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MGT401-MidTerm-subjective

Differentiate between impairment and depreciation

Depreciation is the result of systematic allocation of the depreciable amount of an asset over its estimated useful life. Depreciation for the accounting period is charged to net profit or loss for the period either directly or indirectly.

However the impairment in the value of any asset is a fall in the value of an asset due to many reasons beyond the control of the company, so that its recoverable amount is now less than its carrying value in the balance sheet.

Authorized and paid up capital difference

Authorized Capital:

A maximum limit of the amount of capital that a company can issue is mentioned in the Memorandum and Articles of Association of the company. Company cannot issue capital exceeding this amount unless it amends the memorandum and articles of association.

Paid Up Capital:

Paid up capital is amount that the company issues out of the authorized capital.



• The minimum amount of capital that a company can issue is one share each for each of its members and the maximum is equal to the authorized capital.

• A company can issue shares of different classes having different denominations and different rights attached to them.

Comparison of Cost and NRV

Example:

• Suppose a company has a:

- Partially completed inventory item at the year end.
- Expected selling price of the item when completed is Rs. 2500.
- A further cost of Rs. 500 is required to complete the item
- Expected selling cost of the item is Rs. 100

Required:

What will be the carrying value of the inventory item if the cost incurred to date is:

- Rs. 1000
- Rs. 1900
- Rs. 2100

Solution:

Net Realizable Value of the stock item:

Selling price – Selling Exp – Completion costs



2500 – 100 – 500 = 1900

Comparison of Cost and NRV

- 1900 vs. 1000 – Cost is less than NRV therefore inventory will be shown at cost and no adjustment will be required.
- 1900 vs. 1900 – Cost is equal to NRV therefore inventory will be shown at cost and no adjustment will be required.
- 1900 vs. 2100 – Cost is greater than NRV therefore inventory will be shown at NRV.

Differentiate between Benchmark Treatment and Allowed Alternative Treatment for the Borrowing cost

Recognition of Fixed Assets – Benchmark Treatment

The benchmark treatment of borrowing costs is the most straightforward and prudent. The accounting policy adopted for borrowing costs should be disclosed Under the benchmark treatment of IAS 23 borrowing cost should be treated as expense in the period they are incurred regardless of the of how the loan is used. If benchmark treatment is used the enterprise is only required to disclose the policy adopted for borrowing costs.

Under the allowed alternative treatment, certain borrowing costs may be capitalized. Any other borrowing costs remaining must still be recognized as an expense as under the benchmark treatment.

The standard also lays out the criteria for determining which borrowing costs are eligible for capitalization.



Write down the types of stocks for Trading and Manufacturing concerns

Different types of business have different types of Inventories e.g.

• Trading concerns

- Stock in Trade (Finished inventory only)

• Manufacturing Concerns

- Raw Material
- Work in Process
- Finished Goods

Trade Debts considered as good_ unsecured 11000 Rs
Trade Debts considered doubtful _unsecured 41000 Rs
Provision for doubtful debts 41000 Rs
Then:
You are required to show the above information in Note to the account of Trade

Current Assets (Trade Debts)

TRADE DEBTS

Considered good – unsecured	11,000
Considered doubtful – unsecured	41,000
Less: Provision for doubtful debt	(41,000)
	11,000



Define Current Liabilities. What heads should be included in Current Liabilities?

Current Liabilities are all those liabilities that are expected to be paid or will become due for payment within 12 months from the balance sheet date.

• Current Liabilities may include any or all of the following heads:

- Trade and other payables,
- Interest, profit, return or mark-up accrued on loans and other payables
- Short term borrowings
- Current portion of long term borrowings
- Current portion of long term murabaha
- Provision for taxation

Long term Liabilities and heads:

Long Term Liabilities are all those liabilities that will become due for payment after a period of 12 months from the balance sheet date.

• Long Term Liabilities may include any or all of the following heads:

- Long term financing
- Debentures
- Liabilities against assets subject to finance lease;
- Long term modaraba;
- Long term deposits; and 9 Deferred liabilities.

Difference between LIFO and FIFO method



The LIFO method is one of the most interesting and controversial flow assumptions. The basic assumption in the LIFO method is that the most recently purchased units are sold first and that the older units remain in inventory. This assumption is not in accord with the physical flow of merchandise in most businesses. Under the LIFO method, the costs assigned to the cost of goods sold are relatively current, because they stem for the most recent purchases. Under the FIFO method, on the other hand, the cost of goods sold is based upon "older" costs.

The distinguishing character of the FIFO method is that the oldest purchase costs are transferred to the cost of goods sold, while the most recent costs remain in inventory. When purchase costs are rising, the FIFO method assigns lower (older) costs to the cost of goods sold and the higher more recent) costs to the goods remaining in inventory.

Describe Assumptions- going concern

ASSUMPTIONS - Going Concern

The concept implies that the business will continue to operate for the foreseeable future. It is assumed that the entity has neither the intention nor the need to liquidate or curtail its operations. The effect of going concern assumption is that assets and liabilities of the business are meant to be held for till their maturity (or useful life to the business) and are therefore measured and reported at their cost. If the business is not considered to be a going concern then the assets and liabilities would have to be shown at their current market value.

A company has an asset which originally cost Rs. 1250,000, revalued upwards to Rs. 1750,000 two years ago. The value has now fallen to Rs. 140,000.

Solution:

The double entry is:



DEBIT Revaluation Surplus Rs. 500,000

DEBIT Income and Expense Account Rs. 1,110,000

CREDIT Asset Value (Balance Sheet) Rs. 1,610,000

What type of information must be disclosed separately on the face of financial statement when the equity method is used for the recognition of investment in association?

Investments made for a long term is recorded using equity method and shown separately in the balance sheet as long-term assets

Investment made for a short period of time should be recognized at cost and classified in short term investments.

Different between bad debts and doubtful debts & some factors treatment as in book of account

When debtors fail to settle their accounts for items sold on credit a bad debt will occur. **A bad debt** is an amount that is written off by the business as a loss to the business and classified as an expense because the debt owed to the business is unable to be collected, and all reasonable efforts have been exhausted to collect the amount owed. The debt is immediately written off by crediting the debtor's account and therefore eliminating any balance remaining in that account.

Doubtful debts are those debts which a business or individual is unlikely to be able to collect. The reasons for potential nonpayment can include disputes over supply, delivery, and conditions of goods or the appearance of financial stress within a customer's operations. When such a dispute occurs it is prudent to add this debt or portion thereof to the doubtful debt reserve. This is done to avoid over-stating the assets of the business, as trade debtors are reported net of Doubtful debt.



What qualitative characteristics make the financial information reliable?

The financial statement should possess following qualitative characteristics:

- Understandability:
- Relevance:
- Materiality:
- Reliability:
- Faithful representation:
- Substance over form:
- Neutrality:
- Prudence:
- Completeness:
- Comparability:
- Timeliness:
- Balance between cost and benefit:
- Balance between qualitative characteristics:
- True and fair presentation:

Information to be disclosed for the Classes of Share capital

Share capital shall be classified under the following subheads:

Issued, subscribed and paid up capital, distinguishing in respect of each class between,

(a) Shares allotted for consideration paid in cash;



(b) Shares allotted for consideration other than cash, showing separately shares issued against property and others (to be specified); and

(c) Shares allotted as bonus shares.

Difference between periodic and perpetual inventory system

Perpetual Inventory System:

In perpetual Inventory systems inventory is recorded as:

• Receipt of inventory is debited to Stock Account.

• Issues are credited to Stock Account and Debited to Material Consumption Account.

• Value is assigned to every issue according to selected valuation policy.

• Material Consumption Account becomes part of Trading OR Work in Process Account.

Periodic Inventory System:

In periodic Inventory systems inventory is recorded as:

• Receipt of inventory is debited to purchases account.

• No recording is made for individual issue in the General Ledger.

• Available balance of stock in trade at the end of the period is valued according to selected policy and closing stock is recorded by Debiting the Stock Account and Crediting Trading Account OR Work in Process Account.

What do you know about Financial Assets?



Financial assets are recognized when the company becomes a party to the contractual provisions of the instrument. The particular measurement methods adopted are disclosed in the individual policy statements associated with each item.

Historical cost: Consideration paid (payable) or received (receivable) at the time of recording of transaction (no relation to current costs).

Current cost: The consideration that would have to be paid if a same or an equivalent asset is acquired.

The undisclosed amount of cash or cash equivalents that would be required to settle an obligation currently

Realizable value: The consideration that would be realised by selling an asset in an orderly disposal.

Settlement value: the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

Present value: A current estimate of the present discounted value of the future net cash flows in the normal course of business.

Historical Cost is the most commonly adopted measurement basis, but this is usually combined with other bases, e.g. inventory is carried at the lower of cost and net realizable value.

Write down the component of financial statement with respect to the IASB FRAMEWORK

The Framework consist of several sections, these sections are as follows:

- The Objective of Financial Statements.
- Underlying Assumptions.



- Qualitative Characteristics of Financial Statements.
- The Elements of Financial Statements.
- Recognition of the Elements of Financial Statements.
- Measurement of the Elements of Financial Statements.
- Concepts of Capital and Capital Maintenance.

What is mean by significant influence?

Significant influence is the ability to participate but not to control the financial and management affairs of an enterprise.

As per the IAS 28 an investor is presumed to have a significant influence over the investee if the investor controls Twenty Percent voting power in the investee.

Current Assets under Fourth Schedule of Companies Ordinance 1984

The Fourth Schedule to the Companies Ordinance 1984 has prescribed following additional heads in case of non- current / long term assets.

- Long Term Loans and Advances
- Long Term Deposits, Prepayments and Deferred Costs.

Shareholder’s equity:



Financed By

Share Capital and Reserves

Share Capital

+ General Reserve

Shareholders' Equity

Disclosure requirement of long term loans and advances

Following information must be disclosed in the financial statements in case of long-term loans and advances (it shall also be classified as secured and unsecured.)

- Amounts considered good, doubtful and bad distinguishing between:
- Loans and advances to subsidiary companies, controlled firms, managed modarbas and other associated companies.
- Loans and advances to chief executive, directors and executives of the company.
- Other loans and advances.

Straight Line Depreciation Method

Straight line method depreciates cost evenly throughout the useful life of the fixed asset. Straight line depreciation is calculated as follows:

Depreciation per annum = (Cost - Residual Value) / Useful Life

Reducing Balance Depreciation Method



Reducing Balance Method charges depreciation at a higher rate in the earlier years of an asset the amount of depreciation reduces as the life of the asset progresses. Depreciation under reducing balance method may be calculated as follows:

Depreciation per annum = (Net Book Value - Residual Value) x Rate%

Example:

An asset has a useful life of 3 years.

Cost of the asset is $2,000.

Residual Value is $500.

Rate of depreciation is 50%.

Depreciation expense for the three years will be as follows:

	NBV		R.V		Rate		Depreciation	Accumalated Depreciation
Year1:	(2000	-	500)	x	50%	=	750	750
Year2:	(1250	-	500)	x	50%	=	375	1125
Year3:	(875	-	500)	x	50%	=	375*	1500

What is the main objective for the preparation of Financial Statements?

The objective of the financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.



Such financial statements will meet the needs of most users. The information is, however, restricted.

• It is based on past events not expected future events.

• It does not necessarily contain non-financial information.

How many types of relations exist among different companies?

Two or more companies may be interconnected or interrelated in one of the following manners:

• They can have a business relationship of such a nature that they can be termed as Related Parties.

• They can be Associated to each other.

• One company can be a subsidiary of the other.

Who is responsible for the preparation and maintenance of financial statements of a company?

• It is the responsibility of the directors of every company to prepare annual accounts of the company.

• Directors of every company should lay before the Annual General Meeting, Balance Sheet, Profit and Loss or Income and Expenditure Account as the case may be.

• First annual accounts of the company will be prepared within eighteen (18) months of the incorporation of the company.

• Subsequently annual accounts will be prepared every year.

• In addition listed companies are required to prepare Quarterly and Half Yearly accounts.



What is the effect of revaluation of asset and how it is adjusted?

The value of an item of property, plant and equipment may be increased or decreased as a result of revaluation.

IAS 16 requires the increase to be credited to a revaluation surplus (i.e. part of owners' equity), unless the increase is reversing a previous decrease which was recognized as an expense. To the extent that this offset is made, the increase is recognized as income; any excess is then taken to the revaluation reserve.

A revaluation loss is charged to profit and loss account in the period in which the revaluation is carried out.

However a revaluation decrease should be charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in surplus in respect of the same asset.

Explain different types of financial risks that an entity may transfer to another party while undertaking transactions in Financial Instruments?

In undertaking transactions in financial instruments, an entity may assume or transfer to another party one or more of different types of financial risk as defined below.

Types of financial risk are

- Market risk
- Credit risk
- Liquidity risk
- Cash flow / interest rate risk

Types of Risks - Market Risks



• **Currency Risk:** is the risk that the value of the financial instrument will fluctuate due to changes in foreign exchange rates.

• **Interest rate risk**: is the risk that the value of the financial instrument will fluctuate due to changes in market interest rates.

• **Price risk:** is the risk that the value of the financial instrument will fluctuate due to changes in market prices whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all securities traded in the market.

Types of Risks – Credit Risk

• **Credit risk:** The risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Types of Risks – Liquidity Risk

• **Liquidity Risk:** The risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result for an inability to sell a financial asset quickly at close to its fair value.

Types of Risks – Cash Flow Risk

• **Cash flow / interest rate risk:** The risk that future cash flows of a financial instrument will fluctuate because of changes in market interest rates. In the case of a floating rate debt instrument, for example, such fluctuations result in a change in the effective interest rate of the financial instrument, usually without a corresponding change in its fair value.

• **IAS 01 – Presentation of Financial Statements**

• **IAS 16 – Property Plant and Equipment**



- **IAS 23 – Borrowing Costs**
- **IAS 36 – Impairment of Assets (not included in syllabus)**
- **IAS 38 – Intangible Assets**

- **IAS 27, Consolidated and Separate Financial Statements**
- **IAS 28, Investments in Associates**
- **IAS 31, Interests in Joint Ventures**
- **IAS 32, Financial Instruments Disclosure and Presentation**
- **IAS 39, Financial Instruments Recognition and Measurement**