MGT101 GDB Solution
Prepared By: Raheel Raaj
M. Accounting & Finance

Mr. Hamid is working as a junior accountant in accounts department of a business concern. He has little knowledge in accounting. Recently, it has been observed by his senior manager that Mr. Hamid had ignored the distinction between capital and revenue expenditure and charged an amount of Rs. 200,000 incurred on purchase of a non-current asset to the profit and loss account showing a profit of Rs. 500,000. As a result, the financial statements would be failed to reflect true and fair state of affairs of the business. The purchased asset is estimated to have useful life of 5 years with salvage value of Rs. 20,000.

Required:

1. What would be the annual depreciation expense under the straight line method?

   Ans: Depreciation = (200,000 – 20,000) /5 **= 36,000**

2. Reporting of non-current assets at written down value rather than at historical cost shows more realistic financial position. Which accounting principle is followed for such reporting?

   Ans: The IAS 16 allow companies to revalue their tangible non-current assets and show them in the statement of financial position at Written Down value rather than historical cost. This is known as the alternative treatment.

3. Whether the above error would understate/overstate the capital reported in the balance sheet of business concern?

   Ans: The Balance sheet of the company shown capital understated due to the net profit 164,000 are not shown in balance sheet.

4. What should have been the correct amount of profit?

   Ans: Net Profit = 500,000 + 200,000 – 36,000

   = 664,000

https://www.facebook.com/raheel.raaj.9

https://www.facebook.com/raheel.raaj.9