PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

Valuation of Shares

1. The balance sheet of Major Ltd. has been given to you for the purpose of valuation of shares:

Balance Sheet of Major Ltd. as on 31st December, 2009

Liabilities	Rs.	Rs.		Rs.
Share Capital:			Fixed Assets:	
Equity Shares of Rs.10			Goodwill	50,000
each	5,00,000		Machinery	2,30,000
Less: Call in arrear			Factory shed	3,00,000
(Rs.2 on final call)	10,000	4,90,000	Vehicles	60,000
8% preference shares of			Furniture	25,000
Rs.10 each, fully paid		2,00,000	Investments	1,00,000
Reserve and Surplus:			Current Assets:	
General Reserve		2,00,000	Stock in trade	2,10,000
Profit and Loss Account		1,40,000	Sundry Debtors	3,50,000
Current Liabilities:			Cash at Bank	50,000
Bank Loan		1,00,000	Preliminary Expenses	25,000
Sundry Creditors		2,70,000		
		14,00,000		14,00,000

Additional Information:

1. Fixed Assets are worth 20% above their actual book value. Depreciation on appreciated value of fixed assets to be ignored for valuation of goodwill.
2. Of the investments 80% is non-trading and the balance is trading. All trade investments are to be valued at 20% below cost. A uniform rate of dividend of 10% is earned on all investments.
3. For the purpose of valuation of shares, Goodwill is to be considered on the basis of 4 years' purchase of the super-profits based on average profit of the last 3 years. Profits are as follows:

	Rs.
2007	1,90,000
2008	2,00,000
2009	2,10,000

In a similar business return on capital employed is 15%. In 2007 new furniture costing Rs.10,000 was purchased but wrongly charged to revenue. (No effect has been yet been given for rectifying the same). Depreciation is charged on furniture @ 10%. Find out the value of each fully-paid and partly-paid equity share, assuming tax rate of 50%.

Valuation of Goodwill

2. The Balance Sheets of X Ltd. are as follows:

(Rs. in lakhs)

Liabilities	As at 31.3.2006	As at 31.3.2007
Share Capital	1,000.0	1,000.0
General Reserve	800.0	850.0
Profit and Loss Account	120.0	175.0
Term Loans	370.0	330.0
Sundry Creditors	70.0	90.0
Provision for Tax	22.5	25.0
Proposed Dividend	200.0	250.0
	2,582.5	2,720.0
Assets		
Fixed Assets and Investments (Non-trade)	1,600.0	1,800.0
Stock	550.0	600.0
Debtors	340.0	220.0
Cash and Bank	92.5	100.0
	2,582.5	2,720.0

Other Information:

1. Current cost of fixed assets excluding non-trade investments on 31.3.2006 Rs. 2,200 lakhs and on 31.3.2007 Rs. 2,532.8 lakhs.
2. Current cost of stock on 31.3.2006 Rs. 670 lakhs and on 31.3.2007 Rs. 750 lakhs.
3. Non-trade investments in 10% government securities Rs. 490 lakhs.
4. Debtors include foreign exchange debtors amounting to \$ 70,000 recorded at the rate of \$ 1 = Rs. 17.50 but the closing exchange rate was \$ 1 = Rs. 21.50.
5. Creditors include foreign exchange creditors amounting to \$ 1,20,000 recorded at the rate of \$ 1 = Rs. 16.50 but the closing exchange rate was \$ 1 = Rs. 21.50.
6. Profit included Rs. 120 lakhs being government subsidy which is not likely to recur.
7. Rs. 247 lakhs being the last instalment of R and D cost were written off the profit and loss account. This expenditure is not likely to recur.
8. Tax rate during 2006-07 was 50% effective future tax rate is estimated at 40%.
9. Normal rate of return is expected at 15%.

Based on the information furnished, Mr. Iral, a director contends that the company does not have any goodwill. Examine his contention.

Valuation of Business

3. Xeta Ltd. plans to take over Beta Ltd. Independent Cash Flow forecasts of both companies are as follows:

Year	1	2	3	4	5
Xeta Ltd. (Rs. In lakhs)	2,00	2,25	2,50	2,70	2,85
Beta Ltd. (Rs. In lakhs)	50	65	80	95	110

Year	6	7	8	9	10
Xeta Ltd. (Rs. In lakhs)	3,10	3,50	6,00	6,10	6,50
Beta Ltd. (Rs. In lakhs)	1,20	1,30	1,50	1,70	1,80

Following further information is available from the latest Balance Sheet of Beta Ltd.

Assets:		Rs. in lakhs
Fixed Assets		5,00
Stock		1,15
Debtors		50
		6,65
Less: Liabilities		
Sundry creditors	1,65	
Long term loan	2,00	(3,65)
Net assets		3,00

Xeta Ltd. finds that fixed assets of book value Rs.75 lakhs will not be used which will fetch Rs.50 lakhs on immediate disposal. Moreover, stock will fetch Rs.140 lakhs and debtors Rs.48 lakhs immediately. But Xeta Ltd. has to payoff the liabilities immediately. Also it has to pay Rs.110 lakhs to workers of Beta Ltd. whose service cannot be used. It appears that after merger Xeta Ltd. has to invest Rs.210 lakhs for renovation of the plant and machinery at the end of 1st year and Rs.50 lakhs for modernization at the end of 2nd year after merger.

Forecast of cash flows of Xeta Ltd. after merger.

Year	1	2	3	4	5
Cash flows (Rs. In lakhs)	2,40	2,80	3,50	4,00	4,10

Year	6	7	8	9	10
Cash flows (Rs. In lakhs)	4,80	5,50	8,00	8,80	9,50

Determine the maximum value of Beta Ltd. which its management should ask from Xeta Ltd. You may use 20% discount rate.

Acquisition of Business

4. A company was incorporated on 1st July, 2008 to take over the business of Mr. M as and from 1st April, 2008. Mr. M's Balance Sheet, as at that date was as under:

Liabilities	Rs.	Assets	Rs.
Trade Creditors	36,000	Building	80,000
Capital	1,94,000	Furniture and Fittings	10,000
		Debtors	90,000
		Stock	30,000
		Bank	20,000
	2,30,000		2,30,000

Debtors and Bank balances are to be retained by the vendor and creditors are to be paid off by him. Realisation of debtors will be made by the company on a commission of 5% on cash collected. The company is to issue M with 10,000 equity shares of Rs.10 each, Rs.8 per share paid up and cash of Rs.56,000.

The company issued to the public for cash 20,000 equity shares of Rs.10 each on which by 31st March, 2009 Rs.8 per share was called and paid up except in the case of 1,000 shares on which the third call of Rs.2 per share had not been realized. In the case of 2,000 shares, the entire face value of the shares had been realized. The share issue was underwritten for 2% commission, payable in shares fully paid up.

In addition to the balances arising out of the above, the following were shown by the books of accounts of the company on 31st March, 2009:

	Rs.
Discount (including Rs.1,000 allowed on vendor's debtors)	6,000
Preliminary expenses	10,000
Directors' fees	12,000
Salaries	48,000
Debtors (including vendor's debtors)	1,60,000
Creditors	48,000
Purchases	3,20,000
Sales	4,60,000

Stock on 31st March, 2009 was Rs.52,000. Depreciation at 10% on Furniture and Fittings and at 5% on Building is to be provided. Collections from debtors belonging to the vendor were Rs.60,000 in the period.

Kindly prepare the Trading and Profit & Loss Account for the period ended 31st March, 2009 of the limited company and its Balance Sheet as at that date.

Internal Reconstruction of a Company

5. The following is the Balance Sheet as at 31st December, 2008 of Ginni Ltd.

Liabilities	Rs.	Assets	Rs.
Subscribed capital:		Fixed Assets (including goodwill of Rs.1,00,000)	10,80,000
3,000 Cumulative Preference shares of Rs.100 each fully paid up	3,00,000	Investments	20,000
		Stock in Trade	2,00,000
7,500 Equity share of Rs.100 each fully paid up	7,50,000	Trade Debtors	1,54,500
		Bank Balances	62,500
Securities Premium	12,000		
Preference Shares			
General Reserve	80,000		
Trade Creditors	3,75,000		
	15,17,000		15,17,000

Contingent liability:

Preference Dividends in arrears Rs.66,000.

The Board of Directors of the Company decided upon the following scheme of reconstructions:

(i) The preference shares are to be converted into 13% unsecured debentures of Rs.100 each in regard to 80% of the dues (including arrears of dividends) and for the balance equity shares of Rs.50 paid up would be issued. The authorized capital of the company permitted the issue of additional shares.

(ii) Equity shares would be reduced to share of Rs.50 each paid up.

(iii) All equity holders agree to pay the balance in cash.

(iv) Goodwill has lost its value and is to be written off fully. Investment are to reflect their market value of Rs.30,000. Obsolete items in stock of Rs.50,000 are to be written off. Bad debts to the extent of 5% of the total debtors would be provided for. Fixed assets to be written down by Rs.1,50,000.

The scheme was duly approved and put into effect.

The company carried on trading for six months and after writing off depreciation at 20% p.a. on the revised value of fixed assets, made a net profit of Rs.80,000. The half-yearly working resulted in an increase of Sunday Debtors by Rs.60,000. Stock by Rs.80,000 and cash by Rs.40,000.

Show the journal entries (without narration) necessary in the Company's books to give effect to the scheme and draw the Balance sheet as at 30th June, 2009.

6. Following are the Balance Sheet of companies as at 31.12.2008:

Liabilities	D Ltd.	V Ltd.	Assets	D Ltd.	V Ltd.
	Rs.	Rs.		Rs.	Rs.
Equity share capital (Rs. 100)	8,00,000	6,00,000	Goodwill	6,00,000	—
			Fixed Assets	5,00,000	8,00,000
General Reserve	4,00,000	3,00,000	Investments	2,00,000	4,00,000
Investment Allowance Reserve	—	4,00,000	Current Assets	4,00,000	3,00,000
Sundry Creditors	5,00,000	2,00,000			
	17,00,000	15,00,000		17,00,000	15,00,000

D Ltd. took over V Ltd. on the basis of the respective shares value, adjusting wherever necessary, the book values of assets and liabilities on the basis of the following information:

(i) Investment Allowance Reserve was in respect of addition made to fixed assets by V Ltd. in the year 2002- 2007 on which income tax relief has been obtained. In terms of the Income Tax Act, 1961, the company has to carry forward till 2011 reserve of Rs. 2,00,000 for utilization.

(ii) Investments of V Ltd. included 1,000 shares in D Ltd. acquired at cost of Rs. 150 per share. The other investments of V Ltd. have a market value of Rs. 1,92,500.

(iii) The market value of investments of D Ltd. are to be taken at Rs. 1,00,000.

(iv) Goodwill of D Ltd. and V Ltd. are to be taken at Rs. 5,00,000 and Rs. 1,00,000 respectively.

(v) Fixed assets of D Ltd. and V Ltd. are valued at Rs. 6,00,000 and Rs. 8,50,000 respectively.

(vi) Current assets of D Ltd. included Rs. 80,000 of stock in trade received from V Ltd. at cost plus 25%.

The above scheme has been duly adopted. Pass necessary Journal Entries in the books of D Ltd. and prepare Balance Sheet of D Ltd. after taking over the business of V Ltd. Fractional share to be settled in cash, rest in shares of D Ltd. Calculation shall be made to the nearest multiple of a rupee.

7. Astha Ltd. acquired 80% of both classes of shares in Birat Ltd. on 1.4.2007. The draft Balance Sheets of two companies on 31st March, 2008 were as follows:

(Rs. in 000's)

Liabilities	Astha Ltd.	Birat Ltd.	Assets	Astha Ltd.	Birat Ltd.
Share Capital:					
Equity shares of Rs.10 each, full paid up	3,000	600	Plant & machinery	2,060	600
14% Preference shares of Rs.100 each, fully paid up	-	400	Furniture & fixtures	600	540
General reserve	1,900	40	Investments in equity shares of Birat Ltd.	1,920	-
Profit and loss account	1,600	720	in preference shares of Birat Ltd.	320	-
Creditors	300	320	Stock	680	404
			Debtors	560	316
			Cash at bank	660	220
	6,800	2,080		6,800	2,080

Note:

Contingent liability – Astha Ltd.: Claim for damages lodged by a contractor against the company pending in a law-suit – Rs.1,55,000.

Additional Information:

(i) General reserve balance of Birat Ltd. was the same as on 1.4.2007.

(ii) The balance in Profit and Loss A/c of Birat Ltd. on 1.4.2007 was Rs.3,20,000, out of which dividend of 16% p.a. on the Equity capital of Rs.6,00,000 was paid for the year 2006-07.

(iii) The dividend in respect of preference shares of Birat Ltd. for the year 2007-08 was still payable as on 31.3.2008.

(iv) Astha Ltd. credited its Profit and Loss A/c for the dividend received by it from Birat Ltd. for the year 2006-07.

(v) Sundry creditors of Astha Ltd. included an amount of Rs.1,20,000 for purchases from Birat Ltd., on which the later company made a loss of Rs.10,000.

(vi) Half of the above goods were still with the closing stock of Astha Ltd. as at 31.3.2008.

(vii) At the time of acquisition by Astha Ltd., while determining the price to be paid for the shares in Birat Ltd. it was considered that the value of plant and machinery was to be increased by 25% and that of furniture and fixtures reduced to 80%. There was no transaction of purchase or sale of these assets during the year. The directors wish to give effect to these revaluations in the consolidated balance sheet.

(viii) The directors of Astha Ltd. are of opinion that disclosure of its contingent liability will seriously prejudice the company's position in dispute with the contractor.

Prepare consolidated balance sheet as at 31st March, 2008, assuming the rate of depreciation charged as 25% p.a. and 10% p.a. on plant and machinery and furniture and fixtures respectively. Workings should be part of the answer.

Corporate Restructuring

8. The Balance Sheet of Z Ltd. as at 31st March, 2008 is given below. In it, the respective shares of the company's two divisions namely S Division and W Division in the various assets and liabilities have also been shown.

(All amounts in crores of Rupees)

	S Division	W Division	Total
Fixed Assets:			
Cost	875	249	
Less: Depreciation	360	81	
Written-down value	515	168	683
Investments			97
Net Current assets:			
Current Assets	445	585	
Less: Current Liabilities	270	93	
	175	492	667
			1,447
Financed by:			
Loan funds		15	417
Own funds:			
Equity share capital: shares of Rs. 10 each			345
Reserves and surplus			685
			1,447

Loan funds included, inter alia, Bank Loans of Rs. 15 crore specifically taken for W Division and Debentures of the paid up value of Rs. 125 crore redeemable at any time between 1st October, 2007 and 30th September, 2008.

On 1st April, 2008 the company sold all of its investments for Rs. 102 crore and redeemed all the debentures at par, the cash transactions being recorded in the Bank Account pertaining to S Division.

Then a new company named Y Ltd. was incorporated with an authorized capital of Rs. 900 crore divided into shares of Rs. 10 each. All the assets and liabilities pertaining to W Division were transferred to the newly formed company; Y Ltd. allotting to Z Ltd.'s shareholders its two fully paid equity shares of Rs. 10 each at par for every fully paid equity share of Rs. 10 each held in Z Ltd. as discharge of consideration for the division taken over.

Y Ltd. recorded in its books the fixed assets at Rs. 218 crore and all other assets and liabilities at the same values at which they appeared in the books of Z Ltd.

You are required to:

(i) Show the journal entries in the books of Z Ltd.

(ii) Prepare Z Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Y Ltd. (Schedules in both cases need not be prepared).

Buy-back of Securities

9. The Balance Sheet of Gunshot Ltd. as on 31.3.2008 is given :

(Rs. in '000)

Liabilities	Amount	Fixed Assets	Amount
Share Capital :		Fixed Assets	2,700
Equity shares of Rs. 10 each	800	Non-trade Investments	300
Securities Premium	100	Stock	600
General Reserve	780	Sundry Debtors	360
Profit and Loss Account	120	Cash and Bank	160
10% Debenture	2,000		
Creditors	320		
	4,120		4,120

Gunshot Ltd. buy back 16,000 shares of Rs. 20 per share. For this purpose, the Company sold its all non-trade investments for Rs. 3,20,000. Give Journal Entries with full narrations affecting the buy back.

Value Added Statement

10. (a) What are the advantages of preparation of Value Added (VA) statements? Explain in brief.

(b) The following are the balances in the accounts statements of Addition Ltd. for the year, 2008:

	Rs. in lakhs		Rs. in lakhs
Turnover	2,300	Printing and Stationery	22
Loss on Sale of Machinery	75	Auditor's Remuneration	28
Depreciation on Plant and Machinery	200	Retained Profits (Opening Balance)	994
Dividend to Ordinary Shareholders	146	Retained Profits for the year	288
Debtors	200	Rent, Rates and Taxes	165
Creditors	127	Other Expenses	85
Total Stock of all materials, W.I.P. and finished goods		Ordinary Share Capital issued	1,500
Opening Stock	160	Interest on Borrowings	40
Closing Stock	200	Income Tax for the year	276
Raw Materials purchased	625	Wages and Salaries	327
PF Contribution	28	Employees State Insurance	35

Prepare a value added statement for the company for 2008.

Economic Value Added

11. (a) What is economic value added and how is it calculated? Discuss.

(b) From the following information of Vinod Ltd., compute the economic value added:

Share capital	Rs.2,000 lakhs
Reserve and surplus	Rs.4,000 lakhs
Long-term debt	Rs.400 lakhs
Tax rate	30%
Risk free rate	9%
Market rate of return	16%
Interest	Rs.40 lakhs
Beta factor	1.05
Profit before interest and tax	Rs.2,000 lakhs

Human Resource Accounting

12. (a) Describe the progress made by India so far in the field of human resource accounting.

(b) Why Human Resources Asset is not recognized in the Balance sheet?

Corporate Social Reporting

13. From the following information taken from the books of Srishti Ltd. relating to staff and community benefits, you are required to prepare a statement classifying the various items under the appropriate heads, required under corporate social reporting:

Particulars	Rs. in lakhs
Environmental improvements	36.18
Medical facilities	9.00
Training programmes	18.45
Generation of job opportunities	109.35
Municipal taxes	19.26
Increase in cost of living in the vicinity due to company's operations	29.79
Concessional transport, water-supply etc.	20.25
Generation of business	45.00
Leave encashment and leave travel benefits	93.60
Education facilities for children of staff members	38.88
Subsidised canteen facilities	25.92
Extra work put in by staff and officers for drought relief	33.30

Financial Reporting of Financial Institutions

14. (a) Explain "Non-Performing Assets" as per NBFC Prudential Norms (RBI) directions.

    (b) What do you mean by "Net asset value" (NAV) in case of mutual fund units?

15. (a) Write short note on Capital adequacy requirements of merchant bankers.

    (b) Write short note on Books of account required to be maintained by a Stock Broker.

Accounting for Not-for-profit Organizations

16. The Annuity fund of Punjab University accepts an annuity – based gift from an alumnus who specifies that he receives a monthly payment of Rs.25,000 for the remainder of his life. The gift consists of cash of Rs.20 lakh and securities having a market value of Rs.15 lakh at the time of the gift. The investment income of annuity fund for a particular month comes to Rs.38,500.

    Draft journal entries in the University's books.

Indian AS, IFRS and US GAAPs

17. State the treatment of the following items with reference to Indian Accounting Standards and IFRS:

    (i) Discontinued operations – definition and measurement

    (ii) Acquired intangible assets.

18. (a) XYZ Ltd., with a turnover of Rs.35 lakhs and borrowings of Rs.10 lakhs during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2008. Advise the management the exemptions that are available as per Companies (AS) Rules, 2006.

    If XYZ is a partnership firm is there any other exemptions additionally available.

    (b) What criteria is applied for rating an enterprise as Level II enterprise for the purpose of compliance of Accounting Standards in India?

    (c) If a sale and lease back transaction results in an operating lease, what provisions will be applicable? Describe in line with AS 19.

    (d) A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. Is it a liability?

19. Write short notes on :

    (i) NACAS.

    (ii) Impairment of asset and its application to inventory.

    (iii) Treatment of borrowing costs.

    (iv) Accounting for investment by a holding company in subsidiaries.

    (v) Concept of Cost v/s Fair value with reference to Indian Accounting Standards.

    (vi) Restatement of shares as per AS 20.

    (vii) Provisions of AS 26 relating to retirement and disposal of intangible assets.

    (viii) Change in accounting estimates.

20. (i) Golden Eagle Ltd., has been successful jewellers for the past 100 years and sales are against cash only. The company diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy with references to AS-9.

    (ii) A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.

(iii) Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 2007 for Rs.60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2007-08 the carrying amount was Rs.41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch Rs.36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs.54 crore per annum and has a carrying amount of Rs.3.46 crore. All such machines put together could fetch a sum of Rs.4.44 crore if disposed. Discuss the applicability of Impairment loss.

(iv) A manufacturing company purchased shares of another company from stock exchange on 1st May, 2007 at a cost of Rs.5,00,000. It also purchased Gold of Rs.2,00,000 and Silver of Rs.1,50,000 on 1st April, 2005. How will you treat these investments as per the applicable AS in the books of the company for the year ended on 31st March, 2008, if the values of these investments are as follows:

	Rs.
Shares	2,00,000
Gold	4,00,000
Silver	2,50,000

21\. (i) Rainbow Limited borrowed an amount of Rs.150 crores on 1.4.2008 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized Rs.19.50 crores for the accounting period ending on 31.3.2009. Due to surplus fund out of Rs.150 crores, an income of Rs.3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

(ii) Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2006, 2007 and 2008 for Rs.11,00,000, Rs.16,00,000 and Rs.21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of Rs.7,00,000, Rs.18,00,000 and Rs.23,00,000 for the years 2006, 2007 and 2008 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 2006, 2007 and 2008.

(iii) B Ltd. undertook a construction contract for Rs. 50 crores in April, 2007. the cost of construction was initially estimated at Rs. 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at Rs. 53 crores.

Can the company provide for the expected loss in the book of account for the year ended 31st March, 2008?

(iv) The Board of Directors of X Ltd. decided on 31.3.2007 to increase sale price of certain items of goods sold retrospectively from 1st January, 2007. As a result of this decision the company has to receive Rs.5 lakhs from its customers in respect of sales made from 1.1.2007 to 31.3.2007. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

22. From the following information, prepare cash flow statement as at 31st December, 2008 by using indirect method according to AS 3:

Balance Sheets

Liabilities	2007	2008	Assets	2007	2008
Share Capital	5,00,000	5,00,000	Fixed Assets	8,50,000	10,00,000
Profit & Loss A/c	4,25,000	5,00,000	Stock	3,40,000	3,50,000
Long Term Loans	5,00,000	5,30,000	Debtors	3,60,000	3,30,000
Creditors	1,75,000	2,00,000	Cash	30,000	35,000
			Bills Receivable	20,000	15,000
	16,00,000	17,30,000		16,00,000	17,30,000

Income Statement for the year ended 31st December, 2008

Sales		20,40,000
Less:	Cost of Sales	13,60,000
Gross Profit		6,80,000
Less:	Operating Expenses:	
	Administrative Expenses	(2,30,000)
	Depreciation	(1,10,000)

Operating Profit	3,40,000
Add: Non-Operating Incomes (dividend received)	25,000
	3,65,000
Less: Interest Paid	(70,000)
	2,95,000
Less: Income Tax	1,30,000
Profit after Tax	1,65,000

Statement of Retained Earnings

Opening Balance	4,25,000
Add: Profit	1,65,000
	5,90,000
Less: Dividend paid	90,000
Closing Balance	5,00,000

23. (i) A Ltd. had 6,00,000 equity shares on April 1, 2007. The company earned a profit of Rs.15,00,000 during the year 2007-08. The average fair value per share during 2007-08 was Rs.25. The company has given share option to its employees of 1,00,000 equity shares at option price of Rs.15. Calculate basic EPS and diluted EPS.

(ii) A Ltd., owns 30% of the equity capital of B Ltd. B Ltd. in turn owns 35% of equity capital C Ltd., and 40% of equity capital in D Ltd. You are required to answer the following questions.

(a) Whether B Ltd. is a related party to A Ltd?

(b) Whether C Ltd., is a related party to A Ltd.?

(c) Whether C Ltd. and D Ltd. are related parties?

(iii) A limited company has set up its business in a designated backward area and is entitled to a capital subsidy of 15% under a scheme in force. Accordingly, it received a subsidy of Rs.30 lakhs on an investment of Rs.200 lakhs in the unit. The accountant would like to treat of Rs.30 lakhs on an investment of Rs.200 lakhs in the unit. The accountant would like to treat it as income and reduce the losses made in the first year of its operations ending with 31st March, 2009. You are asked to advise the accountant, whether his view is in conformity with AS 12.

(iv) Induga Company has at its financial year ended 31st March, 2009 fifteen law suits outstanding none of the which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible outcomes as below:

Result	Probability	Amount of loss
	0.6	-
For first ten cases:		
Lose-low damages	0.3	90,000
Lose-high damages	0.1	1,60,000
For remaining five cases:		
Win	0.5	-
Lose-low damages	0.3	60,000
Lose-high damages	0.2	95,000

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss

24. (i) Amigo Mutual Fund Ltd. is a SEBI Registered mutual fund. The Company follows the practice of valuing its investments on "mark to market basis". For the financial year ended March, 2009 the investments which were acquired at a cost of Rs.109 crores were reflected in the Balance Sheet at Rs.89 crore. The company insists that the depreciation in value of the investments need not be disclosed separately in its financial statements since its investment valuation policy is disclosed as part of its accounting policies. Discuss the validity of this argument.

(ii) A company has given counter guarantees of Rs. 2.25 crores to various banks in respect of the guarantees given by the said banks in favour of Government authorities. Outstanding counter guarantees as at the end of financial year 2007-2008 were Rs. 1.95 crores. How should this information be shown in the Financial Statements of the Company.

25. (i) Choice Ltd. grants 100 stock options to each of its 1,000 employees on 1.4.2005 for Rs.20 depending upon the employees at the time of vesting of options. The market price of the share is Rs.50. The options will vest at the end of year 1 if the earning of Choice Ltd. increases 16% or it will vest at the end of the year 2 if the average earning of two years increases by 13% or lastly it will vest at the end of the third year if the average earning of 3 years will increase by 10%. 5,000 unvested options lapsed on 31.3.2006, 4,000 unvested options lapsed on 31.3.2007 and finally 3,500 unvested options lapsed on 31.3.2008.

Following is the earning of Choice Ltd. :

Year	Earning (in %)
Year 1	14%
Year 2	10%
Year 3	7%

850 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life. Pass Journal entries for the above.

(ii) Parikshit Ltd. holds Rs.1,00,000 of loans yielding 18 per cent interest per annum for their estimated lives of 9 years. The fair value of these loans, after considering the interest yield, is estimated at Rs.1,10,000.

The company securitises the principal component of the loan plus the right to receive interest at 14% to Susovana Corporation, a special purpose vehicle, for Rs.1,00,000.

Out of the balance interest of 4 percent, it is stipulated that half of such balance interest, namely 2 per cent, will be due to Parikshit Ltd. as fees for continuing to service the loans. The fair value of the servicing asset so created is estimated at Rs.3,500. the remaining half of the interest is due to Parikshit Ltd. as an interest strip receivable, the fair value of which is estimated at Rs.6,500.

Give the accounting treatment of the above transactions in the form of journal entries in the books of originator.

SUGGESTED ANSWERS/HINTS

1.

(i)

Capital Employed on 31.12.2009	Rs.	Rs.
Machinery		2,30,000
Factory Shed		3,00,000
Vehicles		60,000
Furniture (25,000+7,290)		32,290
		6,22,290
Add: 20%		1,24,458
		7,46,748
Trade Investments		16,000
Stock in Trade		2,10,000
Sundry Debtors		3,50,000
Cash at Bank		50,000
		13,72,748
Less:		
Bank Loan	1,00,000	
Sundry Creditors	2,70,000	3,70,000
		10,02,748

(ii) Average profits for the last three years

	2007	2008	2009
	Rs.	Rs.	Rs.
Reported Profit (taking the figures given in the question as profit after tax)	1,90,000	2,00,000	2,10,000
Add: furniture purchased charged to revenue (net of tax)	5,000	-	-
	1,95,000	2,00,000	2,10,000
Less: Depreciation on furniture purchased (net of tax)	500	450	405
	1,94,500	1,99,550	2,09,595
Less: Dividend on non-trading investments less tax	4,000	4,000	4,000
	1,90,500	1,95,550	2,05,595
Average Profit			1,97,215

(iii) Calculation of Super Profits

	Rs.
Capital employed	10,02,748
Average profit	1,97,215
Normal profit @ 15% on capital employed	1,50,412
Super profit	46,803
Goodwill at four years' purchase	1,87,212

Valuation of Equity Shares		Rs.
Value of Net Tangible Assets [Refer (i)]		10,02,748
Add Goodwill [Refer (iii)]		1,87,212
Add Non-trade investments		80,000
Add Notional Calls		10,000
		12,79,960
Less: Preference Share Capital		2,00,000
		10,79,960
No. of shares	50,000	
Intrinsic value of fully paid share		Rs.21.60
Intrinsic value of partly paid share (Rs.21.60-2.00)		Rs.19.60

2.

(Rs. in lakhs)

(1) Average Capital employed

	As at 31.3.2006	As at 31.3.2007
Current cost of fixed assets other than non trade investments	2,200.0	2,532.8
Current cost of stock	670.0	750.0
Debtors	340.0	222.8
Cash and Bank	92.5	100.0
	3,302.5	3,605.6
Less: Outside Liabilities:		
Term loans	370.0	330.0
Sundry creditors	70.0	96.0
Tax provision	22.5	25.0
	462.5	451.0
Capital Employed	2,840.0	3,154.6
Average Capital Employed at current value = $\frac{2,840.0+3,154.6}{2}=$		2,997.3

(2) Future maintainable profit

Increase in General Reserve		50
Increase in Profit and Loss Account		55
Proposed Dividend		250
Profit after tax		355
Pre-tax profit = $\frac{355}{1-0.5}$		710.00
Less: Non-trading income	49.00	
Exchange loss on creditors [1.2 lakhs $\times$ (21.5 – 16.5)]	6.00	
Subsidy	120.00	175.00
		535.00
Add: Exchange gain on debtors [0.7 lakhs $\times$ (21.5 – 17.5)]	2.80	
R & D costs	247.00	
Stock adjustment	30.00	279.80
Adjusted pre-tax profit		814.80
Less: Tax @ 40%		325.92
Future maintainable profit		488.88

Valuation of Goodwill

		(Rs. in lakhs)
(1)	Capitalisation Method	
	Capitalised value of future maintainable profit $\left(\frac{488.88}{0.15}\right)$	3,259.20
	Less: Average Capital Employed	2,997.30
	Goodwill	261.90
(2)	Super Profit Method	
	Future Maintainable Profit	488.88
	Normal Profit @ 15% on average capital employed	449.60
	Goodwill	39.28

Under capitalisation method, the amount of goodwill is larger than the amount of goodwill computed under super profit method. In either case, the existence of Goodwill cannot be doubted. The director's view cannot, therefore, be upheld.

Working Notes:

		(Rs. in lakhs)
(1)	Stock adjustment	
	Difference between current cost and historical cost of closing stock	150.00
	Difference between current cost and historical cost of opening stock	120.00
		30.00
(2)	Debtors' adjustment	
	Value of foreign exchange debtors at the closing exchange rate ($ 70,000 × 21.5)	15.05
	Value of foreign exchange debtors at the original exchange rate ($ 70,000 × 17.5)	12.25
		2.80
(3)	Creditors' adjustment	
	Foreign exchange creditors at the closing exchange rate ($ 1,20,000 × 21.5)	25.80
	Foreign exchange creditors at the original exchange rate ($ 1,20,000 × 16.5)	19.80
		6.00

3. Maximum value to be quoted

	Particulars	Rs. in Lakhs	Rs. in Lakhs
a.	Value of merged entities as per discounted cashflows (W.N.1)		502.38
b.	Add: Cash to be collected immediately on disposal of assets		
	i. Fixed assets	50.00	
	ii. Stock	140.00	

	iii.	Debtors	48.00	238.00
c.	Less:			
	i.	Sundry creditors	165.00	
	ii.	Long term loan	200.00	
	iii.	Compensation to workers	110.00	
	iv.	Renovation of plant and machinery (210×0.8333) [PV]	174.99	
	v.	Modernisation of Plant and machinery (50 x 0.6944)	34.72	(684.71)
d.	Maximum value to be quoted (a+b-c)			55.67

So, Beta Ltd. can quote as high as Rs.55,67,000 for take over.

Working Note:

Valuation of Xeta Ltd. in case of merger

Year	Cash flow after merger	Cash flow of Xeta Ltd. before merger	Incremental cash flow	Discount factor @ 20%	Discounted cash flow
(1)	(2)	(3)	(4)= (2)-(3)	(5)	(6) = (4) ×(5)
1	240	200	40	0.8333	33.33
2	280	225	55	0.6944	38.19
3	350	250	100	0.5787	57.87
4	400	270	130	0.4823	62.70
5	410	285	125	0.4019	50.24
6	480	310	170	0.3349	56.93
7	550	350	200	0.2791	55.82
8	800	600	200	0.2326	46.52
9	880	610	270	0.1938	52.33
10	950	650	300	0.1615	48.45
					502.38

4. Trading and Profit and Loss Account for the year ended 31.03.09

Dr.					Cr.
		Rs.			Rs.
To	Opening Stock	30,000	By	Sales	4,60,000
To	Purchases	3.20.000	By	Closing Stock	52,000
To	Gross Profit c/d	1,62,000			
		5,12,000			5,12,000

		Pre-Incorporation	Post-Incorporation			Pre-Incorporation	Post-Incorporation
		Rs.	Rs.			Rs.	Rs.
To	Salaries	12,000	36,000	By	Gross Profit c/d	40,500	1,21,500
To	Directors' fee	-	12,000	By	Commission	-	3,000
To	Discount	1,250	3,750				
To	Depreciation:						
	Building	1,000	3,000				
	Furniture	250	750				
To	Pre-incorporation Profit transferred to Capital Reserve Account	26,000	-				
To	Net Profit	-	69,000				
		40,500	1,24,500			40,500	1,24,500

Note: Apportionment has been made in the Profit and Loss Account between pre-incorporation and post-incorporation period using the following basis.

Item	Base	Ratio
Gross Profit	Time	1 : 3
Salaries	Time	1 : 3
Discount	Time	1 : 3
Directors' Fees		100% to post-incorporation period
Commission		100% to post-incorporation period

Balance Sheet as on 31.3.2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital:			Fixed Assets		
30,000 equity shares of Rs.10 each Rs.8 called up	2,40,000		Building	80,000	
			Less: Depreciation	4,000	76,000

Less: Calls in Arrear (of the above 10,000 shares are allotted pursuant to a contract without payments being received in cash)	2,000	2,38,000			
Share Suspense A/c (400 shares to be issued to the underwriter in consideration of under-writing commission on completion of share issue)		4,000	Furniture & Fittings	10,000	
			Less: Depreciation	1,000	9,000
			Investments		Nil
Reserves and Surplus			Current Assets, Loans and Advances		
Capital Reserve	26,000		(A) Current Assets:		
Less: Goodwill w/o	16,000	10,000	Stock	52,000	
Profit & Loss A/c		69,000	Debtors	1,31,000	
Secured Loans		Nil	Cash	91,000	2,74,000
Unsecured loans		Nil	(B) Loans and Advances		Nil
Current Liabilities and Provisions			Miscellaneous Expenditure		
(A) Current Liabilities:			Preliminary Expenses	10,000	
Sundry Creditors	48,000		Underwriting Commission	4,000	14,000
Calls in Advance	4,000	52,000			
(B) Provisions		Nil			
		3,73,000			3,73,000

Working Notes:

(1) Goodwill on acquisition

		Rs.	Rs.
Purchase consideration:			
10,000 equity shares of Rs.10 Rs.8 paid up			80,000
Cash			56,000
			1,36,000
Less:	Assets taken over		
	Building	80,000	
	Furniture and Fittings	10,000	
	Stock	30,000	1,20,000
Goodwill			16,000

(2) Cash Inflows from public issue of equity shares

		Rs.
20,000 equity shares of Rs.10 each Rs.8 called up		1,60,000
Less:	Calls in arrear on 1,000 shares @ Rs.2 per share	2,000
		1,58,000
Add:	Calls-in-advance on 2000 shares @ Rs.2	4,000
		1,62,000

(3) Underwriting Commission 2% on face value Rs.2,00,000 4,000

Underwriting Commission becomes due on completion of the job relating to shares underwritten. It appears that the job relating to public issue was not finished till 31st March, 2009. So a Share Suspense Account should be created showing the amount of shares to be issued to the underwriter in discharge of his claim for commission

(4) Cash collection from Company's debtors

Total Debtors Account

Dr.		Vendor's Debtors	Company's Debtors			Vendor's Debtors	Company's Debtors
		Rs.	Rs.			Rs.	Rs.
To	Balance b/d	90,000	-	By	Discount	1,000	5,000

To	Sales		4,60,000	By	Cash	60,000	[1]3,24,000
				By	Balance c/d	29,000	[2]1,31,000
		90,000	4,60,000			90,000	4,60,000

Note: Assumed that all sales were on credit.

(5) Cash payment for purchases

Dr.					Cr.
		Rs.			Rs.
To	Cash (Balancing figure)	2,72,000	By	Purchases	3,20,000
To	Balance c/d	48,000			
		3,20,000			3,20,000

Note: Assumed that all purchases were on credit

(6) Summary Cash Book

Dr.					Cr.
		Rs.			Rs.
To	Share Capital A/c	1,62,000	By	Total Creditors A/c:	
To	Total Debtors A/c:			Payment to creditors	2,72,000
	Collection from company's debtors	3,24,000	By	Vendor's A/c:	
	Collection from vendor's debtors	60,000		Purchase consideration	56,000
			By	Preliminary Expenses	10,000
			By	Directors' Fees	12,000
			By	Salaries	48,000
			By	Vendor's A/c (Collection less commission Rs.3,000)	57,000
			By	Balance c/d	91,000
		5,46,000			5,46,000

[1] Balancing figure.

[2] Total Debtors Rs.1,60,000 minus Vendor's Debtors Rs.29,000

5. In the books of Ginni Ltd.

Journal Entries

		Debit Rs.	Credit Rs.
Cumulative Preference Share Capital A/c	Dr.	3,00,000	
Capital Reduction A/c	Dr.	66,000	
To Cumulative Preference Shareholders A/c			3,66,000
(Being the cumulative preference shares & arrear dividend transferred to cumulative preference shareholders account in accordance with the resolution of the Board dated……..)			
Cumulative Preference Shareholders A/c	Dr.	3,66,000	
To 13% unsecured debentures A/c			2,92,800
To Equity Share Capital A/c			73,200
(Being the issue of 13% unsecured debentures and 1,464 Equity shares of Rs.100 each issued as Rs.50 paid up as per the Board's resolution dated….)			
Equity Share Capital A/c	Dr.	3,75,000	
To Capital Reduction A/c			3,75,000
(Being the entry for reducing every share of Rs.100 each as Rs.50 paid up 7,500 Equity shares @ 50 per share as per the Board resolution dated….)			
Cash A/c	Dr.	4,48,200	
To Equity Share Capital A/c			4,48,200
(Being the receipt of Cash of Rs.50 each for 8964 being the call made as per Boards resolution dated…..)			
Investments A/c	Dr.	10,000	
Capital Reduction (Balancing figure)	Dr.	2,97,725	
To Goodwill A/c			1,00,000
To Stock A/c			50,000
To Fixed Assets A/c			1,50,000
To Provision for doubtful Debts A/c			7,725
(Being the change in value of assets as per the resolution of the Board dated…..)			
Capital Reduction A/c	Dr.	11,275	
To Capital Reserve A/c			11,275
(Being the transfer of Capital Reduction A/c balance to Capital Reserve)			

Ginni Ltd.

Balance Sheet as at 30th June, 2009

Liabilities	Rs.	Assets	Rs.	Rs.
Subscribed Capital		Fixed Assets	8,30,000	
8,964 Equity Shares of Rs.100 each	8,96,400	Less: depreciation	83,000	7,47,000
		Investments		30,000
Securities premium	12,000			
Capital Reserve	11,275	Stock in Trade		2,30,000
General Reserve	80,000	Trade Debtors	2,14,500	
Profit and Loss A/c	80,000	Less: Provision for Doubtful debts	7,725	2,06,775
13% unsecured debentures	2,92,800	Bank Balance		5,50,700
Trade Creditors	3,92,000			
	17,64,475			17,64,475

Working Notes:

1.	No. of equity shares issued to cumulative preference shareholders	1,464
	No. of shares held by Equity shareholders	7,500
	Total	8,964

		Rs.
2.	Opening Balance on 31.12.2008	62,500
	Add: Calls on shares @ 50 per share (8,964 $\times$ Rs.50 per share)	4,48,200
	Balance on implementation of the scheme	5,10,700
	Add: Change in cash balance (as given in the question)	(+)40,000
		5,50,700
3.	Creditors Balance = Balancing figure	
	Alternative approach: Profit & Loss upto 30.6.2009	80,000
	Add: Depreciation (non cash item)	83,000
	Cash from operations	(A)1,63,000
	Change in Current Assets:	
	Debtors	(+)60,000
	Stock	(+)80,000

Cash Balance	(+)40,000
Cash Outflow	(B)1,80,000
Increase in creditors	
Excess of (B) over (A)	17,000
Add: Opening Balance	3,75,000
	3,92,000

6. Journal Entries in the Books of D Ltd.

		Dr. Amount Rs.	Cr. Amount Rs.
Business Purchase Account	Dr.	12,42,500	
To Liquidator of V Ltd.			12,42,500
(For purchase consideration due)			
Investments Account	Dr.	1,92,500	
Goodwill Account (Balancing figure)	Dr.	1,00,000	
Fixed Assets Account	Dr.	8,50,000	
Current Assets Account	Dr.	3,00,000	
To Sundry Creditors Account			2,00,000
To Business Purchase Account			12,42,500
(For assets and liabilities taken over at agreed value)			
Liquidator of V Ltd.	Dr.	12,42,500	
To Equity Share Capital Account (Rs. 100)			9,03,600
To Securities Premium Account (Rs. 37.50)			3,38,850
To Cash Account			50
(For purchase consideration discharged)			
Goodwill Account	Dr.	16,000	
To Current Assets (Stock) Account			16,000
(For elimination of unrealized profit on unsold stock)			
Amalgamation Adjustment Account	Dr.	2,00,000	
To Investment Allowance Reserve Account			2,00,000
(For incorporation of statutory reserve)			

Balance Sheet of D Ltd. as on 31st December, 2008

Liabilities	Amount Rs.	Assets	Amount Rs.
Equity Share Capital: 17,036 shares of Rs. 100 each (out of which 9036 shares are issued in favour of vendor for consideration other than cash)	17,03,600	Fixed Assets (5,00,000 + 8,50,000)	13,50,000
		Goodwill (6,00,000 + 1,00,000 + 16,000)	7,16,000
General Reserve	4,00,000	Investments (2,00,000 + 1,92,500)	3,92,500
Securities Premium	3,38,850	Current Assets	
Investment Allowance Reserve	2,00,000	(7,00,000 – 50 – 16,000)	6,83,950
Sundry Creditors	7,00,000	Amalgamation Adjustment Account	2,00,000
	33,42,450		33,42,450

Working Notes:

1. Calculation of net asset value of shares

	D Ltd. Rs.	V Ltd. Rs.
Goodwill	5,00,000	1,00,000
Fixed Assets	6,00,000	8,50,000
Investments	1,00,000	3,30,000*
Current Assets	4,00,000	3,00,000
	16,00,000	15,80,000
Less: Sundry Creditors	5,00,000	2,00,000
Net assets	11,00,000	13,80,000
Number of shares	8,000	6,000
Value per equity share	137.50	230

*Investments of V Ltd. are calculated as follows:	Rs.
Shares in D Ltd. (1,000 × 137.50)	1,37,500
Market value of remaining investments (given)	1,92,500
	3,30,000

2. Calculation of Purchase Consideration

	Rs.
Net assets of V Ltd.	13,80,000
Value of Shares of D Ltd.	137.50
Number of shares to be issued in D Ltd. to V Ltd. (13,80,000 ÷ 137.50)	10,036.36
Less: Shares already held by V Ltd.	1,000
Additional shares to be issued	9,036.36
Total value of shares to be issued (9036 × 137.50)	12,42,450
Cash payment for fractional share (.36 × 137.50)	50
	12,42,500

7. Consolidated Balance Sheet of Astha Ltd. and its subsidiary Birat Ltd. as at 31st March 2008

(Rs. in '000s)

Liabilities		Amount	Assets		Amount
Share capital:			Goodwill (W.N.5)		1,088.0
3,00,000 Equity shares of			Plant and machinery		
Rs. 10 each fully paid up		3,000.0	Astha Ltd.	2,060.0	
Minority interest (W.N.4)		360.4	Birat Ltd. (W.N.7)	750.0	2,810.0
General reserves		1,900.0	Furniture and fixtures		
Profit and loss A/c (W.N.6)		1,894.6	Astha Ltd.	600.0	
Creditors			Birat Ltd. (W.N. 8)	432.0	1,032.0
Astha Ltd.	300.0		Stock		
Birat Ltd.	320.0		Astha Ltd.	680.0	
	620.0		Birat Ltd.	404.0	
Less: Mutual owings	120.0	500.0		1,084.0	
			Add: Unrealised loss	5.0	1,089.0
			Debtors		
			Astha Ltd.	560.0	
			Birat Ltd.	316.0	
				876.0	
			Less: Mutual owings	120.0	756.0
			Cash at Bank		
			Astha Ltd.	660.0	
			Birat Ltd.	220.0	880.0
		7,655.0			7,655.0

Contingent liability: Claim against damages lodged by a contractor against Astha Ltd. is pending in a law suit Rs. 155 thousands (W.N. 9).

Working Notes:

1. Calculation of capital profits (pre-acquisition)

		(Rs. in '000s)
General reserve balance as on 1-04-2007		40.0
Profit and loss account balance as on 1-04-2007	320.0	
Less: Dividend at 16% p.a. on Rs. 6,00,000 for the year 2006-07	96.0	224.0
		264.0
Add: Profit on revaluation of plant and machinery (W.N.7)		200.0
		464.0
Less: Loss on revaluation of furniture and fixtures (W.N.8)		120.0
		344.0
Share of Astha Ltd. (80%)		275.2
Share of Minority Interest (20%)		68.8

2. Calculation of revenue profits (post-acquisition)

	(Rs. in '000s)
Profits during the year 2007-08 (720.0 – 224.0)	496.0
Less: Preference dividend for the year 2007-08 @ 14% on Rs.4,00,000	56.0
	440.0
Less: Under charging of depreciation on plant and machinery due to upward revaluation (Rs.2,00,000 x 25%)	50.0
	390.0
Add: Overcharging of depreciation on furniture and fixtures due to downward revaluation (Rs.1,20,000 x 10%)	12.0
	402.0
Share of Astha Ltd. (80%)	321.6
Share of Minority Interest (20%)	80.4

3. Calculation of dividend on preference shares of Birat Ltd.

		(Rs. in '000s)
Dividend on preference shares (Rs. 4,00,000 x 14%)		56.0
Share of Astha Ltd.	(80%)	44.8
Share of Minority Interest	(20%)	11.2
		56.0

4. **Calculation of Minority Interest** (Rs. in '000s)

Equity share capital (20%)	120.0
Preference share capital (20%)	80.0
Share of capital profits (W.N. 1)	68.8
Share of Revenue profit (W.N.2)	80.4
Share of preference dividend (W.N.3)	11.2
	360.4

5. **Calculation of Cost of Control - Goodwill** (Rs. in '000s)

Investment by Astha Ltd. in		
Equity shares of Birat Ltd.	1,920.0	
Less: Dividend received for 2006-07 (600 x 80% 16%)	76.8	1,843.2
Preference shares		320.0
		2,163.2
Less:Paid up value of		
Equity shares (80%)	480.0	
Preference shares (80%)	320.0	
Share in Capital Profit (W.N. 1)	275.2	1,075.2
Goodwill		1,088.0

6. **Calculation of Consolidated Profit and Loss Account** (Rs. in '000s)

Balance in Profit and loss A/c of Astha Ltd. as on 1-04-2007	1,600.0
Add: Revenue profit from Birat Ltd (W.N. 2)	321.6
Preference dividend of Birat Ltd. (W.N. 3)	44.8
Share of unrealised loss on stock (Rs. 10,000 x 50%)	5.0
	1,971.4
Less:Dividend wrongly credited	76.8
	1,894.6

7. **Value of Plant and Machinery of Birat Ltd.** (Rs. in '000s)

Value as on 1.04.07 (600 x 100/75)	800.0
Add: Appreciation on revaluation (25%)	200.0
Revalued figure	1,000.00

Less: Depreciation		
Already charged (800-600)	200.0	
Due to upward revaluation (200 x 25%)	50.0	(250.0)
		750.0

8. Value of Furniture and Fixtures of Birat Ltd.

		(Rs. in '000s)
Value as on 1.4.2007 (540 x 100/90)		600.00
Less: Diminution on revaluation (20%)		(120.00)
Revalued Figure		480.0
Less: Depreciation already charged (600 - 540)	60.0	
Less: Depreciation written back due to downward revaluation		
(120 x 10%)	(12.0)	(48.0)
		432.0

9. Contingent liability:

As per para 68 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', "unless the possibility of any outflow in settlement is remote, an enterprise should disclose contingent liability at the balance sheet date along with a brief description of the nature of such contingent liability." Therefore, it would not be correct to ignore the contingent liability.

8. (i) In Z Ltd.'s Books

Journal Entries

(Rs. in crores)

		Dr. Amount Rs.	Cr. Amount Rs.
Bank Account (Current Assets)	Dr.	102	
To Investments			97
To Profit and Loss Account (Reserves and Surplus)			5
(Sale of investments at a profit of Rs. 5 crore)			
Debentures (Loan Funds)	Dr.	125	
To Bank Account (Current Assets)			125
(Redemption of debentures at par)			
Current Liabilities	Dr.	93	
Bank Loan (Loan Funds)	Dr.	15	

Provision for Depreciation	Dr.	81	
Reserves and Surplus (Loss on Demerger)	Dr.	645	
To Fixed Assets			249
To Current Assets			585
(Assets and liabilities pertaining to W Division taken out of the books on transfer of the division to Y Ltd.)			

(ii) (a) Z Ltd.'s Balance Sheet after demerger

	Rs. in crores	Rs. in crores
Fixed Assets		
Gross Block	875	
Less: Depreciation	360	515
Net Current Assets		
Current Assets	422	
Less: Current Liabilities	270	152
		667
Financed by		
Shareholders' Funds		
Equity Share Capital	345	
Reserves and Surplus	45	390
Loan Funds		277
		667

Working Notes:

		Rs. in crores	Rs. in crores
1.	Reserves and Surplus		
	Balance as on 31st March, 2008		685
	Add: Profit on sale of investments		5
			690
	Less: Loss on demerger		645
	Balance shown in balance sheet after demerger		45
2.	Loan Funds		
	Balance as on 31st March, 2008		417
	Less: Bank Loan transferred to Y Ltd.	15	
	Debentures redeemed	125	140
	Balance shown in balance sheet after demerger		277

3. Current Assets

Balance as on 31st March, 2008	445
Add: Cash received from sale of investments	102
	547
Less: Cash paid to redeem debentures	125
Balance shown in balance sheet after demerger	422

(b) Initial Balance Sheet of Y Ltd.

	Rs. in crores	Rs. in crores
Fixed Assets		218
Net Current Assets		
Current Assets	585	
Less: Current Liabilities	93	492
		710
Financed by		
Shareholders' funds:		
Capital (Issued for acquisition of business)		690
Capital Reserve*		5
Loan Funds		15
		710

9. Journal Entries for Buy-back of shares of Gun Shot Ltd.

			Rs.	Rs.
(i)	Bank A/c	Dr.	3,20,000	
	To Non-trade Investments			3,00,000
	To Profit & Loss A/c			20,000
	(Being the entry for sale of Non-trade Investments)			
(ii)	Shares Buy back A/c (16,000 x Rs. 20)	Dr.	3,20,000	
	To Bank A/c			3,20,000
	(Being purchase of 16,000 shares @ Rs.20 per share)			

* Capital Reserve has been calculated as

		Rs. in crores
Purchase consideration		690
Less: Assets transferred	710	
Loan funds transferred	(-15)	695
Capital reserve		5

(iii)	Equity Share Capital A/c (16,000 x Rs.10)	Dr.	1,60,000	
	Buy-back Premium (16,000 x Rs.10)	Dr.	1,60,000	
	To Shares Buy-back A/c			3,20,000
	(Being cancellation of shares bought back)			
(iv)	Securities Premium A/c	Dr.	1,00,000	
	General Reserve	Dr.	60,000	
	To Buy-back Premium			1,60,000
	(Being adjustment of buy-back premium)			
(v)	General Reserve	Dr.	1,60,000	
	To Capital Redemption Reserve			1,60,000
	(Being the entry for transfer of General Reserve to Capital Redemption Reserve to the extent of face value of equity shares bought back)			

10. (a) Various advantages of preparation of Value Added (VA) Statements are as under:

1. Reporting on VA improves the attitude of employees towards their employing companies. This is because the VA statement reflects a broader view of the company's objectives and responsibilities.
2. VA statement makes it easier for the company to introduce a productivity linked bonus scheme for employees based on VA. The employees may be given productivity bonus on the basis of VA / Payroll Ratio.
3. VA based ratios (e.g. VA / Payroll, taxation / VA, VA / Sales etc.) are useful diagnostic and predictive tools. Trends in VA ratios, comparisons with other companies and international comparisons may be useful.
4. VA provides a very good measure of the size and importance of a company. To use sales figure or capital employed figures as a basis for company's rankings can cause distortion. This is because sales may be inflated by large bought-in expenses or a capital-intensive company with a few employees may appear to be more important than a highly skilled labour–intensive company.
5. VA statement links a company's financial accounts to national income. A company's VA indicates the company's contribution to national income.
6. VA statement is built on the basic conceptual foundations which are currently accepted in balance sheets and income statements. Concepts such as going concern, matching, consistency and substance over form are equally applicable to VA statement.

(b) Value Added Statement

			(Rs. in lakhs)
Turnover			2,300
Add:	Change in Finished Stock		
	(Closing Stock 200 – Opening Stock 160)		40
			2,340
Less:	Bought in Materials and Services:		
	Raw Materials Purchased	625	
	Printing and Stationery	22	
	Auditor's Remuneration	28	
	Rent, Rates and Taxes	165	
	Other Expenses	85	925
	Value Added		1,415
Disposals as follows:			
To	Employees:		
	Wages and Salaries	327	
	Employees State Insurance	35	
	PF Contribution	28	390
To	Providers of Capital:		
	Interest	40	
	Dividend	146	186
To	Government: Income Tax		276
To	Provide for Maintenance:		
	Loss on Sale of Machinery	75	
	Depreciation	200	
	Retained Earnings	288	563
			1,415

11. (a) Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital employed, equity as well as debt, used in the business.

Mathematically EVA= OPBT – Tax – (TCE × COC)

Where:

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

COC = Cost of Control

Because EVA includes both profit and loss as well as balance sheet efficiency as well as the opportunity cost of investor capital - it is better linked to changes in shareholders wealth and is superior to traditional financial measures such as PAT or percentage of return measures such as ROCE or ROE.

EVA, additionally, is a tool for management to focus on the impact of their decisions in increasing shareholders wealth. These include both strategic decisions such as what investments to make, which business to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make inhouse or outsource, repair or replace an equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholders wealth is to integrate EVA framework in four key areas, viz., to measure business performance, to guide managerial decision making, to align managerial incentives with the shareholders' interests and to improve the financial and business literacy throughout the organisation.

(b) Vinod Limited

Computation of Economic Value Added

Economic Value Added	Rs. in Lakhs
Net Operating Profit after Tax (Refer Working Note 5)	1,372.00
Add: Interest on Long-term Fund (Refer Working Note 2)	28.00
	1,400.00
Less:Cost of Capital Rs. 6,400 lakhs × 15.77% (Refer working notes 3 and 4)	1,009. 28
Economic Value Added	390. 72

Working Notes:

1. Cost of Equity = Risk free Rate + Beta Factor (Market Rate – Risk Free Rate)

   9% + 1.05 (16 – 9) = 9% + 7.35% = 16.35%

2. Cost of Debt

Interest	Rs.40 lakhs
Less: Tax (30%)	Rs.12 lakhs
Interest after Tax	Rs.28 lakhs

   Cost of Debt = $\frac{28}{400} \times 100 = 7\%$

3. Weighted Average Cost of Capital

Cost of Equity	Rs. 6,000 lakhs × 16.35% (W.N.1)	Rs. 981 lakhs
Cost of Debt	Rs. 400 lakhs × 7% (W.N.2)	Rs. 28 lakhs
		Rs. 1009 lakhs

$$\text{WACC} = \frac{1{,}009}{6{,}400} = 15.77\% \quad \text{(approx.)}$$

4. Capital Employed

	Rs. in Lakhs
Share Capital	2,000
Reserves + Surplus	4,000
Long-term Debts	400
	6,400

5. Net operating Profit after Tax

Profit before Interest + Tax	2,000
Interest	40
	1,960
Tax 30% on 1,960 Lakhs	588
Operating Profit after Tax	1,372

12. (a) Human resource accounting can be defined as the process of identifying, measuring and communicating information about human resources in financial statements in order to facilitate effective management. Human resource accounting is a recent phenomenon in India. Leading public sector units like OIL, BHEL, NTPC, MMTC and SAIL etc. have started reporting Human Resources in their annual reports as additional information. The Indian Companies basically adopted the model of human resource valuation as advocated by Lev and Schwartz (1971). Indian Companies focused their attention on the present value of employee earning as a measure of their human capital. However the Indian Companies have suitably modified the Lev and Schwartz model to suit their individual circumstances.

(b) Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice does not assign significance to the human resources. Human resources are not recognized in balance sheet as there are no measurement criteria for recognition of human resources. Human resource accounting is at developing stage and no accounting principles have been established for valuation of human assets. Costs incurred on human resources are recognized as expenses in profit and loss account. Leading public sector units like OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information.

13. Srishti Ltd.

Statement relating to Staff and Community Benefits

I.			Social benefits and cost to staff	Rs. In lakhs
	A.		Social Benefits to Staff	
			1. Medical Facilities	9.00
			2. Training Programmes	18.45
			3. Concessional Transport and Later Supply	20.25
			4. Leave Enchashments and Leave Travel Benefits	93.60
			5. Educational Facilities for children of staff members	38.88
			6. Subsidized canteen facilities	25.92
			Total	206.10
	B.	Less:	Social costs to staff	
			Extra work put in by staff and officers for drought relief	33.30
			Net Social benefits to staff (A-B)	172.80
II.			Social benefits for cost to community	
	A.		Social Benefits to Community	
			1. Environmental Improvements	36.18
			2. Generation of Job Opportunities	109.35
			3. Municipal Taxes	19.26
			4. Generation of Business	45.00
			Total	209.79
	B.	Less:	Social costs to community increase in cost of living in the vicinity due to company's operations	29.79
				180.00
			Total Net Social Benefits to staff and community (I +II)	352.80

14. (a) "Non–Performing Asset" as per NBFC Prudential Norms (RBI) directions means:

(i) An asset, in respect of which, interest has remained past due for six months;

(ii) A term loan inclusive of unpaid interest, when the instalment is overdue for more than six months of which interest amount remained past due for six months;

(iii) A bill which remained overdue for six months;

(iv) The interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances that remained overdue for a period of six months;

(v) Any dues on account of sales of assets or services rendered or reimbursement expenses made, which remained overdue for a period of six months;

(vi) The lease rental and hire purchase instalment, which has become overdue for a period of more than twelve months;

(vii) In respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities made available to borrower /beneficiary when anyone of the credit facilities becomes NPA.

However, an NBFC may classify each such account on the basis of record of recovery as regards hire purchase and lease transactions.

(b) Mutual funds sell their shares to public and redeem them at current net Assets Value (NAV) which is calculated as under:–

$$\frac{\text{Total market value of all Mutual Fund holdings - All Mutual Fund liabilities}}{\text{Unit size}}$$

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. Simply stated, NAV is the value of the assets of each unit of the scheme, or even simpler value of one unit of the scheme. Thus, if the NAV is more than the face value (Rs. 10), it means your money has appreciated and vice versa. NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments. NAV is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keeps on changing with change in market value of portfolio under the scheme.

15. (a) Capital adequacy requirements have been specified by SEBI under the SEBI (Merchant Bankers) Regulations, 1992.

Regulation 7 specifies that the requirement of capital adequacy shall not be less than the net worth of the person making the application for grant of registration.

The specified net worth in this connection will be computed as under:

	Minimum requirement
Category I: Merchant bankers who carry on activity of the issue management, which will inter alia, consist of preparation of prospectus and other information relating to the issue, determining the financial structure, tie-up of financiers and final allotment and refund of subscriptions and act as advisor, consultant, manager, underwriter,	

portfolio manager etc.	Rs. 5 crores
Category II – Merchant bankers who act as advisor, consultant, co-manager, underwriter, portfolio manager	Rs.50 lakhs
Category III – Merchant bankers who act as underwriter, adviser, consultant to the issue.	Rs.20 lakhs
Category IV – Merchant bankers who act only as an advisor or consultant to the issue.	Nil

For the purposes of the regulation, a merchant banker has been defined as any person engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities is as manager, consultant, advisory or rendering corporate advising more in relation to issue management.

(b) Every stock broker is required to maintain the following books of account and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:

(a) Register of transactions (Sauda book)/Daily transaction list;

(b) Clients ledger;

(c) General ledger;

(d) Journals;

(e) Cash book;

(f) Bank Pass Book;

(g) Documents register/Inward-outward register showing full particulars of shares and securities received and delivered;

(h) Members' contract book showing details of all contracts entered into by him with other members of the stock exchange or counterfoils or duplicates of memos of confirmation issued to such other members;

(i) Counterfoils or duplicates of contract notes issued to clients;

(j) Written consent of clients in respect of contracts entered into as principals;

(k) Margin deposit book;

(l) Register of accounts of sub-brokers;

(m) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock broker and such sub-brokers.

In addition to the above statutory requirements, stock brokers are also required to maintain scrip wise client wise list in respect of scripts of specified group, client upla statement, duplicate copies of self-certificates submitted on monthly basis, copies of margin statements downloaded by the stock exchange, copies of valan balance sheet (Form 31), details of spot delivery transactions, client data base and broker client agreement, copy of registration certificate of each sub-broker issued by SEBI, copies of the power of attorney/board resolution authorising directors and employees and copies of pool account statements.

16. Journal Entries

Particulars		L.F.	Debit Rs.	Credit Rs.
Bank A/c	Dr.		20,00,000	
Investments A/c	Dr.		15,00,000	
To Annuity Fund A/c				35,00,000
(Being receipt of annuity based gift in the form of cash and marketable securities)				
Bank A/c	Dr.		38,500	
To Annuities Payable A/c				25,000
To Annuity Fund A/c				13,500
(Being monthly investment income received from the fund and surplus accruing after meeting the annuity payable, transferred to the fund)				
Annuities Payable A/c	Dr.		25,000	
To Bank A/c				25,000
(Being monthly annuity payment made)				

17. Treatment under Indian Accounting Standard and IFRS

		Indian Accounting Standards	IFRS
(i)	Discontinuing operations - definition and measurement	Operations and cash flows that can be clearly distinguished for financial reporting and represent major line of business or geographical area of operations are discontinued operations. Measurement of discontinued operations is based on AS 24.	Definition of discontinued operations under IFRS is similar to Indian Accounting Standards. However, it also includes a subsidiary acquired exclusively with a view to resale. Discontinued operations are measured at lower of carrying amount and fair value less cost to sell.

(ii)	Acquired intangible assets	If recognition criteria are satisfied then it can be capitalized. All intangibles are amortized over useful life with rebuttable presumption of not exceeding 10 years. Revaluations are not permitted.	If recognition criteria are satisfied then it can be capitalized. It is amortized over useful life. Intangibles assigned an indefinite useful life are not amortized but reviewed at least annually for impairment. Revaluations are permitted in rare circumstances.

18. (a) XYZ Ltd. is a small and medium sized enterprise (SME) company as per Companies (AS) Rules, 2006. The following relaxations and exemptions are available.

1. AS 3 “Cash Flow Statements” is not mandatory.
2. AS 17 “Segment Reporting” is not mandatory.
3. SMEs are exempt from some paragraphs of AS 19 “Leases”.
4. SMEs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).
5. SMEs are allowed to measure the ‘value in use’ on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 “Impairment of Assets”.
6. SMEs are exempt from disclosure requirements of paragraphs 66 and 67of AS 29 “Provisions , Contingent Liabilities and Contingent Assets”.
7. SMEs are exempt from certain requirements of AS 15 “Employee Benefits”.
8. Accounting Standards 21, 23, 27 are not applicable to SMEs.

If XYZ is not a company, it will be treated as a level III enterprise instead of level II enterprise; XYZ Ltd. will be exempt from requirements of AS 18 “Related Party Disclosures” and AS 24 “Discontinuing Operations”.

(b) Enterprises which are not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises:

(i) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 40 lakhs but does not exceed Rs. 50 crores. Turnover does not include ‘other income’.

(ii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crores at any time during the accounting period.

(iii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

(c) As per para 50 and 52 of AS 19, 'if a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognized immediately.

(d) It is a present obligation as a result of past obligating event. The obligating event is the sale of the product which gives rise to an obligation because obligations also arise from normal business practices. An outflow of resources, embodying economic benefits in settlement is probable because a proportion of goods are returned for refund. For the best estimate of the cost of refunds, a provision should be recognized as per AS 29.

19. (i) NACAS: Under Section 210 A of the Companies Act 1956, the Central Government, by notification, has constituted a committee to advise the Central Government on the formulation of accounting policies and accounting standards for adoption by companies or class of companies specified under the Act. Based on the recommendations of NACAS, the Central Government has notified AS 1 to AS 7 and AS 9 to AS 29 in Dec. 2006 in the form of Companies (Accounting Standards) Rules, 2006. Presently, these rules are called as Companies (Accounting Standards) Amendment Rules, 2008.

(ii) The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Statement requires the enterprise to recognize an impairment loss. This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

(iii) According to AS 16, borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing costs may include: (i) interest and commitment charges on bank borrowings and other short-term and long-term borrowings; (ii) amortization of discounts or premiums relating to borrowings; (iii) amortization of ancillary costs incurred in connection with the arrangement of borrowings; (iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and (v) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset• should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when the conditions specified in AS 16 are satisfied.

(iv) Investments by a holding company in the shares of its subsidiary company are normally considered as long term investments. Indian holding companies show investment in subsidiary just like any other investment and generally classify it as trade investment. As per AS 13 'Accounting for Investments', investments are classified as long term and current investments. A current investment is an investment that by its nature is readily realizable and is intended to be held for more than one year from the date of acquisition. A long term investment is one that is not a current one.

Costs of investment include besides acquisition charges, expenses such as brokerage, fees and duties. If an investment is acquired wholly or partly by an issue of shares or other securities, the acquisition cost is determined by taking the fair value of the shares/securities issued. If an investment were to be acquired in exchange – part or whole – for another asset, the acquisition cost of the investment is determined with reference to the value of the other asset exchanged. Dividends received out of incomes earned by a subsidiary before the acquisition of the shares by the holding company and not treated as income but treated as recovery of cost of the assets (investment made in the subsidiary). The carrying cost for current investment is the lower of cost or fair/market value whereas investment in the shares of the subsidiary (treated as long term) is carried normally at cost.

(v) Cost vs. Fair value

Cost basis: The term cost refers to cost of purchase, costs of conversion on other costs incurred in bringing the goods to its present condition and location. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or

• A qualifying asset is an asset that necessarily takes a substantial period of time[1] to get ready for its intended use or sale.

in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

Fair value: Fair value of an asset is the amount at which an enterprise expects to exchange an asset between knowledgeable and willing parties in an arm's length transaction.

Indian Accounting Standards are generally based on historical cost with a very few exceptions:

AS 2 "Valuation of Inventories" – Inventories are valued at net realizable value (NRV) if cost of inventories is more than NRV.

AS 10 "Accounting for Fixed Assets" – Items of fixed assets that have been retired from active use and are held for disposal are stated at net realizable value if their net book value is more than NRV.

AS 13 "Accounting for Investments" – Current investments are carried at lower of cost and fair value. The carrying amount of long term investments is reduced to recognise the permanent decline in value.

AS 15 "Employee Benefits" – The provision for defined benefits is made at fair value of the obligations.

AS 26 "Intangible Assets" – If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

AS 28 "Impairment of Assets"– Provision is made for impairment of assets.

On the other hand IFRS and US GAAPs are more towards fair value. Fair value concept requires a lot of estimation and to the extent, it is subjective in nature.

(vi) According to para 44 of AS 20, 'If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.

(vii) Para 87, 88 and 89 of AS 26 states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets, and recognises any impairment loss accordingly.

(viii) The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:

(a) the period of the change, if the change affects the period only; or

(b) the period of the change and future periods, if the change affects both.

The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

20. (i) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

In the case of the Jewellery Business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

(ii) The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS I5 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

(iii) As per provisions of Para 91(b) of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

(iv) As per para 32 of AS 13 on 'Accounting for Investments', any investment of long term period is shown at cost. Hence, the investment in Gold and Silver (purchased on 1st April 2005) shall continue to be shown at cost i.e., Rs.2,00,000 and Rs.1,50,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of Rs.3,00,000 is to be charged to profit & loss account for the year ended 31st March, 2008. If investment is of long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

21. (i) Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2008-09 should be calculated as follows:

Actual interest for 2008-09 (11% of Rs.150 crores)	Rs.16.50 crores
Less:Income on temporary investment from specific borrowings	Rs. 3.50 crores
Borrowing costs to be capitalized during year 2008-09	Rs. 13.00 crores

(ii) Omega Limited.

Calculation of Deferred Tax Asset/Liability

Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2006	11,00,000	7,00,000	4,00,000	1,40,000
2007	16,00,000	18,00,000	2,00,000	70,000
2008	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

(iii) As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of Rs.3 crores (Rs. 53 crores less Rs. 50 crores) should be recognised as an expense immediately in the year ended 31st march, 2008. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with para 8 of AS 7.

(iv) As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of Rs.5 lakhs to be recognised as income for financial year 2006-07, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

22. Cash Flow Statement for the year ended December 31, 2008

Cash Flows from Operating Activities	
Profit before Tax	2.95,000
Add: Depreciation (Non-Cash expense)	1,10,000
Interest (Non-operating expense)	70,000
Less:Non-operating Income	(25,000)
Operating Profit	4,50,000
Add: Decrease in Bills Receivable	5,000
Decrease in Debtors	30,000
Increase in Creditors	25,000
Less: Increase in Stock	(10,000)

Cash flow from operation before tax	5,00,000	
Less: Tax paid	(1,30,000)	
Cash provided by Operating Activities		3,70,000
Cash Flows from Investing Activities		
Purchase of Fixed Assets (10,00,000 + 1,10,000 – 8,50,000)	(2,60,000)	
Dividend on Investments	25,000	
Cash used in Investing Activities		(2,35,000)
Cash Flows from Financing Activities		
Long term loan taken	30,000	
Interest paid	(70,000)	
Dividend Paid	(90,000)	
Income from Financing Activities		(1,30,000)
Net Increase in Cash during the year		5,000
Add: Opening Cash Balance		30,000
Closing Cash Balance		35,000

23. (i) Computation of earnings per share

	Earnings	Shares	Earnings per share
Net profit for the year 2007-08	Rs.15,00,000		
Weighted average number of shares outstanding during year 2007-08		6,00,000	
Basic earnings per share			Rs. 2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/25.00	*	(60,000)	
Diluted earnings per share	Rs. 15,00,000	6,40,000	Rs. 2.34 (approx.)

* The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of the computation to have been issued for no consideration.

(ii) (a) As per AS 18, associates and joint ventures of the reporting enterprise are related parties. Since A Ltd. holds more than 20% of the voting power in B Ltd. by virtue of this it has substantial interest and significant influence in B Ltd. Therefore B Ltd. is an associate and is related party to A Ltd.

(b) An associate of an associate is not a related party. Only in the case of a holding company a subsidiary of a subsidiary (sub-subsidiary) also becomes a related party.

(c) C Ltd. and D Ltd. are co-associates. Co-subsidiaries become related parties because of common control. In the case of this common control is missing and therefore they are not related parties.

(iii) According to AS 12 states “where the Government grants are of the nature of promoters’ contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income”.

In the given case the subsidy is given with reference to the total investment in the unit located in the backward area by way of promoter’s contribution, the amount should be treated as capital reserve and not income.

(iv) As per AS 29, Contingent liability should be disclosed in financial statements if following conditions are satisfied:-

- There should be present obligation arising out of past event but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first 10 cases is 60% and for remaining, five cases 50%. In other words, the probability of losing is 40% or 50% respectively. As per the AS-29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note amount may be calculated as under:

Expected loss in first ten cases	=	Rs.90,000 $\times$ 0.3 + Rs.1,60,000 $\times$ 0.1
	=	Rs.43,000 $\times$ 10
	=	Rs.4,30,000
Expected loss in remaining five cases	=	Rs.60,000 $\times$ 0.3 + Rs.95,000 $\times$ 0.2

	=	Rs.37,000 × 5
	=	Rs.1,85,000
Total Contingent Liability	=	Rs.4,30,000 + Rs.1,85,000= Rs.6,15,000

24. (i) The Guidance note on "Accounting for Investments in Financial Statements of Mutual Funds" provides that Investments should be marked to market on balance sheet date with provision for depreciation, if any, in the value of investments debited to revenue account. The provision so created should be shown as a deduction from the value of investments in the Balance Sheet. The Guidance notes further states that the depreciation or appreciation should be worked out on individual basis or by category of investment but not on an overall basis. Keeping in view 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments, the Guidance Note states that the gross value of depreciation on investments should be reflected in the revenue account rather than the same being netted off with the appreciation in the value of other investments. Thus the claim of Amigo Mutual Fund Ltd. is not correct.

(ii) The counter guarantee given by the company is, infact, an undertaking to perform what is, in any event, the obligation of the company itself. In any case, this is a matter which is in the control of the company itself and the mere possibility of a default by the company in the future cannot be said to involve the existence of a contingent liability on the balance sheet date.

Thus, as per 'Guidance Note on Guarantees and Counter-Guarantees given by Companies', no separate disclosure is required in respect of counter guarantees.

25. (i) Journal Entries

Date	Particulars		Rs.	Rs.
31.3.2006	Employees compensation Expenses A/c	Dr.	14,25,000	
	To ESOS outstanding A/c			14,25,000
	(Being compensation expense recognized in respect of the ESOP i.e. 100 options each granted to 1,000 employees at a discount of Rs. 30 each, amortised on straight line basis over vesting years- Refer W.N.)			
	Profit and Loss A/c	Dr.	14,25,000	
	To Employees compensation expenses A/c			14,25,000
	(Being compensation expenses charged to P & L A/c)			

31.3.2007	Employees compensation expenses A/c	Dr.	3,95,000	
	To ESOS outstanding A/c			3,95,000
	(Being compensation expense recognized in respect of the ESOP)			
31.3.2007	Profit and Loss A/c	Dr.	3,95,000	
	To Employees compensation expenses A/c			3,95,000
	(Being compensation expense charged to P & L A/c)			
30.3.2008	Employees compensation expenses A/c	Dr.	8,05,000	
	To ESOS outstanding A/c			8,05,000
	(Being compensation expense recognized in respect of the ESOP)			
30.3.2008	Bank A/c (85,000 X Rs.20)	Dr.	17,00,000	
	ESOS outstanding A/c [(26,25,000/87,500)x85,000]	Dr.	25,50,000	
	To Equity share capital 600XRs. 10			8,50,000
	To Securities premium A/c (85,000 X Rs.40)			34,00,000
	(Being 85,000 options exercised at an exercise price of Rs. 50 each)			
	Profit and Loss A/c	Dr.	8,05,000	
	To Employees compensation expenses A/c			8,05,000
	(Being compensation expenses charged to P & L A/c)			
	ESOS outstanding A/c	Dr.	75,000	
	To General Reserve A/c			75,000
	(Being ESOS outstanding A/c on lapse of 2,500 options at the end of exercise of option period transferred to General Reserve A/c)			

Working Note:

Particulars	Year 1 (31.3.2006)	Year 2 (31.3.2007)	Year 3 (31.3.2008)
Length of the expected vesting period (at the end of the year)	2 years	3 years	3 years
Number of options expected to vest	95,000 options	91,000 options	87,500 options
Total compensation expenses accrued @ Rs.30 (50-20)	Rs. 28,50,000	Rs. 27,30,000	Rs.26,25,000
Compensation expenses of the year	28,50,000 x 1/2 = Rs.14,25,000	27,30,000 x 2/3 = Rs.18,20,000	
Compensation expenses recognized previously	Nil	Rs.14,25,000	Rs. 18,20,000
Compensation expenses to be recognized for the year	Rs.14,25,000	Rs. 3,95,000	Rs. 8,05,000

(ii) Journal Entries in the Books of Originator

S.No.	Particulars	L.F.	Debit Rs.	Credit Rs.
1.	Bank A/c	Dr.	1,00,000	
	To Loans (Cost of Securitised Component)			90,910
	To Profit on Securitisation			9,090
	(Being securitization of principal amount and right to receive interest at 14% interest rate)			
2.	Servicing Asset A/c	Dr.	3,180	
	Interest Strip A/c	Dr.	5,910	
	To Loans			9,090
	(Being creation of servicing asset and interest strip receivable)			

Working Notes:

1. Fair value of securitized component of loan

Fair value of Loan		1,10,000
Less: Fair value of servicing asset	3,500	
Fair value of interest strip	6,500	10,000
		1,00,000

2. Appropriation of carrying amount based on Fair Value

Particulars	Fair Value	% to Fair Value	Proportionate Carrying Amount
	Rs.	Rs.	Rs.
Fair value of securities component of the loan	1,00,000	90.91%	90,910
Fair value of servicing asset	3,500	3.18%	3,180
Fair value of interest strip	6,500	5.91%	5,910
	1,10,000	100.00%	1,00,000

3. Profit on Securitisation

	Rs.
Net proceeds from securitisation	1,00,000
Less: Apportioned carrying amount	90,910
	9,090

Annexure

LIST OF INSTITUTE'S PUBLICATIONS RELEVANT FOR NOVEMBER, 2009 EXAMINATIONS

The following List of Institute's Publications is relevant for the forthcoming examination i.e. November, 2009. Students may kindly take it into consideration while preparing for the examinations.

Final Examination

Paper 1: Advanced Accounting

I. Statements and Standards

1. Framework for the Preparation and Presentation of Financial Statements
2. Accounting Standards – AS 1 to AS 29.

II. Guidance Notes on Accounting Aspects

1. Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets.
2. Guarantees and Counter-Guarantees Given by Companies.
3. Guidance Note on Accrual Basis of Accounting.
4. Guidance Note on Accounting Treatment for Excise Duty.
5. Guidance Note on Accounting for Depreciation in Companies.
6. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
7. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
8. Guidance Note on Accounting for Securitisation.
9. Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options (2003).
10. Guidance Note on Accounting for Corporate Dividend Tax.
11. Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.
12. Guidance Note on Accounting for Employee Share-based Payments.
13. Guidance Note on Accounting for Fringe Benefits Tax.
14. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.
15. Guidance Note on Measurement of Income Tax for Interim Financial Reporting in the context of AS 25.

PAPER –2 : MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS

QUESTIONS

Swap

1. Suppose you are a treasurer of XYZ plc in the UK. XYZ have two overseas subsidiaries, one based in Amsterdam and one in Switzerland. The Dutch subsidiary has surplus Euros in the amount of 7,25,000 which it does not need for the next three months but which will be needed at the end of that period (91 days). The Swiss subsidiary has a surplus of Swiss Francs in the amount of 9,98,077 that, again, it will need on day 91. The XYZ plc in UK has a net balance of £75,000 that is not needed for the foreseeable future.

   Given the rates below, what is the advantage of swapping Euros and Swiss Francs into Sterling?

   Spot Rate €/£ 0.6858- 0.6869

   91 day Pts 0.0037 0.0040

   Spot Rate £/CHF 2.3295- 2.3326

   91 day Pts 0.0242 0.0228

   Interest rates for the Deposits

	91 day Interest Rate % pa		
Amount of Currency			
	£	€	CHF
0 – 100,000	1	¼	0
100,001 – 500,000	2	1 ½	¼
500,001 – 1,000,000	4	2	½
Over 1,000,000	5.375	3	1

Merger and Acquisition

2. Cool-cool Ltd.. makes thermal clothing for winter sports and outdoor work, and is considering acquiring Sking Shell Ltd. which manufactures and sells ski clothing. Sking Shell is about one quarter of Frozen's size and manufactures its entire product line in a small rented factory on a mountaintop in Manali. It costs about Rs.10,00,000 a year in overhead to operate in the factory. Cool-cool Ltd. produces its output in a less popular in North but more popular north-east locations. Its factory has at least 50% excess capacity. Cool-cool's plan is to acquire Sking Shell, and combine production operations in its north-eastern factory, but otherwise run the companies separately.

   Sking Shell's beta is 2.0, Treasury bills currently yield 5% and the Nifty Index is yielding 9%. The corpoarte income tax rate for both firms is 40%. Because Sking Shell will no longer be maintaining its own production facilities, it can be assumed that only a minimal amount of cash will have to be reinvested to keep its equipment current and for future growth. This amount is estimated at Rs. 1,00,000 per year. Selected financial information for Sking Shell is as follows:

Revenue	Rs. 1,25,00,000
EAT	Rs. 13,00,000
Depreciation	Rs. 6,00,000

(a) Calculate the appropriate discount rate for evaluating the Sking Shell acquisition.

(b) Determine the annual cash flow expected by Cool-cool Ltd.from Sking Shell if the acquisition is made (don't forget to include the synergy).

(c) Calculate the value of the acquisition to Cool-cool Ltd.assuming the benefits last for (1) five years, (2) 10 years, and (3) 15 years.

(d) Sking Shell has 2,50,000 shares of stock outstanding. Calculate the maximum price Cool-cool Ltd. should be willing to pay per share to acquire the firm under the three assumptions in part c.

(e) If Cool-cool Ltd. is willing to assume the benefits of the Sking Shell acquisition will last indefinitely but not grow, what should it be willing to pay per share?

3. In above question , assume that the cash flow from the Sking Shell acquisition grows at 10% from its initial value for one year and then grows at 5% indefinitely (starting in the third year). Calculate the value of the firm and the implied stock price under these conditions. Use a terminal value at the beginning of the period of 5% growth. What price premium is implied in dollars and as a percent of market price if Sking Shell's stock is currently selling at Rs. 62?

Corpoarte Restructing

4. The Nishan Ltd. has 35,000 shares of equity stock outstanding with a book value of Rs.20 per share. It owes debt Rs.15,00,000 at an interest rate of 12%. Selected financial results are as follows.

Income and Cash Flow		Capital	
EBIT	Rs. 80,000	Debt	Rs.1,500,000
Interest	1,80,000	Equity	7,00,000
EBT	(Rs.1,00,000)		Rs.2,200,000
Tax	0		
EAT	(Rs.1,00,000)		
Depreciation	Rs. 50,000		
Principal repayment	(Rs. 75,000)		
Cash Flow	(Rs.1,25,000)		

Restructure the financial line items shown assuming a composition in which creditors agree to convert two thirds of their debt into equity at book value. Assume Nishan will pay tax at a rate of 15% on income after the restructuring, and that principal repayments are reduced proportionately with debt. Who will control the company and by how big a margin after the restructuring?

Bond Valuation

5. Given a five-year, 8% coupon bond with a face value of Rs.1,000 and coupon payments made annually, determine its values given it is trading at the following yields: 8%, 6%, and 10%. Comment on the price and yield relation you observe. What are the percentage changes in value when the yield goes from 8% to 6% and when it goes from 8% to 10%?

6. Given a two-year, 8% annual coupon bond with a face value of Rs. 1,000 and with annual coupon payments that is fully taxable and selling at par, and an identical bond that is tax free, what would the yield and price on the tax-free bond have to be for an investor in a 35% tax bracket to be indifferent between the two bonds?

Lease Evaluation

7. Mr. Lee wants to acquire a mechanized feed spreader that cost €80,000. He intends to operate the equipment for 5 years, at which time it will need to be replaced. However, it is expected to have a salvage value of €10,000 at the end of the fifth year. The asset will be depreciated on a straight-line basis (€16,000 per year) over the 5 years, and Lee is in a 30 percent tax bracket. Two means for financing the feed spreader are available. A lease arrangement calls for lease payments of €19,000 annually, payable in advance. A debt alternative carries an interest of €19,000 annually, payable in advance. A debt alternative carries an interest cost of 10 percent. Debt payments will be at the start of each of the 5 years using mortgage type of debt amortization.

   (a) Using the present-value method, determine the best alternative.

   (b) Using the internal-rate-of-return method, which is the best alternative? Does your answer differ from that to part a ?

Right Issue

8. The stock of the Soni plc is selling for £50 per common stock. The company then issues rights to subscribe to one new share at £40 for each five rights held.

   (a) What is the theoretical value of a right when the stock is selling rights-on?

   (b) What is the theoretical value of one share of stock when it goes ex-rights?

   (c) What is the theoretical value of a right when the stock sells ex-rights at £50?

   (d) John Speculator has £1,000 at the time Soni plc goes ex-rights at £50 per common stock. He feels that the price of the stock will rise to £60 by the time the rights expire. Compute his return on his £1,000 if he (1) buys Soni plc stock at £50, or (2) buys the rights as the price computed in part c, assuming his price expectations are valid.

9. PQR Ltd. is a management consultancy firm in the industry for the last 10 year. It got listed its equity share 4 years ago at a Recognized Stock Exchange. The company has pursued a policy of aggressive growth and specializes in providing services to the entities in high technology and high growth sectors. The company has no leverage element in their capital structure and financed by equity shares of Rs.50 Crores of Rs.2 per share (par value).

 The company's result for the year ending 31 March 2009, have just announced. Profit before tax were Rs.12.66 Crores. As per Chairman cum Managing Director's statement (included in the forecast column of company's Annual Report for the year ending 31 March 2009) earnings might be expected to rise by 4% which is lower than annual rate than in the recent years. This is due to global recession especially in US Economy.

 XYZ Ltd. is another company, in the same business but has been established much longer. It sources more to traditional business sectors and its earning track record has been erratic. In most of the daily newspaper poor management have been blamed for poor performance of company and due to this stock of the company in market had lost its value for sometimes. The current earning forecast of XYZ Ltd is also 4% for the foreseeable future. The capital structure of the company consists of Rs.18 crores equity share capital of Rs.1 (par value). The Profit before tax of the company for the year ending 31 March 2009 is Rs.11.25 Crores.

 PQR Ltd. has recently approached the shareholders of XYZ Ltd with a bid of five new share in PQR Ltd for every six shares in XYZ Ltd. Otherwise shareholders can accept a cash payment @Rs.3.45 per share.

 Following the announcement of this bid, the market price of PQR Ltd. shares fell by 10% whereas the price of Shares of XYZ Ltd. rose up by 14%. The P/E ratio and dividend yield of these two companies and other two companies in same industry immediately prior to bid announcement is as follows:

Company	Share Price (Rs.)		P/E Ratio	Dividend yield (%)
	High	Low		
PQR Ltd	4.25	3.25	11	2.4
XYZ Ltd	3.50	2.85	7	3.1
LMN Ltd.	1.87	1.22	9	5.2
DEF Ltd.	2.30	1.59	16	2.4

 The Corporate Tax Rate is 30%. PQR Ltd is post tax cost of equity is 13% and XYZ Ltd's cost of equity is 11%.

 Evaluate, whether the proposed share-for-share offer's likely to be beneficial to shareholders in both PQR Ltd and XYZ Ltd. Please use the information and merger terms available above.

 You may make appropriate assumption to forecast post merger values.

Dividend Theory

10. Zumo & Co. is a watch manufacturing company and is all equity financed and has paid up capital Rs.10,00,000 (Rs.10 per shares)

    The other data related to the company is as follows:

Year	EPS (Rs.)	Net Dividend per share (Rs.)	Share Price (Rs.)
2004	4.20	1.70	25.20
2005	4.60	1.80	18.40
2006	5.10	2.00	25.50
2007	5.50	2.20	27.50
2008	6.20	2.50	37.20

Zumo & Co. has hired one management consultant, Vidal Consultants to analyze the future earnings and other related item for the forthcoming years.

As per Vidal Consultants's report

(1) The earnings and dividend will grow at 25% for the next two years.

(2) Earnings are likely at rate of 10% from 3rd year and onwards.

(3) Further if there is reduction in earnings growth occurs dividend payout ratio will increase to 50%

Assuming the tax rate as 33% (not expected to change in the foreseeable future) calculate the estimated share price and P/E Ratio which analysts now expect for Zumo & Co., using the dividend valuation model.

You may further assume that post tax cost of capital is 18%.

Financial Services

11. The following financial information related to Norwason India Ltd.:

	2008	2007
	Rs. 000	Rs. 000
Sales (all on credit)	37,400	26,720
Cost of sales	34,408	23,781
Operating profit	2,992	2,939
Finance costs (interest payments)	355	274
Profit before taxation	2,637	2,665

	2008		2007	
	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Non-current assets		13,632		12,750

Current assets				
Inventory	4,600		2,400	
Trade receivables	4,600		2,200	
	9,200		4,600	
Current liabilities				
Trade payables	4,750		2,000	
Overdraft	3,225		1,600	
	7,975		3,600	
Net current assets		1,225		1,000
		14,857		13,750
8% Bonds		2,425		2,425
		12,432		11,325
Capital and reserves				
Share capital		6,000		6,000
Reserves		6,432		5,325
		12,432		11,325

The average variable overdraft interest rate in each year was 5%. The 8% bonds are redeemable in ten years' time.

A factor has offered to take over the administration of trade receivables on a non-recourse basis for an annual fee of 3% of credit sales. The factor will maintain a trade receivables collection period of 30 days and Norwason India Ltd will save Rs.1,00,000 per year in administration costs and Rs. 3,50,000 per year in bad debts. A condition of the factoring agreement is that the factor would advance 80% of the face value of receivables at an annual interest rate of 7%.

Evaluate whether the proposal to factor trade receivables is financially acceptable.

Foreign Exchange Management

12. On 30th June 2009 when a forward contract matured for execution you are asked by an importer customer to extend the validity of the forward sale contract for US$ 10,000 for a further period of three months.

Contracted Rate US$1 = Rs.41.87

The US Dollar quoted on 30.6.2009

Spot	40.4800/40.4900
Premium July	0.1100/0.1300
Premium August	0.2300/0.2500
Premium September	0.3500/0.3750

Calculate the cost for your customer in respect of the extension of the forward contract. Rupee values to be rounded off to the nearest Rupee.

Margin 0.080% for Buying Rate

Margin 0.25% for Selling Rate

13. You sold € 1 million value spot to your customer at € 1= Rs.54.60 and covered yourself in Singapore market on the same day when the exchange rate were as under:

    Spot US$ 1 = € 0.7373/0.7375

    Local inter bank US$ 1 = Rs.40.1850/40.1950

    (Brokerage paid Rs.2,000)

    Calculate the cross rate nearest to the fourth decimal and ascertain profit or loss in the transaction to the nearest Rupee.

Decision Tree

14. MCL Technologies is evaluating new software for ERP. The software will have a 3-year life and cost €1,000 thousands. Its impact on cash flows is subject to risk . Management estimates that there is a 50-50 chance that the software will either save the company €1,000 thousands in the first year or save it nothing at all. If nothing at all, savings in the last 2 years would be zero. Even worse, in the second year an additional outlay of €300 thousands may be required to convert back to the original process, for the new software may result in less efficiency. Management attaches a 40 percent probability to this occurrence, given the fact that the new software " failed" in the first year. If the software proves itself, second-year cash flows may be either €1,800 thousands, €1,400 thousands, or €1,000 thousands, with probabilities of 0.20, 0.60, and 0.20, respectively. In the third year, cash, inflows are expected to be €200 thousands greater or €200 thousands less than the cash flow in period 2, with an equal chance of occurrence. (Again, these cash flows depend on the cash flow in period 1 being €1,000 thousands.) All the cash flows are after taxes.

    (a) Set up a probability tree to depict the foregoing cash-flow possibilities.

    (b) Calculate a net present value for each three-year possibility, using a risk-free rate of 5 percent.

    (c) What is the risk of the project?

Derivatives

15. From the following data compute value of call option using the Black-Scholes Option Pricing Model (OPM).

    Stock Price = Rs. 27.00.

    Strike Price = Rs. 25.00

Time to expiration = 6 Months.

Risk-Free Rate = 6.0%.

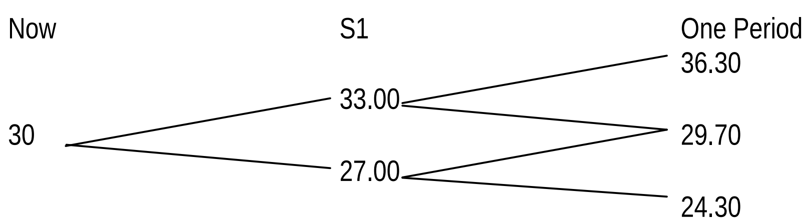
Stock Return Variance = 0.11.

16. The following information is available for a call option:

Time to expiration (months)	3
Risk free rate	8%
Exercise price	€60
Stock price	€70
Call price	€14

What is the value of a put option if the time to expiration is 3 months, risk free rate is 8%, exercise price is €60 and the stock price is €70?

17. Following is a two-period tree for a share of stock in CAB Ltd.:



Using the Binomial model, calculate the current fair value of a regular call option on CAB Stock with the following characteristics : X = Rs. 28, Risk Free Rate = 5 percent (per sub period). You should also indicate the composition of the implied riskless hedge portfolio at the valuation date.

18. In March, a derivatives dealer offers you the following quotes for June British pound option contracts (expressed in U.S. dollars per GBP):

Contract	Strike Price	MARKET PRICE OF CONTRACT Bid	Offer
Call	USD 1.40	0.0642	0.0647
Put		0.0255	0.0260
Call	1.44	0.0417	0.0422
Put		0.0422	0.0427
Call	1.48	0.0255	0.0260
Put		0.0642	0.0647

(a) Assuming each of these contracts specifies the delivery of GBP 31,250 and expires in exactly three months, complete a table similar to the following (expressed in dollars) for a portfolio consisting of the following positions:

(1) Long a 1.44 call

(2) Short a 1.48 call

(3) Long a 1.40 put

(4) Short a 1.44 put

June USD/GBP	Net Initial Cost	Call 1.44 Profit	Call 1.48 Profit	Put 1.40 Profit	Put 1.44 Profit	Net Profit
1.36	—	—	—	—	—	—
1.40	—	—	—	—	—	—
1.44	—	—	—	—	—	—
1.48	—	—	—	—	—	—
1.52	—	—	—	—	—	—

(b) Graph the total net profit (i.e., cumulative profit less net initial cost, ignoring time value considerations) relationship using the June USD/GBP rate on the horizontal axis (be sure to label the breakeven point(s)). Also, comment briefly on the nature of the currency speculation represented by this portfolio.

(c) If in exactly one month (i.e., in April) the spot USD/GBP rate falls to 1.385 and the effective annual risk-free rates in the United States and England are 5 percent and 7 percent, respectively, calculate the equilibrium price differential that should exist between a long 1.44 call and a short 1.44 put position.

19. In mid-May, there are two outstanding call option contracts available on the stock of MGH Co.:

Call #	Exercise Price	Expiration Date	Market Price
1	€50	August 19	€8.40
2	€60	August 19	€3.34

(a) Assuming that you form a portfolio consisting of one Call #1 held long and two Calls #2 held short, complete the following table showing your intermediate steps. In calculating net profit, be sure to include the net initial cost of the options.

Price of MGH Stock at Expiration	Profit on Call #1 Position	Profit on Call #2 Position	Net Profit on Total Position
€40	—	—	—
€45	—	—	—
€50	—	—	—
€55	—	—	—
€60	—	—	—

€65	—	—	—
€70	—	—	—
€75	—	—	—

(b) Graph the net profit relationship in Part a, using stock price on the horizontal axis. What is (are) the breakeven stock price(s)? What is the point of maximum profit?

(c) Under what market conditions will this strategy (which is known as a call ratio spread) generally make sense? Does the holder of this position have limited or unlimited liability?

Futures

20. The following information about copper scrap is given:

- Spot price : \$10,000 per ton
- Futures price : \$10,800 for a one year contract
- Interest rate : 12 %
- PV (storage costs) : \$500 per year

What is the PV (convenience yield) of copper scrap?

Portfolio Management

21. The following data are available to you as a portfolio manager.

Security	Expected Return	Beta	Standard Deviation
O	0.32	1.70	0.50
P	0.30	1.40	0.35
Q	0.25	1.10	0.40
R	0.22	0.95	0.24
S	0.20	1.05	0.28
T	0.14	0.70	0.18
Composite Index	0.12	1.000	0.20
T-bills	0.08	0.00	0.00

(a) In terms of a security market line (SML) , which of the securities listed above are undervalued? Why?

(b) Assume that a portfolio is constructed using equal portions of the six stocks listed above.

(i) Why is the expected return of such a portfolio?

(ii) What would the expected return if this portfolio was increased by 40% through borrowed funds with the cost of borrowing at 12%?

22. Mr. Nirmal Kumar has categorized all the available stock in the market into the following types:

(i) Small cap growth stocks

(ii) Small cap value stocks

(iii) Large cap growth stocks

(iv) Large cap value stocks

Mr. Nirmal Kumar also estimated the weights of the above categories of stocks in the market index. Further more, the sensitivity of returns on these categories of stocks to the three important factor are estimated to be:

Category of Stocks	Weight in the Market Index	Factor I (Beta)	Factor II (Price Book)	Factor III (Inflation)
Small cap growth	25%	0.80	1.39	1.35
Small cap value	10%	0.90	0.75	1.25
Large cap growth	50%	1.165	2.75	8.65
Large cap value	15%	0.85	2.05	6.75
Risk Premium		6.85%	-3.5%	0.65%

The rate of return on treasury bonds is 4.5%

Required:

(a) Using Arbitrage Pricing Theory, determine the expected return on the market index.

(b) Using Capital Asset Pricing Model (CAPM), determine the expected return on the market index.

(c) Mr. Nirmal Kumar wants to construct a portfolio constituting only the 'small cap value' and 'large cap growth' stocks. If the target beta for the desired portfolio is 1, determine the composition of his portfolio.

Mutual Fund

23. Consider the following information about the return on Classic Mutual Fund, the market return and the T-bill returns:

Year	Classic Mutual Fund	Market Index	T-bills
1994	17.1	10.8	5.4
1995	-14.6	-8.5	6.7
1996	1.7	3.5	6.5
1997	8.0	14.1	4.3
1998	11.5	18.7	4.1
1999	-5.8	-14.5	7.0
2000	-15.6	-26.0	7.9
2001	38.5	36.9	5.8
2002	33.2	23.6	5.0
2003	-7.0	-7.2	5.3
2004	2.9	7.4	6.2
2005	27.4	18.2	10.0

2006	23.0	31.5	11.4
2007	-0.6	-4.9	14.1
2008	21.4	20.4	10.7

The following additional information is available regarding the comparative performance of five mutual funds:

	Return (%)	Standard Deviation (%)	Beta	
Alpha	1.95	20.03	0.983	0.819
Beta	11.57	18.33	0.971	0.881
Gama	8.41	22.92	1.169	0.816
Rho	9.05	24.04	1.226	0.816
Theta	7.86	15.46	0.666	0.582

From the above information, calculate all the inputs required for determining the Sharpe's Ratio, Treynor's ratio and Jensen's ratio.

24. Risk appetite, risk aversion and risk premium are sometimes used interchangeably. Explain this statement. How investor's expectation vary with the variation in the level of risk appetite.

25. Write Short Notes on
    - (i) What is relationship between EVA and MVA?
    - (ii) Explain the term "Balance Transfer".
    - (iii) 'Stack hedging' and 'Strip hedging'

SUGGESTED ANSWERS/HINTS

1. Individual Basis

Holland	Total	
€ 7,25,000 x 0.02 x 91/360 = € 3,665.28	€ 7,28,665.28	= £ 5,03,434.84
	(728,665.28x0.6909)	
Switzerland		
CHF 9,98,077x 0.005x91/360 = CHF 1,261.46	CHF 9,99,338.46	= £ 4,33,496.05
	(9,99,338.46÷2.3053)	
UK		
£ 75,000 x 0.01 x 91/365 = £ 186.99		£ 75,186.99
Total GBP at 91 days		£ 10,12,117.88

Swap to Sterling

Sell € 7,25,000 (Spot at 0.6869) buy £	£ 4,98,002.50
Sell CHF 9,98,077(Spot at 2.3295) buy £	£ 4,28,451.16
Independent GBP amount	£ 75,000.00
	£ 1,001,453.66
Interest (1,001,453.66 x 0.05375 x 91/365)	£ 13,420.16
Total GBP at 91 days	£ 1,014,873.82
Less: Total GBP at 91 days as per individual basis	£ 1,012,117.88
Net Gain	£ 2,755.94

2. (a) $k_{SS} = k_{RF} + (k_M - k_{RF})\,ß_{SS}$

$= 5\% + (9\% - 5\%)\ 2.0$

$= 13\%$

(b)

Cash Flow:	(Rs.000)
EAT	1,300
Depreciation	600
Operating cash flow	1,900
Savings on factory operation after tax	600
Less reinvested cash	(100)
	2,400

(c) Value of Sking Shell Acquisition

Planning Horizon

	5 yrs	10 yrs	(Rs.000) 15 yrs
Yearly cash flow	Rs.2,400	Rs.2,400	Rs.2,400
× $PVFA_{13,n}$	3.5172	5.4262	6.4624
Value of acquisition	Rs.8,441	Rs.13,023	Rs.15,510
(d) Divide by # shares	250,000	250,000	250,000
Offer price	Rs. 33.76	Rs. 52.09	Rs. 62.04

(e) Rs.24,00,000/0.13 = Rs.1,84,62,000

Rs.1,84,62,000/2,50,000 = Rs.73.85

3. (Rs. 000)

Year	1	2	3
Cash flow	Rs. 2,400	Rs. 2,640	Rs. 2,772

Value at end of year 2 = $\dfrac{\text{Rs.}2{,}772}{0.13-0.05}$ =Rs. 34,650

(Rs. 000)

PV = Rs. 2,400[$PVF_{13,1}$] + Rs. 2,640[$PVF_{13,2}$] + Rs. 34,650[$PVF_{13,2}$]

= Rs. 2,400(0.8850) + Rs. 2,640(0.7831) + Rs. 34,650(0.7831)

= Rs. 2,124 + Rs. 2,067 + Rs. 27,134

= Rs. 31,325

Price per share = $\dfrac{\text{Rs.}3{,}13{,}25{,}000}{\text{Rs.}2{,}50{,}000}$ = Rs. 125.30

Premium = Rs. 125.30 – Rs. 62 = Rs. 63.30,

Premium is (Rs. 63.30/Rs. 62) = 102.10% of market price.

4. Creditors would convert Rs.10,00,000 in debt to equity by accepting

Rs.1,000,000/Rs.20= 50,000 shares of stock.

The remaining Rs.500,000 of debt would generate interest of

Rs.500,000 × 0.12 = Rs.60,000

Repayment of principal would be reduced by two thirds to Rs.25,000 per year.

The result is as follows

Income and Cash Flow		Capital	
EBIT	Rs. 80,000	Debt	Rs. 500,000
Interest	60,000	Equity	Rs. 1,700,000
EBT	Rs. 20,000		Rs .2,200,000
Tax	3,000		
EAT	Rs. 17,000		
Depreciation	50,000		
Principal repayment	(25,000)		
Cash Flow	Rs. 42,000		

After the restructuring there will be a total of (35,000+50,000) 85,000 shares of equity stock outstanding. The original shareholders will still own 35,000 shares (approximately 41%), while the creditors will own 50,000 shares (59%). Hence the creditors will control the company by a substantial majority.

5.

$$V_0 = \sum_{t=1}^{5} \frac{80}{(1.08)^t} + \frac{1000}{(1.08)^5} = 80\left[\frac{1-(1/1.08)^5}{0.08}\right] + \frac{1000}{(1.08)^5} = \text{Rs}.1{,}000$$

$$V_0 = \sum_{t=1}^{5} \frac{80}{(1.06)^t} + \frac{1000}{(1.06)^5} = 80\left[\frac{1-(1/1.06)^5}{0.06}\right] + \frac{1000}{(1.06)^5} = \text{Rs}.1{,}084.25$$

$$V_0 = \sum_{t=1}^{5} \frac{80}{(1.10)^t} + \frac{1000}{(1.10)^5} = 80\left[\frac{1-(1/1.10)^5}{0.10}\right] + \frac{1000}{(1.10)^5} = \text{Rs}.924.18$$

The answer shows the inverse relationship that exists between the price of a bond and its rate of return.

From 8% to 6%, the percentage change in value is 8.425%; from 8% to 10%, the percentage change in value is –7.582%.

6. For the investor to be indifferent, the tax-free bond's yield would have to be equal to the taxable bond's after-tax yield. Given a 35% tax rate, the taxable bond's after-tax yield is 5.2%:

ATY = (1-0.35)0.08 = 0.052

Thus, the tax-free bond would have to yield 5.2% for the investor to be indifferent. Given a 5.2% discount rate, the price of the tax-free bond would have to be Rs. 1,051.92:

$$P_0 = \frac{80}{(1.052)} + \frac{80+1000}{(1.052)^2} = 1051.92$$

7. (a) Lease Alternative:

End of Year	(1) Lease Payment (€)	(2) Tax Shield (1) x 0.30 (€)	(3) Cash Out Flow (1) - (2) (€)	PVF @ 7 %*	(4) PV of Cash Outflows (€)
0	19,000	0	19,000	1	19,000
1-4	19,000	5,700	13,300	3.3872	45,050
5		5,700	(5,700)	0.713	(4,064)
					€59,986

* 10% (1-0.30)

The present value of cash outflows is €59,986.

(b) Debt Alternative:

Annual debt repayments are:

Let X be the annual installment for loan repayment

Then €80,000 = X + 3.1699X (3.1699 = PV factor for 4-year annuity at 10%)

X = €80,000/4.1699

X = €19,185

End of Year	Debt Payment (€)	Principal Amount Owing (€)	Annual Interest (€)
0	19,185	60,815	0
1	19,185	47,712	6,082
2	19,185	33,298	4,771
3	19,185	17,443	3,330
4	19,187	0	1,774

The principal amount of €80,000 is reduced by the amount of the first payment of €19,185 to give €60,815 at time 0. The last debt payment is slightly higher due to rounding.

Statement showing the Cash Outflows (Debt Alternative)

End of Year	(1) Debt Repayment (€)	(2) Interest (€)	(3) Depreciation (€)	(4) Tax Shield 0.30x [(2)+(3)] (€)	(5) Out-flows (1) - (4) (€)	PV @ 7%	(6) PV Cash of Out flows (€)
0	19,185	0	0	0	19,185	1	19,185
1	19,185	6,082	16,000	6,625	12,560	0.9346	11,738
2	19,185	4,771	16,000	6,231	12,954	0.8734	11,315
3	19,185	3,330	16,000	5,799	13,386	0.8163	10,927
4	19,187	1,774	16,000	5,332	13,855	0.7629	10,570
5	0	0	16,000	4,800	(4,800)	0.7130	(3,422)
5					(7,000)†	0.7130	(4,991)
							55,322

†Residual value x (1 - 0.30)

Conclusion: As the present value of cash outflows under the debt alternative is lower i.e. €55,322 versus €59,986, hence debt option would be preferred.

(b) Schedule of Cash Flows: IRR Analysis of Lease

End of Year	(1) Cost (€)	(2) Lease Payment (€)	(3) Depreciation (€)	(4) Excess Tax Shield 0.30x (L-D) (€)	(5) Post tax Residual Value (€)	(6) Net cash Flows (€)
0	80,000	19,000	0	0		61,000
1		19,000	16,000	900		(18,100)
2		19,000	16,000	900		(18,100)
3		19,000	16,000	900		(18,100)
4		19,000	16,000	900		(18,100)
5		0	16,000	900	7,000	(6,100)

Solving for the internal rate of return for the last column, we find it to 10.11 percent. The after tax cost of borrowing of 7 percent is lower, and it dominates. The answer is the same as in the present value method of analysis, as we would expect.

8. (a) $R_0 = \frac{P_0 - S}{N+1} = \frac{£50 - £40}{5+1} = £1.67$

(b) $P_x = \frac{(P_0 \times N) + S}{N+1} = \frac{(£50 \times 5) + £40}{6} = £48.33$

(c) $R_x = \frac{P_x - S}{N} = \frac{£50 - £40}{5} = £2.00$

(d) (1) £1,000/£50 =20 shares x £60 = £1,200

£1,200 - £1,000 = £200

(2) £1,000 / £2 = 500 rights X £4* = £2,000

£2,000-£1,000 = £1,000

*R_x = (£60 - £40)/5 = £4

9. Working Notes:

	PQR Ltd.	XYZ Ltd	Total
Profit before tax (Rs.crore)	12.66	11.25	23.91
Tax @ 30%	3.80	3.38	7.18
Profit After tax	8.86	7.87	16.73
No. of Shares (Crores)	25	18	40
Earning Per share (Rs.)	0.3544	0.437	0.4183
PE Ratio before Bid	11	7	

Pre Bid Price of share (Rs.)	3.90	3.06	
Market value of company (Rs. Crore)	97.50	55.08	152.058
No. of new shares (Post Bid) (Crores)	25	15	40
% of Combined Entity owned (%)	62.50	37.50	100
Value of original shareholders	95.36	57.22	152.58
Price Per share/Post Bid Price announcement	3.81	3.18	
	(95.36/25)	(57.22/18)	

Thus from above it can be said that in absence of any synergy benefit arising from such merger there will be a transfer of wealth from PQR Ltd. to XYZ Ltd. based on the terms of this offers.

In reality, the price of XYZ Ltd 5 shares is likely to be influenced by the value of cash alternative and the price that will be observed in the market is likely to be below Rs.3.45 per share.

The major question here is what will be P/E Ratio after the merger. If director of PQR Ltd. expect there own pre-bid P/E ratio to be applied to the combind earnings. In such case the market value and share price would be.

Market Value. Rs. 16.73Crores × 11 = Rs. 184.03 Crores.

$$\text{Share Price} = \frac{\text{Rs.}184.03}{40\text{ crores}} = \text{Rs.}4.60\text{ Per share}$$

Calculation of Gain/Loss

(a) As PQR Ltd. Shareholder's have exactly the same number of shares as they did before the merger. There share would have rise by 18% as calculated below.

$$\frac{\text{Rs.}4.60-\text{Rs.}3.90}{\text{Rs.}3.90}\times 100$$

(b) XYZ Ltd's shareholders have five-sixth the number of their old shares. Their share value might therefore be expected to rise by 25% as calculated below.

$$\frac{\text{Rs.}3.83^{*}-\text{Rs.}3.06}{\text{Rs.}3.06}\times 100$$

$$^{*}\ 4.60\times\frac{5}{6}$$

The shareholders of XYZ Ltd are taking more gain from merger in share exchange because cash alternative is lower and unlikely to be accepted, although it is an assured amount. The cash offer the premium only to 12.7% calculated as follows.

$$\left(\frac{\text{Rs.}3.45-\text{Rs.}3.06}{\text{Rs.}3.06}\right)\times 100 = 12.7\%$$

Alternative Method.

We can also use the Dividend Valuation Model by using Gordon's Model the price of Share of PQR Ltd. will be

$$= \frac{EPS}{Ke\ -\ g} = \frac{0.3544\ \times 1.04}{13\%\ - 4\%} = \text{Rs. } 4.09$$

Using the same assumption the value of XYZ Ltd. would be:

$$= \frac{EPS}{Ke - g} = \frac{0.437 \times 1.04}{11\% - 4\%} = \text{Rs.} 6.49$$

On the basis of above alternative model share of PQR Ltd is under valued slightly. Whereas the share of XYZ Ltd is substantially undervalued, may be market is doubtful about growth prospects due to previous disappointments. If we believe PQR Ltd.'s forecast the PQR Ltd. are getting XYZ Ltd's share cheap and especially so if any XYZ's share holders accept the cash offer Rs. 3.45 per share

10. (a) The formula for the Dividend valuation Model is

$$P_0 = \frac{D_1}{K_e - g}$$

K_e = Cost of Capital

g = Growth rate

D_1= Dividend at the end of year 1

On the basis of the information given, the following projection can be made:

Year	DPS (Rs.)	PVF @18%	PV of DPS (Rs.)
2009	3.13	0.847	2.65
2010	3.91	0.718	2.81
2011	5.33*	0.609	3.25
			8.71

*Payout Ratio changed to 50%.

After 2011, the perpetuity value assuming 10% constant annual growth, is:

D_1= Rs. 5.33 × 110% = Rs. 5.863

Therefore P_0 from the end of 2011

$$\frac{\text{Rs. } 5.863}{0.18 - 0.10} = \text{Rs.} 73.29$$

This must be discounted back to the present value, using the 3 year discount factor after 18%.

	Rs.
Present Value of P_0 (Rs. 73.29 × 0.609)	44.63
Add: Dividends 2009 to 2011	8.71
Expected Market Price of Share	53.34

(b) P/E Ratio

$$\text{P E Ratio} = \frac{\text{Expected Market Price of Share } (P_1)}{\text{Earning Per Share}}$$

$$= \frac{\text{Rs. } 53.34}{\text{Rs. } 6.20} = 8.60$$

11.

Current receivables	Rs.46,00,000
Receivables under factor (Rs. 3,74,00,000 x 30/365)	Rs.30,74,000
Reduction in receivables (Rs. 46,00,000 – Rs. 30,74, 000)	Rs.15,26,000

Computation of Net Cost of Factoring

	(Rs.)
Reduction in finance cost (Rs. 15,26,000 x 0.05) per year	(76,300)
Administration cost savings per year	(1,00,000)
Bad debt savings per year	(3,50,000)
Factor's annual fee (3,74,00,000 x 0.03) per year	11,22,000
Extra interest cost on advance	
Rs. 30,74,000 x 80% x (7% – 5%) per year	49,184
Net cost of factoring	6,44,884

The factor's offer cannot be recommended, since the evaluation shows no financial benefit arising.

12. This extension of forward Contract involves following steps

1. Cancel the contract at TT buying rate.
2. Rebook the contract for three months at the current rate of exchange.

Accordingly

Step 1: Cancel the contract at TT buying rate on 30.6.2009

	Rs.
Spot US$ 1	40.4800
Less: Margin 0.080%	0.0324
	40.4476

Hence TT buying rate Rs.40.45 (Rounded off)

US$ 10,000 @ Rs.40.45	Rs.4,04,500/-
US$ 10,000 @ Rs.41.87	Rs.4,18,700/-

Difference in favour of the bank Rs. 14,200/-.

Step 2: New contract to be booked at the appropriate forward rate.

Three months forward rate is as under:

US$ 1	Rs.40.4900	Spot Selling
Add: September Premium	Rs. 0.3750	
	Rs. 40.8650	
Add: Margin (0.25%)	Rs. 0.1022	
	Rs. 40.9672	

Forward rate to be quoted to the customer is US$ 1 = Rs. 40.97

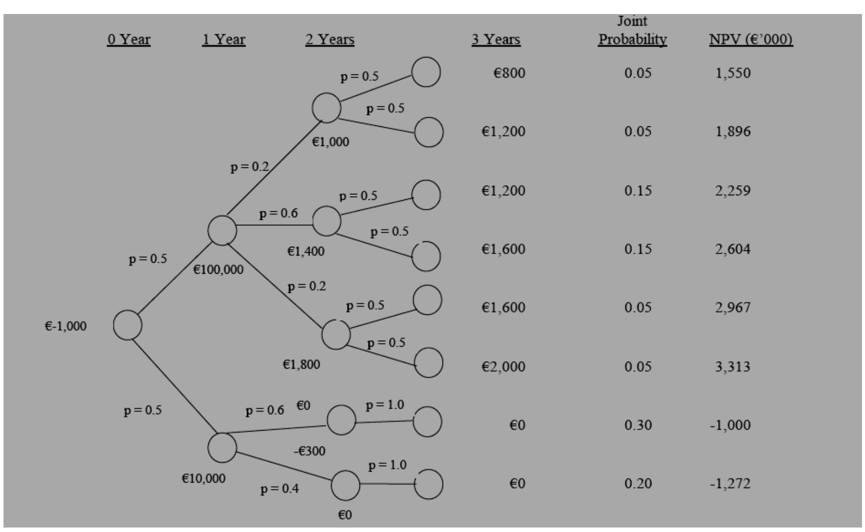
Thus cost to customer Rs. 14,200/-.

13. Our cost of 1 million €

Cross rate Rs. 40.1950/0.7373 = Rs. 54.5165

1 Million € @ 54.5165	Rs. 5,45,16,500
Brokerage	Rs. 2,000
	Rs. 5,45,18,500
Proceeds of sale to customer @ Rs.54.6000	Rs. 5,46,00,000
Profit	Rs. 81,500

14. (a)



Tabular Presentation

Period 0	Period 1		Period 2		Period 3		Overall	
Cash Flow Thousands €	Prob.	Cash Flow Thousands €	Cond. Prob.	Cash Flow Thousands €	Cond. Prob.	Cash Flow Thousands €	Joint Prob	Present Value Thousands €
-1,000	0.5	0	0.4	-€300	1.0	0	0.2	-€1,272
			0.6	0	1.0	0	0.3	-€1,000
	0.5	€1,000	0.2	€1,000	0.5	€800	0.05	€1,550
					0.5	€1,200	0.05	€1,896
			0.6	€1,400	0.5	€1,200	0.15	€2,259
					0.5	€1,600	0.15	€2,604
			0.2	€1,800	0.5	€1,600	0.05	€2,967
					0.5	€2,000	0.05	€3,313

(b) The expected value of net present value of the project is found by multiplying together the last two columns above and totaling them as follows.

(c) The standard deviation is :

$[0.2(-1{,}272-661)^2 + 0.3(-1{,}000-661)^2 + 0.05(1{,}550-661)^2 + 0.05(1{,}896-661)^2 + 0.15(2{,}259-661)^2 + 0.15(2{,}604-661)^2 + 0.05(2{,}967-661)^2 + 0.05(3{,}313-661)^2]^{1/2}$ = €1,805 thousands

Thus, the dispersion of the probability distribution of possible net present values is very wide. In turn, this is due to 50 percent probability of a zero outcome or less.

15. The input variables are:

S = Rs.27.00; X = Rs. 25.00; r_{RF} = 6.0%; t = 6 months = 0.5 years; and $\sigma^2 = 0.11$

Now, we proceed to use the OPM:

$V = Rs.27[N(d_1)] - Rs.25e^{-(0.06)(0.5)}[N(d_2)]$

$$d_1 = \frac{\ln\left(\frac{s}{x}\right)+\left(r+\frac{\sigma^2}{2}\right)T}{\sigma\sqrt{T}} \text{ and } d_2 = d_1 - \sigma\sqrt{T}$$

$$d_1 = \frac{\ln(Rs.\,27/Rs.\,25)+[(0.06+0.11/2)](0.5)}{(0.3317)(0.7071)}$$

$$= \frac{0.0770+0.0575}{0.2345} = 0.5736.$$

$d_2 = d_1 - (0.3317)(0.7071) = d_1 - 0.2345$

$= 0.5736 - 0.2345 = 0.3391.$

$N(d_1) = N(0.5736) = 0.5000 + 0.2168 = 0.7168.$

$N(d_2) = N(0.3391) = 0.5000 + 0.1327 = 0.6327.$

Therefore,

V = Rs. 27(0.7168) - Rs.25$e^{-0.03}$(0.6327) = Rs. 19.3536 - Rs. 25(0.97045)(0.6327)

= Rs. 19.3536 - Rs. 15.3500 = Rs. 4.0036 ≈ Rs. 4.00.

Thus, under the OPM, the value of the call option is about Rs. 4.00.

16. According to put-call parity theorem

$$P_0 = C_0 + \frac{E}{e^{rt}} - S_0$$

$$= €14 + \frac{60}{e^{.08 \times .25}} - €70$$

$$= €14 + \frac{60}{1.0202} - €70 = €2.812$$

17. u = 33.00/30.00 = 36.30/33.00 = 1.10 d = 27.00/30.00 = 24.30/27.00 = 0.90

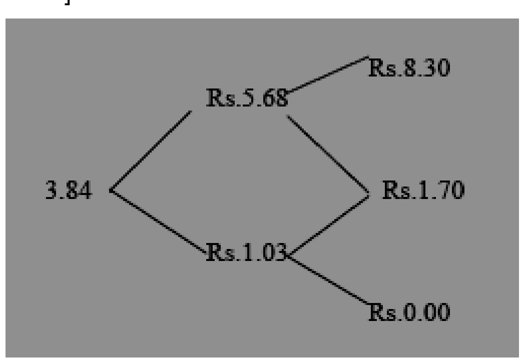
$r = (1 + .05)^{1/2} = 1.0247$

$$p = \frac{r-d}{u-d} = \frac{1.0247-0.90}{1.10-0.90} = 0.1247/0.20 = 0.6235$$

C_{uu} = Max [0, 36.30 – 28] = 8.30

C_{ud} = Max [0, 29.70 – 28] = 1.70

C_{dd} = Max [0, 24.30 – 28] = 0



$$C_U = \frac{(0.6235)(8.30)+(0.3765)(1.70)}{1.025} = \frac{5.175+0.64}{1.025} = 5.815/1.025 = \text{Rs. } 5.675$$

$$C_U = \frac{(0.6235)(1.70) + (0.3765)(0.00)}{1.025} = \frac{1.05995}{1.025} \quad = \text{Rs. } 1.0340$$

$$C_U = \frac{(0.6235)(5.675) + (0.3765)(1.0340)}{1.025} = \frac{3.538 + 0.3895}{1.025} = \text{Rs. } 3.83$$

h = (33.00 – 27.00)/(5.68 –1.03) = 6.00/4.65 = 1.29

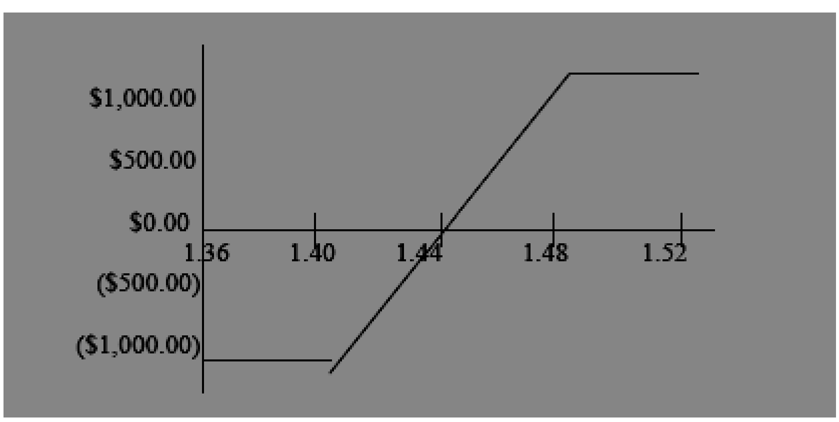
18. (a) Initial Cost

	Cost/Contract	x 31,250
long 1.44 Call	0.0422	($1,318.75)
short 1.48 Call	0.0255	$ 796.88
long 1.40 Put	0.0260	($ 812.50)
short 1.44 Put	0.0422	$1,318.75
		($ 15.62)

June USD/GBP	Net Initial Cost	Long Call 1.44 Profit	Short Call 1.48 Profit	Long Put 1.40 Profit	Short Put 1.44 Profit	Total Net Profit
1.36	($15.62)	0	0	1250	-2500	($1,265.62)
1.40	($15.62)	0	0	0	-1250	($1,265.62)
1.44	($15.62)	0	0	0	0	($15.62)
1.48	($15.62)	1250	0	0	0	$1,234.38
1.52	($15.62)	2500	-1250	0	0	$1,234.38

Example: Long Call 1.44 profit = (1.48 – 1.44) x 31,250 = $1250

(b)



This position resembles a bull vertical spread. The purchaser of this portfolio is probably moderately bullish on the exchange rate. We see this from the willingness to give up the extreme upside in exchange for limiting the downside.

(c) This is a simple application of put-call parity

C - P = R * exp(-rf * dt) - X *exp(-rd *dt)

where R is the exchange rate (1.385), X is the exercise price (1.44)

rd (rf) is the domestic (foreign) risk-free rate,

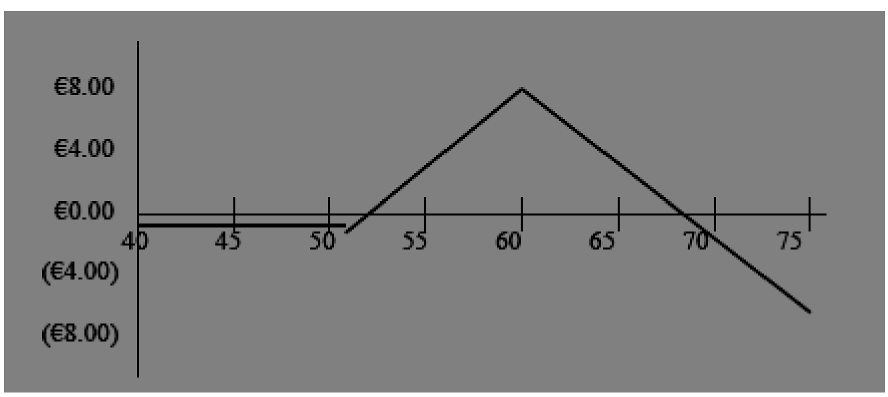
dt is the time to expiration.

C - P = 1.385*exp(-.07*.1667) - 1.44*exp(-.05*.1667) = ($0.0591)

19. (a)

Price of MGH Stock at Expiration	Initial Cost	Profit on Call #1 Position	Profit on Call #2 Position	Net Profit on Total Position
40	(€1.72)	€0.00	€0.00	(€1.72)
45	(€1.72)	€0.00	€0.00	(€1.72)
50	(€1.72)	€0.00	€0.00	(€1.72)
55	(€1.72)	€5.00	€0.00	€3.28
60	(€1.72)	€10.00	€0.00	€8.28
65	(€1.72)	€15.00	(€10.00)	€3.28
70	(€1.72)	€20.00	(€20.00)	(€1.72)
75	(€1.72)	€25.00	(€30.00)	(€6.72)

(b)



Breakeven points are $51.72 and $68.28. Maximum profit occurs at $60.

Maximum profit occurs when the short calls are at-the-money; at prices above $60, the losses on the short calls reduce profit.

Breakeven on the low side occurs at the long call strike price ($50) plus sufficient stock price increase to cover the position's cost ($1.72). This equals $51.72.

Breakeven on the high side occurs with the position's cost ($1.72), profit on the call (P-$50), and loss of the short calls 2($60-P) equal zero: (P-$50) + 2($60-P) - $1.72 = 0 which occurs when price = $68.28

(c) The user of this position is betting on low volatility (that prices will stay between breakeven points). The holder has limited liability for substantial price declines and unlimited liability for substantial price increases.

20. $$\frac{\text{Futures price}}{(1+\text{Risk - free rate})^1} = \text{Spot price} + \text{Present value of storage costs} - \text{Present value of convenience yield}$$

$$\frac{10{,}800}{(1.12)^1} = 10{,}000 + 500 - \text{Present value of convenience yield}$$

Hence the present value of convenience yield is $857.14 per ton.

21. (a)

Security	Expected Return	Beta (β)	Required Return $=0.08 + 0.04\beta$	Under Valued Security
O	0.32	1.70	0.148	UVS
P	0.30	1.40	0.136	UVS
Q	0.25	1.10	0.124	UVS
R	0.22	0.95	0.118	UVS
S	0.20	1.05	0.122	UVS
T	0.14	0.70	0.108	UVS

UVS = Under Valued Security

All the securities listed above are undervalued because their expected returns plot above the SML.

(b) (i) Expected return on the portfolio

$$= \frac{1}{6}\ (0.32 + 0.30 + 0.25 + 0.22 + 0.20 + 0.14) = 0.2383$$

(ii) Expected return on the portfolio

$R_P \quad = XR_M - (X - 1)\ R_P$

$\quad = (1.4)\ (0.2383) - (0.4)\ (0.12) = 0.33362 - 0.048 = 0.28562$

22. (a) Method I

Portfolio's return

Small cap growth = 4.5 + 0.80 x 6.85 + 1.39 x (-3.5) + 1.35 x 0.65 = 5.9925%

Small cap value = 4.5 + 0.90 x 6.85 + 0.75 x (-3.5) + 1.25 x 0.65 = 8.8525%

Large cap growth = 4.5 + 1.165 x 6.85 + 2.75 x (-3.5) + 8.65 x 0.65 = 8.478%

Large cap value = 4.5 + 0.85 x 6.85 + 2.05 x (-3.5) + 6.75 x 0.65 = 7.535%

Expected return on market index

0.10 x 8.8525 + 0.25 x 5.9925 + 0.15 x 7.535 + 0.50 x 8.478 = 7.7526%

Method II

Expected return on the market index

= 4.5% + [0.1x0.9 + 0.25x0.8 + 0.15x0.85 + 0.50x1.165] x 6.85 + [(0.75 x 0.10 + 1.39 x 0.25 + 2.05 x 0.15 + 2.75 x 0.5)] x (-3.5) + [{1.25 x 0.10 + 1.35 x 0.25 + 6.75 x 0.15 + 8.65 x 0.50)] x 0.65

= 4.5 + 6.85 + (-7.3675) + 3.77 = 7.7525%.

(b) Using CAPM,

Small cap growth = 4.5 + 6.85 x 0.80 = 9.98%

Small cap value = 4.5 + 6.85 x 0.90 = 10.665%

Large cap growth = 4.5 + 6.85 x 1.165 = 12.48%

Large cap value = 4.5 + 6.85 x 0.85 = 10.3225%

Expected return on market index

= 0.10 x 10.665 + 0.25 x 9.98 + 0.15 x 10.3225 + 0.50 x 12.45 = 11.33%

(c) Let us assume that Mr. Nirmal will invest X_1% in small cap value stock and X_2% in large cap growth stock

$X_1 + X_2 = 1$

$0.90\ X_1 + 1.165\ X_2 = 1$

$0.90\ X_1 + 1.165(1 - X_1) = 1$

$0.90\ X_1 + 1.165 - 1.165\ X_1 = 1$

$0.165 = 0.265\ X_1$

$\frac{0.165}{0.265} = X_1$

$0.623 = X_1,\ X_2 = 0.377$

62.3% in small cap value

37.7% in large cap growth.

23.

Classic (R_i)	Market Index (R_m)	T-bills (R_p)	$R_i - R_p$	$R_m - R_p$
17.1	10.8	5.4	11.70	5.4
-14.6	-8.5	6.7	-21.30	-15.20
1.7	3.5	6.5	-4.8	-3.00
8.0	14.1	4.3	3.7	9.8
11.5	18.7	4.1	7.4	14.6
-5.8	-14.5	7.0	-12.8	-21.5
-15.6	-26.0	7.9	-23.5	-33.9

38.5	36.9	5.8	32.7	31.1
33.2	23.6	5.0	28.2	18.6
-7.0	-7.2	5.3	-12.3	-12.5
2.9	7.4	6.2	-3.3	1.2
27.4	18.2	10.0	17.4	8.2
23.0	31.5	11.4	11.6	20.1
-0.6	-4.9	14.1	-14.7	-19.0
21.4	20.4	10.7	10.7	9.7
Average 9.406	Average 8.267	Average 7.36		
Standard Deviation 16.40	Standard Deviation 17.126	Standard Deviation 2.815		

Sharpe's measure index

$S = R_p - R_p/\sigma_p$

Where,

R_p = Average Return on portfolio

R_f = Risk-free rate of return

σ_p = Standard deviation of portfolio

Classic Mutual Fund- $S_p = R_p - R_f/\sigma_p$ = 9.407 – 7.360/16.4 = 0.125

Market Index- $S_p = R_m - R_f/\sigma_m$ = 8.267 – 7.360/17.126 = 0.053

Classic Mutual Fund is better on the basis of the Sharpe's measure.

Treynor's measure

$T = R_p - R_f/\beta_p$

β_p = Beta value of portfolio.

Using regression technique to fine Beta

$$b = \frac{\sum xy - n\bar{x}\bar{y}}{\sum x^2 - n\bar{x}^2}$$

After making calculation by taking Market Index as (x) and Classic Mutual Fund as (y) the values are

Market Index (x)	$(x)^2$	Classic (y)	$(y)^2$	(xy)
10.8	116.64	17.1	292.41	184.68
-8.5	72.25	-14.6	213.16	124.1
3.5	12.25	1.7	2.89	5.95
14.1	198.81	8.0	64.00	112.8
18.7	349.69	11.5	132.25	215.05
-14.5	210.25	-5.8	33.64	84.1

-26.0	676.00	-15.6	243.36	405.6
36.9	1361.61	38.5	1482.25	1420.65
23.6	556.96	33.2	1102.24	783.52
-7.2	51.84	-7.0	49.00	50.4
7.4	54.76	2.9	8.41	21.46
18.2	331.24	27.4	750.76	498.68
31.5	992.25	23.0	529.00	724.5
-4.9	24.01	-0.6	0.36	2.94
20.4	416.16	21.4	457.96	436.56

$\Sigma x^2 = 5424.72$	$\bar{y} = 9.406$
$\Sigma y = 141.1$	$\bar{x} = 8.267$
$\Sigma y^2 = 5361.69$	n=15
$\Sigma xy = 5070.99$.	

Substituting values in the above equation

$$b = \frac{5070.99 - 15X9.406X8.267}{5424.72 - 15X(8.267)^2} = \frac{3904.59}{4399.57} = 0.88$$

$a = \bar{y} - b\bar{x}$ = 9.406 – 0.88 x 8.267 = 2.13.

From above calculation Beta value of security = 0.88

Treynor's measure of Classic Mutual Fund - T_1 = 9.407 – 7.360/0.88 = 2.32

Treynor's measure of Market Index- T_m = 8.267 – 7.360/1.00 = 0.907

Jensen's performance measure

$\bar{R}_{jt} - R_{ij} = \alpha_j + \beta_j (\bar{R}_{mt} - R_{ft})$

Where,

$\bar{R}_{jt}$ = Average return on portfolio j for period t

R_{ft} = Risk less rate of interest for period t

α_j = Intercept that measures the forecasting ability of the portfolio manager

β_j = A measure of systematic risk

$\bar{R}_{mt}$ = Average return of a market portfolio for period t.

Substituting values in the above equation = 9.406 – 7.360 = α_j + 0.88 (8.267 – 7.360)

α_i = 2.046 – 0.798 = 1.248

24. Risk appetite, risk aversion and risk premium are sometimes used interchangeably. They are, however, distinctly different. Risk aversion is an intrinsic attribute of investors that leads to the tendency to avoid risk unless adequately compensated. In simple terms, it is the degree to which investors abhor uncertainty surrounding their investment.

    Risk appetite is the willingness to bear risk. It consists of two components. One is the degree to which investors dislike the associated uncertainty and the other component is the level of that uncertainty.

    Risk premium is the reward for holding a risky investment rather than a risk-free one. It measures the additional returns that investors require to hold assets whose returns are more variable than those of low risk ones.

    When investors are unwilling to tolerate risk, they require higher returns for bearing risk. An uncontrollable surge in investor risk appetite can plunge the financial markets into crisis. On the other hand, collapse of investor appetite for risk will dampen the markets. When investor risk appetite increases and shifts towards riskier assets, their prices shoot up, as compared to the less risky ones. One can observe a price rise in low risk assets relative to riskier investments when sentiments across the market are of diminishing risk appetite.

    Investors with a high risk appetite will invest in aggressive equity instruments in high risk/high reward sectors. The probability of losing money is as high as is the probability of reaping rewards. Those with a low risk appetite opt for debt instruments. Between the two extremes is the category of investors who take moderate risk. Balanced funds or a mix of equity and debt in their portfolio is best-suited for them.

    Sharpe ratio characterises how well the returns of an asset compensates the investor for the risk he takes. It is the ratio of a portfolio's total returns minus the risk-free rate divided by standard deviation of the portfolio. It is a measure of performance of the portfolio in return for bearing risk. Hence, a higher Sharpe ratio implies greater rewards for taking additional risks. The ratio measures a portfolio's risk-return trade-off, and helps the investor decide if the investment is worth the risk.

25. (i) Although EVA is used primarily for evaluating management performance, it also is being used by external analysts to evaluate management with the belief that superior internal performance should be reflected in a company's stock performance. Several studies have attempted to determine the relationship between the two variables (EVA and MVA), and the results have not been encouraging. Although the stock of firms with positive EVAs has tended to outperform the stocks of negative EVA firms, the differences are typically insignificant and the relationship does not occur every year. This poor relationship may be due to the timing of the analysis (how fast EVA is reflected in stocks) or because the market values (MVAs) are affected by factors other than EVA—for example, MVA can be impacted by market interest rates and by changes in future expectations for a firm not considered by EVA—that is, it appears that EVA does an outstanding job of evaluating management's past performance in terms of adding value. While one would certainly hope that superior past performance will continue, there is nothing certain about this relationship.

(ii) Home loan repayments are huge commitments that most families face. Sometimes, there is a huge difference in interest rate between what the borrower currently pays his bank and what another lender offers. In such a scenario, people consider either prepaying their loan or switching the lender. Switching to another lender offering better rates is called balance transfer.

Expenses involved

A balance transfer of the outstanding loan from one bank to another can result in savings of a few thousand rupees, month after month in your EMIs. Borrowers must exert due diligence before exploring the balance transfer option. The existing lender charges a penalty for prepayment and the new lender may seek processing fees. These expenses must be taken into account while weighing the benefits of a balance transfer. Some lenders may levy additional switching charges that must be taken into account as well.

When it works well for you

It makes sense to go ahead with a balance transfer if your net gain is more than one percent. This is after factoring in the prepayment penalty of two percent and loan processing charge of 0.5 to one percent. Since lower rates are applicable for a new borrower (rather than existing borrowers) shop for competitive rates and a good lender. After the switching exercise, you shouldn't get a rude jolt that the new lender has increased the rates. So find out if any rate hike is on the cards before switching.

(iii) For longer –term hedging programmes, such as a two-year loan with three-monthly rollover dates, more complicated strategies can be adopted, such as 'stack hedging' and 'strip hedging'.

With a stack hedge, the total number of contract needed to hedge the loan are purchased for the month of the first rollover date. At that date, the remaining, number of contracts necessary are purchased for the next rollover date, and so on.

A strip hedge, on the other hand, treats each three-month segment of the loan as separate entity, and futures contracts are purchased for each rollover date at the outset of the loan.

PAPER – 3 : ADVANCED AUDITING

QUESTION

1. Comment – "Generally an audit is not concerned with the propriety of business conduct".
2. What are the sources of information for acquiring knowledge of client's business?
3. Distinguish with suitable examples between a case where an auditor is obliged to state in his report to the members of a company that the accounts do not show a true and fair view, and a case where he states that he is unable to form an opinion as to whether or not the accounts give a true and fair view.
4. Discuss the design & control procedures which the auditor should adopt in applying CAAT in an audit under EDP environment.
5. Your client is contemplating taking over a manufacturing concern and desires that in the course of due diligence review, you should look specifically for any hidden liabilities and overvalued assets. State the major areas you would examine for the above.
6. What are the methods an auditor may employ in the performance of statistical sampling tests ?
7. The auditor's assessment of materiality and audit risk may be different at the time of initial Planning and while evaluating the results - Comment
8. What are the special issues involved in Investigation?
9. As a Statutory Auditor, how would you deal with the following?

   (a) Mr. Satish is appointed as the auditor of Greenwood Travels Ltd. with audit fees of Rs. 35,000. He purchased air ticket from Delhi to Kolkata and back for Rs. 18,000 from the client for his personal work and the amount remains unpaid at the end of the year as it is a general practice of the client to give credit to all. Mr. Satish claims that he does not incur any disqualification as contained in Section 226(3)(d) of the Companies Act.

   (b) Anjana Ltd., a well reputed manufacturing public limited company has made a contribution of Rs. 2.5 lacs during the financial year ended 31.3.08 to a political party for running a school, situated in the village, where most of the workers of the company reside. It is admitted that the benefit of the school is mostly for the children of the workers of the company. The company has not made any profits in the last four years.

10. Comment on the following:

    (a) The Company auditor became aware of a matter, only after he had issued his audit opinion. Had he become aware of the same prior to his issuing the audit report, he would have issued a different opinion. What are his responsibilities in such a case?

    (b) Rajan and Co., Chartered Accountants, were appointed as statutory auditor of Sonia Ltd. in the annual general meeting in August 2007. They resigned in June, 2008 without auditing the financial statements and submitting an audit report thereon. In the next annual general meeting in August, 2008 S and Co., Chartered

Accountants, have been appointed as the statutory auditor. It has been decided that the accounts for year 2007-08 would be discussed in the next AGM along with the accounts of 2008-09. Is S and Co. responsible for examining and reporting on the annual accounts pertaining to year 2007-08.

11. Your firm has been appointed as auditor of XYZ Co. State your opinion on the following matter:

    The company has also appointed a cost auditor and, therefore, the management had requested your firm not to review cost records.

12. The Chairman of System International Limited, a large trading company with extensive overseas interests, has asked you to accept the nomination to replace the present auditors at the next annual general meeting of the company.

    (a) Before acceptance of any new audit assignment, there are a number of reasons for non-acceptance that have to be considered. List the circumstances in which acceptance of the nomination would be inappropriate under the following:

        (i) Legal aspect

        (ii) Ethical aspect

        (iii) Practical aspect

13. You have just been appointed as auditor of Escort Engineering Ltd., to fill a casual vacancy created by the death of the previous auditor, Mr. Hemanth, a sole practitioner. He has died after carrying out the audit of the company's accounts, but without having signed the audit report of the members for the accounting period.

    Set out the considerations, which apply, and the steps, which you would take in these circumstances.

14. (a) Mr. Ramesh, a chartered accountant, was appointed by Ajeem & Co. to prepare the statement of accounts and income tax returns. He examined the books of accounts and signed a few statements including the trading and profit and loss account and the balance sheet. He also forwarded the statements of account of the firm to the income tax department stating that the accounts were verified by him. But the income tax department late discovered that the profits shown in the above statements were incorrect and false. The department, therefore, brought legal action against the auditor for his negligence in duty.

    (b) Mr. Rakesh, a chartered accountant, was employed by the complainant for the purpose of income tax appeal before the Income Tax Appellate Tribunal. The remuneration for this purpose to be paid had been fixed on certain parentage of the relief of tax.

        The complainant submitted a complaint to the Institute of Chartered Accountants of India on the following grounds:

        1. That the respondent failed to appear at the hearing of the appeal before the tribunal in spite of agreement between them.

2. That a large sum of money were wrongfully taken by him by false representation of the case.

15. How will you conduct -

    (i) Audit of receipts

    (ii) Audit of stores and stock

16. Write a short note on - Solvency margin in case of an insurer carrying on general insurance business.

17. As an auditor comment on the following:

    RST& Co., a firm of Chartered Accounts has three partners, R, S & T; T is also in whole time employment elsewhere. The firm is offered the audit of XYZ Ltd. and its twenty branches. The firm already holds audit of 40 companies including audit of one foreign company.

18. Is there any misconduct on the part of a Chartered Accountant in the following circumstances:

    (i) Mr. L, a Chartered Accountant in practice as a sole proprietor has an office in Bangalore near Trinity Circle. Due to increase in professional work, he opens another office in a suburb of Bangalore which is approximately 60 kilometers away from his existing office. For running the new office he employs three retired Income-tax Officers.

    (ii) Mr. X, a chartered accountant in practice, enters into a partnership with a non-chartered accountant. However, the firm does not undertake any professional assignment and is dissolved after a few months.

19. (a) B, a Chartered Accountant in practice is a partner in 3 firms. While printing his personal letter heads, B gave the names of all the firms in which he is a partner

    (b) The superannuation-cum-pension fund for the employees of a company was under a separate 'trust'.

    Both the company and the trust were under the same management. The auditor, who was auditing the accounts of the company as well as the trust noted some irregularities in the operation of the trust and commented upon these irregularities in the confidential report given to the trustees, but did not mention about these irregularities in his report on the Annual accounts of the Trust.

20. You have been appointed Management Auditor of a large manufacturing company suffering from working capital crunch. Enlist and discuss the related areas which you would probe into to overcome the company's problem.

21. As a Statutory Auditor, how would you deal with the following?

    (a) S Ltd., a listed company, was incurring heavy losses since the last several years and the industry in which it was functioning was not expected to perform better in the next few years. While finalising the accounts for the year ended 31st March 2007, the CFO of the company decided to create a Deferred Tax Asset for the tax benefits that would arise in future years from the earlier years losses that had remained unabsorbed in Income tax.

(b) A father and son are controlling 34% of voting power in AB Company Limited. They are having a separate partnership firm, which supplies mainly the raw material to the Company. The Management says that the above transaction need not be disclosed.

22. Under CARO, 2003 how, as a statutory auditor would you comment on the following:

(i) Fixed assets comprising 1/3rd of the total assets have been disposed off during the year.

(ii) A Term Loan was obtained from a bank for Rs.75 lakhs for acquiring R&D equipment, out of which Rs.12 lakhs was used to buy a car for use of the concerned director, who was overlooking the R&D activities.

23. As an internal auditor of a Cement Manufacturing Company, draft an audit programme for verification of transportation charges for despatches from the factory.

24. Write short notes on - Recognition of Deferred Tax Assets.

SUGGESTED ANSWERS/HINTS

1. The objective of an audit of financial statements of an enterprise, according to SA 200A* entitled 'Objective and Scope of the Audit of Financial Statements', is to enable an auditor to express an opinion as to the truthfulness and fairness of financial statements. The auditor's opinion helps to establish reliability of the financial statements.

The auditors, however, does not give opinion on the propriety of business conduct or its future prospects. SA 200A has specifically pointed out that the user of the "financial statements should not assume that the auditor's opinion is an assurance as to future viability of the enterprise or the efficiency or effectiveness with which the management has conducted the affairs of the enterprise".

In pursuance of the role of the auditor in lending credibility to the financial statements the Companies Act, 1956, has provided that he should be concerned about propriety of some specific transactions.

Section 227(1A) of the Act requires the auditor to enquire into six specified matters and report by exception. This section has been inserted into the Act to ensure that the funds of the company have not been siphoned off by the directors. Also under CARO, 2003 issued by the Central Government in pursuance of powers given to it by Section 227 (4A) of the Companies Act, 1956, the company auditor is required to examine the financial propriety of some transactions.

Further, SA 570, 'Going concern' requires the auditors to evaluate whether the going concern concept is applicable to the circumstances of the entity and whether it will continue for a foreseeable future i.e., a period not exceeding one year after balance sheet. In other words, future viability for one year is to be assessed.

To conclude, we can say that though, generally, an audit is neither concerned with propriety of business conduct nor its future viability yet the auditor would be required to examine the former for the purposes of Section 227(1A) and Section 227(4A) of the Act and the latter for assessing applicability of going concern assumption as per the requirements of SA 570.

(Note: Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (erstwhile AAS 1) and SA 200A (erstwhile AAS 2) will be merged into one Standard, i.e. SA 200.)

2. Sources of information: The sources of information vary according to the nature, size and complexity of each business. Standard on Auditing (SA) 300, Audit Planning, has identified sources from which knowledge of business can be acquired. These are – internal and external reports and other publications; discussions with management / client and visit to premises and plants :

Sources	
Internal reports	• Client's annual report to shareholders • Minutes of board, shareholders' and important committee meetings • Internal financial management reports such as budgets, forecasts and projections • The previous years' working papers • Policy and procedure manuals • Internal audit reports, etc.
External reports	• Trade journal, magazines and newspapers • Text books • Relevant publications of the ICAI and other professional bodies • Industry publications
Discussions with management/client	• The auditor should meet the client or senior management of the enterprise under audit to obtain information, which is not otherwise available, and to gain understanding on certain key issues affecting the business. Such discussions with the client might include subjects such as • changes in organizational structure, • new or closed plant facilities, • scope and timing of examination and other similar issues.

Visit to client's premises and plant facilities	The visit to client's premises and plant facilities is important to gain understanding of plant layout, manufacturing process, physical safeguards surrounding inventories and internal documents generated within the organization to record transactions. For example, receiving reports indicating receipt of materials, goods outward notes indicating dispatch of goods to customers etc. Some potential problems might be noticed by the auditor during such visit, for example, rust on equipment may indicate a potential problem of obsolescence.

3. Adverse Report and Disclaimer of Opinion: SA 200 " Basic Principles Governing an Audit" states that the audit report should contain a clear written expression of opinion on the financial information. In order to express such an opinion, the auditor should review and assess the conclusions drawn from the audit evidence obtained by him. This review and assessment involves forming an overall conclusion as to whether:

   (a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied;

   (b) the financial information complies with relevant regulations and statutory requirements;

   (c) the view presented by the financial information as a whole is consistent with the auditor's knowledge of business environment; and

   (d) there is adequate disclosure of all matters relevant to the proper presentation of financial information.

   The opinion expressed by an auditor may be unqualified, adverse, qualified or a disclaimer of opinion depending upon the degree of satisfaction of the auditor about the overall truth and fairness of the financial statements.

   An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements. Such an opinion is issued when the effect of disagreement is so material and pervasive to financial statements that the auditor concludes that a qualification of his report is not adequate to disclose the misleading or incomplete picture of the financial statements. This conclusion can be reached by the auditor in an extreme case where there had been flagrant violation of the accounting principles or evidence is not available for material transactions or within the knowledge of the auditor there exists material concealment or misstatement about financial affairs. He must have strong and convincing evidence in favour of his conclusion. It should be appreciated that this opinion is also an overall opinion and owes direct relationship to the portrayal of the financial position in the accounting statements. If one or two illegal transactions of not much significance have taken place and they have been fairly presented and disclosed in the accounting statements, it can not be held that the accounting statements are not true and fair. They are true and fair subject to the illegality already disclosed. The audit report stating that the accounts do not show a true and fair view is indeed an extreme and rare case. In case an auditor has to report to that effect, there must exist reservations on the accounts affecting materially the accounts taken as a whole. The reservation should not be such that it only partially affects the accounts. Also, mere reservation in the mind of the auditor is not enough, he must have convincing and definite evidence to state that the accounts are so materially irregular that they do not show a true and fair view.

SA 700, “The Auditor’s Report on Financial Statements” requires that a disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the financial statements. A limitation may be imposed by circumstances, for example, when the timing of the auditor’s appointment is such that the auditor is unable to observe the counting of physical inventories. It may also arise when, in the opinion of the auditor, the entity’s accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed to be desirable. In these circumstances, the auditor would attempt to carry out reasonable alternative procedures to obtain sufficient appropriate audit evidence to support an unqualified opinion. This would also be the case when internal control is so weak as to prevent the auditor from putting any reliance on the accounts. Therefore, to be fair and just, he should state that he is unable to form an opinion as to whether or not accounts give a true and fair view, for example, when the auditor was not able to examine a substantial part of the books of accounts because they were in police custody. In both the situations, the auditor should give also his reasons for the report he makes. Instances in which the auditor faces limitations on the scope of his work, it is appropriate for him to state that he has not been able to form an opinion.

4. The different design and procedural aspects of EDP systems are as follows:

   (i) Consistency of Performance: EDP systems perform functions exactly as programmed and are potentially more reliable than manual systems, provided that all transactions type and conditions that could occur are anticipated and incorporated into the system.

   (ii) Programmed Control Procedures: The nature of computer processing allows the design of internal control procedures in computer programs. These procedures can be designed to provide controls with limited visibility (e.g., protection of data against unauthorized access may be provided by passwords) Other procedures can be designed for use with manual intervention, such as review of reports printed for exception and error reporting and reasonableness and limit checks of data.

   (iii) Single Transaction Update of Multiple or Data Base Computer Files: A single input to the accounting system may automatically update all records associated with the transaction (e.g., shipment of goods documents may update the sales and customers’ accounts receivable files as well as the inventory file). Thus, an erroneous entry in such a system may create errors in various financial accounts.

   (iv) System Generated Transactions: Certain transactions may be initiated by the EDP system itself without the need for an input document. The authorisation of such transactions may neither be supported by visible input documentation nor documented in the same way as transactions which are initiated outside the EDP system (e.g., interest may be calculated and charged automatically to customers' account balances on the basis of pre-authorised terms contained in a computer program).

(v) Vulnerability of Data and Programme Storage Media: Large volumes data and the computer programs used to process such data may be stored on portable or fixed storage media, such as magnetic discs and tapes. These media are vulnerable to theft, or international or accidental destruction.

5. The objective of the Due Diligence exercise will be to look specifically for any hidden liabilities or over valued assets.

   Certain examples of hidden liabilities are:

   - The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
   - The company may have given "Letters of Comfort" to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
   - The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
   - Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation
   - Tax liabilities under direct and indirect taxes
   - Long pending sales tax assessments
   - Pending final assessments of customs duty where provisional assessment only has been completed.
   - Agreement to buy back shares sold at a stated price.
   - Future lease liabilities
   - Environmental problems/claims/third party claims
   - Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
   - Huge labour claims under negotiation when the labour wage agreement has already expired.

   Examples of over valued assets could be:

   - Uncollected/uncollectable receivables
   - Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company

- Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue
- Litigated assets and property
- Investments carried at cost though realizable value is much lower
- Investments carrying a very low rate of income / return
- Infructuous project expenditure/deferred revenue expenditure etc.
- Group Company balances under reconciliation etc.
- Intangibles of no value.

6. The auditor may use a computer to render considerable assistance in the performance of statistical sampling tests, employing the following methods:

   (a) Interval sampling: The computer is programmed to select every nth item stored on magnetic tape, and the items so selected can be copied on to a separate tape and printed out in the form required by the auditor.

   (b) Random number selection: The technique of random number selection can be computerised, the random numbers being stored on tape or generated by the computer separately for each application.

   (c) Random Interval selection: The dangers of selecting a biased example by the use of a uniform interval can be avoided through the use of random variation of the interval between successive items. Random intervals are selected from random number tables maintained on magnetic tape, or produced by means of a random number generator program.

   While applying statistical sampling, it should be remembered that materiality is one of the major considerations to decide whether or not a sample should be selected. For instance in case of certain enterprises like real estate builders, agents, merchant houses, etc. the total number of transactions may be relatively very small and hence are not appropriate for the selection of a sample. Even in case of major enterprises, there are certain items which are so significant that the records relating to them should be scrutinized by the auditor at new item by item basis. For example, the year end closing entries in the journal may be manipulated and, therefore, each entry must be carefully examined and authenticated by the auditor. In actual practice many firms of Chartered Accountants have found limited use of statistical sampling than anticipated by them. The various reasons which may be attributed to this state of affairs are as under:

   (i) Audit has never been a mathematical discipline,

   (ii) Designing and sampling schemes properly take unduly long time.

   (iii) To draw valid conclusions on the basis of statistical sampling, all members of the audit team should have an excellent grasp of the statistical principles involved,

7. Materiality and Audit Risk in Evaluating Audit Evidence: The auditor's assessment of materiality and audit risk may be different at the time of initially planning the engagement from that at the time of evaluating the results of his audit procedures. This could be because of a change in circumstances or a change in the auditor's knowledge as a result of the audit. For example, if the audit is planned prior to period end, the auditor will anticipate the results of operations and the financial position. If actual results of operations and financial position are substantially different, the assessment of materiality and audit risk may also change. Additionally, the auditor may, in planning the audit work, intentionally set the acceptable cut off level for verifying individual transactions at a lower level than is intended to be used to evaluate the results of the audit. This may be done to cover a larger number of items and thereby reduce the likelihood of undiscovered misstatements and to provide the auditor with the margin of safety when evaluating the effect of misstatements discovered during the audit.

   In forming his opinion on the financial information, the auditor should consider whether the effect of aggregate uncorrected misstatements on the financial information is material. Qualitative considerations also influence an auditor in reaching a conclusion as to whether the misstatements are material.

   The aggregate of uncorrected misstatements comprises:

   (a) specific misstatements identified by the auditor, including the net effect of uncorrected misstatements identified during the audit of previous periods; and

   (b) the auditor's best estimate of other misstatements which cannot be specifically identified (that is, projected errors).

   When the auditor tests an account balance or class of transactions by an analytical procedure, he ordinarily would not specifically identify misstatements but would only obtain an indication of whether misstatements might exist in the balance or class and possibly its approximate magnitude. If the analytical procedure indicates that misstatements might exist, but not its approximate amount, the auditor ordinarily would have to employ other procedures to enable him to estimate the aggregate misstatement in the balance or class.

   When an auditor uses audit sampling to test an account balance or class of transactions, he projects the amount of known misstatements identified by him in his sample to the items in the balance or class from which his sample was selected. That projected misstatement, along with the results of other substantive tests, contributes to the auditor's assessment of aggregate misstatement in the balance or class.

   If the aggregate of the uncorrected misstatements that the auditor has identified approaches the materiality level, or if auditor determines that the aggregate of uncorrected misstatements causes the financial information to be materially misstated, he should consider requesting the management to adjust the financial information or extending his audit procedures. In any event, the management may want to adjust the financial information for known misstatements. The adjustment of financial information may involve, for example, application of appropriate accounting principles, other adjustments in amounts, or the addition of appropriate disclosure of inadequately disclosed matters. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate.

8. Investigation broadly range between two extremes – on one hand there are those in respect of which complete accounts, documents, records and other information are available, and on the other hand, those in respect of which little information, besides published accounts and statistical data, is available. Further, investigation may cover the whole of accounting or may relate to only a part or parts of accounting as may be specified. Some of the issues that may arise in investigations are as follows:

   (i) Verification: Whether an investigator is require to undertake a cent percent verification approach or whether he can adopt selective verification;

   (ii) Reliance on Audited Statements: Whether the investigator can put reliance on the already audited statements of accounts will depend on assignment to assignment. While in Short & Compton v Brackert, it was held that reliance can be so put in case of incoming partner, in Mead v Ball Backer & Co., it was held that the investigator cannot put such reliance when advising a proposed investor in a limited company.

   (iii) Experts Opinion: Whether the investigation requires views or opinions of experts in various fields;

   (iv) Independence: The investigator should keep himself scrupulously professional and should keep the interests of all the involved parties in view;

   (v) Investigator's Opinion: The investigator should refrain from issuing speculative opinion and should confine his opinion to the established facts only;

   (vi) Working Papers: The investigator should retain, on his files full notes of the work carried out, copies of schedules and all the working papers. This will help him support his explanations when called up in the court to give evidence of the work performed.

9. (a) Disqualification of auditors: The guidance note on "Independence of Auditors" issued by the ICAI in this context recommends that "a question of indebtedness may also be raised where an auditor of a company purchases goods or services from the company audited by him. In such a case, if the amount outstanding exceeds Rs. 1000, irrespective of the nature of the purchase or period of credit allowed to other customers, the provisions concerning disqualification of auditor as contained in Section 226 (3) (d) will be attracted. This is applicable in the case of purchase of air tickets for personal work by the auditor of a company on normal terms and conditions of the business of the company as the amount outstanding at the end of the year exceeded Rs. 1000. Therefore, the contention of Mr. Satish that he does not incur disqualification is not correct as he has purchased a ticket of the value of Rs. 18,000. The provisions concerning disqualifications of auditor as contained in Section 226 (3) (d) will be attracted.

   (b) Restrictions regarding political contribution: Section 293A of the Companies Act 1956 deals with prohibitions and restrictions regarding political contribution. A non-Government company which has been in existence for not less than three years may contribute any amount or amounts directly or indirectly to any political party or for any political purpose to any person provided that the aggregate of the amounts which may be so contributed by a company in any financial year shall not exceed 5% of its average net profits determined in accordance with the provisions of Sections 349 and 350 during the three immediately preceding financial years. In the given case, the company has not made any profit in last four years and contributed Rs. 2.5 lacs during the year to a political party for running a school. This is violation of the provisions of Section 293-A of the Companies Act although the children of its workers are benefited. The auditor would have to qualify his report stating the contravention of the provisions of the Companies Act.

10. (a) Legal and professional perspective

(i) Right to receive notice and to attend general meeting

❖ According to section 231, the auditor has a right to receive all notices of and other communications relating to any general meeting of a company as are sent to the members of the company.

❖ He can attend any general meeting like a member.

❖ However, he can speak only on the matters which concern him as an auditor.

(ii) SA 560 – As per SA 560, the auditor before issuing the audit report should consider subsequent events i.e. events occurring from date of balance sheet to the date on which audit report is issued.

(iii) Events subsequent to the date of audit report – The auditor, in case he becomes aware of a matter subsequent to his audit report and such a discovery would cause the revision of the audit report, he may bring this to the notice of shareholders.

Present case

Based on the above perspective, can say, in the given situation, the auditor may attend the general meeting and bring to the notice of shareholders the matter concerned and should communicate to them the change in his opinion.

(b) Duty to report

(i) Section 227(2) requires the auditor to make a report to the members of the company on the accounts examined by him and on every balance sheet and profit and loss account and on every document declared to a part of or annexed to the balance sheet or profit and loss account laid before the company in the general meeting during his tenure of office.

(ii) The auditor holds his office from the conclusion of the AGM to the factual conclusion of the next AGM. Thus, he could examine and report on the annual accounts pertaining to all financial years falling during the tenure of his office.

Given situation – On the basis of above arguments, we can say in the present case S and Co. can examine and report on the annual accounts pertaining to both year 2007-08 as well as 2008-09.

11. (i) Legal requirements

    (a) Section 233(B) empowers the Central Government to order audit of cost accounts in certain cases. However, it points out that the audit conducted by cost auditor under this section shall be in addition to the audit conducted by an auditor under section 224 of the Companies Act, 1956.

    (b) Section 227(3) requires the statutory auditor to report whether in his opinion, proper books of account as required by law have been kept by the company, so far it appears from his examination of those books. Proper books of account include cost records. Thus, it is the statutory duty of the auditor to review cost records maintenance.

    (c) CARO, 2003 has laid down similar responsibility on the statutory auditor.

    (ii) In the given situation, based on the provisions of Sections 233B and 227 of the Act we can say, the auditor should not accept management's contention.

12. It would be inappropriate for a person to accept a nomination as auditor under the following circumstances:

    (i) Legal aspect

    Section 226 (3) of the Companies Act, 1956 provides the disqualifications. According to it, the following persons are not qualified to be appointed as auditor of a company:

    - An officer or employee of the company
    - A person who is a partner or who is in employment of an officer or employee of the company.
    - A person who is indebted to the company for an amount exceeding Rs.1,000 or who has given any guarantee or provided any security in connection with indebtedness of any third person

    (ii) Ethical aspect

    Following are the circumstances where a person cannot accept a nomination as auditor on ethical ground:

    - A potential conflict of interest between the company and an existing client might arise.
    - The person has a personal relationship with a senior member of the company's staff.
    - The person is financially involved with the company and wishes to remain so.
    - The person might not wish to be professionally associated with this firm for some reason arising out of the need to change auditors.

(iii) Practical aspect

Following are circumstances where a person cannot accept a nomination as auditor on practical ground:

- The job might be beyond the capacity of the audit firm, because it requires too many staff or expertise not available within the firm.
- The client may have location, which the audit firm cannot visit or arrange to have audited.
- The client may not be willing to pay the fee that the audit firm would need to charge.
- The following steps should be taken when a change of auditors takes place:
  - (i) The proposed auditor should request permission from the company to contact the previous auditors and if permission is refused, the nomination should be declined.
  - (ii) The proposed auditor should contact the previous auditor and ensure that there are no professional reasons why he should not accept the appointment.
  - (iii) The existing auditor must obtain the company's permission to discuss its affairs with the proposed auditor. If refused, the proposed auditor should be informed of this and should then decline the nomination.
  - (iv) The existing auditor should give the proposed auditor all information relevant to the decision of accepting the appointment.

The purpose of these provisions is to protect both the existing and the proposed auditors. The former by allowing him to express his opinion as to why the change is taking place and the latter by ensuring his decision is made with full knowledge of all circumstances.

13. In taking over an unfinished audit of the late Mr. Hemanth, the first consideration to be borne in mind by the new auditor is that he is the one, who is to sign the audit report, and therefore, bears total responsibility for the audit. Late Mr. Hemanth's work cannot be accepted without a through review by the new auditor. It will be important to find out whether he died after a long illness or whether he was in apparently good health before his death.

    The extent of any extra work needed by the new auditor will depend on the results of this review. He cannot sign an audit report based on standards of work lower than his own.

    The steps, which should be taken, are as follows:

    (a) Request the audit working papers from the executors of Mr. Hemanth. They are not obliged to release them and if, for any reason, they refuse the request, the audit will have to be started again.

(b) Carry out a full review of the audit work done by Mr. Hemanth. This will involve the following:

   (i) Obtaining background knowledge of Escort Engineering Limited's business

   (ii) Discovering and assessing the company's systems and internal controls

   (iii) Determining what further audit work, in the new auditor's view, is necessary to arrive at an opinion on the truth and fairness of the view given by the accounts.

(c) Carry out, resulting from the review, any further audit work. However, it would be advisable to include a certain amount of test checking as an integral part of the review. If it appears that Mr. Hemanth's work was in any way negligent or below the standard that the new auditor would set for himself, or departed materially from the principles laid down by the auditing standards and guidelines, the new auditor will have to carry out a complete audit himself.

(d) The overall aim of the new auditor must be to ensure that the duties imposed on an auditor by the Companies Act have been properly carried out and that he was obtained all the evidence required to give his opinion on the accounts.

14. (a) The case was decided in favour of the auditor and he was not held guilty for negligence. It was held that the role of an auditor to the assessee is just like a lawyer or an advocate in a court. It is the responsibility of the income tax officer to investigate the accounts. The auditor owned no duty to the income tax department (third party) and as such, no question of negligence in duty could arise.

(b) The court could not establish any of the above charges against the respondent. However, the disciplinary committee of the Institute of Chartered Accountants of India made a charge against Mr. Rakesh that he had charged his fees at a certain percentage of relief of tax on the ground that no practicing chartered accountant can accept fee on percentage basis as per the provision of Clause 10, Part I of the First Schedule of the Chartered Accountants Act, 1949. Hence, he was held guilty of professional misconduct and suspended from practice for a period of three months.

15. (i) Audit of receipt – Section 16 of the CAG's (DPC) Act, 1971 confers upon him the authority to audit all receipts of the Union/States.

The important aspects of audit of receipts can be elaborated as follows:

   (a) Examine all revenue or other debts due to the Government – Examine all revenues or other debts due to the Government have been correctly assessed, realized and credited to Government account by the designated authorities.

   (b) Procedure for collection – Examine adequate regulations and procedures have been framed by the department/agency concerned to secure an effective check on assessment, collection and proper allocation of cases.

   (c) Implementation – Examine whether such regulations and procedures are actually bring carried out.

(d) Assess adequacy of checks over irregularities and fraud – Ascertain whether adequate checks are imposed to ensure prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue.

(e) Review and suggestions – Review the system and procedure to examine whether there is correct and regular accounting of demands, collection and refunds and settlement of final dues.

(ii) Audit of stores and stock – The Comptroller and Auditor General of India has the power to audit and report on the accounts of stores and stock kept in any office or department of the Union or a State Government. "Stores" here denote all articles and materials purchased or other wise acquired for the use of Government such as plant, machinery, equipment, livestock, etc. The procedure for audit is as follows:

(a) Examine adequacy of regulation - Examine whether regulations governing purchase, receipt and issue, custody, sale and stock-taking of stores are well devised.

(b) Conduct audit of purchases –

- Conduct audit of purchase of stores in the similar manner as audit of expenditure.
- Ensure these are properly sanctioned, made economically and in accordance with the rules for purchases laid down by the competent authority, particularly, when purchases are made on the basis of lowest price determined through open competitive bidding.
- Examine whether the rates paid agree with those shown in the contract or agreement with the vendor.
- Also, examine certificates of quality and quantity furnished by the inspecting and receiving units.
- Comment upon the cases of uneconomical purchases of stores or losses attributable to defective or inferior quality of stores.

(c) Assess adequacy of accounts –

- Determine whether accounts of receipts, issues and balances are accurate and balance in stock is as per the prescribed norms for stock-holding and ascertain whether there is excess or idle stock.
- Review the system of physical verification of stock.

(d) Examine sanctions to write off

- Examine whether sanctions to write off stores have been accorded by a competent authority.

- Ensure that steps are taken to survey, segregate and dispose of unserviceable, surplus or obsolete stores in accordance with prescribed procedures.

(e) Special points in case of priced stores ledger – In case where a priced stores ledger is maintained, ensure that stores are priced accurately and revised where necessary; value accounts tally with physical accounts and adjustment of profits or losses due to revaluation, stock taking or other causes has been carried out.

16. Solvency margin in case of an insurer carrying on general insurance business: In case of an insurer carrying on general insurance business, the solvency margin should be the highest of the following amounts :

    (i) fifty crore rupees (one hundred crores of rupees in case of reinsurer), or

    (ii) a sum equivalent to twenty percent of the net premium income; or

    (iii) a sum equivalent to thirty percent of net incurred claims.

    Subject to credit for reinsurance in computing net premiums and net incurred claims being actual but a percentage, determined by the regulation but not exceeding fifty percent. It may be noted that conditions regarding maintenance of the above mentioned solvency margin may be relaxed by the authorities in certain special circumstances.

    If, at any time, an insurer does not maintain the required solvency margin, the insurer is required to submit a financial plan to the authority indicating the plan of action to correct the deficiency in the solvency margin. If, on consideration of the plan, the authority finds it inadequate the insurer has to modify the financial plan.

    Sub-section (2c) of Section 64 A states that if an insurer fails to comply with the requirements of the insurance Act, 1938, it shall deemed to be insolvent and may be wound up by the court.

17. Ceiling on audits

    (a) Section 224(1B) has prescribed ceiling on auditorships.

    (b) In case of partnership firm of auditors, the ceiling is twenty companies per partner of the firm.

    (c) Moreover, any partner who is in full-time employment elsewhere is not to be taken into account while computing the ceiling of number of companies that the firm can audit.

    (d) For the purposes of calculating the specified number of auditors, certain audits are not counted towards the ceiling. Audit of an Indian company and its branches is counted as one audit. Audit of foreign companies and its branches are not counted towards ceiling because a foreign company is not included in the definition of a company as defined under the Companies Act, 1956.

- The present case
  - (i) The maximum number of audits RST and Co. who has three partners, R, S & T can take is 40. (20 audits per partner × 2 partners) T is in full employment. Therefore, the firm cannot take any audit on his behalf.
  - (ii) At present firm has audit of 40 companies out of which one is a foreign company. For the purpose of section 224(B) audit of foreign company is not counted. Therefore, for section 224(1B) the number of audits the firm has at present is 39 and it can take one more company for audit.
  - (iii) The firm can take audit of XYZ Ltd. and its 20 branches, as it would be counted as one audit only.

18. (i) In terms of section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. There is however an exemption for the above if the second office is located in the same premises, in which the first office is located; or the second office is located in the same city, in which the first office is located; or the second office is located within a distance of 50 kms from the municipal limits of a city, in which the first office is located. Since the second office is situated beyond 50 kms of municipal limits of Bangalore city. Thus Mr. L would be liable for committing a professional mis-conduct.

    (ii) According to Clause 4 of the First Schedule (Part-I) of the Chartered Accountants Act, 1949 Mr. X is guilty of professional misconduct, because a chartered accountant is restricted to enter into professional partnerships with non-chartered accountants. It is immaterial whether any professional assignment has been undertaken or not.

19. (a) Advertisement of Professional Attainments: Clause 7 of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public. Even a member is not permitted to specify the date of setting up of practice or establishment of firm. However, there is no prohibition for printing names of all the three firms on the personal letterheads in which a member holding Certificate of Practice is a partner. Thus B is not guilty of any misconduct under the Chartered Accountants Act, 1949.

    (b) disclosure of material facts: A Chartered Accountant in practice is deemed to be guilty of professional misconduct under clause 5 of Part I of the Second Schedule if he "fails to disclose a material fact known to him which is not disclosed in a financial statement but disclosure of which is necessary to make the financial statement not misleading". In this case, the Chartered Accountant was aware of the contraventions and irregularities committed by the trust as these were referred to in the confidential report given by the Chartered Accountant to the trustees of the company. However, he had issued the annual accounts without any qualification. On similar facts it was held by the Supreme Court in Kishorilal Dutta Vs. P. K. Mukherjee that it was the duty of the Chartered Accountant to have disclosed the irregularities and contravention to the beneficiaries of the fund in the statement of accounts signed by him. Accordingly, in the present case also it has to be held that the Chartered Accountant is guilty of professional misconduct if the amount of irregularities is proved material.

20. Adequate working capital is required for liquidity and smooth operations of the company. To ensure an adequate flow of working capital to the manufacturing company, the following action plan may be considered:

    (i) Working Capital Estimation: The company should start by preparing a statement of the projected working capital requirements. This should be based on the functional budgets in sales, production, expenses, capital expenditure and the Master Budget consisting of projected profit and loss and the Balance Sheet.

    (ii) Cash Flow Statement / Cash Budget: Month-wise cash budgets showing inflows and outflows of cash heading-wise should be prepared to analyse the major inflows and outflows affecting the entity. At this stage any wasteful outflow can be traced and eliminated. Bank reconciliation should be undertaken periodically so that outstanding can be traced and acted upon. This is also necessary to reduce the float time.

    (iii) Inventory / Stock Management: Raw materials and inventories should be classified properly to determine the level of stock of materials. The method of costing also needs to be looked at minutely. There is a need to establish linkage with the production pattern and work backwards accounting for time factor in receipt of material. This needs to be worked out carefully since at no cost, production schedule should be hampered. The caution also need to be exercised that there is no unused/obsolete inventory. The system of inventory management needs to be looked at so as to check the avoidable wastes/scraps generated during storage and handling. Just in time philosophy will enable the company to reduce processing time, stocks and related costs. The adoption of such a mechanism would bring down the cost to a considerable extent.

    (iv) Credit Management: The company should lay down a proper policy for evaluating customers, determining the credit period and offering discounts for early payment. An age-wise analysis of debtors should also be prepared so as to avoid credit to defaulters. The sale department need to be geared up so that realisation can be made in time. A careful analysis should be done of various customers according to pattern of sales so as to exercise control on their respective debit balances. The company should through its purchase department endeavour to avail the maximum credit period from its creditors. This would enhance the working capital of the company.

(v) Funds Flow Analysis: The company should prepare a funds flow analysis, distinguishing between long-term and short-term sources and applications.

(vi) Investment Management: The idle funds of the company, if any, should be invested in short-term securities to augment the income.

(vii) WIP Analysis: Minimum WIP should be monitored and for the purpose it is necessary to ensure that no bottlenecks develop at any stage during the production process.

21. (a) Recognition of Deferred Tax Assets: Accounting Standard 22 on "Accounting for Taxes on Income", requires that deferred tax should be recognised for all timing differences, subject to the considerations of prudence in respect of deferred tax assets. The standard further states that where an enterprise has unabsorbed depreciation or carry forward of losses under the tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised. In this context, virtual certainty supported by convincing evidence would mean that there is a reasonable certainty that the carry forward losses would be recouped in the future years. In the instant case, looking to the fact that the industry in which the company was functioning was not expected to perform well in the next few years, getting virtual certainty and convincing evidence for the same would be almost impossible. Hence, in the absence of virtual certainty for offset of the losses in future years, creating a deferred tax asset would not be possible for the company. The statutory auditor would therefore have to qualify his report by stating that deferred tax assets have been created though there is no virtual certainty for getting the said benefit in income tax. He would also have to mention the amount by which the loss for the year has been understated and the amount by which the reserves are overstated.

(b) Disclosure of Transactions with Related Parties: AS 18, "Related Party Disclosures" and SA 550 "Related Parties", if applicable, requires disclosure of related party relationships and transactions between a reporting enterprise and its related parties. The parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. The control can be exercised through controlling the composition of the Board or more than half of voting power or substantial interest in the voting power and the power to direct financial and/or operating policies. Significant influence can be exercised through several ways, e.g., participation in financial/operating policies, material inter-company transaction, etc. However as per the explanation given in the Standard, significant influence is said to exist in case the investing party has 20% or more voting power of the enterprise unless it can be demonstrated that this is not the case. As per the facts given, in the absence of other circumstances, it appears that father and son will be in a position to exercise significant influence since they are holding 34% of voting power in the company. Hence, relationship as well as nature of transactions would have to be disclosed. In case of non-disclosure, the auditor should qualify the audit report.

22. (i) Disposal of Fixed Assets: Under CARO, 2003, an auditor is required to state if substantial part of the fixed assets have been disposed off during the year, whether it has affected the going concern. This clause requires the auditor to carry out adequate audit procedures to satisfy himself that the company shall be able to continue as going concern for the foreseeable future despite the sale of substantial part of the fixed assets.

    Accordingly, in the instant case, the auditor should satisfy himself as to whether disposal off of 1/3rd of fixed assets during the year had any effect on the going concern assumption on account of such sale of fixed assets. The Auditor is required to exercise his professional judgement to determine whether disposal off of one-third of total assets constitutes substantial part or not. Depending upon the judgement arrived at by the auditor, he shall report whether substantial part of fixed assets have been disposed off or not during the year and it has affected or not affected the going concern status of the company. Alternatively, in case the auditor is of the opinion that it constitutes substantial sale but the going concern assumption is appropriate because of mitigating factors then he has to ensure that the same are disclosed in the financial statements or else he shall have to modify the auditor report. The manner of reporting shall also be modified appropriately in case the going concern assumption is resolved or not.

    (ii) Utilisation of Term Loans: Under CARO, 2003, an auditor is required to comment whether term loans were applied for the purpose for which the loans were obtained.

    The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

    In the instant case, since term loan taken for the purpose of R&D equipment has been utilized for purchase of car which has no relation with R&D equipment. Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report that the out of term loan of R&D lack, Rs.12 lakhs was not utilised for the purpose of acquiring the R & D equipment.

23. Procedure for Audit of Transportation Charges

    (i) Check rates contracted with transporters for carriage of goods.

    (ii) Check whether the rates mentioned as per the contract are correctly taken in the transporter's invoice.

    (iii) In case of discrepancy, check whether the same is authorised by the appropriate sanctioning authority.

(iv) Check that the transporter's invoice includes a delivery challan which has customers stamp indicating the receipt of goods.

(v) In case there is no stamp on the delivery challan, check whether the goods are received back and there is a corresponding inward note.

(vi) Check whether all the goods to be dispatched have a transport booking order reference.

(vii) Check whether each transporter's invoice mentions the transport booking order reference.

(viii) Check whether all the transport booking orders have corresponding transporters names.

(ix) Check whether the transport booking orders are prenumbered.

(x) Check whether all the invoices are correctly booked in the books of accounts.

(xi) In case there is an additional charge by the transporter due to extra carriage, check for the relevant supporting records (like material inward note/customer rejection note) and necessary authorisation by the sanctioning authority.

(xii) Check whether service-tax on the transporters is correctly calculated and accounted.

(xiii) Verify that for there is a mechanism for linking all the transport bills to the sale invoices.

24. Recognition of Deferred Tax Assets: Deferred Tax Assets (DTA) are to be recognised as laid down by AS 22 "Accounting for Taxes on Income" a DTA arises on account of a timing difference in which the taxable income is more than the book income. A deferred tax asset (and the corresponding tax saving) should be recognised only after applying the test of prudence. Thus, where the enterprise does not have unabsorbed depreciation and carried forward losses as per the tax laws, deferred tax assets should be recognised and carried forward to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realized. In other words, no deferred tax asset should be created if there is no reasonable certainty about the requisite future taxable income. The existence or absence of a reasonable level of certainty would normally be determined by examining the past record of the reasonable and by making realistic estimates of profits for the future.

A much stricter test of prudence has to be satisfied where the enterprise has unabsorbed depreciation or carried forward losses under tax laws. In such a situation, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised. The existence of unabsorbed depreciation or carried forward losses under tax laws is strong evidence that future taxable income may not be available. Therefore, in such a situation, the enterprise can recognise deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient taxable income or there is other convincing evidence of virtual certainty of availability of sufficient taxable income against which deferred tax assets can be realised.

ICAI has stated that virtual certainty refers to the extent of certainty which, for all practical purposes, can be considered certain. Determination of virtual certainty of availability of sufficient future taxable income is a matter of judgement which will have to be made on a case-to-case basis.

LIST OF INSTITUTE PUBLICATIONS - NOVEMBER, 2009

I. Professional Topics/Subjects

1. Code of Ethics

   (The Chartered Accountants (Amendment) Act, 2006 is applicable for November, 2008 Final Examination)

II. Statements and Standards

1. Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.
2. Standards on Auditing as given below. (All these SAs have been hosted in the Institute's website)

S.No.	Standards on Auditing and Number
1.	Basic Principles Governing an Audit (SA 200)
2.	Objectives and Scope of the Audit of Financial Statements (SA 200A)
3.	Terms of Audit Engagement (SA 210)
4.	Quality Control for Audit Work (SA 220)
5.	Audit Documentation (230) (Revised)
6.	The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (SA 240) (Revised)
7.	Consideration of Laws and Regulations in an Audit of Financial Statements (SA 250) (Revised)
8.	Communication of Audit Matters with Those Charged with Governance (SA 260) (Revised)
9.	Responsibility of Joint Auditors (SA 299)
10.	Planning an Audit of Financial Statements (300)
11.	Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment (SA 315) (Newly issued)*
12.	Audit Materiality (SA 320)
13.	The Auditor's Responses to Assessed Risks (SA 330) (Newly issued)*
14.	Audit Considerations Relating to Entities Using Service Organisations (SA 402)
15.	Audit Evidence (SA 500)

16. Audit Evidence - Additional Considerations for Specific Items (SA 501)
17. External Confirmations (SA 505)
18. Initial Engagements – Opening Balances (SA 510) (Revised)
19. Analytical Procedures (SA 520)
20. Audit Sampling (SA 530) (Revised)
21. Auditing of Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures (SA 540) (Revised)
22. Related Parties (SA 550) (Revised)
23. Subsequent Events (SA 560) (Revised)
24. Going Concern (SA 570) (Revised)
25. Written Representations (SA 580) (Revised)
26. Using the Work of Another Auditor (SA 600)
27. Relying Upon the Work of an Internal Auditor (SA 610)
28. Using the Work of an Expert (SA 620)
29. The Auditor's Report on Financial Statements (SA 700)
30. Comparatives (SA 710)
31. Engagements to Compile Financial Information (SRS 4410)
32. Engagements to Perform Agreed- upon Procedures Regarding Financial Information (SRS 4400)
33. Engagements to Review Financial Statements (SRE 2400)
34. The Examination of Prospective Financial Information (SRE 3400)

NOTE: 1

* Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (erstwhile AAS 1) and SA 200A (erstwhile AAS 2) will be merged into one Standard, i.e. SA 200.)

** SA 315 & SA 330 – become effective in April, 2008. For November 2009 Final (Old) Examination 34 standards on Auditing as given in the Annexure – I. The Standard on Auditing (SA) 400, "Risk Assessments and Internal Control", SA 310, "Knowledge of the Business", and SA 401, "Auditing in a Computer Information Systems Environment", issued in June 2002, April 2000 and January 2003, respectively, would stand withdrawn.

NOTE: 2

Newly issued SA 450 “Evaluation of Misstatements Identified during the Audit” effective for all audits relating to accounting periods beginning on or after April 1, 2010.It is not applicable for the November 2009 examination.

3. Statement on Reporting under Section 227(1A) of the Companies Act, 1956
4. Statement on the Companies (Auditor’s Report) Order, 2003 [2005 Edition].

III. Guidance Notes/Study Guide/Monograph

Guidance Notes on Auditing Aspects:

1. Guidance Note on Independence of Auditors
2. Internal Control Questionnaire.
3. Guidance Note on Audit Reports and Certificates for Special Purposes
4. Guidance Note on Audit of Fixed Assets.
5. Guidance Note on Audit under Section 44AB of the Income Tax Act [2005 Edition].
6. Guidance Note on Audit of Abridged Financial Statements.
7. Guidance Note on Audit of Inventories.
8. Guidance Note on Audit of Debtors, Loans and Advances.
9. Guidance Note on Audit of Investments.
10. Guidance Note on Audit of Miscellaneous Expenditure.
11. Guidance Note on Audit of Cash and Bank Balances.
12. Guidance Note on Audit of Liabilities.
13. Guidance Note on Audit of Revenue.
14. Guidance Note on Audit of Expenses.
15. Guidance Note on Section 227 (3) (e) and (f) of the Companies Act, 1956.
16. Guidance Note on Certificate of Corporate Governance [2006 Edition].
17. Guidance Note on Revision of Audit Report.
18. Guidance Note on Computer Assisted Audit Techniques (CAATs).
19. Guidance Note on Audit of Payment of Dividend.
20. Guidance Note on Audit of Capital and Reserves.

PAPER – 4: CORPORATE LAWS AND SECRETARIAL PRACTICE

UPDATES

I. Companies Bill, 2008 and Companies Bill, 2009 (Not applicable for November, 2009 examinations)

Students are aware that the Companies Bill, 2008 and Companies Bill, 2009 which was introduced in the Lok Sabha has made extensive changes in the existing Companies Act, 1956. At present, it in the form of a Bill only and hence it is not applicable for the November, 2009 examinations.

II. SEBI (DIP) Guidelines, 2000, February 24, 2009 (applicable for November, 2009 examinations)

(a) Amendments to SEBI (Disclosure and Investor Protection) Guidelines, 2000.

The full text of the amendments is given in Annexure I and the amendments are explained in brief as under:

(i) Enhancing the validity period of observations.

(a) The validity period of the observations issued by SEBI has been enhanced from the existing period of three months to twelve months. The benefit of extended validity period would be available in respect of all the observation letters whose validity period has not expired on December 4, 2008.

(b) Before opening of the issue, every issuer shall be required to file an updated offer document with SEBI, highlighting all changes made in the document.

(c) Where updation include significant changes in the offer document, such an updated Red herring prospectus/ prospectus or letter of offer shall be filed with SEBI at least one month before filing the same with Registrar of Companies or with Designated Stock Exchange as the case may be. The procedure for submitting such updated documents including what will constitute "significant changes", "additional fees" etc will be specified by SEBI shortly.

(ii) Reduction in timelines for completion of bonus issues.

(a) At present, in terms of the SEBI (DIP) Guidelines, a listed company is required to complete a bonus issue within a maximum period of six months from the date of approval of the issue by the board of directors of the company.

(b) The DIP Guidelines have been amended to reduce the timeline for completion of bonus issues. Accordingly, where no shareholders' approval is required as per the Articles of Association of the issuer, the bonus issue shall be completed within fifteen days from the date of the approval by the board of directors of the issuer in this regard. However, where shareholders' approval is required for capitalization of profits or reserves as per the Articles of Association of the issuer, the bonus issue shall be completed within sixty days from the date of the meeting of board of directors where-in bonus was announced subject to shareholders' approval.

(iii) Announcement of price band.

(a) At present, the floor price or price band in an initial public offer through the book building process is required to be disclosed in the Red Herring Prospectus registered with the Registrar of Companies, before the issue opening date.

(b) The amended DIP Guidelines permit the issuer making an initial public offer to announce the floor price or price band after the date of registration of the Red Herring Prospectus with the Registrar of Companies, atleast two working days before the issue opening date.

(c) Further, where the floor price or price band is announced after the date of registration of the Red Herring Prospectus with the Registrar of Companies, every issuer making a public issue, whether initial public offer or further public offer, shall ensure wide dissemination of the floor price or price band through various means, including newspaper advertisement. While announcing the floor price or price band, the issuer shall also disclose details of the relevant financial ratios used for justification of the floor price or price band. In case of a price band, such financial ratios shall be calculated for both upper and lower end of the price band.

(iv) Amendments in provisions pertaining to Preferential Allotment.

- Preferential allotment of warrants.

  (a) At present, the SEBI (DIP) Guidelines provide that warrants can be allotted on preferential basis, subject to the allottees paying upfront, an amount equivalent to at least 10% of the price fixed, at he time of allotment of warrants. It has now been decided to enhance the upfront amount payable from 10% to 25%.

  (b) Certain clarifications regarding lock-in requirements of instruments allotted on preferential basis have been made in clause 13.3.1(c) and (d) of the DIP Guidelines.

- Non-applicability of certain provisions of Chapter XIII of the SEBI (DIP) Guidelines.

  (a) It has been decided that an issuer, which has been granted relaxation by the Board in terms of regulation 29A of the SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations, 1997, shall be exempted from certain provisions of Chapter XIII of DIP Guidelines, subject to the condition that in the explanatory statement to the notice for the general meeting of the shareholders, the issuer gives adequate disclosures about the details of the plan including the process proposed to be followed by it for identification of the allottees in addition to the disclosures required in other applicable laws.

(v) Policy on relaxation from strict enforcement of rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957 (SCRR).

(a) At present the SEBI (DIP) Guidelines provides for the policy regarding considering the requests for relaxation of the strict enforcement of requirements of rule 19(2)(b) of the SCRR where an unlisted company intends to list its shares issued to the shareholders of a listed company pursuant to a scheme of arrangement approved by a High Court, without making an initial public offer.

(b) The DIP Guidelines have now been amended to provide for the policy for considering relaxation from strict enforcement of requirements of rule 19(2)(b) of SCRR in case of proposal for listing of following securities by a listed issuer :-

→ Equity shares with differential rights as to dividend, voting or otherwise, offered through rights or bonus issue.

→ Warrants issued along with Non Convertible Debentures through Qualified Institutions Placement.

ANNEXURE I

AMENDMENTS TO SEBI (DIP) GUIDELINES, 2000

CHAPTER II

ELIGIBILITY NORMS FOR COMPANIES ISSUING SECURITIES

1. In clause 2.2.2B, in sub-clause (iv), for the words and figures “sub-clause (iv)”, the words and figures “sub-clause (iii)” shall be substituted.

CHAPTER IV

PROMOTERS’ CONTRIBUTION AND LOCK-IN REQUIREMENTS

2. In clause 4.6.5:-

(a) the figures and punctuation “4.1.2,” and mark and figure “& 4.5.1” shall be omitted;

(b) for the punctuation mark “,” appearing after the figure “4.3.1” and before the figure “4.4.1”, the word “and” shall be substituted.

3. In clause 4.7.1:-

   (a) the figures and punctuation “4.1.2,” and mark and figure “& 4.5.1” shall be omitted;

   (b) for the punctuation mark “,” appearing after the figure “4.3.1” and before the figure “4.4.1”, the word “and” shall be substituted.

4. In clause 4.11.1:-

   (a) the mark and figure “& 4.5” shall be omitted;

   (b) for the punctuation mark “,” appearing after the figure “4.3” and before the figure “4.4”, the word “and” shall be substituted.

CHAPTER V

PRE – ISSUE OBLIGATIONS

5. In clause 5.7.2, for the words “one week”, appearing after the words “shareholders at least” and before the words “before the date of opening”, the words “three days” shall be substituted.

CHAPTER VIII

OTHER ISSUE REQUIREMENTS

6. In clause 8.3.5, the words “by an unlisted company” appearing at the end shall be omitted.

7. After clause 8.3.5 and before the existing clause 8.3.5.1, the following clause shall be inserted, namely:-

   “8.3.5.1 Application by an unlisted company for listing of equity shares pursuant to scheme sanctioned by a High Court”

8. The existing clause “8.3.5.1” shall be renumbered as clause “8.3.5.1.1”.

9. Clause “8.3.5.2” shall be omitted.

10. Clause “8.3.5.3” shall be renumbered as clause “8.3.5.1.2”.

11. Clause “8.3.5.4” shall be renumbered as clause “8.3.5.1.3”.

12. After the renumbered clause 8.3.5.1.3, the following clauses shall be inserted, namely:-

    “8.3.5.2 Application by a listed company for listing of equity shares with differential rights as to dividend, voting or otherwise.

    8.3.5.2.1 A listed company may make an application to the Board for relaxatio from applicability of clause (b) to sub-rule (2) of Rule 19 of the Securities Contracts (Regulation) Rules, 1957 for listing of its equity shares with differential rights as to dividend, voting or otherwise, without making an initial public offer of such equity shares, if it satisfies the following conditions:

i. issue of such equity shares are made to all the existing shareholders as on record date by way of rights or bonus;

ii the issuer is in compliance with the conditions of minimum public shareholding requirement with reference to the equity shares already listed and the equity shares with differential rights proposed to be listed;

iii. the issuer undertakes to disclose the shareholding pattern of the equity shares with differential rights separately under clause 35 of the Equity Listing Agreement.

8.3.5.3 Application by a listed company for listing of warrants offered along with Non Convertible Debentures (NCDs) under Chapter XIII A.

8.3.5.3.1 A listed company may make an application to the Board for relaxation from applicability of clause (b) to sub-rule (2) of Rule 19 of the Securities Contracts (Regulation) Rules, 1957 for listing of its warrants, if it satisfies the following conditions:

i. warrants are issued as combined offering of NCDs and warrants under Chapter XIII A of the SEBI (DIP) Guidelines,2000;

ii. the issuer is in compliance with all the provisions of Chapter XIII A, including eligibility of the issuer company, pricing guidelines, etc.;

iii. NCDs and warrants shall be traded in the minimum trade lot of Rs.1 lakh.

8.3.5.4 An application to the Board under clauses 8.3.5.1, 8.3.5.2 and 8.3.5.3 shall be made through the designated stock exchange of the listed company and the designated stock exchange may forward the application along with its recommendations, giving reasons in writing to the Board.

8.3.5.5 The Board may, while granting relaxation under clauses 8.3.5.1, 8.3.5.2 and 8.3.5.3, stipulate any other conditions as may be deemed necessary in the interest of investors and securities market under the facts and circumstances of the specific case."

13. In clause 8.21.1:-

(a) for the words "3 months", appearing after the words "shall open within" and before the words "from the date of issuance of the observation letter" the words "12 months" shall be substituted;

(b) in proviso the word "or fast track issue" appearing at the end, shall be omitted.

14. After clause 8.21.1, the following shall be inserted:-

"8.21.2 The issuer shall, before filing a red herring prospectus (in case of a book built issue) or prospectus(in case of a fixed price issue) with ROC or letter of offer with Designated Stock Exchange, as the case may be, file with the Board through the lead merchant banker an updated offer document highlighting all changes made in the document.

8.21.3 Where there are significant changes in the offer document, the updated offer document shall be filed with the Board, atleast one month before the date of filing of the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC or letter of offer with Designated Stock Exchange, as the case may be, as per the procedure specified by the Board in this regard."

15. Clause 8.21.2 shall be renumbered as clause "8.22".

CHAPTER X

GUIDELINES FOR ISSUE OF CONVERTIBLE DEBT INSTRUMENTS

16. In clause 10.7.1.1:-

    (a) in the opening para of the body, the words "or the NCDs", appearing after the words "portions of PCDs" and before the words "issued by a listed company" shall be omitted;

    (b) in sub-clause (c), the words "NCDs or", appearing after the words "Before roll over of any" and before the words "non-convertible portion" shall be omitted.

17. In sub-clause (b) of clause 10.9:-

    (a) for the word and comma "NCDs," occurring after the words "In case of", and before the words "redemption amount" the word "PCDs" shall be substituted;

    (b) for the mark and word "/ NCDs" appearing at the end of the sub-clause, the word "PCDs" shall be substituted.

CHAPTER XI

GUIDELINES ON BOOK BUILDING

18. In clause 11.3.1, in sub clause (viii)(a) :-

    (a) for the first proviso, the following provisos shall be substituted, namely:-

    "Provided that the issuer may not disclose the floor price or price band in the red herring prospectus if the same is disclosed in case of an initial public offer, at least two working days before the opening of the bid and in case of a further public offer, at least one working day before the opening of the bid, by way of an announcement in all the newspapers in which the pre-issue advertisement was released by the issuer or the merchant banker;

    Provided further that the announcement shall contain the relevant financial ratios, computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the offer document."

    (b) in the second proviso:-

        (i) for item (a), the following shall be substituted, namely:-

"a statement that the floor price or price band, as the case may be, shall be disclosed at least two working days (in case of an initial public offer) and at least one working day (in case of a further public offer) before the opening of the bid;"

(ii) in item (b), the words "in case of a further public offer" shall be added at the end.

19. In sub-clause (viii)(b)of clause 11.3.1, for the opening statement, the following shall be substituted, namely:-

"Where the issuer decides to opts for price band instead of floor price, the lead book runner shall ensure compliance with the following conditions:"

CHAPTER XIII

GUIDELINES ON PREFERENTIAL ISSUES

20. In clause 13.1.2.3, for the words "ten percent", appearing after the words "to atleast" and before the words "of the price", the words "twenty five percent" shall be substituted.

21. In clause 13.3.1,

(i) for sub-clause (c), the following clauses shall be substituted, namely:-

"(c) The instruments allotted on preferential basis and the shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to the promoter/promoter group of the issuer, in addition to the instruments or shares specified in sub-clauses (a) and (b) of clause 13.3.1, shall be locked-in for a period of one year from the date of their allotment.

(c-a) The instruments allotted on preferential basis and the shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to any person other than the promoter / promoter group of the issuer shall be locked-in for a period of one year from the date of their allotment."

(ii) in sub-clause (d), after the words "convertible instrument" wherever they appear, the words "other than warrants" shall be inserted.

(iii) in sub clause (h), before the explanation, the following proviso shall be inserted, namely:-

"Provided that the Board may, on an application made by the issuer in respect of the preferential allotment of shares fully convertible debentures and partly convertible debentures, grant relaxation from the requirements of this sub-clause if the Board has granted relaxation to the company in terms of Regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997."

22. In clause 13.4.1, after the existing proviso the following proviso shall be inserted, namely:-

"Provided that where the Board has granted relaxation to the issuer in terms of regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the preferential allotment of shares, fully convertible debentures and partly convertible debentures, shall be made by it within such time as may be specified by the Board in its order granting relaxation."

23. After clause 13.7.2, the following clause shall be inserted, namely:-

"13.7.3 Clause 13.1.1, 13.1.2, 13.1.3, 13.1A, and 13.5.1 shall not be applicable to a preferential allotment of equity shares, fully convertible debenture and partly convertible debentures, where the Board has granted relaxation to the company in terms of Regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997; Provided that adequate disclosures about the plan including the process proposed to be followed for identifying the allottees, are given in the explanatory statement to notice for the general meeting of shareholders, in addition to disclosures required in terms of any other law."

CHAPTER XV

GUIDELINES FOR BONUS ISSUES

24. For clause 15.1.7 the following shall be substituted namely:-

"A company which announces bonus issue after the approval of board of directors and does not require shareholders' approval for capitalisation of profits or reserves for making bonus issue as per the Articles of Association, shall implement bonus issue within fifteen days from the date of approval of the issue by the board of directors of the company and shall not have the option of changing the decision.

Provided where the company is required to seek shareholders' approval for capitalisation of profits or reserves for making bonus issue as per the Articles of Association, the bonus issue shall be implemented within two months from the date of the meeting of the board of directors wherein the decision to announce bonus was taken subject to shareholders' approval."

Note: For further details, students may log on www.sebi.gov.in

III Amendments in Competition Act, 2002(List of Sections are not applicable for November, 2009 examinations)

(a) Competition Act, 2002 – Date of coming into force of certain Sections

The full text of amendments are given in Annexure II:

Annexure II

MINISTRY OF CORPORATE AFFAIRS
NOTIFICATION
New Delhi, 15th May 2009

S.O. 1241(E) - In exercise of the powers conferred by sub-section (3) of Section 1 of the Competition Act, 2002 (12 of 2003), the Central Government hereby appoints the 20th day of May, 2009 as the date on which Sections 3, 4 18, 19, 21, 26, 27, 28, 32, 33, 35, 38, 39 41, 42, 43, 45, 46, 47, 48, 54, 55 and 56 of the said Act, shall come into force.

(b) Competition (Amendment) Act, 2007 – Date of coming into force of certain Sections

The full text of amendments are given in Annexure III:

Annexure III

MINISTRY OF CORPORATE AFFAIRS
NOTIFICATION
New Delhi, 15th May 2009

S.O. 1242(E) - In exercise of the powers conferred by sub-section (2) of Section 1 of the Competition (Amendment) Act, 2007 (39 of 2007), the Central Government hereby appoints the 20th day of May, 2009 as the date on which Sections 3, 10, 13, 15, 16, 19, 20, 21, 25, 26, 28, 31, 33, 34, 35, 36, 38, 39 and 43 (53B, 53N, 53O, 53P, 53Q, 53R, 53S, 53T and 53U) of the said Act, shall come into force.

Note: For further details, students may log on www.cci.gov.in

In view of the above stated two notifications issued by the Ministry of Corporate Affairs, it is seen that most of the amended sections in the Competition Act, 2002 and further amended by the Competition (Amendment) Act, 2007 comes into force w.e.f. 15th May, 2009. Therefore these amended sections will be relevant for the May 2010 examinations.

In order to bring the clarity of the relevant applicable sections, students may study the definitional aspects covered in Sections 2 and Competition Commission of India covered in Sections 7-17 of the Competition Act, 2002 for November, 2009 examination.

IV The Companies (Appointment and Qualifications of Secretary) Amendment Rules, 2009 (Applicable for November, 2009 examinations)

The full text of amendments are given in Annexure IV:

Annexure IV

MINISTRY OF CORPORATE AFFAIRS
NOTIFICATION
New Delhi, 5th January 2009

G.S.R. 11(E) - In exercise of the powers conferred by clauses (a) and (b) of subsection (1) of Section 642 read with clause (45) of Section 2 and Section 383A of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following rules further to amend the Companies (Appointment and Qualifications of Secretary) Rules, 1988, namely : –

1. (1) These rules may be called the Companies (Appointment and Qualification of Secretary) Amendment Rules, 2009.

   (2) They shall come into force from the 15th day of March, 2009.

2. In the Companies (Appointment and Qualification of Secretary) Rules, 1988, in rule 2 –

   (i) in sub-rule (1) and in the proviso to sub-rule (4), for the words "rupees two crores" the following words shall be substituted, namely : –

   "five crore rupees";

   (ii) in sub-rule (3), the second and third proviso shall be omitted;

   (iii) after sub-rule (3), the following sub-rule shall be inserted, namely : –

   "(3A) A company having a paid up share capital two crore rupees or more but less than five crore rupees may appoint any individual who possesses the qualification of membership of the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980), as a whole-time secretary to perform the duties of a secretary under the Companies Act, 1956:

   Provided that where a company has appointed under subrule (3) or this sub-rule, a whole-time company secretary, possessing the qualification of membership of the Institute of Company Secretaries of India, such a company is not required to obtain a certificate from a secretary in wholetime practice under rule 3 of the Companies (Compliance Certificate) Rules, 2001."

   Note: For further details, students may log on www.mca.gov.in

QUESTIONS

COMPANIES ACT, 1956

Board Meetings & Proceedings-Frequency of a meeting

1. The Board of Directors of a public company met on three times in the previous year, the fourth meeting though called could not be held for want of quorum on two occasions successively. Discuss whether any provisions of the Companies Act,1956 has been contravened?

Board Meetings & Proceedings-Signing of minutes

2. Academy computers Ltd. maintains the Minutes Book of the Board Meetings in loose-leaf system and get them bound once in three months. Can it do so? Board meetings were held on 24th March, 2008 and 15th April, 2008. Mr. Mangal, who was the Chairman of these two Board Meetings died on 1.5.2008, without signing the Minutes. How should be the Minutes be signed and by whom?

Board Meetings & Proceedings-Quorum for a meeting

3. What is the required quorum for holding a Board meeting? Examine the following cases:
   (i) In a Board meeting, only 3 directors were present out of the total of 11 directors. None of the 3 directors was interested in any of the items of the agenda. Examine the validity of meeting.
   (ii) In a meeting of the Board, out of the total of 11 directors, 7 directors were present of which only 2 directors were not interested in one of the transactions. How should the meeting deal with the matter?

Board Meetings & Proceedings-Notice of a meeting

4. Kartik, a director residing abroad, complains that he does not receive notices for the Board meetings regularly. Advice.

Directors-Contracts in which directors are interested

5. Star Automobiles Ltd. having a paid up share capital of Rs. 80 Lakhs proposes to enter into contract with the following parties for the supply of certain components for a period of five years with effect from 1st January, 2008:
   (i) Active Forgings Private Limited where 'X', a director of Star Automobiles Limited, is interested as a director and member.
   (ii) Pure Casting Limited, where 'Y', a director of Star Automobiles Limited, is interested as a member holding 25 per cent of the paid up share capital.

   State briefly the legal requirements to be complied with under the Companies Act to give effect to the above proposals. Will the agreements continue to be valid after the paid up share capital of XYZ Machineries Ltd. is increased to Rs. 4 Crores in December 2008 by further issue of shares?

Directors-Restrictions on the directors

6. The Board of Directors of Excellent Fabrics Ltd. at a meeting held on 15.1.2008 resolved to borrow a sum of Rs. 15 crores from a nationalized bank. Subsequently the said amount was received by the company. One of the Directors, who opposed the said borrowing as not in the interest of the company has raised an issue that the said borrowing is outside the powers of the Board of Directors. The company seeks your advice and the following data is given for your information:

(i)	Share Capital	Rs. 5 crores
(ii)	Reserves and Surplus	Rs. 5 crores
(iii)	Secured Loans	Rs. 15 crores
(iv)	Unsecured Loans	Rs. 5 crores

Advice the management of the company.

Directors-Validity of acts done by directors

7. Leena was appointed as director of the company in an annual general meeting. She took over the office and carried on his functions as director. Subsequently, it was found that there were some irregularities in voting and hence the appointment was declared invalid. Would the acts done by Leena, while in office as director, be binding upon the company?

Directors-Casual vacancy

8. Mr. Ajay who was appointed as a Director at the last annual general meeting resigned. The Board filled up the casual vacancy by appointing Mr. Vijay. But within a few days of his becoming director, Vijay died. The Board wishes to fill up the casual vacancy by appointing Mr. Bijoy in place of Mr. Vijay in the next Board meeting. State the legal position.

Directors-Retire by rotation

9. Mars Travels Ltd. in its first General Meeting appointed six Directors whose period of office is liable to be determined by rotation. Briefly explain the procedure and rules regarding retirement of these directors. Will it make any difference, if Mars Travels Ltd. does not carry on business for Profit?

Directors-Disqualifications

10. The Managing Director of a company is convicted of an offence involving moral turpitude. He prefers an appeal against conviction. Can he continue as Managing Director pending disposal of the appeal? Can the appellate court remove the disqualification or stay the same pending the disposal of the appeal?

Directors-Appointment by single resolution

11. East West Garments Ltd. in its annual general meeting appointed all its directors by passing one single resolution. No objection was made to the resolution. Examine the validity of appointment of directors explaining the relevant provisions of the Companies Act, 1956. Will it make any difference, if East West Garments Ltd. was a private company?

Inter Corporate Loans and Investments

12. The Board of Directors of Hindustan Clothes Ltd. has agreed in principal to grant 'loan' worth Rs. 38 lakhs to Bharat Ltd. on the basis of the following information. Advice Hindustan Clothes Ltd. about the requirements to be complied with under the Companies Act, 1956 for the proposed inter corporate loan to Bharat Ltd.

(i)	Authorized share capital	Rs.	1,00,00,000
(ii)	Issued, subscribed and paid up capital	Rs.	50,00,000
(iii)	Free reserves	Rs.	10,00,000

Inter Corporate Loans and Investments

13. A group of shareholders consisting of 25 members decides to file a petition before the Company Law Board for relief against oppression and mismanagement by the Board of Directors of M/s Fortnight Operators Ltd. The company has a total of 300 members and the group of 25 members holds one-tenth of the total paid-up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is that due to mismanagement by the Board of directors, the company is incurring losses and the company has not declared any dividends even when profits were available in the past years for declaration of dividend. Advise the group of shareholders regarding the success of (i) getting the petition admitted and (ii) obtaining relief from the Company Law Board.

Winding-up of Companies

14. Pacific Yarn Limited has its subsidiary company Woolmark Ltd, which is formed to carry out some of the objectives of Pacific Yarn Limited. Pacific Yarn Ltd suspends one of its several businesses, by passing a resolution at the company's extraordinary general meeting, with effect from Ist January 2007. The business so suspended continues to be suspended until March 2007. On Ist April 2007, a group of shareholders of Pacific Yarn Ltd file a petition in the court for winding of the company on the ground of suspension of business by the company.

    Referring to the provisions of the Companies Act, 1956, decide:

    (1) Whether the shareholders' contention shall be tenable?

    (2) What would be your answer in case Pacific Yarn Ltd suspends all its business?

(3) Can shareholders of Woolmark Ltd. file a petition in the court for winding up of their company (Woolmark Ltd) on the ground that the holding company viz, Pacific Yarn Ltd has suspended its entire business, though Woolmark Ltd. has not suspended business?

Winding-up of Companies

15. Write short notes on:

    (i) Overriding preferential payment;

    (ii) Workmen's dues.

Miscellaneous Provisions-Sole Selling Agent

16. On 1st January, 2008 the Board of Directors of Carbon Paper Ltd. appointed Mr. Y as Sole Selling Agent of the Company for a period of five years. On 6th February, 2008 Carbon Paper Ltd. in its General Meeting disapproved the appointment of Mr. Y as Sole Selling Agent of the Company. Explain:

    (a) Is Mr. Y entitled to payment of compensation for Loss of Office?

    (b) Are there some other circumstances when compensation for loss of office is prohibited to a Sole Selling Agent?

Miscellaneous Provisions- Foreign Company

17. Examine with reference to the provisions of the Companies Act, 1956 whether the following companies can be treated as foreign companies:

    (i) A company incorporated outside India having a share registration office at Mumbai.

    (ii) Indian citizens incorporated a company in Singapore for the purpose of carrying on business there?

Producer Companies

18. Who can become members of the producer Company and what are their voting rights?

Producer Companies

19. What provisions a Producer Company has to follow while investing in other companies, or in formation of subsidiaries?

Foreign Exchange Management Act, 1999

20. Mr. Samuel, an Indian national desires to obtain Foreign Exchange on current account transactions for the following purposes:

    (i) Payment of commission on exports made towards equity investment in wholly owned subsidiary abroad of an Indian Company.

(ii) Remittance of hiring charges of transponder.

(iii) Remittance for use of trade mark in India.

Advise Mr. Samuel whether he can obtain Foreign Exchange and, if so, under what conditions?

(SEBI) Act, 1992

21. Briefly examine the powers vested in the Securities and Exchanges Board of India to regulate and prevent undesirable transactions in securities under the Securities Contracts (Regulation) Act, 1956, by virtue of the SEBI Act, 1992.

The Competition Act 2002

22. Write short notes on-

    (i) Restriction on disclosure of information

    (ii) Members, Director General, Registrar, officers and other employees, etc. of Commission to be public servants

    (iii) Exclusion of jurisdiction of civil courts

Securities Contracts (Regulation) Act, 1956

23. Delhi Stock Exchange has refused to grant listing of the shares of Sunshine Floor Limited but the Exchange has not disclosed any reason therefore. The company wants to challenge the decision of the Stock Exchange in the Civil Court.

    Advise the company pursuant to relevant provisions of the Securities Contracts (Regulation) Act, 1956

Interpretation of Statutes, Deeds and Documents

24. Explain the rules relating to interpretation of the terms 'subject to' and 'notwithstanding' used in the provisions of an Act. State the effect of the term 'notwithstanding anything contained in this Act' used in Section 408 of the Companies Act empowering the Central Government to prevent oppression or mismanagement.

Corporate Secretarial Practice

25. Draft a Board Resolution for Purchase of shares of other companies.

SUGGESTED ANSWERS/HINTS

1. As per section 285 of the Companies Act, 1956, a company must hold a meeting of its Board of Directors at least once in every 3 calendar months and there should be at least 4 meetings of the Board every year. But, section 288(2) of the said Act provides that where a meeting is called but could not be held for want of quorum, there is no contravention of section 285. Thus, as per the facts in the above case, there has been no contravention of any provisions of the Companies Act, 1956.

2. Ordinarily minutes cannot be kept in loose-leaf system. Section 193(1) of the Companies Act, 1956 enjoins the Minutes must be entered within 30 days of the conclusion of the relevant meeting. Ordinarily Minutes cannot be kept in loose-lead system. The Department of Company Affairs, however, has expressed that it would refrain from taking any action against a company which maintained its minutes in the loose-leaf form, provided that adequate safeguards are taken against falsification, and loose-leaves are bound in books at reasonable intervals, say six months.

   In this case, since the Minutes Book leaves are bound once in three months (January to March, 2008), and as such the same is in order.

   The minutes of the Board Meeting are required to be written within a period of 30 days from the date of the meeting held. [Section 193(1)]. But there cannot be any insistence that the same must be signed within a period of 30 days from the date of the Board Meeting. (Dept.'s circular No. 25/76 dated 1.9.1976). According to section 193(1A), the minutes of a Board Meeting may be signed by the Chairman of the said meeting or the Chairman of the next succeeding meeting.

   In this case, Mr. Mangal, who was the Chairman of the Board Meeting held on 24.3.2008 and 15.4.2008 died on 1.5.2008 without signing the minutes.

   The Chairman of the Board Meeting held after 15th April, 2008 for the first time may sign the minutes of Board Meeting, held on 15th April, 2008 in accordance with section 193(1A)(a).

   According to the provisions of section 193(1) read with section 193(1A) the minutes of Board Meeting held on 24th March, 2008 should have been signed by Mr. Mangal himself as he was the Chairman of the Board Meeting held on 24th March, 2008 as well as the Chairman of the next succeeding meeting. There is no specific provision in the Companies Act, 1956 as to the person who can sign the minutes of Board Meeting held on 24th March, 2008 in this case. Hence a board meeting may be convened and the Chairman of the said meeting may sign the minutes of Board Meeting held on 24th March, 2008.

3. The provisions relating to quorum for a Board meeting are contained in section 287 of the Companies Act,1956. Unless the articles provide for a higher quorum, the quorum shall be one third of the 'total strength' (any fraction contained in that one third shall be rounded off to one) or two directors whichever is higher [Section 287(2)]. However, proviso to section 287(2) states that where at any time the number of interested directors exceeds or is equal to two third of the 'total strength', the number of disinterested directors present at the meeting, being not less than two, shall form the quorum.

   (a) In the instant case, one third of 11 comes to 3.67; the fraction 0.67 shall be rounded off to 1. Thus, at least 4 disinterested directors must be present in the Board meeting. However, only 3 directors are present in the Board meeting.

   Moreover, there is no interested director present in the meeting and so the benefit of proviso to section 287 cannot be availed. Therefore, the quorum is not present and the meeting cannot be held valid.

   (b) In the given case, the required quorum comes to 4 directors, but only 2 disinterested directors are present.

   Two third of the 'total strength' comes to 8 (Being two third of 11 is 7.33; the fraction 0.33 shall be rounded off to 1). Since the number of interested directors is only 5, the proviso to section 287 is not attracted. Thus, the remaining 2 directors who are not interested do not constitute a quorum and hence the Board meeting cannot be validly convened.

   In the case of a private company, interested directors are also counted in quorum. In this case, if the company is a private company, all the 7 directors shall be counted while determining quorum. Since the required quorum is only 4, the quorum is present if it is assumed that the company is a private company.

4. As per section 286 of the Companies Act, 1956, notice to a director who is out of India must be sent at his usual address in India. Section 286 does not differentiate between a director who is resident of India but is temporarily out of India and a director who is permanently resident outside India.

   In a similar question, the Company Law Board has held that if notice is sent to a director who mostly stays out of India at his usual local address, the notice is inadequate (even if the articles of the company do not require the sending of notice abroad). He would not be able to attend the meeting. It would show lack of probity and fair play on the part of directors. The meeting was held to be null and void [Dr. Kamal Kumar Dutta vs Ruby General Hospital Ltd. (2000) 36 CLA 214, 231].

   In the given case, there is no legal requirement of sending notice to Mr. Kartik at his foreign address; notice given to him at his usual address in India is sufficient (Section 286). However, considering the judgement given by the Company Law Board in Dr. Kamal Kumar Dutta vs Ruby General Hospital Ltd., the company should also give a copy of the notice to Mr. Kartik at his foreign address, if any.

5. (i) Under section 297 of the Companies Act, 1956 it will require a resolution of the Board of Directors to be passed at its meeting.

   In the event of capital of Star Automobiles Ltd. being increased to Rs. 4 crores, previous approval of the Central Government shall also be required under section 297. Approval of the Central Government is required where the paid up share capital of the company is Rs. 1 Crore or more. But, applicability of the section is to be deteremined at the time of entering into the contract. If no permission under this section is required at the time of entering into the contract, subsequent permission is not necessary even though there may be a change of circumstances which would require permission to be taken for a fresh contract.

   Thus, it appears that, where contracts entered into by companies when their paid up capital was less than Rs. 1 Crore, and raised upwards subsequently [as in the given case], approval of the Central Government would not be necessary until the expiry of the contract.

   Also under section 299, 'X' must disclose his interest to the Board and not participate in the said meeting/deliberations.

   (ii) Section 297 does not cover cases of public limited companies. Thus, the aforesaid approvals shall not be necessary.

6. According to the provisions of Section 293(1)(d) of the Companies Act, 1956 there are restrictions on the borrowing powers to be exercised by the Board of directors. According to this section, the borrowings should not exceed the aggregate of the paid up capital and free reserves. While calculating the limit, the temporary loans obtained by the company from its bankers in the ordinary course of business will be excluded. However, from the figures available in the present case the proposed borrowing of Rs. 15 crores will exceed the limit mentioned. Thus the borrowing will be beyond the powers of the Board of directors. However the share holders have the power to ratify the act of the Board of Directors, if it is not beyond the powers of the company as laid down in the memorandum of association. In that case the shareholders can ratify as it is intra vires the company even though it may be beyond the powers of the Board of Directors.

   Thus the management of Excellent Fabrics Ltd., should take steps to convene the annual general meeting and pass a resolution by the members in the meeting as stated in Section 293(1)(d) of the Act. Then the borrowing will be valid and binding on the Company and its members.

7. According to section 290 of the Companies Act, 1956, the acts done by a director shall be valid notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification in his appointment. The section will protect, the bonafide acts and not where they are done with notice that they were done wrongfully or illegally. Hence, the acts done by Leena as a director, before the irregularity

was found, are in order and interests of company as well as outsiders dealing with the company would be protected. But the acts done after the discovery of invalidity would not be protected.

8. Section 262 of the Companies Act, 1956 provides that in the case of a public company or a private company which is a subsidiary of a public company, if the office of any director appointed by the company in general meeting is vacated before the expiry of his term of office in the normal course, the resulting casual vacancy may, subject to any regulations in the Articles of the company, be filled by the Board of directors at a meeting of the Board.

   It would thus be noted that the Board of directors is empowered to fill a casual vacancy only in respect of a director appointed by the company in general meeting. If a casual vacancy arises in the office of a director appointed in the casual vacancy under section 262, there is no casual vacancy within the meaning of section 262. However, the Deptt. Of Company Affairs has opined that the same may be filled by the Board of directors as a casual vacancy. Consequently Board can appoint Mr. Bijoy in place of Mr. Vijay.

9. According to section 255 of the Companies Act 1956, unless the articles provide for the retirement of all directors in every general meeting, at least 2/3rds of the total number of directors of the public limited company in question must, in the first place, be appointed, save as otherwise expressly provided in the Act by the company in general meeting; Secondly, they must be persons whose period of office is liable to be determined by rotation.

   According to section 256, out of 2/3rd rotational directors only 1/3rd must retire by rotation at one general meeting.

   If the number is not three or multiple of three, then the number nearest to 1/3 must retire from office.

   Yes it will make a difference if Mars Travel Ltd. does not carry on business for Profit. Provisions of Section 256 do not affect those companies which do not carry on business for profit or those which by their articles prohibit the payment of dividend to their members. Such companies are not affected by Section 255 also which provides that at least 2/3rd of the directors shall retire by rotation while section 256 provides that 1/3rd of the retiring directors shall retire every year.

10. The Managing Director cannot continue as such, as he is disqualified to act as managing director, pursuant to section 267 of the Companies Act, 1956. The purpose of section 267 is to ensure that the management and affairs of the company and its control is not in the hands of a person who has been found by a competent Court to be guilty of an offence involving moral turpitude. Section 267 enacts that any person who has suffered a conviction by a Court of an offence involving moral turpitude shall not be appointed or

employed or continue in employment or appointment by any company as its managing director. Thus, the provisions are stringent. Under Criminal Procedure Code (CrPC), an appeal against the order of conviction may either be dismissed summarily or heard by an Appellate Court. However, order of conviction does not on the mere filing of an appeal disappear and it is difficult to hold that Section 267 of the Companies Act must be read to apply only to final order of conviction as such interpretation may defeat the very object and purpose for which it came to be enacted. In view of the above observation, the Appellate court will not be inclined to stay the operation of section 267 pending disposal of appeal [See Roma Narang v. Ramesh Narang (1995)SCALE 276]

11. Section 263 (1) of the Companies Act 1956 requires that the appointment of every director shall be voted on individually. Thus two or more directors cannot be appointed by a single resolution. However an exception has been carried out where under if a resolution has been first passed to the effect that all the directors shall be appointed by a single resolution without any vote being against it.

    Any resolution, as per Section 263(2), in contravention of the aforesaid provisions shall be void whether or not objection was taken at the time of its being so moved.

    The aforesaid provision, however apply to a public company or a private subsidiary of a public company. Hence, the appointments so made are void. However if East West Garments Ltd. was a private limited company, then the condition of provision of Section 263(1)(2) were not applicable as regards the condition of single resolution is concerned.

12. Inter corporate loans and investments are governed by the provisions of Section 372A of the Companies Act, 1956. As per this Section, a company can advance loans to other companies or invest in the securities, of other companies up to 60% of the paid-up capital and free reserves or upto 100% of free reserves, which is more. Further no loan or investment exceeding the said limits can be made by a company unless authorized by a previous special resolution passed in this regard.

    First determine whether a special resolution is required for providing loans to Bharat Ltd.

    This can be determined as follows:

Paid up capital of the company	(A)	Rs. 50,00,000.00
Free reserves	(B)	Rs. 10,00,000.00
Aggregate of paid up capital and free reserves	(C)	Rs. 60,00,000.00
60% of aggregate of paid up capital and free reserves	(D)	Rs. 36,00,000.00

    Higher of (B) or (D) i.e. the ceiling limit for incorporate loan and investment etc. without requiring a special resolution Rs.36,00,000.00

    Proposed loans to Bharat Ltd. Rs. 38,00,000.00

Since the proposed loan exceeds the ceiling limit a special resolution is required. The company shall adopt the following procedure for providing loan to Bharat Ltd.

(i) Unanimous approval of the Board shall be obtained by passing a resolution at a Board meeting.

(ii) A special resolution shall be passed in the general meeting

The notice of special resolution shall stake the specific limits, particulars of the company to which loan is proposed to given, specific source of funding and other relevant details. The company shall file a copy of special resolution with the registrar within 30 days of passing the special resolution. If the company is listed company, it shall pass the resolution by postal ballot as prescribed under Section 192A.

(iii) The company shall obtain the prior approval of the Public Financial Institution, if any, from whom it has taken a term loan.

(iv) The company can provide such loan to other companies only if no default in respect of public deposits is subsisting.

(v) The prescribed particulars shall be entered in the register maintained under Section 372A(5).

13. (i) Since the group of shareholders do not number 100 or hold 1/10 of the issued share capital or 1/10 of the total number of members, they have no right to approach the Company Law Board for relief. However, the Central Government, if it is of the view that circumstances exist which make it just and equitable to do so, may authorise any member(s) to apply to the Company Law Board [Section 399(4)]. So members may approach Central Government to authorise them to approach Company Law Board inspite of deficiency in number.

(ii) As regards obtaining relief from Company Law Board, continuous losses cannot, by itself, be regarded as oppression. [Ashok Betelnut Co. (P.) Ltd. vs M.K.Chandrakanth].

Similarly, failure to declare dividends or payments of low dividends also does not amount to oppression (Thomas Vekkon vs. Kuttanand Rubber Co. Ltd.). Thus, the shareholders may not succeed in getting any relief from Company Law Board.

14. The problem relates to suspension of business by a company. Section 433 of the Companies Act, 1956 provides that if a company does not commence its business within a year from its incorporation or suspends its business for a whole year, it may be wound up by the court .The contention of the shareholders of Pacific Yarn Ltd that the company is liable to be wound up in the ground so suspension of business, is not tenable for the following reasons:

(i) (a) A company may be wound up by court if a company suspends its business for a whole year. Here the business was suspended only on 1.1.2007. Hence on 1st April, 2007 the business has not been suspended for the whole year to attract Section 433(c)

(b) Where a company having much business discontinues one of them, it cannot be said to have suspended business within the meaning of Section 433(c).

(c) Where a company ceases to do any business but is a holding company of subsidiaries engaged in the pursuit of the business, which it was previously doing, it cannot be said that the company has suspended its business (Ref; Eastern Telegraph Company Ltd).

(ii) Even if Pacific Yarn Ltd suspended all its business the suspension was not for a period of more that 1year as on1.4.2007 and hence the provisions of Section 433(c) are not applicable. Again for the reasons stated in (i) (c) above Pacific Yarn Ltd cannot be said to have suspended its business as its subsidiary is carrying on the business.

(iii) As Woolmark Ltd has not suspended its business, the shareholders of Woolmark Limited have no right to file winding up petition on the ground that its holding company has suspended its business. Again for reasons stated in (i)(c) above the holding company also cannot be said to have suspend its business.

15. (i) Overriding preferential payment: Under Section 529A of the Companies Act, 1956 notwithstanding anything contained in other provisions of this Act or any other law for the time being in force in the winding-up of a company – (i) workmen's dues and (ii) debts due to secured creditors to the extent such debts rank, under clause (c) of the proviso to Sub-section (1) of Section 529, pari passu with such dues, shall be paid in priority to all other debts. These debts payable under (i) and (ii) above shall be paid in full, unless the assets are insufficient to meet them, in which the case they shall be paid in equal proportions.

(ii) "workmen's dues" means the aggregate of the following sums due from the company to its workmen, namely:

(a) all wages, salaries including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workmen, in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;

(b) all accrued holiday remuneration becoming payable to any workman, or in the case of his death to any other person in his right, o the termination of, the winding-up other or resolutions;

(c) unless the company is being wound-up voluntarily merely for the purposes of reconstruction or of amalgamation with another company or unless the company has, at the commencement of the winding-up, under such a contract with insurers as mentioned in Section14 of the Workmen's Compensation Act, 1923, rights capable of being transferred to and vested in the workman, all amounts due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company. In other words, in the absence of alternative circumstances mentioned in the beginning of this clause the provision of this clause will fall within the provision of the phrase "workmen's dues";

(iii) all sums due to any workman from a provident fund, a gratuity fund or any other fund for the welfare of the workman maintained by the company.

16. (i) According to Section 294(2)of the Companies Act, 1956, the Board of Directors of Carbon Paper Ltd. shall not appoint a sole selling agent for any area except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made.

It has been held that the appointment of a sole selling agent must be made by the company in its general meeting and such clause must be inserted as a mandatory condition in all appointments of sole selling agents; an appointment without such a clause being inserted is void ab-intio (Arante manufacturing Corp. vs. Bright Bills Private Ltd. 1967 Comp/ Case 759, Shelagram Jhaigharia vs. National Co. Ltd. 1965 Comp. Cas. 706) If the company in the general meeting disapproves the appointment it shall become invalid form the date of the general meeting.

In the given case, assuming that the general meeting of Carbon Paper Ltd. held on February 6, 2008 was their first general meeting after January 1 , 2008 and the disapproval of the company, in this meeting will make the appointment of Mr. Y as sole selling agent invalid w.e.f. February 6, 2008.

(ii) Section 294(A) prohibits payment of compensation to the sole selling agent for the loss of his office in the following cases in addition to the one discussed in part (2) above :

(a) Where the sole selling agent resigns his office as a result of reconstruction or amalgamation of the company, and is appointed as the sole selling agent of the reconstructed company or the body corporate resulting from the amalgamation.

(b) Where the sole selling agent resigns his office otherwise than in the circumstances envisages in the foregoing clause (i)

(c) Where a sole selling agent has been found to be guilty of fraud or breach of trust in relation to, or of gross negligence in the conduct of his duty as the sole selling agent.

(d) Where the sole selling agent has investigated or taken part directly or indirectly in bringing about the termination of the sole selling agency.

17. “Foreign company” as per Section 591 of the Companies Act 1956, means a company incorporated outside India but having a place of business in India. Accordingly, to qualify as ‘foreign company’ a company must have both the following features:

(a) it should be a company incorporated outside India; and

(b) it should have a place of business in India.

As to what amount to having a place of business in India, Section 602 (e) provides that the expression ‘place of business’ includes a share transfer or share registration office.

Thus a company incorporated outside India having a share registration office at Mumbai is a foreign company.

But, the company incorporated in Singapore for the purpose of carrying on business in Singapore is not a foreign Company. Its incorporation by Indian citizen is immaterial. In order to be a foreign company it has to have a place of business in India.

18. Membership and voting rights of members (Section 581D)

A person, who has any business interest which is not in conflict with business of the producer company, shall become a member. On the other hand, a member, who acquires any business interest which is in conflict with the business of the producer company, shall cease to be a member and be removed as a member in accordance with articles of the producer company.

The articles of any producer company may provide for the conditions, subject to which a member may continue to retain his member, and the manner in which voting rights shall be exercised by the members.

These voting’s rights are:

(a) In a case where the member consists solely of individual member, the voting rights shall be based on a single vote for every member, irrespective of his shareholding or patronage of the producer company.

(b) In a case where the member consists of producer institutions only, the voting rights of such Producer institutions shall be determined on the basis of their participation in the business of the producer company in the previous year, as may be specified by articles.

Provided that during the first year of registration of a producer company, the voting rights shall be determined on the basis of the shareholding by such Producer institutions.

(c) In a case where the member consists of individuals and producer institutions, the voting rights shall be computed on the basis of a single vote for every member. However, a producer company may, if so authorised by its articles, restrict the voting rights to active member, in any special or general meeting.

19. Investment in other companies, formation of subsidiaries, etc. (Section 581ZL)

The producer company has to follow the following provisions under this Section.

(1) The general reserves of any producer company shall be invested to secure the highest returns available from approved securities, fixed deposits, units, bonds issued by the Government or co-operative or scheduled bank or in such other mode as may be prescribed.

(2) Any producer company may, for promotion of its objectives acquire the shares of another producer company.

(3) Any producer company may subscribe to the share capital of, or enter into any agreement or other arrangement, whether by way of formation of its subsidiary company, joint venture or in any other manner with any body corporate, for the purpose of promoting the objects of the producer company by special resolution in this behalf.

(4) Any producer company, either by itself or together with its subsidiaries, may invest, by way of subscription, purchase or otherwise, shares in any other company, other than a producer company, specified under sub-section (2), or subscription of capital under sub-section (3), for an amount not exceeding thirty per cent of the aggregate of its paid-up capital and free reserves:

Provided that a producer company may, by special resolution passed in its general meeting and with prior approval of the Central Government, invest in excess of the limits specified in this section.

(5) All investments by a producer company may be made if such investment are consistent with the objects of the producer company.

(6) The Board of a producer company may, with the previous approval of member by a special resolution, dispose of any of its investments referred to in sub-sections (3) and (4).

(7) Every producer company shall maintain a register containing particulars of all the investments, showing the names of the companies in which shares have been acquired, number and value of shares; the date of acquisition; and the manner and price at which any of the shares have been subsequently disposed of.

(8) The register referred to in sub-section (7) shall be kept at the registered office of the producer company and the same shall be open to inspection by any member who may take extracts there from.

20. Under Section 5 of Foreign Exchange Management Act, 1999, certain rules have been framed for drawal of foreign exchange on current account. According to the said rules, drawal of foreign exchange for certain transactions is prohibited. In respect of certain

transactions drawal of foreign exchange is permissible with the prior approval of Central Government. In respect of some of the transaction, prior permission of Reserve Bank of India is sufficient for drawal of foreign exchange.

(i) In respect of item No.1 i.e. Payment of Commission on exports made towards equity investment in wholly owned subsidiary abroad of an Indian company is prohibited.

(ii) Drawal of foreign exchange for remittance of hiring charges of transponder, can be made with the prior approval of the Central Government.

(iii) So far as remittance for use of Trade Mark in India is concerned, the necessary foreign exchange can be obtained with the prior permission of the Reserve Bank of India.

In the case of (ii) & (iii) above, approval of concerned authority is not required if the payment is made out of funds held in Resident Foreign Currency (RFC) Account or Exchange Earner's Foreign Currency (EEFC) Account of the remitter. Further foreign Exchange can be drawn only from an authorised person.

21. By virtue of the SEBI Act, certain provisions contained in the Securities Contracts (Regulation) Act, 1956 have been amended with a view of giving power to SEBI to regulate and prevent undesirable transacations in securities by regulating the business of dealing therein, by prohibiting options and by providing for certain othere matters connected therewith. The functions of the Central Government under the Act have been granted to SEBI. These are:

(a) Power to call for periodical returns or direct enquiries to be made (Section 6)

(b) Power to approve the bye-laws of stock exchanges (section 9)

(c) Power of SEBI to make or amend bye-laws of recognized stock exchanges (Section 10)

(d) Licensing of dealers in securities in certain areas (section 17)

(e) Power to compel listing of securities by public companies (Section 21), and to punish.

22. (i) Restriction on disclosure of information (Section 57)

No information relating to any enterprise, being an information which has been obtained by or on behalf of the Commission for the purposes of this Act, shall, without the previous permission in writing of the enterprise, be disclosed otherwise than in compliance with or for the purposes of this Act or any other law for the time being in force.

(ii) Members, Director General, Registrar, officers and other employees, etc. of Commission to be public servants (Section 58)

The Chairperson and other Members and the Director General, Additional, Joint, Deputy or Assistant Directors General and Registrar and officers and other employees of the Commission shall be deemed, while acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

(iii) Exclusion of jurisdiction of civil courts (Section 61)

This section provides no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Commission is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

23. Under section 22A of the Securities Contracts (Regulation) Act, 1956 where a recognised Stock Exchange refuses to list the securities of any public company, the company shall be entitled to be furnished with reasons for such refusal. If aggrieved, the company may appeal to the Securities Appellate Tribunal:

(i) within 15 days from the date on which the reasons for such refusal are furnished to it, or

(ii) where the Stock Exchange has omitted or failed to dispose of within the time specified in section 73(1A) of the Companies Act, 1956 (i.e., before the expiry of ten weeks from the date of closing of the subscription list as per prospectus) within 15 days from the expiry of the specified time or within such further period not exceeding one month as Securities Appellate Tribunal may allow.

In terms of section 22E of the Act, Civil Court has no jurisdiction to entertain any suit in respect of this matter.

The company may be advised accordingly.

24. Interpretation of the terms 'notwithstanding' and 'subject to'

The word 'notwithstanding anything contained' characterise the non obstante clause. It is generally included to give an overriding effect to the clause over the other. If there is any inconsistency or departure between the non obstante clause and another provision, it is the non obstante clause which will prevail (K. Parasuramaiah v. Pakari Lakshman, A/R 1965 AP 220).

But the word 'subject to' conveys the idea of a provision yielding place to another provision or provisions to which it is made 'subject to'. Hence the effect of non obstante clause (i.e. notwithstanding) is the opposite of a provision which states 'subject to'.

Section 408 of the Companies Act, 1956 opens with the words 'notwithstanding anything contained in this Act. This is a non obstante clause which vests overriding powers in the Government to nominate directors to prevent mismanagement or oppression (Oriental Industrial Investment Corporation Ltd vs. Union of India (1981) 52 Com cases 487, 493 (Del)). This expression indicates that the appointment of directors under this section is not to be controlled by the maximum number or other proportion, if any, fixed by any provisions of the Act. Further, they cannot be removed by the company at general meeting under section 284 of the Companies Act.

25. Board Resolution for purchase of shares of other companies

"Resolved that pursuant to Section 372A of the Companies Act, 1956, the company do purchase 3,50,000 equity shares of Rs. 10 each to M/s MPC & Company Limited (not being under the same management as this company) and that the resolution be passed by all the directors present unanimously.

Resolved further that Mr John, a Director of the company, be and is hereby authorized to sign/ execute the necessary documents in this connection."

PAPER – 5 : COST MANAGEMENT

QUESTIONS

Basic Cost Concepts for Decision Making

1. (a) "Costs may be classified in a variety of ways according to their nature and the information needs of the management" Explain.

   (b) Indicate the major areas of short-term decisions in which differential cost analysis is useful.

   (c) "Relevant cost analysis helps in drawing the attention of managers to those elements of cost which are relevant for the decision." Comment.

Marginal Costing

2. AB Ltd has two divisions A and B. Division A manufacture a product 'AAA' for industrial use whereas division B is manufactures the containers and stores product 'AAA' by using protective materials 'BBB'. AB ltd is exploring the possibility of closing down the division B and outsource the work to an outside company X Ltd.

   (i) The details of expenses of division B during the previous year is as given below :

	For manufacturing Container (Rs)	For storing Product AAA (Rs)
Direct Material	6,35,000	
Cost of protective material BBB		1,75,000
Direct labour	2,50,000	1,20,000
Maintenance of Machine	96,000	
Depreciation of Machine	44,000	
Rent of warehouse		1,25,000
Manufacturing overheads	1,70,000	
Administrative overheads apportioned to division B	2,40,000	60,000

   (ii) X Ltd after full assessment of requirement offered to manufacture the containers at a cost of Rs 12,00,000 per annum on a contact basis and store the product 'AAA' at a cost of Rs 5,00,000 per annum.

   (iii) The stock of protective materials costing Rs 4,25,000 with division B, if disposed off, will fetch only 60% of its value.

   (iv) In case of closure of manufacturing department of division B, the terminal benefits to be given to employees who can be transferred to division A is estimated to be Rs 2,00,000 whereas the same for store is Rs 1,00,000.

(v) In case of closure of B, 75% of the administrative overheads of B will be curtailed.

(vi) Old machine of division B, if disposed off, would fetch Rs 1,50,000.

You are required to evaluate the following proposals on the basis of 5 years term, taking cost of capital 12% per annum :

Proposal 1 : Closing division B and manufacturing & storing may be given to X Ltd.

Proposal 2 : Continue division B for manufacturing & Storing may be given to X ltd

Proposal 3 : Continue division for Storing only and manufacturing may be given to X Ltd.

Marginal Costing

3. (a) How is marginal costing different from absorption costing? What are the various limitations attributed to marginal costing?

(b) Jay Kay Limited is a single product manufacturing company. The following information relates to the months of May and June, 2009:

		May	June
		Rs.	Rs.
(i)	Budgeted Costs and Selling prices:		
	Variable manufacturing cost per unit	2.00	2.20
	Total fixed manufacturing cost (based on budgeted output of 25,000 units per month)	40,000	44,000
	Total fixed marketing cost	14,000	15,400
	Selling price per unit	5.00	5.50
(ii)	Actual production and sales:		
		Units	Units
	Production	24,000	24,000
	Sales	21,000	26,500

(iii) There was no stock of finished goods at the beginning of May, 2009. There was no wastage or loss of finished goods during May or June, 2009.

(iv) Actual costs incurred corresponded to those budgeted for each month.

You are required to calculate the relative effects on the monthly operating profits of applying: (i) Absorption costing and (ii) Marginal costing.

Decision making

4. ABC Ltd is in the business of publishing, printing and distributing a range of catalogues and other manuals. The management have now decided to discontinue printing and distribution and concentrate solely on publishing. Instead of ABC Ltd, XYZ Ltd shall now print and distribute the range of catalogues and other manuals. This shall be done on behalf of ABC Ltd . commencing either at 30 June 2009 or 30 November, 2009. XYZ Ltd

will receive Rs. 65,000 per month for a contract which will commence either at 30 June, 2009 or 30 November 2009.

The results of ABC Ltd for a typical month are as follows:

	Publishing	Printing	Distribution
	Rs. '000	Rs. '000	Rs. '000
Salaries and wages	28	18	4
Materials and supplies	5.5	31	1.1
Occupancy costs	7	8.5	1.2
Depreciation	0.8	4.2	0.7

Information related to the possible closure proposals is as follows:

(i) Two specialist staff from printing will be retained at their present salary of Rs. 1,500 each per month in order to fulfill a link function with XYZ Ltd One further staff member will be transferred to publishing to fill a staff vacancy through staff turnover, anticipated in July. This staff member will be paid at his present salary of Rs. 1,400 per month which is Rs. 100 more than that of the staff member who is expected to leave. On closure all other printing and distribution staff will be made redundant and paid an average of two months redundancy pay.

(ii) The printing department has a supply of materials (already paid for) which cost Rs. 18,000 and which will be sold to XYZ Ltd. for Rs. 10,000 if closure takes place on 30 June, 2009. Otherwise the material will be used as part of the July 2009 printing requirements. The distribution department has a contract to purchase pallets at a cost of Rs. 500 per month for July and August, 2009. A cancellation clause allows for non-delivery of the pallets for July and August for a one-off payment of Rs. 300. Non-delivery for August only will require a payment of Rs. 100. If the pallets are taken from the supplier, XYZ Ltd has agreed to purchase them at a price of Rs. 380 for each month's supply which is available. Pallet costs are included in the distribution material and supplies cost stated for a typical month.

(iii) Company expenditure on apportioned occupancy costs to printing and distribution will be reduced by 15% per month if printing and distribution departments are closed. At present, 30% of printing and 25% of distribution occupancy costs are directly attributable costs which are avoidable on closure, whilst the remainder are apportioned costs.

(iv) Closure of the printing and distribution departments will make it possible to sub–let part of the building for a monthly fee of Rs. 2,500 when space is available.

(v) Printing plant and machinery has an estimated net book value of Rs. 48,000 at 30 June, 2009. It is anticipated that it will be sold at a loss of Rs. 21,000 on 30 June, 2009. If sold on 30 November, 2009 the prospective buyer will pay Rs. 25,000.

(vi) The net book value of distribution vehicles at 30 June, 2009 is estimated as Rs. 80,000. They could be sold to the original supplier at Rs. 48,000 on 30 June, 2009. The original supplier would purchase the vehicles on 30 November, 2009 for a price of Rs. 44,000.

Required:

Using the above information, prepare a summary to show whether ABC Ltd. should close the printing and distribution departments on financial grounds on 30 June, 2009 or on 30 November, 2009. Explanatory notes and calculations should be shown. Ignore taxation.

Decision Making

5. Unique Products manufactures and sells in a year 20,000 units of a particular product to definite customers at a price of Rs.100 per unit. The concern has a capacity to produce 25,000 unit of the product per annum. To produce beyond 25,000 units per annum, the concern will have to install a new equipment at a cost of Rs.15 lakhs. The equipment will have a life span of 10 years and will have no residual value. There is an offer from a client to purchase 10,000 units of the product regularly at a price of Rs.90 per unit. The order accepted, will have to be over and above the existing level of production of 20,000 units.

   The cost structure is as under:

	Per Unit
Direct Material	30
Direct Labour	20
Variable Overhead	10
Profit	20
Fixed Overhead	Rs. 4,00,000

   During the coming year, it has been estimated that the cost of direct material, as company the current year will increase by 10%. Because of certain wage agreement direct labour will increase by 25%. Fixed overheads will increase by 10%. If the new order for 10,000 is accepted, fixed overheads will increase further by Rs.60,000 due to increased administrative charges.

   You are required to analyse whether the concern should accept the order or instead of that try to secure order for the balance unused capacity, as available now, through some sales promotion expenses which will be Rs.50,000 per annum. Ignore financial charges for the new investment.

Areas of Decision Making

6. R Ltd. has spare capacity in two of its manufacturing departments – Department 4 and Department 5. A five-day week of 40 hours is worked, but there is only enough internal work for 3 days per week so that 2 days per week (16 hours) could be available in each department. R Ltd. has sold this time to another manufacturer, but there is some concern about the profitability of this work.

The accountant has prepared a table giving the hourly operating cost in each department. The summarised figures are as follows:

	Department 4	Department 5
	Rs.	Rs.
Power costs	40	60
Labour costs	40	20
Overhead costs	40	40
	120	120

The labour is paid on a time basis and there is no charge in the weekly wage bill whether or not the plant is working at full capacity. The overhead figures are based on firm's current overhead absorption rates (fixed and variable) when the departments are operating at 90% of full capacity (assume a 50 week year). The budgeted fixed overhead attributed to Department 4 is Rs. 36,000 p.a. and that for Deptt. 5 Rs. 50,400 p.a.

As a short term measure the company has been selling processing time to another manufacturer @ Rs. 70 per hour in either departments. The customer is willing to continue this arrangement and to purchase any spare time available, but R Ltd. is considering the introduction of a new product on a minor scale to absorb the spare capacity.

Each unit of the new product would require 45 minutes in Deptt. 4 and 20 minutes in Deptt. 5. The variable cost of the required input material is Rs. 10 per unit. The market study indicated as follows:

(i) with a selling price of Rs. 100, the demand would be 1,500 units p.a.

(ii) with a selling price of Rs. 110, the demand would be 1,000 units p.a.

(iii) with a selling price of Rs. 120, the demand would be 500 units p.a.

You are required to calculate the best weekly programme for the spare time in the two manufacturing departments, to determine the best price to charge for the new product and to quantity the weekly gain that this programme and price should yield.

Standard Costing and variance Analysis

7. ABC Ltd manufactures a product '1+7 ASCS' at its plant at Faridabad, the maximum capacity of which is 200 units per month. Details of raw material which go into the making of 1 unit of '1+7 ASCS' are provided to you below;

S. No.	Raw Material description	Standard quantity per finished unit (No)	Standard purchase price per unit (Rs 00)
1	A	1	6
2	B	2	5
3	C	3	4
4	D	4	3

5	E	5	2
6	F	6	1

Standard Fixed overheads are Rs. 20,00,000 per month whereas the standard variable overhead rate has been estimated as equal to Rs. 1,400 per unit of finished good. You are required to compute the

(a) standard cost of the product

(b) compute the production volume variance in case the company produces and sells only 100 units of finished goods in the concerned month.

(c) compute the usage and material price variances considering the following actual data(actual production and sale: 100 units)

Raw material description	Actual quantity consumed (Nos)	Actual price(Rs 00)
A	102	7
B	201	6
C	310	5
D	415	4
E	540	3
F	610	2

(d) Assuming no deviations in the actual selling price (Rs 30,000) and the actual overheads from what was projected in standards , you are required to compute actual profits .

Standard Costing and Variance Analysis

8. Budgetary control and standard costing are used within an insurance company and a standard cost of Rs. 20 has been set for obtaining and issuing each new life policy.

Prior to the commencement of the annual financial period, the life business manager had forecast that 7,500 policies would be sold during the year and the Rs. 20 standard cost was based on the following budgeted costs for the department. Actual costs are also shown.

Code	Budget	Actual
301	Rs. 30,000	Rs. 33,750
302	30,000	28,500
303	15,000	13,000
431	45,000	50,000
599	30,000	33,000
	1,50,000	1,58,250

At the end of the year, it was ascertained that

1. 6,750 new life policies had been issued.
2. the sales staff and underwriting staff received as salaries pay award of 12½% which had been back-dated to the beginning of the year and this had not been included in the budget.
3. expenses on codes 302, 303 and 431 are regarded as direct costs which vary with activity, and those on code 301 are treated as a direct fixed cost whilst those on code 599 are an indirect fixed cost.

You are required to

(i) present a statement (or control report) for the life business manager showing the variances which have arisen,

(ii) comment on the likely cause or causes for each variance identifying, so far as you can from the information given, how much of each variance arises from price differences and how much can be related to efficiency or inefficiency.

Pricing Decisions

9. (a) A manufacturer has three products X, Y, and Z. Currently sales, cost and selling price details and processing time requirements are as follows:

	Product X	Product Y	Product Z
Annual sales (units)	6000	6000	750
Selling price (Rs.)	20.00	31.00	39.00
Unit cost (Rs.)	18.00	24.00	30.00
Required per unit (hours)	1	1	2

The firm is working at full capacity (13,500 processing hours per year). Fixed manufacturing overheads are absorbed into unit costs by a charge of 200% of variable cost. This procedure fully absorbs the fixed manufacturing overhead. Assuming that:

(i) processing time can be switched from one product line to another.

(ii) The demand at current selling prices is:

Product X	Product Y	Product Z
11000	8000	2000

(iii) The selling prices are not to be altered. You are required to calculate the best production programme for the next operating period and to indicate the increase in net profit that this should yield. In addition identify the shadow price of a processing hour.

(b) A review of the selling prices is in progress and it has been estimated that, for each product, an increase in the selling price would result in a fall in demand at the rate of 2000 units for an increase of Rs.1 and similarly, that a decrease of Rs.1 would increase demand by 2000 units. Specifically the following price/demand relationships would apply:

Product X		Product Y		Product Z	
Selling Price Rs.	Estimated Demand	Selling Price Rs.	Estimated Demand	Selling Price Rs.	Estimated demand
24.50	2000	34.00	2000	39.00	2000
23.50	4000	33.00	4000	38.00	4000
22.50	6000	32.00	6000	37.00	6000
21.50	8000	31.00	8000	36.00	8000
20.50	10000	30.00	10000	35.00	10000
19.50	12000	29.00	12000	34.00	12000
18.50	14000	28.00	14000	33.00	14000

From this information you are required to calculate the best selling prices, the revised best production plan and the net profit that this plan should produce.

Pricing Decisions

10. Z Electronics Co (ZEC) has made an agreement with Tuzuki of Japan for import of kits of Automatic Washing Machine in completely knocked down (CKD) condition. The terms of agreement are :

(i) Tuzuki will supply some items keeping 20% margin on cost. These imported items are of value of 40% of FOB price of Washing Machine and balance 60% will be locally manufactured.

(ii) ZEC will pay a lump sum of Rs 300 lakhs for technical know how and drawing for manufacturing of 3 lakhs washing machines.

(iii) ZEC will also pay a royalty at 10% of selling price fixed by it in the local market less landed cost of imported kits and cost of locally procured components.

The following related information is also available :

(i) FOB price for washing machine is Rs 8000.

(ii) Insurance & freight is Rs 300 per set of imported items

(iii) Effective custom duty is @ 40% on CIF price

(iv) Assembling & other overhead costs will be Rs 1,000 per set.

(v) Expected profit is 20% on selling price

You are required to calculate the selling price of Washing machine (rounded to Rs 10)

Transfer Pricing

11. The interdivisional transfer prices at ABC Ltd are fixed by using a cost plus return on investment approach. The budget details for Division A for the year 2008-2009 are as follows;

Investment in Division A	Rs.
Fixed Assets	5,00,000
Current Assets	3,00,000
Debtors	2,00,000
Annual Fixed Cost for the Division	8,00,000
Variable cost per unit of the product	10
Budgeted volume	4,00,000 units per year
Desired ROI	28%

Determine the Transfer price for Division A?

Transfer Pricing

12. ABC Ltd which is manufacturing consumer products has two divisions Assembling and Finishing. The two divisions are operating as cost centres

(i) Present activities and cost involved in Assembling division & Finishing division and in a year:

Assembly Division :

No of sets assembled : 12,000

Manufacturing of parts (including material) : Rs 6.00 lakhs

Parts purchased from market : Rs 4.00 lakhs

Other Variable cost : Welding cost : Rs 5 lakhs and Assembling cost : Rs 9.00 lakhs

Fixed cost for the unit : Rs 6 lakhs

25% of the production of Assembly division is sold in the market at a price of Rs 300 per set and 75% is transferred to Finishing Division at Rs 280

Cost incurred in Finishing Division :

Painting cost : Rs 5.00 lakhs

Polishing cost : Rs 1.00 lakhs
Other fixed cost Rs 4.00 lakhs.
Selling Price per set is Rs 450.

(ii) Division Assembly has proposed for expansion of their division for an enhancement of capacity by 20% at a cost Rs 20 lakhs. It is indicated that there will be no change in factory fixed cost in the operation of additional volume of job. Division Assembly proposes to maintain the transfer to finishing division to the existing level and selling additional sets to market at present price.

(iii) Division Finishing has proposed for a transfer of whole of the output of Assembly division at a price of Rs 280 per unit and the additional units can be sold in the market at existing price which will involve advertisement expenses to the extent of Rs 4.00 lakhs and fixed cost in the division will go up by Rs 1.00 lakhs.

(iv) Assembly division claims that transfer rate of Rs 280 is irrational in a sense of undue favour to Finishing division at their cost and Finishing Division is given the advantage of market price for their products whereas the Assembly division is deprived of that advantage. Assembly division agreed to transfer the whole of its output to Finishing Division at a price of Rs 300.

You are required to give your recommendation assuming opportunity cost of capital is 15%

Target Costing

13. (a) What is Target Costing and list the steps involved in target costing process with the help of a block diagram.

(b) You are the manager of a paper mill (XYZ Ltd) and have recently come across a particular type of paper, which is being sold at a substantially lower rate (by another company –ABC Ltd) than the price charged by your own mill. The value chain for one use of one tonne of such paper for ABC Ltd is as follows,

ABC Ltd. ⟶ Merchant ⟶ Printer ⟶ Customer

ABC Ltd sells this particular paper to the merchant at the rate of Rs 1,466 per tonne. ABC Ltd pays for the freight which amounts to Rs 30 per tonne. Average returns and allowances amount to 4% of sales and approximately equals Rs 60 per tonne.

The value chain of your company, through which the paper reaches the ultimate customer is similar to the one of ABC Ltd. However, your mill does not sell directly to the merchant, the latter receiving the paper from a huge distribution center maintained by your company at Haryana. Shipment costs from the mill to the Distribution Center amount to Rs 11 per tonne while the operating costs in the Distribution Center have been estimated to be Rs 25 per tonneThe return on investments required by the Distribution Center for the investments made amount to an estimated Rs 58 per tonne.

You are required to compute the "Mill manufacturing Target Cost" for this particular paper for your company. You may assume that the return on the investment expected by your company equals Rs 120 per tonne of such paper.

Costing of Service Sector

14. HAL is an aircraft manufacturer that has introduced a new airplane model. It expects the plane to cost Rs. 150,000,000 to manufacture to (not including development cost) but their products have historically exhibited an 85% experience curve. Assuming the same experience rate will apply to this product.

    1. Compute the cost of computing the each of the first five planes
    2. Compute the average cost per plane to produce the first 25 planes.

Activity Based Cost Management

15 ABC Ltd plans to use activity-based costing to determine it product costs. It presently, uses a single plantwide factory overhead rate for allocating factory overhead to products, based on direct labour hours. The total factory overhead cost is as follows:

Department	Factory overhead
	Rs.
Production Support	12,25,000
Production (factory overhead only)	1,75,000
Total cost	14,00,000

The Company determined that it performed four major activities in the Production Support Department. These activities, along with their budgeted costs, are as follows:

Production Support Activities	Budgeted Cost
	Rs.
Set up	4,28,750
Production control	2,45,000
Quality control	1,83,750
Materials management	3,67,500
Total	12,25,000

ABC Ltd estimated the following activity-base usage quantities and units produced for each of its three products:

Products	Number of Units	Direct Labour hours	Setups	Production Orders	Inspections	Material requisitions
Product K	10,000	25,000	80	80	35	320
Product L	2,000	10,000	40	40	40	400
Product M	50,000	1,40,000	5	5	0	30
Total cost	62,000	1,75,000	125	125	75	750

Instructions:

1. Determine the factory overhead cost per unit for Products K, L and M under the single plantwide factory overhead rate method. Use direct labor hours as the activity base.
2. Determine the factory overhead cost per unit for Products K, L and M under activity-based costing.
3. Which method provides more accurate product costing? Why?

Activity Based Cost Management

16. ALPHA Limited specializes in the distribution of pharmaceutical products. It buys from the pharmaceutical companies and resells to each of the three different markets.

    (i) General Supermarket Chains

    (ii) Drugstore Chains

    (iii) Chemist Shops

    The following data for the month of April, 2009 in respect of ALPHA Limited has been reported:

	General Supermarket Chains	Drugstore Chains	Chemist Shops
Average revenue per delivery	Rs. 84,975	Rs. 28,875	Rs. 5,445
Average cost of goods sold per delivery	Rs. 82,500	Rs. 27,500	Rs.4,950
Number of deliveries	Rs. 330	Rs. 825	Rs. 2,750

In the past, ALPHA Limited has used gross margin percentage to evaluate the relative profitability of its distribution channels.

The company plans to use activity –based costing for analysing the profitability of its distribution channels.

The Activity analysis of ALPHA Limited is as under:

Activity Area	Cost Driver
Customer purchase order processing	Purchase orders by customers
Line-item ordering	Line-items per purchase order
Store delivery	Store deliveries
Cartons dispatched to stores	Cartons dispatched to a store per delivery
Shelf-stocking at customer store	Hours of shelf-stocking

The April, 2009 operating costs (other than cost of goods sold) of ALPHA Limited are Rs. 8,27,970. These operating costs are assigned to five activity areas. The cost in each area and the quantity of the cost allocation basis used in that area for April, 2009 are as follows:

Activity Area	Total costs in April, 2009	Total Units of Cost Allocation Base used in April, 2009
Customer purchase order processing	Rs. 2,20,000	5,500 orders
Line-item ordering	Rs. 1,75,560	58,520 line items
Store delivery	Rs. 1,95,250	3,905 store deliveries
Cartons dispatched to store	Rs. 2,09,000	2,09,000 cartons
Shelf-stocking at customer store	Rs. 28,160	1,760 hours

Other data for April, 2009 include the following:

	General Supermarket Chains	Drugstore Chains	Chemist Shops
Total number of orders	385	990	4,125
Average number of line items per order	14	12	10
Total number of store deliveries	330	825	2,750
Average number of cartons shipped per store delivery	300	80	16
Average number of hours of shelf-stocking per store delivery	3	0.6	0.1

Required:

(i) Compute for April, 2009 gross-margin percentage for each of its three distribution channels and compute ALPHA Limited's operating income.

(ii) Compute the April, 2009 rate per unit of the cost-allocation base for each of the five activity areas.

(iii) Compute the operating income of each distribution channel in April, 2009 using the activity-based costing information. Comment on the results. What new insights are available with the activity-based cost information?

(iv) Describe four challenges one would face in assigning the total April,2009 operating costs of Rs. 8,27,970 to five activity areas.

Business Environment & Life Cycle Costing

17 (a) What do you understand by MRP? What are its objectives?

(b) Describe the concept of Back flushing as used in the JIT system. What problems need to be addressed before implementing such a concept? Briefly discuss.

(c) What is product life cycle costing? What are the costs that you would include in product life cycle cost?

Total Quality Management & Value Chain Analysis

18 (a) Define Total Quality Management? What are the six Cs for successful implementation of TQM?

(b) What is the concept of 'Value-chain' and what steps are involved in value chain analysis approach for assessing competitive advantages?

Budgeting Control and Performance Measurement

19. (a) Distinguish between fixed budget and flexible budget.

(b) Explain the role of bench marking in continuous improvement in an organisation.

(c) The performance of a company at two levels of operations during 2008-09 is as under:

Capacity utilisation	50%	60%
Direct materials	Rs.1,00,000	1,20,000
Direct wages	Rs.1,60,000	1,92,000
Production overheads	Rs.6,00,000	6,50,000
Adm. Overheads	Rs.1,20,000	1,20,000
Selling overheads	Rs.2,20,000	2,40,000

The company produced 12,000 units at 60% capacity utilisation. The profit margin is 20% on sales.

During the next year 2009-10, the company is poised for increasing the capacity utilisation to 75%. The company desires to have the same profit margin as in 2008-09. The following percentage changes in costs are expected to be applicable in the next year.

- Direct material prices will increase by 5%
- Direct wage rates will increase by 3%.
- Direct labour efficiency will fall by 4%.
- Variable production overheads will increase by 6%.
- Fixed production overheads will increase by 10% upto 80% capacity utilisation and by 22% thereafter.
- Variable selling expenses will increase by 10%.
- Fixed selling expense will increase by 8%.
- Administrative Overheads will increase by 15%.

The company expects to receive an export order for 3000 units while operating at 75% capacity utilisation. The anticipated export price offer is Rs.92 per unit.

Required:

(i) Prepare a flexible budget for 2009-10 and determine the cost per unit of output at the capacity utilisation levels of 75% and 90%.

(ii) Calculate the sales value and profit for 2009-10 at 75% capacity.

(iii) Advise the management as to whether or not the export order at the price of Rs.92 per unit should be accepted.

Linear Programming

20. (a) The simplex tableau for a maximisation problem of linear programming is given below:

Product mix.(x_i)	x_1	x_2	s_1	s_2	Quantity (bi)
x_2	1	1	1	0	10
s_2	1	0	–1	1	3
c_j	4	5	0	0	
z_j	5	5	5	0	50
$z_j–c_j$	1	0	5	0	

Answer the following questions, giving reasons in brief:

(i) Is the above solution optimal?

(ii) Are there more than one optimal solution?

(iii) Is this solution degenerate?

(iv) Is this solution feasible?

(v) If s_1 is slack in machine A (in hours/week) and s_2 is slack in machine B (in hours/ week), which of these machines is being used to the full capacity when producing according to this solution?

(vi) A customer would like to have one unit of product x_1 and is willing to pay in excess of the normal price in order to get it. How much should the price be increased in order to ensure no reduction of profit?

(vii) Machine A (associated with slack s_1, in hours/week) has to be shut down for repairs for 2 hours next week. What will be the effect on profits?

(viii) How many units of the two-product x_1 and x_2 are being produced according to this solution and what is the total profit?

(b) (a) The management accountant of Atul Enterprises Ltd. has suggested that a linear programming model might be used for selecting the best mix of five possible products, A, B, C, D and E.

(i) The following information is available:

	Per unit of product				
	A	B	C	D	E
	Rs.	Rs.	Rs.	Rs.	Rs.
Selling price	48	42	38	31	27
Costs:					
Materials	15	14	16	15	16
Direct labour	18	16	6	4	4
Fixed overheads*	9	8	3	2	2
Total costs	42	38	25	21	22
Net profits	6	4	13	10	5

*based on 50% of direct labour cost.

(ii) Expected maximum unit demand per week for each product at the prices indicated:

A	B	C	D	E
1,500	1,200	900	600	600

(iii) Cost of materials includes a special component, which is in short supply; it costs Rs.3 a unit. Only 5,800 units will be available to the company during the week. The number of units of the special component needed for a unit of each product is:

A	B	C	D	E
1	1	3	4	5

(iv) Labour is paid at a rate of Rs.1.50 per hour and only 20,000 hours will be available in a week.

(v) The management of Atul Enterprises Ltd. has ruled that expenditure on materials must not exceed a sum of Rs.30,000.

(vi) All other resources are freely available in sufficient quantities for planned needs.

Formulate a linear programming model stating clearly the criterion you use.

The Transportation Problem

21. A ladies fashion shop wishes to purchase the following quantities of summer dresses:

Dress Size	I	II	III	IV
Quantity	100	200	450	150

Three manufacturers are willing to supply dresses. The quantities given below are the maximum they are able to supply of any given combination of orders for dresses:

Manufacturer	A	B	C
Total quantity	150	450	250

The shop expects the profit per dress to vary with the manufacturer as given below:

	Sizes			
	I	II	III	IV
Manufacturer	Rs.	Rs.	Rs.	Rs.
A	2.50	4.00	5.00	2.00
B	3.00	3.50	5.50	1.50
C	2.00	4.50	4.50	2.50

You are required to:

(a) use the transportation technique to solve the problem of how the orders should be placed on the manufacturers by the fashion shop in order to maximize profits: and

(b) explain how you know that there is no further improvement possible. Show your workings.

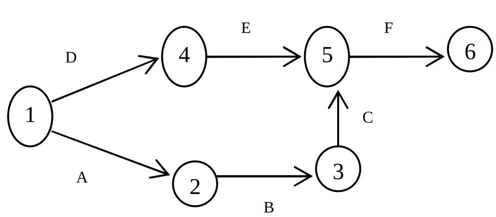
The Assignment Problem

22. Methods engineer wants to assign four new methods to work centers. The assignment of new methods will increase Production (in units) and they are given below. If only one method can be assigned to a work center, determine the optimum assignment.

Work Center / Methods	A	B	C
1	10	7	8
2	8	9	7
3	7	12	6
4	10	10	8

Critical Path analysis and PERT

23. In the project net work shown in the figure given below, the nodes are denoted by numbers and activities by letters. The normal and crash durations of the various activities along with Costs are shown below.



Activity	Normal Duration (Days)	Normal cost (Rs.)	Crash Duration (Days)	Crash cost
A	8	1800	6	2200
B	16	1500	11	2200
C	14	1800	9	2400
D	12	2400	9	3000
E	15	800	14	2000
F	10	2000	8	4000

Determine the least cost for 36 days schedule.

Critical Path Analysis and PERT

24. The activities involved in a PERT project detailed below:

Job	Duration		
	a = optimistic	m = most likely	b = pessimistic
1-2	4	7	16
2-3	7	13	31
3-5	6	12	18
7-8	5	20	29
5-8	2	5	8
6-7	4	10	28
4-5	4	7	16
1-6	3	6	15
2-4	3	6	9

Required:

(i) Draw a net work diagram.

(ii) Find the critical path after estimating the earliest and latest event times for all nodes.

(iii) Find the probability of completing the project before 35 weeks.

(iv) What is the chance of project duration exceeding 50 weeks?

Simulation

25. An investment corporation wants to study the investment projects based on three factors: market demand in units, price per unit minus cost per unit and the investment is required These factors are felt to be independent of each other. In analyzing a new consumer product, the corporation estimates the probability distributions.

Annual Demand		(Price-Cost) Per unit		Investment Required	
Units	Probability	Rs.	Probability	Rs.	Probability
20000	0.05	3.00	0.10	1750000	0.25
25000	0.10	5.00	0.20	2000000	0.50
30000	0.20	7.00	0.40	2500000	0.25
35000	0.30	9.00	0.20		
40000	0.20	10.00	0.10		
45000	0.10				
50000	0.05				

Using simulation process, repeat the trails 10 times, compute the return on investment for each trail taking these three factors into account .Approximately, what is the most likely return?

SUGGESTED ANSWERS

Basic Cost Concepts for Decision Making

1. (a) Cost classification is the process of grouping costs according to their characteristics. Costs are classified or grouped according to their common characteristics. Costs may be classified according to elements, according to functions or operations, according to their behaviour, according to controllability or according to normality.

The break up of the aggregate costs into relevant types, is an essential pre-requisite of decision making as well as of controlling costs. Classification of costs on different bases is thus necessary for various purposes. For the purpose of decision-making and control, costs are distinguished on the basis of their relevance to different type of decisions and control functions. The importance of distinguishing cost as direct or indirect lies in the fact that direct costs of a product or an activity can be accurately allocated while indirect costs have to be apportioned o the basis of certain assumptions. This is so because direct costs are controllable at the operational level whereas indirect costs are not amenable to such control.

(b) Cost information is required both for short-term and long-run managerial problems. Differential costs are of particular use in short-term problems which are non-repetitive, onetime, ad-hoc problems. The following are the most common short-term problems and areas where differential costs analysis may be deployed.

1. Accept – or – reject special order decisions.

2. Make – or – buy decisions.

3. Sell – or – process decisions.

4. Reduce – or – maintain price decisions.
5. Add – or – drop product decisions.
6. Operate – or shut down decisions.

(c) Relevant costs are pertinent or valid costs for a decision. These bear upon or 'influence decision' and are directly related to the decisions to be made. These are critical to the decisions, and have significance for it. These are the cots whish generally respond to managerial decision making, and have significance in arriving at correct conclusions. These costs are capable of making of difference in user-decisions and enter into a choice between alternative courses of action. In specific terms relevant costs for decisions are defined as "expected future costs that will differ under alternatives".

Relevant costs are futuristic in nature. These are the costs that are expected to occur during the time period covered by the decisions. These costs are different between alternative being considered. Only costs that differ among decisions alternatives are relevant to a decision.

Marginal Costing

2.

	Saving in case B discontinue Manufacturing	Saving in case B discontinue Storing
Direct Material / protective material	635	175
Direct Labour	250	120
Maintenance of Machine	96	
Depreciation of machine	44	
Rent of warehouse		125
Manufacturing overheads	170	
Reduction in administrative overheads	180	45
Total	1375	465

Evaluation of the proposals :

	Proposal 1	Proposal 2	Proposal 3
Saving of manufacturing expenses	1375		1375
Saving of storing expenses	465	465	
Total avoidable expenses (A)	1840	465	1375
Additional expenses to be incurred :			
Loss in sale of protective materials	170		170

Terminal benefit to employees	300	100	200
Total (B)	470	100	370
Net saving (A -B)	1370	365	1005
Sale value of Machine ©	150		150
Cash inflow in first year (D= A - B + C)	1520	365	1155
Contract value (E)	1700	500	1200
Net Cash flow in the first year(F= D - E)	-180	-135	-45
Cash flow in subsequent years (A - E)	140	-35	175
Cumulative cash flow value from 2nd year to 5th year (multiple factor 3.038 for 12%) (G)	425.32	-106.33	531.65
NPV (F + G)	245.32	-241.33	486.65

Hence, proposal 3 may be accepted i.e Division B may continue with storing and manufacturing may be given to outside firm X Ltd.

3. (a) Marginal Costing vs. Absorption Costing

1. While applying Marginal Costing only variable costs are considered for Product Costing and Inventory Valuation purposes whereas both fixed and variable costs are considered while using Absorption Costing.
2. Expenses are classified on the basis of their nature i.e, fixed or variable in Marginal Costing whereas the classification of expenses is done on the basis of functions while applying Absorption Costing.
3. Marginal Costing considers fixed costs as period costs whereas the same costs are considered to be inventoriable costs for Absorption Costing purposes.
4. Marginal Costing reports emphasise more on the Contribution quantum whereas Absorption Costing highlights Net Profits.
5. The difference in the magnitude of the opening and the closing stock does not effect the unit cost of production in case Product Costing is done using the Marginal Costing concepts. However, in case Absorption Costing is used the unit cost of production may be effected due to the impact of fixed overheads.
6. There is no related Volume Variance in case a Marginal Costing system is used. However, in case of an Absorption Costing system, Volume Variance plays a prominent role for decision making and control purposes.

Limitations of Marginal Costing

- ♦ The use of Marginal Costing necessitates the need to classify expenses as fixed and variable. Frequently most of the expenses are semi-variable and so need to be divided amongst their variable and fixed components. This is difficult in practical situations.

- ♦ Contribution by itself is not a guide towards attaining optimum profitability. It needs to be interpreted along with the key factor.
- ♦ It is not practical to exclude overheads of fixed nature for valuing work-in-progress of large contracts. The use of Marginal Costing does not provide with useful results for decision making purposes nor does it give a correct valuation of the work-in-progress in such cases.
- ♦ Marginal Costing ignores the time factor as well as the investment involved for decision making purposes. For example two products may have the same Marginal Cost , however one of them can be produced in a shorter time and hence it should be the preferable produce. However , Marginal Costing ignores this time factor. Similarly the quantum of investment involved for alternative uses available are not considered in Marginal Costing.

(b) (a) Quantity tally:

		May 2009	June 2009
Opening Stock	units	–	3,000
Production	units	24,000	24,000
Total	units	24,000	27,000
Sales	units	21,000	26,500
Closing Stock	units	3,000	500
Fixed manufacturing overheads	Rs.	40,000	44,000
Budgeted output	units	25,000	25,000
Fixed overheads absorption rate per unit	Rs.	1.60	1.76

(i) Profitability based on absorption costing:

	May 2009	June 2009
	Rs.	Rs.
Sales:		
May: 21,000 units @ Rs. 5.00	1,05,000	
June: 26,500 units @ Rs. 5.50		1,45,750
Production Costs:		
Variable: May 24,000 units @ Rs. 2.00	48,000	
June 24,000 units @ Rs. 2.20		52,800
Fixed: May 24,000 units @ Rs. 1.60	38,400	
June 24,000 units @ Rs. 1.76		42,240

Total production costs	86,400	95,040
Add: Opening stock		
May Nil		
June 3,000 units @ Rs. 3.60*		10,800
Total	86,400	1,05,840
Less: Closing stock		
May 3,000 units @ Rs. 3.60*	10,800	
June 500 units @ Rs. 3.96*		1,980
Production cost of goods sold	75,600	1,03,860
Marketing fixed costs	14,000	15,400
Total cost of goods sold	89,600	1,19,260
Profit (Sales – COGS)	15,400	26,490
Budgeted output		
Actual output		
Shortfall		
Under recovery of fixed overheads		
May 1,000 units @ Rs. 1.60	1,600	
June 1,000 units @ Rs. 1.76		1,760
Net profit	13,800	24,730

*Total cost = VC + FC

May 2.00 + 1.60 = 3.60

June 2.20 + 1.76 = 3.96

(ii) Profitability based on marginal costing:

	May 2009	June 2009
	Rs.	Rs.
Sales	1,05,000	1,45,750
Production cost – variable	48,000	52,800
Add: Opening stock		
May Nil		
June		6,000
Total	48,000	58,800
Less: Closing stock		
May 3,000 units @ Rs. 2.00	6,000	
June 500 units @ Rs. 2.20		1,100

Variable cost of goods sold			42,000	57,700
Contribution			63,000	88,050
Fixed costs:	May	June		
Production	40,000	44,000		
Marketing	14,000	15,400	54,000	59,400
Net profit			9,000	28,650

Decision Making

4. The costs/benefits of closing on 30 November, 2009 instead of closing on 30 June, 2009 are:

	Rs.	Rs.
Payments to XYZ Ltd avoided (5 months @ Rs. 65,000)		3,25,000
*Salaries and wages cost		
5 months @ (Rs. 18,000 + Rs. 4,000 – Rs. 3,000 + Rs. 1,300)		(1,01,500)
**Printing materials		
(5 months @ Rs. 31,000) – Rs. 18,000 + Rs. 10,000)		(1,47,000)
***Distribution materials		(5,280)
Occupancy costs		
****Printing	17,212.50	
*****Distribution	2,175.00	
		(19,387.50)
Loss of sub-letting income (5 months @ Rs. 2,500)		(12,500)
******Additional loss on sale of plant		(2,000)
Additional loss on sale of vehicles (Rs. 48,000 – Rs. 44,000)		(4,000)
Net benefit of closing on 30 November		33,332.50

The plant should remain open until 30 November.

* The total salaries equal Rs. 22,000 (Rs. 18,000 + Rs. 4,000) but two staff will be retained so the net saving of closing on 30 June is reduced by their salaries (Rs. 3,000 per month). If closure does not occur until November, the vacancy in the publishing department will need to be filled (at Rs. 1,300 per month) until closure in November when the transfer occurs. The redundancy pay will arise whenever closure occurs and is therefore irrelevant.

** The future cash outflow on printing materials is Rs. 31,000 per month for five months less the Rs. 18,000 held in stock. However, the opportunity to sell the stock is lost, therefore, there is an additional cost of Rs. 10,000.

*** If the department is closed then the options are (from note (ii) in the question):

(i) Accept both deliveries, pay for them and sell the goods to XYZ Ltd:

$(2 \times$ Rs. $500) - (2 \times$ Rs. $380) =$ Rs. 240 net cost.

(ii) Accept the July delivery, pay for it, sell it to XYZ Ltd and pay the cancellation cost for August:

(Rs. 500 – Rs. 380) + Rs. 100 = Rs. 220 net cost.

(iii) Cancel both deliveries at a net cost of Rs. 300.

The lowest cost option would be selected if closure occurred, therefore this is a benefit of continuing to November.

The distribution material costs to November are (5 months @ Rs. 1,100) – Rs. 220 = Rs. 5,280.

**** Attributable costs are [(Rs. 8,500 × 30%) + (Rs. 8,500 × 70% × 15%)] × 5 months = Rs. 17,212.50.

***** Attributable costs are [(Rs. 1,200 × 25%) + (Rs. 1,200 × 75% × 15%)] × 5 months = Rs. 2,175.

******

	Rs.	
Net book value	48,000	
June sale	21,000	loss
Therefore June proceeds	27,000	
November proceeds	25,000	
Additional loss	2,000	

Decision Making

5. Comparative profit Statement (based on Revised Cost Structure)

	Proposal 1 Sell 20,000 units only	Proposal 2 Secure orders for 5,000 additional units (unused capacity) and sell 25,000 units	Proposal 3 Accept the new order for 10,000 additional units and sell 30,000 units
	Rs.	Rs.	Rs.
Total sales revenue (A)	20,00,000	25,00,000	29,00,000
	(Rs.20,000 units × Rs.100)	25,000 units × Rs.100)	(20,000 units × 100 + 10000 units × 90)
Direct Material	6,60,000	8,25,000	9,90,000
	(20000 units × Rs. 33)	(25,000 units × Rs. 33)	(30,000 units × Rs. 33)
Director Labour	5,00,000	6,25,000	7,50,000

	(20,000 units × Rs.25)	(Rs.25,000 units × Rs. 25)	(30,000 units × Rs.25)
Variable overhead	2,00,000	2,50,000	3,00,000
	(20,000 units × Rs.10)	(25,000 units × Rs.10)	(30,000 units × Rs.10)
Fixed overheads	4,40,000	4,40,000	4,40,000
	(Rs.4,00,000+ Rs.40,000)		
Add: Administrative charges	-	-	60,000
Add: Sales promotion expenses	-	50,000	-
Depreciation (New equipment)			1,50,000
Total cots (B)	18,00,000	21,90,000	26,90,000
Profit (C) = [(A) – (B)]	2,00,000	3,10,000	2,10,000

Analysis

An analysis of the profit figures of M/s Unique products under three proposals clearly shows that it is maximum under proposal 2. Therefore, it is advisable for the concern to produce and sell 25,000 units @ Rs.100/- per unit and utilise its full production capacity.

Areas of Decision Making

6. The relevant cost of producing the new product is the variable cost plus the lost contribution from selling the processing time to another manufacturer. It is given that, the main product will absorb 3 days per week.

Calculation of variable overhead rates

	Dept. 4	Dept. 5
Normal Hrs.per annum (0.9×40 hr×50 wks)	1,800 hrs	1,800hrs
Fixed O.H. rate/hr. (Rs.)	20 (36,000/1,800)	28(50,400/1800)
Total O.H. rate/hr (given) (Rs.)	40	40
Thus variable OH rate/hr (Rs.)	20	12

The variable costs per hour are:

Department 4 : Power Cost Rs 40 + Variable Cost Rs 20 = Rs 60

Department 5 : Power Cost Rs 60 + Variable Cost Rs 12 = Rs 72

Note: labour costs are fixed (given).

If the new product is not developed, dept. 4 shall sell unused processing time at Rs. 70 per hour. It is not profitable for Dept. 5 to sell processing time at Rs. 70 per hour since the variable costs is more at Rs. 72. Therefore the relevant cost per processing hour are

Dept. 4 Rs. 70 (Rs. 60 variable cost + Rs. 10 lost contribution for selling processing time)

Dept. 5 Rs. 72

Relevant cost for producing the new product

	Rs
Direct Material (Given)	10.00
Dept. 4, variable operating cost (0.75 hr $\times$Rs. 70)	52.50
Dept. 5 variable operating cost (0.33 hr. $\times$ Rs. 72)	24.00
Relevant cost	86.50

Additional contribution for various selling prices/demand levels

	Rs.	Rs.	Rs.
Selling price per unit	100	110	120
Restricted demand (Units)	* 1067	1000	500
Relevant cost (Rs)	86.50	86.50	86.50
Contribution (Rs)	13.50	23.50	33.50
Total Contribution (Rs)	14,404.50	23,500	16,750

* Dept 4 (800 Hrs $\times \frac{4}{3}$) = 1,067 units

* Dept. 5 (800 Hrs $\times$ 3) = 2400 units

Hence selling 1000 units @ Rs. 110 per unit will achieve optimum contribution.

Computation of spare time for production of 1,000 units pa

	Department 4	Department 5
Time required per unit (Hours)	$\frac{3}{4}$	$\frac{1}{3}$
Total time for producing 1,000 units (Hours)	750	334
Time available (Hours)	800	800
Spare time (Hours)	50	466
Spare time per week (Hours)	1	9.32

Therefore Dept 4 can sell 1 hr. per week at Rs. 70 per hour.

It is not profitable to sell spare capacity of 9.32 hrs. / week at the existing rate of Rs. 70 per hour.

Weekly gain from this programme

	Rs.
Selling price	110
Variable cost	
Direct materials	10
Dept. 4 variable operating cost 0.75×60	45
Dept. 5 variable operating cost 0.33×72	24
	79
Contribution / unit	31
Weekly sale	20 units
Additional contribution / week	620
Plus contribution of selling 1 hr (selling price – variable cost = 70-60)	10
Total contribution	630
Without the new product the weekly contribution 16 hours × Rs. 10 per hr	160
Additional gain for introducing the new product	470

Standard Costing and Variance Analysis

7. (a) Standard Cost Sheet

Description	Cost per unit of Finished Good
Standard Raw Material Cost	Rs 5,600
Variable Overheads	Rs 1,400
Standard Fixed Overheads	Rs 10,000
Standard Cost per Unit of Finished Good	Rs 17,000

(b) Production Volume Variance

Unutilised capacity × Standard Fixed Cost per Finished Good

100 × Rs 10,000 = Rs 10,00,000 Adverse

(c) Usage and Material Price Variance (Actual Production : 100 Units)

Raw Mat.	Std Qty/FG	Std Qty on actual prod	Actual Qty on actual prod	Act Price per Ut of RM(Rs)	Std Price per Ut of RM (Rs)	Usage Variance (Rs)	Price Variance (Rs)
A	1	100	102	700	600	(1,200)	(10,200)
B	2	200	201	600	500	(500)	(20,100)

C	3	300	310	500	400	(4,000)	(31,000)
D	4	400	415	400	300	(4,500)	(41,500)
E	5	500	540	300	200	(8,000)	(54,000)
F	6	600	610	200	100	(1,000)	(61,000)
						(19,200)	(2,17,800)

(d)

Standard Profit (Rs 13,000 × 100)	Rs 13,00,000
Usage Variance	(19,200)
Price Variance	(2,17,800)
Production Volume Variance	(10,00,000)
Actual Profit	63,000

Standard Costing and Variance Analysis

8. (i) Control Report

Code		Fixed budget	Flexed Budget	Actual	Variances
		7,500 units	6,750 units	6750	
301	Sales salaries	Rs. 30,000	Rs. 30,000	33,750	Rs. 3750 (A)
302	Staff Commission	30,000	27,000	28,500	1,500 (A)
303	Staff expenses	15,000	13,500	13,000	500 (F)
431	Underwriting Staff	45,000	40,500	50,000	9,500 (A)
599	Other Admin Costs	30,000	30,000	33,000	3,000 (A)
		1,50,000	1,41,000	158,250	17,250 (A)

(ii) Sales Salaries. Rs. 3,750 (A) Rate Variance is due to unanticipated pay award.

Sales Commission – Rs. 3000 (F) is due to drop in activity and Rs. 1500 (A) may be due to increasing sales commission on selected policies or due to inefficiency.

Sales Expenses – Rs. 1500 reduction due to drop in activity and Rs. 500 (F) for improved control.

Underwriting Salaries – Rs. 4,500 (F) due to drop in activity, Rs. 5062 (A) due to unbudgeted salaries increases and Rs. 4,438 (A) due to inefficiency.

Other Administration – Rs. 3,000 (A) seem to have been caused by changes due to high cost suppliers or hiring temporary office staff

Product Pricing

9. (a) The question states that fixed manufacturing costs are absorbed into the unit costs

by a charge of 200% of variable cost. Therefore unit variable cost is one third of total unit cost.

Contribution per processing hour

	Product X	Product Y	Product Z
Selling price	20	31	39
Variable cost	6	8	10
Production contribution	14	23	29
Contribution per processing hour	14	23	14.50
Ranking	3	1	2

Optimal programme

	Output	Hours used	Contribution(Rs.)
Product Y	8000	8000	184000
Z	2000	4000	58.00
X	1500	1500	21.00
			263.00

Existing programme

	Output	Hours used	Contribution(Rs.)
Product X	6000	6000	84,000
Y	6000	6000	1,38,000
Z	750	1500	21,750
			2,43,750

Contribution and profits will increase by Rs.19250 if the optimal production programme is implemented. An additional hour of processing would be used to increase product X by one unit, thus increasing contribution by Rs.14. Therefore the shadow price (or opportunity cost) of one scarce processing hour Rs.14.

Capacity is limited to 13500 hours. It is therefore necessary to allocate output on the basis of marginal contribution per hour. Products X and Y each require processing hour, whereas product Z requires 2 processing hours. To simplify the calculations, hours are allocated in 2000 blocks. Consequently, the allocation of the fiALPHA 2000 hours will yield a marginal contribution of Rs.37000 from X, RS.52000 from Y and 29500 from Z Note that an output of 2000 units of Z will require 4000 processing hours, and will yield a contribution of Rs.59,000 In other words, the marginal contributions for X and Y in the above schedule are expressed in terms of blocks of 2000 hours, whereas the marginal contribution for Z is expressed in terms of blocks of 4000 hours. To express the marginal contribution of

Z in terms of blocks of 2000 hours, if is necessary to divide the final column of the above schedule by 2.

Processing hours are allocated as follows.

	Hours		Marginal contribution(Rs.)
Product Y	FiALPHA 2000		52000
Y	Next 2000		48000
Y	2000		44000
Y	2000		40000
X	2000		37000
Y	2000		36000
X	1500	(balance)	24250
	13500		281250

Note

*3500×(Rs.23.50- Rs.6)-RS.37000=Rs.24250

The optimum output is Rs.10,000 units of product B at a selling price of Rs.30 and 3500 units of Y at a selling price of Rs.23.50, and contribution will be maximized at Rs.2,81,250 . It is assumed that it is company policy to change selling prices only in steps of Rs.1

(b)

	Product X			Product Y			Product Z		
Demand	Price (Rs.)	Total contribut-ion (Rs,000)	Marginal contribut-ion (Rs,000)	Price (Rs.)	Total contribut-ion (Rs,000)	Marginal contribut-ion (Rs,000)	Price (Rs.)	Total contribut-ion (Rs,000)	Marginal contribut-ion (Rs,000)
2000	24.50	37	37	34	52	52	39.50	59	59
4000	23.50	70	33	33	100	48	39.00	116	57
6000	22.50	99	29	32	144	44	38.50	171	55
8000	21.50	124	25	31	184	40	38.00	224	53
10000	20.50	145	21	30	220	36	37.50	275	51
12000	19.50	162	17	29	252	32	37.00	324	49
14000	18.50	175	13	28	280	28	36.50	371	47

Pricing Decisions

10.

	(Rs)
FOB price of complete Washing Machine	8000
Value of imported items (40% of FOB price)	3200

Value of locally manufactured items (60% of FOB Price)		4800
A.	Cost of imported Items :	
	(i) FOB price of imported parts	3200
	(ii) Freight & Insurance	300
	(iii) CIF value	3500
	(iv) Custom duty 40% on CIF value	1400
	Landed cost of imported kits (iii) +(iv)	4900
B.	Cost of material - both imported + local (4800 +4900)	9700
C.	Assembling cost	1000
D.	Technical know how cost per machine	100
E.	Total cost excluding royalty (B+ C + D)	10800
F.	Royalty	434
G.	Total Cost	11234
H.	Profit (25% of Cost)	2806
Selling Price of Washing Machine (G + H)		14040

Working note for calculation of royalty :

Let Royalty = X

Cost = (10800 + X)

Selling price = (10800 + X) x 1.25

= (13500 +1.25 X)

Royalty = (Selling Price – landed cost of imported kits – landed cost of local items) x 0.10

Or X = (13500 + 1.25 X – 9700) x 0.10

Or X = 380 + 0.125 X

Or 0.875 X = 380

Or X = 434

Transfer Pricing

11. Assumptions

Investments include fixed assets and net working capital.

Current liabilities and creditors may be taken as nil as they have been not been provided for in the question.

Investments	Rs	Rs
Fixed Assets		5,00,000
Net working capital		

Current Assets	3,00,000	
Debtors	2,00,000	5,00,000
Total investments		10,00,000

The desired rate of return is 28%

Therefore the profit margin = 28% of Rs 10,00,000

= Rs 2,80,000

Budgeted volume = 4,00,000 units

Profit margin per unit	= Re 0.70
Fixed cost per unit	= Rs 2.00
(Rs 8,00,000 ÷4,00,000 units)	
Variable cost per unit	=Rs 10.00
Transfer price per unit	= Rs 12.70

Transfer Pricing

12.

(i) Existing profitability of divisions & company

Assembly Division	Rs lakhs
Total Sales value (3000 x 300 + 9000 x 280)	34.20
Total Variable cost for Division	24.00
Contribution	10.20
Fixed cost	6.00
profit for division Assembly	4.20
Finishing Division	
Total sales value 9000 set @ Rs 450	40.50
Variable cost (9000 x 280) + 6 lakhs	31.20
Contribution	9.30
Fixed Cost	4.00
Profit for division Finishing	5.30
Total Profit of the company	9.50

(ii) Evaluation of the proposal : Expansion of assembly division & transfer to Finishing division at existing level

Total Sales value (5400 x 300 + 9000 x 280)	41.40
Total Variable cost for Division (24 x 1.2)	28.80
Contribution	12.60

	Fixed cost + opportunity cost of capital invested (6.00 +20 x 0.15)	9.00
	Profit for division Assembly	3.60
	Finishing Division	
	Total sales value 9000 set @ Rs 450	40.50
	Variable cost (9000 x 280) + 6 lakhs	31.20
	Contribution	9.30
	Fixed Cost	4.00
	Profit for division Finishing	5.30
	Total Profit of the company	8.90
(iii)	Evaluation of the proposal : Expansion of assembly division & transfer of whole assembly output to Finishing division at a price of Rs 280	
	Assembly Division	
	Total Sales value (14400 x 280)	40.32
	Total Variable cost for Division (24 x 1.2)	28.80
	Contribution	11.52
	Fixed cost + opportunity cost of capital invested (6.00 +20 x 0.15)	9.00
	Profit for division Assembly	2.52
	Finishing Division	
	Total sales value 14400 set @ Rs 450	64.80
	Variable cost (14400 x 280) + 6 lakhs	46.32
	Contribution	18.48
	Fixed Cost + Advertisement cost	9.00
	Profit for division Finishing	9.48
	Total Profit of the company	12.00
(iv)	Evaluation of the proposal : Expansion of assembly division & transfer of whole assembly output to Finishing division	
	Total Sales value (14400 x 300)	43.20
	Total Variable cost for Division (24 x 1.2)	28.80
	Contribution	14.40
	Fixed cost + opportunity cost of capital invested (6.00 +20 x 0.15)	9.00
	Profit for division Assembly	5.40
	Finishing Division	
	Total sales value 14400 set @ Rs 450	64.80
	Variable cost (14400 x 300) + 6 lakhs	49.20

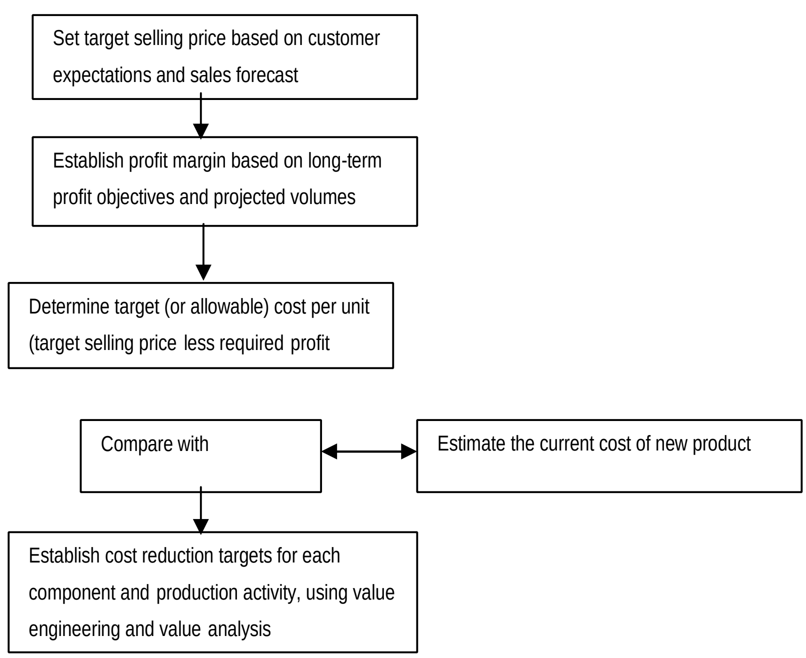
Contribution	15.60
Fixed Cost + Advertisement cost	9.00
Profit for division Finishing	6.60
Total Profit of the company	12.00

The proposal (iv) i.e transfer of all units from Assembly to Finishing Division at a transfer price of Rs 300 is recommended. With adoption of this price, profitability of the company as a whole will go up and each division will get its due share of profitability.

Target Costing

13. (a) Target Costing: It is a management tool used for reducing a product cost over its entire life cycle. It is driven by external Market factors. Marketing management prior to designing and introducing a new product determines a target market price. This target price is set at a level that will permit the company to achieve a desired market share and sales volume. A desired profit margin is then deducted to determine the target maximum allowable product cost. Target costing also develops methods for achieving those targets and means to test the cost effectiveness of different cost-cutting scenarios.

Target Costing Process



(b) Computation of Target Cost

	Per tonne (in Rs)
ABC Ltd selling price to the merchant	1,466
Less freight paid by ABC Ltd	(30)
Less normal sales returns and allowances	(60)
XYZ Ltds Capital charge	(120)
Target cost for XYZ Ltd	1,256
Ship to Distribution Centre	(11)
Distribution Centre operating cost	(25)
Subtotal	1,220
Distribution centre capital charge	(58)
Mill target manufacturing cost	1,162

Costing of Service Sector

14. Using the 85% experience curve the cost of first five planes should be approximately

$T_1 =$ Rs. 150,000,000 × 1.0000 = Rs. 150,000,000

$T_2 =$ Rs. 150,000,000 × 0.8500 = Rs. 127,500,000

$T_3 =$ Rs. 150,000,000 × 0.7730 = Rs. 115,950,000

$T_4 =$ Rs. 150,000,000 × 0.7230 = Rs. 108,450,000

$T_5 =$ Rs. 150,000,000 × 0.6860 = Rs. 102,900,000

From the 85% column in table the total time factor for 25 units is 14.801, so the total cost for the 25 planes will be Rs. 150,000,000×14.801 = Rs. 2,220,150,000. Dividing this by 25 gives the average cost of Rs. 88,806,000.

Activity Based Cost Management

15. 1. $$\text{Single plantwide factory overhead rate} = \frac{\text{Rs.}14{,}00{,}000}{1{,}75{,}000 \text{ direct labour hours}}$$

= Rs. 8 per direct labour hour

Factory overhead cost per unit:

	Product K	Product L	Product M
Number of direct labour hours	25,000	10,000	1,40,000
Single plant wide factory overhead rate	× Rs.8/dlh	× Rs.8/dlh	× Rs.8/dlh
Total factory overhead	Rs.2,00,000	Rs.80,000	Rs.11,20,000
Number of units	÷ 10,000	÷ 2,000	÷ 50,000
Cost per unit	Rs. 20.00	Rs. 40.00	Rs. 22.40

2. Under activity-based costing, an activity rate must be determined for each activity pool:

Activity	Activity Cost Pool Budget	÷	Estimated Activity Base	=	Activity Rate
Set up	Rs. 4,28,750	÷	125 set ups	=	Rs. 3,430 per setup
Production control	Rs. 2,45,000	÷	125 production orders	=	Rs. 1,960 per production order

Activity	Activity Cost Pool Budget	÷	Estimated Activity Base	=	Activity Rate
Quality control	Rs. 1,83,750	÷	75 inspections	=	Rs. 2,450 per inspection
Materials management	Rs. 3,67,500	÷	750 requisitions	=	Rs. 490 per requisition
Production	Rs. 1,75,000	÷	1,75,000 direct labour hours	=	Rs. 1 per direct labour hour

These activity rates can be used to determine the activity-based factory overhead cost per unit as follows:

Product K

Activity	Activity –Base Usage	×	Activity Rate	=	Activity Cost
Set up	80 setups	×	Rs. 3,430	=	Rs. 2,74,400
Production control	80 production orders	×	1,960	=	1,56,800
Quality control	35 inspections	×	2,450	=	85,750
Materials management	320 requisitions	×	490	=	1,56,800
Production	25,000 direct labour hours	×	1	=	25,000
Total factory overhead					Rs.6,98,750
Unit volume					÷ 10,000
Factory overhead cost per unit					Rs. 69.88

Product L

Activity	Activity –Base Usage	×	Activity Rate	=	Activity Cost
Set up	40 setups	×	Rs. 3,430	=	Rs. 1,37,200
Production control	40 production orders	×	1,960	=	78,400
Quality control	40 inspections	×	2,450	=	98,000
Materials management	400 requisitions	×	490	=	1,96,000

Production	10,000 direct labour hours	×	1	=	10,000
Total factory overhead					Rs.5,19,600
Unit volume					÷ 2,000
Factory overhead cost per unit					Rs. 259.80

Product M

Activity	Activity –Base Usage	×	Activity Rate	=	Activity Cost
Set up	5 setups	×	Rs. 3,430	=	Rs. 17,150
Production control	5 production orders	×	1,960	=	9,800
Quality control	0 inspections	×	2,450	=	0
Materials management	30 requisitions	×	490	=	14,700
Production	1,40,000 direct labour hours	×	1	=	1,40,000
Total factory overhead					Rs.1,81,650
Unit volume					÷ 50,000
Factory overhead cost per unit					Rs. 3.63

3. Activity-based costing is more accurate, compared to the single plant wide factory overhead rate method. Activity-based costing properly shows that Product M is actually less expensive to make, while the other two products are more expensive to make. The reason is that the single plant wide factory overhead rate method fails to account for activity costs correctly. The setup, production control, quality control, and materials management activities are all performed on products in rates that are different from their volumes. For example, Product L requires many of these activities relative to its actual unit volume. Product L requires 40 setups over a volume of 2,000 units (average production run size = 50 units), while Product M has only 5 setups over 50,000 units (average production run size = 10,000 units). Thus, Product L requires greater support costs relative to Product M.

   Product M requires minimum activity support because it is scheduled in large batches and requires no inspections (has high quality) and few requisitions. The other two products exhibit the opposite characteristics

16. (i) ALPHA Limited's

Statement of operating income and gross margin percentage for each of its three distribution channel

	General Super Market Chains	Drugstore Chains	Chemist Shops	Total
Revenues: (Rs.)	2,80,41,750 (330 x Rs. 84,975)	2,38,21,875 (825 x Rs. 28,875)	1,49,73,750 (2,750 x Rs. 5,445)	6,68,37,375
Less: Cost of goods sold: (Rs.)	2,72,25,000 (330 x Rs 82,500)	2,26,87,500 (825 x Rs 27,500)	1,36,12,500 (2,750 x Rs 4,950)	635,25,000
Gross Margin: (Rs.)	8,16,750	11,34,375	13,61,250	33,12,375
Less: Other operating costs: (Rs)				8,27,970
Operating income: (Rs.)				24,84,405
Gross Margin	2.91%	4.76 %	9.09%	4.96%
Operating income %				3.72

(ii) Computation of rate per unit of the cost allocation base for each of the five activity areas for April 2009

	Rs.
Customer purchase order processing (Rs. 2,20,000/ 5,500 orders)	40/ order
Line item ordering (Rs. 1,75,560/ 58,520 line items)	3/ line item order
Store delivery (Rs. 1,95,250/ 3,905 store deliveries)	50/ delivery
Cartons dispatched (Rs. 2,09,000/ 2,09,000 dispatches)	1/ dispatch
Shelf-stocking at customer store (Rs.) (Rs. 28,160/ 1,760 hours)	16/ hour

(iii) Operating Income Statement of each distribution channel in April-2009 (Using the Activity based Costing information)

	General Super market Chains	Drugstore Chains	Chemist Shops
Gross margin (Rs.) : (A) (Refer to (i) part of the answer)	8,16,750	11,34,375	13,61,260

Operating cost (Rs.) : (B) (Refer to working note)	1,62,910	1,90,410	4,74,650
Operating income (Rs.) : (A–B)	6,53,840	9,43,965	8,86,600
Operating income (in %) (Operating income/ Revenue) x 100	2.33	3.96	5.96

Comments and new insights: The activity-based cost information highlights, how the 'Chemist Shops' uses a larger amount of ALPHA Ltd's resources per revenue than do the other two distribution channels. Ratio of operating costs to revenues, across these markets is:

General supermarket chains (Rs. 1,62,910/ Rs. 2,80,00,750) x 100	0.58%
Drug store chains (Rs. 1,90,410/ Rs. 2,38,21,875) x 100	0.80%
Chemist shops (Rs. 4,74,650/ Rs. 1,49,73,750) x 100	3.17%

Working note:

Computation of operating cost of each distribution channel:

	General Super market Chains Rs.	Drugstore Chains Rs.	Chemist Shops Rs.
Customer purchase order processing	15,400 (Rs. 40 x 385 orders)	39,600 (Rs. 40 x 990 orders)	1,65,000 (Rs. 40 x 4125 orders)
Line item ordering	16,170 (Rs. 3 x 14 x 385)	35,640 (Rs. 3 x 12 x 990)	1,23,750 (Rs. 3 x 10 x 4125)
Store delivery	16,500 (Rs. 50 x 330 deliveries)	41,250 (Rs. 50 x 825 deliveries)	1,37,500 (Rs. 50 x 2750 deliveries)
Cartons dispatched	99,000 (Re. 1 x 300 cartons x 300 deliveries)	66,000 (Re. 1 x 80 cartons x 825 deliveries)	44,000 (Re. 1 x 16 cartons x 2,750 deliveries)
Shelf stocking	15,840 (Rs. 16 x 330 deliveries x 3 Av. hrs.)	7,920 (Rs. 16 x 825 deliveries x 0.6 Av. hrs)	4,400 (Rs. 16 x 2,750 deliveries x 0.1 Av. hrs)
Operating cost	1,62,910	1,90,410	4,74,650

(iv) Challenges faced in assigning total operating cost of Rs. 8,27,970 :

- Choosing an appropriate cost driver for activity area.
- Developing a reliable data base for the chosen cost driver.
- Deciding, how to handle costs that may be common across several activities.
- Choice of the time period to compute cost rates per cost driver.
- Behavioural factors.

Business Environment & Life Cycle Costing

17. (a) Material Requirements Planning (MRP) is a software based production planning and inventory control system used to manage manufacturing processes. Although it is not common nowadays, it is possible to conduct MRP by hand as well.

MRP is designed to answer three questions: what is needed, how much is needed, and when is it needed. The primary inputs of MRP are a bill of materials, which tells what goes into a finished product; a master schedule, which tells how much finished product is desired and when; and an inventory-records file, which tells how much inventory is on hand or on order. This information is processed, using various computer programs to determine the net requirements for each period of the planning horizon. Outputs from the process include planned-order schedules, order releases, changes, performance-control reports, planning reports, and exception reports.

An MRP system is intended to simultaneously meet the following 3 objectives:

1. Ensure materials and products are available for production and delivery to customers.
2. Maintain the lowest possible level of inventory.
3. Plan manufacturing activities, delivery schedules and purchasing activities.

For further details please refer to chapter 10 of the Institute's Cost Management book.

(b) Traditional accounting systems record the flow of inventory through elaborate accounting procedures. Such systems are required in those manufacturing environment where inventory/WIP values are large. However, since JIT systems operate in modern manufacturing environment characterized by low inventory and WIP values, usually also associated with low cost variances, the requirements of such elaborate accounting procedures does not exist.

Back flushing requires no data entry of any kind until a finished product is completed. At that time the total amount finished is entered into the computer system which is multiplied by all components as per the Bill of materials (BOM) for each item produced. This yields a lengthy list of components that should have been used in the production process and this is subtracted from the opening stock to arrive at the closing stock to arrive at the closing stock/inventory.

The problems with back flushing that must be corrected before it works properly are:

(i) The total production quantity entered into the system must be absolutely correct, if not, then wrong components and quantities will be subtracted from the stock.

(ii) All abnormal scrap must be diligently tracked and recorded. Otherwise materials will fall outside the black flushing system and will not be charged to inventory.

(iii) Lot tracing is impossible under the back flushing system. This is required when a manufacturer needs to keep records of which production lots were used to create a product in case all the items in a lot need be recalled.

(iv) The inventory balance may be too high at all times because the back flushing transactions that relieves inventory usually does so only once a day, during which time other inventory is sent to the production process. This makes it difficult to maintain an accurate set of inventory records in the warehouse.

(c) Product life cycle costing traces costs and revenues of each product over several calendar periods throughout their entire life cycle.

The costs are included in different stages of the product life cycle.

Development phase – R & D cost / Design cost.

Introduction phase – Promotional cost / Capacity costs.

Growth phase/Maturity–Manufacturing cost/Distribution costs/Product support cost.

Decline/Replacement phase - Plants reused/sold/scrapped/related costs.

Total Quality Management & Value Chain Analysis

18. (a) The total quality management is a set of concepts and tools for getting all employees focused on continuous improvement in the eyes of the customer. Quality is an important aspect of world-class manufacturing. The success of Japanese companies is grass rooted in their long-term commitment to improvement of quality. A world class manufacturing approach demands that the quality must be designed into product and the production process, rather than an attempt to remove poor quality by inspection. This means that the objectives of quality assurance in a world-class-manufacturing environment, is not just reject defective product, but to systematically investigate the cause of defects so that they can be gradually eliminated. Though the goal is zero defect, the methodology is one of continuous improvement.

Six Cs of TQM

(i) Commitment - If a TQM culture is to be developed, so that quality improvement becomes normal part of everyone’s job, a clear commitment, from the top must be provided. Without this all else fails.

(ii) Culture - Training lies at the centre of effecting a change -in culture and attitudes. Negative perceptions must be changed to encourage individual contributions.

(iii) Continuous improvement - TQM is a process, not a program, necessitating that we are committed in the long term to the never ending search for ways to do the job better.

(iv) Co-operation: The on-the-job experience of all employees must be fully utilized and their involvement and co-operation sought in the development of improvement strategies and associated performance measures.

(v) Customer focus: Perfect service with zero defects in all that is acceptable at either internal or external levels.

(vi) Control: Documentation, procedures and awareness of current best practice are essential if TQM implementations are to function appropriately The need for control mechanisms is frequently overlooked, in practice.

(b) Value chain is the linked set of value creating activities from the basic raw materials and components sources to the ultimate end use of the product or service delivered to the customer.

The six business functions contained in the value chain are (i) Research and Development, (ii) Design (iii) Production (iv) Marketing (v) Distribution and (vi) Customer service.

Most corporations define their mission as one of creating products and services. In contrast, the other companies are acutely aware of the strategic importance of individual activities within their value chain, They are concentrating on those activities that allow them to capture maximum value for their customers and themselves.

These firms use the value chain analysis approach to better understand which segments, distribution channels, price points. product differentiation. selling prepositions and value chain configuration will yield them the greatest competitive advantage.

The way the value chain approach helps these organizations to assess competitive advantage includes the use of following steps of analysis.

(i) Internal cost analysis - to determine the sources of profitability and the relative cost positions of internal value creating processes;

(ii) Internal differentiation analysis - to understand the sources of differentiation with internal value-creating process; and

(iii) Vertical linkage analysis - to understand the relationships and associated costs among external suppliers and customers in order to maximize the value delivered to customers and to minimize the cost.

The value chain approach used for assessing competitive advantages is an integral part of the strategic planning process. Like strategic planning, value chain analysis is a continuous process of gathering, evaluating and communicating information for business decision-making.

Budgeting Control and Performance Measurement

19. (a) Distinction between fixed budget and flexible budget:

- Fixed budget does not change with the change in the volume of activity attained whereas the flexible budget changes in accordance with the activity attained.
- Fixed budget operates at one level of activity and under one set of conditions flexible budget consists of a series of budgets at different levels of activity.
- In fixed budget both fixed and variable costs are related to only one level of activity and hence the variance analysis does not serve any useful purpose. In flexible budgeting since budgets are flexed to the level of activity attained, control is facilitated.
- In fixed budgeting, if the actual activity attained differs significantly cost ascertainment and price fixation are rendered difficult. Flexible budgeting facilitates correct ascertainment of costs and facilitates price quotations.
- Comparison of actual performance with the budgeted targets is meaningless in fixed budgets whereas such comparisons in flexible budgets provide a meaningful basis of performance measurement.

(b) Bench marking is a technique which is being adopted as a mechanism for achieving continuous improvement. It is a continuous process of measuring a company's products, services or activities against the other best performing organizations either internal or external to the company. The objective is to ascertain how the processes and activities can be improved. The latest developments, best practices and model examples can be incorporated within various operations of the business of the company. It represents an ideal way of achieving high competitive standards.

(c) Year 2008-2009

At 60% production 12,000 units

At 50% production 10,000 units

Production overheads:

	Rs.		
12,000 units	6,50,000	Total cost of 12,000 units	6,50,000
10,000 units	6,00,000	Variable cost @ Rs. 25/- per unit	3,00,000
2,000 units	50,000	Fixed costs	3,50,000

Selling overheads:

Units	Rs.		
12,000	2,40,000	Total cost of 12,000 units	2,40,000
10,000	2,20,000	Variable cost @ Rs.10/- per unit	1,20,000
2,000	20,000	Fixed costs	1,20,000

Flexible budget for 2009-10:

Account	Cost @ 60%	Increase	Revised @ 60%	75%	90%
Units				15,000	18,000
Materials	1,20,000	5%	1,26,000	1,57,500	1,89,000
Labour	1,92,000	3%	1,97,760	1,97,760	
	Efficiency fall	4%	2,06,000	2,57,500	3,09,000
Production Overheads V	3,00,000	6%	3,18,000	3,97,000	4,77,000
F	3,50,000	10%	3,85,000	3,85,000	4,27,000
Admn.Overheads F	1,20,000	15%	1,38,000	1,38,000	1,38,000
Selling overheads V	1,20,000	10%	1,32,000	1,65,000	198,000
F	1,20,000	8%	1,29,600	1,29,600	1,29,600
Total				16,30,100	18,67,600
				108.67	103.67

Cost per unit

At 75% capacity : Profit 20%

$\therefore$ Sales = $\dfrac{16{,}30{,}100 \times 100}{80} = 20{,}37{,}625$

Profit = 20,37,625 – 16,30,100 = Rs.4,07,525

Incremental cost of 3,000 units = (16,30,100 – 18,67,600) = Rs.2,37,500

Incremental cost per unit = 79.17 S.P offered is Rs.92

Hence the export order is acceptable

Linear Programming

20. (a) (i) The solution is optimal, since all the elements in the last row are non–negative.

(ii) No, because the elements in the last row under non-basic variables x_1 and s_1 are strictly positive.

(iii) No, because none of the basic variables x_2 or s_2 is zero.

(iv) Yes, because the values of basic variable x_2 and s_2 are non-negative.

(v) Machine A is being used to the full capacity because the value of slack variable s_1 is zero in the optimum simplex table. This indicates that the entire time (in hours/week) is consumed by the activities of the model.

(vi) From the given table, the element in the last row under x_1 is 1; therefore, an increase of x_1 from its current zero level to a positive level will mean the reduction in the total profit at the rate of unity per week. Hence in order to ensure that there should not be any reduction, price of x_1 should be increased by Re. one.

(vii) There will be no effect on the profits as s_1 is not in the final basis.

(viii) $x_1=0$ and $x_2 = 10$ with total profit of Rs.50.

(b) To formulate a linear programming model based on the given data, an objective function in contribution terms is required. (The "net profit" figures per unit of product include an arbitrary absorption of fixed overheads. This will lead to a distortion of the appropriate product mix.)

Let the decision variable x_1, x_2, x_3, x_4 and x_5 represent the units of products A, B, C, D and E to be produced.

Then, the objective function is to maximise the contribution i.e.

Maximise $C = 15x_1 + 12x_2 + 16x_3 + 12x_4 + 7x_5$

subject to the following constraints:

$$\left.\begin{array}{l} x_1 \le 1{,}500 \\ x_2 \le 1{,}200 \\ x_3 \le 900 \\ x_4 \le 600 \end{array}\right] \text{(expected maximum demand constraints)}$$

$$x_5 \le 600$$

$$x_1 + x_2 + 3x_3 + 4x_4 + 5x_5 \le 5{,}800 \quad \text{(special component constraint)}$$

$$12x_1 + 10\frac{2}{3}x_2 + 4x_3 + 2\frac{2}{3}x_4 + 2\frac{2}{3}x_5 \le 20{,}000 \quad \text{(labour hours constraint)}$$

$$15x_1+14x_2+16x_3+15x_4+16x_5 \le 30{,}000 \quad \text{(material expenditure constraint)}$$

$$x_1, x_2, x_3, x_4, x_5 \ge 0 \quad \text{(non–negativity conditions)}$$

The Transportation Problem

21. (a) .The total requirements of shops are = 100 + 200 + 450 + 150 = 900 dresses. But, the availability is only 150 + 450 + 250 = 850 dresses. Accordingly a dummy manufacturer capable of providing 50 dresses must be included so that the table balances. The dummy will be given zero profit per dress. The initial allocations as made in the loss matrix to give maximum profit are as follows:

Table 1

Manufacturer	Size				Quantity Available
	I	II	III	IV	
A	100 3.00	1.50	0.50	50 3.50	150
B	2.50	2.00	450 0.00	4.00	450
C	3.50	200 1.00	1.00	50 3.00	250
Dummy	5.50	5.50	5.50	50 5.50	50
Quantity Required by shops	100	200	450	150	900 / 900

The number of allocations is six. Whereas m + n – 1 = 7. It means a degenerate situation exists. Accordingly a small allocation 'ε' must be made, so that the shadow profits can be calculated. Cell A/III will be deemed to occupy the said allocation. We introduce u_i , v_j, i = (1, 2, 3, 4) j = (1, 2, 3, 4) such that $(u_i + v_j) = C_{ij}$ for allocated cells. We assume $u_1 = 0$, and remaining u_i's and v_j's are calculated as below and are shown in the Table 2.

Table 2

Manufacturer	Size				Quantity Available	u_i's
	I	II	III	IV		
A	100 3.00	1.50	ε 0.50	50 3.50	150	$u_1 = 0$
B	2.50	2.00	450 0.00	4.00	450	$u_2 = (-0.5)$
C	3.50	200 1.00	1.00	50 3.00	250	$u_3 = (-0.5)$
Dummy	5.50	5.50	5.50	50 5.50	50	$u_4 = 2$
Quantity Required by shops	100	200	450	150	900 / 900	
v_j's	$v_1 = 3.00$	$v_2 = 1.50$	$v_3 = 0.50$	$v_4 = 3.50$		

Compute $C_{ij} – (u_i + v_j)$ for all of the non-allocated cells. Since it is positive for all of the non-allocated cells, hence the initial solution is an optimal one. The maximum profit of the concern in this case is computed as below:

The following table shows the allocations, which will yield the optimal profit.

Manufacturer	Size	Quantity	Profit / Unit Rs.	Total Profit Rs.
A	I	100	2.50	250
	IV	50	2.00	100
B	III	450	5.50	2,475
C	II	200	4.50	900
	IV	50	2.50	125
			Total Profit	3,850

(b) No improvement to this profit is possible because of actual/shadow profit comparison given in Table 2. Where there is zero difference, it means alternative solution is possible. For example, some dresses could be ordered from manufacturer A in Sizes II, III and from manufacturer B in size I.

Working Notes:

Values relating to Table 2

Occupied Cells, $C_{ij} = u_i + v_j$	Unoccupied cells: Compute $\Delta_{ij} = C_{ij} - (u_i + v_j)$
Cell A, I $\Rightarrow u_1 + v_1 = 3.00$ Since $u_1 = 0$, therefore $v_1 = 3.00$	Cell A, II $\Rightarrow 1.50 - (0 + 1.50) = 0$
Cell A, III $\Rightarrow u_1 + v_3 = 0.50$ Since $u_1 = 0$, therefore $v_3 = 0.50$	Cell B, I $\Rightarrow 2.50 - (-0.5 + 3.00) = 0$
Cell A, IV $\Rightarrow u_1 + v_4 = 3.50$ Since $u_1 = 0$, therefore $v_4 = 3.50$	Cell B, II $\Rightarrow 2.00 - (-0.5 + 1.50) = 1$
Cell B, III $\Rightarrow u_2 + v_3 = 0$ Since $v_3 = 0.50$, therefore $u_2 = (-0.50)$	Cell B, IV $\Rightarrow 4.00 - (-0.5 + 3.50) = 1$
Cell C, IV $\Rightarrow u_3 + v_4 = 3$ Since $v_4 = 3.5$ therefore $u_3 = (-0.5)$	Cell C, I $\Rightarrow 3.50 - (-0.5 + 3.00) = 1$
Cell C, II $\Rightarrow u_3 + v_2 = 1$ Since $u_3 = (-0.5)$; therefore $v_2 = 1.50$	Cell C III $\Rightarrow 1 - (-0.5 + 0.5) = 0$
Consider Dummy, IV $\Rightarrow u_4 + v_4 = 5.50$ Since $v_4 = 3.50$ therefore $u_4 = 2.00$	Cell Dummy, I $\Rightarrow 5.50 - (2 + 3) = 0.50$
	Cell Dummy, II $\Rightarrow 5.50 - (2 + 1.5) = 2$
	Cell Dummy, III $\Rightarrow 5.50 - (2 + 0.5) = 3$

22. (a) This problem is of maximization and is also unbalanced Introducing one more column for a fictious work center (say D) in order to get balanced assignment problem.

Work Center → / ↓ Methods	A	B	C	D
1	10	7	8	0
2	8	9	7	0
3	7	12	6	0
4	10	10	8	0

For converting it into the minimization problem subtract every element from the maximum element i.e. 12.

Work Center → / ↓ Methods	A	B	C	D
1	2	5	4	2
2	4	3	5	2
3	5	0	6	2
4	2	2	4	2

Apply Hangarian rule for obtaining the solution.

Work Center → / ↓ Methods	A	B	C	D
1	0	3	0	1
2	1	0	0	0
3	5	0	4	3
4	0	0	0	1

Since the minimum number of lines drawn are equal to four. Hence we arrive at the solution as follows.

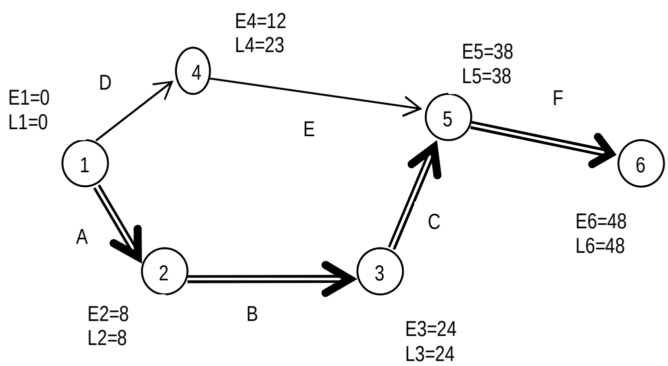
Work Center → / ↓ Methods	A	B	C	D
1	0	3	0	1
2	1	0	0	0
3	5	0	4	3
4	0	0	0	1

Hence the optimal solution is:

Methods		Work centres		Units
1		C		8
2		D		0
3		B		12
4		A		10
				30

Critical Path Analysis

23.



First assume that all activities occur at normal times. Then the following net work shows the critical path computations under normal conditions. The critical path is A → B → C → F. The schedule of project is 48 days and its associated normal cost becomes = Rs.(1800+1500+1800+2400+800+2000) = Rs.10,300.

The different minimum cost schedule that can occur between normal and crash times, which are mainly depend on the cost time slopes for different activities. The cost times slopes can be computed by the formula:

$$\text{Cost-time slope}=\frac{\text{Crash cost} - \text{Normal cost}}{\text{Normal time} - \text{Crash time}}$$

These slopes for the activities of the above net work are obtained as follows:

Activity :	A	B	C	D	E	F
Slope :	200	140	120	200	1200	1000

Now proceed step-by step as follows:

Step 1: Since the present schedule consumers more time, the schedule can be reduced by crashing some of the activities. Since the project duration controlled by the activities lying on the critical path, the duration of some activities on the critical path is reduced.

First reduce the duration of that activity which involves minimum cost. Activity C with minimum slopes given in the minimum cost. So the duration of activity C is compressed from 14 days to 9 days with an additional cost Rs.5 × 120 = Rs.600. Therefore, new schedule corresponds to 43 days with accost of Rs.(10,300+600) = Rs.10,900

Step 2: Now it can be observed that the present schedule still consumers more time and also not all the activities on the critical path are at their crash durations. Hence the project duration can be reduced by crashing some other activity .Out of the remaining activities on the critical path, the activity B has the least slpoe.So reduce the duration of activity from B from 16 days to 11 days at a cost of Rs.5 ×140=Rs.700.Thus the new project duration becomes 38 days with a cost of Rs(10900+700)=Rs.11600.

Step 3: This project duration is still more than required duration of 36 days. So select some other activity lying on the critical path for crashing .Obviously only the activities A and F on the critical path can be considered for crashing .Since activity A has smaller slope, the duration of A can by only one day although it can be compressed by 2 days (from 8 to 6 days). Because, the path 1 $\rightarrow$ 4 $\rightarrow$ 5 $\rightarrow$ 6 becomes a parallel critical path as soon as A is compressed by one day. Thus new schedule corresponds to 37 days with accost of Rs.(11600+200) = Rs.11800.

Step 4: Since only 36 days schedule is required, compress some activity by one day. To do so compress one day in each of the two parallel critical paths. So there are three choices:

(i) Activity F can be compressed by one day at accost of Rs.1000.

(ii) Activities A and D can be compressed by one day each (Since B and C are already at their crash points) .This gives the total cost of Rs. (200+200)=Rs.400.

(iii) Activities A and E can be compressed by one day each at total cost of Rs(200+1200)=Rs.1400

But, the second choice gives the least cost schedule and it should be selected .This involves a 36 days schedule with a cost of Rs. (11800+400) =Rs.12200.

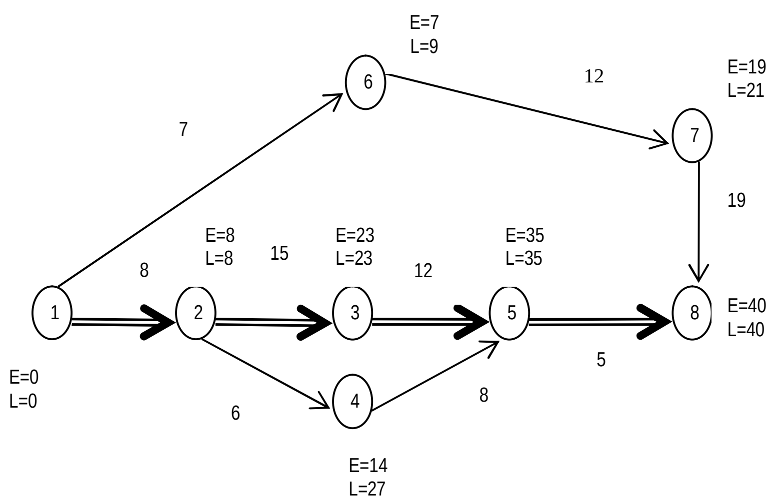
After effective crashing for a schedule of 36 days, the duration of activities and the cost involved are :

Activity	Duration (days)	Cost (Rs)
A	6	2200
B	11	2200
C	9	2400

D	11	2600
E	15	800
F	10	2000

Critical Path Analysis and PERT

24. (i) The required net work is given below



Various path	Duration paths
1-2-3-5-8	8+15+12+5= 40
1-2-4-5-8	8+6+8+5 = 27
1-6-7-8	7+12+19 = 38

Hence the critical path is 1-2-3-5-8 with duration of 40 weeks

(ii) Expected duration of various activities is calculated in the following table;

Job	Duration			Expected duration = $\left(\frac{a+4m+b}{6}\right)$	Variance $=\left(\frac{b-a}{6}\right)^2$
	(a)	(m)	(b)		
1-2	4	7	16	8	4
2-3	7	13	31	15	16
3-5	6	12	18	12	4
7-8	5	20	29	19	16
5-8	2	5	8	5	1
6-7	4	10	28	12	16
4-5	4	7	16	8	4

1-6 2-4	3 3	6 6	15 9	7 6	4 1

The earliest and latest event times for all the nodes are shown in the above diagram.

From this time estimates, it is evident that the critical path for project is 1-2-3-5-8 and the project duration is 40 weeks.

(iii) Variance for various activities which constitute the critical path is calculated and shown in the last column of the table.

Variance overall project duration= σ^2 = (4+16+4+1) =25 weeks

Standard deviation of all critical paths σ = 5 weeks

Now, we want to find probability of completing the project before 35 weeks.

Then we have to find the value from normal variate:

$Z = \frac{X - \overline{X}}{\sigma}$ here $\overline{X}$ = 35 weeks

So, $Z = \frac{35-40}{5} = -1$

Area under normal curve corresponds to Z=-1 is 0.3413

Therefore the probability of completing the project before 36 weeks is 0.5 - 0.3413 =0.16 or 16% approximately.

(iv) To calculate the chance of project duration exceeds 50 weeks, then first find

$Z = \frac{50-40}{5} = 2.0$

Area under normal curve corresponds Z=2.0 is 0.4772

Hence the probability of project duration before 50 weeks is given by 0.5 + 0.4772 = 0.9772 or 97.72%.

Probability of project duration exceeding 50 weeks =100%-97.72%=2.28%

25. The yearly return can be determined by the formula:

$$\text{Return (R)} = \frac{(\text{price} - \text{cost})}{\text{Investment}} \times \text{number of units demanded}$$

To determine accumulative probability distribution corresponding to each of three factors, we assign appropriate set of random numbers corresponding each of three factors as shown in table 1, 2 and 3.

Table: 1

Annual Demand	Probability	Cumulative probability	Random Number
20000	0.05	0.05	00-04
25000	0.10	0.15	05-14
30000	0.20	0.65	15-34
35000	0.30	0.65	35-64
40000	0.20	0.85	65-84
45000	0.10	0.95	85-94
50000	0.05	1.00	95-99

Table: 2

(Price - Cost) per unit	Probability	Cumulative probability	Random Number
3.00	0.10	0.10	00-09
5.00	0.20	0.30	10-29
7.00	0.40	0.70	30-69
9.00	0.20	0.90	70-89
10.00	0.10	1.00	90-99

Table: 3

Investment Required	Probability	Cumulative probability	Random Number
17,50,000	0.25	0.25	00-24
20,00,000	0.50	0.75	25-74
25,00,000	0.25	1.00	75-99

We prepare the simulation work-sheet for 10 trials. The simulated return (R) is also calculated by using formula R, the results are shown table-4

Table-4

Trials	Random Numbers of Demand	Simulated Demand ('000)	Random number for profit (price-cost) per unit	Simulated profit	Random Numbers for investment	Simulated Investment ('000's)	Simulated return(%) $= \frac{\text{Demand} \times \text{Profit per unit}}{\text{Investment}}$
1	28	30	19	5.00	18	1750	8.57
2	57	35	07	3.00	67	2000	5.25
3	60	35	90	10.00	16	1750	20.00
4	17	30	02	3.00	71	2000	4.5
5	64	35	57	7.00	43	2000	12.25
6	20	30	28	5.00	68	2000	7.50
7	27	30	29	5.00	47	2000	7.50
8	58	35	83	9.00	24	1750	18.00
9	61	35	58	7.00	19	1750	14.00
10	30	30	41	7.00	97	2500	8.40

Result: Table: 4 shows, the highest likely return is 20% which is corresponding to the annual demand of Rs.35,000 units resulting a (profit of Rs.10 per unit and the required investment will be Rs.17, 50,000.

PAPER – 6 : MANAGEMENT INFORMATION AND CONTROL SYSTEMS

QUESTIONS

Basic Concepts of Systems

1. (a) Write a note on deterministic and probabilistic systems

   (b) Define "Information". What are the characteristics of good or useful information?

Transaction Processing Systems

2. (a) Explain the coding in Accounting Information System (AIS) of Transaction Processing System (TPS).

   (b) Discuss in brief the transaction cycles which exist in all businesses?

Basic Concepts of MIS

3. (a) What is Management Information System? With the help of a figure explain the functions of MIS of an organisation.

   (b) What are the major constraints in operating a Management Information System?

Systems Approach and Decision Making

4. (a) Explain the role played by Financial Information System in making financial decisions.

   (b) Draw a schematic chart representing the flow of information for making financial decisions.

Decision Support and Executive Information Systems

5. (a) Describe Decision Support Systems (DSSs). What are their major components?

   (b) List out the software tools of Decision Support System.

Enabling Technologies

6. (a) Explain the characteristics of Client-Server technology.

   (b) Describe the various components of Client-Server architecture.

System Development Process

7. (a) Draw a context diagram for payroll processing.

   (b) Why should users be involved in the software development process?

Systems Design

8. (a) Distinguish between logical design and physical design.

   (b) Discuss briefly the guidelines based on which the printed and visual display outputs are designed.

System's Acquisition, Software Development and Testing

9. (a) Discuss some of the program design tools available for software development.

   (b) What basic features should be ascertained by the system analyst before purchasing packaged software?

Systems Implementation and Maintenance

10. (a) Discuss in brief operation evaluation of the new system.

    (b) Why is personnel training important for the success of systems implementation? What type of training should be imparted to system operators and users?

Design of Computerised Commercial Applications

11. (a) Write an overview of an Accounting Information System.

    (b) Draw a flow chart explaining the processes involved in a payroll application.

Enterprise Resource Planning: Redesigning Business

12. List out various steps involved in the implementation of a typical ERP package

13. List out various functions of Treasury Cash Management

Controls in EDP Set-up: General Controls

14. Explain the following:

    (a) Access token

    (b) Access control list

    (c) Threats to operating system integrity.

15. What controls and procedures can be adopted to reduce threats from misuse of passwords?

Controls in EDP Set-up: Application Controls

16. What is a source document fraud? What controls can be used to prevent this type of frauds?

17. Explain the following input controls.

    (a) Data coding controls

    (b) Validation controls

    (c) Input error correction

18. Briefly describe the various checks that could be performed during the validation run.

Detection of Computer Frauds

19. (a) "During computer processing the system might fail to detect erroneous input, improperly correct input errors, process erroneous input, or improperly distribute or

disclose output". Discuss the control procedure to detect and prevent these errors and the system review and the test of control procedures employed by the auditor.

(b) What measures can be taken by the organization to prevent computer fraud?

Cyber Laws and Information Technology Act, 2000

20. Define some of the following terms as mentioned in Information Technology Act, 2000:

    (a) Computer System

    (b) Computer Network

    (c) Digital Signature

    (d) Secure System

21. Discuss various sections relating to suspension and revocation of digital signature certificate.

Audit of Information Systems

22. (a) Explain the purpose of using reprocessing technique and parallel simulation to the auditor.

    (b) Describe the major techniques of concurrent audit of information systems.

Information Security

23. (a) Briefly describe the role of awareness, training and education in implementing Information security.

    (b) Give examples of the information security controls.

Use of Simple Case Tools, Analysis of Financial Statements using Digital Technology

24. (a) What are CASE Tools? Explain the benefits of Computer Aided Software Engineering.

    (b) Write a short note on evolution of CASE tools.

25. What is a programming CASE work-bench? Give some tools, which are part of a programming work-bench.

SUGGESTED ANSWERS/HINTS

1. (a) Deterministic and probabilistic system: A deterministic system operates in a predictable manner. The interaction among the parts is known with certainty. If one has a description of the state of the system at a given point in time plus a description of its operation, the next state of the system may be given exactly, without error. An example is a correct computer program, which performs exactly according to a set of instructions.

The probabilistic system can be described in terms of probable behaviour, but a certain degree of error is always attached to the prediction of what the system will do. An inventory system is an example of a probabilistic system. The average demand, average time for replenishment, etc, may be defined, but the exact value at any given time is not known.

(b) Information is data that has been put into a meaningful and useful context. It is defined as "Information is data that has been processed into a form that is meaningful to the recipient and is of real or perceived value in current or progressive decision."

The term "data" and "information" are often used interchangeably. However, the relation of data to information is that of raw material to finished product. Business decisions are generally based on the information. The management plays the part of converting the information into action through the process of decision-making.

Information flows are as important to the survival of a business as the flow of blood is to the life and survival of an individual. Information flow is important for good business decisions and it has been often said that a receipt of a good business is "90% information and 10% inspiration."

Important characteristics of good or useful information are as follows:

(a) Timeliness	(b) Purpose	(c) Mode and Format
(d) Redundancy	(e) Rate	(f) Frequency
(g) Completeness	(h) Reliability	(i) Cost-benefit analysis
(j) Validity	(k) Quality	

For details to above points, please refer to study material, Chapter-1, Section 1.5.1.

2. (a) For a transaction processing system to gather and process data efficiently, accounting data are often coded. AISs can use codes to identify accounting information uniquely, to compress data, to classify transactions in accounts, and to convey special meanings.

Four types of codes are generally used:

(i) Mnemonic codes,

(ii) Sequence codes,

(iii) Block codes, and

(iv) Group codes.

The choices among these codes and the way these codes are constructed are determined by:

- The code's use,
- The need for consistency,

- Considerations of design efficiency,
- An allowance for growth, and
- The desire to use standard codes throughout a company.

(b) A transaction processing cycle organises transactions by an organisation's business processes. The nature and types of transaction processing cycles vary, depending on the information needs of a specific organisation. Nevertheless, most business organisations have in common, transactions that may be grouped according to four common cycles of business activity. These cycles exist in all types of business – both profit –seeking and not – for- profit.

(a) Revenue cycle: Firms sell their finished goods to customers through this cycle. It involves processing cash sales, credit sales, and receipt of cash following a credit sale.

(b) Expenditure cycle: Events related to acquisition of goods and services from other entities in exchange for cash.

(c) Production cycle: Events related to the transformation of resources into goods and services. It involves the planning, scheduling, and control of the physical product through the manufacturing process.

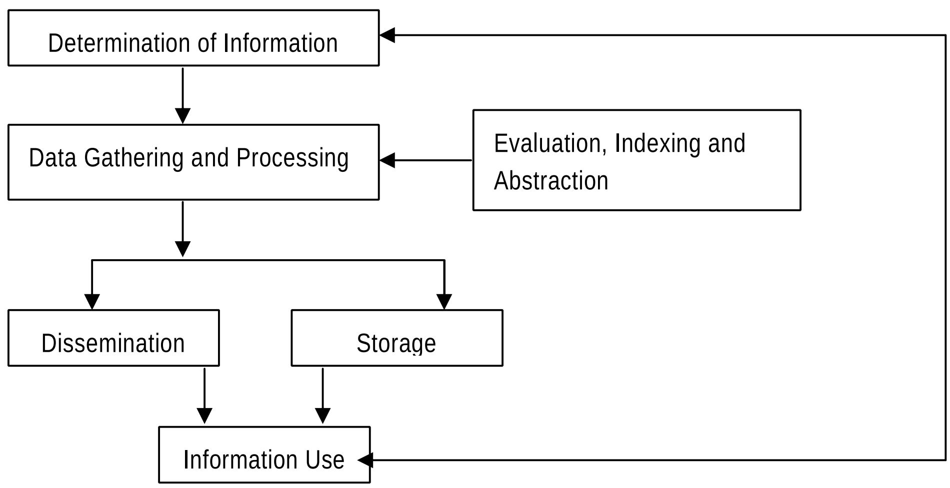
(d) Finance cycle: Events related to the acquisition and management of capital funds, including cash. It might also include application systems concerned with cash management and control, debt management, and administration of employee benefit plans.

The transaction cycle model of an organisation includes a fifth cycle – the financial reporting cycle. It is not an operating cycle. It obtains accounting and operating data from other cycles and processes these data in such a manner that financial reports may be prepared.

3. (a) Management Information System: Information is critical to the success of any business organisation. Management Information System (MIS) is a computer based system which deals with the use, storage and retrieval of information in an organisation.

MIS is a "system of people, equipment, procedures, documents and communication that collects, validates, and operates on transformers, stores, retrieves and present data for use in various management activities such as planning, budgeting, accounting, controlling and various other processes.

Management Information Systems (MIS) are information systems typically computer-based, that are used within an organisation. An information system can be defined as "a system that collects and processes data (information) and provides it to managers at all levels who use it for decision making, planning, program implementation, and control." An information system is comprised of all the components that collect, manipulate, and disseminate data or information. It usually includes hardware, software, communications systems such as telephone lines, and the data itself. The activities involved include inputting data, processing of data into information, storage of data and information, and the production of outputs such as management reports. The functions of MIS can be shown with the help of the following diagram:



(b) The major constraints which come in the way of operating a management information system are as follows:

(i) Non-availability of experts, who can diagnose the objectives of the organisation and provide a desired direction for installing and operating system. This problem may be overcome by grooming internal staff. The grooming of staff should be preceded by proper selection and training.

(ii) Non-availability of standard MIS product. Experts usually face the problem of selecting the sub-system of MIS to be installed and operated upon.

(iii) Non-availability of cooperation from staff. Educating the staff may solve this problem. This task should be carried out by organising lectures, showing films and also explaining to them the utility of the system. Besides this, some persons should also be involved in the development and implementation of the system.

(iv) High turnover of experts in MIS. Turnover in fact arises due to several factors like pay packet; promotion chances; future prospects, behaviour of top ranking managers etc. Turnover of experts can be reduced by creating better working conditions and paying at least at par with other similar concerns.

(v) Difficulty in quantifying the benefits of MIS, so that it can be easily comparable with cost. This raises questions by departmental managers about the utility of MIS.

4. (a) Financial information system plays an important role in making following financial decisions:

(i) Estimation of requirements of funds: This is the very important and starting point of making financial decisions. A very careful estimation of funds and the time at which these funds are required is made in this stage. This can be done by forecasting all physical activities of the firm and translating them into monetary units.

(ii) Capital structure decisions: Decisions are to be taken to select an optimum mix of different sources of capital structure. There are many options available for procuring funds. Decision maker has to decide the ratio between debt and equity, long-term and short-term funds etc. He has to ensure that overall capital structure is such that the company is able to procure funds at optimum cost.

(iii) Capital budgeting decisions: Funds procured from various sources are required to be invested in different assets. With the help of capital budgeting, decision maker can determine feasibility of investment in long-term assets. This will help in attainment of financial objectives.

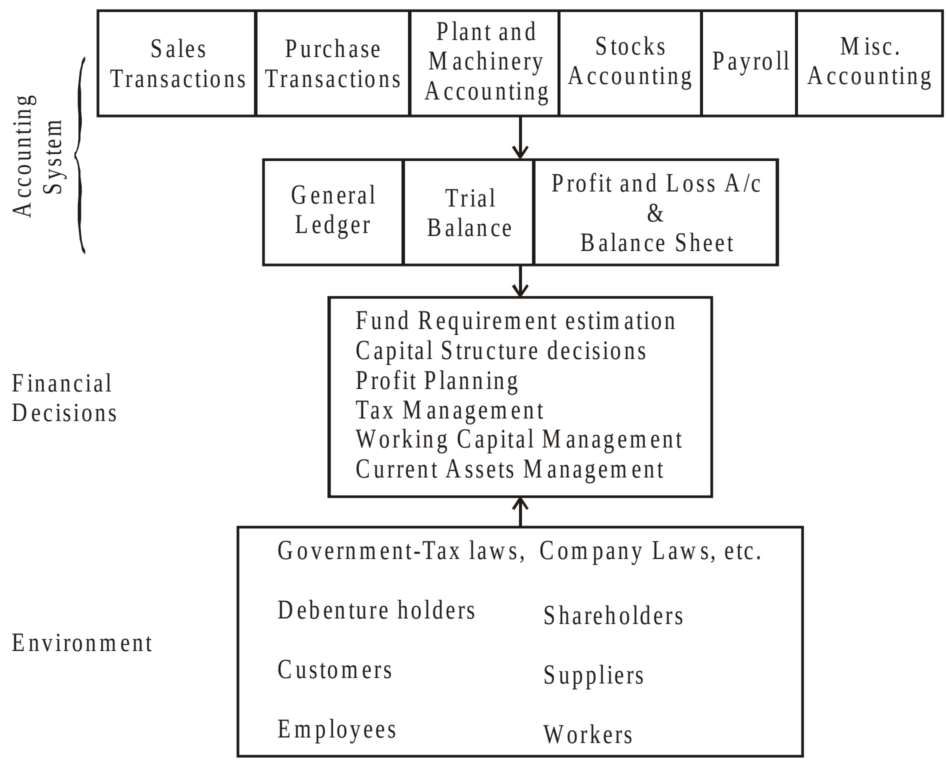
(iv) Profit planning: This part of profit planning is essential for the growth of the organisation. The decision maker has to make decision regarding profits and dividends.

(v) Tax management: Tax planning is aimed at reducing of outflow of cash resources by way of taxes so that the same may be effectively utilized for the benefit of business. The purpose of tax planning is to take full advantage of exemptions, deductions, concessions, rebates, allowances and other relief.

(vi) Working capital management: Working capital management is concerned with the investment of long term funds into current assets. Decisions are to be taken for effective financing of current assets required for day-to-day running of the organisation.

(vii) Current assets management: Policy decisions are taken regarding various items of current assets. Credit policy determines the amount of sundry debtors at any point of time. Inventory policy is to be determined jointly between finance and production department.

(b) The schematic chart representing flow of information for making financial decisions is given below:



5. (a) A Decision Support System (DSS) can be defined as 'a system that provides tools to managers to assist them in solving, semi-structured and unstructured problems.' It provides managers with a set of capabilities that enables them to generate the information required by them in making decisions. Thus, a DSS supports the human decision-making process, rather than providing a means to replace it.

A decision support system has four basic components:

(i) The users (iii) Planning languages

(ii) Databases (iv) Model base.

For details to above points, please refer to study material, Chapter 5, Section 5.3.

(b) The tools of decision support include a variety of software supporting database query, modelling, data analysis and display. A comprehensive toolkit for DSS would include software supporting these application areas. Examples of software tools falling into these four categories are given in table below:

Data based software	Model based software	Statistical software	Display based software
Dbase Plus	IFPS	SAS	SASGRAPH
Foxpro	Lotus 1-2-3	SPSS	TELLAGRAF
Sysbase	Multiplan	Minitab	ChartMaster
R:base 7.6 / 5000	Omnicalc		
SQL	Calc		
MySQL	Foresight		

6. (a) The key characteristics of a client / server technology are:

- Client/server architecture consists of a client process and a server process that can be distinguished from each other.
- The client portion and the server portions can operate on separate computer platforms.
- Either the client platform or the server platform can be upgraded without having to upgrade the other platform.
- The server is able to service multiple clients concurrently; in some client/server systems, clients can access multiple servers.
- The client/server system includes some sort of networking capability.
- A significant portion of the application logic resides at the client end.
- Action is usually initiated at the client end, not the server end.
- A user-friendly Graphical User Interface (GUI) generally resides at the client end.
- A Structured Query Language (SQL) capability is characteristic of the majority of client/ server systems.

(b) Various components of client–server architecture are briefly described below:

(i) Clients: Clients, which are typically PCs, are the "users" of the services offered by the servers. There are three types of clients: (a) Non-Graphical User Interface (NGUI) clients, (b) GUI-clients, (c) Object –Oriented User Interface (OOUI) clients.

(a) Non-GUI clients include ATMs, Cell phones, fax machines and robots that require minimum amount of human interaction.

(b) GUI-clients are human interaction models usually involving objects / action models like the pull-down menus as in windows operating system.

(c) OOUI clients take GUI clients even further with expanded visual formats, multiple work places, and object interaction rather than application interaction. Windows 95 is a common OOUI-client.

(ii) Servers: Servers await requests from the client and regulate access to shared resources. There are four types of servers:

(a) File server: It shares files across a network by maintaining a shared library of documents, data and images.

(b) Database server: This has processing power to execute Structured Query Language (SQL) requests from clients.

(c) Transaction server: It executes a series of SQL commands, an Online Transaction Processing program (OLTP) as opposed to database servers, which respond to a single client command.

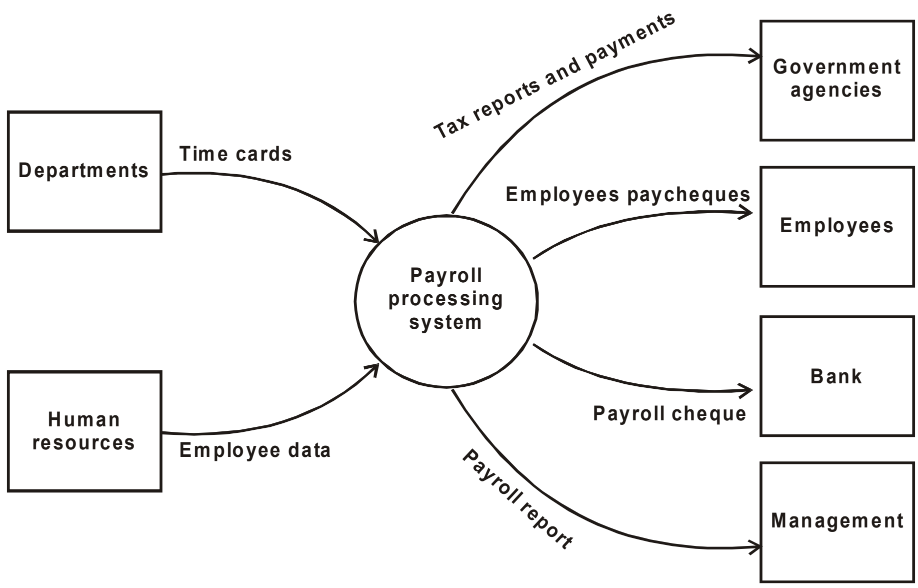
(d) Web server: This allows clients and servers to communicate with a universal language called HTTP.

(iii) Middleware: The network system implemented within the client/server technology is commonly called by the computer industry as middleware. It is the distributed software that is needed to allow clients and servers to interact. The middleware is typically composed of four layers which are service, back-end processing, network operating system and transport stacks. The service layer carries coded instructions and data from software applications to the back-end processing layer for encapsulating network-routing instructions. Next, the network operating system adds additional instructions to ensure that the transport layer transfers data packets to its designated receiver efficiently and correctly.

(iv) Fat-client or Fat-server: Fat client or fat-servers are popular terms which serve as vivid description of the type of client/server system in place. In a fat-client system, more of the processing takes place on the client, like with a file server or database server. Fat-servers place more emphasis on the server and try to minimise the processing done by clients. Examples of fat –server are groupware and web server. Visually fat-clients are referred to as 2-tier system and fat-servers referred to as 3-tier systems.

(v) Network: The network hardware is the cabling, the communication cords and the devices that link the server and the clients. The communication and data flow over the network is managed and maintained by network software.

7. (a) The context diagram for payroll processing is given below:



(b) Involving users in the development process provides valuable feedback and ensures that the users themselves understand the system's limitations and capabilities. Specifically, it enables users to share in the responsibility for the success or failure of the system developed for them. In addition, involving users secures their aid in detecting missing, unnecessary, or awkward system features and in pointing out errors in procedures, input and output specifications, data stores and other design features. Most importantly, user involvement often leads to productive changes in the specifications, thus preventing problems later in the development process.

8. (a) The differences between the logical design and physical design are:

- The logical design of an information system is like an engineering blueprint; it shows major features of the system and how they are related to one another. The reports and outputs of the system are like the engineer's design components. Data and procedures are linked together to produce a working system.

- The physical design activity follows the logical design; the activity involves producing program software, files and a working system. Design specifications; instruct programmers about what the system should do. The programmers, in turn, write the programs that accept input from users, process data, produce the reports, and store data in the files.

(b) Following are the guidelines, which should be followed while preparing the printed and visual display outputs. It will not only make the analyst's job easier, but will also ensure that users will receive an understandable output.

Printed Outputs:

1. Reports and documents should be designed to read from left to right and top to bottom.
2. Most important items should be easiest to find.
3. Each printed reports should include the heading or title of the report, page number, date of preparation and column headings. The heading or title of the report orients the user to what it is they are reading. The title should be descriptive, yet concise. Each page should be numbered so that the user has an easy point of reference when discussing output with others or relocating important figures. The date of report preparation should be included on each print out. Sometimes this helps users to estimate the value of the output. Column headings serve to further orient the user as to the report contents.
4. Each data item must have a heading, which should be short and descriptive. Data items that are related to one another should be grouped together on the report.
5. Control breaks should be used in the report to help readability. There should be control breaks, summaries and other important information by boxing them off with special characters such as asterisks or extra space. This makes it easier to find critical information.
6. Sufficient margin should be made available on the right and left as well as top and bottom of an output report. This enables the user to focus his attention on the material centered on the page and makes reading easier.
7. The detail line for variable data should be defined by indicating whether each space is to be used for an alphabetic, special or numeric character.
8. The mock up reports should be reviewed by users and programmers for feasibility, usefulness, readability, understand ability and an aesthetic appeal.

Visual display outputs: Many of the principles of good design discussed for printed output also apply to output that is shown on work-stations or video display terminals. However, it should be noted that a visual display terminal offers less space to work with compared to most printed outputs. Moreover, the system analyst is also required to give instructions to the user on how to use the display unit.

Layout of display screen: Each display page is commonly called a screen or panel. It's lay out will ease or impede its use. Designing a layout begins with verifying the characteristics of the display screen. These include:

(i) Physical dimensions of the screen;

(ii) Number of rows and columns of data that can be displayed;

(iii) Degree of resolution (high, medium, low);

(iv) Number of colours available (for example, monochrome, three colours, eight colours etc.);

(v) Methods of highlighting (underline, bold, blinking, alternate intensities);

(vi) Methods of intensity control (high / low; normal / inverse).

Visual display screens typically have 80 columns with 24 or 25 lines. Point-of-sale display and some portable computers have smaller dimensions. Screen design begins with the recognition that the screen is composed of different areas. Layout tools assist the analyst in specifying the contents of a single or multiple design formats.

It is helpful to divide the display screens into sections that are consistently used in the same way to present information, identifications and messages to the user. In designing output screens, we need areas for (i) headings and titles, (ii) content of the display, (iii) messages and instructions and (iv) sometimes explanations for the information in the report. The headings and titles are positioned as the top portion of the screen, messages and instructions at the bottom, and explanations if needed, on the right-hand side. If only a very small amount of information is to be presented, it can be placed in the centre of the screen or in the upper left quadrant. However, it is mainly a matter of preference of the concerned system analysts.

9. (a) Some of the several program design tools are discussed below:

(i) Program flow chart: Program flow chart is among the most common program design tools that managers and users encounter when reviewing the design work of the system development project. These flow charts depict the logical steps through which a computer program must proceed when solving a problem. At one time, program flow charts were considered the premier program design tool. Although they are still widely used, sometimes it is difficult for programmers to translate a program flow chart directly into a structured code.

(ii) Pseudo code: When reviewing the work done by a program designer, users may also need to review narrative descriptions of program logic. Pseudo code, like program flow charts, also represents program logic. However, instead of using graphical symbols and flow lines, pseudo code presents program logic in English - like statements. Pseudo code is generally preferred by programmers over flowcharts because it represents program code more closely.

(iii) Structure chart: Another type of program design tool that a user may review is the program structure chart. Structure charts, which look similar to corporate organisation charts, are useful for organising problems.

(iv) 4GL Tools: The various tools described above were developed as manually applied methods for designing programs or systems. The main drawback of manually applied tools is that they take a lot of time to prepare. Also, when a program flow chart is prepared or a structure chart is drawn, the programmer is not sure if it is internally consistent. Fourth-generation languages provide a way out to remove these obstacles by automating many of these manual tasks by using 4GL tools. These tools ensure that the work done with them is consistent with the other work performed by the system team. The automation of manual task and internal consistency checks are two reasons due to which productivity gains result from using 4GL tools.

(v) Object oriented programming and design tools: These tools provide a means of enhancing programmer productivity and of reducing the application backlogs common in many organisations. Object oriented software design results in a model that describes object, classes and their relationships to one another. The object-oriented design is often taken from a data flow diagram (DFD). In fact, every input and output screen, every process and data store found in a fully decomposed DFD may be a candidate for an object in an object-oriented design. There is a wide variety of object oriented development tool kits available in the market. For example, Microsoft's Application provides an integrated object oriented program development system that includes (1) tools for creating and manipulating objects, (2) a visual programming environment for constructing object and application interfaces, and (3) a shell that supports either object oriented programming or traditional structured program.

For details to above points, please refer to study material, Chapter 9, Section 9.6.

(b) The following features of package software may be ascertained before purchasing the same:

(i) What is the package designed to do?

(ii) How developed is the software package?

(iii) How is the package organised?

(iv) Is the package operable?

(v) Can the package operate on our hardware configuration?

(vi) Can the program provide the needed reports?

(vii) Does the program have adequate capacity in terms of the number of transactions it can process, the number and length of fields per record it can process, the total file size permitted and so on?

(viii) How many processing runs on the computer are required to complete each data processing job? Some programs will perform several tasks each time they are executed. Others may perform only one task per run and hence a programme may, have to be executed several times, requiring more operator time and computer processing to complete the job.

(ix) How long does the program take to process? The efficiency of program processing varies considerably among the programs that perform the same task. Some may require much more time compared to other programs.

(x) Will the package require modifications?

(xi) Can the package be modified if necessary?

(xii) What are the overall costs?

(xiii) Is comprehensive documentation available?

(xiv) Who will maintain the package?

(xv) What are the package constraints?

(xvi) Where is the package currently used?

(xvii) What is the primary language? How many languages the package support?

(xviii) What input/output techniques are utilised?

(xix) What are the required input/output formats?

(xx) How must input be organised?

(xxi) What kind of user training is provided or required?

10. (a) The evaluation of the information system's operation pertains to whether the hardware, software and personnel are capable to perform their duties and they do actually perform them so. Operation evaluation answers such questions as:

- Are all transactions processed on time?
- Are all values computed accurately?
- Is the system easy to work with and understand?
- Is terminal response time within acceptable limits?
- Are reports processed on time?
- Is there adequate storage capacity for data?

Operation evaluation is relatively straightforward if evaluation criteria are established in advance. For example, if the systems analyst lays down the criterion that a system which is capable of supporting one hundred terminals should give response time of less than two seconds, evaluation of this aspect of system operation can be done easily after the system becomes operational.

(b) Importance of training personnel: A system can succeed or fail depending on the way it is operated and used. Therefore, the quality of training received by the personnel involved with the system in various capacities helps or hinders the successful implementation of information system. Thus, training is becoming a major component of systems implementation. When a new system is acquired which often involves new hardware and software, both users and computer professionals generally need some type of training. Often this is imparted through classes, which are organised by the vendor, and through hands-on learning techniques.

Training systems operators: Many systems depend on the computer-centre personnel who are responsible for keeping the equipment running as well as for providing the necessary support services. Their training must ensure that they are able to handle all possible operations, both routine and extra-ordinary. Operator training must also involve the data entry personnel. If the system calls for the installation of new equipment, such as a new computer systems, special terminals or data-entry equipments, the operators training should include such fundamentals as how to turn the equipment on and use it, and knowledge of what constitute normal operation and use. The operators should also be instructed in what common malfunctioning may occur, how to recognise them, and what steps to take when they arise. As part of their training, operators should be given both a trouble shooting list that identifies possible problems and remedies for them, as well as the names and telephone numbers of individuals to contact when unexpected or unusual problem arise. Training also involves familiarization with run procedures, which involve working through the sequence of activities needed to use a new system on an on-going basis.

User training: User training may involve equipment use, particularly in the case where a micro-computer is in use and the individual involved is both operator and user. In these cases, users must be instructed how to operate the equipment. User training must also instruct the individuals involved in trouble shooting of the system, determining whether the problem is caused by the equipment or software or by something they have done in using the system. Most user training deals with the operation of the system itself. Training in data coding emphasises the methods to be followed in capturing data from transactions or preparing data for decision support activities. Users should be trained on data handling activities such as editing data, formulating inquiries (finding specific records or getting responses to questions) and deleting records of data. From time to time, users will have to prepare disks, load paper into printers, or change ribbons on printers. Some training time should be devoted to such system maintenance activities. If a micro computer or data entry system uses disks, users should be instructed in formatting and testing disks.

Training is often seen as a necessary evil by managers. While recognising its importance, many mangers have to release employees from their regular job activities so that they can be trained. When managers are actively involved in determining training needs, they are usually more supportive of training efforts. It is generally wise to have managers directly involved in evaluating the effectiveness of training activities because training deficiencies can translate into reduced user productivity level.

11. (a) A typical Accounting Information System can be divided into four separate areas:

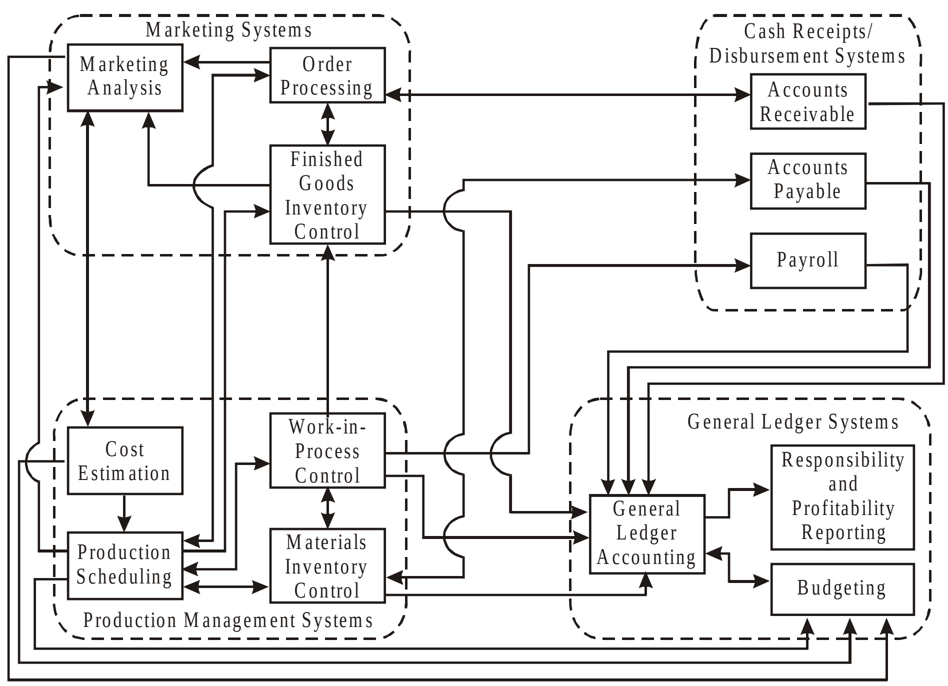
(i) The general ledger systems, which include the general ledger, budgeting, and responsibility/profitability reporting.

(ii) The cash receipts/disbursements systems, which include the accounts payable, payroll and accounts receivable systems.

(iii) The production management systems, which include the materials inventory control, work-in-process control, cost estimation, and production scheduling systems.

(iv) The marketing systems, which include finished goods inventory control, order processing, and marketing analysis systems.

The flow lines between the various systems in the figure below illustrate interfaces between these systems. The arrows on the flow lines indicate the direction of the information flow from one system to another.



(b) The flow chart drawn on the next page shows the processing of payroll. Inputs to the system consists of keyed data for time cards, batch control information and the employee master file, updated by the preliminary master payroll file update. Outputs from the system include a completed employee master file, updated by time cards information, reports and documents as discussed below:

In run # 1, the payroll edit program is executed. The first function of this program is to detect errors in the input data. If an error is detected, it is immediately printed to permit correction. If accumulated totals computed by the computer program from individual records do not balance control totals contained in the lead record, the difference is also printed. Processing is discontinued at this point so that errors can be corrected. Once this is done, the edit program is rerun to produce an error free input file. The input file produced by the payroll edit program is recorded on magnetic disk or tape.

In run # 2, the payroll transaction file is sorted by the employee number within department number.

In run # 3, the sorted transaction file is used to update the master file on magnetic disk. The type of cost code stored in master file indicates the nature of the account to which employee's gross pay is charged such as direct labour, indirect labour etc.

Gross and net pay are calculated in this run; year-to-date and current period data are accumulated and written on the payroll master file. The data necessary for printing pay slips and pay cheques for the current period are put on a magnetic disk constituting another output of this run. Payroll register is also printed during this run. Payroll register is a printed record of details in the computed employee master file.

In run #4, the current period payroll master disk is used to produce pay cheques and pay slips.

In run #5, the current period payroll disk is sorted by job number.

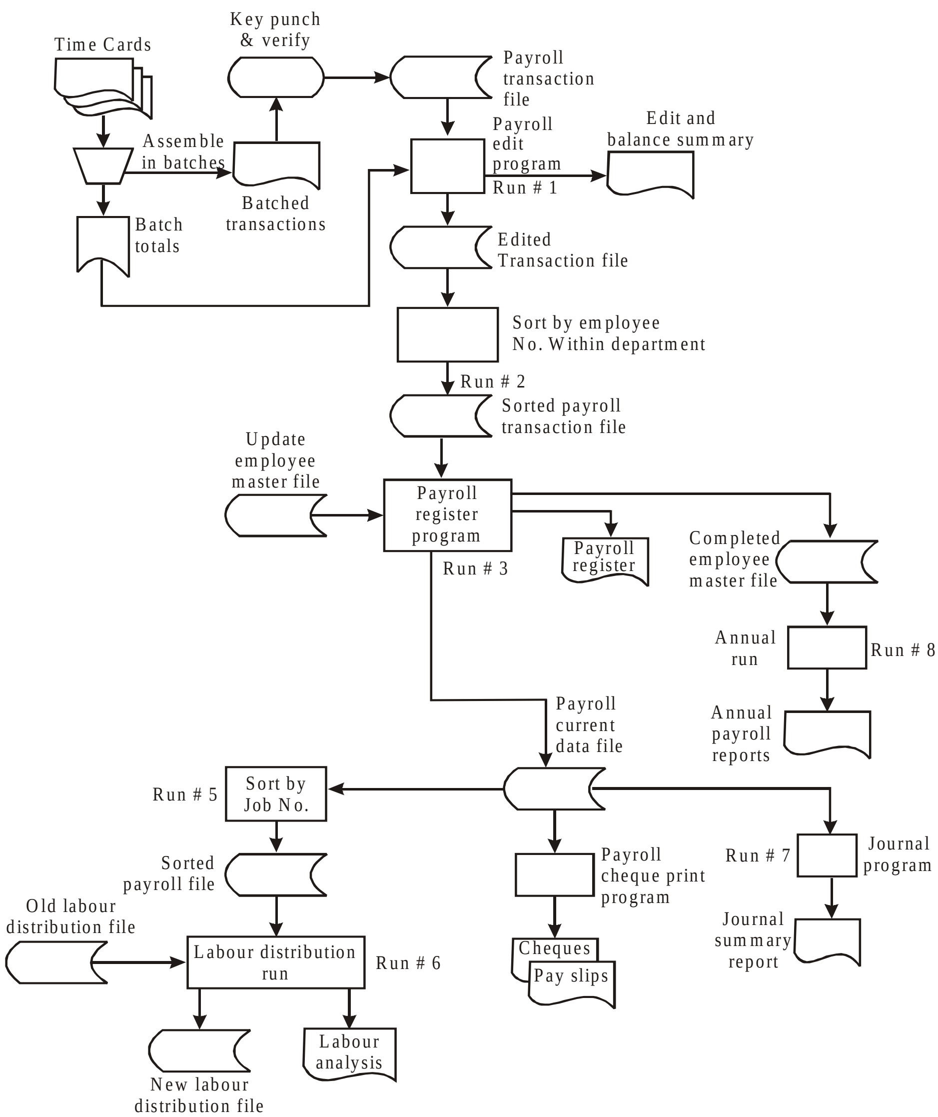
In run # 6, the output file of run # 5 is used to update the old labour distribution file.

The cumulative values of various trades as at the end of last month are updated to as at the end of this month by means of the payroll file.

The labour analysis is printed for each job as another output of this run.

In run # 7, a journal report is printed. This report is used to supply current and year–to–date entries to the general ledger, which is the final consolidated accounting document. Journal reports record total funds expended by source and by disposition. For example, total money amount for overtime and total amount for special advances etc are summarized by separate account on the general ledger. Similarly, total insurance premium deductions, provident fund deductions, staff welfare fund, income tax deduction etc. make up other accounts.

In run #8, the completed master payroll file is used to print quarterly/ annual reports. Government regulations require quarterly/ annual reports on payroll activities. Such reports include provident fund deduction statement, income-tax deductions, insurance premium deductions etc. Many other reports for internal accounting purposes may also be printed on quarterly/ yearly basis.



12. Several steps are involved in the implementation of a typical ERP package. These are:

    (i) Identifying the needs for implementing an ERP package.

    (ii) Evaluating the 'As Is' situation of the business i.e., to understand the strength and weakness prevailing under the existing circumstances.

    (iii) Deciding the 'Would be' situation for the business i.e., the changes expected after the implementation of ERP.

    (iv) Reengineering the business process to achieve the desired results in the existing processes.

    (v) Evaluating the various available ERP packages to assess suitability.

    (vi) Finalising of the most suitable ERP package for implementation.

    (vii) Installing the required hardware and networks for the selected ERP package.

    (viii) Finalising the Implementation consultants who will assist in implementation.

    (ix) Implementing the ERP package.

13. In a Treasury cash management, the company's payment transactions are grouped into cash holdings, cash inflows and cash outflows. Cash Management provides following information:

    (i) Information on the sources and uses of funds to secure liquidity to meet payment obligations when they become due.

    (ii) Monitors and Controls incoming and outgoing payment flows.

    (iii) Supplies data required for managing short-term money market investment and borrowing.

    (iv) Enables to know current cash position, short term cash management and medium and long term financial budgeting.

    (v) Enables analysis of liquidity.

    (vi) Helps in cash management decisions.

    (vii) In bank accounting, helps in electronic banking and control functions for managing and monitoring of bank accounts.

    (viii) The liquidity forecast function integrates anticipated payment flows from financial accounting, purchasing and sales to create a liquidity outlook from medium to long term.

    (ix) Covers foreign currency holdings and foreign currency items.

14. (a) Access token: If the log-on attempt is successful, the operating system creates an access token that contains key information about the users, including user ID, password, user group, and privileges granted to the user. The information in the access token is used to approve all actions attempted by the user during the session.

(b) Access control list: Access to system resources such as directories, files, programs, and printers are controlled by an access control list assigned to each resource. These lists contain information that defines the access privileges for all valid users of the resource. When a user attempts to access a resource, the system compares his or her ID and privileges contained in the access token with those contained in the access control list. If there is a match, the user is granted access.

(c) Threats to operating system integrity: Operating system control objectives are sometimes not achieved because of flaws in the operating system that are exploited either accidentally or intentionally.

Accidental threats include hardware failures that cause the operating system to crash. Operating system failures are also caused by errors in user application program that the operating system cannot interpret. Accidental system failures may cause whole segments of memory to be “dumped” to disks and printers, resulting in the unintentional disclosure of confidential information.

Intentional threats to the operating system are most commonly attempts to illegally access data or violate user privacy for financial gain. However, a growing form of threat is from destructive programs from which there is no apparent gain. These exposures come from three sources:

(i) Privileged personnel who abuse their authority. Systems administrators and systems programmers require unlimited access to the operating system to perform maintenance and to recover from system failures. Such individuals may use this authority to access users’ programs and data files.

(ii) Individuals both internal and external to the organisation who browse the operating system to identify and exploit security flaws.

(iii) An individual who intentionally (or accidentally) inserts a computer virus or other form of destructive program into the operating system.

15. The controls and procedures that can be adopted to reduce threats from misuse of passwords are:

- The most common method of password control is the reusable password. The user defines the password to the system once and then reuses it to gain future access. Most operating systems set only basic standards for password acceptability.

- The user must be encouraged to use “Strong” passwords. Software’s are available that automatically scans password files and notifies the security administrator when weak passwords are detected, thus assuring that only “smart” passwords are used on the system.

- The user should be educated about the use of strong passwords and the benefits of changing the passwords periodically.

- The user should be informed about possible traps that they may fall into if they reveal their login and passwords.

- The authentication system must not allow re-entry of password more than 2-3 times in case the authentication fails.

16. Systems using physical source documents to initiate transactions are vulnerable to source document fraud. Source document fraud can be used to remove assets from the organisation. For example, an individual with access to purchase orders and receiving reports could fabricate a purchase transaction to a non-existent supplier. If these documents were entered into the data processing stream, along with a fabricated vendor's invoice, the system could process these documents as if a legitimate transaction had taken place. In the absence of other compensating controls to detect this type of fraud, the system would create an account payable and subsequently write a cheque for payment. To control against this type of exposure, the organisation must implement control procedures over source documents to account for each document, as described below:

    (i) Use Prenumbered Source Documents: Source documents should come pre-numbered from the printer with a unique sequential number on each document. Source document numbers permit accurate accounting of document usage and provide an audit trail for tracing transactions through accounting records.

    (ii) Use Source Documents in Sequence: Source documents should be distributed to the users and used in sequence. This requires that adequate physical security be maintained over the source document inventory at the user site. When not in use, documents should be locked away. At all times, access to source documents should be limited to authorised persons.

    (iii) Periodically Audit Source Documents: Missing source documents should be identified by reconciling document sequence numbers. Periodically, the auditor should compare the numbers of documents used to date with those remaining in inventory plus those voided due to errors. Documents not accounted for should be reported to management.

17. (a) Data coding controls: Coding controls are checks on the integrity of data codes used in processing. A customer's account number, an inventory item number, and a chart of accounts number are all examples of data codes. Three types of errors can corrupt a data code and cause processing errors: transcription, single transposition and multiple transposition. Check digit can be used to ensure integrity of the code in subsequent processing.

    (b) Validation controls: Input validation controls are intended to detect errors in transaction data before the data are processed. Validation procedures are most effective when they are performed as close to the source of the transaction as possible. However, depending on the type of CBIS in use, input validation may occur at various points in the system. There are three levels of validation controls: field interrogation, transaction interrogation and file interrogation.

(c) Input error correction: When errors are detected in a batch they must be corrected and the records resubmitted for reprocessing. This must be a controlled process to ensure that errors are dealt with completely and correctly. There are three common error handling techniques: immediate correction; create an error file, and reject the entire batch.

For details to above points, please refer to study material, Chapter 14, Section 14.1.

18. The checks which could be performed during a validation run can be categorised as field checks and transaction checks. Various field checks have been described below:

(i) Limit check: This is a basic test for data processing accuracy and may be applied to both the input and output data. The field is checked by the program against predefined limits to ensure that no input/output error has occurred or at least no input error exceeding certain pre–established limits has occurred.

(ii) Picture check: Under this check, only certain characters are allowed in a data field. The computer can test the field to determine that no invalid characters are used.

(iii) Valid code check: If there are a limited number of valid codes, the code being read may be checked against pre–determined transaction codes, or table to ensure that it is one of the valid codes.

(iv) Check digit: It is an extra digit that is computed from the code itself and placed alongside it for subsequent checking. There are a number of check digit schemes. Module 11 check digit scheme has been empirically established as the best to detect transposition errors.

(v) Arithmetic check: Arithmetic check is performed in different ways to validate the results of other computations or the value of selected data field.

(vi) Valid combinations of fields: In addition to each of the individual fields being tested, combination of fields may be tested for validity.

(vii) Cross check: It may be employed to verify fields appearing in different files to see that the results tally.

(viii) Valid field size, sign and composition: If the code number should be specified number of digits in length, the computer may be programmed to test that the field size is as specified. If the sign of the field must always be positive or always negative, a test may be made to determine that the field does indeed contain a proper composition of characters.

Various transaction checks are given below:

(i) Sequence checks are exercised to detect any missing transactions, off–serially numbered vouchers.

(ii) Format completeness checks are used to check the presence and position of all the fields in a transaction.

(iii) Redundant data checks are employed to check the validity of codes with reference to the description.

(iv) Checks may be incorporated to ensure that transactions pertain to the correct period.

(v) Combination checks may be exercised on various fields of a file.

(vi) Passwords may be issued to check entry of data by unauthorised persons in on–line systems.

(vii) Probability checks are used to avoid unnecessary rejection of data as data can, on occasions, exceed normal values in a range due to purely random causes.

In addition to above checks, hash totals and batch totals can also be applied to ensure that all the transactions have been transcribed correctly.

19. (a) During computer processing the system might fail to detect erroneous input, improperly correct input errors, process erroneous input, or improperly distribute or disclose output. The control procedures to detect and prevent these errors and the system review and tests of control procedures which the auditor employs are given below. The purpose of these audit procedures is to gain an understanding of the controls, evaluate their adequacy, and observe operations for evidence that the controls are actually being followed:

Types of Errors and Fraud

- Failure to detect incorrect, incomplete, or unauthorised input data.
- Failure to properly correct errors flagged by data editing procedures.
- Introduction of errors into files or data bases during updating.
- Improper distribution or disclosure of computer output.
- Intentional or unintentional report inaccuracies.

Control Procedures

- Computer data editing routines.
- Proper use of internal and external file labels.
- Reconciliation of batch totals.
- Effective error correction procedures.
- Understandable operating documentation and run manuals.
- Competent supervision of computer operations.
- Effective handling of data input and output by data control personnel.

- File change listings and summaries prepared for user department review.
- Maintenance of proper environmental conditions in computer facility.

Audit Procedures: System Review

- Review administrative documentation for processing control standards.
- Review systems documentation for data editing and other processing controls.
- Review operating documentation for completeness and clarity.
- Review copies of error listings, batch total reports, and file change lists.
- Observe computer operations and data control functions.
- Discuss processing and output controls with operators and IS supervisory personnel.

Audit Procedures: Tests of Controls

- Evaluate adequacy of processing control standards and procedures.
- Evaluate adequacy and completeness of data editing controls.
- Verify adherence to processing control procedures by observing computer operations and the data control function.
- Verify that selected application system output is properly distributed.
- Reconcile a sample of batch totals, and follow up on discrepancies.
- Trace disposition of a sample of errors flagged by data edit routines to ensure proper handling.
- Verify processing accuracy for a sample of sensitive transactions.
- Verify processing accuracy for selected computer-generated transactions.
- Search for erroneous or unauthorised code via analysis of program logic.
- Check accuracy and completeness of processing controls using test data.
- Monitor on-line processing systems for using concurrent audit techniques.
- Re-create selected reports to test for accuracy and completeness.

Compensating Controls

- Strong user controls.
- Effective source data controls.

(b) Organisations must take every precaution to protect their information systems. A number of measures can significantly decrease the potential for fraud and any resulting losses.

(i) Make Fraud Less Likely to Occur: Some computer consultants claim that the most effective method of obtaining adequate system security is to rely on the integrity of company employees. At the same time, research shows that most frauds are committed by current and former employees. Thus employees are both the greatest control strength and weakness. Organisations can take steps to increase employee integrity and reduce the likelihood of employees committing a fraud.

(ii) Use Proper Hiring and Firing Practices: A manager's most important responsibilities are to hire and retain honest people. Similarly, a company should be very careful when firing employees. Dismissed employees should be removed from sensitive jobs immediately and denied access to the computer system to prevent sabotage or copying confidential data before they leave.

(iii) Manage Disgruntled Employees: Many employees who commit fraud are seeking revenge or "justice" for some wrong they perceive has been done to them. Hence companies should have procedures for identifying these individuals and either helping them resolve their feelings or removing them from jobs with system access.

(iv) Train Employees in Security and Fraud Prevention Measures: Many top executives believe that employee training and education is the most important element of any security program. Fraud is much less likely to occur in an environment where employees believe security is everyone's business.

20. (a) Some of the important terms as defined in the Information Technology Act, 2000 "computer system" means a device or collection of devices, including input and output support devices and excluding calculators which are not programmable and capable of being used in conjunction with external files, which contain computer programmes, electronic instructions, input data and output data, that performs logic, arithmetic, data storage and retrieval, communication control and other functions;

(b) "computer network" means the interconnection of one or more computers through-

(i) the use of satellite, microwave, terrestrial line or other communication media; and

(ii) terminals or a complex consisting of two or more interconnected computers whether or not the interconnection is continuously maintained;

(c) "digital signature" means authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of section 3;

(d) "secure system" means computer hardware, software, and procedure that-

   (a) are reasonably secure from unauthorised access and misuse;

   (b) provide a reasonable level of reliability and correct operation;

   (c) are reasonably suited to performing the intended functions; and

   (d) adhere to generally accepted security procedures;

21. Suspension of digital signature certificate: Chapter VIII of the Act containing sections 35 to 39 lay down procedures relating to digital signature certification. The Certifying Authority may suspend such certificate if it is of the opinion that such a step needs to be taken in public interest.

    Such certificate shall not be suspended for a period exceeding 15 days unless the subscriber has been given an opportunity of being heard.

    Section 38 provides for the revocation of Digital Signature Certificate under certain circumstances. Such revocation shall not be done unless the subscriber has been given an opportunity of being heard in the matter. Upon revocation or suspension, the Certifying Authority shall publish the notice of suspension or revocation of a Digital Signature Certificate.

22. (a) The pre-processing technique and parallel simulation can be used by auditors to detect unauthorised program changes. The reprocessing technique uses a verified copy of the source code. On a surprise basis, the auditor uses the program to reprocess data and compare that output with the company's data. Discrepancies in the two sets of output are investigated to ascertain their cause. Parallel simulation is similar to reprocessing except that the auditor writes a program instead of saving a verified copy of the source code. The auditor's results are compared with the company's, and any differences are investigated. Parallel simulation can be used to test a program during the implementation process.

    (b) Major techniques of concurrent audit of information systems are discussed below:

       (1) Integrated test facility technique: places a small set of fictitious records in the master file. Processing test transactions to update these dummy records will not affect the actual records. Because fictitious and actual records are processed together, employees remain unaware that this testing is taking place. The auditor compares processing and expected results in order to verify that the system and its controls are operating correctly.

       (2) Snapshot technique: examines the way transactions are processed; selected transactions are marked with a special code that triggers the snapshot process. Audit modules in the program record these transactions and their master file records before and after processing. Snapshot data are recorded in a special file and reviewed by the auditor.

(3) SCARF (System Control Audit File Review): uses embedded audit modules to continuously monitor transaction activity and collect data on transactions with special audit significance. The data are recorded in a SCARF file or audit log. Transactions that might be recorded in a SCARF file include those exceeding a specified rupee limit. Periodically the auditor examines the information to identify any questionable transactions.

(4) Audit hooks: These are audit routines that flag suspicious transactions, for example, an Insurance Company determined that their policy holder systems was vulnerable to fraud each time a policy holder changed his name or address and subsequently withdrew money. Internal auditors of the company devised a system of audit hooks to tag records with a name or address change whenever a policy holder changed his name or address and then subsequently withdraw funds from the policy. When audit hooks are employed, auditors can be informed of questionable transactions as soon as they occur.

(5) Continuous and intermittent simulation (CIS): This embeds an audit module in a data base management system. The CIS module examines all transactions that update the DBMS using criteria similar to those of SCARF. If a transaction has special audit significance, the module independently processes the data, records the results and compares them with DBMS results. In case of discrepancies, the details are written into an audit log for subsequent investigation.

23 (a) People are often the weakest link in securing information. Awareness of the need to protect information, training in the skills needed to operate them securely, and education in security measures and practices are of critical importance for the success of an organisation's security program.

The overriding benefits of awareness, training, and education, are in improving employee behaviour and attitudes towards information security and in increasing the ability to hold employees accountable for their actions. Raising the collective awareness level of the organisation regarding security matters can be achieved through a variety of training methods-videos, newsletters, posters, briefings, etc. To be effective, the campaign must be creative and frequently changed.

Training and communication are usually focused on security-related job skills and stimulate practices such as protecting the physical area and equipment (caring for media such as diskettes), protecting passwords, and reporting security violations. Advanced training may be needed for managers and specialised training necessary for system administrators and information systems auditors.

Education is more in-depth and typically targeted for information systems security professionals to gain expertise. It is normally achieved through external programs and should be regarded as part of career development.

(b) Information security controls are generally grouped into three types of control: Physical, Logical and Administrative. The examples of each type of control are as follows:

1. Physical: Doors, Locks, Guards, Floppy disk and magnetic disk access locks, Cables locking system to desks/walls, CCTV, Paper shredders and Fire Suppression Systems.

2. Logical (Technical): Passwords, File permissions, Access control lists, Account Privileges and Power protection Systems.

3. Administrative: Security Awareness, User Account Revocation Policy etc.

For details to above points, please refer to study material, Chapter-18, Section 18.4.

24. (a) CASE stands for 'Computer Aided Software Engineering'. CASE tools are automated software tools. CASE is the use of a computer-assisted method to organize and control the development of software, especially on large, complex projects involving many software components and people. Using CASE allows designers, code writers, testers, planners, and managers to share a common view of where a project stands at each stage of development. CASE helps ensure a disciplined, check-pointed process. A CASE tool may portray progress (or lack of it) graphically. It may also serve as a repository for or be linked to document and program libraries containing the project's business plans, design requirements, design specifications, detailed code specifications, the code units, test cases and results, and marketing and service plans.

Some of the benefits of CASE and similar approaches are that, by making the customer part of the process (through market analysis and focus groups, for example), a product is more likely to meet real-world requirements. Because the development process emphasises testing and redesign, the cost of servicing a product over its lifetime can be reduced considerably. An organised approach to development encourages code and design reuse, reducing costs and improving quality. Finally, quality products tend to improve an organisations image, providing a competitive advantage in the market.

(b) CASE originated in the 1970s when computer companies were beginning to borrow ideas from the hardware manufacturing process and applied them to software development. Some CASE tools supported the concepts of structured programming and similar organised development methods. More recently, CASE tools have had to encompass or accommodate visual programming tools and object-oriented programming. A CASE tool may be part of a spectrum of processes designed to ensure quality in what is developed. Many companies have their processes audited and certified as being in conformance with the ISO 9000 standard. Some typical CASE tools are:

- Configuration management tools
- Data modelling tools

- Model transformation tools
- Program transformation tools
- Refactoring tools
- Source code generation tools, and
- Unified Modelling Language.

25. Programming workbench is made up of a set of tools to support the process of program development tools:

    (i) Language compiler: Translates host programs to object code. As part of a translation process, an abstract syntax tree and a symbol table is created.

    (ii) Structured editor: Incorporates embedded programming language knowledge and edits the syntax representation of the program in the Abstract Syntax Tree (AST) rather than its source code text.

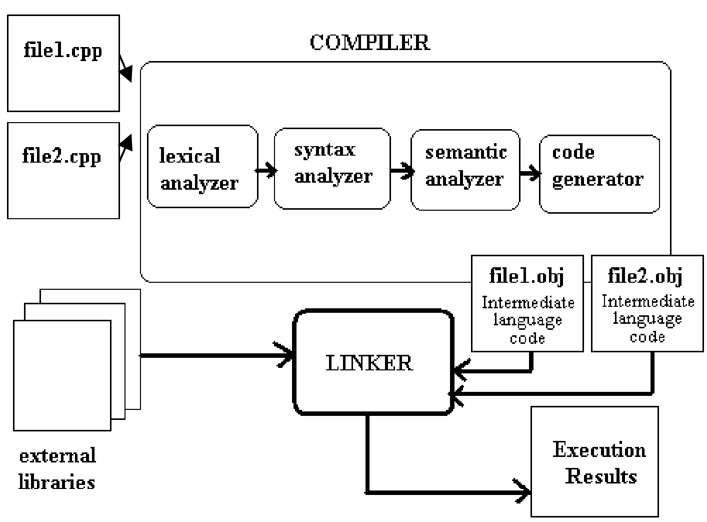
    (iii) Linker: Links the object code program with components which have already been compiled.

    (iv) Loader: Loads the executable program into the computer memory prior to execution.

    (v) Cross referencer: Produces a cross-reference listing showing where all program names are declared and used.

    (vi) Pretty printer: Scans the AST and prints the source program according to embedded formatting rules.

    (vii) Static analyzer: Analyses the source code to discover anomalies such as un-initialised variables, unreachable code etc.



The flowchart demonstrates the process of compiling two source files (file1.cpp and file2.cpp) into object files (file1.obj and file2.obj) and further execution.

(viii) Dynamic analyzer: Produces a source code listing annotated with the number of times each statement was executed when the program was run & generates information on program benches and loops and statistics of processor usage.

(ix) Interaction debugger: Allows the user to control the execution sequence and view the program state as execution processes.

PAPER – 7 : DIRECT TAXES

QUESTIONS

1. Basic Concepts

"The illegality tainted with the income has no bearing on its taxability" – Elucidate this statement with the help of a recent case law.

2. Residential Status and Scope of total income

"Territorial nexus is essential for taxing income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fees for technical services" – Discuss the correctness or otherwise of this statement.

3. Incomes which do not form part of total income

Mr. Ramesh, aged 55 years, died on account of a bomb blast in a Mumbai local train. His son, Mr.Gopal, received a compensation of Rs.4 lakh from the State Government. Explain the tax treatment of the compensation received by Mr.Gopal from the State Government.

4. Charitable or religious trusts and institutions

An institution operating for promotion of education claiming exemption under section 11 since 1993 furnishes the following data for the assessment year 2009-10.

Sl. No.	Particulars	Rs. in crores
(i)	Fees collected from students	4.5
(ii)	Expenses incurred to run the institution	2.0
(iii)	Land acquired to be used as a cricket field for the students	1.2
(iv)	Amount earmarked and set apart for construction of an arts block within the next 4 years.	1.0

Compute the total income of the institution for the A.Y.2009-10.

5. Salaries

Find out the taxable value of perquisite from the following particulars in case of an employee to whom the following assets held by the company were sold on 1.8.2008:

	Amount in Rs.		
	Ford Car	Computer	Furniture
Cost of Purchase (July, 2006)	9,13,000	2,05,000	42,000
Sale Price	5,20,000	46,000	21,000

The assets were put to use by the company from the day they were purchased.

6. Income from house property

Rajesh owns a house in Hyderabad. During the previous year 2008-09, 3/4th portion of the house was self-occupied and 1/4th portion was let out for residential purposes at a rent of Rs.12,000 p.m. The tenant vacated the property on February 28th, 2009. The property was vacant during March, 2009. Rent for the months of January 2009 and February 2009 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied. Municipal value of the property is Rs.4,00,000 p.a., fair rent is Rs.4,40,000 p.a. and standard rent is Rs.4,80,000. He paid municipal taxes @10% of municipal value during the year. A loan of Rs.30,00,000 was taken by him during the year 2005 for acquiring the property. Interest on loan paid during the previous year 2008-09 was Rs.1,48,000. Compute Rajesh's income from house property for the A.Y. 2009-10.

7. Profits and gains of business or profession

(a) A Ltd. paid IDBI a lump sum prepayment premium of Rs.1.2 lakh on 7.4.2008 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y.2008-09. The Assessing Officer, however, held that the prepayment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre-payment premium in the P.Y.2008-09. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.

(b) Explain the tax treatment for depreciation on emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year.

8. Profits and gains of business or profession

The written down value of plant and machinery on 1.4.2008 of ABC Ltd. engaged in manufacturing of PVG granules is Rs.800 lakh. The company purchased additional plant and machinery for Rs.500 lakh on 1.5.2008 inclusive of one second hand machinery of Rs.350 lakh imported from Japan to increase its installed capacity of production from 2000 TPA to 3000 TPA. The new machinery was put to use from 1.11.2008. Compute the depreciation allowable in the hands of ABC Ltd. for the A.Y.2009-10.

9. Capital Gains

Mr. Ganesh sold his residential house in Mumbai and purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Ganesh sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase of one residential house only and the two flats cannot be treated as one residential unit since –

(i) the flats were purchased through different sale deeds; and

(ii) it was found by the Inspector that, before the sale, the residential flats were in occupation of two different tenants.

Discuss the correctness of the contention of the Assessing Officer.

10. Capital Gains

Rewari Ltd. owns two industrial undertakings – one engaged in production of television sets and the other engaged in production of air-conditioners. As a restructuring drive, the company has decided to sell its undertaking producing air-conditioners as a going concern by way of slump sale for Rs.525 lakh to a new company called Adya Ltd., in which it holds 80% equity shares. The balance sheet of Rewari Ltd. as on 31st March, 2009 reads as follows:

Rs. in lakh

Particulars	Television Unit	Air-conditioner Unit
	Rs.	Rs.
Fixed Assets (Depreciable assets)	200	250
Debtors	180	150
Inventories	100	50
Liabilities	90	100
Paid up share capital	500	
General Reserve	200	
Share Premium	40	

The company set up the air-conditioner unit on 1st January, 2005. The written down value of the block of assets for tax purpose as on 31st March, 2009 is Rs.300 lakh of which Rs.120 lakh is attributable to the air-conditioner unit. Determine the tax liability which would arise to Rewari Ltd. as a consequence of the slump sale.

11. Income from other sources

Mrs. Harini Rao, who draws a salary of Rs.12,000 p.m. received the following gifts during the previous year 2008-09 -

(i) Gift of Rs.1,50,000 on 15-5-2008 from her close friend.

(ii) Gift of jewellery worth Rs.3,00,000 on 1-8-2008 from her fiancée.

(iii) Gifts of Rs.51,000 each received from her two friends on the occasion of her marriage on 30-10-2008.

(iv) Gift of Rs.51,000 on 1-11-2008 from her father's sister.

(v) Gift of Rs.21,000 from her husband's friend on 1-1-2009.

(vi) Gift of Rs.25,000 on 12-1-2009 from her family friend.

(vii) Gift of Rs.11,000 on 12-2-2009 from her brother's mother-in-law.

(viii) Gift of Rs.75,000 from her sister-in-law.

Compute her gross total income for the assessment year 2009-10.

12. Deductions from Gross Total Income

(a) Mr.Harsh, aged 42 years, furnishes the following information relating to premium on mediclaim policy paid by cheque for the year ending 31.03.2009 :

(i) for self – Rs.8,000;

(ii) for spouse, aged 35 years – Rs.8,000;

(iii) for non-dependent father, aged 70 years - Rs.21,000;

(iv) for dependent mother-in-law, aged 65 years - Rs.11,000.

Compute his eligible deduction under section 80D for A.Y.2009-10. Would your answer be different, in case the premium was paid in cash?

(b) Mr.Ravi, a Cost Accountant, derives Rs.2,12,000 as taxable professional income. Income of Mr.Ravi from other sources is Rs.21,000. He pays medical insurance premium of Rs.28,000 for insuring the health of his non-dependant parents; Rs.17,000 for self and spouse and Rs.4,000 for his sister. He incurs expenditure of Rs.25,000 on medical treatment of his dependant mentally retarded (severe disability) brother in an approved hospital duly certified. He pays rent of Rs.4,000 per month. Calculate his total income for the assessment year 2009-10.

13. Relief under section 89

In the case of Mr. Hari, you are informed that the salary for the previous year 2008-09 is Rs.6,20,000 and arrears of salary received is Rs.80,000. Further, you are given the following details relating to the earlier years to which the arrears of salary received is attributable to:

Previous year	Taxable Salary	Arrears now received (Rs.)
2000 - 2001	75,000	15,000
2001 - 2002	80,000	25,000
2002 - 2003	90,000	40,000

Compute the relief available under section 89 of the Income-tax Act and the tax payable for the A.Y. 2009-10.

Note 1: Rates of Taxes:

(a) For A.Y. 2001-02; 2002-03 & 2003-04

Upto 50,000 – Nil; 50,001 to 60,000 – 10% ;

60,001 to 1,50,000 – 20% ; above 1,50,000 –30%

(b) Surcharge

A.Y. 2001-02	-12% (if total income exceeds Rs.60,000)
	-17% (if total income exceeds Rs.1,50,000)
A.Y. 2002-03	- 2% (if total income exceeds Rs.60,000)
A.Y. 2003-04	- 5% (if total income exceeds Rs.60,000)

14. Assessment of Firms – Computation of total income of a firm

M/s. Harilal Industries, a partnership firm, submits the following profit and loss account for computation of its business income for the assessment year 2009-10.

Profit and loss account for the year ending 31.03.2009

Expenses	Rs.	Income	Rs.
To Salaries	4,23,000	By gross profit	7,35,000
" Rent	32,000	" Dividend from UTI	8,000
" Printing & Stationery	5,600		
" Telephone	3,700		
" Conveyance	21,000		
" Travelling	14,000		
" Interest	72,000		
" Depreciation	27,000		
" Legal fees	15,000		
" Auditor's fees	18,000		
" PF contribution	24,000		
" Net profit	87,700		
Total	7,43,000	Total	7,43,000

Additional information:

(i) Salaries include Rs.1,50,000 paid to working partner A and Rs.1,00,000 to working partner B.

(ii) Interest paid includes Rs.54,000, being interest paid on loan given by partner B at the rate of 18% simple interest.

(iii) Out of provident fund contribution debited to profit and loss account, Rs.10,000 is outstanding beyond the due date of filing of return.

(iv) The firm purchased goods by issuing account payee drafts except in the case of one bill for Rs.80,000 for which payment has been made by cash. This has been debited to trading account as part of purchases.

15. Fringe Benefit Tax

Discuss whether fringe benefit tax liability is attracted in respect of the following expenses -

(i) Expenditure on gifts to employee on the occasion of his marriage;

(ii) Payment of club membership fee;

(iii) Expenditure on use of telephones installed in office;

(iv) Expenditure on Group Medical Insurance;

(v) Subsidy provided to a school not meant exclusively for employees' children.

16. Assessment of Companies – Computation of Minimum Alternate Tax

ABC Ltd., engaged in diversified activities, earned a net profit of Rs.4,25,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2009:

(a)	Items debited to Profit and Loss Account	Rs.
	Provision for income-tax	80,000
	Interest on income-tax	4,000
	Education cess on income-tax	1,600
	Secondary and higher education cess on income-tax	800
	Dividend distribution tax	10,000
	Provision for deferred tax	7,000
	Wealth-tax	19,000
	Securities Transaction Tax	13,500
	Fringe Benefit Tax	16,000
	Transfer to General Reserve	15,000
	Provision for gratuity based on actuarial valuation	12,000
	Provision for losses of subsidiary company	14,000
	Proposed dividend	16,000
	Preference dividend	13,000
	Expenditure to earn agricultural income	5,000
	Expenditure to earn LTCG exempt under section 10(38)	4,000
	Expenditure to earn dividend income	2,000
	Depreciation (including depreciation of Rs.15,000 on revaluation)	35,000
(b)	Items credited to Profit and Loss Account	
	Amount credited to P& L A/c from Special Reserve	10,000
	Amount credited to P& L A/c from Revaluation Reserve	18,000

Agricultural income	25,000
LTCG exempt under section 10(38)	16,000
Dividend income	12,000

The company provides the following additional information:

Brought forward Business Loss/Unabsorbed Depreciation:

Assessment Year	Amount as per books	
	Loss	Depreciation
2006-07	50,000	40,000
2007-08	30,000	Nil
2008-09	10,000	25,000

You are required to examine the applicability of section 115JB of the Income-tax Act, and compute book profit and the tax credit to be carried forward, assuming that the total income computed as per the provisions of the Income-tax Act is Rs.1,20,000.

17. Assessment Procedure

(a) Explain the scheme for submission of returns through tax return preparers.

(b) In respect of a case which is pending before the Appellate Tribunal, does the Assessing Officer have the power to assess or reassess an income which is chargeable to tax and has escaped assessment? Discuss.

18. Appeals and Revision

"The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal and such period of stay can exceed one year from the date of such order, if the delay is not attributable to the assessee" – Discuss the correctness or otherwise of this statement.

19. Collection and Recovery of tax

"The scope of coverage of TDS provisions under section 194C has been widened by the Finance Act, 2008" – Discuss the correctness of this statement.

20. Penalties and Prosecution

(a) "The presence of "mens rea" is essential for imposition of penalty under section 271(1)(c)" – Discuss the correctness or otherwise of this statement with the aid of a recent Apex Court ruling.

(b) Does the Commissioner of Income-tax have power to grant immunity from penalty and prosecution in respect of a person whose case has been abated under section 245HA? If so, can such immunity granted be withdrawn? Discuss.

21. Assessment Procedure / Transfer Pricing

What is the time limit for completion of assessment/re-assessment where a reference is made to the Transfer Pricing Officer under section 92CA(1) in the following cases –

(i) for completion of assessment under section 144 for the A.Y.2009-10.

(ii) for completion of re-assessment under section 147, if notice is served under section 148 on 1.5.2008.

(iii) for completion of assessment in cases where the last of the authorizations for search under section 132 was executed during the financial year 2008-09.

22. Double Taxation Relief

Gautam, a resident both in India and Malaysia in the previous year 2008-09, owns a land, a rubber estate and a residential house at Malaysia. He has earned income of Rs.35 lakh from his rubber estate in Malaysia during the financial year 2008-09. He also sold his land in Malaysia resulting in short-term capital gain of Rs.17 lakh during the year. Gautam has no permanent establishment of business in India. However, he has derived rental income of Rs.4 lakh from property let out in Pune. He has a house in Mumbai where he stays during his visit to India. The Article 4 of the Double Taxation Avoidance Agreement between India and Malaysia provides that where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).

You are required to state with reasons whether the business income of Gautam arising in Malaysia and the capital gains in respect of sale of land situated in Malaysia can be taxed in India.

23. Wealth-tax

Enlist the persons who are not liable to wealth-tax under the Wealth-tax Act, 1957.

24. Wealth-tax

Gamma Limited is engaged in the construction of residential flats. For the valuation date 31.3.2009, it furnishes the following data and requests you to compute the taxable wealth:

(i) Land in urban area (Construction is not permitted as per municipal laws in force) Rs.42 lakh

(ii) Motor-cars (used for running on hire by the company) Rs.12 lakh.

(iii) Jewellery (investment) Rs.25 lakh. Loan taken for purchase of the same Rs.14 lakh.

(iv) Cash balance (as per books) Rs.3 lakh.

(v) Bank balance Rs.8 lakh.

(vi) Guest House (situated in a place which is 45 kms away from the local limits of the municipality) Rs.15 lakh.

(vii) Residential flat occupied by the Managing Director Rs.12 lakh. The managing director is on whole time appointment and is drawing remuneration of Rs.1.50 lakh per month.

(viii) Residential house let out on hire for 150 days Rs.6 lakh.

The computation should be supported with proper reasoning for inclusion or exclusion.

25. Wealth-tax

State, with reasons, whether the following constitute assets chargeable to wealth tax on the valuation date 31.3.2009:

(i) Agricultural farm house situated 50 kms outside the municipal limits of Jaipur, but within 18 kms of Niwai Municipal Corporation.

(ii) Factory building and godowns leased out on rent.

(iii) Silver and gold in the jewellers shop

(iv) Cash balance of Rs.4 lakh.

SUGGESTED ANSWERS/HINTS

1. The statement is correct.

This issue came up before the Madras High Court in CIT v. K. Thangamani (2009) 309 ITR 0015. The Court observed that the income-tax authorities are not concerned about the manner or means of acquiring income, and allowing tainted income to escape the tax net would be nothing but a premium or reward to the person for doing illegal trade. The Income-tax Act treats the income earned legally as well as illegal income alike. In the event of taxing the income of only those who acquire the same through legal manner, the tendency of those who acquire income by illegal means would increase.

In this case, the assessee had collected refund from the Income-tax Department on the basis of bogus TDS certificates filed by it. The Court held that such income received by the assessee by getting refund from the Income-tax Department by fabricating TDS certificates is taxable. Therefore, even if the assessee has been prosecuted by the law enforcing authorities for commission of offence, the income earned by him would be an income liable for assessment. It would not be a defence in such cases that the State is also becoming a party to the illegal act by sharing the ill-gotten wealth.

Therefore, illegality tainted with the earning has no bearing on its taxability.

2. This statement is not correct.

The Supreme Court, in Ishikawajima-Harima Heavy Industries Ltd. v. Director of Income-tax (2007) 288 ITR 408, observed that in order to tax the income of a non-resident assessee under section 9(1)(vii), relating to fee for technical services, the income sought to be taxed must have sufficient territorial nexus with India i.e. the fees paid for technical services provided by a non-resident cannot be taxed in India unless the services were utilized in India and rendered in India. This observation is not in consonance with the source rule spelt out in the law and the stand taken by India in the bilateral treaties with different countries.

The Finance Act, 2007 has now clarified that such income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India. An Explanation has been inserted in section 9 to clarify that income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services is to be taxed irrespective of territorial nexus.

3. Section 10(10BC) exempts any amount received or receivable as compensation by an individual or his legal heir on account of any disaster. Such compensation should be granted by the Central Government or a State Government or a local authority. However, exemption would not be available in respect of compensation for alleviating any damage or loss, which has already been allowed as deduction under the Act.

"Disaster" means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or man made causes, or by accident or negligence. It should have the effect of causing -

(1) substantial loss of life or human suffering; or

(2) damage to, and destruction of, property; or

(3) damage to, or degradation of, environment.

It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area.

Therefore, the compensation received by Mr. Gopal on the death of his father in the Mumbai bomb blast, is exempt under section 10(10BC) since it is received -

(1) on account of a disaster;

(2) from the State Government; and

(3) by the legal heir.

4. Computation of total income of the institution for the A.Y. 2009-10

Particulars	Rs. in crores
Fees received	4.500
Less : Expenses incurred to earn the income	2.000
	2.500
Less : 15% (exempt even if not spent for the objects of the institution)	0.375
	2.125
Less : Accumulated for specified purpose (See Note 2)	1.000
Balance to be spent	1.125
Actual amount spent on purchase of land for cricket field (See Note 1) Rs.1.2 crores - restricted to	1.125
Total income	Nil

Notes –

1. The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Therefore, land acquired to be used as a cricket field for students amounts to capital expenditure incurred for promoting the objects of the institution.

2. Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by informing the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 years. The amount so accumulated should be invested in the specified forms and modes. In this case, it is assumed that the institution has informed the concerned Assessing Officer and invested Rs.1 crore in the specified forms and modes.

5. Computation of taxable value of perquisite

Sl. No.	Description of asset	Value of perquisite Rs.
1.	Ford Car	64,320
2.	Computer	5,250
3.	Furniture	12,600
	Total	82,170

	Nature of Asset		
	Ford Car – 20% (WDV)	Computer – 50% (WDV)	Furniture - 10% (SLM)
Sale Price (B)	5,20,000	46,000	21,000
Cost of purchase (July, 2006)	9,13,000	2,05,000	42,000
Less : Normal wear & tear	1,82,600	1,02,500	4,200
Reduced actual cost (July 2007)	7,30,400	1,02,500	37,800
Less : Normal wear & tear	1,46,080	51,250	4,200
Reduced actual cost (July 2008) (A)	5,84,320	51,250	33,600
Taxable perquisite (A) – (B)	64,320	5,250	12,600

Note: According to Rule 3(7), the value of perquisite in respect of transfer of a movable asset shall be the difference between sale price and the actual cost as reduced by the specified rate for normal wear and tear for each completed year of usage.

6. There are two units of the house. Unit I with 3/4th area is used by Rajesh for self-occupation throughout the year and no benefit is derived from that unit, hence it will be treated as self-occupied and its annual value will be nil. Unit 2 with 1/4th area is let-out during the previous year and its annual value has to be determined as per section 23(1).

Computation of Income from house property of Mr. Rajesh for the A.Y. 2009-10

Particulars		Amount in rupees
Unit I (3/4th area – self-occupied)		
Annual Value		Nil
Less: Deduction u/s 24(b) 3/4th of Rs.1,48,000		1,11,000
Income from Unit I (self-occupied)		-1,11,000
Unit II (1/4th area – let out)		
Computation of GAV		
Step 1 – Computation of Annual Letting Value (ALV)		
ALV = Higher of municipal valuation (MV) and fair rent (FR), but restricted to standard rent (SR). However, in this case, standard rent of Rs.1,20,000 (1/4th of Rs.4,80,000) is more than the higher of MV of Rs.1,00,000 (1/4th of Rs.4,00,000) and FR of Rs.1,10,000 (1/4th of Rs.4,40,000). Hence the higher of MV and FR is the ALV. In this case, it is the fair rent.	1,10,000	

Step 2 – Computation of actual rent received/ receivable		
12,000×9 = 1,08,000	1,08,000	
[The property was let-out for 11 months. However, rent for 2 months i.e. January and February, 2009 could not be realized. As per Explanation to section 23(1), actual rent should not include any amount of rent which is not capable of being realized. Therefore, actual rent has been computed for 9 months]		
Step 3 – GAV is the higher of ALV and actual rent received/receivable. However, as per section 23(1)(c), where the let-out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ALV, then the actual rent received would be the GAV of the property. In this case, the actual rent is lower than the ALV owing to vacancy, since had the property not been vacant in March 2009, the actual rent would have been 1,20,000 (i.e., 1,08,000 + 12,000), which is higher than the ALV of Rs.1,10,000. Therefore, in this case, section 23(1)(c) would apply and the actual rent of Rs.1,08,000 would be the GAV, since it is lower than the ALV owing to vacancy.	1,08,000	
Gross Annual Value(GAV)		1,08,000
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion		
1/4th of (10% of Rs.4,00,000) = 40000/4 = 10,000		10,000
Net Annual Value(NAV) = (1,08,000-10,000)		98,000
Less: Deductions under section 24		
(a) 30% of NAV = 30% of Rs.98,000	29,400	
(b) Interest paid on borrowed capital (relating to let out portion) [1/4th of Rs.1,48,000]	37,000	66,400
Income from Unit II (let-out)		31,600

Loss under the head “Income from house property” = -1,11,000 + 31,600 -79,400

7. (a) This issue came up before the Delhi High Court in CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434. The Court observed that the assessee company’s claim for deduction has to be allowed in one lump sum keeping in view the provisions of section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of

accounting regularly followed by the assessee. The High Court concurred with the Tribunal's view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that prepayment premium paid was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

Note – Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –

(i) pre-payment premium represents interest as per section 2(28A);

(ii) such interest is deductible as business expenditure as per section 36(1)(iii);

(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

(b) This issue was dealt with by the Delhi High Court in CIT v. Insilco Ltd (2009) 179 Taxman 55. The Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note – One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use for business purposes.

8. Computation of allowable depreciation in the hands of ABC Ltd. for the A.Y. 2009-10

Particulars	Rs. in lakh
WDV as at 1.4.2008	800
Add : Addition during the year (put to use for less than 180 days)	500
WDV as at 31.3.2009	1300
Normal depreciation	
- On opening WDV of Rs.800 lakh @15%	120.00
- On addition of Rs.500 lakh @ 7.5% (i.e. 50% of 15%) [See Note 1]	37.50
Enhanced deprecation	
- On addition of Rs.150 lakh @ 10% (i.e. 50% of 20%) [See Note 2]	15.00
Total depreciation allowable	172.50

Notes –

(1) Normal depreciation would be restricted to 50% of the specified rate if the new asset is put to use for less than 180 days during the year.

(2) In addition to normal depreciation, enhanced depreciation @ 20% of the actual cost of new machinery or plant installed is allowable in the year in which the new machinery is first put to use. Such enhanced depreciation shall also be restricted to 10% (i.e.,50% of 20%), if the new machinery is put to use for a period of less than 180 days in the year. Further, such enhanced depreciation is not available in respect of second-hand machinery. Hence, imported second hand machinery of Rs.350 lakh is not eligible for such enhanced depreciation.

9. This issue came up recently before the Karnataka High Court in CIT v. D.Ananda Basappa (2009)309 ITR 0329. The Court observed that the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one unit.

Applying the ratio of the above decision to the case on hand, Mr. Ganesh is entitled to exemption under section 54 in respect of purchase of two flats to form one apartment. Therefore, the contention of the Assessing Officer is not correct.

10. Computation of tax liability of Rewari Ltd. consequent to slump sale

Particulars	Rs. in lakh
Sale consideration	525
Less : Net worth (as per Working Note below)	220
Long term capital gain (See Notes 1 & 2 below)	305
Income tax thereon @ 20%	61.000
Add : Surcharge @ 10%	6.100
	67.100
Add : Education cess @ 2% and secondary and higher education cess @ 1%	2.013
Tax liability as a consequence of slump sale	69.113

Working Note – Computation of net worth of the air-conditioner unit

Particulars		Rs. in lakh
Written down value of depreciable assets as per the Income-tax Act (relating to air-conditioner unit)		120
Book value of non-depreciable assets		
Debtors	150	
Inventories	50	200
Total assets		320
Less : Liabilities (value as appearing in the books of account)		100
Net worth		220

Notes -

(1) As per section 50B, any profits or gains arising from the slump sale effected in the previous year is chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. In this case, since the undertaking was held for a period of more than 36 months, it is a long term capital asset and the capital gain on transfer of such asset would be regarded as long term capital gain.

(2) In the case of slump sale, indexation benefit is not allowed.

11. Computation of gross total income of Mrs. Harini Rao for the A.Y.2009-10

	Particulars	Rs.	Rs.
Salary			
Salary 12,000 x 12			1,44,000
Income from other sources			
(i)	Gift from close friend is taxable	1,50,000	
(ii)	Gift of jewellery is exempt as it is in kind	-	
(iii)	Gifts received from her two friends are exempt as they have been received on the occasion of her marriage	-	
(iv)	Gift from her father's sister is exempt as the donor is covered in the definition of relative	-	
(vi)	Gift from her husband's friend is taxable	21,000	
(vii)	Gift from her family friend is taxable	25,000	
(viii)	Gift from her brother's mother-in-law is taxable as the donor is not covered in the definition of relative	11,000	
(ix)	Gift from her sister-in-law (husband's sister) is exempt as the donor is covered in the definition of relative	-	
			2,07,000
Gross Total Income			3,51,000

12. (a) In the given case, Mr.Harsh has paid Rs.16,000 in aggregate towards self and spouse's mediclaim premium, deduction in respect of which shall be restricted to Rs.15,000. Mediclaim premium of Rs.21,000 paid for insuring the health of his father, who is a senior citizen, is eligible for additional deduction of up to Rs.20,000 even though his father is not dependent on him. Therefore, total deduction of Rs.35,000 [i.e., Rs.15,000 + Rs.20,000] shall be allowed to Mr. Harsh under section 80D. It may be noted that, Rs.11,000 paid for dependent mother-in-law is not allowable, since the definition of the term 'family' does not include mother-in-law. Section 80D requires payment of premium on health insurance by any mode other than cash. In case the payment is made by cash, the amount paid cannot be availed as deduction.

(b) Computation of total income of Mr. Ravi for the A.Y. 2009-10

Particulars	Rs.	Rs.
Professional income		2,12,000
Income from other sources		21,000
Gross Total Income		2,33,000
Less: Deductions under Chapter VI A		
1. Medical insurance premium paid under section 80D – (15,000 + 20,000) [See Note 1]	35,000	

2.	Expenditure for dependant mentally retarded - section 80DD [See Note 2]	75,000	
3.	Rent paid under 80GG [See Note 3]– least of the following is eligible for deduction -		
	(i) Excess of rent paid over 10% of total income (48,000 - 12,300) = 35,700		
	(ii) 25% of total income = 30,750		
	(iii) Ceiling limit Rs.2,000 p.m. = 24,000	24,000	1,34,000
	Total income		99,000

Notes -

(1) Medical insurance premium paid for self and spouse would qualify for deduction under section 80D subject to a maximum of Rs.15,000.

Mediclaim insurance premium paid for parents shall qualify for additional deduction under section 80D, subject to a maximum of Rs.20,000 (since they are senior citizens), irrespective of whether they are dependent or non-dependent on Mr. Ravi.

Medical insurance premium paid for insuring the health of sister does not qualify for deduction under section 80D, since sister does not fall within the definition of "family".

(2) Deduction under section 80DD is a flat amount of Rs.75,000, irrespective of the actual expenditure incurred in respect of a dependent, who is a person with severe disability. It is assumed that Mr.Ravi has furnished a copy of the certificate issued by the medical authority, in the prescribed form and manner, along with the return of income under section 139 in respect of A.Y.2009-10.

(3) Total income for the purpose of section 80GG would be -

Gross Total Income	2,33,000
Less : Deduction under sections 80D & 80DD	1,10,000
Total income	1,23,000

It is presumed that all the conditions for claim of deduction under section 80GG have been fulfilled by Mr. Ravi.

13. Computation of tax payable by Mr. Hari for the A.Y 2009-10

Particulars	Incl. arrears of salary	Excl. arrears of salary
Current year salary	6,20,000	6,20,000
Add: Arrears of salary	80,000	
Taxable Salary	7,00,000	6,20,000

Income-tax thereon	1,15,000	91,000
Add : Education cess @ 2% plus secondary and higher education cess @1%	3,450	2,730
Total payable	1,18,450	93,730

Computation of tax payable on arrears of salary if charged to tax in the respective assessment years

Particulars	A.Y. 2001-02		A.Y. 2002-03		A.Y. 2003-04	
	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears
Taxable salary	75,000	75,000	80,000	80,000	90,000	90,000
Add: Arrears of salary	15,000	---	25,000	---	40,000	---
Taxable salary	90,000	75,000	1,05,000	80,000	1,30,000	90,000
Tax on the above	7,000	4,000	10,000	5,000	15,000	7,000
Add: Surcharge	840	480	200	100	750	350
Tax payable	7,840	4,480	10,200	5,100	15,750	7,350

Computation of relief under section 89

	Particulars	Rs.	Rs.
i)	Tax payable in A.Y. 2009-10 on arrears :		
	Tax on income including arrears	1,18,450	
	Less : Tax on income excluding arrears	93,730	24,720
ii)	Tax payable in respective years on arrears :		
	Tax on income including arrears (Rs.7,840+Rs.10,200+Rs.15,750)	33,790	
	Less : Tax on income excluding arrears (Rs.4,480+Rs.5,100+Rs.7,350)	16,930	16,860
	Relief under section 89 - difference between tax on arrears in A.Y 2009-10 and tax on arrears in the respective years		7,860

Tax payable for A.Y 2009-10 after relief under section 89

Particulars	Rs.
Income-tax payable on total income including arrears of salary	1,18,450
Less : Relief under section 89 as computed above	7,860
Tax payable after claiming relief	1,10,590

14. Computation of business income of M/s. Harilal Industries for the A.Y 2009-10

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		87,700
Add : Remuneration to partners (considered separately)		2,50,000
		3,37,700
Add: Inadmissible expenses :		
Interest [54,000 – 36,000 (calculated@12%)]	18,000	
Provident fund payment outstanding as on due date of filing of return - disallowed under section 43B	10,000	
Cash purchases [disallowed under section 40A(3)]	80,000	1,08,000
		4,45,700
Less : Amount credited but exempt		
Dividend from UTI [exempt under section 10(35)]		8,000
Book Profit		4,37,700
Less : Remuneration to partners deductible (see note below)		2,27,580
Taxable business income		2,10,120

Note - Computation of remuneration allowable as deduction as per 40(b)(v)

Particulars	Percentage allowable	Rs.
On first 75,000 of book profit	90%	67,500
On next 75,000 of book profit	60%	45,000
On the balance book profit of Rs.2,87,700	40%	1,15,080
Remuneration allowable as per 40(b)(v)		2,27,580

Since the actual remuneration of Rs.2,50,000 is more than the allowable limit of Rs.2,27,580, only Rs.2,27,580 is deductible. It is presumed that the remuneration paid is as per the terms of the partnership deed.

15. (i) Expenditure on gifts to employee on the occasion of his marriage – Yes, such expenditure is liable to FBT, whether the gift is on the occasion of marriage or otherwise.

(ii) Payment of club membership fee – Yes, since it is a fixed levy for use of some basic club facilities (like the lounge facilities).

(iii) Expenditure on use of telephones installed in office – Yes, expenditure on use of telephones installed in the office is liable to FBT, irrespective of whether the telephone is in the name of the company or not, or whether the payment for its use is made directly or indirectly by the company.

(iv) Expenditure on Group Medical Insurance – Yes, since it is for the purposes of employee welfare. However, if there is a statutory obligation, such expenditure would not be liable to FBT.

(v) Subsidy provided to a school not meant exclusively for employees' children – Yes, since the proximate purpose is promotion of employee welfare.

16. Computation of Book Profit under section 115JB

Particulars		Rs.	Rs.
Net Profit as per Profit & Loss Account			4,25,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB			
Income-tax paid or payable or provision therefor			
Provision for income-tax	80,000		
Interest on income-tax	4,000		
Education cess on income-tax	1,600		
Secondary and higher education cess on income-tax	800		
Dividend distribution tax	10,000	96,400	
Provision for deferred tax		7,000	
Transfer to General Reserve		15,000	
Provision for losses of subsidiary company		14,000	
Dividend paid or proposed			
Proposed dividend	16,000		
Preference dividend	13,000	29,000	
Expenditure to earn income exempt u/s 10 [except section 10(38)]			
Expenditure to earn agricultural income [exempt u/s 10(1)]	5,000		
Expenditure to earn dividend income [exempt u/s 10(34)]	2,000	7,000	
Depreciation		35,000	2,03,400
			6,28,400
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB			
Amount credited to P& L A/c from Special Reserve		10,000	
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e. Rs.35,000 – Rs.15,000)		20,000	
Amount credited to P& L A/c from Revaluation Reserve (to the extent of depreciation on revaluation)		15,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less taken on cumulative basis		65,000	

Income exempt u/s 10 [except section 10(38)]		
Agricultural Income [since it is exempt under section 10(1)]	25,000	
Dividend income [since it is an income exempt under section 10(34)]	12,000	1,47,000
Book Profit		4,81,400

10% of book profit		48,140
Add: Education cess @ 2%	963	
Secondary and higher education cess @ 1%	481	1,444
Tax liability under section 115JB		49,584

Total income computed as per the provisions of the Income-tax Act	1,20,000	
Tax payable @ 30%		36,000
Add: Education cess @ 2%	720	
Secondary and higher education cess @ 1%	360	1,080
Tax Payable as per the Income-tax Act		37,080

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 10% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 10% thereof plus education cess @2% and secondary and higher education cess @ 1%. Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 10% of book profit, the book profit of Rs.4,81,400 is deemed to be the total income and income-tax is payable @ 10% thereof plus education cess @2% and secondary and higher education cess @1%. The tax liability, therefore, works out to Rs.49,584.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, will be allowed as tax credit in the subsequent years. The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for seven assessment years succeeding the assessment year in which the credit became allowable. Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	Rs.
Tax on book profit under section 115JB	49,584
Less: Tax on total income computed as per the other provisions of the Act	37,080
Tax credit to be carried forward	12,504

Notes:

1. Wealth-tax, securities transaction tax and fringe benefit tax do not form part of income-tax and hence, should not be added back to net profit for computing book profit.
2. Provision for gratuity based on actuarial valuation is a provision for meeting an ascertained liability. Therefore, it should not be added back for computing book profit.
3. Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, deduction of such long-term capital gains is not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit. Section 10(38) also provides that such long term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.

17. (a) Scheme for submission of returns through tax return preparers

(1) Section 139B provides that, for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income, the CBDT may notify a Scheme to provide that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

(2) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return.

(3) A Tax Return Preparer can be an individual, other than

(i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(ii) any legal practitioner who is entitled to practice in any civil court in India.

(iii) a chartered accountant.

(iv) an employee of the 'specified class or classes of persons'.

(4) The "specified class or classes of persons" for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.

(5) The Scheme notified under the said section may provide for the following -

   (i) the manner in which and the period for which the Tax Return Preparers shall be authorised,

   (ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,

   (iii) the code of conduct for the Tax Return Preparers,

   (iv) the duties and obligations of the Tax Return Preparers,

   (v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

   (vi) any other relevant matter as may be specified by the Scheme.

(6) Every Scheme framed by the CBDT under this section shall be laid before each House of Parliament while it is in session to make the same effective.

(7) If both the houses decide in making any modification of Scheme, then the Scheme will have effect only in such modified form.

(8) Similarly, if both the Houses decide that any Scheme should not be framed, then such Scheme will thereafter be of no effect.

(9) However, such modification or annulment should be without prejudice to the validity of anything previously done under that scheme.

(b) The Assessing Officer can reopen a case under section 148 if he has reason to believe that any income has escaped assessment. In order to ensure that such power is used rationally and objectively by the Assessing Officers, sufficient measures have been provided in the Act. However, there have been contentions between the department and the assessees on the issue of valid reopening of assessment.

In Metro Auto Corporation v. ITO (2006) 286 ITR 618, the Bombay High Court held that reassessment was not permissible when an assessment was pending in appeal before the Tribunal. In view of such interpretation, it may not be possible to issue notice under section 148 in any case which is pending before the Appellate Tribunals or Courts. Further, by the time the Tribunal or the Court judgment is received, reopening of the case may be barred by limitation. Such a situation is not in accordance with the legislative intent.

The true legislative intent was correctly reflected in the Bombay High Court judgment in CIT v. Sakseria Cotton Mills Ltd. (1980) 124 ITR 570, where it was held that in a case where an assessment is made the subject of an appeal, only that part of the Assessing Officer's order merges with the appellate authority's order in respect of which the appellate authority has exercised the appellate jurisdiction. Hence, notice under section 148 can be issued for assessment/reassessment of income which has escaped assessment and which has not been made the subject matter of an appeal, reference or revision.

Hence, in order to clarify the true legislative intent, a second proviso has been inserted in section 147 with effect from 1.4.2008 to provide that the Assessing Officer may assess or reassess an income which is chargeable to tax and has escaped assessment other than the income involving matters which are the subject matter of any appeal, reference or revision.

18. This statement is not correct.

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed. The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose of the appeal within this period of stay.

Where the appeal has not been disposed of within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed on an application made by the assessee in this behalf. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days. The Appellate Tribunal is required to dispose of the appeal within this extended period.

The objective of these provisions is unambiguous that the Appellate Tribunal cannot grant stay either under the original order or under any subsequent order, beyond the period of 365 days in aggregate. However, the Bombay High Court in Narang Overseas (P.) Ltd. v. ITAT (2007) 295 ITR 22 observed that this limit would not apply where there is a delay beyond this period and the same is not attributable to the assessee. However, this decision does not reflect the true legal intention.

Therefore, section 254(2A) has been amended to clarify the correct intention. It has now been provided that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

19. This statement is correct.

Section 194C provides for deduction of tax at source from payments to contractors and sub-contractors. Sub-section (1) of this section lists the persons who are liable to deduct tax at source from payments to a resident contractor. So far, Association of Persons and Body of Individuals were not included in this list and were therefore, not liable to deduct tax at source under section 194C(1).

The Finance Act, 2008 has now included within the scope of section 194C(1), Association of Persons and Body of Individuals, whether incorporated or not, whose total sales/gross receipts/turnover from the business or profession exceed the monetary limits specified in section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the contractor.

Thus, such Association of Persons and Body of Individuals subject to tax audit in the immediately preceding financial year are now liable to deduct tax at source from payments to resident contractors.

20. (a) This statement is not correct.

The Apex Court, in its ruling in Dilip N. Shroff v. Joint CIT (2007) 291 ITR 519, required the presence of 'mens rea' for imposition of penalty under section 271(1)(c). "Mens rea" means a guilty mind. However, the Larger Bench of the Supreme Court, in the case of Union of India v. Dharmendra Textile Processors (2007) 295 ITR 244, observed that the conceptual and contextual difference between section 271(1)(c) and section 276C was lost sight of in Dilip B. Shroff's case. The object behind the enactment of section 271(1)(c) read with the Explanations is to provide a remedy for loss of revenue. The penalty under that provision is a civil liability. The Larger Bench held that in cases related to imposition of penalty under section 271(1)(c), willful concealment is not an essential ingredient for attracting civil liability as is the case in the matter of prosecution under section 276C. The Larger Bench, therefore, overruled the decision in Dilip N. Shroff v. Joint CIT requiring the presence of 'mens rea' in cases of penalty imposed under section 271(1)(c). Therefore, while considering an appeal against an order made under section 271(1)(c), what is required to be examined is the record which the officer imposing penalty had before him and if that record can sustain the finding that there has been concealment, that would be sufficient to sustain the penalty. Hence, there is no need for the revenue to prove that concealment was done by the assessee 'wilfully' in order to impose penalty under section 271(1)(c).

(b) Yes, the Commissioner of Income-tax has the power to grant immunity from penalty and prosecution in respect of a person whose case has been abated under section 245HA. The power to grant immunity from penalty is conferred by section 273AA and the power to grant immunity from prosecution is conferred by section 278AB.

Section 273AA empowers the Commissioner to grant immunity from penalty.

(1) The application for the immunity has to be made by the assessee (person whose case has been abated under section 245HA) to the Commissioner of Income-tax.

(2) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –

(i) co-operated in the proceedings after abatement; and

(ii) made a full and true disclosure of his income and the manner in which such income has been derived.

(3) The immunity granted shall stand withdrawn, if such assessee fails to comply with any condition subject to which the immunity was granted.

(4) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -

(i) concealed any particulars material to the assessment from the income-tax authority; or

(ii) given false evidence.

Consequently, such person would become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Section 278AB empowers the Commissioner to grant immunity from prosecution.

(1) The application for the immunity must be made by the assessee (person whose case has been abated under section 245HA) to the Commissioner of Income-tax before institution of the prosecution proceedings after abatement.

(2) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –

(i) co-operated in the proceedings after abatement; and

(ii) made a full and true disclosure of his income and the manner in which such income has been derived.

(3) Where the application for settlement under section 245C had been made before 1st June, 2007, the Commissioner can also grant immunity from prosecution for any offence under this Act or under the Indian Penal Code or under any other Central Act.

(4) If the assessee fails to comply with any condition subject to which the immunity was granted, the same would be withdrawn.

(5) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -

(i) concealed any particulars material to the assessment from the income-tax authority; or

(ii) given false evidence.

Consequently, the person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

21. (i) 33 months from the end of the assessment year in which the income was first assessable i.e. by 31.12.2012.

    (ii) 21 months from the end of the financial year in which notice under section 148 is served i.e. by 31.12.2010.

    (iii) 33 months from the end of the financial year in which the last of the authorizations for search under section 132 was executed i.e. by 31.12.2011.

22. According to section 5(1), a resident is chargeable to tax is respect of his global income. In this case, Gautam is a resident both in India and Malaysia.

    Section 90(1) empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

    Gautam has a residential house both in Malaysia and India. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with Malaysia provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he is deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations. Gautam owns a rubber estate in Malaysia from which he derives business income. However, Gautam has no permanent establishment of his business in India. Therefore his personal and economic relations with Malaysia are closer, since Malaysia is the place where –

    (a) the property is located and

    (b) the permanent establishment (PE) has been set-up

    Therefore, he shall be deemed to be resident of Malaysia for A.Y. 2009-10.

    The facts of the case and issues arising therefrom are similar to that of CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 137 Taxman 460, where the Supreme Court held that –

    (1) If an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

(2) The treaty has application as well to capital gains derived from immovable property situated at Malaysia.

Therefore, in this case, Gautam is not liable to income-tax in India for assessment year 2009-10 in respect of business income and capital gains arising in Malaysia.

23. As per section 3 of the Wealth-tax Act, 1957, wealth-tax is leviable only on individuals, HUFs and companies. Therefore, wealth-tax is not leviable on a firm, association of persons, local authority, artificial juridical person, public charitable or religious trust other than those covered under section 21A.

Further, section 45 specifically provides that no tax shall be levied under the Wealth-tax Act in respect of the net wealth of –

(i) any company registered under section 25 of the Companies Act;

(ii) any co-operative society;

(iii) any social club;

(iv) any political party as per section 13A of the Income-tax Act;

(v) a mutual fund specified under section 10(23D) of the Income-tax Act.

24. Computation of net wealth of Gamma Ltd. as on valuation date 31.3.2009

	Particulars	Notes	Rs. in lakh
(i)	Land in urban area	1	Nil
(ii)	Motor-cars	2	Nil
(iii)	Jewellery	3	25
(iv)	Cash balance	4	Nil
(v)	Bank Balance	5	Nil
(vi)	Guest House	6	15
(vii)	Residential flat occupied by Managing Director	7	12
(viii)	Residential house let out for 150 days	8	6
			58
	Less : Debts - Loan obtained for purchase of jewellery	9	14
	Taxable wealth as on 31.03.2009		44

Notes:

(1) Land in urban area on which the construction is not permitted as per municipal laws in force does not fall within the meaning of 'asset' defined under section 2(ea) and is therefore, not taxable.

(2) Motor cars used for running on hire is not an asset as per section 2(ea) and is, therefore, not taxable.

(3) Jewellery is always taxable unless the same is held as stock-in-trade.

(4) In the case of assessees, other than individuals and HUFs, cash in hand is not taxable to the extent reflected in the books of account. In this case, since the entire cash balance of Rs.3 lakh is reflected in the books of account, it is not taxable.

(5) Bank balance is not as asset with in the meaning of 'asset' defined under section 2(ea)

(6) Guest House situated in rural area is an asset and is, therefore, taxable. Only in the case of farm house, if it is situated beyond 25 kms from the local limits of any municipality, taxability does not arise.

(7) Residential flat which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having gross annual salary of less than Rs.5 lakh is not an asset within the meaning of asset defined under section 2(ea). In the given case, the residential flat is a taxable asset since it is occupied by the Managing Director whose gross annual remuneration exceeds Rs.5 lakh.

(8) Any residential property which is let out for a minimum period of 300 days in the previous year is not an asset. In the given case, the residential house is taxable since it has been let out for less than 300 days during the previous year.

(9) Debts incurred in relation to assets chargeable to tax shall be allowed as deduction in the computation of net wealth. Accordingly, loan obtained for purchase of jewellery shall be allowed as deduction since jewellery is assessable to wealth tax.

25. (i) Farm house situated within 25 kilometers from the local limits of municipality

Section 2(ea) of the Wealth-tax Act defines the term "asset". According to the said definition, buildings including farm house situated within 25 kilometers from the local limits of a municipality shall be considered as an asset. Therefore, the farmhouse situated within 18 kilometers from Niwai Municipal Corporation shall be an asset chargeable to wealth-tax.

(ii) Factory building and godowns leased out on rent

Section 2(ea) provides for exceptions to the chargeability of building or land appurtenant thereto to wealth-tax. One such exception is the property in the nature of commercial establishments or complexes. Therefore, factory buildings and godowns are not assets within the meaning of section 2(ea) of the Wealth-tax Act and are accordingly not chargeable to wealth-tax.

(iii) Silver and gold used in the jewellers' shop

Jewellery is considered as an asset within the meaning of section 2(ea) of the Wealth-tax Act. However, if jewellery is used as stock in trade, the same shall be excluded from the assets chargeable to wealth-tax. Therefore, silver and gold used in the jewellers' shop represent his stock-in-trade and would, therefore, not be chargeable to wealth-tax.

(iv) Cash balance of Rs.4 lakh

Cash in hand in excess of Rs.50,000 is considered as an "asset" under section 2(ea) for individuals and HUF. In case of other persons, any amount not recorded in the books of account shall be considered as an asset. In the given case, if the assessee is an individual or HUF, the cash balance in excess of Rs.50,000 (i.e. Rs.3.50 lakh) shall be chargeable to wealth-tax. In any other case, if the entire cash balance is accounted for in the books of account, it would not be chargeable to wealth-tax. If the cash balance is not accounted for in the books of account, the same would be chargeable to wealth-tax.

IMPORTANT CIRCULARS / NOTIFICATIONS ISSUED BETWEEN 1.5.08 and 30.4.09

I. CIRCULARS

1. Circular No. 5/2008 dated 14.7.2008

The CBDT has, vide notification S.O. No. 493(E), dated 13.3.2008, notified the categories of taxpayers who are mandatorily required to electronically pay taxes on or after 1st April, 2008. The taxpayers who are required to pay taxes by the prescribed mode are - (i) a company; and (ii) a person (other than a company), to whom the provisions of section 44AB of the Income-tax Act, 1961 are applicable. Further, payment of tax electronically has been defined to mean payment of tax by way of - (i) internet banking facility of the authorised bank or (ii) credit or debit cards.

Consequent to issue of the notification, foreign assessees have been facing difficulties in complying with the provisions with regard to mandatory e-payment of taxes. Since they do not have a presence in India, they are not able to meet the 'know your customer norms' of the banks. This has resulted in their inability to open bank accounts and make payment of taxes through the electronic mode. Also, the resident taxpayers have been facing difficulties in availing internet banking facilities of the authorized banks. A clarification has also been sought as to whether payment of tax deducted at source by a deductor will fall within the meaning of 'tax' for the purpose of the impugned notification.

Therefore, with a view to facilitating electronic payment of taxes by different categories of taxpayers, CBDT has issued Circular No.5/2008 dated 14.7.2008 to clarify that an assessee can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank. Further, it is also clarified that payment of any amount by a deductor by way of Tax Deducted at Source (TDS) or Tax Collected at Source (TCS) shall fall within the meaning of 'tax' for the purpose of Rule 125 of the Income-tax Rules, 1962.

2. Circular No.7/2008 dated 1.8.2008

Order under section 119(1) of the Income-tax Act, 1961 regarding exemption from the TDS provisions under section 197 read in conjunction with section 10(26BBB) of the Income-tax Act, 1961

The CBDT has, in exercise of the powers conferred under section 119(1) of the Income-tax Act, 1961, directed that corporations which are established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen and whose income qualifies for exemption from income-tax under section 10(26BBB) would also be exempt from tax deduction/collection at source on their receipts. This exemption shall be valid for 3 years from the date of issue of this order. However, this exemption shall not absolve such organisation from their statutory obligation of deducting TDS on all contractual payments made by them to other parties including sub-contractors etc.

3. Circular No.10/2008 dated 5.12.2008

Clarification regarding the meaning of the expression 'fish or fish products' used in Rule 6DD(e)(iii) of the Income-tax Rules, 1962

Under section 40A(3), disallowance is attracted in the computation of income in a case where a payment or aggregate of payments exceeding twenty thousand rupees is made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft. However, payment otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft exceeding twenty thousand rupees does not attract the aforesaid disallowance in certain circumstances as prescribed under Rule 6DD of the Income-tax Rules, 1962. Such exceptions, inter-alia, refer to payment made to the producer for the purchase of fish or fish products under sub-clause (iii) of clause (e) of rule 6DD.

In regard to this sub-clause, the following clarifications have been issued for proper implementation of Rule 6DD -

(i) The expression 'fish or fish products' used in rule 6DD(e)(iii) would include 'other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.'.

(ii) The 'producers' of fish or fish products for the purpose of rule 6DD(e) would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.

However, the above exception will not be available on the payment for the purchase of fish or fish products from a person who is not proved to be a 'producer' of these goods and is only a trader, broker or any other middleman, by whatever name called.

4. Circular No.11/2008 dated 19.12.2008

Exemption under section 11 in case of an assessee claiming both to be a charitable institution as well as a mutual organisation

Section 2(15) defines charitable purpose to include the following:-

(i) Relief of the poor

(ii) Education

(iii) Medical relief, and

(iv) the advancement of any other object of general public utility.

An entity with a charitable object of the above nature was eligible for exemption from tax under section 11 or alternatively under section 10(23C) of the Act. However, it was seen that a number of entities who were engaged in commercial activities were also claiming exemption on the ground that such activities were for the advancement of objects of general public utility in terms of the fourth limb of the definition of charitable purpose. Therefore, section 2(15) was amended vide Finance Act, 2008 by adding a proviso which states that the advancement of any other object of general public utility shall not be a charitable purpose if it involves the carrying on of -

(a) any activity in the nature of trade, commerce or business; or

(b) any activity of rendering any service in relation to any trade, commerce or business;

for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention of the income from such activity.

The following implications arise from this amendment -

(1) The newly inserted proviso to section 2(15) will not apply in respect of the first three limbs of section 2(15), i.e., relief of the poor, education or medical relief. Consequently, where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute charitable purpose even if it incidentally involves the carrying on of commercial activities.

(2) Relief of the poor encompasses a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity, subject, however, to the conditions stipulated under section 11(4A) or the seventh proviso to section 10(23C) which are that -

    (i) the business should be incidental to the attainment of the objectives of the entity, and

    (ii) separate books of account should be maintained in respect of such business.

    Similarly, entities whose object is education or medical relief would also continue to be eligible for exemption as charitable institutions even if they incidentally carry on a commercial activity subject to the conditions mentioned above.

The newly inserted proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e. the fourth limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) of the Act if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

There are industry and trade associations who claim exemption from tax u/s 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

In the final analysis, however, whether the assessee has for its object the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible.

II NOTIFICATIONS

1. Notification No. 86/2008 dated 13.8.2008

The Central Government has, vide notification no.86/2008 dated 13.8.2008, specified the cost inflation index for the financial year 2008-09. The CII for F.Y. 2008-09 is 582.

S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100
2.	1982-83	109
3.	1983-84	116
4.	1984-85	125

5.	1985-86	133
6.	1986-87	140
7.	1987-88	150
8.	1988-89	161
9.	1989-90	172
10.	1990-91	182
11.	1991-92	199
12.	1992-93	223
13.	1993-94	244
14.	1994-95	259
15.	1995-96	281
16.	1996-97	305
17.	1997-98	331
18.	1998-99	351
19.	1999-2000	389
20.	2000-01	406
21.	2001-02	426
22.	2002-03	447
23.	2003-04	463
24.	2004-05	480
25.	2005-06	497
26.	2006-07	519
27.	2007-08	551
28.	2008-09	582

2. Notification No. 88/2008/F.NO. 275/43/2008-IT(B), dated 21.8.2008

The CBDT has, in exercise of the powers conferred by clause (a) of the Explanation to section 194J, notified the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the section 194J:

a. Sports Persons,

b. Umpires and Referees,

c. Coaches and Trainers,

d. Team Physicians and Physiotherapists,

e. Event Managers,

f. Commentators,

g. Anchors and

h. Sports Columnists.

3. Notification No. 90/2008, dated 28.8.2008

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the Official Gazette, for granting relief of tax or, as the case may be, for avoidance of double taxation. The Central Government has now notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

4. Notification No. 91/2008, dated 28.8.2008

Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India for granting relief of tax or, as the case may be, for avoidance of double taxation. The Central Government has now notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

5. Notification No.97/2008 dated 10.10.2008

Rule 6DD of the Income-tax Rules has been substituted. This Rule now provides for cases and circumstances in which a payment or aggregate of payments exceeding twenty thousand rupees may be made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft.

As per this rule, no disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees in the cases and circumstances specified hereunder, namely:

(a) where the payment is made to -

(i) the Reserve Bank of India or any banking company;

(ii) the State Bank of India or any subsidiary bank;

(iii) any co-operative bank or land mortgage bank;

(iv) any primary agricultural credit society or any primary credit society;

(v) the Life Insurance Corporation of India;

(b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;

(c) where the payment is made by -

(i) any letter of credit arrangements through a bank;

(ii) a mail or telegraphic transfer through a bank;

(iii) a book adjustment from any account in a bank to any other account in that or any other bank;

(iv) a bill of exchange made payable only to a bank;

(v) the use of electronic clearing system through a bank account;

(vi) a credit card;

(vii) a debit card.

(d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

(e) where the payment is made for the purchase of -

(i) agricultural or forest produce; or

(ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or

(iii) fish or fish products; or

(iv) the products of horticulture or apiculture,

to the cultivator, grower or producer of such articles, produce or products;

(f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

(g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

(h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;

(i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -

    (i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and

    (ii) does not maintain any account in any bank at such place or ship;

(j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;

(k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

(l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

6. Notification No.1/2009 dated 5.1.2009

The Finance Act, 2008 had amended section 115WB(2)(B)(iii) to provide that any expenditure on or payment through pre-paid electronic meal card shall be excluded from hospitality expenditure and hence, would not be included for valuation of fringe benefit chargeable to tax, provided such card is not transferable and usable only at eating joints or outlets and fulfills such other prescribed conditions.

Rule 40E has now been inserted to provide that, for the purposes of section 115WB(2)(B)(iii), the non-transferable pre-paid electronic meal card has to fulfil the following conditions, namely:

(i) The card should be granted by the employer to its employees under a scheme framed by the employer specifying therein the circumstances under which the meal card can be used by the employee.

(ii) Such card should be issued by the issuing bank i.e. a banking company which issues the card to the employees of an employer in pursuance of an agreement entered into with the employer and which has entered into a contract with the member establishment authorizing him to allow purchases against the said card.

(iii) An employee should not be issued more than one card.

(iv) The card should bear the name of the employer along with the name, photograph and signature of the employee to whom the card is issued.

(v) The card should be used only by the employee to whom the card is issued.

(vi) The card should be used by the employee only for the purpose of purchasing ready to eat food or non-alcoholic beverage from a member establishment.

(vii) The aggregate amount of ready to eat food or non-alcoholic beverage purchased during a day by an employee should not exceed one hundred rupees.

(viii) The details of each transaction of purchase made by the employee against the card should be maintained by the employer and the member establishment in such manner and for such period as is required under the Act for any other similar transaction. "Member establishment" means a restaurant, hotel, canteen or an outlet which sells ready to eat food or non-alcoholic beverage, but should not include a restaurant, hotel, canteen or an outlet selling alcoholic beverage.

7. Notification No. 3/2009 dated 5.1.2009

Clause (xv) of section 80C(2) provides that the subscription to any such deposit scheme of the National Housing Bank as the Central Government may notify in this behalf would qualify for deduction under section 80C. Accordingly, in exercise of the powers conferred in section 80C(2)(xv), the Central Government has specified the National Housing Bank (Tax Saving) Term Deposit Scheme, 2008, the subscription to which would qualify for deduction under section 80C.

8. Notification No. 9/2009 dated 7.1.2009

Section 10(15)(iv)(h) exempts interest payable by any public sector company in respect of such bonds or debentures specified by the Central Government by notification in the Official Gazette. The notification would also specify the conditions subject to which the exemption would be available. Accordingly, in exercise of the powers conferred in section 10(15)(iv)(h), the Central Government has specified the issue of tax free bonds by India Infrastructure Finance Company Limited during the financial year 2008-09, the interest on which would be exempt under the said section. Further, it has been provided that such benefit shall be admissible only if the holder of such bonds registers his or her name and the holding with the said Corporation.

9. Notification No.15/2009, dated 30.1.2009

Rule 8C of the Wealth-tax Rules, 1957 has been substituted. New Rule 8C provides for the following scale of fees to be charged by a registered valuer.

(1) The fees to be charged by a registered valuer for valuation of any asset should not exceed the amount calculated at the following rates, namely:

(a) On the first Rs.5 lakh of the asset as valued	1/2 per cent of the value;
(b) On the next Rs.10 lakh of the asset as valued	1/5 per cent of the value;
(c) On the next Rs.40 lakh of the asset as valued	1/10 per cent of the value;
(d) On the balance of the asset as valued	1/20 per cent of the value.

(2) Where two or more assets are required to be valued by a registered valuer at the instance of an assessee all such assets shall be deemed to constitute a single asset for the purposes of calculating the fees payable to such registered valuer.

(3) However, where the amount of fees calculated in accordance with (1) and (2) above is less than Rs.500, the registered valuer may charge Rs.500 as his fees.

10. Notification No. 28/2009, dated 16.3.2009

Rule 37BA providing for credit for tax deducted at source for the purposes of section 199 and Rule 37-I providing for credit for tax collected at source for the purposes of section 206C(4) have been inserted with effect from 1.4.2009.

Rule 37BA provides for credit for tax deducted at source for the purposes of section 199.

Sub-rule (1) provides that credit for tax deducted at source and paid to the Central Government in accordance with the provisions of Chapter XVII, shall be given to the person to whom payment has been made or credit has been given (i.e., the deductee) on the basis of information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorised by such authority.

Sub-rule (2) provides that if the income on which tax has been deducted at source is assessable in the hands of a person other than the deductee, credit for tax deducted at source shall be given to the other person in cases where-

(a) the income of the deductee is included in the total income of another person under the provisions of section 60, section 61, section 64, section 93 or section 94;

(b) the income of a deductee being an association of persons or a trust is assessable in the hands of members of the association of persons, or in the hands of trustees, as the case may be;

(c) the income from an asset held in the name of a deductee, being a partner of a firm or a karta of a Hindu undivided family, is assessable as the income of the firm, or Hindu undivided family, as the case may be;

(d) the income from a property, deposit, security, unit or share held in the name of a deductee is owned jointly by the deductee and other persons and the income is assessable in their hands in the same proportion as their ownership of the asset:

However, in such cases, the deductee should file a declaration with the deductor. Such declaration filed by the deductee should contain the name, address, permanent account number of the person to whom credit is to be given, payment or credit in relation to which credit is to be given and reasons for giving credit to such person.

Also, the deductor should report the tax deduction in the name of the other person in the information relating to deduction of tax referred to in sub-rule (1). The deductor should issue the certificate for deduction of tax at source in the name of the person in whose name credit is shown in the information relating to deduction of tax referred to in sub-rule (1) and should keep the declaration in his safe custody.

Sub-rule (3) provides that the credit for tax deducted at source and paid to the Central Government, shall be given for the assessment year for which such income is assessable. Where tax has been deducted at source and paid to the Central Government and the income is assessable over a number of years, credit for tax deducted at source shall be allowed across those years in the same proportion in which the income is assessable to tax.

Sub-rule (4) provides that credit for tax deducted at source and paid to the account of the Central Government shall be granted on the basis of -

(i) the information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorized by such authority; and

(ii) the information in the return of income in respect of the claim for the credit,

subject to verification in accordance with the risk management strategy formulated by the Board from time to time.

Rule 37-I provides for credit for tax collected a source for the purposes of section 206C(4).

Sub-rule (1) provides that the credit for tax collected at source and paid to the Central Government in accordance with provisions of section 260C, shall be given to the person from whom the tax has been collected, on the basis of the information relating to collection of tax at source furnished by the collector to the income-tax authority or the person authorized by such authority.

Sub-rule (2) provides that where tax has been collected at source and paid to the Central Government, credit for such tax shall be given for the assessment year for which the income is assessable to tax. Where tax has been collected at source and paid to the Central Government and the lease or license is relatable to more than one year, credit for tax collected at source shall be allowed across those years to which the lease or license relates in the same proportion.

Sub-rule (3) provides that the credit for tax collected at source and paid to the account of the Central Government shall be granted on the basis of -

(i) the information relating to collection of tax furnished by the collector to the income-tax authority or the person authorized by such authority; and

(ii) the information in the return of income in respect of the claim for the credit,

subject to verification in accordance with the risk management strategy formulated by the Board from time to time.

11. Notification No. 37/2009 dated 21.4.2009

The CBDT has, through Notification No.10/2009 dated 19.1.09, notified the Income-tax (Third Amendment) Rules, 2009 which came into force from 1.4.2009. This notification had inserted "new commercial vehicles acquired on or after 1.1.2009 but before 1.4.2009 and put to use before 1.4.2009 for the purposes of business or profession" under the head MACHINERY AND PLANT, which would be eligible for depreciation at the rate of 50%.

Subsequently, the CBDT has, through this notification notified that the benefit of increased depreciation of 50% on commercial vehicles be extended to such vehicles acquired and put to use before 1st October 2009. Therefore, the commercial vehicles acquired on or after 1.1.2009 but before 1.10.2009 and put to use before 1.10.2009 will be eligible for depreciation at the rate of 50%.

PAPER - 8 : INDIRECT TAXES

QUESTIONS

EXCISE

Manufacture

1. Parsavnath Furnishers Limited (PFL) is engaged in procuring the duty paid Office Furniture System/Work Stations (OFS/WS) from the suppliers and erecting and installing them at site of customers, from whom it has procured the orders. After receiving the orders from its clients, a team of engineers prepares a lay out on computer aided design system where ready-made furniture systems and work stations manufactured by independent manufactures/suppliers are superimposed. Thereafter, based on the clients' specifications, orders are placed upon the manufacturer of the furniture for each works station. After procuring the various elements of furniture system from the manufacturer, they join the same together according to the site drawing and the project code.

   The assessee contends that that they are only marketing OFS/WS. However, the Revenue alleges that PFL is liable to pay duty as the said activity amounts to manufacture.

   Examine, with reference to a decided case law, if any, whether the Revenue's allegation is tenable in law?

Power of arrest under excise

2. Briefly explain the power of arrest under section 13 and section 18 of the Central Excise Act, 1944.

Appeal

3. The CESTAT passed its order on 01.01.2008. The assessee filed the application for rectification of a mistake apparent from the record in the said order on 23.05.2008. However, the Tribunal could not dispose of the application till 30.06.2008. Thereafter, the Tribunal rejected the application on the ground that the six months period had lapsed.

   Do you think that the stand taken by the Tribunal is valid in law?

Settlement Commission

4. Sonata Steel Industries (SSI) manufactures 'kitchen sink' and classifies it as 'sanitary ware'. However, the Revenue insists that the said product should be classified under the heading 'household article of iron and steel'. SSI approaches you for the professional advice asking whether it can take the issue before the Settlement Commission. You are required to provide them the required advice.

Advance Ruling

5. Can a writ petition be invoked against advance rulings?

SSI

6. Cupurus Coporations - a small scale unit - has affected clearances of goods of the value of Rs. 900 lakh during the financial year 2008-09. The said clearances include the following:

   (i) Clearance of excisable goods without payment of excise duty to a 100% EOU : Rs. 250 lakh

   (ii) Export to Nepal and Bhutan : Rs. 125 lakh

   (iii) Job work under exemption Notification No. 214/86 C.E.: Rs. 270 lakh

   (iv) Goods manufactured in rural area with the brand name of others: Rs. 120 lakh

   Examine, whether the benefit of exemption under the Notification No. 8/2003 dated 01.03.2003 would be available to the unit for the financial year 2009-10.

Refund

7. What is a Consumer Welfare Fund? How is this fund utilized?

Classification under central excise

8. When entries in Harmonized System of Nomenclature (HSN) and the Excise Tariff are not aligned, can reliance be placed upon HSN for the purpose of classification of goods?

Appeal

9. An appeal filed under section 35(2) of the Central Excise Act, 1944 by the Committee of Commissioners themselves and not by subordinate officer based on authorization is not maintainable. Examine, with the help of a decided case law, if any, the validity of the statement.

Central Excise Rules, 2002

10. Can goods lost by 'theft' or 'dacoity' be considered to be "goods lost or destroyed by natural causes or by unavoidable accident" under rule 21 of the Central Excise Rules, 2002?

Valuation

11. Dodo Foods is engaged in manufacturing Dodo soft drinks. Valuation of the soft drinks is done as per section 4A of the Central Excise Act, 1944. In order to sustain the tough market competition, the company reduced its prices from Rs. 12 to Rs. 10. Hence, on the existing stock of the soft drink bottle, MRP of Rs. 12 is scored out and MRP of Rs. 10 is printed. However, the crossed out MRP of Rs. 12 is clearly visible. Which MRP shall be considered for valuation purposes?

CENVAT Credit Rules, 2004

12. Triveni Texturisers purchased inputs from Khaitani Industries and availed the CENVAT credit of the entire excise duty paid by Khaitani Industries as reflected in the invoice. Subsequently, Khaitani Industries gave certain amount of discount for the reason of the

bulk purchases made by Triveni Texturisers during the period. This trade discount was given by issuing credit notes for the basic price. Department contends that Triveni Texturisers is not entitled to the CENVAT credit on the entire duty paid on the price initially invoiced and should reverse the credit proportionately.

Discuss whether the contention of the Revenue is justifiable.

Removal of goods from 100% EOU to Domestic Tariff Area

13. Briefly explain the procedure for removal of goods from a hundred percent export oriented unit to the domestic tariff area.

CUSTOMS

Section 121 of the Customs Act, 1962

14. Whether custom authorities are authorized to auction the confiscated goods during the period of pendency of appeal?

Valuation

15. Gulf Corporation Limited imported some goods from USA. The details of the transaction are as follows:-

Authority	Rate of exchange
CBEC	1 US $=Rs 45
RBI	1 US $=Rs 46.10

CIF value of the goods is $ 20,000

Rate of basic custom duty is 40%

Rate of education cess is 3%

If similar goods were manufactured in India, excise duty payable as per Tariff is 8%.

Calculate assessable value and total duty payable thereon.

Warehousing

16. Explain ‘Warehousing without warehousing’ under the Customs Act, 1962.

Appeal

17. Can there be a difference in the final order issued by Tribunal and the handwritten order in the order sheet?

Section 2 of the Customs Act, 1962

18. Define briefly, the following with reference to section 2 of the Customs Act, 1962:-

(a) Importer

(b) Person-in-charge

(c) Foreign going vessel

(d) Adjudicating authority

Confiscation of conveyances

19. Illustrate the conveyances which are liable to confiscation under section 115 of the Customs Act, 1962.

Baggage Rules, 1998

20. Answer the following question with reference to the Baggage Rules, 1998:-

Amarnath, an IT professional and a person of Indian origin, is residing in Denmark for the last 14 months. He wishes to bring a used microwave oven (costing approximately Rs. 4,200 and weighing 15 kg) with him during his visit to India. He purchased the oven in Denmark 6 months back and he has been using that oven for his personal use in his kitchen. He is not aware of Indian customs rules. Could you please provide him some advice in this regard?

SERVICE TAX

Taxable services

21. Discuss, with the help of a decided case law, if any, whether the explanation inserted by Finance Act, 2008 to the definition of 'business auxiliary service' under section 65(19)(ii) of the Finance Act, 1994 as amended can be construed having retrospective effect and retroactive operation.

Credit of input services

22. M/s Ojha Cements Limited (OCL) was engaged in the business of manufacturing and selling of cement and had been duly paying the excise duty in respect of cement produced by it. OCL supplied cement to its customers "FOR destination" and bore the freight up to the door steps of the customer i.e. the destination point. The assessee had taken the CENVAT credit of the service tax paid on the aforementioned freight by it.

The Department contended that the payment of service tax on the freight incurred by the assessee was not input service as per rule 2(l) of the CENVAT Credit Rules, 2004 and hence the CENVAT credit was not admissible on it under the said rules.

Explain, with the help of a decided case law, if any, whether the stand taken by Department is tenable in law.

Refund of the service tax

23. Answer the following questions, with reference to the Notification No. 41/2007 dated 06.10.2007 as amended:-

(a) What is the time limit for filing the refund claim?

(b) Whether the limitation period for filing the refund claim would be counted from the date of exports or from the date of receipt of remittances?

(c) Whether refund would be admissible on specified taxable service received prior to the date it is notified in the said notification, if such services are used in relation to goods which are exported subsequent to the date on which such taxable services are notified under Notification No. 41/2007-ST?

Filing of return

24. Briefly answer the following questions:-

(a) Is filing of return compulsory even if no taxable service is provided or received or no payments are received during a period (a particular half year)?

(b) Whether a single return is sufficient when an assessee provides more than one service?

(c) What are the returns a service tax assessee has to file?

Penal provisions

25. Briefly discuss the residual penalty under section 77 of the Finance Act, 1994 as amended.

SUGGESTED ANSWERS/HINTS

1. The facts of the given case are similar to the case of CCE v. Blow Plast Ltd. 2009 (236) E.L.T. 631 (Del.). The Tribunal arrived at the conclusion that since the supplier had cleared the complete set of elements required for the work station in a knocked down condition, it could not be said that the supplier had manufactured the parts and not the complete system.

   The High Court while affirming the Tribunal's order held that the same product as known to the trade could not be manufactured twice over. Consequently, nothing new had come into existence so as to bring the activities of the assessee within the parameters specified in section 2(f) of the Central Excise Act, 1944. What the assessee received was complete OFS/WS and what it left on its clients' sites was also complete OFS/WS. Nothing new had come into existence. Hence, no duty was payable by the assessee.

   Therefore, it can be inferred that the Revenue's allegation is not tenable in law

2. Section 13 and section 18 of the Central Excise Act, 1944 contain the provisions relating to arrest under Central Excise Act.

   Any Central Excise Officer not below the rank of Inspector can arrest any person whom he has a reason to believe to be liable to punishment under the Central Excise Act, 1944. Such an arrest can be only with the prior approval of Commissioner of Central Excise.

   The arrested person must be produced before the Magistrate within twenty four hours of the arrest. Normally, the Magistrate exercises the power to grant bail.

   As per section 18, all arrests shall be carried out in accordance with the provisions of the Code of Criminal Procedure relating to arrest.

3. In case of Sree Ayyangar SPG & WVG Mills Ltd. v. CIT 2008 (229) ELT 164 (SC), the Supreme Court while interpreting section 254(2) of the Income Tax Act, 1961 held that once the assessee had moved the application within four years from the date of order, the Tribunal could not reject that application on the ground that four years had lapsed, which included the period of pendancy of the application before the Tribunal. Therefore, it concluded that if the assessee had moved the application within four years from the date of the order, the Tribunal was bound to decide the application on the merits and not on the ground of limitation.

   Applying the ratio of the aforementioned case in the given situation, it can be inferred that limitation period for filing rectification of mistake is not the time limit for deciding the rectification of mistake under section 35C(2) of the Central Excise Act, 1944. Hence, in the instant case, the Tribunal is not justified in rejecting the application on the ground that the six months period has lapsed as the application had been filed before the expiry of six months.

4. As per section 32E of the Central Excise Act, 1944, an application cannot be made in Settlement Commission for interpretation of classification of goods. Since, this case relates to interpretation of classification of goods, hence, application shall not be admitted by the Settlement Commission.

5. Recently, the Delhi High Court, in case of UAE Exchange Centre Ltd. v. UOI 2009 (236) E.L.T. 223 (Del.), has held that the ruling by Advance Rulings Authority is binding on the applicant, transaction on which the ruling is sought and the departmental officers concerned. It does not exclude the jurisdiction of the Courts either expressly or by implication. There is no provision which gives finality to the decision of the Authority. The High Court viewed that the Courts would have jurisdiction to entertain actions under Article 226 of the Constitution (writ petition) impugning the ruling given by the Authority. Therefore, a writ petition can be invoked against advance rulings.

6. Cupurus Coporations will be eligible for benefit of exemption under Notification No. 8/2003 dated 01.03.2003 only if value of clearances during preceeding financial year - 2008-09 does not exceed 400 lakhs.

   Calculation of value of clearances during the financial year 2008-09:-

Particulars	Rs.
Total value of clearances	900 lakhs
Less : Clearance to 100% EOU (Note – 1)	250 lakhs
Less: Clearance under exemption Notification No. 214/86 (Note - 2)	270 lakhs
Total value of clearances	380 lakhs

   Since, the value of clearances for home consumption in financial year 2008-09 didn't exceed Rs. 400 lakh, the benefit of exemption shall be available during financial year 2009-10.

Notes : For the purpose of computing the limit of 400 lakh:-

1. clearances to 100 % EOU shall be excluded as these clearances are otherwise exempt also,
2. clearance under exemption Notification No. 214 / 86 shall be excluded,
3. export to Nepal & Bhutan shall be treated clearance for home consumption and hence not excluded,
4. goods bearing the brand name of others are excluded but if produced in rural area then it qualifies for exemption and hence not excluded.

7. Meaning of Consumer Welfare Fund:-

The Consumer Welfare Fund has been established by the Central Government under the provisions of section 12C of the Central Excise Act, 1944 wherein the following amounts are credited:-

(i) the refund of duty of excise/customs, which is not to be granted to the applicant,

(ii) any income from investment of the amount credited to the Fund and any other monies received by the Central Government for the purposes of this Fund, and

(iii) surplus amount of service tax referred to in section 73A(6) of the Finance Act, 1994 as amended.

Utilization of funds:-

Section 12D of the Central Excise Act, 1944 provides that:-

(1) any money credited to the fund shall be utilized by the Central Government for the welfare of the consumers in accordance with such rules framed in this behalf.

(2) The Central Government shall maintain or, if it thinks fit, specify the authority, which shall maintain, proper and separate account and other relevant records in relation to the Fund in such form as may be prescribed in consultation with the Comptroller and Auditor General of India.

8. The Supreme Court in case of Camlin Ltd. v. CCEx., Mumbai 2008 (230) E.L.T. 193 (SC) has held that when the entries in the Harmonised System of Nomenclature (HSN) and the Excise Tariff are not aligned, reliance cannot be placed upon HSN for the purpose of classification of goods under the said Tariff. It further added that in the instant case, the Tribunal erred in relying upon the HSN for the purpose of classification of the impugned product. The Tribunal failed to appreciate that since the entries under the HSN and the entries under the said Tariff are completely different, the Tribunal could not base its decision on the entries in the HSN.

9. The statement is not valid. The Gujarat High court, in case of Commr. Of C.Ex. & Cus. v. Shree Ganesh Dyeing & Ptng. Works 2008 (232) ELT 775 (Guj.), has decided the issue as to whether the appeal filed by Commissioner himself and not by subordinate officer based on authorization, is maintainable. In the instant case, the assessee raised a preliminary objection as to maintainability of the appeal on the ground that the appeal

had been filed by Commissioner himself, instead of by the Central Excise Officer authorised by the Commissioner, as required by section 35B(2) of the Central Excise Act, 1944.

The Court, while analyzing section 35B(2) of the Central Excise Act, 1944, held that section 35B(2) is made up of two parts or two stages. The first stage is formation of an opinion by Commissioner that the order made by the appellate authority is not legal or proper. The second stage is filing of an appeal against order of appellate authority by directing any Central Excise Officer authorised by the Commissioner in this behalf to file an appeal on behalf of the Commissioner. Thus, the Commissioner is vested with a discretion, in the first instance to form an opinion as to whether appellate order is legal or proper and then exercise the discretion to decide whether an appeal should be preferred or not, having come to the conclusion that the order is not proper or legal.

The High Court further clarified that when a person is statutorily entitled to delegate powers to another person to file an appeal on behalf of the first named person, it goes without saying that the power which can be delegated is the power which the first named person would be entitled to exercise. Hence, until and unless the Commissioner himself is entitled to file an appeal, there is no question of the Commissioner authorising another officer to file appeal on behalf of the Commissioner. The language of the latter part of sub-section (2) of section 35B of the Act itself makes this more than abundantly clear when the provision uses the phrase 'to appeal on his behalf'.

Therefore, if an appeal has been preferred by Commissioner or the authorised officer, the appeal would be valid and shall be treated to be a valid appeal in eyes of law.

Note : Section 35B(2) was amended vide the Finance Act, 2005 to provide that instead of Commissioner of Central Excise, a Committee of Commissioners of Central Excise shall review the orders of Commissioner of Central Excise (Appeals) and direct any Central Excise Officer authorized by him to appeal on its behalf to the Appellate Tribunal. However, the principle enunciated in this judgment will hold good in respect of amended section 35B (2) as well.

10. The question as to whether goods lost by 'theft' or 'dacoity' can be considered to be "goods lost or destroyed by natural causes or by unavoidable accident" under rule 21 of the Central Excise Rules, 2002 was decided by the larger bench of the Tribunal in case of Gupta Metal Sheets v. CCE 2008 (232) E.L.T. 796 (Tri.-LB). It clarified that the term 'loss' cannot be understood in the limited sense of 'loss to the manufacturer'. In the context of the Central Excise Law, it has to be understood as being unavailable for consumption in the market. In case of theft or dacoity, the goods are not 'lost' or 'destroyed'; they rather enter the market for consumption, albeit stealthily, after being removed from the approved premises or the place of storage. As per rule 49 of the erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002); loss must be attributable to any natural cause or unavoidable accident.

'Natural cause' refers to some natural phenomenon i.e. vagary of nature or some act of nature like fire, flood or a similar natural calamity. The act of forcibly removing the goods by any means - non-violent or violent - amounting to theft or dacoity under the Indian Penal Code cannot be said to be a natural cause.

Considering the definitions of 'theft' and 'robbery' in the Indian Penal Code, the Tribunal held that 'theft' or 'dacoity' involves forcible removal of goods by non-violent or violent means, as the case may be, and this cannot be said to be a natural cause. The Tribunal opined that theft or dacoity is an incident and not an accident, much less unavoidable. Theft and dacoity are committed by a design and they cannot be said to be accident by any logic. By taking due care and caution, they can be avoided and, therefore, it cannot be said that theft or dacoity is 'unavoidable accident'.

In view of the above, the Tribunal held that 'theft' or 'dacoity' cannot be called unavoidable accident within the meaning of the rule 49 of erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002) and the goods lost in theft or dacoity would not be eligible for remission.

11. Circular no. 673/64/2002-CX dated 28.10.2002 provides that once MRP is scored out, (even if it remains visible) and another MRP is printed on the package, it can not be said that the package has two MRPs printed on it, since the scored out MRP could not be considered as an MRP either by the seller or by the consumer. Hence, the scored out MRP is to be ignored. Therefore, in the instant case, the new MRP of Rs. 10 shall be considered for the purpose of valuation.

12. No, the contention of the Revenue is not justifiable in law.

    In ACS Hydraulics Pvt. Ltd. v. CCE 2008 (227) ELT 425 (Tri.), the Tribunal held that there was no loss to the Revenue as far as the payment of duty was concerned by the supplier of the goods on the proper correct assessable value. Therefore, the Department could not direct the appellant to reverse the credit or to disallow the credit as the supplier had paid the duty and taken credit which was equivalent to duty shown in the invoice issued by the supplier.

    Besides, Circular No. 877/15/2008-CX dated 17.11.2008 has also clarified that in such cases, the entire amount of duty paid by the manufacturer, as shown in the invoice, would be available as credit irrespective of the fact that subsequent to clearance of the goods, the price is reduced by way of discount or otherwise.

    In view of the above discussion, it can be concluded that Triveni Texturisers is entitled to the CENVAT credit on the entire duty paid on the price initially invoiced and need not reverse the credit proportionately.

13. Rule 17 of the Central Excise Rules, 2002 provides that where any goods are removed from a hundred percent export oriented unit to domestic tariff area, such removal shall be made under an invoice in the procedure specified under rule 11 of the said rules. Further, removal shall be made only after payment of appropriate duty by crediting the duty payable to the account of the Central Government in the manner specified in rule 8 or by utilizing the CENVAT credit.

Such unit is required to maintain appropriate accounts related to production in the prescribed form giving the following details :

(i) description of goods

(ii) quantity removed

(iii) duty paid.

Such unit shall submit a monthly return in the specified form (E.R - 2) in respect of the excisable goods manufactured, and receipt of inputs and capital goods, in the unit, to the Superintendent of Central Excise within 10 days from the close of the month to which the return relates.

The proper officer may on the basis of information contained in the return filed by the unit, and after such further enquiry as he may consider necessary, scrutinize the correctness of the duty assessed by the assessee on the goods removed, in the manner to be prescribed by the Board.

Every assessee shall make available to the proper officer all the documents and records for verification as and when required by such officer.

14. Bombay High Court, in case of Shabir Ahmed Abdul Rehman v. UOI 2009 (235) ELT 402 (Bom.), decided the similar issue in favour of assessee. In this case, Revenue confiscated the gold carried by the petitioner from Muscat. The petitioner informed the custom authorities that he was filing an appeal against the order of confiscation. Revenue informed the petitioner that the confiscated goods had been handed over to the warehouse of the Custom House for disposal and consequently, auctioned the confiscated goods.

The High Court held that handing over the confiscated gold immediately after serving the order of confiscation itself was improper. In any event, after receiving letter from the petitioner, the custom authorities ought to have stopped the auction sale of the confiscated gold. The action of the custom authorities in selling the gold during the pendency of the appeal was not justified.

Hence, it can be concluded that the custom authorities are not authorized to auction the confiscated goods during the period of pendency of appeal.

15. Computation of assessable value and total custom duty payable:-

Particulars	
CIF Value	$ 20,000
Add : Landing charges @ 1% of CIF value (Note – 1)	$ 200
	$ 20,200
Assessable value (in Rupees) =$20,200 × Rs. 45 (Note -2)	Rs. 9,09,000
Add : Basic custom duty @ 40% (Rs. 9,09,000 × 40%)	Rs. 3,63,600
	Rs. 12,72,600

Add : Countervailing duty (Rs. 12,72,600 × 8.24%)	Rs. 1,04,862.20
	Rs.13,77,462.24
Education cess [(Rs. 3,63,600 + Rs. 1,04,862.20) × 3%]	Rs. 14,053.87
Total custom duty payable (Rs. 3,63,600 + Rs. 1,04,862.20 + Rs. 14,053.87)	Rs. 4,82,516.11

Notes :-

(1) Landing charges at the rate of 1% of the CIF value of the imported goods, shall be added, whether ascertainable or not [First proviso to rule 10(2) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

(2) Applicable exchange rate is Rs. 45/- per $ as notified by CBEC because explanation to section 14(1) provides that rate of exchange shall be the rate as notified by CBEC.

16. Warehousing without warehousing (Section 49 of the Customs Act, 1962)

Section 49 allows the importer to store the goods in a public warehouse, but the goods shall not be treated as warehoused goods for the purpose of the Customs Act, 1962 and accordingly warehousing provisions shall not apply to such goods. This may arise in following two cases:-

(i) Where due to some genuine difficulty, the importer is unable to clear the goods for home consumption within the stipulated time, the goods may be deposited in a warehouse without double duty bond. This facility is available irrespective of whether the goods are dutiable or not.

(ii) If the importer makes a declaration and for any reason the importer is unable to furnish all the particulars of the goods, he can seek permission to deposit the goods in a public bonded warehouse appointed under section 57 pending receipt of the necessary information and the supporting documents under section 49.

17. The High Court in case of Dinkar Khindria v. UOI 2008 (231) ELT 47 (Del.) held that a difference in the Final Order issued by Tribunal and the Handwritten Order in Order Sheet i.e. a change of order by Members of the Tribunal, amounts to tampering with the judicial records. Once an order is passed and it is signed by the members, the same cannot be altered unless law provides for a review of the same and that too only after hearing the parties. The High court held that Tribunal should ensure that such unsavory incidents should not occur in the course of their conduct of judicial proceedings.

18. (a) Importer: [Section 2(26)]:

Importer in relation to any goods at any time between their importation and the time when they are cleared for home consumption, includes any owner or any person holding himself out to be the importer.

(b) Person-in-charge: [Section 2(31)]:

Person-in-charge means-

(a) in relation to a vessel, the master of the vessel;

(b) in relation to an aircraft, the commander or the pilot-in-charge of the aircraft;

(c) in relation to a railway train, the conductor, guard or other person having the chief direction of the train;

(d) in relation to any other conveyance, the driver or other person-in-charge of the conveyance.

(c) Foreign going vessel or aircraft: [Section 2(21)]:

The term is defined to mean any vessel or aircraft for the time being engaged in the carriage of goods or passengers between any port or airport in India and any port or airport outside India, whether touching any intermediate port or airport in India or not, and includes-

- any naval vessel of any foreign Government taking part in any naval exercise;

- any vessel engaged in fishing or any other operations outside the territorial waters of India;

- any vessel or aircraft proceeding to a place outside India for any purpose whatsoever;

(d) "Adjudicating authority" [Section 2(1)]

means any authority competent to pass any order or decision under the Customs act, 1962, but does not include the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act,1963 (54 of 1963), Commissioner of Central Excise (Appeals) or Appellate Tribunal;

19. The following conveyances shall be liable to confiscation:-

(a) any vessel which is or has been within the Indian customs waters, any aircraft which is or has been in India, or any vehicle which is or has been in a customs area, while constructed, adapted, altered or fitted in any manner for the purpose of concealing goods;

(b) any conveyance from which the whole or any part of the goods is thrown overboard, staved or destroyed so as to prevent seizure by an officer of customs;

(c) any conveyance which having been required to stop or land under section 106 fails to do so, except for good and sufficient cause;

(d) any conveyance from which any warehoused goods cleared for exportation, or any other goods cleared for exportation under a claim for drawback, are unloaded, without the permission of the proper officer;

(e) any conveyance carrying imported goods which has entered India and is afterwards found with the whole or substantial portion of such goods missing, unless the master of the vessel or aircraft is able to account for the loss of, or deficiency in, the goods.

20. As per rule 5 of the Baggage Rules, 1998, Amarnath is entitled to bring the used household articles upto an aggregate value of Rs. 12,000 free of duty. Hence, Amarnath can clear the used Microwave oven free of duty within the permissible allowance.

21. In a recent case, the Apex Court in the case of Union of India & Ors v. M/s Martin Lottery Agencies Ltd. 2009 (14) STR 593 (SC) ruled that by reason of an explanation, a substantive law may also be introduced. If a substantive law is introduced, it will have no retrospective effect. Subject to the constitutionality of the Finance Act, 2009 as amended in view of the explanation appended to this, the Supreme Court opined that the service tax, if any, would be payable only with a prospective effect and not with retrospective effect.

    It further opined that in a case of this nature, the Court must be satisfied that the Parliament did not intend to introduce a substantive change in the law. As stated herein before, for the aforementioned purpose, the expressions like 'for the removal of doubts' are not conclusive. The said expressions appear to have been used under assumption that organizing games of chance would be rendition of service. It held that the explanation is not clarificatory or declaratory in nature. Hence, it could not be construed having retrospective effect and retroactive operation.

22. No, the stand taken by the Department is not tenable in law.

    The facts of the given case are similar to the case of Ambuja Cements Ltd. v. UOI 2009 (14) S.T.R. 3 (P & H). In this case, the High Court observed that the 'input service' has been defined under rule 2(l) of the CENVAT Credit Rules, 2004 to mean any service used by the manufacturer whether directly or indirectly and also includes, inter alia, services used in relation to inward transportation of inputs or export goods and outward transportation up to the place of removal.

    Further, the Board's Circular No. 97/8/2007-ST dated 23-8-2007 contemplates compliance of certain conditions where the sale has taken place at the destination point. These conditions are as follows:-

    (i) the ownership of goods and the property in the goods remained with the seller of the goods till the delivery of the goods in acceptable condition to the purchaser at his door step;

    (ii) the seller bore the risk of loss of or damage to the goods during transit to the destination; and

    (iii) the freight charges were an integral part of the price of goods.

    The first requirement was fulfilled because:-

    (i) the supply of cement by appellant to its customer was 'FOR destination',

    (ii) the freight up to the door step of the customer was borne by the appellant, and

    (iii) the service tax on the freight charges was paid by the appellant.

Moreover, for transportation purposes insurance cover has also been taken by the appellant which further shows that the ownership of the goods and the property in the goods has not been transferred to the seller till the delivery of the goods in acceptable condition to the purchaser at his door step. Accordingly, the second condition also stood fulfilled.

Since, the delivery of the goods is at "FOR destination' price, the third condition that the freight charges were integral part of the excisable goods also stood fulfilled.

In view of above discussion, the High Court opined that the questions of law deserved to be answered in favour of the assessee-appellant and against the Revenue. Hence, it held that the assessee was entitled to the credit of the service tax paid on the freight up to the door steps of the customer.

23. (a) Notification No. 32/2008 ST dated 18.11.2008 has extended the time-limit for filing the refund claim from sixty days to six months from the end of the relevant quarter during which the said goods have been exported.

(b) Circular No. 112/06/2009 dated 12.03.2009 clarifies that it is clearly prescribed in the notification that limitation period of six month is to be computed from the date of exports.

(c) Circular No. 112/06/2009 dated 12.03.2009 clarifies that being prospective in nature refund is not admissible on such services received prior to the date they are notified in the said notification, even if the goods, in relation to which these services are used, are exported after the date when such services are notified under Notification No. 41/2007-ST.

24. (a) Filing of return within the prescribed time limit is compulsory, even if it may be a nil return, failing which penal action is attracted.

(b) A single return is sufficient because the ST-3 Return is designed to capture details of each service separately with in the same return.

(c) (i) ST-3 Return – For all the registered assessee, including input service distributors.

(ii) ST-3A Return – The assessee who is making provisional assessment under rule 6(4) of the Service Tax Rules, 1994 is required to file a memorandum in form ST-3A accompanying the return.

25. Penalty for contravention of rules and provisions of the Finance Act, 1994 as amended for which no penalty is specified elsewhere [Section 77]:

(1) Any person,

(a) who is liable to pay service tax, or required to take registration, fails to take registration in accordance with the provisions of section 69 or rules made under this Chapter shall be liable to pay a penalty which may extend to Rs. 5,000 or Rs. 200 for every day during which such failure continues, whichever is higher, starting with the first day after the due date, till the date of actual compliance;

(b) who fails to keep, maintain or retain books of account and other documents as required in accordance with the provisions of this Chapter or the rules made thereunder, shall be liable to a penalty which may extend to Rs.5,000;

(c) who fails to,

(i) furnish information called by an officer in accordance with the provisions of this Chapter or rules made thereunder; or

(ii) produce documents called for by a Central Excise Officer in accordance with the provisions of this Chapter or rules made thereunder; or

(iii) appear before the Central Excise Officer, when issued with a summon for appearance to give evidence or to produce a document in an inquiry, shall be liable to a penalty which may extend to Rs. 5,000 or Rs. 200 for every day during which such failure continues, whichever is higher, starting with the first day after the due date, till the date of actual compliance;

(d) who is required to pay tax electronically, through internet banking, fails to pay the tax electronically, shall be liable to a penalty which may extend to Rs.5,000;

(e) who issues invoice in accordance with the provisions of the Act or rules made thereunder, with incorrect or incomplete details or fails to account for an invoice in his books of account, shall be liable to a penalty which may extend to Rs.5,000.

(2) Any person, who contravenes any of the provisions of this Chapter or any rules made thereunder for which no penalty is separately provided in this Chapter, shall be liable to a penalty which may extend to Rs.5,000.

IMPORTANT AMENDMENTS MADE BETWEEN 01.05.2008 TO 30.04.2009

Students may note that the Study Material for Indirect Taxes contains all the relevant amendments made by the Finance Act, 2008. Further, circulars/notifications issued up to 30.04.2008 have also been incorporated therein. The following are the amendments which have been made between 01.05.2008 to 30.04.2009. It may be carefully noted that for the students appearing in November 2009 exams, the amendments made by the notifications, circulars and other legislations up to 30.04.2009 are relevant.

A. EXCISE

1. Following amendments have been made in the Central Excise Rules, 2002:

(i) Rule 12(2A) inserted- Annual Installed Capacity Statement

This rule provides that every assessee shall submit to the Superintendent of Central Excise, an Annual Installed Capacity Statement declaring the annual production capacity of the factory for the financial year to which the statement relates in Form ER-7 by the 30th April of the succeeding financial year.

However, the Central Government may specify assessee or class of assessees who may not require to submit such an Annual Installed Capacity Statement.

For the year 2007-08, the said statement shall be furnished by 31st October, 2008.

[Notification No. 38/2008 CE (NT) and Notification No. 39/2008 CE (NT) dated 29.09.2008]

(ii) Amendments to rule 17 - Removal of goods by a 100% EOU for DTA

Notification No. 23/2008 CE (NT) dated 23.05.2008 has amended rule 17 of the Central Excise Rules, 2002 with effect from 01.06.2008as follows:-

(a) Rule17(1) Monthly payment of duty by 100% EOUs

In case of removal of excisable goods from 100% Export Oriented Unit (EOU) to Domestic Tariff Area (DTA), the duty leviable on such goods shall be paid by utilizing the CENVAT credit or by crediting the duty payable to the account of the Central Government in the manner specified in rule 8. Thus, duty can be paid monthly in case of removals from 100% EOUs also.

(b) Rule17(4) Scrutiny by the proper officer

The proper officer may on the basis of information contained in the return filed by the unit under rule 17(3), and after such further enquiry as he may consider necessary, scrutinize the correctness of the duty assessed by the assessee on the goods removed, in the manner to be prescribed by the Board.

(c) Rule17(5) Furnishing of documents and records by assessee

Every assessee shall make available to the proper officer all the documents and records for verification as and when required by such officer.

(d) Amendment of Form ER-2

Notification No. 24/2008 CE (NT) dated 23.05.2008 has amended Form ER-2- form prescribed for monthly return for 100% EOU in respect of goods manufactured, goods cleared and receipt of inputs and capital goods.

2. CENVAT Credit Rules, 2004:

I. Amendments in CENVAT Credit Rules, 2004

(a) Rule 3(7)(a) CENVAT credit admissible on inputs received from 100% EOU/unit in EHTP/STP

Rule 3(7)(a) provided that CENVAT credit in respect of inputs/capital goods produced or manufactured, by a 100% Export Oriented Undertaking (EOU) or by a unit in an Electronic Hardware Technology Park (EHTP) or in a Software Technology Park (STP) and which pays excise duty levied under section 3 of the Excise Act read with serial number 2 of Notification No. 23/2003-CE, dated 31.03.2003, used in the manufacture of the final products or in providing an output service, in any other place in India, shall be admissible equivalent to the amount calculated in the following manner namely :-

=Assessable Value [(1+BCD/400)×(CVD/100)]

wherein, BCD stands for Basic Custom Duty

CVD stands for Countervailing Duty

Notification No. 48/ 2008-Central Excise (N.T.) dated 05.12.2008 has amended the aforesaid formula. Consequently, the CENVAT credit in respect of inputs cleared from 100% EOU, by a unit in EHTP, or by a unit in STP to any other place in India shall be as follows:-

=Assessable Value [(1+BCD/200)×(CVD/100)]

(b) Proviso to rule 3(1)(xi) of the CENVAT Credit Rules, 2004

The amount equal to excise duty paid on the capital goods at the time of debonding of the unit in terms of the para 8 of Notification No. 22/2003 CE dated 31.03.2003 (which exempts certain goods when brought into 100% EOU / STP complex) shall be allowed as CENVAT credit.

(c) Rule 6(6)(i) Benefit under rule 6(6) extended to a developer of a SEZ

Rule 6(6)(i) provided that CENVAT credit shall be admissible on the inputs used in the manufacture of the final product cleared without payment of duty to a unit in a Special Economic Zone (SEZ).

Notification No. 50/2008 – CE (N.T.) dated 31.12.2008 has extended this benefit to "a developer of a Special Economic Zone (SEZ)" also.

II. Clarifications relating to CENVAT Credit Rules, 2004

(a) Clarification of certain issues relating to rule 6(3) of the CENVAT Credit Rules, 2004

A. Circular No. 868/6/2008 CX dated 09.05.2008 has clarified the following issues with regard to rule 6(3) of the CENVAT Credit Rules, 2004*:

S.No.	Question	Answer
1.	Whether an assessee availing option (i) or option (ii) under rule 6(3) is allowed to take CENVAT credit of duty paid on inputs and input services which are used for both dutiable and exempted goods or services?	Yes, credit on such inputs and input services is allowed. However, an assessee following option (i) or (ii) under rule 6(3) shall not be allowed to take CENVAT credit of duty paid on those inputs and input services which are used exclusively for the manufacture of exempted goods or provision of exempted services [refer Explanation II of rule 6(3)]. For the purpose of the calculation of amount under formula given under rule 6(3A), the total CENVAT credit taken on inputs and input services does not include

		excise duty paid on inputs or service tax paid on input services which are used exclusively for the manufacture of exempted goods or provision of exempted services.
2.	Whether an assessee availing option (i) in respect of certain exempted goods/services can also avail option (ii) in respect of other exempted goods or services simultaneously?	An assessee opting for either of the option is required to avail the said option for all the exempted goods manufactured by him and all the exempted services provided by him and the option once exercised during a financial year (F.Y.) cannot be withdrawn during the remaining part of the FY. Therefore, the same assessee cannot avail both option (i) and option (ii) simultaneously during a financial year. [Explanation I to Rule 6(3)].
3.	Assessee opting for option (i) is required to pay an amount equivalent to 10% of value of exempted goods or 8% of value of exempted services. What is the scope of term "value" for the said purpose?	Value of the exempted goods is the transaction value as determined in terms of section 4 of the Central Excise Act, 1944 or value determined under section 4A. However, in case of goods chargeable to specific rate of duty, the value, shall be the transaction value to be determined under section 4. Value of the exempted service is the gross amount charged for providing the exempted service [without abatement].
4.	What is the accounting code to be followed by the assessee who is required to pay 8% or other amount for the exempted service under Rule 6(3)?	For the present, the assessee can pay the said amount under the accounting code applicable for service tax i.e. 0044.
5.	Whether input services distributor can also opt for option (i) or option (ii)?	As ISD does not provide any service, and is like a trader, the question of availing either of the options would not arise.
6.	Whether export of service without payment of service tax under Export of Service Rules shall be treated as exempted service for the purpose of rule 6(3)?	No, export of services without payment of service tax are not to be treated exempted services.

7.	What is the manner for calculation of CENVAT Credit amount attributable to inputs used in or in relation to the manufacture of exempted goods?	It is required to be done on the basis of actual consumption of inputs used and the quantification may be made based upon the stores/production records maintained by the manufacturer. Further, a certificate from Cost Accountant/Chartered Accountant giving details of quantity of inputs used in the manufacture of exempted goods, value thereof and CENVAT credit taken on these input may be submitted at the end of the year.
8.	Whether credit in respect of input services covered by rule 6(5) would be required to be taken into account for determination of amount payable as per formula provide in rule 6(3A)?	No, the credit attributable to services mentioned in sub-rule (5) shall not be taken into account for determination of amount under rule 6(3A).

*Note - Rule 6(3) pertains to an assessee opting not to maintain separate CENVAT credit accounts for dutiable and exempted outputs. Such assessee has to opt for one of the following two options:

(i) Pay an amount equal to 10% of the value of the exempted goods or 8% of the value of the exempted services. Exempted service includes non-taxable service also.

OR

(ii) Pay an amount equivalent to the CENVAT credit attributable to inputs and input services used in or in relation to manufacture of exempted goods or for provision of exempted services. Rule 6(3A) prescribes the conditions and procedure to determine the amount of CENVAT credit attributable to exempted outputs.

Schemes under rule 6(3) are optional and each individual scheme is comprehensive and self-contained. An assessee can exercise the option in relation to all his activities as an assessee and the option is not available only in relation to a part of his activity and the option once exercised cannot be withdrawn during the said financial year.

B. Rule 11D not applicable to amount collected under rule 6(3) of the CENVAT Credit Rules, 2004

It has been clarified that so long as the amount of 8% or 10% is paid to the Government in terms of rule 6(3) of the CENVAT Credit Rules, 2004*, the provisions of section 11D shall not be applied even if the amount is recovered from the buyers. As per section 11D, the Central Government shall be liable to recover any amount which has been collected as excise duty and not paid to the credit of the Central Government. It is to be noted that the CENVAT credit can be taken by the buyer only if it is a payment of duty in terms of rule 3(1) of the aforementioned rules. Therefore, the CENVAT credit of the said amount of 8% or 10% cannot be taken since such payment is not a payment of duty in terms of rule 3(1) of the said rules. So, the said 10% amount should be shown in the invoice as "10% amount paid under rule 6 of the CENVAT Credit Rules, 2004".

[Circular No. 870/08/2008-CX dated 16.05.2008]

*Note - W.e.f. 01.04.2008, rule 6(3) of the CENVAT Credit Rules, 2004 has been amended and it provides for payment of an amount equal to 10% of value of the exempted goods, instead of 10% of the price of the exempted goods as provided earlier. The value is to be determined as per section 4 or 4A of the Central Excise Act, 1944 read with rules made thereunder.

(b) Clarification regarding reversal of CENVAT credit in case of trade discount

Sometimes, the supplier allows trade discount to the manufacturer. However, the manufacturer avails the CENVAT credit of the entire excise duty paid by the supplier as reflected in the invoice. The issue raised was whether proportionate credit should be reversed in such a case.

Circular No. 877/15/2008-CX dated 17.11.2008 has clarified that in such cases, the entire amount of duty paid by the manufacturer, as shown in the invoice, would be available as credit irrespective of the fact that subsequent to clearance of the goods, the price is reduced by way of discount or otherwise.

However, if the duty paid is also reduced, along with the reduction in price, the reduced excise duty would only be available as credit. It may however be confirmed that the supplier, who has paid duty, has not filed/claimed the refund on account of reduction in price.

3. Pan Masala notified for the purpose of charging duty on the basis of capacity of production

Section 3A, as inserted by the Finance Act, 2008, contains the provisions to charge excise duty on the basis of capacity of production in respect of notified goods.

Notification No. 29/2008 CE (NT) dated 01.07.2008 has notified pan masala [falling under tariff item 2106 90 20 of the First Schedule to the Central Excise Tariff Act, 1985 (except the pan masala containing not more than 15% betel nut)] and pan masala containing tobacco, commonly known as gutkha (falling under tariff item 2403 99 90 of the said Tariff Act) manufactured with the aid of packing machine and packed in pouches, for the purpose of section 3A.

In this regard, Notification No. 30/2008 CE (NT) dated 01.07.2008 has notified the Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008. They have come into force on the 1st day of July, 2008.

Further, Notification No. 32/2008 CE (NT) dated 28.08.2008 has granted rebate of duty on Pan Masala containing tobacco (gutkha) on which duty of excise has been paid under section 3A of the Central Excise Act, 1944, on their exportation out of India on or after

1st July, 2008, to any country except Nepal and Bhutan subject to the conditions, limitations and procedures prescribed therein.

4. Condition of paying excise duty from account current, done away with, in the following cases:

(a) Notification No. 39/2004 CE (NT) dated 25.11.2004 inter alia exempts class of manufacturers, who manufacture certain specified excisable goods prescribed therein and have paid excise duty of less than Rs.100 lakh from account current during the preceding financial year, from filing the annual information relating to principal inputs and monthly return of receipt and consumption of each of the principal inputs.

Notification No. 41/2008 CE (NT) dated 29.09.2008 has amended the said notification so as to remove the condition of paying the stipulated amount of duty from account current i.e., in cash. Now, the duty can be paid by utilizing the CENVAT credit also.

Consequently, now the manufacturers of the prescribed excisable goods shall be exempted from filing the annual information relating to principal inputs and monthly return of receipt and consumption of each of the principal inputs if they have paid the duty of less than Rs.100 lakh during the financial year, by any mode - either in cash or by utilizing CENVAT credit.

(b) Notification No. 17/2006 CE (NT) dated 01.08.2006 inter alia exempts the assessees who have paid excise duty of less than Rs.100 lakh from account current during the financial year, from filing of the Annual Financial Information Statement.

Notification No. 42/2008 CE (NT) dated 29.09.2008 has amended the said notification so as to remove the condition of paying the stipulated amount of duty from account current i.e., in cash. Now, the duty can be paid by utilizing the CENVAT credit also.

Consequently, now the asseessees shall be exempted from filing the Annual Financial Information Statement if they have paid the duty of less than Rs.100 lakh during the financial year, by any mode - either in cash or by utilizing CENVAT credit.

5. Proviso to clause (2) of Notification No. 35/2001 CE (NT) dated 26.06.2001* amended

If a person has more than one premise requiring registration, he may obtain a single registration for all such premises if following conditions are satisfied:-

(i) Such person manufactures Compressed Natural Gas (falling under heading 2711 of the of First Schedule to the Central Excise Tariff Act, 1985), and

(ii) all the premises fall within the jurisdiction of one Chief Commissioner of Central Excise, and

(ii) he has submitted the details of all such premises along with the application for registration.

However, prior intimation shall be given before starting any additional premises subsequent to obtaining such registration:

Further, if the assessee is registered under the existing provision, he may apply for fresh registration or file amendment to the registration as the case may be, in accordance with provisions of this notification.

[Notification No.43/2008-CE (NT) dated 06.10.2008]

*Note - Clause (2) of Notification No. 35/2001 CE (NT) dated 26.06.2001 prescribes that if the person has more than one premises requiring registration, separate registration certificate shall be obtained for each of such premises.

6. SSI exemption extended to SSIs producing specified packing materials bearing the brand name of another person

Notification No. 47/2008 CE dated 01.09.2008 has amended Notification No. 8/2003 CE dated 01.03.2003 to extend the benefit of small scale exemption of excise duty to SSIs producing goods bearing the brand name or trade name of another person if these goods are in the nature of packing materials, namely, printed cartons of paper or paper board, metal containers, HDPE woven sacks, adhesive tapes, stickers, PP caps, crown corks, metal labels.

However, this exemption shall be restricted to Rs.90 lakh for the remaining part of the financial year 2008-09.

7. LTUs to pay duty electronically only

The Large Taxpayer Units (LTUs) shall pay the central excise and service tax dues electronically only, through internet banking.

However, in case of difficulties in e-payment, a large taxpayer is permitted to pay the duty through banks (except in such cases where e-payment is mandatory) in the jurisdiction of the LTU Commissionerate only.

[Circular No.878/16 /2008-CX dated 21.11.2008]

8. Guidelines for provisional attachment of property under section 11DDA of the Central Excise Act, 1944

The key points of guidelines issued to implement section 11DDA of the Act to maintain uniformity in its implementation are as follows:-

(a) The types of offences which may be considered for provisional attachment of property (resorted only when the duty or CENVAT Credit alleged is more than Rs. 25 lakhs) are as follows:

1. When the goods are removed without the cover of an invoice and without payment of duty, or without declaring the correct value.
2. CENVAT Credit has been taken without receipt of goods or on the basis of Excise duty invoices or other documents which a person has a reason to believe as not genuine.
3. Excise duty invoice is issued without delivery of goods.
4. Refund or rebate is claimed in a fraudulent manner.

(b) The property which is attached is immovable property/ properties which is/ are used for commercial purpose. If immovable property is not sufficient to protect the interest of revenue then movable property can be attached

(c) The property provisionally attached shall be of value as nearly as may be equivalent to that of the amount demanded in the proceedings under section 11A or Section 11D of the Act.

(d) Provisional attachment of the property shall be made only between sunrise and sunset.

(e) After attachment, the proper officer shall prepare an inventory and specify in it the place where it is lodged or kept and shall hand over a copy of the same to the defaulter or the person from whose charge the property is destrained.

(f) All such property as is by the Code of Civil Procedure, 1908 exempted from attachment and sale for execution of a Decree of a Civil Court shall be exempt from provisional attachment. The decision of the Commissioner of Central Excise in this regard shall be final.

[Circular No. 874/12/2008-CX dated 30.06.2008]

B. CUSTOMS

Clarification in respect of procedure for sanctioning the custom duty refunds under section 27(2) of the Customs Act, 1962

It has been clarified that in terms of sub-section (2) of section 27, the concerned Assistant/Deputy Commissioner of Customs has to go through:-

(i) the facts of the case and the material placed before him in order to determine whether the amount claimed by an applicant is refundable to him or not, and

(ii) the details of audited Balance Sheet and other related financial records, certificate of the Chartered Accountant etc., submitted by the applicant in order to decide whether the applicant had not passed on the incidence of the duty and interest thereon, if any, to any other person.

The Order-in-Original passed by the Assistant/Deputy Commissioner of Customs in the adjudication process should be a speaking order providing specific details including the relevant financial records that are relied upon to arrive at a conclusion whether the burden of duty or interest, as the case may be, has been passed on or not.

Refund orders issued in a routine and casual manner thereby sanctioning the amount but crediting the same to the Consumer Welfare Fund without going through the factual details of the case and the due process as provided in the first proviso cannot be considered as a complete and speaking order

[Circular No.7/2008-Cus dated 28.05.2008].

C. SERVICE TAX

Notification No. 18/2008 ST dated 10.05.2008 has notified 16.05.2008 as the date on which the services introduced by the Finance Act, 2008 have become effective. Further, the amendments made in the existing service vide the Finance Act, 2008 have also become effective from 16.05.2008.

Exemptions:

1. Notification No. 41/2007 ST dated 06.10.2007 which exempts certain specified taxable services received by an exporter and used for export of goods

A. Amendment in Notification No. 41/2007 ST dated 06.10.2007

(a) Insertion of four more services

Notification No. 24/2008 ST dated 10.05.2008 (with effect from 16.05.2008) and Notification No. 33/2008 ST dated 07.12.2008 (with effect from 18.11.2008) have amended Notification No.41/2007 ST dated 06.10.2007 which exempts certain specified taxable services received by an exporter and used for export of goods. The following services received by an exporter and used for export of goods have also been exempted vide these notifications subject to fulfillment of conditions specified therein:-

S.No.	Section of the Finance Act, 1994 as amended	Description of taxable service	Conditions
1.	Section 65(105)(zm)	services of purchase or sale of foreign currency, including money changing provided to an exporter in relation to export goods.	exporter shall produce evidence to prove that the services specified in column (3) are in relation to goods exported.
2.	Section 65(105)(zzk)	services of purchase or sale of foreign currency, including money changing provided to an exporter in relation to export goods.	exporter shall produce evidence to prove that the services specified in column (3) are in relation to goods exported.
3.	Section 65(105)(zzzzj)	services of supply of tangible goods for use, without transferring right of possession and effective control of tangible goods, provided to an exporter in relation to goods exported by the exporter.	exporter shall produce evidence to prove that the services specified in column (3) are used in relation to export of goods.
4.	Section 65(105)(j)	services provided by a clearing and forwarding agent in relation to export	exporter shall produce,- (i) invoice issued by clearing and forwarding

S.No.	Section of the Finance Act, 1994 as amended	Description of taxable service	Conditions
		goods exported by the exporter.	agent for providing services specified in column (3) specifying: (a) number and date of shipping bill, (b) description of export goods, (c) number and date of the invoice issued by the exporter relating to export goods, (d) details of all the charges, whether or not reimbursable, collected by the clearing and forwarding agent from the exporter in relation to export goods, (ii) details of other taxable services provided by the said clearing and forwarding agent and received by the exporter, whether or not relatable to export goods.

(b) Condition of not availing the drawback of service tax paid relaxed

As per Notification No. 41/2007 ST dated 06.10.2007, the exporter could claim the refund of the service tax paid during the course of export of goods provided that the said goods have been exported without availing drawback of service tax paid under the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995.

However, now the condition of not availing the drawback of service tax paid has been relaxed by Notification No. 33/2008 ST dated 07.12.2008. Consequently, now the exporter, who is availing drawback of service tax paid, can also claim the refund of the service tax paid during the course of export of goods.

Moreover, the form prescribed for claiming the refund has been suitably amended to give effect to the above amendment.

(c) Time Limit for filing the refund claim extended

The time-limit for filing the refund claim under the aforesaid notification has been extended from sixty days to six months from the end of the relevant quarter during which the said goods have been exported [Notification No. 32/2008 ST dated 18.11.2008].

Clarification in this regard:-

In view of the amended condition, CBEC vide Circular No. 112/06/2009 dated 12.03.2009 has clarified that consequent upon revision of limitation period, any refund claim that is filed within such revised limitation period would be admissible if it is otherwise in order. Consequently, refund claims of service tax on specified taxable services used for exports of goods made in the quarter Mar-Jun 08 could be filed till 31st Dec 08.

The circular further clarifies that the limitation period of six months shall be computed from the date of exports and not from the date of receipt of remittances.

(d) Amendment in the conditions for two services

S.No.	Sub-clause of clause (105) of section 65	Description of taxable service	Conditions
1.	Section 65(105)(zzh)	Services provided by a technical testing and analysis agency in relation to technical testing and analysis of said goods where such technical testing and analysis is required to be undertaken as per the written agreement between the exporter and the buyer of the said goods	(i) the exporter furnishes a copy of the written agreement entered into with the buyer of the said goods requiring testing and analysis of the said goods; In this regard, Notification No. 32/2008 ST dated 18.11.2008 has clarified that where the buyer of the said goods does not require testing and analysis of the said goods, but testing is statutorily stipulated by domestic rules and regulations, the exporter shall furnish copy of such rules or regulations stipulating testing and analysis of the said goods.
2.	Section 65(105)(zzb)	Services provided by a commission agent, located outside India, and engaged	(vi) <u>Earlier condition:-</u> the refund of service tax shall

		under a contract or agreement or any other document by the exporter in India, to act on behalf of the exporter, to cause sale of goods exported by him.	be restricted to:- (i) actual amount of service tax paid or (ii) service tax calculated on two per cent of FOB value of export goods, whichever is less. <u>Amended condition:-</u> Notification No. 33/2008 ST dated 07.12.2008 has modified the above condition as follows:- The refund of service tax shall be restricted to:- (i) actual amount of service tax paid Or (ii) service tax calculated on ten per cent of FOB value of export goods, whichever is less.

B. Clarification on certain procedural issues involved in implementation of Notification No. 41/2007-ST dated 6/10/2007

Circular no. 106 /9 /2008-ST dated the 11.12.2008 and Circular No. 112/06/2009 dated 12.03.2009 have been issued in order to resolve the procedural difficulties in implementation of above mentioned notification. Following issues have been clarified:-

S.No.	Issue	Clarification
1.	One of the conditions of the notification is that the exporter claiming exemption has actually paid the service tax on the specified services. The other condition is that the refund claim shall be accompanied by document	(i) The invoices/challans/bills issued by supplier of taxable service, in conformity with rule 4A of the Service Tax Rules, 1994, are reasonable evidence that the services on which refund is being sought are taxable service. The compliance of condition

	evidencing payment of service tax. In this regard the following issues have been raised. (i) Whether the invoices/bills/challan issued by the service provider, showing service tax amount could be treated as evidence that the exporter has paid the service tax?	that exporter has actually paid the service tax rests with the exporter claiming refund. Therefore, in so far as this condition is concerned, the refund claim should be processed based on furnishing of appropriate invoices/ bills/ challan by the person claiming refund and undertaking to the effect of payment of service tax by him. For the purposes of compliance verification, random checks should be carried out independently and where the refund amount is significant, post refund audit may also be carried out.
	(ii) The invoices produced by the exporters are at times not complete (i.e. does not have STC code of service provider).	(ii) As regards incomplete invoices/bills etc, rule 4A of the Service Tax Rules, 1994 prescribes the statutory requirement. Compliance of this rule requires that the invoices/challan/bills should be complete in all respect. Therefore, the exporter claiming refund of service tax under Notification No. 41/2007-ST should ensure in their own interest that invoices/bills/challan should contain requisite details (name, address and registration no. of service provider, serial number and date of invoice, name and address of service receiver, description, classification and value of taxable service and the service tax payable thereon). Refund claim cannot be allowed on the basis of invoices not having complete details as required verification cannot be carried out by the department on the basis of incomplete invoices.
2.	It has been directed that refund claim must be disposed of within thirty days. Commissioners have stated that it is not practically feasible in all cases to	The difficulties arising in processing of claims may be brought to the notice of the Board. This should enable the field formations to dispose of the pending

	dispose of the refund claim within this time frame in view of procedural and other issues involved in processing of claim.	refund claims expeditiously. Therefore, every effort should be made by field formations to adhere to the prescribed timelines.
3.	The bank deducts certain commissions from the export remittance in lieu of service provided by them. Refund is not allowed on such deduction. Refund should be allowed on the gross remittances.	Refund is admissible on the basis of gross amount received for the exports and deductions made by the banks from export remittances, in lieu of services provided by bank, should not be deducted while granting refund.
4.	For exporters exporting to a customer regularly, the foreign exchange remittance certificates (FIRC) are made on running account basis by the banks. Therefore, it is often not possible to show the linkage between the export invoice and the remittance. This has resulted in denial of refund. Further in case where payments are received by cheque, banks do not issue FIRC and refunds are denied.	In such cases where FIRCs are issued on consolidated basis, the exporters should submit self-certified statement alongwith FIRC showing the details of export in respect of which the FIRC pertains. Refunds should be allowed on such certified statements. However, exporters should maintain a register showing running account which should be reconciled between the export and the remittance periodically. In cases where banks do not issue FIRC for the reason that payments are received by cheque, refund may be allowed on the basis of duly certified bank statement.
5.	Whether refund would be admissible on specified taxable service received prior to the date it is notified in the said notification, if such services are used in relation to goods which are exported subsequent to the date on which such taxable services are notified under notification No. 41/2007-ST.	Being prospective in nature refund is not admissible on such services received prior to the date they are notified in the said notification, even if the goods, in relation to which these services are used, are exported after the date when such services are notified under notification No. 41/2007-ST.
6.	Authorities granting refund are insisting on original documents such as invoice, BL, SB, BRC etc. Such	Normally, certified copy of the documents should be accepted. Only in case of in-depth enquiry original

	documents are required under the law to be kept in the Head office for audit. Refunds are denied on this ground.	documents can be verified.
7.	The service provider providing services to the exporter provides various services. But he has registration of only one service. The refund is being denied on the grounds that the taxable services that are not covered under the registration are not eligible for such refunds.	Notification No. 41/2007 ST provides exemption by way of refund from specified taxable services used for export of goods. Granting refund to exporters, on taxable services that he receives and uses for export do not require verification of registration certificate of the supplier of service. Therefore, refund should be granted in such cases, if otherwise in order. The procedural violations by the service provider need to be dealt separately, independent of the process of refund.
8.	Whether refunds under Notification No. 41/2007-ST, dated 6.10.2007 would be admissible for the quarter July-Sep 2007.	The Notification No.41/2007-ST exempts service tax on specified taxable services used for export of goods. This exemption is operated through the route of refund. Being prospective in nature, refund could only be sanctioned on taxable services provided on or after the date they are notified in the said notification, i.e., 6.10.2007.

2. Exemption from service tax leviable on taxable services provided to GTA for use in transportation of goods by road

Notification No. 29/2008 ST dated 26.06.2008 has exempted from the whole of the service tax, the service of supply of a goods carriage [taxable under section 65(105)(zzzzj)], (without transferring right of possession and effective control of such goods carriage), provided by any person to a goods transport agency for transportation of goods by road in the said goods carriage.

Notification No. 1/2009 ST dated 05.01.2009 has exempted from the whole of the service tax, the following mentioned services, provided to a goods transport agency for transportation of goods by road in the said goods carriage, subject to the condition

that the invoice issued by such service provider, providing services should mention the name and address of the goods transport agency and also the name and date of the consignment note, by whatever name called, issued in his behalf:-

(a) Services provided by a clearing and forwarding agent in relation to clearing and forwarding operations,

(b) Services provided by a manpower recruitment or supply agency in relation to the recruitment or supply of manpower, temporarily or otherwise

(c) Services provided by a cargo handling agency in relation to cargo handling services

(d) Services provided by a storage or warehouse keeper in relation to storage and warehousing of goods

(e) Services provided by any person in relation to business auxiliary service

(f) Services provided by any other person, in relation to packaging activity

(g) Services provided by any other person, in relation to support services of business or commerce, in any manner

(h) Services provided by a processing and clearing house in relation to processing, clearing and settlement of transactions in securities, goods or forward contracts including any other matter incidental to, or connected with, such securities, goods and forward contracts.

Others:

3. Following amendments have been made in the Service Tax Rules, 1994:

(i) Amendments in rule 6

(a) Explanation to third proviso to rule 6(1)

For the removal of doubts, it is hereby declared that where the transaction of taxable service is with any associated enterprise, any payment received towards the value of taxable service, in such case shall include any amount credited or debited, as the case may be, to any account, whether called 'Suspense account' or by any other name, in the books of account of a person liable to pay service tax.

[Notification No. 19/2008 ST dated 10.05.2008]

(b) Rule 6(7B) - option to pay 0.25% of the gross amount in case of services provided in relation to purchase or sale of foreign currency

The person liable to pay service tax in relation to purchase or sale of foreign currency, including money changing, provided by a foreign exchange broker, including an authorised dealer in foreign exchange or an authorized money changer, referred to in sub-clauses (zm) and (zzk) of clause (105) of section 65 of the Finance Act, 1994 as amended shall have the option to pay an amount calculated at the rate of 0.25% of the gross amount of currency exchanged towards discharge of his service tax liability instead of paying service tax at the rate specified in section 66 of Chapter V of the Act.

However, such option shall not be available in cases where the consideration for the service provided or to be provided is shown separately in the invoice, bill or, as the case may be, challan issued by the service provider.

Illustration

Buying rate $US 1 = Rs.38, selling rate $US 1 = Rs.40

(i) Person exchanged $100 for equivalent rupees

Transaction value = Rs.3800 (Rs.38 x 100)

Service tax payable = Rs.9.5 (0.25% x 3800)

(ii) Person exchanged equivalent rupees for $100

Transaction value = Rs.4000 (40 x 100)

Service tax payable = Rs.10 (0.25% x 4000).

[Notification No. 19/2008 ST dated 10.05.2008]

(c) Rule 6(1A) - amendment of Form ST-3

Notification No. 31/2008 ST dated 02.09.2008 has amended service tax return Form ST-3. Sub-rule (1A) empowers the assessee to pay advance service tax on his own volition and adjust the amount so paid against the service tax which he is liable to pay for the subsequent period.

(ii) Amendment in rule 4A

With effect from 16.05.2008, in rule 4A, the words "to a customer" have been substituted by the words "to any person".

[Notification No. 19/2008 ST dated 10.05.2008]

(iii) Amendment in rule 4B

With effect from 16.05.2008, in rule 4B, the words "to the customer" have been substituted by the words "to the recipient of service".

[Notification No. 19/2008 ST dated 10.05.2008]

(iv) Form No. ST-3 amended for the returns prepared by SRTPs

Notification No. 10 / 2009-ST dated 17.03.2009 has amended Form No. ST-3 in Service Tax Rules, 1994 to furnish the details of name and identification of Service Tax Return Preparers in case the return has been prepared by them.

4. Following amendments have been made in the Export of Services Rules, 2005 and the Taxation of Services (Provided from Outside India and Received in India) Rules, 2006:

(a) With effect from 16.05.2008, Export of Services Rules, 2005 and the Taxation of Services (Provided from Outside India and Received in India) Rules, 2006 have been amended vide Notification No. 20/2008 ST dated 10.05.2008 and Notification No. 21/2008 ST dated 10.05.2008 so as to categorise the newly specified taxable services under Rule 3. Taxable services have been categorised as under:

Sl. No.	Taxable service	Sub-clause of section 65(105)	Export of Services Rules, 2005	Taxation of Services (Provided from Outside India and Received in India) Rules, 2006
1.	Information technology software services	zzzze	*Category 3 [Rule 3(1)(iii)]	Category 3 [Rule 3(iii)]
2.	Investment management services provided under ULIP	zzzzf	*Category 3 [Rule 3(1)(iii)]	Category 3 [Rule 3(iii)]
3.	Stock exchange services in relation to securities	zzzzg	*Category 2 [Rule 3(1)(ii)]	Category 2 [Rule 3(ii)]
4.	Commodity exchange services	zzzzh	Category 2 [Rule 3(1)(ii)]	Category 2 [Rule 3(ii)]
5.	Processing and clearing house services	zzzzi	Category 2 [Rule 3(1)(ii)]	Category 2 [Rule 3(ii)]
6.	Supply of tangible goods services	zzzzj	Category 3 [Rule 3(1)(iii)]	Category 3 [Rule 3(iii)]
7.	Internet telecommunication services	zzzu	Category 3 [Rule 3(1)(iii)]	Category 3 [Rule 3(iii)]

Note – (1) Category 1 [Rule 3(1)(i)] – For services under this category, criterion of services being in relation to an immovable property situated outside India is prescribed.

(2) Category 2 [Rule 3(1)(ii)] – For services under this category, criterion of services as are performed outside India is prescribed.

(3) Category 3 [Rule 3(1)(iii)] – For services under this category, criterion of location of recipient of service outside India is prescribed.

(b) Similarly, Notification No. 21/2008 ST dated 10.05.2008 has amended the "Taxation of Service (Provided from Outside India and Received in India) Rules, 2006" by inserting a proviso after clause (iii) of rule 3. The proviso lays down that where the supply of tangible goods service [section 65(105)(zzzzj)] is received by a recipient located in India, then such taxable service shall be treated as taxable service provided from outside India and received in India subject to the condition that the tangible goods supplied for use are located in India during the period of use of such tangible goods by such recipient."

(c) Notification No. 20/2008 ST dated 10.05.2008 has amended Export of Services Rules, 2005 by inserting a second proviso after the first proviso to clause (iii) of sub-rule (1) of rule 3. The new proviso provides that where the supply of tangible goods service [section 65(105)(zzzzj)] is provided to a recipient located outside India, then such taxable service shall be treated as export of taxable service subject to the condition that the tangible goods supplied for use are located outside India during the period of use of such tangible goods by such recipient.

5. Amendments to abatement notification - Notification No.1/2006 ST dated 01.03.2006

(a) With effect from 16.05.2008, Notification No. 22/2008 ST dated 10.05.2008 has made the following amendments in Notification No.1/2006 ST dated 01.03.2006 which prescribes various abatements in respect of certain taxable services specified therein:

In the said notification,

S.no.	in case of	for the words	the words that have been substituted are
1.	mandap keeper services	to the client	to any person
2.	convention services	client	recipient of service
3.	erection, commissioning or installation service	customer	recipient of service

(b) Abatement of 30% from the gross amount charged in case of services in relation to chit

Notification No. 27/2008 ST dated 27.05.2008 has amended Notification No. 1/2006 ST dated 01.03.2006 so as to provide an abatement of 30% in case of services provided in relation to chit from the gross amount charged for such service.

"Chit" has been defined to mean a transaction whether called chit, chit fund, chitty, kuri, or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical installments over a definite period and that each subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount.

6. With effect from 16.05.2008, Notification No. 23/2008 ST dated 10.05.2008 has amended the following notifications in the manner given below:

S.No.	In Notification No.	for the words	the words that have been substituted are
1	18/2002 ST dated 16.12.2002: It exempts the taxable services provided by a consulting engineer to a client on transfer of technology from so much of the service tax leviable thereon as is equivalent to the amount of cess paid on the said transfer of technology under the provisions of section 3 of the Research and Development Cess Act, 1986.	to a client	to any person
2	33/2004 ST dated 03.12.2004: It exempts the taxable service provided by a goods transport agency to a customer, in relation to transport of fruits, vegetables, eggs or milk by road in a goods carriage, from the whole of service tax leviable thereon.	to a customer	to any person
3	34/2004 ST dated 03.12.2004: It exempts the taxable service provided by a goods transport agency to a customer, in relation to transport of goods by road in a goods carriage, from the whole of service tax where- (i) the gross amount charged on consignments transported in a goods carriage does not exceed rupees one thousand five hundred; or (ii) the gross amount charged on an individual consignment transported in a goods carriage does not exceed rupees seven hundred fifty.	to a customer	to any person

7. Conditions specified for exemption to services provided to a developer or units of special economic zone-Notification No. 4/2004 dated 31.03.2004 superseded

Notification No.9/2009-ST dated 03.03.2009 has exempted service tax paid on the services provided in relation to the authorized operations in a Special Economic Zone, and received by a developer or units of a Special Economic Zone, whether or not the said taxable services are provided inside the Special Economic Zone.

Provided that

(a) Approval of list of services

The developer or units of Special Economic Zone shall get the services required in relation to the authorised operations in the Special Economic Zone approved from the Approval Committee (hereinafter referred to as the specified services);

(b) Actual use of specified services

The developer or units of Special Economic Zone claiming the exemption actually uses the specified services in relation to the authorised operations in the Special Economic Zone;

(c) Exemption in the form of refund

The exemption claimed by the developer or units of Special Economic Zone shall be provided by way of refund of service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone;

(d) Actual payment of service tax

The developer or units of Special Economic Zone claiming the exemption has actually paid the service tax on the specified services;

(e) No CENVAT credit of service tax paid on specified services

No CENVAT credit of service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone has been taken under the CENVAT Credit Rules, 2004;

(f) Exemption under no other notification claimed

Exemption or refund of service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone shall not be claimed except under this notification.

Conditions to be satisfied:-

(a) the person liable to pay service tax under sub-section (1) or sub-section (2) of section 68 of the said Finance Act shall pay service tax as applicable on the specified services provided to the developer or units of Special Economic Zone and used in relation to the authorised operations in the Special Economic Zone, and such person shall not be eligible to claim exemption for the specified services:

Provided that where the developer or units of Special Economic Zone and the person liable to pay service tax under sub-section (2) of section 68 for the said services are the same person, then in such cases exemption for the specified services shall be claimed by that person;

(b) the developer or units of Special Economic Zone shall claim the exemption by filing a claim for refund of service tax paid on specified services;

(c) the developer or units of Special Economic Zone shall file the claim for refund to the jurisdictional Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be;

(d) the developer or units of Special Economic Zone who is not registered as an assessee under the Central Excise Act, 1944 (1 of 1944) or the rules made thereunder, or the said Finance Act or the rules made thereunder, shall, prior to filing a claim for refund of service tax under this notification, file a declaration in the Form annexed hereto with the respective jurisdictional Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be;

(e) the jurisdictional Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be, shall, after due verification, allot a service tax code (STC) number to the developer or units of Special Economic Zone within seven days from the date of receipt of the said Form;

(f) the claim for refund shall be filed, within six months or such extended period as the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be, shall permit, from the date of actual payment of service tax by such developer or unit to service provider;

(g) the refund claim shall be accompanied by the following documents, namely:-

   (i) a copy of the list of specified services required in relation to the authorised operations in the Special Economic Zone, as approved by the Approval Committee;

   (ii) documents for having paid service tax;

   (iii) a declaration by the Special Economic Zone developer or unit, claiming such exemption, to the effect that such service is received by him in relation to authorised operation in Special Economic Zone.

(h) the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be, shall, after satisfying himself that the said services have been actually used in relation to the authorised operations in the Special Economic Zone, refund the service tax paid on the specified services used in relation to the authorised operations in the Special Economic Zone;

   (i) where any refund of service tax paid on specified services is erroneously refunded for any reasons whatsoever, such service tax refunded shall be recoverable under the provisions of the said Finance Act and the rules made thereunder, as if it is a recovery of service tax erroneously refunded.

8. Clarification regarding levy of service tax on services provided by "commercial training or coaching centers"

Circular No. 107/01/2009 – ST dated 28.01.2009

Section 65(26) provides that commercial training or coaching means any training or coaching provided by a commercial training or coaching centre;

Section 65(27) defines commercial training or coaching centre as-

- any institute or establishment providing commercial training or coaching for imparting skill or knowledge or lessons
- on any subject or field other than the sports,
- with or without issuance of a certificate and
- includes coaching or tutorial classes but
- does not include

(i) preschool coaching and training centre or

(ii) any institute or establishment which issues any certificate or diploma or degree or any educational qualification recognised by law for the time being in force;

The aforesaid circular clarifies on the following mentioned issues:-

A. Commercial nature of the institute

The commercial training or coaching does not mean that such institute must have 'commercial' (i.e. profit making) intent or motive. It has to be interpreted in a wider sense.

B. Vocational Training Institutes - whether institutes offering general course on improving communication skills, how to be effective in group discussions or personal interviews, personality development, general grooming and finishing etc are covered

The circular clarifies that such institutes are not covered under the definition of vocational training institute because they only improve the chances of success for a candidate possessing required skill and do not impart training to enable the trainee to seek employment or self-employment.

C. Post school education

(a) Institutes falling under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force-hence not taxable under the category of "commercial coaching and training services"

1. University as defined under section 2(f) of the UGC Act, 1956

2. Deemed University as defined under section 3 of the UGC Act, 1956

3. A college or institution, recognized by UGC, run by a trust/registered society/body corporate/body incorporated under Central or State Act as an institution affiliated to or form as constituent member with a university, providing education up to a bachelors degree, masters degree or diploma of a duration of minimum one academic year.

4. Autonomous colleges as per National Policy on Education, 1986.

(b) Institutes not falling under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force- hence taxable under the category of "commercial coaching and training services"

An institution or establishment which is derecognized by the professional councils (such as All India Council for Technical Education-AICTE, Medical Council of India-MCI, Indian Council for Agricultural Research-ICAR, Bar Council of India-BCI) created through independent Union Acts.

(c) Deemed to be University not required to obtain the approval of AICTE to start any programme in technical or management education leading to an award, including degrees in disciplines covered under the AICTE Act, 1987

From the year 2005 onwards, a technical institution or establishment (which is otherwise recognized being a university, or affiliate college) has to obtain AICTE approval to fall under the category of institutes/establishments which issue diploma or certificate recognized by the law for the time being in force. However 'Deemed to be University' have been exempt from this requirement.

(d) Taxability of the courses conducted

In India, due to change in legal provisions, an institute/establishment may be recognized by the law at one time and not recognized at other. However, the taxability of the courses conducted would depend on the legal status of such institute or establishment at the point of time when such service is provided (i.e. course is conducted).

9. Whether the theatre owners are required to pay service tax on the rent received by them from distributors?

Screening of movie is not taxable except in the following case:-

Where the distributor leases out the hall for screening of the movie,

(i) the theater owner gets a fixed rent from the distributor.

(ii) the profit or loss from exhibiting the film is borne by the distributor.

In such a case, the theatre owner provides the taxable service of 'renting of immovable property' for furtherance of business or commerce and is accordingly liable to pay service tax on the rent received from the distributor.

[Circular No. 109/03/2009 dated 23.02.2009]

10. Service Tax (Provisional Attachment of Property) Rules, 2008

These rules introduced by Notification No.30/2008 ST dated 01.07.2008 with effect from 01.07.2008 provide as follows:-

Rule 3 - Procedure for provisional attachment of property

(a) The Assistant or the Deputy Commissioner of Central Excise, after due verification of the facts and circumstances of the case, for the purpose of protecting the interest of revenue, during the pendency of any proceeding under section 73/73A of the Finance Act, 1994, may forward a proposal for provisional attachment of property belonging to a person on whom a notice has been served under section 73(1)/73A(3) of the Act, to the Commissioner in the format prescribed in these Rules.

(b) The Commissioner may cause service of a notice on such person who can make a submission in this regard within 15 days of service of the notice.

(c) Upon consideration of submission, the Commissioner may pass an order to attach the property provisionally.

Rule 4 - The property that can be attached

(1) Value of property attached shall be of value as nearly as may be equivalent to that of the amount of pending revenue against such person.

(2) The movable property of such person shall be attached only if the immovable property available for attachment is not sufficient to protect the interest of revenue.

Rule 5 - Obligations of person whose property has been attached provisionally

The said person or his representative shall not mortgage, lease, transfer, deliver or deal with the attached property in any manner except with the previous approval of the Commissioner of Central Excise.

Rule 6 - Period for which order of provisional attachment of property remains in force

Every such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of the service of the order passed.

However, Chief Commissioner of Central Excise may grant an extension for a maximum period of two years.

11. Guidelines in respect of provisional attachment of property

Circular No. 103/06/2008 ST dated 01.07.2008 has issued the following guidelines in respect of provisional attachment of property for the purposes of protecting the interests of revenue during the pendency of any proceedings under section 73 or section 73A of the Act:

1. The following types of offences committed by a service provider or an exporter may be considered for provisional attachment of property:-

   (a) Provision of a taxable service without the cover of an invoice or any other document, as prescribed, and without payment of tax;

(b) Provision of a taxable service without declaring the correct value for payment of service tax, where a portion of value of taxable service, in excess of invoice price, is received by him or on his behalf but not accounted for in the books of account.

(c) Taking of CENVAT credit without the receipt of goods or services specified in the document based on which the said credit has been taken;

(d) Taking of CENVAT credit on invoices or other documents which a person has reasons to believe as not genuine;

(e) Issue of service tax invoice or any other document, without providing or to be providing a taxable service, as specified in the said invoice or other document;

(f) Claiming of refund or rebate in a fraudulent manner such as on invoice or other documents which a person has reason to believe as not genuine.

2. The provisional attachment of property shall be resorted only in a case where the service tax or CENVAT credit alleged to be involved is more than Rs.25 lakh.

3. Personal property of a sole proprietor or partners shall not be attached. Personal property means any movable or immovable property which is in personal use of the sole proprietor or partner. However, immovable property/ properties which is/ are used for commercial purpose may be provisionally attached. Movable property should be attached only if the immovable property available for attachment is not sufficient to protect the interests of revenue.

   It should also be ensured that such attachment does not hamper the normal business of the assessees. This would mean that inputs required for provision of a service should not be attached by the department.

4. Provisional attachment of the property shall not be excessive, that is to say, the property provisionally attached shall be of value as nearly as may be equivalent to that of the amount demanded in the proceedings under section 73 or section 73A of the Act.

5. The provisional attachment of the property of the concerned person shall be made after sunrise and before sunset and not otherwise.

6. After provisional attachment of the property, the Central Excise Officer shall prepare an inventory of the property attached and specify in it the place where it is lodged or kept and shall hand over a copy of the same to defaulter or the person from whose charge the property is distrained.

7. All such property as is by the Code of Civil Procedure, 1908 exempted from attachment and sale for execution of a decree of a Civil Court shall be exempt from provisional attachment. The decision of the Commissioner of Central Excise in this regard shall be final.

12. Clarification of issues relating to service tax levy on goods transport road services

Circular No. 104/07/2008-ST dated 06.08.2008 has clarified the following issues relating to service tax levy on goods transport by road services:

(i) Issue: GTA provides service to a person in relation to transportation of goods by road in a goods carriage. The service provided is a single composite service which may include various intermediary and ancillary services such as loading/unloading, packing/unpacking, transshipment, temporary warehousing. For the service provided, GTA issues a consignment note and the invoice issued by the GTA for providing the said service includes the value of intermediary and ancillary services. In such a case, whether the intermediary or ancillary activities is to be treated as part of GTA service and the abatement should be extended to the charges for such intermediary or ancillary service?

Clarification: GTA provides a service in relation to transportation of goods by road which is a single composite service. GTA also issues consignment note. The composite service may include various intermediate and ancillary services provided in relation to the principal service of the road transport of goods. Such intermediate and ancillary services may include services like loading/unloading, packing/unpacking, transshipment, temporary warehousing etc., which are provided in the course of transportation by road. These services are not provided as independent activities but are the means for successful provision of the principal service, namely, the transportation of goods by road. The contention that a single composite service should not be broken into its components and classified as separate services is a well-accepted principle of classification. As clarified earlier vide F.No. 334/4/2006-TRU dated 28.2.2006 (para 3.2 and 3.3) and F. No. 334.1/2008-TRU dated 29.2.2008 (para 3.2 and 3.3), a composite service, even if it consists of more than one service, should be treated as a single service based on the main or principal service and accordingly classified. While taking a view, both the form and substance of the transaction are to be taken into account. The guiding principle is to identify the essential features of the transaction. The method of invoicing does not alter the single composite nature of the service and classification in such cases is based on essential character by applying the principle of classification enumerated in section 65A. Thus, if any ancillary/intermediate service is provided in relation to transportation of goods, and the charges, if any, for such services are included in the invoice issued by the GTA, and not by any other person, such service would form part of GTA service and, therefore, the abatement of 75% would be available on it.

(ii) Issue: GTA providing service in relation to transportation of goods by road in a goods carriage also undertakes packing as an integral part of the service provided. It may be clarified whether in such cases service provided is to be classified under GTA service.

Clarification: Cargo handling service [Section 65(105)(zr)] means loading, unloading, packing or unpacking of cargo and includes the service of packing together with transportation of cargo with or without loading, unloading and unpacking. Transportation is not the essential character of cargo handling service but only incidental to the cargo handling service. Where service is provided by a person who is registered as GTA service provider and issues consignment note for transportation of goods by road in a goods carriage and the amount charged for the service provided is inclusive of packing, then the service shall be treated as GTA service and not cargo handling service.

(iii) Issue: Whether time sensitive transportation of goods by road in a goods carriage by a GTA shall be classified under courier service and not GTA service?

Clarification: On this issue, it is clarified that so long as, (a) the entire transportation of goods is by road; and (b) the person transporting the goods issues a consignment note, it would be classified as 'GTA Service'.

13. Clarifications of service tax issues relating to units in SEZ

Circular No. 105/08/2008 -ST dated 16.09 2008 has clarified the service tax issues relating to units in Special Economic Zones. It has been observed that there has been lack of clarity in the field formations administering service tax as regards the applicability of service tax levy on units located in SEZ. This lack of clarity has resulted in certain problems especially with respect to service tax administration. The issues and the proposed actions are mentioned below:

(i) Non-payment of service tax by SEZ units providing taxable service outside SEZ

There is no exclusion to SEZs in the Chapter V of the Finance Act, 1994 Taxable services received by SEZ units and SEZ developers for consumption within the SEZ are exempt for service tax under notification No. 4/2004-ST, dated 31.3.2004. However, service tax is applicable on taxable services provided by SEZ units, except such services which are exempt by notification No. 4/2004-ST. The C &AG, has pointed out instances, where SEZ units in Chennai & Cochin were providing taxable services like manpower supply service, technical testing and analysis service etc., to units / persons outside SEZ, without payment of service tax. In this regard the Ministry of Commerce (MOC) has observed that monitoring and collection of service tax does not come under the jurisdiction of the Development Commissioner and that such responsibility rests with the jurisdictional service tax (or CX & ST) authorities under the Central Board of Excise and Customs. Therefore, field formations should ensure that SEZs units, providing taxable services to any person for consumption in DTA (or providing any taxable service which is otherwise not exempt), or is otherwise liable to pay service tax under the service tax law, take registration with the jurisdictional service tax authorities and discharge their service tax liability in terms of the Finance Act, 1994.

(ii) Refund of Service Tax on taxable services used for the purposes of exports of goods by SEZ units

Refund of service tax paid on certain taxable services used in export of goods is permitted under notification 41/2007-ST. This notification prescribes that the refund would be allowed by the jurisdictional Deputy Commissioner/Assistant Commissioner of Central Excise. Doubts have arisen as to the authority that would process these claims when made by SEZ, i.e., the SEZ authorities or jurisdictional service tax authorities. As stated above, the Ministry of Commerce has already opined that administering the service tax law is responsibility of CBEC. Refund of service tax is to be processed by the respective jurisdictional authority administering service tax law. Accordingly, it is clarified that the SEZ units, claiming refund of service tax, should take registration with the jurisdictional ST authorities and file their claims there.

RECENT AMENDMENTS IN DIRECT TAX LAWS AND INDIRECT TAX LAWS

Students are advised to study thoroughly the Supplementary Study Paper-2008 on Direct Tax Laws and Indirect Tax Laws for the Final Course. This contains the amendments made by the Finance Act, 2008 as well as the significant Notifications/Circulars issued between 01.05.2007 and 30.04.2008. This Supplementary Study Paper is available at various branch and regional sales counters of the Institute. This RTP contains the significant amendments made through notifications/circulars issued between 1.5.2008 and 30.04.2009.

This is very important since considerable weightage is being given to the latest amendments in the examinations. Students may note that the Board of Studies has come out with a publication "Select Cases in Direct and Indirect Taxes [2008] – An Essential Reading for Final Course". This contains important recent judgements of Supreme Court, High Court and Appellate Tribunal in both Direct Taxes and Indirect Taxes.