

# **CHARTERED ACCOUNTANCY PROFESSIONAL II (CAP-II)**

## **Revision Test Paper**

### **Group I**

**June 2023**



## **The Institute of Chartered Accountants of Nepal**

The Revision Test Papers are prepared by the institute with a view to assist the students in their study. The suggested answers given here are indicative and not exhaustive. Students are expected to apply their knowledge and write the answer in the examinations taking the suggested answers as guide. Due care has been taken to prepare the revision test paper. In case students need any clarification, creative feedbacks or suggestions for the further improvement on the material, or any error or omission on the material, they may report to the email of the Institute.

## Contents

<b>Paper 1: Advanced Accounting .....</b>	<b>3</b>
<b>Paper 2: Audit and Assurance .....</b>	<b>42</b>
<b>Paper3: Corporate and Other Laws.....</b>	<b>63</b>

# **Paper-1**

## **Advanced Accounting**

### Hire Purchase Transactions

1. Shankar bought 2 cars from Auto Motors Pvt. Ltd. on 01.04.2076 on the following terms (for both cars):

Down payment	6,00,000
1 <sup>st</sup> Instalment at the end of first year	4,20,000
2 <sup>nd</sup> Instalment at the end of 2nd year	4,90,000
3 <sup>rd</sup> Instalment at the end of 3rd year	5,50,000

Interest is charged at 10% p.a.

Shankar provides depreciation @ 25% on the diminishing balances.

On 32.03.2079 Shankar failed to pay the 3rd instalment upon which Auto Motors Pvt. Ltd. repossessed one car. Shankar agreed to leave one car with Auto Motors Pvt. Ltd. and adjusted the value of the car against the amount due. The car taken over was valued on the basis of 40% depreciation annually on written down basis. The balance amount remaining in the vendor's account after the above adjustment was paid by Shankar after 3 months with interest @ 20% p.a.

You are required to:

- Calculate the cash price of the cars and the interest paid with each instalment.
- Prepare Cars Account in the books of Shankar assuming books are closed on Ashadh end, every year.

Figures may be rounded off to the nearest rupee.

### Branch Accounting

2. ABC Ltd. has its head office at Kathmandu and two branches at Pokhara and Gorkha. The branches purchase goods independently. Pokhara branch makes a profit of one third on cost and Gorkha branch makes a profit of 20% on sales. Goods are also supplied by one branch to another at the respective sales price. From the following particulars, prepare the Trading and Profit and Loss Account of Pokhara branch and find out the profit or loss made by it considering the reserve for unrealised profits:

Particulars	Pokhara Branch (Rs.)	Gorkha Branch (Rs.)
Opening Stock	40,000	30,000
Purchases (including Inter branch transfers)	200,000	250,000
Sales	280,000	295,625
Chargeable expenses	15,000	27,500
Closing Stock	30,000	43,500
Office and Administration Expenses	13,250	7,000
Selling and Distribution Expenses	15,000	10,000

Information:

- Opening stock at Pokhara Branch includes goods of Rs.10,000 (invoice price) taken from Gorkha Branch,
- Opening stock at Gorkha Branch includes goods of invoice price Rs. 17,000 taken from Pokhara Branch,

- iii. The Pokhara Branch sales includes transfer of goods to Gorkha Branch at selling price Rs. 20,000
- iv. The sales of Gorkha Branch include transfer of goods to Pokhara Branch at selling price Rs.15,000.
- v. Closing stock at Pokhara Branch includes goods received from Gorkha Branch (invoice price Rs.5,000.
- vi. Closing stock at Gorkha Branch includes goods of Rs. 4,000 (invoice price).

### Departmental Accounts

3. Ace Ltd. has a factory which has two manufacturing departments X and Y. Part of the output of X Department is transferred to Y Department for further processing and the balance is directly transferred to the Selling Department. The entire production of Y Department is transferred to the Selling Department.

Inter-Departmental stock transfers are made as follows:

X Department to Y Department at 33 1/3% over department cost.

X Department to Selling Department at 50% over department cost.

Y Department to Selling Department at 25% over department cost.

The following information is given for the year ended 31st March, 2022:

Particulars	Department X		Department Y		Selling Department	
	Quantity (MT)	Amount (Rs.)	Quantity (MT)	Amount (Rs.)	Quantity (MT)	Amount (Rs.)
Opening Stock	60	600,000	20	40,000	50	145,000
Raw Material Consumption	90	1,000,000	20	20,000		
Labour Charge		50,000		80,000		
Sales						500,000
Closing Stock	30		50		60	

Out of the total production in X. Department, 30 MT were for transfer to the Selling Department, Apart from these stocks which were transferred during the year, the balance output and the entire opening and closing stocks of X Department were for transfer to Y Department. The per tonne material and labour consumption in X Department on production to be transferred directly to the Selling Department is 300 per cent of the labour and material consumption on production meant for Y Department. The Administrative and Office Expenses totalled Rs. 1,65,000.

Prepare Departmental Profit and Loss accounts and the General Profit and Loss Account.

### Insurance Claims for Loss of Stock and Profit

4. On 02.06.2079, there occurred a fire in the warehouse of Mr. Rabin and his total stock was destroyed by fire. However, following information could be obtained from the records saved:

	Rs.
Stock at cost on 01.04.2078	1,080,000
Stock at 90% of cost on 31.03.2079	1,296,000

Purchases for the year ended 31.03.2079	5,160,000
Sales for the year ended 31.03.2079	7,200,000
Purchases from 01.04.2079 to 02.06.2079	1,800,000
Sales from 01.04.2079 to 02.06.20719	3,840,000

Sales till 02.06.2079 includes Rs.6,00,000 (invoice price) being the goods not dispatched to the customers. Purchases till 2.6.2079 includes a machinery acquired for Rs.1,20,000. However, it does not include goods worth Rs. 2,40,000 received from suppliers, as invoice not received up to the date of fire. These goods have remained in the godown at the time of fire. The insurance policy is for Rs. 9,60,000 and it is subject to average clause.

You are required to ascertain the amount of claim for loss of stock applying average clause.

### Investment Accounts

- Asha Ltd. purchased 5,000, 13.5% Debentures of Face Value of Rs.100 each of Panchkanya Ltd. on 1st May 2022 @ Rs. 105 on cum interest basis. The interest on these instruments is payable on 31st & 30th of March & September respectively. On August 1st 2022 the company again purchased 2,500 of such debentures @ Rs. 102.50 each on cum interest basis. On October 1st, 2022 the company sold 2,000 Debentures @ Rs. 103 each on ex-interest basis. The market value of the debentures as at the close of the year was Rs. 106.

You are required to prepare the Investment in Debentures Account in the books of Asha Ltd. for the year ended 31st Dec. 2022 on Average Cost Basis.

### Accounting for Bonus Share

- Following is the information of Chirag Ltd. as at 31st Ashadh 2078:

Particulars	Rs.
Authorized Capital	
30,000 12% Preference share of Rs.10 each	300,000
400,000 Equity shares of Rs.10 each	4,000,000
	4,300,000
Issued and Subscribed capital:	
24,000 12% Preference share of Rs.10 each fully paid	240,000
300,000 Equity shares of Rs.10 each, Rs.8 paid up	2,400,000
Reserves and surplus:	
General Reserve	360,000
Capital Redemption Reserve	120,000
Securities premium (collected in cash)	75,000
Profit and Loss account	600,000

On 1st Shrawan 2078, the Company has made final call @ Rs. 2 each on 3,00,000 equity shares. The call money was received by 20th Shrawan, 2021. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.

You are required to prepare necessary journal entries in the books of the company.

### Underwriting of Shares

7. Kamana Ltd. issued 1,20,000 Equity Shares which were underwritten as follows:

A & Co	72,000 Equity Shares
B & Co.	30,000 Equity Shares
C& Co.	18,000 Equity Shares

The above mentioned underwriters made applications for 'firm' underwritings as follows:

A & Co	9,600 Equity Shares
B & Co	12,000 Equity Shares
C& Co.	3,600 Equity Shares

The total applications excluding 'firm' underwriting, but including marked applications were for 60,000 Equity Shares.

The marked applications were as under:

A & Co	12,000 Equity Shares
B & Co.	15,000 Equity Shares
C& Co.	6,000 Equity Shares

The underwriting contracts provide that underwriters be given credit for 'firm' applications and that credit for unmarked applications be given in proportion to the shares underwritten. You are required to show the allocation of liability. Workings will be considered as part of your answer

### Preparation of Financial Statements

8. Mr. Bikram runs a wholesale business where all purchases and sales are made on credit. He furnishes the following closing balances:

Particulars	31-03-2078	32-03-2079
	Rs.	Rs.
Sundry Debtors	70,000	92,000
Bills Receivable	15,000	6,000
Bills Payable	12,000	14,000
Sundry Creditors	40,000	56,000
Stock	110,000	190,000
Bank	90,000	87,000
Cash	5,200	5,300

Summary of the Cash Transactions during the year 2078/79:

- Deposited to bank after payment of shop expenses @ Rs. 600 p.m.; wages @ Rs. 9,200 p.m. and personal expenses @ Rs. 1,400 p.m. Rs. 762,750
- Withdrawals Rs. 121,000
- Cash Payments to suppliers Rs. 77,200 for suppliers and Rs. 25,000 for Furniture.
- Cheques collected from customers but dishonoured Rs. 5,700
- Bills accepted by the customers Rs. 40,000
- Bills endorsed Rs. 10,000

- vii) Bills discounted Rs. 20,000 and discount Rs. 750
- viii) Bills Matured and duly collected Rs 16,000
- ix) Bills Accepted Rs. 24,000
- x) Paid to suppliers by cheque Rs. 320,000
- xi) Received Rs. 20,000 on maturity of one Life Insurance Policy of Mr. Bikram by Cheque.
- xii) Rent received Rs. 14,000 by cheque.
- xiii) A Building was purchased on 30-02-2079 for opening a branch for Rs. 350,000 and some expenses were incurred the details of which are not maintained.
- xiv) Electricity and telephone bills paid by cash Rs. 18,700; due Rs. 2,200

**Other Transactions:**

- a) Claim against the firm for damage Rs.155,000 is under legal dispute. Legal expenses Rs. 17,000. The firm anticipates defeat in the suit.
- b) Goods returned to suppliers Rs. 4,200
- c) Goods returned by customers Rs. 1,200
- d) Discount offered by suppliers Rs. 2,700
- e) Discount offered to customers Rs. 2,400
- f) The business is carried on at the premises owned by Mr. Bikram. 50 % of the ground floor space is used for the business and rest 50 % space is let out for an annual rent of Rs. 20,000.

Prepare the Statement of Profit or Loss of Mr. Bikram for the year ended 32-03-2079 and the Financial Position as on that date.

**Amalgamation of Companies**

9. M Ltd. and N Ltd. give the following information of assets, equity and liabilities as on 31st Ashadh, 2078:

	<b>M Ltd. (Rs.)</b>	<b>N Ltd. (Rs.)</b>
Equity and Liabilities		
Equity Shares of Rs.10 each	30,00,000	9,00,000
9% Preference Shares of Rs.100 each	3,00,000	-
10% Preference Shares of Rs.100 each	-	3,00,000
General Reserve	2,10,000	2,10,000
Retirement Gratuity Fund (long term)	1,50,000	60,000
Trade Payables	3,90,000	2,40,000
<u>Assets</u>		
Goodwill	1,50,000	75,000
Land & Buildings	9,00,000	3,00,000
Plant & Machinery	15,00,000	4,50,000
Inventories	7,50,000	5,25,000
Trade Receivables	6,00,000	3,00,000
Cash and Bank	1,50,000	60,000

M Ltd. absorbs N Ltd. on the following terms:



- (i) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of M Ltd.
- (ii) Goodwill of N Ltd. on absorption is to be computed based on two times of average profits of preceding three financial years (2076-77: Rs. 90,000; 2075-76 : Rs.78,000 and 2074-75: Rs.72,000). The profits of 2074 -75 included credit of an insurance claim of Rs. 25,000 (fire occurred in 2073-74 and loss by fire Rs.30,000 was booked in Profit and Loss Account of that year). In the year 2075 -76, there was an embezzlement of cash by an employee amounting to Rs.10,000.
- (iii) Land & Buildings are valued at Rs. 5,00,000 and the Plant & Machinery at Rs. 4,00,000.
- (iv) Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%.
- (v) There was an unrecorded current asset in the books of N Ltd. whose fair value amounted to Rs. 15,000 and such asset was also taken over by M Ltd.
- (vi) The trade payables of N Ltd. included Rs. 20,000 payable to M Ltd.
- (vii) Equity Shareholders of N Ltd. will be issued Equity Shares @ 5% premium.

You are required to: (i) Prepare Realisation A/c in the books of N Ltd. (ii) Show journal entries in the books of M Ltd. (iii) Prepare the Balance Sheet of M Ltd. after absorption as at 31st Ashadh, 2078.

### Internal Reconstruction of a Company

10. Prabhu Limited decided to reconstruct its business as it has accumulated huge losses. The following is the Balance Sheet of the company as on 31.03.2078 before reconstruction:

**Balance Sheet as on 31.03.2078**

<b>Equity &amp; Liabilities</b>	<b>Rs.</b>	<b>Assets</b>	<b>Rs.</b>
6,00,000 Equity shares of Rs.10 each fully paid up	60,00,000	Patents	3,00,000
3,20,000, 6% Preference shares of Rs.10 each fully paid up	32,00,000	Land & building	34,00,000
6% Debentures (secured against land & building)	30,00,000	Plant & machinery	4,00,000
Bank overdraft	11,60,000	Investments (at cost)	4,40,000
Trade payables	24,00,000	Trade receivables	34,80,000
Provision for income tax	4,00,000	Inventory	34,00,000
		Profit & loss A/c	47,40,000
	<u>1,61,60,000</u>		<u>1,61,60,000</u>

Following scheme of reconstruction is approved by all interested parties and the Court:

- i. All equity shares are reduced to Rs.3 each and preference shares to Rs.7 each.
- ii. Debenture holders agreed to take over a part of land and building, book value of which is Rs.14,00,000, towards their 50% claim. Rate of interest of balance 50% debentures will be increased to 9%.
- iii. Patent will be written off.
- iv. 10% of Trade receivables to be provided for bad debts.

- v. Inventory to be written off by Rs.5,20,000.
- vi. 50% of balance Land & Building sold for Rs.12,00,000 and remaining Land & Building valued at Rs.12,00,000.
- vii. Investments to be sold for Rs.4,00,000.
- viii. The income tax liability of the company is settled at Rs.4,50,000. Provision for income tax will be raised accordingly.
- ix. 1/3 of trade payables decided to forgo their claim.
- x. After making all the above adjustments, balance amount available through scheme, will be utilized to write off the value of plant & machinery to that extent.

You are required to pass the necessary Journal Entries.

### Cash Flow Statement

11. Mr. Ram Kumar of IBN Private Limited has collected the following information for the preparation of cash flow statement for the year 2079:

	(Rs. in Lakhs)
Net Profit	25,000
Dividend (including dividend tax) paid	8,535
Provision for Income tax	5,000
Income tax paid during the year	4,248
Loss on sale of assets (net)	40
Book value of the assets sold	185
Depreciation charged to Profit & Loss Account	20,000
Amortisation of Capital grant	6
Profit on sale of Investments	100
Carrying amount of Investment sold	27,765
Interest income on investments during the year	2,506
Increase expenses	10,000
Interest paid during the year	10,520
Increase in Working Capital (excluding Cash & Bank Balance)	56,075
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and Bank balance	5,003
Closing cash and Bank balance	6,988

Prepare the Cash Flow Statement for the year 2079 with the given information.

### Accounting from Incomplete Records

12. The books of account of Mr. Manohar of Mumbai showed the following figures:

Particulars	31.03.2078	32.03.2079
Furniture & fixtures	260,000	234,000
Stock	245,000	320,000
Debtors	125,000	?
Cash in Hand	110,000	?
Creditors	135,000	190,000
Bills Payable	70,000	80,000
Outstanding salaries	19,000	20,000

An analysis of the cash book revealed the following:

Cash sales	1,620,000
Collection from debtors	1,058,000
Discount allowed to debtors	20,000
Cash purchases	615,000
Payment to creditors	973,000
Discount received from creditors	32,000
Payment for bills payable	430,000
Drawings for domestic expenses	120,000
Salaries paid	236,000
Rent paid	132,000
Sundry trade expenses	81,000

Depreciation is provided on furniture & fixtures @10% p.a. on diminishing balance method.

Mr. Manohar maintains a steady gross profit rate of 25% on sales.

You are required to prepare Trading and Profit and Loss account for the year ended 32nd Ashadh 2079 and Balance Sheet as on that date.

### Accounts of Insurance Companies

13. Compute saving amount to be transferred to Life Insurance Fund from the following information relating to Life Insurance Company for FY 2077/78:

Particulars	Rs. in Million
Premium Income	4,137.85
Re-insurance premium paid	210.90
Reinsurance Commission	19.63
Investment Income	3,456.27
Claim Payment (Net)	3,965.19
Agent Commission Payment	1,336.91
Medical fee	13.75

Management Expenses	1,068.44
Provision for income tax	Tax rate @ 30%
Transfer of profit on the Actuarial Valuation	547.67

### Partnership Account

14. Ram, Shyam and Laxman are in partnership sharing profit & loss equally. Interest on partner's capital and remuneration to partners not to be provided as agreed among partners. On 32nd Ashadh 2079 their Balance Sheet stood as follows:

Equity & Liabilities	Rs.	Assets	Rs.
Capital a/c:		Building	450,000
Ram	270,000	Plant and Machinery	90,000
Shyam	240,000	Furniture and Fittings	69,000
Laxman	240,000	Closing Stock	27,000
Current a/c – Ram	4,200	Sundry Debtors	60,600
Current a/c – Shyam	6,000	Cash at Bank	85,200
Sundry Creditors	24,600	Current a/c - Laxman	3,000
	784,800		784,800

On 31<sup>st</sup> Kartik, 2079 Ram died. According to the partnership deed, on the death of partner, the sum to be paid to his estate will be:

- the amount of his capital and current account balance at the end of last financial year.
- his share of profit for the relevant part of the year of death.
- his share of goodwill.

Goodwill is to be valued at two years purchase of the average profit of immediately preceding three accounting years.

The profit as per Books of Accounts were as follows:

For accounting year ended 31<sup>st</sup> Ashadh, 2076 Rs. 86,700

For accounting year ended 31<sup>st</sup> Ashadh, 2077 Rs. 143,200

For accounting year ended 31<sup>st</sup> Ashadh, 2078 Rs. 1,07,600

No goodwill account is to remain in the books after any change in the partnership's constitution. The stock value at 31<sup>st</sup> Kartik 2079 has been calculated and all other accounts balanced off, including provision for depreciation, accrued expenses and prepaid expenses.

This results in the following position of assets and liabilities at 31<sup>st</sup> Kartik 2079:

Particulars	Rs.	Particulars	Rs.
Building	450,000	Stock	33,000
Plant & Machinery (including addition of Rs.12,000)	97,700	Sundry Debtors	66,900
Furniture & Fixtures	66,700	Cash at Bank	101,100
		Sundry Debtors	29,400

There were no additions to, or reduction in the capital accounts during the four months, but the following drawings have been made by the partners:

Ram	Rs. 60,000
Shyam	Rs. 48,000
Laxman	Rs. 54,000

It has also been agreed that the share of deceased partner should be repaid in three equal instalments, the first payment being made on the day after the day of death.

On 1st Mangsir 2079, Ram's son Shankar was admitted in to partnership as a new partner and agreed that he would bring in to the business Rs. 1,20,000 as his capital together with a premium for his share of goodwill using the existing valuation.

The new profit sharing ratio Shyam: 2/5th, Laxman: 2/5th and Shankar: 1/5th.

You are required to prepare the partnership firm's Balance Sheet as at 1st Mangsir 2079, on the assumption that the above transactions have been completed by that date.

### Analysis and Interpretation of Financial Statements

15. Following is the summarised Balance Sheet of Mahendra Ltd. as on 32-03-2079.

Particulars	Rs.	Particulars	Rs.
Equity Shares of Rs. 10 each	10,00,000	Fixed Assets	20,00,000
10% Pref. Sh. of Rs.100 each	4,00,000	Investments	2,00,000
Reserves and Surplus	7,00,000	Closing Stock	2,00,000
15% Debentures	5,00,000	Sundry Debtors	4,60,000
Sundry Creditors	2,40,000	Bills Receivable	60,000
Bank Overdraft	1,60,000	Cash at Bank	60,000
		Preliminary Expenses	20,000
	<b>30,00,000</b>		<b>30,00,000</b>

Summarised Profit and Loss Account is as under for the year ending on 32-03-2079:

	Rs.
Sales (25% Cash sales)	80,00,000
Less: Cost of goods sold	56,00,000
Gross Profit	24,00,000
Net profit (Before interest and tax 50%)	9,00,000

Calculate the following ratios:

- (1) Rate on Return on Capital Employed
- (2) Proprietary Ratio
- (3) Debt-Equity
- (4) Capital gearing Ratio
- (5) Debtors Ratio (365 days of the year.)
- (6) Rate of Return on Shareholders' Funds
- (7) Rate of Return on Equity shareholders fund

### Pre and Post Incorporation Profit

16. The partnership of Sunrise Enterprise decided to convert the partnership into Private Limited Company named Sunrise Company Pvt. Ltd with effect from 1<sup>st</sup> Baishakh 2078. The consideration was agreed at Rs.11,700,000 based on firm's Balance Sheet as on 31<sup>st</sup> Chaitra 2078. However due to some legal procedures, the company could be incorporated only on 1<sup>st</sup> Shrawan 2078. Meanwhile, the business was continued on behalf of the company and the consideration was settled on that day with interest at 12% p.a. The same books of accounts were continued by the company, which closed its accounts for the first time on 32<sup>nd</sup> Ashadh 2079 and prepared the following summarized Profit and Loss Account:

Particulars	Rs. '000	Rs. '000
Sales		23,400
Cost of goods sold	16,380	
Salaries	1,170	
Depreciation	180	
Advertisement	702	
Discount	1,170	
Managing director's remuneration	90	
Miscellaneous office expenses	120	
Office cum showroom rent	720	
Interest	951	21,483
To profit		1,917

The company's only borrowing was a loan of Rs. 5,000,000 at 12% p.a. to pay the purchase consideration due to the firm and for working capital requirements. The company was able to double the monthly average sales of the firm from 1<sup>st</sup> Shrawan 2078, but the salaries trebled from the date. It has to occupy additional space from 1<sup>st</sup> Kartik, 2078 for which rent was Rs.30,000 per month. Prepare a statement showing apportionment of costs and revenue between pre incorporation and post incorporation periods and calculation of profit/loss for the period. Also, suggest how the pre-incorporation profits are to be dealt with.

### Accounting for Non-Profit Organization

17. Prepare an Income and Expenditure Account for the year ended 31st December, 2022, and Balance Sheet as on that date of Paropakar Hospital from the following Receipts and Payments Account and the information:

#### Receipts and Payments Account for the year ended 31 December, 2022

Receipts.	Rs.	Payments	Rs.
To Balance b/d		By Salaries : (Rs. 7,200 for 2021)	31,200
Cash 800		By Hospital Equipment	17,000
Bank 5,200	6,000	By Furniture purchased	6,000
To Subscriptions :		By Additions to Building	50,000

For 2021	5,100	By Printing and Stationery	2,400
For 2022	24,500	By Diet expenses	15,600
For 2023	2,400	By Rent and rates (Rs. 300 for 2023)	2,000
To Government Grant :		By Electricity and water charges	2,400
For building	80,000	By office expenses	2,000
For maintenance	20,000	By Investments	20,000
Fees from sundry patients	4,800	By Balances:	
To Donations (not to be capitalised)	8,000	Cash 1,400	
To Net collections from benefit shows	6,000	Bank <u>6,800</u>	8,200
	<b><u>1,56,800</u></b>		<b><u>1,56,800</u></b>

<b>Additional Information</b>	<b>Rs.</b>
Value of building under construction as on 31.12.2022	1,40,000
Value of hospital equipment on 31.12.2022	51,000
Building Fund as on 01.01. 2022	80,000
Subscriptions in arrears as on 31.12.2021	6,500
Investments in 8% Govt. securities were made on 1st July 2022	

### Accounting Standards

18. When reading the accounting policies note in the consolidated financial statements, the shareholder notice that company measures all of its freehold properties using a fair value model but that it measures its plant and equipment using a cost model. He further notices that both of these asset types are shown in the 'property, plant and equipment' figure which is a single component of non-current assets in the consolidated statement of financial position. It makes no sense to me that assets which are shown as property, plant and equipment are measured inconsistently. If it's OK to measure different parts of property, plant and equipment using two different measurement models, why not the company use the fair value model for the more readily accessible properties and use the cost model for the properties in remote locations to save on time and cost?
19. State with reason, as per NAS 10, how the following events would be dealt with in the financial statements of Kathmandu Limited for the year ended 32<sup>nd</sup> Ashadh 2079. Date of Board meeting for approving the accounts is 5<sup>th</sup> Bhadra, 2079:
- The Board of the directors of the Company has proposed dividend of Rs. 1 crore 15 lakhs on 4<sup>th</sup> Bhadra, 2079.
  - The Company has filed a legal suit against one debtor from whom Rs. 25 lakh is recoverable as on 31.3.2079. As per legal opinion received by the counsel on 25<sup>th</sup> Shrawan, 2079, the chances of recovery by way of legal suit are not good.
  - The cashier of the Company embezzled cash of Rs. 19 lakhs fraudulently in Chaitra 2078 and returned back Rs. 15 lakhs in Jestha, 2079. The same was detected on 5<sup>th</sup> Shrawan 2079.

**20. Write short notes on:**

- a. Neutrality of financial statements
- b. Other Comprehensive Incomes' as per NFRS.
- c. Accounting treatment of contingency gains
- d. Unexpired Risk Reserve



## Answers

### 1. Hire Purchase Transactions

(i) Calculation of Interest and Cash Price

No. of Instalments	Outstanding balance at the end after the payment of instalment	Amount due at the time of instalment	Outstanding balance at the end before the payment of the instalment	Interest	Outstanding balance at the beginning
(a)	(b)	(c)	(d)= (b)+(c)	(e)=(d)*10/110	(f)=(d)-(e)
3 <sup>rd</sup>	-	550,000	550,000	50,000	500,000
2 <sup>nd</sup>	500,000	490,000	990,000	90,000	900,000
1 <sup>st</sup>	900,000	420,000	1,320,000	120,000	1,200,000

Total cash price = Rs. 1,200,000+ 600,000 (down payment)  
= Rs. 1,800,000

(ii) In the books of Shankar

#### Cars Account

Date	Particulars	Rs.	Date	Particulars	Rs.
01.04.2076	To Auto Motors a/c	1,800,000	31.03.2077	By depreciation a/c	450,000
			31.03.2077	By balance c/d	1,350,000
		1,800,000			1,800,000
01.04.2077	To Balance b/d	1,350,000	31.03.2078	By depreciation a/c	337,500
			31.03.2078	By balance c/d	1,012,500
		1,350,000			1,350,000
01.04.2078	To Balance b/d	1,012,500	31.03.2079	By depreciation a/c	253,125
				By Auto Motors a/c [WN-1]	194,400
				By P/L a/c (loss transferred – b/f)	185,288
				By balance c/d $\frac{1}{2}*(1,012,500-253,125)$	379,687
		1,012,500			1,012,500

WN-1: Value of 1 car taken over

Value of 1 car taken over after depreciation for 3 years@ 40% p.a.)  
=900,000 -(360,000 + 216,000 +129,600)  
=194,400

## 2. Branch Accounting

### Pokhara Branch

#### Trading and Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To opening stock (including Rs.10,000 from Gorkha Branch)	40,000	By sales (including Rs.20,000 to Gorkha Branch)	280,000
To purchases	200,000	To closing stock (including Rs.5,000 from Gorkha Branch)	30,000
To chargeable expenses	15,000		
To gross profit	55,000		
	<u>310,000</u>		<u>310,000</u>
To stock reserve (for unrealized profit in closing stock lying at Gorkha Branch) (Rs.4000*25/100)	1,000	By gross profit	55,000
To office and admin expenses	13,250	By stock reserve (for unrealized profit in Opening stock lying at Gorkha Branch)	4,250
To selling and distribution expenses	15,000		
To net profit	30,000		
	<u>59,250</u>		<u>59,250</u>

## 3. Departmental Accounts

### Departmental Profit and Loss accounts

Particulars	Dept. X		Dept. Y		Selling Department		Dept. X		Dept. Y		Selling Department	
	Qty. (MT)	Rs.	Qty. (MT)	Rs.	Qty. (MT)	Rs.	Qty. (MT)	Rs.	Qty. (MT)	Rs.	Qty. (MT)	Rs.
To opening stock	60	60,000	20	40,000	50	145,000	120	255,000	80	200,000		
To raw materials consumed	90	100,000	20	20,000			30	30,000	50	100,000	100	500,000
To labour charges		50,000		80,000							60	180,000
To stock transferred from Dept. X			90	120,000	30	135,000						
To Stock transferred from Dept. Y					80	200,000						
To Profit t/f to General Profit & Loss a/c		75,000		40,000		200,000						
	<u>150</u>	<u>285,000</u>	<u>130</u>	<u>300,000</u>	<u>160</u>	<u>680,000</u>	<u>150</u>	<u>285,000</u>	<u>130</u>	<u>300,000</u>	<u>160</u>	<u>680,000</u>

**General Profit or Loss Account**  
**for the year ended 31st March 2022**

Particulars	Rs.	Particulars	Rs.
To Administrative and office expenses	165,000.00	By profit from:	
To Stock reserve :		Dept X	75,000.00
Dept. Y	8,182.00	Dept Y	40,000.00
Selling Department	12,103.00	Selling Department	200,000.00
To Net profit	129,715.00		
	<b><u>315,000.00</u></b>		<b><u>315,000.00</u></b>

**4. Insurance Claims For Loss of Stock and Profit**

In the books of Mr. Rabin

**Trading Account for the year ended 32.3.2079**

Particulars	Rs.	Particulars	Rs.
To opening stock	1,080,000	By sales	7,200,000
To purchases	5,160,000	To closing stock	1,440,000
		(1,296,000*100/90)	
To gross profit	2,400,000		
	<b><u>8,640,000</u></b>		<b><u>8,640,000</u></b>

**Memorandum Trading Account**

**for the period from 01.04.2079 to 02.06.2079**

Particulars	Rs.	Particulars	Rs.
To opening stock at cost	1,440,000	By sales 3,840,000	3,240,000
		Less: Goods not dispatched	
		<u>600,000</u>	
To purchases 1,800,000	1,920,000	To closing stock (b/f)	1,200,000
Add: Goods received but invoice not received <u>240,000</u>			
2,040,000			
Less: Machinery <u>120,000</u>			
To gross profit (WN)	1,080,000		
	<b><u>4,440,000</u></b>		<b><u>4,440,000</u></b>

**Calculation of Insurance Claim**

Claim subject to average clause

= Actual loss of stock /Value of stock on the date of fire\* Amount of policy

= 9,60,000 x 12,00,000/12,00,000

= Rs.9,60,000

**Working Note:**

G.P. ratio =  $24,00,000 / 72,00,000 = 33.33\%$

Amount of Gross Profit =  $\text{Rs.}32,40,000 \times 33.33\% = \text{Rs.}10,80,000$

## 5. Investment Accounts

### In Books of Asha Ltd.

#### Investment in 13.5% Debentures in Panchkanya Ltd. Account

(Interest payable on 31st March & 30th September)

Date	Particulars	Nominal	Interest	Amount	Date	Particulars	Nominal	Interest	Amount
2022					2022				
May 1	To Bank	500,000	5,625	519,375	Sept 30	By Bank		50,625	
Aug 1	To Bank	250,000	11,250	245,000	Oct 1	By Bank	200,000		206,000
Oct 1	To P/L a/c			2,167	Dec 31	By Balance c/d	550,000	18,563	560,542
Dec 31	To P/L a/c		52,313						
		<u>750,000</u>	<u>69,188</u>	<u>766,542</u>			<u>750,000</u>	<u>69,188</u>	<u>766,542</u>

Note: Cost being lower than Market Value the debentures are carried forward at Cost.

**Working Notes:**

- Interest paid on Rs. 5,00,000 purchased on May 1st, 2017 for the month of April 2022, as part of purchase price:  $5,00,000 \times 13.5\% \times 1/12 = \text{Rs. } 5,625$
- Interest received on 30th Sept. 2022  
 $\text{On Rs. } 5,00,000 = 5,00,000 \times 13.5\% \times 1/2 = 33,750$   
 $\text{On Rs. } 2,50,000 = 2,50,000 \times 13.5\% \times 1/2 = \underline{16,875}$   
Total Rs. 50,625
- Interest paid on Rs. 2,50,000 purchased on Aug. 1st 2022 for April 2017 to July 2022 as part of purchase price:  
 $2,50,000 \times 13.5\% \times 4/12 = \text{Rs. } 11,250$
- Loss on Sale of Debentures  
Cost of acquisition  
 $(\text{Rs. } 5,19,375 + \text{Rs. } 2,45,000) \times \text{Rs. } 2,00,000 / \text{Rs. } 7,50,000 = 2,03,833$   
Less: Sale Price  $(2,000 \times 103) = 2,06,000$   
Profit on sale = Rs. 2,167
- Cost of Balance Debentures  
 $(\text{Rs.}5,19,375 + \text{Rs. } 2,45,000) \times \text{Rs. } 5,50,000 / \text{Rs.}7,50,000 = \text{Rs.}5,60,542$
- Interest on Closing Debentures for period Oct.-Dec. 2022 carried forward (accrued interest)  
 $\text{Rs. } 5,50,000 \times 13.5\% \times 3/12 = \text{Rs.}18,563$

## 6. Accounting for Bonus Share

### Journal Entries

In the books of Chirag Ltd.

Date	Particulars	Debit (Rs.)	Credit (Rs.)
01.04.2078	Equity share final call A/c Dr To equity share capital a/c (Being final calls of Rs.2 per share on 300000 equity shares due as per Board decision dated on ....)	600,000	600,000
20.04.2078	Bank a/c Dr To equity share final call a/c (Being final call money on 300000 equity shares received)	600,000	600,000
	Share premium a/c Dr Capital redemption reserve a/c Dr General Reserve a/c Dr Profit or Loss a/c (b/f) Dr To bonus to shareholders a/c (Being provision made for bonus issue of one share for every four shares held)	75,000 120,000 360,000 195,000	750,000
	Bonus to shareholders a/c Dr To equity share capital a/c (Being issue of bonus shares)	750,000	750,000

## 7. Underwriting of Shares

Computation of liabilities of underwriters (No. of shares):

Particulars	A & Co.	B & Co.	C & Co.	Total
Gross liability	72,000	30,000	18,000	1,20,000
Less: Marked applications (excluding firm underwriting)	(12,000)	(15,000)	(6,000)	(33,000)
	60,000	15,000	12,000	87,000
Less: Unmarked Applications (WN) (Ratio 72:30:18)	(16,200)	(6,750)	(4,050)	(27,000)
	43,800	8,250	7,950	60,000
Less: Firm underwriting	(9,600)	(12,000)	(3,600)	(25,200)
	34,200	(3,750)	4,350	34,800
Credit for excess of B & Co. (ratio 72:18)	(3,000)	3,750	(750)	
Net liability (excluding firm underwriting)	31,200	-	3,600	
Add: Firm underwriting	9,600	12,000	3,600	
Total liability (No. of shares)	40,800	12,000	7,200	

### Working Note:

Total Applications 60,000 Shares

Less: Marked Applications	<u>33,000 Shares</u>
Unmarked applications	<u>27,000 Shares</u>

## 8. Preparation of Financial Statements

### In the Books of Mr. Bikram

#### Statement of Profit or Loss

For the year ended 32-03-2079

Particulars	Rs.	Particulars	Rs.
To Opening Stock	110,000	By Sales 959,750	
		Less: Return <u>1,200</u>	958,550
To Purchases 454,100	449,900	By closing stock	190,000
Less: Return <u>1,200</u>			
To gross profit	588,650		
	1,148,550		1,448,550
To wages	110,400	By gross profit	558,650
To electricity and telephone charges	20,900	By discount	2,700
To legal expenses	17,000		
To discount	3,150		
To shop expenses	7,200		
To provision for claims for damages	155,000		
To shop rent (nominal)	20,000		
To net profit	257,700		
	<u>591,350</u>		<u>591,350</u>

#### Statement of Financial Position

As on 32-03-2079

Equity & Liabilities	Rs.	Assets	Rs.
Capital 238,200		Building	372,000
Less: Life Policy 20,000		Furniture	25,000
Less: Rent 14,000		Stock	190,000
Less: Notional rent 20,000		Sundry Debtors	92,000
Add: Net Profit 257,700	549,900	Bills receivable	6,000
Less: Drawings	(16,800)	Cash at Bank	87,000
	533,100	Cash in Hand	5,300
Sundry Creditors	56,000		

Bills payable	14,000		
Outstanding expenses:			
Legal expenses	17,000		
Electricity and telephone expenses	2,200		
Provisions for claims for damages	155,000		
	<b>777,300</b>		<b>777,300</b>

**Working Notes:**

**Statement of Affairs**

**As on 31.03.2078**

<b>Equity &amp; Liabilities</b>	<b>Rs.</b>	<b>Assets</b>	<b>Rs.</b>
Sundry creditors	40,000	Stock	110,000
Bills payable	12,000	Debtors	70,000
Capital a/c (B/f)	238,200	Bills receivable	15,000
		Cash at Bank	90,000
		Cash in Hand	5,200
	<b>290,200</b>		<b>290,200</b>

**Sundry Debtors a/c**

<b>Particulars</b>	<b>Rs.</b>	<b>Particulars</b>	<b>Rs.</b>
To Balance B/d.	70,000	By Bills Receivable	40,000
To Bills Receivable - B/R Dishonoured	3,000	By Bank	5,700
To Bank – Cheque Dishonoured	5,700	By Cash	897,150
To Sales (Credit Sales) (Bal. Fig)	959,750	By Return inwards	1,200
		By Discount	2,400
		By Balance c/d	92,000
	<b>1,038,450</b>		<b>1,038,450</b>

**Sundry Creditors a/c**

<b>Particulars</b>	<b>Rs.</b>	<b>Particulars</b>	<b>Rs.</b>
To bank	320,000	By Balance B/d.	40,000
To cash	77,200	By credit purchase (b/f)	454,100
To Bills payable	24,000		
To bills receivable	10,000		
To return outward	4,200		
To discount received	2,700		



To Balance c/d	56,000		
	<b><u>494,100</u></b>		<b><u>494,100</u></b>

**Bills receivable a/c**

Particulars	Rs.	Particulars	Rs.
To Balance B/d	15,000	By sundry creditors – bills received	10,000
To sundry debtors – bills accepted	40,000	By discount on bills	750
		By bank	19,250
		By bank (bills collected)	16,000
		By sundry debtors (bills dishonoured) (b/f)	3,000
		By Balance c/d	6,000
	<b><u>55,000</u></b>		<b><u>55,000</u></b>

**Bills payable a/c**

Particulars		Particulars	Rs.
To bank (b/f)	22,000	By Balance B/d.	12,000
To balance c/d	14,000	By sundry creditors – bills accepted	24,000
	<b><u>36,000</u></b>		<b><u>36,000</u></b>

**Cash Book**

Particulars	Cash (Rs.)	Bank (Rs.)	Particulars	Cash (Rs.)	Bank (Rs.)
To Balance B/d	5,200	90,000	By bank	762,750	
To sundry debtors (b/f)	897,150		By cash		121,000
To cash		762,750	By shop expenses	7,200	
To bank	121,000		By wages	110,400	
To sundry debtors		5,700	By drawing	16,800	
To bills receivable		19,250	By bills payable		22,000
To bills receivable		16,000	By sundry creditors	77,200	320,000
To capital (life insurance)		20,000	By furniture	25,000	
To capital (rent)		14,000	By sundry debtors		5,700
			By electricity and telephone	18,700	
			By building (B/f)		372,000

			By balance c/d	5,300	87,000
	<b>1,023,350</b>	<b>927,700</b>		<b>1,023,350</b>	<b>927,700</b>

## 9. Amalgamation of Companies

**In the books of N Ltd.**

### **Realisation A/c**

<b>Particulars</b>	<b>Rs.</b>	<b>Particulars</b>	<b>Rs.</b>
To Sundry Assets: Goodwill 75,000 Land & Building 3,00,000 Plant & Machinery 4,50,000 Inventory 5,25,000 Trade receivables 3,00,000 Bank <u>60,000</u>	17,10,000	By Retirement Gratuity Fund	60,000
To Preference Shareholders (Premium on Redemption)	30,000	By Trade payables	2,40,000
To Equity Shareholders (Profit on Realisation)	1,50,000	By M Ltd. (Purchase Consideration)	15,90,000
	<b>18,90,000</b>		<b>18,90,000</b>

**In the Books of M Ltd.**

### **Journal Entries**

<b>Particulars</b>	<b>Debit (Rs.)</b>	<b>Credit (Rs.)</b>
Business Purchase A/c Dr.	15,90,000	
To Liquidators of N Ltd. Account (Being business of N Ltd. taken over)		15,90,000
Goodwill Account Dr.	1,50,000	
Land & Building Account Dr.	5,00,000	
Plant & Machinery Account Dr.	4,00,000	
Inventory Account Dr.	4,72,500	
Trade receivables Account Dr.	3,00,000	
Bank Account Dr.	60,000	
Unrecorded assets Account Dr.	15,000	
To Retirement Gratuity Fund Account		60,000
To Trade payables Account		2,40,000
To Provision for Doubtful Debts Account		7,500
To Business Purchase A/c (Being Assets and Liabilities taken over as per agreed valuation)		15,90,000
Liquidators of N Ltd. A/c Dr.	15,90,000	
To 9% Preference Share Capital A/c		3,30,000
To Equity Share Capital A/c		12,00,000
To Securities Premium A/c (Being Purchase Consideration satisfied as above)		60,000

**Balance Sheet of M Ltd. (after absorption)**

**As at 31st Ashadh, 2078**

<b><u>Equity &amp; Liabilities</u></b>	<b><u>Rs.</u></b>	<b><u>Assets</u></b>	<b><u>Rs.</u></b>
Equity Share capital	42,00,000	Land and Building	14,00,000
Preference Share Capital	6,30,000	Plant & machinery	19,00,000
Reserves and Surplus	2,70,000	Goodwill (1,50,000+1,50,000)	3,00,000
Long-term provisions	2,10,000	Inventories (7,50,000+4,72,500)	12,22,500
Trade Payables (3,90,000+2,40,000-20,000)	6,10,000	Trade receivables (6,00,000+3,00,000-20,000)	8,80,000
Provision for doubtful debts	7,500	Other current Assets	15,000
		Cash and cash equivalents	2,10,000
	<u>59,27,500</u>		<u>59,27,500</u>

**Working Notes**

1. Computation of goodwill

<b>Particulars</b>	<b>Rs.</b>
Profit of 2076-77	90,000
Profit of 2075-76 adjusted (78,000 + 10,000)	88,000
Profit of 2074-75 adjusted (72,000 – 25,000)	47,000
	2,25,000
Average profit	75,000

Goodwill to be valued at 2 times of average profits = Rs. 75,000 x 2 = Rs. 1,50,000

2. Calculation of Purchase Consideration

<b>Particulars</b>	<b>Rs.</b>
Goodwill	1,50,000
Land & Building	5,00,000
Plant & Machinery	4,00,000
Inventory	4,72,500
Trade receivables	3,00,000
Unrecorded assets	15,000
Cash at Bank	<u>60,000</u>
	18,97,500
Less: Liabilities	
Retirement Gratuity	60,000
Trade payables	2,40,000
Provision for doubtful debts	7,500
	<u>(3,07,500)</u>

Net Assets/ Purchase Consideration	<b>15,90,000</b>
To be paid as:	
10% Preference Shareholders of N Ltd.	3,00,000
Add: 10% Premium	<u>30,000</u>
9% Preference Shares of M Ltd.	3,30,000
Equity Shareholders of N Ltd. to be satisfied by issue of 1,20,000 equity Shares of M Ltd. at 5% Premium	12,60,000
Total	<b><u>15,90,000</u></b>

## 10. Internal Reconstruction of a Company

### In the books of Prabhu Limited (& Reduced)

#### Journal Entries

S. No.	Particulars	LF	Debit (Rs.)	Credit (Rs.)
1.	Equity share capital A/c (Rs.10) Dr. To Equity share capital A/c (Rs.3) To Capital reduction A/c (Reduction of equity share of Rs.10 each to shares of Rs.3 each as per the reconstruction scheme)		60,00,000	18,00,000 42,00,000
2.	6% Preference share capital A/c (Rs. 10) Dr. To 6% Preference share capital A/c (Rs. 7) To Capital reduction A/c (Reduction of preference share of Rs.10 each to shares of Rs.7 each as per the reconstruction scheme)		32,00,000	22,40,000 9,60,000
3.	6 % Debentures A/c Dr. To Land & building A/c To 9% Debentures A/c To Capital reduction A/c (50% claim of debenture holders discharged by transfer of a part of land & building having book value Rs.14,00,000 and rate of interest of balance 50% debentures increased to 9% as per the reconstruction scheme).		30,00,000	14,00,000 15,00,000 1,00,000
4.	Bank A/c Dr. To Land & building A/c To Capital reduction A/c (50% of balance land & building having book value Rs. 10,00,000 sold as per the reconstruction scheme)		12,00,000	10,00,000 2,00,000
5.	Land & building A/c Dr. To Capital Reduction A/c (50% of balance land & building having book value Rs. 10,00,000, valued at Rs. 12,00,000, as per the reconstruction scheme)		2,00,000	2,00,000
6.	Bank A/c Dr. Capital reduction A/c Dr. To Investment A/c		4,00,000 40,000	4,40,000

	(All the investment sold as per the reconstruction scheme)			
7.	Trade payables A/c Dr. To Capital reduction A/c (1/3 of Trade payables decided to forgo their claim as per the reconstruction scheme)		8,00,000	8,00,000
8.	Capital reduction A/c Dr. To Patents A/c To Provision of doubtful debts A/c To Inventory A/c To Provision for income tax A/c To Profit & loss A/c To Plant & machinery A/c To Capital Reserve (Bal. fig.) (Written off patent, profit & loss, part value of stock, plant & machinery, and provision made for doubtful debts, income tax and balance transferred to capital reserve, as per the reconstruction scheme)		64,20,000	3,00,000 3,48,000 5,20,000 50,000 47,40,000 4,00,000 62,000

## 11. Cash Flow Statement

### IBN Private Limited

#### Cash Flow Statement

For the year ended 32.03.2079

Particulars	Rs. In Lakhs	Rs. In Lakhs
<i>Cash Flows from Operating Activities</i>		
Net profit before taxation (25,000 + 5,000)	30,000	
<u>Adjustments:</u>		
Depreciation	20,000	
Loss on Sale of Assets (net)	40	
Amortization of capital grant	(6)	
Profit on sale of investments	(100)	
Interest income on investments	(2,506)	
Interest expenses	<u>10,000</u>	
<i>Operating profit before working capital changes</i>	57,428	
Changes in working capital (excluding cash and bank balance)	<u>(56,075)</u>	
<i>Cash generated from operations</i>	1,353	
Income taxes paid	<u>(4,248)</u>	
<b>Net cash used in operating activities (A)</b>		<b>(2,895)</b>
<i>Cash Flows from Investing Activities</i>		
Proceeds from Sale of assets (185-40)	145	
Proceeds from Sale of investments (27,765 + 100)	27,865	

Interest income on investments	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
<b>Net cash used in investing activities (B)</b>		<b>(22,634)</b>
<i>Cash Flows from Financing Activities</i>		
Proceeds from calls in arrear	2	
Receipts of grant for capital projects	12	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	
<b>Net cash used in financing activities (C)</b>		<b>27,514</b>
<i>Net increase in cash and cash equivalents (A+B+C)</i>		<i>1,985</i>
Cash and cash equivalents at the beginning of the period		5,003
<b>Cash and cash equivalents at the end of the period</b>		<b>6,988</b>

## 12. Accounting from Incomplete Records

### Trading & Profit and Loss Account In the books of Mr. Manohar for the year ended 32nd Ashadh, 2079

Particulars	Rs.	Particulars	Rs.
To opening stock	245,000	By sales	
		Cash	1,620,000
		Credit (WN 3)	1,100,000
To purchases		To closing stock	320,000
Cash	615,000		
Credit (WN 2)	1,500,000		
To gross profit	680,000		
	<b>3,040,000</b>		<b>3,040,000</b>
To salaries (WN 5)	237,000	By gross profit	680,000
To rent	132,000	By discount received	32,000
To Sundry trade expenses	81,000		
To discount allowed	20,000		
To depreciation on furniture and fixtures	26,000		
To net profit	216,000		

	<b><u>712,000</u></b>		<b><u>712,000</u></b>
--	-----------------------	--	-----------------------

### Balance Sheet

As at 32nd Ashadh, 2079

Equity & Liabilities	Rs.	Assets	Rs.
Capital:		Fixed Assets:	
Opening Balance (WN 7) 516,000		Furniture & fixtures	234,000
Add: Net profit <u>216,000</u>			
732,000			
Less: Drawings <u>120,000</u>	612,000		
Current liabilities & provisions:		Current Assets:	
Creditors	190,000	Stock	320,000
Bills payables	80,000	Debtors (WN 4)	147,000
Outstanding Salaries	20,000	Cash and Bank (WN 6)	201,000
	<b><u>902,000</u></b>		<b><u>902,000</u></b>

### Working Notes

#### 1. Bills Payable Account

Particulars	Rs.	Particulars	Rs.
To cash/bank	430,000	By balance b/d	70,000
To Balance c/d	80,000	By creditors (b/f)	440,000
	<b><u>510,000</u></b>		<b><u>510,000</u></b>

#### 2. Creditors Account

Particulars	Rs.	Particulars	Rs.
To cash/bank	973,000	By balance b/d	135,000
To Bills payable	440,000	By credit purchases (b/f)	1,500,000
To discount received	32,000		
To Balance c/d	190,000		
	<b><u>1,635,000</u></b>		<b><u>1,635,000</u></b>

#### 3. Calculation of Credit Sales

Particulars	Rs.
Opening Stock	245,000
Add: Purchases (Cash purchase 615,000 + Credit purchase 1,500,000)	2,115,000
	2,360,000
Less: Closing stock	(320,000)
Cost of goods sold	2,040,000
Gross profit ratio on sales	25%

Sales (2,040,000*100/75)	2,720,000
Less: Cash Sales	1,620,000
Credit Sales	1,100,000

4. Debtors a/c

Particulars	Rs.	Particulars	Rs.
To balance b/d	125,000	By cash/bank	1,058,000
To credit sales (WN 3)	1,100,000	By discount allowed	20,000
		By balance c/d (B/f)	147,000
	<b>1,225,000</b>		<b>1,225,000</b>

5. Salaries

Salaries paid during the year	236,000
Add: Outstanding as on 32.03.2079	<u>20,000</u>
	256,000
Less: Outstanding as on 31.03.2078	<u>19,000</u>
	237,000

6. Cash/bank a/c

Particulars	Rs.	Particulars	Rs.
To balance b/d	110,000	By cash purchases	615,000
To cash sales	1,620,000	By creditors	973,000
To debtors	1,058,000	By bills payable	430,000
		By drawings	120,000
		By salaries	236,000
		By rent	132,000
		By sundry trade expenses	81,000
		By balance c/d	201,000
	<b>2,788,000</b>		<b>2,788,000</b>

7.

**Balance Sheet**

**As at 31.03.2078**

Equity & Liabilities	Rs.	Assets	Rs.
Creditors	135,000	Furniture and fixtures	260,000
Bills payable	70,000	Stock	245,000
Outstanding salaries	19,000	Debtors	125,000
Capital (b/f)	516,000	Cash and Bank	110,000
	<b>740,000</b>		<b>740,000</b>



### 13. Accounts of Insurance Companies

#### Computation of Saving amount to be transferred to Life Insurance Fund

Particulars	Amount (Rs. In Million)
Premium Income	4,137.85
Renewal Premium Income	-
Total Premium Income	4,137.85
Deduction: Re-insurance premium	(210.90)
Net Premium	3,926.95
Reinsurance Commission	19.63
Late Fee	-
Investment Income	3,456.27
Total Income (A)	7,402.86
Claim Payment (Net)	3,965.19
Agent Commission Payment	1,336.91
Service Charge to the Insurance Board	-
Medical fee	13.75
Management Expenses	1,068.44
Total Expenses (B)	6,384.29
Saving (A-B)	1,018.56
Provision for income tax	(305.57)
Net Saving	712.99
Transfer of profit on the Actuarial Valuation	(547.67)
Net Saving transferred to Life Insurance Fund	165.33

### 14. Partnership Account

#### Balance Sheet of firm

As at 1st Mangsir 2079

Equity & Liabilities	Rs.	Assets	Rs.
Capital a/c:		Building	450,000
Shyam	225,000	Plant and Machinery	97,700
Laxman	225,000	Furniture and Fittings	66,700
Shankar	120,000	Closing Stock	33,000
Current a/c – Shyam	21,600	Sundry Debtors	66,900
Current a/c – Laxman	6,600	Cash at Bank	148,500
		(101,100+165,000+117,600)	
Sundry Creditors	29,400		

Ram's Executor Loan a/c	235,200		
	<b>862,800</b>		<b>862,800</b>

### Working Notes:

#### 1. Calculation of Goodwill:

Profit for the year ended 31.03.2076	86,700
Profit for the year ended 31.03.2077	143,200
Profit for the year ended 31.03.2078	<u>107,600</u>
	337,500

Average profit =  $337,500/3$

=112,500

Goodwill = Rs.1,12,500 X 2 years = Rs. 225,000

Ram's share of goodwill =  $225,000 \times 1/3 = 75,000$

Shankar's share of goodwill =  $225,000 \times 1/5 = 45,000$

#### 2. Balance Sheet of firm as at 31<sup>st</sup> Kartik, 2079

Equity & Liabilities	Rs.	Assets	Rs.
Capital a/c (b/f)	786,000	Building	450,000
Sundry Creditors	29,400	Plant and Machinery	97,700
		Furniture and Fittings	66,700
		Closing Stock	33,000
		Sundry Debtors	66,900
		Cash at Bank	101,100
	<u>815,400</u>		<u>815,400</u>

#### 3. Calculation of profits made during the period of 1<sup>st</sup> Shrawan, 2079 to 31<sup>st</sup> Kartik, 2079

Particulars	Rs.
Combined Capital (of all partners) as on 31.07.2079	786,000
Less: Combined Capitals on 01.04.2079 (2,70,000 + 2,40,000 + 2,40,000 + 4,200 + 6,000 less 3,000)	<u>757,200</u>
	28,800
Add: Drawings of all partners (60,000 + 48,000 + 54,000)	<u>162,000</u>
Total Profit	<u>190,800</u>
Share of Profit of each partner	63,600

#### 4. Partners' Capital Accounts

Dr.					Cr.				
Particulars	Ram	Shyam	Laxman	Shankar	Particulars	Ram	Shyam	Laxman	Shankar
	Rs.	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.	Rs.
To Ram (Goodwill adj.)	-	37,500	37,500		By balance b/d	270,000	240,000	240,000	
To Ram's Executor a/c	352,800				By goodwill adjustment	75,000			
To Shyam and Laxman				45,000	By Ram's Current a/c	7,800			
To Balance c/d		225,000	225,000	120,000	By cash a/c				165,000
					By Shankar (Goodwill adjustment)		22,500	22,500	
	<b>352,800</b>	<b>262,500</b>	<b>262,500</b>	<b>165,000</b>		<b>352,800</b>	<b>262,500</b>	<b>262,500</b>	<b>165,000</b>

#### 5. Partner's Current Accounts

Dr.				Cr.			
	Ram	Shyam	Laxman		Ram	Shyam	Laxman
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To balance b/d			3,000	By balance b/d	4,200	6,000	
To drawings	60,000	48,000	54,000	By Profit & Loss a/c	63,600	63,600	63,600
To capital a/c (b/f)	7,800						
To balance c/d		21,600	6,600				
	<b>67,800</b>	<b>69,600</b>	<b>63,600</b>		<b>67,800</b>	<b>69,600</b>	<b>63,600</b>

#### 6. Ram's Executor a/c

Dr.		Cr.	
Particulars	Rs.	Particulars	Rs.
To cash and bank	117,600	By Ram's capital a/c	352,800
To Ram's Executor loan a/c	235,200		
	<b>352,800</b>		<b>352,800</b>

## 15. Analysis and Interpretation of Financial Statements

### Statement of Profitability

Particulars	Rs.
Sales	80,00,000
Less: Cost of goods sold	56,00,000
<b>Gross profit</b>	<b>24,00,000</b>
Less: Operating expenses (including Depreciation)	15,00,000
<b>Earnings before Interest &amp; Tax (EBIT)</b>	<b>9,00,000</b>
Less: Interest Cost	75,000
<b>Earnings before Tax (EBT)</b>	<b>8,25,000</b>
Less: Tax liability (50%)	4,12,500
<b>Earnings after Tax (EAT/ PAT)</b>	<b>4,12,500</b>
Less: Preference share dividend	40,000
<b>Distributional Profit</b>	<b>3,72,500</b>

#### 1. Capital Employed

= Equity Share capital + Preference Share Capital + Reserves & Surplus + Debenture + Long Term Loan – Fictitious Assets

= 10,00,000 + 4,00,000 + 7,00,000 + 5,00,000 – 20,000

= 25,80,000

Rate of Return on Capital Employed =  $\text{EBIT} / \text{Capital employed} \times 100$

=  $9,00,000 / 25,80,000 \times 100$

= 34.88%

#### 2. Proprietary Ratio = Shareholders' Funds/Total Assets

Shareholders' Funds = Equity Share capital + Reserves & Surplus + Preference Share Capital – Fictitious Assets

Total Assets = Total Assets – Fictitious Assets

Proprietary Ratio =  $(10,00,000 + 7,00,000 + 4,00,000 - 20,000) / (30,00,000 - 20,000)$

=  $20,80,000 / 29,80,000$

= 0.70 : 1

#### 3. Debt – Equity Ratio = Long Term Debt (Liabilities)/Shareholders Fund

Long Term Debt (Liabilities) = Debentures + long term loans

= 5,00,000

Debt – Equity Ratio =  $5,00,000 / 20,80,000$

= 0.24:1

#### 4. Capital gearing ratio = Fixed Interest or Dividend Securities / Equity Shareholders Fund

Fixed Interest or Dividend Securities = Debentures + Preference share capital

= 4,00,000 + 5,00,000

$$= 9,00,000$$

$$\text{Equity Shareholders Fund} = \text{Eq. Sh. Cap.} + \text{Reserves \& Surplus} - \text{Fictitious Assets}$$

$$= 10,00,000 + 7,00,000 - 20,000$$

$$= 16,80,000$$

$$\text{Capital gearing ratio} = 9,00,000 / 16,80,000$$

$$= 0.54:1$$

$$5. \text{ Debtors Ratio (Avg. debt collection period)} = \frac{\text{Debtors} + \text{Bills receivable}}{\text{Credit sales}} \times 365 \text{ days}$$

$$= (4,60,000 + 60,000) / 60,00,000 \times 365 \text{ days}$$

$$= 0.461 \times 365 \text{ days}$$

$$= 31.63 \text{ days}$$

$$= 32 \text{ days (approx..)}$$

$$6. \text{ Rate of Return on Shareholders' Fund} = \frac{\text{PAT}}{\text{SHF}} \times 100$$

$$= 4,12,500 / 20,80,000 \times 100$$

$$= 19.83\%$$

$$7. \text{ Rate of return on Equity Shareholders' Fund} = \frac{(\text{PAT} - \text{Preference shares})}{\text{Equity Shareholders' Fund}} \times 100$$

$$= 3,72,500 / 16,80,000 \times 100\%$$

$$= 22.17\%$$

## 16. Pre and Post Incorporation Profit

### Sunrise Company Pvt. Ltd

#### Statement showing the calculation of Profits

##### for the pre-incorporation and post-incorporation periods

Particulars	Basis Allocation of	Pre-incorporation (Rs.)	Post-incorporation (Rs.)
Sales	Sales ratio	2,600	20,800
Less: Cost of goods sold	Sales ratio	1,820	14,560
Salaries	WN 4	90	1,080
Depreciation	Time ratio	36	144
Advertisement	Sales ratio	78	624
Discounts	Sales ratio	130	1,040
Managing Director's remuneration	Post incorporation	0	90
Misc. office expenses	Time ratio	24	96
Rent	WN 5	90	630
Interest	Time ratio	351	600
Net Profit/(Loss)		-19	1,936

**Working Notes:**

## 1. Calculation of Sales Ratio:

Let the average sales in pre-incorporation period be Rs. x. The average sales in post incorporation period be Rs. 2x. The total sales are  $(3 \times x) + (12 \times 2x) = 27x$ . Ratio of sales will be  $3x:24x = 1:8$

## 2. Cost of goods sold, advertisement and discounts are apportioned based on sales.

## 3. Depreciation and miscellaneous expenses are apportioned based on time basis.

## 4. Ratio for apportionment of salaries:

If pre-incorporation monthly average is x, for 3 months is 3x.

Average for balance 12 months is 3x, for 12 months is 36x.

Hence, ratio is  $3x:36x = 1:12$

## 5. Apportionment of Rent

Particulars	Amount
Total rent	720,000
Additional rent for 9 months (From 1 <sup>st</sup> Kartik 2078 to 32 <sup>nd</sup> Ashadh 2079)	(270,000)
Rent for old premises for 15 months at Rs. 30,000 per month	450,000

	Pre-incorporation	Post-incorporation
Old premises	90,000	360,000
Additional Rent	-	270,000
	90,000	630,000

**17. Accounting for Non-Profit Organization****Paropakar Hospital****Income & Expenditure Account**

**for the year ended 31 December, 2022**

Expenditure	Rs.	Income	Rs.
To Salaries	24,000	By Subscriptions	24,500
To Diet expenses	15,600	By Govt. Grants (Maintenance)	20,000
To Rent & Rates	1,700	By Fees - Sundry patients	4,800
To Printing & Stationery	2,400	By Donations	8,000
To Electricity & Water charges	2,400	By Benefit shows (net collections)	6,000
To Office expenses	2,000	By Interest on Investments	800
To Excess of Income over expenditure transferred to capital fund	16,000		
	<u>64,100</u>		<u>64,100</u>

**Balance Sheet**  
**as at 31st Dec., 2022**

<b>Reserves &amp; Liabilities</b>	<b>Rs.</b>	<b>Assets</b>	<b>Rs.</b>
Capital Fund :		Building :	
Opening balance 49,300		Opening balance 90,000	
Excess of Income over expenditure <u>16,000</u>	65,300	Addition <u>50,000</u>	1,40,000
Building Fund :		Hospital Equipment:	
Opening balance 80,000		Opening balance 34,000	
Add : Govt. Grant <u>80,000</u>	1,60,000	Addition <u>17,000</u>	51,000
Subscriptions received in advance	2,400	Furniture	6,000
		Investment – 8% government securities	20,000
		Subscriptions receivable	1,400
		Accrued interest	800
		Prepaid expenses (Rent)	300
		Cash at Bank	6,800
		Cash in Hand	1,400
	<b><u>227,700</u></b>		<b><u>227,700</u></b>

**Working Notes:**

1.

**Balance sheet**  
**as at 31st Dec., 2021**

<b>Reserves &amp; Liabilities</b>	<b>Rs.</b>	<b>Assets</b>	<b>Rs.</b>
Capital Fund (B/f)	49,300	Building	90,000
Building Fund	80,000	Equipment	34,000
Salaries payable	7,200	Subscriptions receivable	6,500
		Cash at Bank	5,200
		Cash in Hand	800
	<b><u>1,36,500</u></b>		<b><u>1,36,500</u></b>

2. Building

Balance on 31st Dec. 2022	1,40,000
Paid during the year	<u>(50,000)</u>
Balance on 31st Dec. 2021	90,000

3. Equipment

Balance on 31st Dec. 2022	51,000
Paid during the year	<u>(17,000)</u>

Balance on 31st Dec. 2021	34,000
4. Subscription due for 2021	
Receivable on 31st Dec. 2021	6,500
Received in 2022	<u>(5,100)</u>
Still Receivable for 2021	1,400

### Accounting Standards

18. NAS 16, *Property, Plant and Equipment* allows (but does not require) an entity to revalue its property, plant & equipment (PPE) to fair value. However, it requires that the measurement model used (cost or fair value) for PPE should be consistent on a class by class basis. A class of PPE is a grouping of assets of a similar nature and use in an entity's operations. Based on this definition, it is likely that property (or 'land and buildings') would form one distinct class of PPE and that plant and equipment would form another class. Therefore it is perfectly consistent with the accounting standard for property to be measured under the revaluation (fair value) model and plant and equipment to be measured under the cost model. However, it would be inappropriate to 'cherry pick' or apply a 'mixed measurement model' to property (or land and buildings) based simply on its geographical location. This prevents entities only revaluing items which have increased in value and leaving other items at their (depreciated) cost. If we do use the fair value model, then we need to make sure we revalue with sufficient regularity to ensure that the carrying amount of the revalued asset is a true reflection of its current value.

19.

- (i) If dividends are declared after the reporting period but before the financial statements are authorized for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. No liability for proposed dividends has to be created and no adjustment to be made in financial statements for year ended 32<sup>nd</sup> Ashadh 2079. Such proposed dividends are to be disclosed in the notes to the financial statements.
- (ii) As per NAS 10, *Events After the Reporting Date*, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In the given case, the company should make the provision for doubtful debts, as legal suit has been filed on 32<sup>nd</sup> Ashadh 2079 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalization of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 32<sup>nd</sup> Ashadh 2079.
- (iii) As per NAS 10, *Events after the Reporting Date*, an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes. As the fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss amounting Rs. 4,00,000 (19,00,000 less 15,00,000) and adjust the accounts of the company for the year ended 32<sup>nd</sup> Ashadh 2079.

20.

#### a. Neutrality of financial statements

To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion on the business results. For example, if the assets of a company primarily



consist of trade receivables and insurance claims and the financial statements do not specify that the insurance claims have been lying unrealized for a number of years or that a few key trade receivables have not given balance confirmation certificates, an erroneous conclusion may be drawn on the liquidity of the company. Financial statements are said to depict the true and fair view of the business of the organization by virtue of neutrality.

**b. Other Comprehensive Income as per NFRS**

Other comprehensive income comprises items of income and expenses (including reclassification adjustments) that are not recognized in profit and loss as required or permitted by other NFRSs.

The components of other comprehensive income include:

- (i) Changes in revaluation surplus
- (ii) Re-measurements of defined benefit plans
- (iii) Gains and losses arising from translating the financial statements of a foreign operation
- (iv) Gains and losses from investments in equity instruments measured at fair value through other comprehensive income
- (v) The effective portion of gains and losses on hedging instruments in a cash flow hedge
- (vi) For particular liabilities designated as at fair value through profit or loss, the amount of the change in the fair value that is attributable to changes in the liability's credit risk.

**c. Accounting treatment of contingency gains**

Contingency gains are not recognized in financial statements since their recognition may result in the recognition of revenue which may never be realized. However, when the realization of a gain is virtually certain, then such a gain is not a contingency and accounting for the same is appropriate.

**d. Unexpired Risk Reserve**

As per Rule 15 of the Insurance Regulation 2049, every insurer operating non-life insurance business shall transfer an amount not less than fifty percent of the Net Insurance Premium shown in Revenue Account to the Unexpired Risk Reserve account. Such amount shall be allocated for every category of insurance the insurer operating. E.g., an insurer operating non-life insurance business and accepting risk for Fire Insurance, Marine Insurance, Motor Insurance and Aviation Insurance, then the insurer shall maintain the Unexpired Risk Reserve for each of the fire, marine motor and aviation insurance. Such Unexpired Risk Reserve shall be recognized as income in next year except the Unexpired Risk Reserve maintained for Marine Insurance. In case of Marine Insurance, Unexpired Risk Reserve maintained for it shall not be recognized as income for at least three years.

# **Paper-2**

## **Audit & Assurance**

## **PRINCIPLES AND CONCEPT OF ASSURANCE**

Q.N. 1. Briefly mention about the objectives of an audit.

Q.N.2. You are the audit manager for the audit of PQR Pvt. Ltd. which is a new start-up and is planning to raise funds from new investors. Explain the concept of fraud and error to your audit team and look for the reasons that may exist in the company that indicate the possibility of fraud and error.

## **REGULATORY AND ETHICAL ISSUES**

Q.N. 3 Explain the fundamental principles of ethics and why ethics is important for professional accountants.

Q.N. 4 M is the auditor of two companies Cupboard Ltd. and Door Ltd. who are in the similar line of business. The government recently passed new regulations for the industry which resulted in fines and penalties to Cupboard Ltd. M disclosed to the management of Door Ltd. about that Cupboard Ltd. had not complied some provisions and faced the fines & penalties. M disclosed this fact so that Door Ltd. can avoid the possible fines and penalties by complying with the government regulations. Is M correct in this regard?

Q.N. 5

The auditor of a company issued audit report for financial year 75-76. But he failed to comment on the compliance/noncompliance of the applicable Nepal Accounting Standards. Also the auditor could not show his working papers and supporting documents sufficient to prove that he had carried out the audit in accordance with Nepal Standards on Auditing.

## **PLANNING AN ASSURANCE ENGAGEMENT**

Q.N. 6 R has been recently appointed as the auditor of XYZ Ltd. of FY 2079/80. What are the things to be considered by R before preparing the audit plan of the company?

Q.N. 7

What do you mean by professional skepticism? How and when does the auditor apply professional skepticism?

Q.N. 8

How do you conduct risk analysis of an audit client who has established the ERP system recently?

## **AUDIT EVIDENCE AND INTERNAL AUDIT**

Q.N. 9 Mr. C is reappointed as the auditor of Pie Ltd. During the course of audit, Mr. C felt the need of external confirmation to verify a debtor's balance. The staff of Pie Ltd. told Mr. C that he will provide written representation regarding this debtor's balance. Do you think such written representation can be considered as audit evidence?

Q.N. 10 Gorkha Ltd. is a company whose 70% shares are owned by the Government of Nepal. The company has established internal audit department for overseeing the internal audit functions. The chief of the department is invited in the meeting of the Board of Directors on need basis to provide the update of audit. Comment in this structure as per Companies Act 2063.

## **VOUCHING**

Q.N. 11

While conducting the audit of ABC Pvt. Ltd., you observed that the other income has increased by 60% as compared to last year. The income from scrap sales constitutes around 50% of the other income and the recovery from bad debts written off constitutes the other 50%. What are the vouching procedures that you will consider in this case?

## **VERIFICATION OF ASSETS AND LIABILITIES**

Q.N. 12 X Pvt. Ltd. is a supplier of mobile phones. The company has provisioned 10% of total sales during the year as provision for warranty claims. What are the audit procedures to be followed to verify the assertions relating to provision for warranty claims?

## **COMPANY AUDIT**

Q.N. 13

After the issue of audited financial statements of XYZ Company Ltd, one of the staff has filed a petition that the auditor did not report the incident of recent vandalism in the office by the trade union. Does the scope of audit covers reporting on such events?

## **AUDIT OF SPECIAL SECTORS**

Q.N. 14 You have accepted the audit appointment of ABC Constructions Pvt. Ltd. While obtaining the relevant information for understanding of the entity, you found that the company has entered into many joint venture agreements with other construction companies. When you asked about the audit report of joint ventures, the director of the company said that the joint venture audits have not been done and he is not aware of any such requirements. You are required to explain why the audit of joint venture is done and draft an audit plan for ABC Construction Pvt. Ltd.'s joint venture operations.

## **GOVERNMENT AUDIT**

Q.N. 15 Explain the 3Es principles in a performance audit.

## **COMPLETING AND REPORTING ON AN ASSURANCE ENGAGEMENT**

Q.N. 16 Write short note on Emphasis of Matter paragraph in an audit report.

Q.N. 17 You have been appointed as auditor of MNE Microfinance Ltd. (which is listed in the Nepal Stock Exchange) for FY 2078/79. While issuing the audit report of 2078/79, the management enquired about the key audit matters as it was not included in the audit report by previous auditors. You are required to explain about the key audit matters to the management of MNE Microfinance Ltd.

## **NEPAL STANDARDS ON AUDITING (NSA)**

Q.N. 18 Chartered Accountant X is the auditor of ABC Pvt. Ltd. since many years. This year, a new managing director Y has joined the company. Y requested X for the engagement letter before the beginning of the audit and requested to remove the clause. You have also undertaken to provide us with unrestricted access to any persons from whom we deem it necessary to obtain audit evidence” from the engagement letter. You are required to analyse this as per Nepal Standards on Auditing.

Q.N. 19 How the concept of materiality is applied by the auditor?

Q.N. 20 You have been appointed as auditor of GIF Ltd. for FY 2079/80. What would be your responsibilities regarding opening balances when you are auditing the financial statements of GIF Ltd. for the first time?

## **PRINCIPLES AND CONCEPT OF ASSURANCE**

### **Answer to Q.N. 1**

As per NSA 200, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (b) To report on the financial statements, and communicate as required by the NSAs, in accordance with the auditor's findings.

The primary objective of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework.

Earlier, the principal objective was on arithmetical accuracy; adequate attention was not paid to appropriate application of accounting principles and disclosure, for ensuring preparation of accounting statements in such a way as to enable the reader of the accounting statement to form a fair view of the state of affairs. But some of the organization took advantage of the situation and manipulated profit or loss and assets and liabilities to highlight or conceal affairs according to their own design.

There has been a shift of emphasis from arithmetical accuracy to the question of reliability of the financial statements.

The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of an enterprise or the efficiency or effectiveness with which the management has conducted the affairs of the enterprise.

Summarizing above, it can be said that auditing has the principal objective of seeing whether or not the financial statements portray a true and fair view, detect frauds and making recommendations to prevent their occurrence.

### **Answer to Q.N. 2**

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:-

1. *Self-revealing and not self-revealing*: These are such errors the existence of which becomes apparent in the process of compilation of accounts. If errors could not be noticed during normal course, such errors are not self-revealing errors.

2. *Unintentional and intentional*: Fraud is the word used to mean intentional error. 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.

3. *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.

Fraud refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Fraud involving one or more members of management or those charged with governance is referred to as management fraud and fraud involving only employees of the entity is referred to as employee fraud. In either case, there may be collusion with third parties outside the entity.

Two types of intentional misstatements are relevant to the auditor's consideration of misstatements due to fraud:

1. *Fraudulent Financial Reporting*: It involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users.

2. *Misappropriation of Assets*: It involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

### **Reasons for errors and Frauds**

- a) Ignorance on the part of employees of accounting developments, generally accepted accounting principles, appropriate account classification and good accounting practices in general.
- b) Carelessness on the part of those doing the accounting work.
- c) A desire to conceal the effect of defalcations or shortages of one kind or another.
- d) A tendency of the management to permit prejudice or bias to influence the interpretation of transactions or events or their presentation in the financial statements.
- e) An ever present desire to hold taxes on income to minimum.
- f) Show up the picture depicted by the statements;
- g) Depress the picture depicted by the statements; and
- h) Convert the error to a personal benefit

## **REGULATORY AND ETHICAL ISSUES**

### **Answer to Q.N. 3**

As per the ICAN's **Handbook of the Code of Ethics for Professional Accountants**, there are five fundamental principles of ethics for professional accountants:

- 1. Integrity – to be straightforward and honest in all professional and business relationships.

2. Objectivity – not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.
3. Professional Competence and Due Care – to:
  - a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
  - b) Act diligently and in accordance with applicable technical and professional standards.
4. Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships
5. Professional Behaviour – to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know might discredit the profession.

The fundamental principles of ethics establish the standard of behaviour expected of a professional accountant.

The Code recognizes that the objectives of the accountancy profession are to work to the highest standards of professionalism, to attain the highest levels of performance and generally to meet the public interest requirement set out above. These objectives require four basic needs to be met:

- Credibility: - In the whole society there is a need for credibility in information and information systems.
- Professionalism: - There is a need for individuals who can be clearly identified by clients, employers and other interested parties as professional persons in the accountancy field.
- Quality of Services: - There is a need for assurance that all services obtained from a professional accountant are carried out to the highest standards of performance.
- Confidence: - Users of the services of professional accountants should be able to feel confident that there exists a framework of professional ethics which governs the provision of those services.

#### **Answer to Q.N. 4**

As per the Code of Ethics, a professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and business relationships. An accountant shall:

- a) Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member;
- b) Maintain confidentiality of information within the firm or employing organization;
- c) Maintain confidentiality of information disclosed by a prospective client or employing organization;
- d) Not disclose confidential information acquired as a result of professional and business relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;



- e) Not use confidential information acquired as a result of professional and business relationships for the personal advantage of the accountant or for the advantage of a third party;
- f) Not use or disclose any confidential information, either acquired or received as a result of a professional or business relationship, after that relationship has ended; and
- g) Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in the knowledge that the information will not be disclosed to a third party. Nevertheless, the following are circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

- a) Disclosure is required by law, for example:
  - i) Production of documents or other provision of evidence in the course of legal proceedings; or
  - ii) Disclosure to the appropriate public authorities of infringements of the law that come to light
- b) Disclosure is permitted by law and is authorized by the client or the employing organization &
- c) There is professional duty or right to disclose, when not permitted by law:
  - i. To comply with the quality review of a professional body
  - ii. To respond to an inquiry or investigation by professional or regulatory body
  - iii. To protect the professional interests of a professional accountant in legal proceedings; or
  - iv. To comply with technical and professional standards, including ethics requirements.

In deciding whether to disclose confidential information, factors to consider, depending on the circumstances, include:

- Whether the interests of any parties, including third parties whose interests might be affected, could be harmed if the client or employing organization consents to the disclosure of information by the professional accountant.
- Whether all the relevant information is known and substantiated, to the extent practicable.
- The proposed type of communication, and to whom it is addressed.
- Whether the parties to whom the communication is addressed are appropriate recipients.

In this regard, M has violated the principle of confidentiality by disclosing the information of Cupboard Ltd. to the management of Door Ltd. This disclosure is neither required by law nor authorized by the client, i.e. Cupboard Ltd. Therefore, M will be held guilty of professional misconduct.

### **Answer to Q.N. 5**

The auditor was found compromising the provisions of Section 34(9) of the Nepal Chartered Accountants Act 2053 which requires that members holding Certificate of Practice shall discharge their duties with due care in the course of their profession and shall draw attention of all concerned to all material facts which are or have taken place contrary to the prevailing law and do not comply with generally accepted principles of auditing.

Similarly the auditor was found compromising the provisions the Code of Ethics, which requires that a Professional Accountant should carry out professional services in accordance with the technical and professional standards and that Professional accountants have a duty to carry out with care and skill the instructions of the client in so far as they are compatible with the requirements of integrity, objectivity, and independence and that they should conform with the technical and professional standards promulgated by the Nepal Accounting Standards Board, Nepal Auditing Standards Board, ICAN or other regulatory body, and relevant legislation.

## **PLANNING AN ASSURANCE ENGAGEMENT**

### **Answer to Q.N. 6**

After accepting a client, the auditor must first obtain a thorough understanding of the entity and its environment, including the entity's internal control. The auditor must understand the risks the client faces, how it is dealing with those risks, and what remaining risks are most likely to result in a material misstatement in the financial statements. With this understanding, the auditor develops an audit strategy and an audit plan that will produce evidence helpful in forming and supporting an opinion on the financial statements.

The auditor's understanding of the entity and its environment should include a general knowledge of the economy and the industry within which the entity operates and more particular knowledge of how the entity operates. It includes:

- Industry, regulatory, and other external factors, including the applicable financial reporting framework
- Nature of the entity, including the entity's selection and application of accounting policies
- Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements
- Measurement and review of the entity's financial performance
- Internal control
- Information System, Including the Related Business Processes, Relevant to Financial Reporting, and Communication

### **Answer to Q.N. 7**

The term 'professional skepticism' is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence. NSA 200 requires the use of professional skepticism as a means of enhancing the auditor's ability to identify risks of material misstatement and to respond to the risks identified. Professional skepticism is also linked to the application of professional

judgment by the auditor. An audit performed without an attitude of professional skepticism is not likely to be a high-quality audit. At its core, the application of professional skepticism should help to ensure that the auditor does not neglect unusual circumstances, oversimplify the results from audit procedures or adopt inappropriate assumptions when determining the audit response required to address identified risks, all of which should improve audit quality.

The auditor is likely to apply professional skepticism at various stages from client acceptance and at various points during the audit process, and some typical examples are given below:

- **When assessing engagement acceptance** – at this stage the auditor should consider whether the management of the intended audit client acts with integrity and whether there are any matters that may impact on the auditor being able to act with professional skepticism if they accept the engagement, such as ethical threats to objectivity.
- **When performing risk assessment procedures** – an auditor should be skeptical when performing risk assessment procedures at the planning stage of the audit. For example, when discussing the results of analytical procedures with management, the auditor should not accept management's explanations at face value and should obtain corroboratory evidence for the explanations offered.
- **When obtaining audit evidence** – the auditor should be ready to challenge management, especially on complex and subjective matters and matters that required a degree of judgment to be exercised by management. The reliability and sufficiency of evidence should be considered, especially where there are risks of fraud. There may also be specific issues arising during an audit which impacts on professional skepticism – for example, if management refuses the auditor's request to obtain evidence from a third party. The auditor will have to consider how much trust can be placed on evidence obtained from management – for example, evidence in the form of enquiry with management or written representations obtained from management. ISA 200 states that 'a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance'.
- **When evaluating evidence** – the auditor should critically assess audit evidence and be alert for contradictory evidence that may undermine the sufficiency and appropriateness of evidence obtained.
- The auditor should also apply professional skepticism **when forming the auditor's opinion**, by considering the overall sufficiency of evidence to support the audit opinion, and by evaluating whether the financial statements depict fair presentation of underlying transactions and events. Ultimately, the application of professional skepticism should reduce detection risk because it enhances the effectiveness of applied audit procedures and reduces the possibility that the auditor will reach an inappropriate conclusion when evaluating the results of audit procedures.

### Answer to Q.N. 8

In an organization with ERP system, the business functions are fully or partially automated. The auditor should obtain an understanding of the system, including the related business processes, relevant to financial reporting, including:

- a. The classes of transactions in the company's operations that are significant to the financial statements;

- b. The procedures, within both automated and manual systems, by which those transactions are initiated, authorized, processed, recorded, and reported;
- c. The related accounting records, supporting information, and specific accounts in the financial statements that are used to initiate, authorize, process, and record transactions;
- d. How the information system captures events and conditions, other than transactions, that are significant to the financial statements; and
- e. The period-end financial reporting process.

Further, the auditor also should obtain an understanding of how IT affects the company's flow of transactions. The identification of risks and controls within IT is not a separate evaluation. Instead, it is an integral part of the approach used to identify significant accounts and disclosures and their relevant assertions and, when applicable, to select the controls to test, as well as to assess risk and allocate audit effort. A company might use automated procedures to initiate, record, process, and report transactions, in which case records in electronic format would replace paper documents. When IT is used to initiate, record, process, and report transactions, the IT systems and programs may include controls related to the relevant assertions of significant accounts and disclosures or may be critical to the effective functioning of manual controls that depend on IT.

The auditor should obtain an understanding of specific risks to a company's internal control over financial reporting resulting from IT. Examples of such risks include:

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both;
- Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (particular risks might arise when multiple users access a common database);
- The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby breaking down segregation of duties;
- Unauthorized changes to data in master files;
- Unauthorized changes to systems or programs;
- Failure to make necessary changes to systems or programs;
- Inappropriate manual intervention; and
- Potential loss of data or inability to access data as required.

After the thorough analysis of these aspects, the auditor prepares the audit strategy and audit plan.

## **AUDIT EVIDENCE AND INTERNAL AUDIT**

### **Answer to Q.N. 9**

Written representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has

provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions.

The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. Those individuals may vary depending on the governance structure of the entity, and the relevant law or regulation; however, management (rather than those charged with governance) is often the responsible party. Written representations may, therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles. In some circumstances however, other parties, such as those charged with governance, are also responsible for the preparation of financial statements. Therefore, Mr. C should consider whether the staff is the appropriate person to provide the written representations.

### **Answer to Q.N. 10**

Gorkha Ltd., whose 70% shares are owned by the Government of Nepal is a company substantially owned by the government. As per Section 164 (1) of Companies Act 2063 provides that a listed company with paid up capital of thirty million rupees [3 crores] or more or a company which is fully or partly owned by the Government of Nepal shall form an audit committee consisting of a least three members under the chairpersonship of a director who is not involved in the day-to-day operations of the company.

At least one member of the audit committee shall be an experienced person having obtained professional certificate in accounting or a person having gained experience in accounting and financial field after having obtained at least bachelor's degree in accounts, commerce, management, finance or economics [Section 164 (3)].

A person who is a close relative of the chief executive of a company shall not be eligible to be a member of the audit committee formed pursuant to Sub-section (1) [Section 164 (2)].

The report of board of directors required to be prepared by a company shall set out a short description of the activities of the audit committee, working policies adopted by the board of directors to implement the suggestions, if any, given by the audit committee, the allowances or facilities, if any, received by the members or the audit committee and the names of the members of audit committee Section [164 (4)].

The audit committee may, for inquiring into any matter, notify the managing director of the company, chief executive or the company or other director, auditor, internal auditor and accounts chief involved in the day-to-day operations of the company to attend its meeting; and it shall be their duty to be present in the meeting of that committee if they are so notified [Section 164(5)].

The board of directors shall implement the suggestions given by the audit committee in respect of the accounts and financial management the company; and where any suggestion cannot be implemented, the board of directors shall also mention the reasons for the same in its report. [Section 164(6)].

The company shall arrange for such means and resources as may be adequate for the fulfilment of responsibilities of the audit committee; and the audit committee may fix its internal rules of procedures on its own. [Section 164(5)].

The chairperson of the audit committee shall be present in the annual general meeting of the company [164(8)].

The audit committee shall meet as per necessity [164(9)].

Functions, duties and powers of audit committee as given in Section 165 are as follows:

- (a) To review the accounts and financial statements of the company and ascertain the truth of the facts mentioned in such statements;
- (b) To review the internal financial control system and the risk management system of the company;
- (c) To supervise and review the internal auditing activity of the company;
- (d) To recommend the names of potential auditors for the appointment of the auditor of the company, fix the remuneration and terms and conditions of appointment of the auditor and present the same in the general meeting for the ratification thereof;
- (e) To review and supervise as to whether the auditor of the company has observed such conduct, standards and directives determined by the competent body pursuant to the prevailing law as required to be observed in the course of doing auditing work;
- (f) Based on the conduct, standard and directives determined by the competent body pursuant to the prevailing law, to formulate the policies required to be observed by the company in respect of the appointment and selection of the auditor;
- (g) To prepare the accounting policy of the company and enforce, or cause to be enforced, the same;
- (h) Where any regulator body has provided for the long-form audit report (LFAR) to be set out in the audit report of the company, to comply with the terms required to prepare such report;
- (i) To perform such other terms as prescribed by the board of directors in respect of the accounts, financial management and audit of the company.

## **VOUCHING**

### **Answer to Q.N. 11**

#### **Vouching of sale proceeds of scrap materials**

- (a) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.
- (b) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.
- (c) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.
- (d) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.
- (e) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.
- (f) See that scrap materials sold have been billed and check the calculations on the invoices.
- (g) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it.

- (h) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

#### **Vouching of recovery of bad debts written off**

- (a) Ascertain the total amount of bad debts.
- (b) Ensure that recovery pertains to bad debts properly written off in earlier years and the decision for writing off bad debts was recorded properly
- (c) Ensure that all recoveries of bad debts have been properly recorded in the books of account.
- (d) Examine notification from the Court or from bankruptcy trustee, letters from collecting agencies or from debtors should also be seen.
- (e) Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.

### **VERIFICATION OF ASSETS AND LIABILITIES**

#### **Answer to Q.N. 12**

“Accounting estimate” means an approximation of the amount of an item in the absence of a precise means of measurement.

It means an approximation of the amount of an item in the absence of a precise means of measurement. Accounting estimates are made in conditions of uncertainty and involve the use of judgement. The use of reasonable estimates is an essential part of the preparation of financial statements.

As a result, the risk of material misstatement is greater when accounting estimates are involved. The auditor should obtain sufficient appropriate audit evidence as to whether an accounting estimate is reasonable in the circumstances and, when required, is appropriately disclosed.

The auditor should adopt one or a combination of the following approaches in the audit of an accounting estimate:

- Review and test the process used by management to develop the estimate which includes
  - Evaluation of the data and consideration of assumptions on which the estimate is based;
  - Testing of the calculations involved in the estimate;
  - Comparison, when possible, of estimates made for prior periods with actual results of those periods; and
  - Consideration of management's approval procedures.
- Use an independent estimate for comparison with that prepared by management;
- Review subsequent events which confirm the estimate made.

The auditor should make a final assessment of the reasonableness of the estimate based on the auditor's knowledge of the business and whether the estimate is consistent with other audit evidence obtained during the audit.

## **COMPANY AUDIT**

### **Answer to Q.N. 13**

As per Section 115 of Companies Act 2063, following are the functions and duties of auditor:

- 1) The auditor shall submit his/her report to the company, addressing to the shareholders or the appointing authority, certifying the Statement of Financial Position, Statement of Profit or Loss and Statement of cash flows based on the books of account, records and accounts audited by him/her.
- 2) The audit report shall be prepared in accordance with the prevailing law or in consonance with the auditing standards prescribed by the competent body; and such report shall disclose the matters to be set out prescribed under this Act.
- 3) The audit report as referred to in Sub-Section (2) shall also indicate the following matters, inter alia:
  - (a) Whether such information and explanations have been made available as required for the completion of audit;
  - (b) Whether the books of account as required by this Act have been properly maintained by the company in a manner to reflect the real affairs of its business;
  - (c) Whether the Statement of Financial Position, Statement of Profit or Loss and Statement of cash flows received have been prepared in compliance with the accounting standards prescribed under the prevailing law and whether such statements are in agreement with the books of account maintained by the company;
  - (d) Whether, in the opinion of the auditor based on the explanations and information made available in the course of auditing, the present balance sheet properly reflects the financial situation of the company, and the Statement of Profit or Loss and Statement of cash flows for the year ended on the same date properly reflect the profit or loss, cash flow of the company, respectively;
  - (e) Whether the board of directors or any representative or any employee has acted contrary to law or misappropriated any property of the company or caused any loss or damage to the company or not;
  - (f) Whether any accounting fraud has been committed in the company
  - (g) Suggestion, if any.

In this regard, the auditor has the responsibility to assess whether any loss or damage has been made to the company property and assets. The auditor should take the sufficient appropriate audit evidence from the management, ensure that necessary adjustments are made in the books of accounts, assess the extent and materiality of such damage and ensure that the material damages are properly disclosed in the notes. Further, as required by Section 115 of the Companies Act 2063, the auditor should report to the shareholders regarding the loss to the company due to this incident.

## **AUDIT OF SPECIAL SECTORS**

### **Answer to Q.N. 14**

Joint venture audits review operator activities, procedures and costs over a defined scope period. Non-operating partners schedule and fund a review of detail transactions and related



supporting documentation to ensure their individual ownership interests are productive and are being protected.

Joint venture audit is conducted to

- a. Confirm that all transactions and billed charges are in compliance with agreement;
- b. Ensure unrelated costs have not been billed incorrectly to the Joint Account;
- c. Perform a vendor audit review to confirm credits for deposits, refunds and returns have been appropriately reflected;
- d. Provide valuable insight about the Operator transactions to the Non-Operator investors; &
- e. Increase profitability by disqualifying and recovering any overcharges.

Objectives of typical joint venture audits are-

- Ensure billed charges are in compliance with the operating agreement and supported by adequate documentation.
- Ensure unrelated costs have not been charged to the project.
- Determine whether all vendor credits for deposits, refunds and returns have been appropriately reflected in net project costs.
- Ensure the operator activities are in compliance with the agreement, including maintaining adequate insurance coverage and timely regulatory reporting.
- Ensure goods, services and applicable taxes are paid in a timely manner.
- Ensure project assets and costs are adequately managed, controlled and reported. Analyse the cash call process and ensure funding adequately matches the operation needs without material surplus.

Joint venture audits are traditionally conducted in the following manner:

- i. Preliminary work, including notification to operator, data acquisition and transaction request.
- ii. On site testing at Operator location.
- iii. Development and Communication of Findings.
- iv. Summarization of Findings and Audit Close meeting.
- v. Preparation and Presentation of the Final Report.
- vi. Operator Response to Final Report.
- vii. Resolution and Settlement of Audit Issues.

## **GOVERNMENT AUDIT**

### **Answer to Q.N. 15**

Performance auditing is an independent, objective and reliable examination of whether government undertakings, systems, operations, programmes, activities or organisations are operating in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement.

Performance auditing seeks to provide new information, analysis or insights and, where appropriate, recommendations for improvement. Performance audits deliver new information, knowledge or value by:

- providing new analytical insights (broader or deeper analysis or new perspectives);
- making existing information more accessible to various stakeholders;
- providing an independent and authoritative view or conclusion based on audit evidence;
- providing recommendations based on an analysis of audit findings.

The principles of economy, efficiency and effectiveness can be defined as follows:

- a. The principle of economy means minimising the costs of resources. The resources used should be available in due time, in and of appropriate quantity and quality and at the best price.
- b. The principle of efficiency means getting the most from the available resources. It is concerned with the relationship between resources employed and outputs delivered in terms of quantity, quality and timing.
- c. The principle of effectiveness concerns meeting the objectives set and achieving the intended results.

Performance audits often include an analysis of the conditions that are necessary to ensure that the principles of economy, efficiency and effectiveness can be upheld. These conditions may include good management practices and procedures to ensure the correct and timely delivery of services. Where appropriate, the impact of the regulatory or institutional framework on the performance of the audited entity should also be taken into account.

## **COMPLETING AND REPORTING ON AN ASSURANCE ENGAGEMENT**

### **Answer to Q.N. 16**

NSA 706 *Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report* deals with the auditor's consideration of the inclusion in the auditor's report of:

- a. An Emphasis of Matter paragraph to draw users' attention to a matter presented or disclosed in the financial statements that the auditor judges important to their understanding of the financial statements; or
- b. An Other Matter(s) paragraph to draw users' attention to any other matter that may be relevant to their understanding of the financial statements or the audit.

In certain circumstances, an auditor's report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph does not affect the auditor's opinion. The paragraph would preferably be included after the paragraph containing the auditor's opinion but before the section on any other reporting responsibilities, if any. The emphasis of matter paragraph would ordinarily refer to the fact that the auditor's opinion is not qualified in this respect.

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- a. Include it immediately after the Opinion paragraph in the auditor's report;

- b. Use the heading “Emphasis of Matter;”
- c. Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements; and
- d. Indicate that the auditor’s opinion is not modified in respect of the matter emphasized.

### **Answer to Q.N. 17**

Key audit matters are those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

NSA 701, *Communicating Key Audit Matters in The Independent Auditor’s Report*, applies to the audit of general purpose financial statements of listed entities. Communicating key audit matters provides additional information to users of the financial statements to assist them in understanding those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period.

Communicating key audit matters may also assist users of the financial statements in understanding the entity and areas of significant management judgment in the audited financial statements, as such matters are areas of focus in performing the audit. The communication of key audit matters in the auditor’s report may also provide users of the financial statements a basis to further engage with management and those charged with governance about certain matters relating to the entity and the audited financial statements.

The auditor shall determine which of the matters communicated with those charged with governance are the key audit matters. In making this determination, the auditor shall take into account areas of significant auditor attention in performing the audit, including:

- a. Areas identified as significant risks in accordance with NSA 315 or involving significant auditor judgment.
- b. Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence.

Circumstances that required significant modification of the auditor’s planned approach to the audit, including as a result of the identification of a significant deficiency in internal control.

The auditor shall communicate the key audit matters determined in a separate section of the auditor’s report under the heading “Key Audit Matters.” The auditor’s report shall state that:

- a. Key audit matters are those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements [of the current period];
- b. Key audit matters are selected from matters communicated with [those charged with governance], but are not intended to represent all matters that were discussed with them;
- c. The auditor’s procedures relating to these matters were designed in the context of the audit of the financial statements as a whole; and
- d. The auditor’s opinion on the financial statements is not modified with respect to any of the key audit matters, and the auditor does not express an opinion on these individual matters.

## NEPAL STANDARDS ON AUDITING (NSA)

### Answer to Q.N. 18

Issuance of the engagement letter is one of the procedures to be followed before the commencement of an audit and is in response to the appointment for a new audit assignment. As per NSA 210 *Terms of Audit Engagement*, it is in the interest of both client and auditor that the auditor sends an engagement letter, preferably before the commencement of the engagement, to help in avoiding misunderstandings with respect to the engagement. The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports

The auditor may decide not to send a new engagement letter each period. Auditor should assess the need whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.

However, in case of the following it is appropriate to send a new letter:

- a. Any indication that the client misunderstands the objective and scope of the audit;
- b. Any revised or special terms of the engagement;
- c. A recent change of senior management;
- d. A significant change in ownership;
- e. A significant change in nature or size of the client's business;
- f. A change in legal or regulatory requirements.
- g. A change in the financial reporting framework adopted in the preparation of the financial statements; and
- h. A change in other reporting requirements.

If an auditor is requested to change terms of the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

Where it is changed, the auditor and the client should agree on the new terms.

The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report to board of directors or shareholders, the circumstances necessitating such withdrawal.

### Answer to Q.N. 19

As per NSA 320 *Materiality in Planning and Performing an Audit*, the concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. These judgments provide a basis for:

- (a) Determining the nature, timing and extent of risk assessment procedures;

- (b) Identifying and assessing the risks of material misstatement; and
- (c) Determining the nature, timing and extent of further audit procedures.

When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality.

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is in its life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The relative volatility of the benchmark.

### **Answer to Q.N. 20**

NSA 510 *Initial Engagements - Opening Balances* provide guidance regarding opening balances when the financial statements are audited for the first time or when the financial statements for the prior period were audited by another auditor.

Opening balance means those account balances which exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of:

- a) Transactions of prior periods and reflect the effects of transactions and events of prior periods; and
- b) Accounting policies applied in the prior period.

In an initial audit engagement, the auditor will not have previously obtained audit evidence supporting such opening balances.

For initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

- a. The opening balances do not contain misstatements that materially affect the current period's financial statements;
- b. The prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated; and
- c. Appropriate accounting policies reflected in the opening balances are consistently applied or changes in accounting policies have been properly accounted for and adequately disclosed in accordance with applicable reporting framework.

The auditor should consider performing one or more of the following:

- (i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;
- (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

When the prior period's financial statements were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by reviewing the predecessor auditor's working papers. In these circumstances, the current auditor would also consider the professional competence and independence of the predecessor auditor. If the prior period's auditor's report was modified, the auditor would pay particular attention in the current period to the matter which resulted in the modification. The auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements in accordance with NSA 315.

# **Paper-3**

## **Corporate & Other Laws**

## **NEPAL CHARTERED ACCOUNTANT ACT, 2053 AND RULES, 2061**

### **Question No. 1**

Election of the 9<sup>th</sup> Council of the Institute of Chartered Accountants of Nepal (ICAN) was conducted recently and 14 members were elected. Additional 3 council members were nominated by the Government of Nepal on recommendation of the Governor of Nepal Rastra Bank since he was considered to be an expert in the concerned field being a Chartered Accountant and also the council member of 5<sup>th</sup> Council of ICAN. Describe as per the provisions of Nepal Chartered Accountants Act 2053, whether the Constitution of Council is valid.

### **Question No. 2**

Mr. Rajesh Reddy, an Indian citizen holding membership of the Institute of Chartered Accountants of Nepal (ICAN) was interested to register and operate an audit firm in Nepal. He approached Mr. Devraj Dahal, a member holding certificate of practice of ICAN for partnership with the proposal that Mr. Reddy has a very strong public relationship with the business persons of Nepal and will give guarantee to bring more than 80% of the client in the total business and hence requires 60% of the total profit. Mr. Dahal was very happy with the terms and rushed to register the partnership firm along with the partnership deed. Mention the related provisions of registration of audit firm as per Nepal Chartered Accountants Rule, 2061.

## **COMPANIES ACT, 2063**

### **Question No. 3**

Sanu Laghubitta Bittiya Sanstha Ltd. is in operation since 5<sup>th</sup> Ashwin 2075 and has been regularly publishing its audited financial statements from the date of operation. The company published a notice on 4<sup>th</sup> Poush 2079 regarding its initial public offer inviting for subscription of its shares with payment of full value of shares along with the application. However, section 27 of the Companies Act, 2063 states that in inviting an application by a public company for the subscription of its shares, no amount exceeding fifty per cent of the face value of each share shall be demanded with the application. Is the issue of share by the concerned company inconsistent with the Companies Act, 2063?

### **Question No. 4**

Ms. Bibisha Rana, one of the shareholders of Wash Company Ltd. had subscribed 100,000 shares of Rs. 100 each. Out of the subscribed shares, she had fully paid for 40,000 shares of Rs. 100 each and the remaining 60,000 shares of Rs. 100 each were unpaid. Besides these, there were 200,000 shares of Rs. 100 each unpaid. The company called up for all of the unpaid share. All the shareholders paid the unpaid share except Ms. Rana who paid only for 50,000 shares of Rs. 100 each due to financial crisis. One year after the unpaid shares were called up, Wash Company Ltd. went into liquidation for not being able to pay its creditors. The company had Rs. 10 crores payable to its creditors. One of the creditor to whom Rs. 2 crore was payable by the company sued Ms. Rana on the ground that since she had not paid the subscribed amount in full, she should pay whole of the creditors. Advise Ms. Rana as per Companies Act, 2063, whether she is liable to pay the creditors.



**Question No. 5**

Proposal Company Ltd. is a newly incorporated company. The promoters had no information about the publication of its MOA and AOA and thus requested you to give necessary suggestion on the following matters as per the Companies Act, 2063.

1. Is a newly incorporated company required to publish its MOA and AOA? If yes, what is the time limit?
2. Will the answer be different if an existing company makes amendment in its MOA and AOA?
3. Where should the company keep the amended MOA and AOA?

**Question No. 6**

Hamro Company Pvt. Ltd. provided loan to its employees and directors to purchase the shares of its holding company under the scheme of selling shares to its directors and employees. Explain the validity of the transaction with reference to Companies Act, 2063.

**SECURITIES ACT, 2063****Question No. 7**

Mr. Hem Pathak, representative of ICAN and Mr. Gopal Shah, representative of FNCCI are the members of SEBON. They had some agenda for the Board Meeting and so wrote a request letter to the Chairperson to call the Board Meeting. The Chairperson refused to call the meeting mentioning that the request letter should be signed by all the members of the board. Is the act of the Chairperson valid? Explain in line with Securities Act, 2063.

**Question No. 8**

Nepal Stock Exchange (NEPSE) revokes the listing of the securities of Photoshop Company Ltd. on the ground of failure to make a notice of information that was capable of affecting the value of its securities. The shareholders organized a protest in front of office of NEPSE to pay compensation against the loss or damage they suffered due to delisting of securities. Will NEPSE be liable towards the shareholders of Photoshop Company Ltd.? Explain with reference to Securities Act, 2063.

**BANKS AND FINANCIAL INSTITUTIONS ACT, 2073****Question No. 9**

New York Bank of America wishes to incorporate a Financial Institution in joint venture with a corporate body in Nepal. What are the additional documents and details required for obtaining prior approval for the incorporation of Bank or Financial Institution in Foreign Investment?

**Question No. 10**

The Chairperson of the Board of Directors of Bagmati Development Bank Ltd. passed an agenda in the Board meeting dated 10<sup>th</sup> Magh, 2079 to reappoint one of its independent directors Mr. Ravi Silwal for the second term since he was the only person possessing the

required qualifications and experience set forth in BAFIA, 2073 and successfully completed his first tenure. Is Mr. Silwal eligible to be appointed as an independent director? What is the Term of Office of Directors?

## **NEPAL RASTRA BANK ACT, 2058**

### **Question No. 11**

Electric Industries Pvt. Ltd. was dissatisfied with the service of one of the class A financial institutions of Nepal and thus wishes to open an account in the Nepal Rastra Bank (NRB) for operation of its banking transactions with an expectation of receiving desired service quality from the central bank. Explain as per the provisions of Nepal Rastra Bank Act, 2058 whether NRB will open and operate account for the concerned industry. Also list out the functions that are not to be carried out by NRB.

### **Question No. 12**

Mr. Hem Karna, who was found to be involved in money laundering offense, offered some heavy gifts to Ms. Sadhana Sedai, a Secretary at the Ministry of Finance and a director of Nepal Rastra Bank. The gift was believed to cause undue influence in discharging her duties. Can she accept the gift? Explain with reference to Nepal Rastra Bank Act, 2058.

## **INSURANCE ACT, 2079**

### **Question No. 13**

Quality Life Insurance Company Ltd. is a company registered in the Office of Company Registrar with registration number of 534222/2077/78. During the review of the documents of company, it was noticed that the insurance business was conducted only through mere registration in the Office of Company Registrar. Advise the company on the following matters as per the Insurance Act, 2079.

1. Whether the company can be operated without obtaining license?
2. What fines may be imposed to the company?

## **INDUSTRIAL ENTERPRISES ACT, 2076**

### **Question No. 14**

The promoters of Nepal Mountain Industries Ltd. appointed you as a valuator for valuation of its fixed capital for the purpose of industry registration. They requested you to include pre-investment and pre-operational expenses as a part of fixed capital so that they can be registered as a medium scale industry. With reference to Industrial Enterprises Act, 2076 answer the following:

1. Can the concerned expenses be included for calculating fixed capital?
2. What is the fixed capital required for medium scale industry?

**Question No. 15**

Ms. Menuka Upadhyaya has a habit of reading newspapers every day. She was frustrated with the everyday news of declining foreign exchange reserve and wishes to register and operate a manufacturing industry of cosmetic products in Nepal with an effort to stop the outflow of foreign exchange for the purchase of cosmetics. For that purpose, she had to import the required raw materials from Dubai and she did not have enough capital required for the import. Kindly advise her about the additional facilities that are provided to female entrepreneurs by the Industrial Enterprises Act, 2076.

**LABOUR ACT, 2074****Question No. 16**

Department of Labour received a complaint against Hamro Employment Group of Company Ltd. for employing children and accordingly sent a letter demanding justification to the company who had employed ten children with the age range of 12 to 14 years. The company wrote a justification letter mentioning that the children were of very poor family background, had nothing to eat and their parents approached the owner of the company to give employment to their children. The company has been providing remuneration and facilities to the children as per the Labour Act and the children were only required to serve tea to the employees twice a day. The company also claimed that the children and their parents were very happy with their job and so the company should be rewarded rather than punished for his contribution towards decreasing unemployment of the country and reducing poverty. Give your views in accordance with the provision of the Labour Act, 2074. What are the duties of Labour Office regarding child employment?

**Question No. 17**

Mrs. Kumari Khatiwada (Dhamala) was happily married for seven years and had a baby of four years. She was an MBS graduate and wanted to continue her career that she had left during her pregnancy. She went to the same company Hukum Enterprises Ltd. and requested the HR manager for a job. The HR Manager verbally proposed her to start with working for only six days a month until any of the position becomes vacant since the official post (darbandi) was not vacant. She accepted the verbal proposal and joined office from 15<sup>th</sup> Magh, 2079 without signing any employment contract. Comment whether there is a violation of the provisions of Labour Act, 2074.

**BONUS ACT, 2030 (AMENDED 2074)****Question No. 18**

M. Tech. Company Ltd. allocated Rs. 10 crores which is 10% of the net profit of the enterprise to its employees as bonus. The company distributed Rs. 7 crores to its employees and separated Rs. 3 crores for the employee welfare fund and national level welfare fund. You are the compliance head of the company and the CEO asked you whether there are any reporting requirements to the department of labour regarding the bonus distribution as per the provisions of Bonus Act, 2030.

## **NEGOTIABLE INSTRUMENTS ACT, 2034**

### **Question No. 19**

Mr. Hari Baral and Mr. Shyam Siwakoti are running a partnership firm in Kathmandu. Mr. Baral promises Mr. Siwakoti, through a promissory note, to pay a crypto currency equivalent to Rs.100,000 to Mr. Siwakoti if he can bring consultancy business from American client within 12<sup>th</sup> December 2022. Mr. Siwakoti was successful in the assignment of bringing consultancy business of Rs. 120,000 from American Client. On 25<sup>th</sup> December, Mr. Shiwakoti asked Mr. Baral to pay the amount specified in the promissory note but Mr. Baral denied to pay. Please specify whether the Promissory Note is a valid instrument as per Negotiable Instruments Act, 2034.

## **SOCIAL WELFARE ACT, 2049**

### **Question No. 20**

Social Welfare Council (SWC) is in the process of audit of its financial statement of F.Y 2078/79. All the team members of SWC including the Chief Executive Officer, Mr. Prem Sharma were newly recruited on 5<sup>th</sup> Shrawan, 2079. The audit is ongoing and seems that it would not be completed at the end of Ashwin 2079. Mr. Sharma is worried about the reporting deadline of the audit to the agencies of the Government. Also, he is unaware when the audit report shall be submitted by the social organizations or institutions affiliated with SWC to the office of SWC. Advise Mr. Sharma as per the provisions of Social Welfare Act, 2049.

## **WORLD TRADE ORGANIZATION AND NEPALESE LAWS**

### **Question No. 21**

On 5<sup>th</sup> Magh 2079, Money Bill was presented in the National Assembly. The following agenda on the bill was discussed and passed.

1. Tax to be levied at the rate of 1% on the total sales amount and the same shall be used for establishing pesticide industry as Nepal is facing problem in importing pesticide during agriculture plantation season.
2. 50% Tax exemption was announced to the industry undergoing legal cases against Inland Revenue Department for tax assessment.

Discuss as per the Constitution of Nepal the legal status of the above agenda passed by the National Assembly.

## **CIVIL CODE, 2074 (PART 5) (MULUKI DEWANI SAMHITA, 2074)**

### **Question No. 22**

Mr. Basu Deva lost his passport and iPhone at the airport while returning from the United Kingdom. He made an offer through the newspaper publicly that he will pay Rs. 50,000 to any person whosoever returns the lost passport and iPhone within 10 days. Mr. Shiva Rimal found the lost goods and returned the goods on the 9<sup>th</sup> day of advertisement to the location specified in the advertisement. On the basis of Muluki Dewani Samhita, 2074 answer the following:

1. Is Mr. Basu Deva liable to pay the amount specified in the advertisement to Mr. Shiva Rimal in the above case?

2. Is Mr. Basu Deva liable to pay the amount specified in the advertisement to Mr. Shiva Rimal if Mr. Shiva Rimal returns the goods found to the police without knowing such advertisement?
3. Is Mr. Basu Deva liable to pay the amount specified in the advertisement to Mr. Shiva Rimal if he returns the goods on the 11<sup>th</sup> day?

## **Answers**

### **NEPAL CHARTERED ACCOUNTANTS ACT, 2053 AND RULES, 2061**

#### **Answer No. 1**

In the given case, 3 members of the Council of The Institute of Chartered Accountants of Nepal (ICAN) apart from the members elected from the 9<sup>th</sup> election of council were nominated by the Government of Nepal on recommendation of the Governor of Nepal Rastra Bank.

Section 7(3) of Nepal Chartered Accountant Act, 2053 mentions that the Council shall consist of the following council members:

- (a) Ten persons elected by the chartered accountant members from amongst themselves - Member
- (b) Four persons elected by the registered auditor members from amongst themselves -Member
- (c) Three persons nominated by Government of Nepal upon the recommendation of the Auditor General, from amongst the persons having experience on accountancy -Member

Hence, three persons nominated by the Government of Nepal as per the recommendation of Governor of Nepal Rastra Bank is against the provision of ICAN Act and thus the constitution of 9<sup>th</sup> council of ICAN is not valid.

#### **Answer No. 2**

In the given case, Mr. Rajesh Reddy, an Indian citizen holding membership of ICAN agreed to register a partnership audit firm with Mr. Devraj Dahal, a member holding Certificate of Practice of ICAN with a profit sharing ratio of 60% and 40%.

As per rule 56(1) of Nepal Chartered Accountants Rules, 2061, foreign national qualified to operate audit firm may register an audit firm in partnership with Nepali citizen. Further, as per rule 58(5), any audit firm registered by a foreign national, the maximum share of the foreign national shall not exceed 51%.

Hence, Mr. Reddy should decrease the percentage of his shareholding to 51% from 60% to register the firm in ICAN.

### **COMPANIES ACT, 2063**

#### **Answer No. 3**

In the given case, Sanu Laghubitta Bittiya Sanstha Ltd. is in operation since 5<sup>th</sup> Ashwin 2075 and has been regularly publishing its audited financial statements from the date of operation. The company published a notice on 4<sup>th</sup> Poush 2079 regarding its initial public offer inviting for subscription of its shares with payment of full value of shares along with the application.

According to Section 27(3) of the Companies Act, 2063, in inviting an application by a public company for the subscription of its shares, no amount exceeding fifty per cent of the face value of each share shall be demanded with the application.

Provided, however, that in raising capital by a company which has been in operation since at least three years ago by publishing its audited fiscal statements for its last three years, at the time of publication of its prospectus, this provision shall not be applicable.

Hence, Sanu Laghubitta Bittiya Sanstha Ltd. can publish a notice inviting for subscription of its shares with payment of full value of shares along with the application.

#### **Answer No. 4**

In the given case, Ms. Bibisha Rana, one of the shareholders of Wash Company Ltd. is unable to pay for 10,000 shares of Rs. 100 each subscribed by her. One year after the unpaid shares were called up, Wash Company Ltd. went into liquidation when the company had Rs. 10 crore payable to its creditors. One of the creditor to whom Rs. 2 crore was payable by the company sued Ms. Rana on the ground that since she had not paid the subscribed amount in full, she should pay whole of the creditors.

According to Section 8 of the Companies Act, 2063, the liability of a shareholder of a company incorporated under this Act in respect of its transactions shall be limited on to the maximum value of shares which he/she has subscribed or undertaken to subscribe.

In the given case, one of the creditor to whom Rs. 2 crore was payable by the company sued Ms. Rana on the ground that since she had not paid the subscribed amount in full, she should pay whole of the creditors. Hence as per section 8 of Companies Act, Ms. Rana is liable to pay the company only to the extent of unpaid share of the shares subscribed by her i.e. Rs. 10 lakhs only and not the whole amount outstanding to the creditor.

#### **Answer No. 5**

In the given case, the promoters of Proposal Company Ltd., a newly incorporated company had no information about the publication and amendments of its MOA and AOA.

As per Section 22 of the Companies Act, 2063;

1. A public company shall publish its memorandum of association and articles of association within three months after getting license to commence its business.
2. If any amendment is made to the memorandum of association and articles of association of a public company, the amended memorandum of association and articles of association shall be published within three months after such amendment.
3. A public company shall so keep the memorandum of association and articles of association published pursuant to sub-section (1) or (2) at its registered office that such memorandum and articles can be made available as and when so demanded by the concerned.

Thus, Proposal Company Ltd. should publish its MOA and AOA within three months after getting license to commence its business.

In case amendment is made in the existing MOA and AOA, it should be published within three months after such amendment.

The Proposal Company Ltd. should keep the MOA and AOA at its registered office.

#### **Answer No. 6**

In the given case, Hamro Company Pvt. Ltd. provided loan to its employees and directors to purchase the shares of its holding company under the scheme of selling shares to its directors and employees.

As per Section 62 of Companies Act, 2063, no company shall provide any loan or financial assistance of any kind to any person for purchasing its own shares or the shares of its holding company or getting entitlement to such shares in any manner.

Provided, however, that nothing contained in this section shall prevent a company from providing loans to any employees of the company to purchase the fully paid up shares of that company or its holding company or acquire ownership over such share in any manner, under a scheme of selling shares to its employees.

Thus, Hamro Company Pvt. Ltd. can provide loan only to the employees to purchase the shares of its holding company under a scheme of selling shares to its employees, but providing loan to directors is against the provision of Companies Act, 2063.

## **SECURITIES ACT, 2063**

### **Answer No. 7**

In the given case, Mr. Hem Pathak, representative of ICAN and Mr. Gopal Shah, representative of FNCCI and both being the members of SEBON wrote a request letter to the Chairperson to call the Board Meeting. The Chairperson refused to call the meeting mentioning that the request letter should be signed by all the members of the board.

According to sec 6 of the Securities Act, 2063,

1. The chairperson shall call the meeting of the Board as per necessity. Such a meeting shall be held at least once a month.
2. The meeting of the Board shall be held on such date, at such time and at such place as may be specified by the chairperson.
3. The meeting of the Board shall be presided over by the chairperson and by a member chosen by the members from amongst themselves, in the absence of the chairperson.
4. Where at least two members request in writing to call a meeting of the Board, the chairperson shall have to call a meeting of the Board within seven days from the date of receipt of such notice.
5. The secretary of the Board shall provide the agenda to be discussed at the meeting to the members, along with the notice for the meeting.
6. The presence of more than fifty percent of the total number of members of the Board shall be deemed to have been constituted a quorum for a meeting of the Board.
7. A majority opinion shall prevail at the meeting of the Board and in the event of a tie; the person presiding over the meeting shall exercise the casting vote.
8. There shall be maintained a separate minute book recording the names of members present at, matters discussed at and decisions made by each meeting of the Board, and such a book shall be signed by members present.
9. The decisions made by the Board shall be authenticated by the secretary of the Board and shall provide to all members.
10. Other procedures relating to the meeting of the Board shall be as determined by the Board itself.

Thus, as per sub-section 4, the Chairperson should call the meeting of the board within seven days from the date of receipt of such notice at the request of the two members.



**Answer No. 8**

In the given case, Nepal Stock Exchange (NEPSE) revokes the listing of the securities of Photoshop Company Ltd. on the ground of failure to make a notice of information that was capable of affecting value of its Securities. The shareholders organized a protest in front of office of NEPSE to pay compensation against the loss or damage they suffered due to delisting of securities.

As per section 35 of the Securities Act, 2063, where a body corporate issuing any securities has enlisted the securities by making agreement with a stock exchange and the stock exchange revokes the listing of such securities by the reason of the failure of such body corporate to observe such matters as required to be observed by it under this Act or the rules or bye-laws framed under this Act and any shareholder sustains any loss and damage by virtue of such revocation of enlisting, the directors of such a body corporate shall personally or collectively pay compensation to such a shareholder.

In the given case, NEPSE will not be liable towards the shareholders of the company and the directors of Photoshop Company Ltd. shall personally or collectively pay compensation to the shareholders.

**BANKS AND FINANCIAL INSTITUTIONS ACT, 2073****Answer No. 9**

In the given case, New York Bank of America wishes to incorporate a Financial Institution in joint venture with a corporate body in Nepal.

The additional documents and details required for obtaining prior approval for incorporation of Bank or Financial Institution in Foreign Investment is mentioned in the section 5 of the Bank and Financial Institutions Act, 2073 as follows;

A foreign bank or financial institution shall, for the purpose of obtaining prior approval to incorporate a bank or financial institution as a subsidiary company in accordance with this Act in joint venture with a corporate body registered in Nepal or with a Nepali citizen or to maintain the share capital as specified by the Rastra Bank, shall submit in addition to the documents set forth in Sub-Section (1) of Section 4 the following documents and details along with the fee specified by the Rastra Bank:-

- (a) The Memorandum of Association, Articles of Association of the foreign bank or financial institution and a copy of the certificate of incorporation of the bank or financial institution in the country concerned and capital structure thereof,
- (b) A copy of the license of the foreign bank or financial institution obtained from the country concerned for carrying out banking and financial transactions,
- (c) Details as to the principal place of business,
- (d) A certified copy of the audited balance-sheet and profit and loss account of the last three years of the foreign bank or financial institution,
- (e) Details as to the proposed business plan in Nepal, business strategies and types of transaction to be carried out, internal control, and risk management,
- (f) Decision made by the foreign bank or financial institution as per the prevailing laws of the country concerned to open bank or financial institution in Nepal and the authority granted by the regulatory body of the country concerned.

Thus, the above additional documents are required for obtaining prior approval to New York Bank of American Ltd. so as to incorporate a Financial Institution in joint venture with a corporate body in Nepal.

#### **Answer No. 10**

In the given case, the Chairperson of Board of Directors of Bagmati Development Bank Ltd. passed an agenda in the Board meeting to reappoint Mr. Ravi Silwal, one of its independent director for the second term.

As per section 15, the term of office of a Director shall be for a maximum period of four years as provided for in the Articles of Association and he/she may be eligible to be reappointed or re-nominated.

Provided that an Independent Director may be appointed for only one term of office.

However, the Executive Chairperson or Managing Director appointed after the commencement of this Act shall remain in office only for two consecutive terms.

In the given case, the re-appointment of Mr. Silwal is against the provision of the section 15(1) of BAFIA. Further, as per the provision of the section 15(2), the term of office of the Chairperson or Managing Director is for a maximum period of four years and can be re-appointed.

#### **NEPAL RASTRA BANK ACT, 2058**

#### **Answer No. 11**

In the given case, Electric Industries Pvt. Ltd. was dissatisfied with the service of one of the class A financial institutions of Nepal and thus wishes to open an account in the Nepal Rastra Bank (NRB) for operation of its banking transactions.

As per section 13 of Nepal Rastra Bank Act, 2058, the Bank may open and operate account for Government of Nepal and other governmental bodies, commercial banks and financial institutions, public corporations, foreign diplomatic missions, foreign central banks, foreign banks and international organization, associations. The procedures for opening and operating such accounts shall be as prescribed by the Bank.

Provided that, the Bank shall not operate account for any individual, industry and political organization.

Thus, as per section 13, Electric Industries Pvt. Ltd. cannot open an account in the Nepal Rastra Bank (NRB) for operation of its banking transactions.

As per section 7 of the Act, the functions not to be carried out by the NRB are as follows;

Except otherwise provided for in this Act, the Bank shall not carry out the following functions:-

- (a) Providing any loan, accepting any type of deposit or making any type of financial gift;
- (b) Purchasing shares of any commercial bank, financial institution, public corporation or a company or acquiring any type of proprietary right in any financial, commercial, agricultural, industrial or other institution;
- (c) Carrying out any type of trade; and

- (d) Acquiring right over movable and immovable property by way of purchase, lease or in any manner whatsoever.

Provided that the Bank may acquire such property as required for carrying out its function or for achieving its objectives.

### **Answer No. 12**

In the given case, Mr. Hem Karna, involved in money laundering offence, offered gift that was believed to cause undue influence in discharging duties to Ms. Sadhana Sedai, Secretary at Ministry of Finance and a director of Nepal Rastra Bank.

As per section 37 of the Nepal Rastra Bank Act, 2058,

1. The Governor and Deputy Governor shall, so long in office, fully devote his/her professional service to the Bank. Except nominated by the Bank they shall not be entitled to assume any type of office or accept job in or render services to anyone else with or without remuneration.

Provided that this Sub-section shall not restrict to render services by assuming any post in any non-profit making organizations such as Medical Association, Engineers Association, Bar Association, Bankers Association, Chartered Accountants Association and in any other trade and professional organization.

2. The Governor, Deputy Governor or Director shall have to provide highest priority to the interests of the Bank while discharging their official duties.
3. The Governor, Deputy Governor or Director shall not accept, personally or through any person having any commercial, financial relationship with him, any type of gift or loan in a manner that may cause undue influence of any type in discharging his duties.

Thus, Ms. Sadhana Sedai should not accept the gift that was believed to cause undue influence in discharging duties to her offered by Mr. Hem Karna.

### **INSURANCE ACT, 2079**

#### **Answer No. 13**

In the given case, Quality Life Insurance Company Ltd. is a company registered in the Office of Company Register with registration number of 534222/2077/78. The company is involved in the business of insurance but was conducted only through a mere registration in the Office of Company Register.

As per section 24 of the Insurance Act, 2079, no person shall operate or cause to operate the Insurance Business without obtaining a certificate pursuant to this Act.

As per section 26, the person willing to conduct insurance business should by paying the fees prescribed apply along with the documents mentioned in this section for prior approval in the Insurance Authority.

Further, as per section 141, the amount so involved in the offence shall be confiscated along with fine of three times of the amount so involved in the offense and imprisonment from 5 year to 10 years.

Thus, Quality Life Insurance Company Ltd. should obtain prior approval from the Insurance Authority by paying the fees prescribed apply along with the documents mentioned in section 26 and obtain a certificate pursuant to section 24.

Further, the company will be fined with the amount equivalent to three times of the amount so involved in the offense along with the amount confiscated and imprisonment from 5 year to 10 years as per section 141 of the Insurance Act, 2079.

## **INDUSTRIAL ENTERPRISES ACT, 2073**

### **Answer No. 14**

In the given case, the promoters of Nepal Mountain Industries Ltd. requested to include pre-investment and pre-operational expenses as a part of fixed capital.

According to section 18 of Industrial Enterprises Act, 2076,

1. While valuating the fixed capital of an industry for the purposes of this Act, valuation is made taking into account the following assets:
  - (a) physical structure constructed or improvement on land, underground, space, water or below water;
  - (b) physical structure constructed above land (e.g. sewage, internal road, drinking water related infrastructure, water supply system);
  - (c) office, factory, building or ware house of the industry;
  - (d) residence building constructed for employees or workers;
  - (e) electric supply and related equipment and system;
  - (f) machinery, equipment, tools and reserve spare parts thereof;
  - (g) means of transportation;
  - (h) office goods and equipment of capital nature;
  - (i) fixture and furniture;
  - (j) communication materials and related equipment and system.
2. In addition to the assets set forth in sub-section (1), the following expenses incurred prior to the establishment of an industry or at various stages of construction are also valuated as the fixed capital of the industry:
  - (a) technical and inspection expenses to be capitalized;
  - (b) pre-investment and pre-operational expenses;
  - (c) interest expenses to be capitalized;
  - (d) environmental study and research expenses prior to the operation of the industry.

Further, According to section 17 of Industrial Enterprises Act, 2076,

1. For the purposes of this Act, industries are classified into the following:
  - (a) Micro-industry: An industry with the following conditions other than an industry requiring permission under section 8 is considered to be a micro-enterprise:
    - (1) with the fixed capital not exceeding two million rupees, excluding house and land;
    - (2) the entrepreneur himself or herself is involved in the operation and management of the industry;
    - (3) with a maximum of nine workers including the entrepreneur;

- (4) with annual transaction of less than ten million rupees;
- (5) with the capacity of electric energy, fuel or other oil engine to be consumed by the engine, equipment or machine, if any, used being twenty KW or less.
- (b) Cottage industry: An industry in the following condition is considered to be a cottage industry:
  - (1) based on traditional skills and technology;
  - (2) labour-oriented and based on specific skills or local raw materials and local technology, arts and culture;
  - (3) with the capacity of electric energy to be consumed by the engine, equipment or machine, if any, used being up to fifty KW;
  - (4) any industry mentioned in Schedule-2.
- (c) Small industry: An industry with the fixed capital not exceeding one hundred fifty million rupees, other than a micro enterprise and cottage industry;
- (d) Medium industry: An industry with the fixed capital exceeding one hundred fifty million rupees but not exceeding five hundred million rupees;
- (e) Large industry: An industry with the fixed capital exceeding five hundred million rupees.

Thus, as per section 18(2), pre-investment and pre-operational expenses can be included in the calculation of fixed capital.

As per section 17(1), the fixed capital required for medium scale industry is from one hundred fifty million rupees to five hundred million rupees.

### **Answer No. 15**

In the given case, Ms. Menuka Upadhyaya wishes to register and operate a manufacturing industry of cosmetic products in Nepal with an effort to stop the outflow of foreign exchange for the purchase of cosmetics. For that purpose, she had to import the required raw materials from Dubai and she did not have enough capital required for the import.

According to Sec 27 of Industrial Enterprises Act, 2076, the additional facilities for female entrepreneurs are as follows;

1. Notwithstanding anything contained in the prevailing law, if an industry or firm is registered with the sole ownership of a female entrepreneur, it is entitled to thirty-five percent exemption on the fee or charge leviable on the registration of that industry or firm under the prevailing law.
2. Notwithstanding anything contained in the prevailing law, an industry registered with the sole ownership of a female entrepreneur is entitled to twenty percent exemption on the fee or charge leviable under the prevailing law on the registration of an industrial property to be used in that industry.
3. If a female entrepreneur intends to establish a new industry within an industrial zone or industrial village, the body operating such area shall be given priority to providing a space.
4. If an industry with the sole ownership of a female entrepreneur requests for a loan for the purpose of exporting its industrial products, an export loan may be provided as prescribed

through the banking system from a fund disbursing loans for female entrepreneurs on the basis of financial situation of the female entrepreneur.

## **LABOUR ACT, 2074**

### **Answer No. 16**

In the given case, Department of Labour sent a letter demanding justification to Hamro Employment Group of Company Ltd. for employing ten children with the age of 12 to 14 years. Hamro Employment Group of Ltd. claimed that since the company had paid the remuneration and facilities as per the Labour Act, 2074 to the children from a poor family and the children did not have much work load, they weren't liable to the punishment. Rather, the company should be rewarded for the contribution towards decreasing unemployment of the country and reducing poverty.

Section 5 of Labour Act, 2074 prohibits on employment of children. It states that no person shall so employ a child in any work as to be contrary to law.

As per section 94(g) the Labour Office's duty is to inspect as to whether or not children have been employed, and immediately rescue them if found employed and take action against such an employer.

Hence Hamro Employment Group of Company Ltd. should be punished as per the Labour Act, 2074 on account of employing children in contrary to the act. The Labour Office should inspect as to whether or not children have been employed, and immediately rescue them and take action against such employer.

### **Answer No. 17**

In the given case, Mrs. Kumari Khatiwada (Dhamala), an MBS graduate wanted to continue her career in Hukum Enterprises Ltd. where she had left during her pregnancy. The HR Manager verbally proposed her to start working for only six days a month until any of the position becomes vacant for which she agreed and joined office from 15<sup>th</sup> Magh 2079.

As per section 10 of the Labour Act, 2074, "casual employment" means employment that the employer provides or has provided to the labour on the condition that the labour has to provide any service or perform any work, for seven days or less within a period of one month. Thus, the nature of employment is a casual employment.

Further, section 11 prohibits on employment without entering into employment contract.

1. No employer shall employ a person without entering into an employment contract.
2. Notwithstanding anything contained in sub-section (1), it shall not be necessary to enter into an employment contract in writing for a casual employment.
3. While entering into an employment contract pursuant to sub-section (1), remuneration, benefits to be received by the labour, conditions of employment and other matters as prescribed shall be set out in such a contract.

Thus, since the nature of employment is a casual employment, as per section 11(2), it shall not be necessary to enter into an employment contract in writing for a casual employment.

Hence, in the above case Labour Act, 2074 is not violated.

## **BONUS ACT, 2030**

### **Answer No. 18**

In the given case, M. Tech. Company Ltd. allocated Rs. 10 crores which is 10% of the net profit of the enterprise as bonus. The company distributed Rs. 7 crores to its employees and separated Rs. 3 crores for the employee welfare fund and national level welfare fund.

As per section 14 of Bonus Act, 2030, the management of each factory and enterprise shall have to submit details in the format as prescribed to the Labour Office within seven days from the date of completion of bonus distribution.

Hence, M. Tech. Company Ltd. should submit details to the Labour Office within seven days from the date of completion of distribution of bonus.

## **NEGOTIABLE INSTRUMENTS ACT, 2034**

### **Answer No. 19**

In the given case, Mr. Hari Baral promises his partner Mr. Shyam Siwakoti to pay a crypto currency equivalent to Rs.100,000 by a promissory note if Mr. Siwakoti brings consultancy business from American client within 12<sup>th</sup> December 2022. Mr. Siwakoti was successful in the assignment of bringing consultancy business of Rs. 120,000 from American Client. Mr. Baral denied to pay.

According to section 26 of Negotiable Instruments Act, 2034 (1977), the person obtaining a negotiable instrument by means of any offence or fraud or unlawful consideration or the person, who found the lost negotiable instrument, cannot make a claim upon the amount mentioned on such instrument with drawer, acceptor or holder of such negotiable instrument.

Since, transaction of crypto currency is illegal in Nepal, it is an unlawful consideration. Thus, Mr. Siwakoti cannot make a claim and Mr. Baral is not liable to pay.

## **SOCIAL WELFARE ACT, 2049**

### **Answer No. 20**

In the given case, Social Welfare Council (SWC) is in the process of audit of its financial statements of F.Y 2078/79. All the team members of SWC were newly recruited. The ongoing audit is not supposed to be completed at the end of Ashwin 2079 and the chairman is worried about the reporting deadline of the audit report to the agencies of the Government. He also wants to know the deadline of submission of the audit report by the social organizations or institutions affiliated with SWC to the office of SWC.

As per section 23(1) of Social Welfare Act, the Council shall submit an audit report to the Government of Nepal within six months after the completion of its fiscal year, along with detail descriptions of its work and activities.

Further, the social organizations or institutions affiliated with the Council shall have to submit audit report, to the Council within six months after the completion of fiscal year along with the detail descriptions of their work and activities.

Thus, as per section 23(1) the reporting deadline of the audit report to the agencies of the Government is within Poush end 2079. Also, the social organizations or institutions affiliated with SWC should submit report within Poush end 2079 to the office of SWC.

## **WTO AND NEPAL LAWS**

### **Answer No. 21**

On 5<sup>th</sup> Magh 2079, Money Bill was presented in the National Assembly. The agenda on the bill was passed to levy 1% tax on the total sales amount and the same shall be used for establishing pesticide industry and 50% tax exemption was announced to the industry undergoing legal cases against Inland Revenue Department for tax assessment.

As per section 110 of Constitution of Nepal, Bill may, subject to this Constitution, be introduced in any House of the Federal Parliament. Provided that a Money Bill shall be introduced only in the House of Representatives.

Thus the money bill presented in the National Assembly is contrary to the Constitution of Nepal. Hence, 1% tax on the total sales amount cannot be levied and 50% exemption on tax cannot be given to anyone.

## **CIVIL CODE, 2074 (PART 5) (MULUKI DEWANI SAMHITA, 2074)**

### **Answer No. 22**

Mr. Basu Deva lost his passport and iPhone at the airport for which he made an offer to pay Rs. 50,000 to the finder of passport and iPhone if returned within 10 days. Mr. Shiva Rimal found it and returned it to Mr. Basu Deva on the 9<sup>th</sup> day of advertisement.

As per section 511 of Muluki Dewani Samhita, 2074:

1. If a person makes an offer publicly by means of an advertisement that he or she will pay certain remuneration to any person for doing any act specified in the advertisement, and if any person does such an act, the advertiser shall pay remuneration specified in the advertisement to such a person.

Provided that if a person does the act specified in the advertisement without knowing such advertisement, such a person shall not be entitled to the remuneration.

2. If more than one person do the act specified in the offer under sub-section (1), only the person who does the act first shall be entitled to the remuneration.

Provided that if two or more persons do the act specified in the offer at the same time, all of such persons shall be entitled to the equal share of the remuneration, and if the remuneration is incapable of being shared, the proceeds of the sale of the remuneration shall be equally divided among them.

3. If a specific period is prescribed for doing the act according to the advertisement published pursuant to sub-section (1), the offer made according to the advertisement shall be deemed to have been revoked immediately after the expiry of that period.
4. An offer made pursuant to sub-section (1) may be revoked through the same medium through which it was published.
5. Notwithstanding anything contained in sub-section (4), if anyone has already done the act specified in the advertisement under sub-section (1) before the publication of the notice of revocation of the offer, the remuneration specified in the advertisement shall be provided.

Provided that the person who does the act specified in the advertisement shall notify the advertiser of the completion of the act as soon as possible.



6. If any person begins to do the act specified in the advertisement under sub-section (1) by giving its notice to the advertiser, appropriate remuneration shall be paid to such a person for the act done until the revocation of the advertisement.

In the first case, as per sub-section (1), if a person makes an offer publicly by means of an advertisement that he or she will pay certain remuneration to any person for doing any act specified in the advertisement, and if any person does such an act, the advertiser shall pay remuneration specified in the advertisement to such person. Hence, Mr. Basu Deva is liable to pay the amount specified in the advertisement to Mr. Shiva Rimal since Mr. Rimal is aware of the notice.

In the second case, as per sub-section (1), if a person does the act specified in the advertisement without knowing such advertisement, such a person shall not be entitled to the remuneration. Hence, Mr. Basu Deva is not liable to pay the amount specified in the advertisement to Mr. Shiva Rimal since he returns the goods found to the police without knowing such advertisement.

In the third case, as per sub-section (3), if a specific period is prescribed for doing the act according to the advertisement published pursuant to sub-section (1), the offer made according to the advertisement shall be deemed to have been revoked immediately after the expiry of that period. Hence, Mr. Basu Deva is not liable to pay the amount specified in the advertisement to Mr. Shiva Rimal if he returns the goods on the 11<sup>th</sup> day.