrary to the prevailing laws or committed any irregularity or caused any loss or damage to the bank or financial institution,

(e) Whether or not credits have been written off as per the Credit Write-off Byelaws or directives of the Rastra Bank,

(f) Whether or not the transactions of the bank or financial institution have been carried on in a satisfactory manner as prescribed by the Rastra Bank,

(g) Matters to be informed to the shareholders,

(h) Matters prescribed by the prevailing laws and other matters as prescribed by the Rastra Bank to be mentioned in audit report by the auditor,

(i) Other suggestions which the auditor deems necessary to be furnished.

2 c)

NRB is a banker of the bank. It inspects and supervises the mobilization of financial resources whether it has collected through public or from loan and refinance or its promoters. As this matter is concerned, NRB may make available loan and refinance to commercial bank and financial institution under the provision of section 49 of NRB Act. The provision is as follows:

(1) The Bank may, subject to the terms and conditions prescribed by it, make available loan and refinance to commercial banks and financial institutions for a maximum period of one year against the security of the following assets:

(a) International negotiable instrument referred to Section 66 (1) (e);

(b) The debt bond issued by Government of Nepal payable within Nepal;

(c) The deposits accumulated in the Bank or the gold and precious metals, which the Bank may transact under this Act;

(d) The bill of exchange or the promissory notes referred to Section 48 (1);

(e) Other securities as prescribed.

(2) Notwithstanding anything contained in Sub-section (1) of the Bank may provide any type of credit to a commercial bank and financial institution for a maximum period of one year in cases where Government of Nepal has, for the sake of public interest and welfare, deemed it appropriate to provide loan and has requested the Bank therefore and Government of Nepal has given a guarantee of securities of prevailing market rate for such loan or in extraordinary circumstances where the Bank has to work as a lender of the last resort.

(3) Loan, as provided in accordance with the provision of sub section (1) or (2), shall be renewed for the period of One-year subject to the terms and conditions prescribed by it.

3. Answer the following questions: **(2×5=10)**

a) No person will operate or cause to operate the insurance business without obtaining a certificate pursuant to the Insurance Act, 2049. Thus, who is interested to carry out insurance business it is mandatory to obtain license from the concerned authority. State the conditions when the registration of an insurer may be cancelled as per the Insurance Act, 2049?

b) Now a day's Security Market is gaining popularity among the people of Nepal. A group of young graduates are willing to start securities business in Nepal. The group approaches you to advise them in following matters:
If there is any obligation to obtain license to carry on securities business, if yes from which entity and what are the matters to be specified while giving application for license to carry on securities business? Explain with reference to securities Act, 2063.

Answer:

3a)

Section 13 of the Insurance Act, 2049 prescribes the provision regarding the cancellation of the Registration of an Insurer.

(1) According to it the Board may cancel the registration of an Insurer by providing a written notice with effect from the date prescribed in the same notice in the following circumstances:

(a) If the Insurance Business is not started within six months from the date of obtaining the certificate,
(b) If it is felt that the liability of the Insurer exceeds its assets within Nepal,
(c) If the Insurer could not fulfill the liability pursuant to the decision within three months from the date of final decision of the court in the case filed under the Insurance Policy issued within Nepal,
(d) If the head office of the Insurance Business of any foreign Insurer is situated outside Nepal and in case it is felt that Nepalese Insurer has not obtained equal facilities there which are enjoyed by the foreign Insurer pursuant to the prevailing law of such country,
(e) If the Insurer does not open its office inside Nepal,
(f) If the Insurer does not perform the functions to be performed or has performed any functions which is not to be performed pursuant to this Act or the Rules made under this Act.

(2) Before canceling the registration of an Insurer pursuant to Subsection (1), the Board shall provide a reasonable time-limit to submit clarification to the concerned Insurer, stating the reasons for canceling its registration.
(3) If the concerned Insurer does not submit its clarification within the time period mentioned in Sub-section (2) or in case the clarification submitted by it is found not to be satisfactory, the Board shall cancel the registration of such Insurer pursuant to Sub-section (1), and shall publish a notice in two major newspapers to be published Nepal for the information public in general.
(4) Mere cancellation of the registration of an Insurer pursuant to this Section shall not make any effect to the rights and liabilities of the concerned Insurer regarding to any action taken or functions performed before the cancellation.

3b)

According to Section 56 of the Securities Act, 2063 A company or body desirous of carrying on securities business has to obtain license to carry on securities business from the Securities Board under the Securities Act, 2063. No one shall carry on securities business without obtaining license from the Board.
As per Section 57 institution desirous of carrying on dealing in securities has to make an application with the required documents and fees as prescribed. Matters to be provided at

the time of making an application to the board for carrying securities dealing business, are as follows:

i. Type of securities business and services to be provided;
ii. If an agent is to be appointed to carry on securities business and if such business is to be carried on in collaboration with others, matters pertaining thereto;
iii. In the case of those business persons, as prescribed, who are allowed to carry on business only upon obtaining a membership of a stock exchange, a recommendation letter of the concerned stock exchange; and
iv. Grounds proving the ability to carry on the proposed securities business and such other information as may be specified by the board.

4. Answer the following questions: **(2×5=10)**

a) Employees of Barahi Motors Ltd. demanded for bonus in advance which was refused by the manager and asked the board of directors to handle the matter. As no balance sheet and statement of profit and loss accounts have been prepared, the board became unable to decide the matter. Give your advice stating the provisions of the Bonus Act, 2030.

b) What are the deductions allowed from the remuneration to be obtained by the workers or employees as per the Labour Act, 2074?

Answer:

4a)

Section 11 of the Bonus Act, 2030 prescribes the provisions regarding the distribution of bonus in Advance. Sub-clause (1) states that if any enterprise fails not submit the balance-sheet and statement of profit and loss of such enterprise within the time limit as provided in sub-clause (1) of section 4, or if bonus could not be distributed within the time limit of Section 9 by the reasons of inquiry or examination conducted by the concerned Labor Office on the balance sheet and statement of profit and loss submitted pursuant to Sub-section (2) of Section 4, the management of such enterprise, after making tentative computation, shall have to distribute at least five percent of the net, income as bonus.

Similarly, Sub-section (2) provides that after preparation of balance sheet and statement of profit and loss or after final assessment is made in this matter. It the amount of bonus distributed pursuant to the Sub-section (1) is found less than the amount to be distributed as bonus, the difference amount shall have to be redistributed to the employees proportionately having considered previously distributed amount.

Finally, Subsection (3) has provide further that if the amount, distributed as bonus is found excess to the amount assessed for distribution of bonus under Sub-section (2), the excess amount, whatever may be, shall be deducted for recovery it, while assessing the net income of the enterprise in the next fiscal year.

4b)

As per section 38 of Labor Act, 2074, the remuneration of workers or employees shall not be deducted except under the following circumstances:

(a) Any tax, fees leviable under law,
(b) Any amount of contribution required to be made for provident fund or insurance or any other social security,
(c) Any amount required to be deducted pursuant to the order or decision by any judicial or quasi-judicial body or arbitration,
(d) Such amount as prescribed for such service or facility provided by the employer to the labour as prescribed,

(e) Amount of remuneration for the period during which the labour remains absent from the work,

(f) In the event of loss of or damage to cash or in-kind of the employer with ulterior motive or recklessly, such amount as mentioned in the cash or in-kind book or the amount equivalent to the production cost in the case of a manufactured good,

(g) Such amount as specified in the collective agreement to be deductible from remuneration,

(h) Membership fee chargeable by the trade union,

(i) Amount of loan or advance provided or paid to the labour by the employer.

5. Answer the following questions: **(2×5=10)**

a) State the circumstances where a councilor may cease from his post and how such vacant post is fulfilled pursuant to the Nepal Chartered Accountants Act, 2053.

b) What do you mean by “Certificate of Practice (COP)? Why it is required? Explain with reference to the provisions of Nepal Chartered Accountants Act, 2053.

Answer:

5 a)

Pursuant to Section 8 (1) of the Act, a councilor shall cease to hold his/her office in any of the following circumstances:

(a) If the councilor ceases to be a member of the Institute.

(b) If resignation tendered by the councilor from his/her office is accepted by the Council.

(c) If the councilor absents himself or herself from three consecutive meetings of the Council without giving a notice with reason to the Council.

(d) If the term of office of the councilor expires.

(e) If it is proved that the councilor has not abided by the conduct referred to in Section 34.

(f) If he dies.

Vacancy and fulfillment: Where the remaining term of office of any councilor elected whose office has become vacant due to his/her death or resignation or being disqualified to be a member of the Institute pursuant to the provisions of this Act, is less than One year, the Council shall designate as the council and where such term is more than One year, the vacancy shall be filled by way of election.

5b)

Section 2(j) of Nepal Chartered Accountants Act, 2053 defines the Certificate of Practice (COP)

"Certificate of Practice (COP)" means the certificate issued pursuant to section 28, to render accounting profession.

Section 28 of Nepal Chartered Accountants Act, 2053 states that "Certificate of Practice (COP)"

(1) Member willing to carry out audit profession shall make an application, in a prescribed format, for Certificate of Practice, along with the prescribed fees, to the Institute.

(2) The Council, prescribed that the applying member as per sub-section (1), has fulfilled all conditions prescribed by the Council, shall provide a Certificate of Practice, in a prescribed format, to such member.

(3) The Council shall ensure that the members observe or shall cause to observe conditions prescribed for members holding Certificate of Practice may prescribe Code of Conduct for such member.

Without getting certificate of practice from the Institute no member of the Institute shall carry out the accounting profession. Therefore, certificate of practice is required to member to comply the provisions contained in Nepal Chartered Accountants Act, 2053 to carry out the accounting profession.

6. Answer the following questions: **(5×4=20)**
   a) State the legal provisions as to the fund and the account and auditing of the Social Welfare Council.
   b) Mention the provision related to mitigation of adverse effect on environment as per Industrial Enterprises Act, 2076.
   c) Under what circumstances, the registration certificate of insurers cannot be renewed. Explain in the light of relevant provisions of the Insurance Act, 2049.
   d) Highlight the legal provisions relating to the lay off period and remuneration thereof under the Labour Act, 2074.
   e) State some major functions of WTO.

Answer:

6a)

Fund is an essential to achieve the objective of the council. All money of the Council shall be deposited by opening an account in the name of the Council in Nepal Rastra Bank or any Commercial Bank. All expenditure of the Council shall be borne from the fund. The operation of the account of the Council shall be as prescribed and its fundamental objective is to use the fund in transparent and wise manner. Pursuant to Section 17 of the Act, the Council shall have own separate fund and the fund shall contain the following money:

- Money received from Government of Nepal.
- Money received from foreign Governments, international organizations or foreign organizations, through Government of Nepal.
- Money received from the movable or immovable property of the Council.
- Money received from any individual, institutions or countries in the form of donation, assistance, grants and presents.
- Money received from any other sources.

According to Section 18 of the Social Welfare Act, 2049,the account of the Council shall be maintained in accordance with the procedures accepted by Government of Nepal. Pursuant to Subsection (2), the Audit of the Council shall be carried by the Office of the Auditor General.

As per Subsection (4),the Government of Nepal, if it so wishes, may inspect or cause to inspect the accounts document along with cash and kind of the council at any time.

Further, Subsection (5) empowers the Council to inspect or cause to inspect the accounts document along with cash and kind of the social organization and institutions affiliated with the Council at any time if it so wishes. Account and auditing of the social organizations, affiliated with the council shall be as prescribed.

6b)

Section 7 “Adverse effects on environment to be mitigated” of the Industrial Enterprises Act, 2076 mentions the provision to mitigate the adverse effect on the environment. They are as follows :

Section 7(1) states that if an industry registered under Section 5 “Industry registration certificate to be given” is required to carry out environmental impact assessment or initial environmental examination under the prevailing law, it shall commence its establishment, operation, commercial production and transaction only after the approval of a report on such assessment or examination.

Section 7(2) states that notwithstanding anything contained in subsection (1), environmental impact assessment or initial environmental examination shall also be carried out if so required under the prevailing law when an industry needs to increase its capital or capacity, add or change its objective, change its location or transfer it to another place.

Section 7(3) states that the concerned industry shall be responsible for mitigating adverse environmental effects caused or likely to be caused on the environment in the course of its operation.

Section 7(4) states that the industry registration body may, as required, monitor whether environmental effects are mitigated under this section and give a direction, take action or recommend the concerned body for action.

Section 7(5) states that an industry which is not required to carry out environmental impact assessment or initial environmental examination when making application for its registration, shall make a self-declaration, accompanied by the reasons and grounds for not requiring to carry out such assessment or examination, that it will take necessary measures to mitigate possible adverse effects on the environment from the establishment and operation of the industry.

6c)

Section 11A of Insurance Act, 2049 mentions few circumstances that can lead to non-renewal of certificate of registration of an insurer. These circumstances are as follows:

a) In case it doesn't submit the balance sheet according to section 23
b) in case it doesn't submit the statement of income according to section 24
c) In case it doesn't submit auditor's report according to section 25
d) In case it doesn't submit the actuary's report according to section 26
e) In case it doesn't pay the insurance service fee according to section 40
f) In case it has been prohibited from engaging in the insurance business according to section 12A.

In case the certificate of registration of an insurer cannot be renewed because of any of the circumstances mentioned in the above, the Board shall notify the insurer accordingly within 15 days from the date of emergence of such circumstances.

6d)

Lay off period: During the operation of an industry, under Section 15 of the Act, the employer may stop the work and lay off workers in case any special situation occurs because of shortage of electricity, water, raw material or lack of fund or inability to reach the workplace or work or operate the workplace because of any situation beyond control.
As per Sub-section (2) of Section 15 the employment relationship between the employer and workers shall continue during the lay off period. Any employer employing ten or more than ten workers may lay off workers for a period maximum of fifteen days. In case, there is a need to lay off the workers for more than fifteen days, the employer shall be required to consult the authorized trade union or labor Management Committee.

Remuneration for layoff period: The Act has provided the provision for the remuneration of the workers kept under the layoff period. Under Section 39 of the Labor Act, 2074, the workers who are laid off pursuant to this Act, shall be paid half of their remuneration which they are entitled to until the work is resumed by the employer. Provided that such workers shall not be required to give attendance in the workplace during the layoff period unless the requirement of attendance is mentioned in the notice issued relating to the layoff.

6e)

Among the various functions of the WTO, basically, it oversees the implementation, administration and operation of the covered agreements and provides a forum for negotiations and for settling disputes. Additionally, it is WTO's duty to review and propagate the national trade policies, and to ensure the coherence and transparency of trade policies through surveillance in global economic policy-making. Another priority of the WTO is the assistance of developing, least-developed and low-income countries in transition to adjust to WTO rules and disciplines through technical cooperation and training. In general, the functions of WTO are given as follows :-

- The WTO shall facilitate the implementation, administration and operation and further the objectives of this Agreement and of the Multilateral Trade Agreements, and shall also provide the framework for the implementation, administration and operation of the multilateral Trade Agreements.
- The WTO shall provide the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreement in the Annexes to this Agreement.
- The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes.
- The WTO shall administer Trade Policy Review Mechanism.
- With a view to achieving greater coherence in global economic policy making, the WTO shall cooperate, as appropriate, with the international Monetary Fund (IMF) and with the International Bank for Reconstruction and Development (IBRD) and its affiliated agencies.

7. write short notes: **(2×5=10)**

   a) Establishment of the Nepal Securities Board.

   b) Promissory Note - as per Negotiable Instruments Act, 2034.

Answer:

7a)

1. Nepal Securities Board has been established by under section 3 of the Securities Act, 2063. It is established in order to regulate and manage the activities of the securities markets and persons involved in securities business by regulating the issue, purchase sale and exchange of securities in order to develop capital market and protect the interests of investors in securities.

2. The Board shall consist the members as follows:
   a. A person appointed by the Government of Nepal – Chairperson
   b. Joint Secretary, Ministry of Finance – Member
   c. Joint Secretary, Ministry of Law, Justice and Parliamentary Affairs – Member
   d. Representative, Nepal Rastra Bank – Member
   e. Representative, Institute of Chartered Accountants of Nepal – Member
   f. Representative, Federation of Nepalese Chambers of Commerce and Industries – Member
   g. A person nominated by the Government of Nepal from amongst the experts who have obtained at least master's degree in economics, management, finance, commerce or law form a recognized university and gained at least seven years of experience in stock exchange, management, capital market development, finance and economic sector – Member

3. The concerned organization shall, in nominating its representative pursuant to Clauses (e) and (f) above, nominate a person who has obtained at least bachelor's degree and gained at least seven years of experience in accounts, industry, commerce, finance, banking, economics or law matters.
4. The tenure of office of the member nominated pursuant to clause (g) above shall be three years.

5. No act or proceeding of the Board shall be affected merely on the reason of any vacancy in office of any member.
6. An officer employee designated by the Board shall act as the Secretary of the Board.
7. If the Board thinks it necessary, it may invite any native or foreign expert, adviser to attend its meeting as an observer.
8. The central office of the Board shall be situated in Kathmandu Valley; and the Board may, as required, open its branch or contact office within or outside of Nepal.

7b)

Section 2(f) of the Negotiable Instrument Act, 2034 has defined the term as "Promissory Note" means an instrument in writing except government or Bank note containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to, or to the order of, a certain person or to the bearer of the instrument.

Provided that this word shall not include the document prepared pursuant to the chapter 15 of part 4 of National Civil Code 2074.

This instrument should satisfy the elements of writing, express promise, unconditional, money only, must be authorized with signature by the maker and certainty of the parties whether certain person or bearer. In this document, parties are certain and should indicate in the face of the instrument. Generally, two parties i.e. maker the person who makes the note and is known as the maker, and payee- to whom the promise is made, are involved in the promissory note.

Therefore, promissory note, is, a written instrument prepared by the maker for the fulfillment of own promise to pay certain sum of money to the certain person or bearer without condition.

Examiner's Commentary on Students' Performance in December 2022 Examinations

Paper 1: Advanced Accounting

List of Questions	**Specific Comments on the Performance of the Students**
Question no. 1	Overall performance of the student was poor. Students were not able to obtain Goodwill Valuation, Cash Balance . Majority of the students answered profit and loss account correctly.
Question no. 2	Most of the students attempted the question of Amalgamation. The calculation of Purchase consideration was straight forward but students were providing much more unnecessary information to calculate purchase consideration.
Question no. 3	Majority of the students were not able to calculate correct gross profit and Net profit. Part(b) was correctly answered by majority students.
Question no. 4	Majority of the students were unable to calculate share capital, turnover calculation of current assets.
Question no. 5	Majority of the students were unable to attempt part (a), (b) was correctly answered. In part (c) few students did not have clarity on the question hence performance was poor.
Question no. 6	Majority students answered short notes but not able to answer precisely.

Paper 2: Audit and Assurance

List of Questions	**Specific Comments on the Performance of the Students**
Question no. 1	a. Most of the students did not refer to NSA 570 "Going Concern" that required auditor to assess event and condition if they cast significant doubt on Going Concern. b. It was wrongly linked to event after Balance Sheet date in most of the cases. c. Students' conclusion was wrong in most of the case.
Question no. 2	Satisfactory performance
Question no. 3	a. Students knew the answer, but precise answer was missing in most of the cases. b. Types of error was missing in half of the answer sheet. c. Well performed by students.
Question no. 4	Understanding of Code of Ethics was there but precise answer was missing.
Question no. 5	a. Students either answered from Auditor General perspective or from Public Company Perspective. Very few linked responsibilities of both in case of Company where GON have substantial investment. b. Answers were not precise and lack of understanding.
Question no. 6	Satisfactory performance
Question no. 7	Satisfactory performance.

Paper 3: Corporate and Other Laws

List of Questions	**Specific Comments on the Performance of the Students**
Question no. 1	Satisfactory performance
Question no. 2	Answers were not exact and precise. They answered the question with common understanding.
Question no. 3	They were failed to mention the legal provision in a satisfactory manner as they have not gone through these laws and confused.

Question no. 4	Satisfactory performance
Question no. 5	Almost all were failed to explain the COP and it's need. First part of 5(a) was answered in proper way.
Question no. 6	Satisfactory Performance.
Question no. 7	Only few of them attempted in right way the question 7(a) and majority of the students failed to answer 7(b).