

PRIME ACADEMY

25th SESSION MODEL EXAM

FINAL

Total No of Questions: 6
Time Allowed: 3 Hours

Total No of Printed Pages: 4
Max. Marks: 100

CT

(Question no.1 is compulsory. Answer any 4 from the rest)

- 1 (a)** X Ltd manufactures and sells a special component. It follows a standard Marginal Costing system. For the year ended 31.03.2007, it produced 1400 components against a budgeted capacity of 2000 components. Out of the production 100 components were scrapped. Due to a computer virus most of the financials could not be retrieved. However the Chief Cost Accountant gave the following information.

Particulars	Rs.
Selling Price per component	208
Direct materials total cost	84,000
Direct labour cost per component (Actual efficiency 80%)	?
Variable manufacturing overhead per component	15
Variable selling overhead per component	8
Fixed selling and Administration overheads	40,000
Fixed overhead manufacturing absorption rate per component (on the basis of budgeted capacity)	30
Closing stock (100 units)	9000

You are required to prepare the actual Profit and Loss statement. Reconcile the standard profit with that of Actual Profit/Loss.

(12 marks)

- 1 (b)** The following table lists the activities of a maintenance project.

Activity	1-2	1-3	1-4	2-7	3-6	4-5	4-6	5-8	6-9	7-8	8-9
Duration in days	8	5	2	4	3	5	8	4	7	1	3

- a) Draw the project network and compute the critical path
 b) Suppose we are required to employ a special piece of equipment on activities 2-7, 4-5 and 8-9 one at a time, will it affect the duration of the project? Explain

(8 marks)

- 1 (c)** What is the usefulness of Pareto Analysis.

(4 marks)

- 2(a)** On the basis of expected market share of 25% MARS Ltd prepares the following standard cost card of its product:

	Rs.
Materials 5kg @Rs.20 per kg	100
Labour 20 hours @ Rs.10 per hour	200
Overheads – Variable	60
Fixed (based on a Budgeted capacity of 7500 units)	80

Selling price per unit 600

For the year ending 31.03.2007 the actual Profit and Loss account was as follows:

	Rs.(000's)
Sales 7000 units @ Rs.630 per unit	4410
Materials consumed	759
Labour	1463
Overheads – Variable	400
Fixed	630
Profit	1158

You are informed that actual material price were higher by 10% and actual labour rate were lower by 5% as compared to standard. The actual market demand was 36000 units. Prepare a statement on the basis of detailed variances reconciling the budgeted and actual Profit. (13 marks)

2(b) Distinguish between ERP and MRP (6 marks)

3(a) A firm produces three products A, B and C. It uses two types of raw materials I and II of which 5000 and 7500 units respectively are available.

Raw Material	Requirements per unit of Product		
	A	B	C
I	3	4	5
II	5	3	5

The labour time for each unit of the product A is twice that of product B and three times that of product C. The entire labour force of the firm can produce the equivalent of 3000 units. The (marks) minimum demand of the three products is 600, 650 and 500 units respectively. Also, the ratios of the number of units products must be equal to 2:3:4. Assuming the profits per units of A, B and C as Rs.50, 50 and 80 respectively.

Formulate the problem as a linear programming model in order to determine the number of units of each product which will maximize the profit.

(7 marks)

3(b) PQ Limited manufactures a special toy for children. A preliminary market survey conducted by the company indicated the following demand potential for the toys for the first three months.

Month 1 – 1200 toys, Month 2 – 900 toys, Month 3 – 1200 toys

The selling price per toy in Rs.200. Sales will be invoice on the 15th and last day of each month. Terms are 2% discount, if payment in made within 10 days, otherwise full amount is to be paid within 30 days (that is 2/10 net30). Past experience indicates sales are made evenly throughout the month. 50% of the customers pay the invoiced amount within the discount period and the reminder pay at the end of 30 days except for bad debts, which average 1% of gross sales. The average total cost of toy is Rs.150. The company never carried any stock of the toys. All production was sold. Payments for production were 50% in the same month and the remaining 50% in the subsequent month. The company has a beginning Cash balance of Rs.50000

You are required to prepare a projected cash forecast for the three months showing opening balance, receipts itemized by dates of collection and balance at the end of the month.

(12 marks)

- 4(a)** A group has two companies
 K Ltd which is operating at just above 50% capacity, and
 L Ltd which is operating at full capacity (7000 production hours)
 L Ltd produce two products X and Y using the same labour force for each product. For the next year its budgeted capacity involves a commitment to the sale of 3000 kgs of Y, the remainder of its capacity being used on X.

	X	Y
	Rs. per kg	Rs. per kg
Direct Material	18	14
Direct wages	15 (1 production hour)	10 (2/3 production hour)

The company's overhead is Rs.1,26,000 per annum relating to X and Y in proportion to their direct wages. At full capacity, Rs.70,000 of this overhead is variable. L Ltd prices its products with a 60% markup on its total costs.

For the coming year K Ltd wishes to buy from L Ltd 2,000 kgs of product X which it proposes to adopt and sell as product Z for Rs.100 per Kg. The direct costs of adaptation are Rs.15 per kg. K Ltd's total fixed costs will not change, but variable overhead of Rs.2 per Kg will be incurred

You are required to recommend as group management accountant

- At what range of transfer prices, if at all 2000 Kgs of product X should be sold to K Ltd
- What other points should be borne in mind when making any recommendations about transfer price in the above circumstances.

(12 marks)

- 4(b)** A Company Ltd. has received an order for 32 newly designed machines. The customer says he needs all of the machines delivered as soon as possible. The Production Manager of A Company Ltd. is not at all certain that he has the capacity to be able to make all 32 machines. Having checked his budgets, targets, and revised schedules, the Production

Manager has the following information to hand:

Estimated hours for first machine	500
Estimated learning rate (%)	80
Total labour hours available until year end	12,500
Labour hours committed on existing orders	7,500

The Production Manager is keen to ensure that he does not interrupt any of his existing schedules and orders. Will the firm will be able to finish the order by the year end?

(4 marks)

- 4(c)** What are the uses of Artificial Variables in Linear Programming

(3 marks)

- 5(a)** A company produces 3 products A, B and C. The following information is available for a period

Product	A	B	C
Contribution (Sales – Direct Materials)	Rs.24	Rs.20	Rs.12
Machine hours required per unit:			
Machine 1	12	4	2
Machine 2	18	6	3
Machine 3	6	2	1
Estimated sales demand	200	200	200

It is given that machine capacity is limited to 3,200 hours for each machine, you are required to analyse the above information and Theory of Constraints process to remove the constraint.

(8 marks)

- 5(b)** A firm produces four products. These are four operators who are capable of producing any of these four products. The processing time varies from operator. The firm records 8 hours a day

and allow 30 minutes for lunch. The processing time in minutes and the profit for each of the products are given below.

Operators	Products			
	A	B	C	D
1	15	9	10	6
2	10	6	9	6
3	25	15	15	9
4	15	9	10	10
Profit (Rs.) per unit	8	6	5	4

Find the optimal assignment of products to operators.

(8 marks)

5(c) Write a short note on Ideal Standards.

(3 marks)

6(a) Alfa Engineering Works Ltd. had the following annual budget for the year ending on 30 June 2007.

Production Capacity	60%	80%
Costs (Rs. lakhs)		
Direct materials	9.60	12.80
Direct labour	7.20	9.60
Factory expenses	7.56	8.04
Administrative expenses	3.72	3.88
Selling and distribution expenses	4.08	4.32
Total Cost	32.16	38.64
Profit	4.86	10.72
Sales	37.02	49.36

Owing to adverse trading conditions, the Company has been operating during July/September 2007 at 40% capacity, realizing budgeted selling prices.

Owing to acute competition, it has become inevitable to reduce prices by 25% even to maintaining the sales at the existing level. The directors are considering whether or not their factory should be closed down until the trade recession has passed. A market research consultant has advised that in about a year's time there is every indication that sales will increase to 75% normal capacity and that the revenues to be produced for a full year at that volume could be expected to Rs.40 lakhs.

If the directors decide to close down the factory for a year it is estimated that:

1. The present fixed costs would be reduced to Rs.6 lakhs per annum;
2. Closing down costs (redundancy payments, etc.) would amount to Rs. 2 lakhs;
3. Necessary maintenance of plant would cost Rs. 50,000 per annum and on re-opening the factory, the cost of overhauling the plant, training and engagement of new personnel would amount to Rs.80,000.

Prepare a report for the directors, making your recommendations.

(10 marks)

6(b) Illustrate Contribution Break-even chart and Cash Break-even chart.

(6 marks)

6(c) Write a short note on Simulation and Inventory Control

(3 marks)

PRIME ACADEMY
SUGGESTED ANSWERS

FINAL- COST MANAGEMENT AND QUANTITATIVE TECHNIQUES

1a	PROFIT & LOSS ACCOUNT																																																		
<table> <tr> <th>Actual Profit and Loss account</th><th>Total Rs.</th></tr> <tr> <td>Sales</td><td>249,600</td></tr> <tr> <td>Less : Variable costs</td><td></td></tr> <tr> <td>Direct materials</td><td>84,000</td></tr> <tr> <td>Direct labour #</td><td>26,250</td></tr> <tr> <td>Variable manufacturing overheads</td><td>21,000</td></tr> <tr> <td>Variable mfg cost of goods produced</td><td>131,250</td></tr> <tr> <td>Less: Closing stock</td><td>9,000</td></tr> <tr> <td>Variable mfg cost of goods sold</td><td>122,250</td></tr> <tr> <td>Variable Selling Overhead</td><td>9,600</td></tr> <tr> <td>Total variable costs</td><td>131,850</td></tr> <tr> <td>CONTRIBUTION</td><td>117,750</td></tr> <tr> <td>Less: Fixed costs</td><td></td></tr> <tr> <td>Fixed Manufacturing Overhead (2000*30)</td><td>60,000</td></tr> <tr> <td>Fixed Selling and Admn Overhead</td><td>40,000</td></tr> <tr> <td>PROFIT</td><td>17,750</td></tr> </table>	Actual Profit and Loss account	Total Rs.	Sales	249,600	Less : Variable costs		Direct materials	84,000	Direct labour #	26,250	Variable manufacturing overheads	21,000	Variable mfg cost of goods produced	131,250	Less: Closing stock	9,000	Variable mfg cost of goods sold	122,250	Variable Selling Overhead	9,600	Total variable costs	131,850	CONTRIBUTION	117,750	Less: Fixed costs		Fixed Manufacturing Overhead (2000*30)	60,000	Fixed Selling and Admn Overhead	40,000	PROFIT	17,750	<table> <tr> <th colspan="2">STANDARD</th></tr> <tr> <td>No of units</td><td>1200</td></tr> <tr> <td>Selling price per unit</td><td>208</td></tr> <tr> <td>Standard Variable cost (manufacturing)</td><td>90</td></tr> <tr> <td>Variable selling costs</td><td>8</td></tr> <tr> <td>Standard Contribution P.U</td><td>110</td></tr> <tr> <td>Contribution</td><td>132000</td></tr> <tr> <td>Fixed costs</td><td>100000</td></tr> <tr> <td>Profit</td><td>32000</td></tr> </table>	STANDARD		No of units	1200	Selling price per unit	208	Standard Variable cost (manufacturing)	90	Variable selling costs	8	Standard Contribution P.U	110	Contribution	132000	Fixed costs	100000	Profit	32000
Actual Profit and Loss account	Total Rs.																																																		
Sales	249,600																																																		
Less : Variable costs																																																			
Direct materials	84,000																																																		
Direct labour #	26,250																																																		
Variable manufacturing overheads	21,000																																																		
Variable mfg cost of goods produced	131,250																																																		
Less: Closing stock	9,000																																																		
Variable mfg cost of goods sold	122,250																																																		
Variable Selling Overhead	9,600																																																		
Total variable costs	131,850																																																		
CONTRIBUTION	117,750																																																		
Less: Fixed costs																																																			
Fixed Manufacturing Overhead (2000*30)	60,000																																																		
Fixed Selling and Admn Overhead	40,000																																																		
PROFIT	17,750																																																		
STANDARD																																																			
No of units	1200																																																		
Selling price per unit	208																																																		
Standard Variable cost (manufacturing)	90																																																		
Variable selling costs	8																																																		
Standard Contribution P.U	110																																																		
Contribution	132000																																																		
Fixed costs	100000																																																		
Profit	32000																																																		
# Sales units = Production – Scrap – Stock = 1400 – 100 – 100 = 1200 Direct Labour cost per unit Marginal cost per unit 9000/100 = 90 Material cost per unit 84000/1400 = 60 Variable overhead = 15 Labour cost per unit = 15 Actual labour cost per unit } Rs.15 / 80% = 18.75 Total actual labour cost = Rs.26250	Reconciliation Standard profit 32000 Less: Units Scrapped (100*90) 9000 Labour efficiency variance 5250 ACTUAL PROFIT 17750																																																		
1b	a) Critical path = 1-4-6-9 = 17 days b) The activity 2-7 will start only on the 9th day, by which time activity 4-5 would be completed (on the 7th day) using the special piece of equipment. Activity 8-9 starts on the 13th day, by which time the special equipment will be free after being utilized for both 2-7 and 4-5. Hence the availability of the special piece of equipment, one at a time will not affect the project duration.																																																		

1c

Usefulness of Pareto Analysis: It provides the mechanism to control and direct effort by fact, not by emotions. It helps to clearly establish top priorities and to identify both profitable and unprofitable targets. Pareto analysis is useful to:

- Prioritize problems, goals, and objectives
- Identify root causes
- Select and define key quality improvement programs
- Select key customer relations and service programs
- Select key employee relations improvement programs
- Select and define key performance improvement programs
- Maximize research and product development time
- Verify operating procedures and manufacturing processes
- Product or services sales and distribution
- Allocate physical, financial and human resources

2a

Working note: VARIANCES

Material variances

SP * SQ 20 * (7000*5)	SP * AQ 20*(759000/22)	AQ * AP 759000
Usage 10000 (F)	Price 69000 (A)	

Labour variances

SR*SH 20*(7000*20)	SR*AH 10*(1463000/9.50)	AH*AR 1463000
Efficiency 140000 (A)	Rate 77000 (F)	

Variable overhead variances

SR*SH 3*140000	SR*AH 3*154000	Actual OH 400000
Efficiency 42000 (A)	Expenditure 62000 (F)	

Fixed overhead variances

SR*SH (80/20)*140000	SR*AH 4*154000	SR*BH 4*(7500*20)	Actual OH 630000
Efficiency 56000 (A)	Capacity 16000 (F)	Expenditure 30000 (A)	

Sales Margin variances

AQ*(ASP-BC) 7000*(630-440)	AQ*(BSP-BC) 7000*(600-440)	RBQ*(BSP-BC) 9000*(600-440)	BQ*(BSP-BC) 7500*(600-440)
Price 210000 (F)	Market share 320000 (A)	Market size 240000 (F)	

RECONCILIATION STATEMENT

Particulars	Rs. '000s	Rs. '000s
BEDGETED PROFIT		1200
Add : Favourable variances		
Material usage	10	
Labour Rate	77	
Variable overhead expenditure	62	
Fixed Overhead Capacity	16	
Sales Margin price	210	
Market size	240	615
		1815
Less : Adverse Variances		
Material Price	69	
Labour efficiency	140	
Variable overhead efficiency	42	
Fixed overhead efficiency	56	
Fixed overhead expenditure	30	
Market share	320	657
		657
ACTUAL PROFIT		1158

2b

Material Requirements planning	Enterprise Requirements planning
MRP is a computerized production scheduling system which takes the forward schedule of final product requirements and translates it progressively into the number of sub-assemblies, components and raw materials required at each stage of the manufacturing cycle	ERP attempts to integrate all departments and functions across a company into a singly computer system that can serve all those different departments particular needs MRP is a part of ERP
MRP provides a detailed forecast of the inventory position highlighted period by period, thereby ensuring availability of materials and components at the requested time and makes it possible to manufacture the end items as per the master schedule.	ERP provides for real-time analysis, control and forecasting besides facilitating standardization, economies of scale and cost reduction in product and also enables fast, flexible and accurate response and customization of reports.

3a

Let the firm produce x_1 units of product A, x_2 units of product B and x_3 units of product C. Maximize $Z = 50x_1 + 50x_2 + 80x_3$, Subject to

Constraint	Based on
$3x_1 + 4x_2 + 5x_3 \leq 5000$ $5x_1 + 3x_2 + 5x_3 \leq 7500$	Raw material
$x_1 + x_2/2 + x_3/3 \leq 3000$ i.e., $6x_1 + 3x_2 + 2x_3 \leq 18000$	Labour time
$x_1 \geq 600, x_2 \geq 650, x_3 \geq 500$	Minimum demand
$3x_1 = 2x_2$ and $4x_2 = 3x_3$	Ratio of products
x_1, x_2 and $x_3 \geq 0$	General condition

3b

Analysis of receipts from debtors

Invoice Date	Amount	Category	Amt invoice	Date of receipt	Amount received	Subtotal	
15 th Month 1	120000	Discount	60000	25-Month 1	58800	58800	Month 1
End month 1	120000	Credit	60000	15-Month 2	58800		
		Discount	60000	10-Month 2	58800		
		Credit	60000	28-Month 2	58800		
15 th Month 2	90000	Discount	45000	25-Month 2	44100	220500	Month 2
End month 2	90000	Credit	45000	15-Month 3	44100		
		Discount	45000	10-Month 3	44100		
		Credit	45000	30-Month 3	44100		
15 th Month 3	120000	Discount	60000	25-Month 3	58800	191100	Month 3
End month 3	120000	Credit	60000	15-Month 4			
		Discount	60000	10-Month 4			
		Credit	60000	30-Month 4			

Cash forecast

Particulars	Month 1 Rs.	Month 2 Rs.	Month 3 Rs.
Opening Balance	50000	18800	81800
Receipts from debtors	58800	220500	191100
Payment to cost of production for the month	90000	90000	67500
for previous month		67500	90000
Closing balance	18800	81800	115400

4a

L Ltds profit statement for product X

	Rs. Per kg
Variable costs	
Direct materials	18.00
Direct wages	15.00
Variable overheads	10.00
	43.00
Fixed overhead (Rs.126000-70000)/7000	8.00
TOTAL COST	51.00
Profit (60% of total cost)	30.60
Selling price	81.60

If L Ltd sells to K Ltd at the existing price of Rs.81.60 per kg then K Ltd will make a profit of Rs.1.40 per kg i.e., $\text{Rs.}100 - (81.60 + 15 + 2)$ On the order of 2000 kg the profit will be Rs.2800.

The product should be sold to K Ltd if there is no long term detrimental effects on L Ltd's total business. The range of transfer price from L Ltd's view point is Rs.81.60, since market price is normally considered as the best transfer price as it gives buyer and seller an equitable basis for inter company trading.

From the point of view of K Ltd : K Ltd is making only a small margin of Rs.1.40 per kg on the incremental cost of Rs.17, which is equal to about 8%. This is well below L Ltds margin included in the transfer price. K Ltd could point out that L Ltd will save some variable overhead for example transport advertisement and credit control etc. Assuming that to be Rs.2 per kg, the reduced transfer price should be $\text{Rs.}81.60 - (\text{Rs.}2 \times 1.6) = \text{Rs.}78.40$ per kg.

The transfer price hence can be in the range of Rs.78.40 to Rs.81.60.

Other points to be borne in mind

- o Even a small additional profit of Rs.2800 may improve staff morale
- o New product Z may have an expanding market and there may a possibility of higher prices in future
- o Impact of this transaction in the business of Z Ltd
- o Can L Ltd improve its output of X by working overtime or by subcontracting so as to handle present business plus extra 200 kg.

4b

Time required for producing 32 machines:

No of machines	Time reqd per machine (with a learning curve of 80%)	Total time required
1	500.00	500.00
2	400.00	800.00
4	320.00	1,280.00
8	256.00	2,048.00
16	204.80	3,276.80
32	163.84	5,242.88

Time available = $12500 - 7500 = 5000$ hours

Since the time available is less than time required, the firm will not be able to finish the order by the year end.

4c

Uses of artificial variable:

- o It is the basic assumption that none of the basic variables in the Linear Programming problem can have a negative value. Thus artificial variable is added to act as basic variable in a particular equation and hence it avoids the possibility of getting negative values for basic variables.
- o The artificial variables are such that their objective function co-efficient impose a huge and hence unacceptable penalty. In the case of maximization problem, the objective function is modified by subtracting a quantity MA where M is arbitrarily large value and A is the quantity. For minimisation the objective function is modified by adding the quantity MA. The artificial variable enable us to make a convenient and correct start in obtaining an initial solution.
- o The artificial variables with the high penalty once replaced by a real variable will never enter the optimal program. Hence the solution to the modified problem will give the optimal solution to the original problem.

Computation of required machine hours:

Computation of required machine utilization

The Theory of Constraints is applied as follows

- | Product | A | B | C |
|-------------------------------|------|------|------|
| Contribution per units Rs. | 24 | 20 | 12 |
| Machine hours required | 18 | 6 | 3 |
| Contribution per machine hour | 1.33 | 3.33 | 4.00 |
| Ranking | 3 | 2 | 1 |

The allocation of products based on the ranking

For removing the constraint it is required to increase machine capacity of machine 2. Assuming capacity could be increased one more machine of type 2 can be purchased. The no of hours will be 6400 hours, which will reduce the constraint.

Calculation of processing time available per operator.

The no of products processed by each operator in the available 450 minutes is as follows

Operators	Products			
	A	B	C	D
1	30	50	45	75
2	45	75	50	75
3	18	30	30	50
4	30	50	45	45
Profit (Rs) per unit	8	6	5	4

Since we are given the profit per unit of each product, the profit matrix is computed as follows

Operators	Profit in Rs.			
	A	B	C	D
1	240	300	225	300
2	360	450	250	300
3	144	180	150	200
4	240	300	225	180

Applying the assignment algorithm (i.e., deducting the maximum element in a row from each of the elements in the row and then deducting the least element in the column from each of the elements in the column the following matrix is obtained.

	A	B	C	D
1	4	0	25	0
2	34	0	150	150
3	0	20	0	0
4	4	0	25	120

Since the minimum number of lines to cover all zeros is three which is one less than the order of matrix, the minimum uncovered element is deducted from all uncovered elements and added to elements lying at the intersection of two lines. The resultant matrix is as follows

	A	B	C	D
1	0	0	21	0
2	30	0	146	150
3	0	24	0	4
4	0	0	21	120

Since the minimum lines required to cover the zeros is four, the optimal assignment is arrived

Operators	Products	Profit (Rs)
1	D	300
2	B	450
3	C	150
4	A	240
		1140

5c

Ideal Standards: These represent the level of performance attainable when prices for material and labour are most favourable, when the highest output is achieved with the best equipment and layout and when the maximum efficiency in utilization of resources results in maximum output with minimum cost. These type of standards are criticized on three grounds:

- Since such standards would be unattainable, no one would take them seriously.
- The variances disclosed would be variances from ideal standards. These would not, therefore, indicate the extent to which they could have been reasonably and practically avoided.
- There would be no logical method of disposing of these variances.

6a

The Directors
Alpha Engineering Works Ltd.

Dear Sirs

As desired, we have analysed the cost implications of the decision of temporary closure of the trade recession. We find that if the factory is run at 40% capacity and with reduced selling prices, the loss likely to be incurred in one full year (the estimated period of recession) should be around Rs.7.17 lakhs as detailed below.

PARTICULARS	Rs. In lakhs
Direct materials	6.40
Direct labour	4.80
Factory expenses	7.08
Administrative expenses	3.56
Selling & Distribution expenses	3.84
	25.68
Loss	(7.17)
Sales (Rs.37.02 lakhs*40/60*75/100)	18.51

If the factory is closed the following cost will be incurred

PARTICULARS	Rs. (in lakhs)
Fixed costs	6.00
Closing down costs	2.00
Maintenance costs	0.50
Cost of overhauling the plant, training and engagement of staff	0.80
	9.30

It is obvious from the above, that despite the fact that running 40% capacity would imply a loss of Rs.7.17 lakhs, it is better not to close down the factory since in that case the loss would be higher.

In our view, even if running the factory entailed a somewhat bigger loss as compared to the loss incurred by closing it down temporarily, it may be better to keep the factory in operation. This is because a closure, even if temporary results in the loss of regular and old customers, suppliers and skilled personnel. This, coupled with a loss of goodwill in the market, may give rise to substantial losses at the time of restarting the factory.

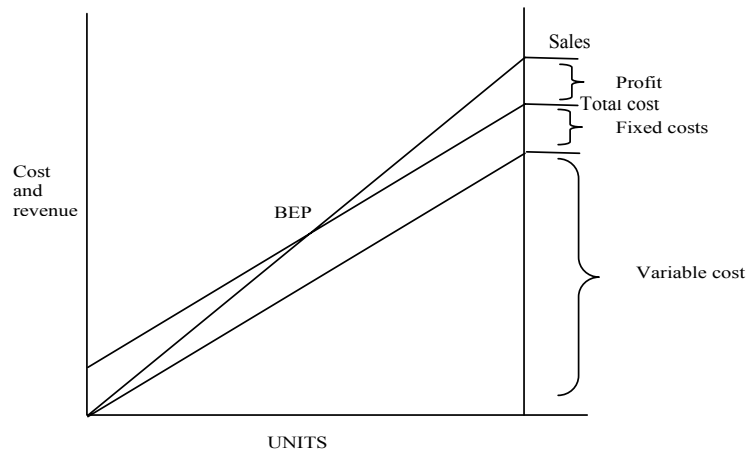
We shall be glad to be of any further assistance that may be required in this regard

Yours faithfully
XXXXXXXXXX

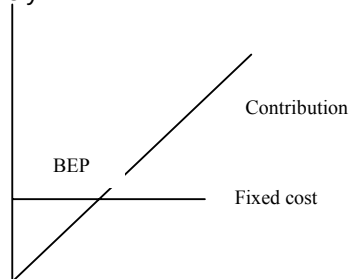
WORKING NOTES

	Factory expense	Admn. Expenses	Selling expenses
	(Rs in lakhs)		
Amount for 60%	7.56	3.72	4.08
Amount for 80%	8.04	3.88	4.32
Change for 20%	0.48	0.16	0.24
Amount for 40% (1-3)	7.08	3.56	3.84

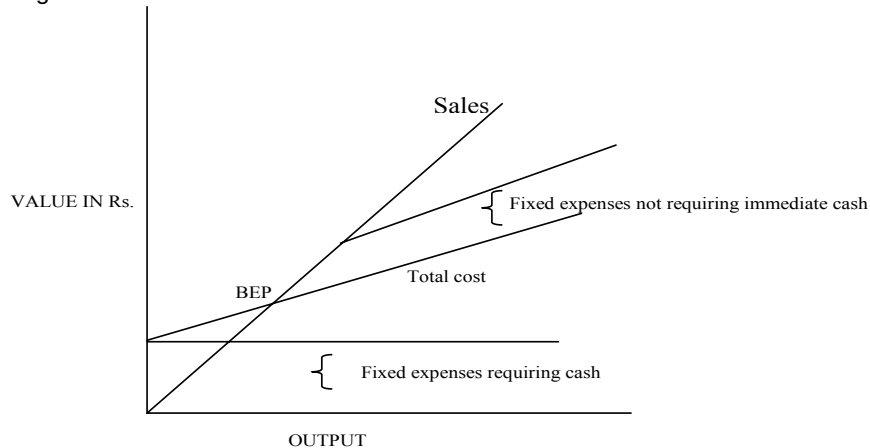
6b **Contribution break even chart** : The chart shows contribution earned by the firm at different levels of activity



Alternatively



Cash Break-even chart: In this chart the variable costs are assumed to be payable in cash. The fixed expenses are divided into two (a) those requiring immediate cash payment and (b) those not requiring immediate cash resources.



6c **Simulation and inventory control:** The Monte Carlo simulation is widely used to solve inventory problems characterized by uncertainty of demand and lead time. The distribution of demand during the lead time can be obtained from an empirical analysis of past data or by computer simulation using random numbers. The cumulative probability distribution of demand during the lead time is used as a basis to determine the annual inventory costs and stock-out costs for different levels of the safety stock. The management can experiment the effect of various inventory policies by using simulation and finally select an optimum inventory policy. The purpose of simulation, as applied to inventory, is to facilitate the management in selecting an inventory policy that will result in minimum annual inventory costs-ordering, carrying and stock-out costs.

PRIME ACADEMY
25th SESSION MODEL EXAM
FINAL

Total No of Questions: 7
Time Allowed: 3 Hours

Total No of Printed Page: 1
Max. Marks: 100

MS

Question No.1 is compulsory. Answer **any Four** questions from the remaining **Six** questions

- 1(a)** "The benefits of client server technology are many but there are related risks associated with C/S technology"- Explain **(10Marks)**
- 1(b)** Explain in detail stage 2 of SDLC **(10 Marks)**
- 2(a)** What are the factors to be considered while designing data communication systems **(10 Marks)**
- 2(b)** What are the factors to be considered while evaluating vendor's proposals **(10 Marks)**
- 3(a)** Detail the activities involved in conversion of an old system to a new system. **(10 Marks)**
- 3(b)** Explain in brief the concept of Business process re-engineering. **(5 Marks)**
- 3(c)** Explain as to how an organisation can control denial of service (DoS) attacks. **(5 Marks)**
- 4(a)** Explain the term disaster recovery planning. Explain the various components of a disaster recovery plan. **(10 Marks)**
- 4(b)** Explain the various output control methods. **(10 Marks)**
- 5(a)** Explain the terms: Asymmetric crypto systems, Key pair, Digital signature as per the IT Act 2000 **(10 Marks)**
- 5(b)** "The audit methods that are effective for manual audits prove ineffective in many IS Audits"- Comment **(10 Marks)**
- 6(a)** Explain the points to be considered by organisations for establishing better information protection. **(10 Marks)**
- 6(b)** MIS is fraught with myths/misconceptions- explain **(5 Marks)**
- 6(c)** Explain the term value of information **(5 Marks)**
- 7** Write short notes on the following: **(4x 5 Marks = 20 Marks)**
- (a) Individual and group decisions
 - (b) Bio-Metric devices
 - (c) Testing work benches
 - (d) System Stress

SUGGESTED ANSWERS

FINAL - MANAGEMENT INFORMATION AND CONTROL SYSTEMS

Question No.1 is compulsory. Answer **any Four** questions from the remaining **Six questions**

1 (a) Operating in a C/S environment pose the following risks:

<i>Kind of risk</i>	<i>Meaning</i>	<i>Solution to mitigate risk</i>
Technological risk	• Will the C/S model work (short run) • Will the C/S model become obsolete (long run)	Company & it department should understand the standards and market trends while deciding on what system to incorporate
Operational risk	• Will it achieve the performance level required(short run) • Will it meet the future requirements (long run)	Sound planning and factoring future issues is the solution
Economic risk	• In short run hidden costs of C/S – costs will rise as both C/S and old system may run parallely for some time • In long run concern about support / maintenance cost	An economic feasibility study should be carried out before implementing C/S technology.

<i>Kind of risk</i>	<i>Meaning</i>	<i>Solution to mitigate risk</i>
Political risk (Implies risk associated with user acceptance etc.)	- In short range the risk involved in transition- whether end users and management will be satisfied - In long range whether all the departments can be moved from mainframe to C/S model-if not some dept. operating in mainframe may have increased cost of processing and may create political problems.	The organisation and the IT department should work towards a smooth transition from mainframes to C/S environment. Also timetable should be drawn to migrate all the systems over a period of time from the mainframes to the C/S environment so as to bring down over all cost of processing and avoid political problems.

1(b) Stage 2: Requirement Analysis or Systems Analysis:

- Once the management decides to go ahead with the development , the user needs should be studied in detail.
- The systems analyst uses various tools like interviews, questionnaires, environment analysis to understand the requirements.
- He identifies the problems and short comings of the existing system which should be addressed in the new system

What is the focus of this stage?

- If traditional method of systems development is followed-** focus is on understanding user needs, in-depth study of the application area, strength and weakness of the current system and reporting results to management.

2. If prototyping approach is used - in this methodology, the requirement analysis and design phase run parallel. As the user is testing with the initial prototype, the analyst observes and incorporates the requirements- which form the basis for next level of prototype.

(Apart from the above the student should write in brief about the methods through which information can be gathered about the requirements, analysis of the present system and analysis of the proposed system)

2 (a): Design of data communications deals with networks and other channels or medium of communication

Role of systems analyst

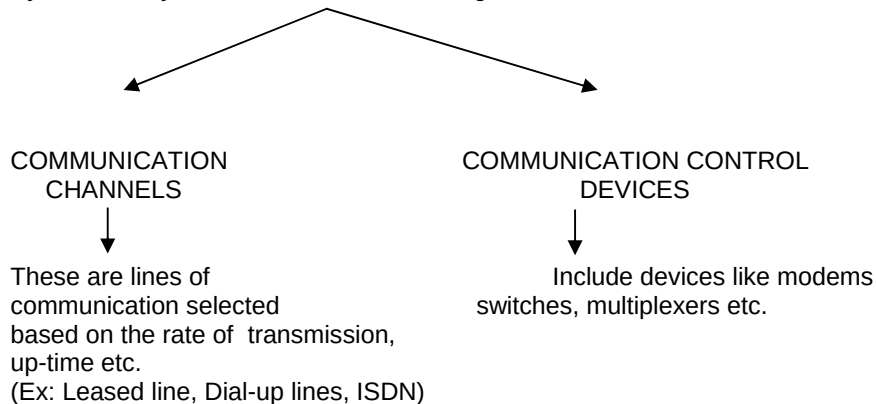
Systems analyst is responsible for

- Selecting the correct communication equipment
- Steps to be taken to design the application and specifying ways by which the application would be connected to the communication network
- Selecting the most useful and cost effective communication service.

He should know what communication components are needed by the new system and how they will interact with the components existing in the present system.

Requirements of data communication system

Systems analyst has to select the following :



In on-line/real-time systems the analyst must provide for user and transaction authorisation, protect against illegal/unexpected processing requests and audit trail for reliability and integrity.-----

2(b. Meaning of the term validation: It implies evaluating and ranking the proposals submitted by the various vendors.

1. Performance of the system (system efficiency) vis-à-vis their cost:

- The vendor's system should be capable of processing organisation data within the time frame stipulated by the management.
- Various indicators of performance are: speed, response time (the time gap in user requesting a query and the system responding to it), number of users the system can support (**Ex:** 5 users' concurrent access) .
- Benchmarking is one of the methods of evaluating efficiency. The vendors system is fed with some data and the outputs analysed for accuracy, consistency and efficiency.

2. Cost benefit analysis (CBA) of each proposed system:

- The accountant in the design team will compare the anticipated benefits of the system with its cost.

- They would also evaluate the option of Leasing Vs. Buying
- If system is to be bought, the accountant should draw up a depreciation schedule.

3. Maintainability of each proposed system:

- Maintainability implies capability to alter the system to meet changing business requirements.

Ex: A sales software should be capable of being altered to provide for value added tax or any other new taxes as and when introduced by the government.

- Cost of maintaining a system should be factored since it is substantial and may even be greater than the purchase cost over a period of time.

4. Compatibility of the proposed system with the existing system

- The proposed system should be compatible with the existing hardware , application software and in some cases compatibility should also be checked for operating system.

Ex. for hardware compatibility: the proposed system may not fit on the existing LAN and hence the network may need to be upgraded.

Ex. for operating system compatibility : the organisation may currently be working in a stand alone environment while the new system may require a network environment and hence may need to move from a standalone O/S to network based O/S (**Ex:** Windows NT)

5. Vendor support

Vendor support in the following areas should be evaluated:

- User training for a hands-on experience of the new system.
- System implementation and testing
- System maintenance through a maintenance contract.
- Back-up systems for temporary processing of organisations data if required.
- Support/help-desk facilities. It is better if the vendor offers round the clock support (24 * 7 * 365) rather than support only during office hours.

3(a) : Meaning: Implies those activities which need to be completed so as to successfully convert from old system to new system.

What are these activities? These activities can be categorised into :

- Procedure conversion
- File conversion
- System conversion
- Scheduling of personnel and equipment
- Fail-over/back-up plans if equipment fails

i. Procedure conversion:

- Operating procedures – for both computer operations and functional areas should be documented.

- Information on input, data files, methods, procedures etc. Should be presented in terms as would be understood by users.
- Written operating procedures should be supplemented by oral communication during training.
- Despite training efforts, queries would be raised during conversion stage and hence qualified people should be present to answer user doubts.
- Once new system stabilises in live area, implementation group should co-ordinate with supervisory personnel. Minor changes as conditions change may be expected and should be made if beneficial to organisation. Change control procedures should be in place to monitor changes.

ii. File conversion

When should this phase start ? It should start before programming and testing are completed as large amount of data may be needed to be converted from one format/medium to another.

Need for file conversion

If migrating from manual to computer environment → manual files tend to be inaccurate, incomplete and not in a standardised format as compared to computer based files.

If migrating from one computer system to another → existing file formats may be different from that of the new system format (format incompatibility) and hence may be unacceptable.

Other reasons for file conversion

- Files may require **character translation** that is acceptable to new system.
- **Medium of data** storage may have to be converted from floppy, discs etc. to mass storage files for providing on-line data base.
- **Re-arrangement of data fields** may be necessary for **efficient programming**.

Methods to ensure accurate file conversion

- File conversion programs should be tested exhaustively.
- Control measures like record count, control totals (hash totals) should be generated.
- Existing computer files should be retained for sufficient time to act as back-up if some error/bug is discovered in the conversion routine.

iii. System conversion

- After on-line and off-line files converted and reliability of new system proved in a live area, daily processing of information system can be migrated from old to new system.
- A **cut-off point** is established. Till this point all databases and data requirements are updated and any **transaction after the cut-off point** will be **done in the new system**

(Ex: A bank migrating a branch to core banking software may decide august 31st to be cut-off point → all transactions from 1st would be processed only in the new system)

- Organisation may decide to continue with the old system for some time to check the outputs of both systems and reconcile differences if any. Corrections are made in the new system if required.

iv. **Scheduling personnel and equipment**

- Systems manager finds it difficult to schedule the data processing operations of a new system for first time. The situation improves as users gain familiarity with the system.
- Production runs tend to sideline new program testing. System manager should allot sufficient time (may be second shift) for those working on programs.

Methods to set up schedules

- System manager should co-ordinate with departmental heads of those units which are using the new equipment.
- Draw up the master schedule for the subsequent month providing for sufficient computer time to handle processing.
- Based on the master schedule draw up daily schedules providing time for testing, re-runs and special reports
- The organisation can track the time gap between a query and execution of request by a system. This helps in identification of system efficiency (response time), the areas which are problematic and hence require attention.
- Personnel operating the system (like data entry operators) should also be scheduled to ensure that data is available for the system when it needs it for processing.

They should follow the procedure laid down by MIS section.

v. **Alternative plans in case of equipment failure (also called as business continuity/disaster recovery planning)**

- It involves continuing of critical business operations like billing, inventory etc. in case of systems failure till it is set right.
- A documented manual should be prepared by the computer section containing therein :
 - What are the critical jobs
 - How they would be handled in case of a equipment failure
 - Where are other back-up/compatible equipment located
 - Which personnel is responsible for each area in case of emergency
 - What is the minimum level of performance/dead-lines in case of emergency

3(b) Every company wanting to implement an ERP has to reengineer its processes (activities) in order to suit to the ERP.

- It is a fundamental **rethinking, radical redesign of processes/activities to achieve dramatic improvements in performance like quality and cost saving.**
 - Fundamental rethinking: refers to asking questions like “why do we do a process – what value does it add?”. If a process does not add any value, it may better be dropped rather than simplifying/automating it.
 - Radical redesign: refers to reinventing processes and not just enhancing or improving. It uses methods like “clean slate approach” (similar to zero based budgeting (ZBB))

- **Dramatic improvements:** Aims to achieve 80% to 90% reduction in costs. It is possible only through major improvements/breakthroughs and not through small incremental changes.
-

3(c) Methods to prevent and limit Exposure a DOS attack

- **Identify the server which is causing the attack** and program the firewall to ignore all messages from that site (similar to if we know the phone number from which missed calls are being received , we can block calls from that number).

Limitation: The attacker uses IP spoofing method to disguise the source of the message and hence makes it appear that message is coming from different sources from the internet. Organisation cannot block all sources.

- **Firewalls must engage in a policy of social responsibility** → Block information from source sites which have no internal addresses. This prevents attackers from disguising /hiding their location and assure management that no attack is launched from its site

Limitation: This method will work only if firewalls screen outgoing transmission from its internal network.

- **Use of security software :**

The targeted site can use this software to scan for half-open (incomplete) connections



Looks for SYN packets not followed by ACK packets



Such clogged /choked ports can be restored to allow legitimate connections to be made.

4(a) Disaster recovery plan (DRP)

Meaning:

- Refers to contingency measures that the organisation should adopt to recover from or prevent any disaster(disaster could be flood, earthquake etc. or any violent act of terrorism that could ruin the organisation).

Purpose/objective

- To assure the management that in case of any disaster :
 1. Normalcy would be restored within a set time
 2. Hence impact of loss would be minimized.

Components of a DRP



a. Emergency plan:

- Outlines actions to be taken immediately after a disaster occurs
- Identifies personnel to be notified immediately on happening of a disaster like the fire service, police and insurance company.
- Provides guidelines for equipment shutdown, power shut down, and removal of files
- It sets out evacuation procedures like triggering alarm bell, activating fire extinguishers and evacuation of personnel.
- Provides for return procedures once the facility is ready for operations. It takes the form of data back-up at off-site, data deletion at 3rd party site etc.

b. Recovery plan:

- Sets out how full capabilities would be restored.
- A recovery committee would be constituted which sets out priorities for recovery of application systems, hardware replacements etc.

- **Steps in this plan are:**

1. Inventory of hardware, application systems, system software and documents are to be taken.
2. Ranking applications on the basis of their criticality to the organisation and impact of their loss should be studied. It should spell out the efforts and cost involved in restoring these applications.
3. Setting out an application hierarchy which would be used when management decides to accept a degraded mode of operation.
4. Selection of disaster recovery site which may take the form of a reciprocal arrangement with a company having compatible hardware and software. However the problem of availability and data security should be considered.
Ex: If company A & B have a reciprocal arrangement for their payroll application and assuming that company A's system is down during a month end, it may not be able to use company B's system as it may clash with its own pay-roll run.

Hiring of a service bureau or having a fully operational back-up site could also consider.

5. Formal back-up arrangement with another company must be made. It should cover periodic exchange of information regarding changes to hardware/software, time duration of availability and test procedures.

c. Backup plan:

- Despite physical security, organisation's systems are always vulnerable to disaster.
- Hence better to provide a back-up of anything that could be destroyed (hardware / software).
- Software back-up involves taking copies of program files, data files, operating systems and test program and keeping it in a physically distant location from the original site. This site should not be susceptible or vulnerable to the same risks as the original site.

d. Test plan:

- Implies testing of the DRP and analysis of the test results in order to identify weakness, deficiencies and gaps in the emergency, backup or recovery plan.

- **Some type of tests are:**

1. **Paper walk-through/desk checking-** involves critical personnel who are involved in the plan reasoning out and discussing the various steps in DRP and seeing what might happen in the event of different disasters (it is a mental execution of the various steps done to identify if there are any gaps/weaknesses in the plans).
2. **Localised tests** - this simulates system crash and is performed for various aspects of the DRP
3. **Full operational test-** it is a near disaster condition and this can be carried out only if the earlier two tests have been carried out and then shutdown the system and simulate a disaster.

4 (b) Meaning : Refers to controls that ensure that system outputs are not:

- ❖ Lost
- ❖ Misdirected
- ❖ Corrupted
- ❖ Privacy is not violated

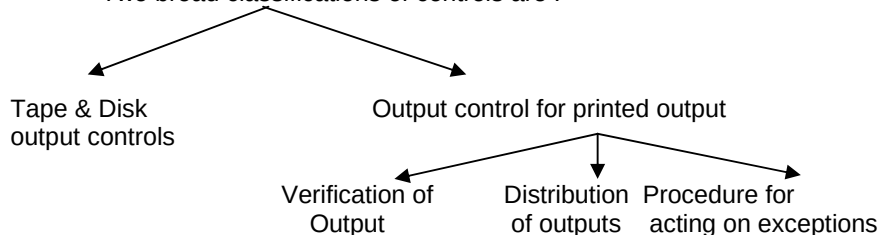
Ex: If the cheques issued by a company are lost, it may loose its credibility. If patient medical records are disclosed , may result in legal liability.

Types of controls to implement

Depends on type of processing used. Batch processing systems are more susceptible to exposures and hence require greater degree of control than real-time systems.

Controls over batch-processing outputs

Two broad classifications of controls are :



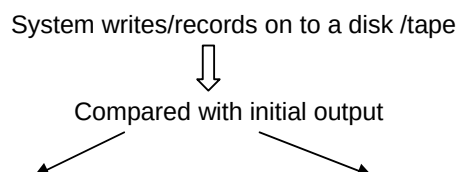
1. *Tape & Disk Output controls*

- Computer outputs on files /tapes not visible to human eye ,unlike printed outputs. Hence require controls to ensure accuracy of encoding / writing of information.

Some **examples** of controls:

a. Hardware controls like parity bit and software controls like check digits can be carried along with information output. This ensures that no data loss occurs in transmission.

b. Echo check:



If both are identical
signals that recording
has occurred correctly

If there is any variation, implies
that some hardware error has
occurred

A second write
attempt is initiated

Notifies computer
operator for alternate
action

c. File labels:

- Involves updating of information in trailer records to reflect new status of the file.
- **Ex:** The number of logical records / physical records in the file should be updated in the trailer record. This would be used as a processing control when file later used for input.
- File retention date should be carefully checked by the program. It should be updated if need to reflect a longer retention period.

2. Controls over printed output

A. Verification of output:

- It is based on the relationship of the output bears to the input and the processing that is carried out.
- Outputs can be of three types :
 - i. Outputs directly related to inputs
 - ii. Outputs indirectly related to inputs
 - iii. Exception reports.

i. Outputs directly related to inputs

These can be of two types:

Outputs identical
to the inputs

Output in part identical with
input + additional standard
information

Usually results from updating
or creating files & takes the
form of lists or documents

Ex: List of purchase invoices

Ex: Payroll produced from clock
rates and rates of pay

ii. Outputs indirectly related to input:

These would include output generated by programs taking into account:

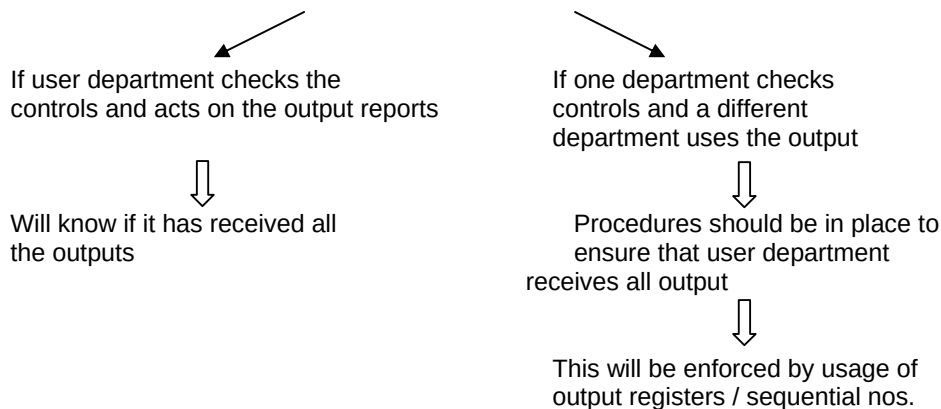
- a. Current input data
- b. Previous or latest input data
- c. All input for a given period of time

How are these outputs controlled? These outputs are verified manually using cumulative controls established over the input (**Ex:** Control totals) and placing emphasis on correct functioning of computer programs.

iii. Exception reports:

- Refers to variations thrown out by the system, when on scrutiny of input data / master files , conditions / validations are not satisfied. (**Ex:** Overtime hours total exceeding the maximum allowable hours)
- It may not be practicable to verify exceptional reports with control totals. It depends on correct functioning of the computer programs.

B. Distribution of output:



C. Procedure for acting on exception reports

- Exceptional reports provide information for important control functions.
- A high degree of control is required over investigation of the exception reports and the resulting action taken. Independent review to be done to ensure that exceptional items are investigated and prompt action taken.

Controlling real-time systems-output

- Real-time systems direct their output to the end-users computer screens, printers etc.
- This reduces the number of intermediaries in the distribution channel and hence reduces the associated risks and exposures.

Primary threat to real-time system outputs are attack on the communication channel that may lead to data interception, corruption or destruction.

5(a) Asymmetric Crypto System: According to S.2 (f) of the Information Technology Act, 2000, "asymmetric crypto system" means a system of a secure key pair consisting of a **private key for creating a digital signature** and a **public key to verify the digital signature**.

Key Pair : "Key pair", in an asymmetric crypto system, means a private key and its mathematically related public key, which are so related that the public key can verify a digital signature created by the private key.

Digital Signature : As per S.2 (p) of the IT Act, 2000 "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.

5(b) The audit approaches used in manual auditing may prove ineffective in IS Audits because :

S.No.	REASONS	MEANING
1.	Electronic Evidence	Evidence is not physically retrievable and may not be readable in its original form
2.	Terminology	Tools and techniques used in automated applications are difficult for non-EDP auditor to understand
3.	Automated processes	Processing is automated. Non-EDP auditor may not grasp the processing concepts and logic
4.	New risks and controls	Threats and counter measures / controls to threats are new to non-EDP auditors. They may not understand the magnitude of risks and the effectiveness of the controls.
5.	Reliance on controls	- In manual systems , auditors could rely to an extent on hard-copy evidence irrespective of the adequacy of controls. - In computerised environment, electronic evidence is only as valid as the controls (hence very critical to understand controls)

6(a) Points to be considered for better information protection

S. No.	Points to be considered	Meaning
1.	Not all data have same value	- Organisation must determine value of different data (relative importance) and then decide on the type of protection. Ex: Payroll data more sensitive than petty cash expenses data & hence varied degree of protection needs to be applied.
2.	Know where critical data resides	- Refers to company's information systems infrastructure. Each piece of information requires different levels of protection. Identifying information's location helps establish an integrated security solution. - This approach provides significant cost benefits so as to ensure that cost of protection need not exceed the value of data.
3.	Develop an access control methodology	- Information loss can happen by mere copying or disclosure of data and need not have to be removed to cause damage. - This can be addressed by providing for adequate access control methods like user-IDs and passwords .
4.	Protect information on stored media	- Data loss/theft can occur if employees have facility to copy data into removable media- floppies, CDs - hence need to be controlled. Magnetic media like hard discs should be controlled to protect programs and data. During migration/change-over from one system to another, all discs and data should be controlled(to prevent loss, duplication, exposure).
5.	Review hard copy	Refers to review of hardcopy output of employee's daily work –

	outputs	like drafts, working papers, papers kept in recycle or trash containers(may be valuable. If falls in wrong hands may be misused)
--	---------	--

6(b) MISCONCEPTIONS/MYTHS ABOUT MIS

S.No.	Myths about MIS	Facts/truths about MIS
1.	Study of MIS is about use of computers	- MIS may or may not be computer based - Computer is only a tool
2.	More data (quantity) means more information to managers	- Quantity does not matter, relevance of data to decision making is what is important - Form & presentation is important-unorganised data creates confusion
3.	Accuracy of reporting is of vital importance	- True at operational level (Ex: Temperature in chemical storage) - Higher levels of accuracy- higher is the cost of obtaining the data - Decision making at higher levels of management are macro decisions where a fairly correct presentation of relevant data is adequate (Ex: Project outlay is around 300 to 320 crores)

6(c) CONCEPT OF VALUE OF INFORMATION:

$$= \text{VALUE OF "CHANGE IN DECISION / BEHAVIOUR" CAUSED BY INFORMATION} \quad \text{LESS} \quad \text{COST OF OBTAINING INFORMATION}$$

$$= \left\{ \begin{array}{l} \text{OUTCOME OF NEW DECISION} \\ \text{CAUSED BY INFO.(LESS)} \\ \text{OUTCOME OF OLD DECISION} \end{array} \right\} \quad \text{LESS} \quad \text{COST OF OBTAINING INFORMATION}$$

Example:

- Mr. is approached directly by a prospective buyer to buy his house for Rs.50 lakhs (old decision)

- A real estate agent brings a new person who is willing to pay Rs 60 lakhs (new decision)
- Agent commission is 1% of sale value
Hence value of information given by the agent is :

$$\begin{aligned}
 &= (\text{Rs.60 lakhs (less) Rs.50 lakhs}) \text{ less } (1\% \text{ of } 60 \text{ lakhs}) \\
 &= 10 \text{ lakhs (less) Rs.60 Thousands} \\
 &= \text{Rs.9.4 lakhs}
 \end{aligned}$$

It may be noted that the above example deals with value of information that has been calculated for change in revenue flows. Value of information can also be calculated for change in costs.

7 (a) Individual and group decisions

Individual decisions:

- Decisions made by individual managers, who take full responsibility of the consequence of the decision.(may even be critical decisions)
- Such managers are vested with the required authority to carry out their jobs.
- In the process they may get the reports, information from sub-ordinates. However the final onus lies on manager to make the decision.

Group decisions:

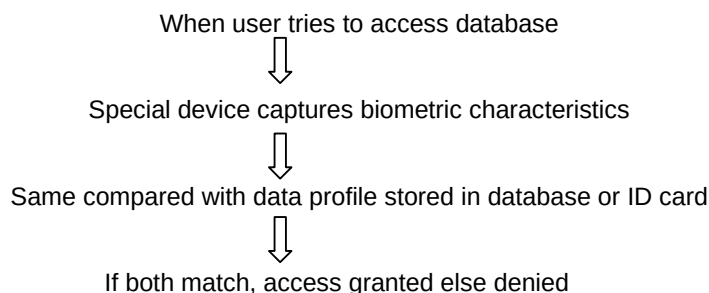
- Such decisions are made by more than one manager joining together for this purpose; especially those which have inter-departmental effect.

Ex: Decision to increase the price of a product may be taken by a group constituted by the sales manager, purchase manager and finance manager.

Ex: Board of directors, planning committee

(b) Bio-Metric devices

- The term “Bio” refers to physiological characteristics (like voice, fingerprint, face etc.) and “Metric” means measure.
- Such devices **capture the personal characteristics** like finger prints, retina scans and voice prints. These are digitised and stored in a database file or in a identification card that user carries.



(c) Testing work benches

- Refer to **open workbenches** that evolve to **suit the needs of the system being tested**
- **Some of the tools are :**

S.No.	TOOL	MEANING
1.	Test manager	• Manages the running & reporting of program tests. • Involves keeping track of test data, expected results, program facilities tested.
2.	Test data generator	• Generates test data. This is done by selecting sample data from dbase or by using patterns to generate random data
3.	Oracle	• Generates predictions of expected results
4.	File compactor	• Compares results of program test vs. results of previous tests and reports differences
5.	Report generator	• Helps in report definition & generation for test results
6	Dynamic analysers	• Adds codes to a program to keep track of number of times each statement is executed
7.	Simulators	• Ex: Target simulation, user interface simulators, I/O simulators etc.

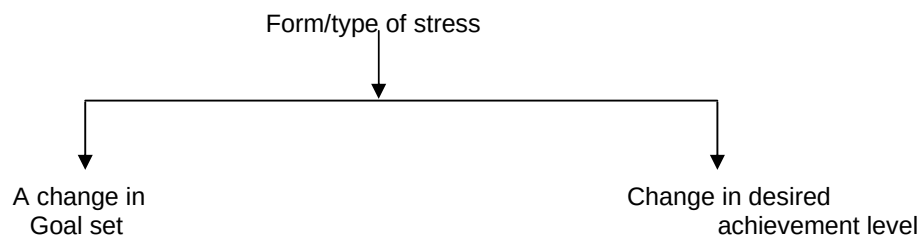
(d) System Stress

Stress:

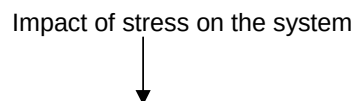
- Meaning : Force transmitted by systems' supra-system
- Effect : Causes system to change
- Purpose : To enable supra system to better achieve its goals

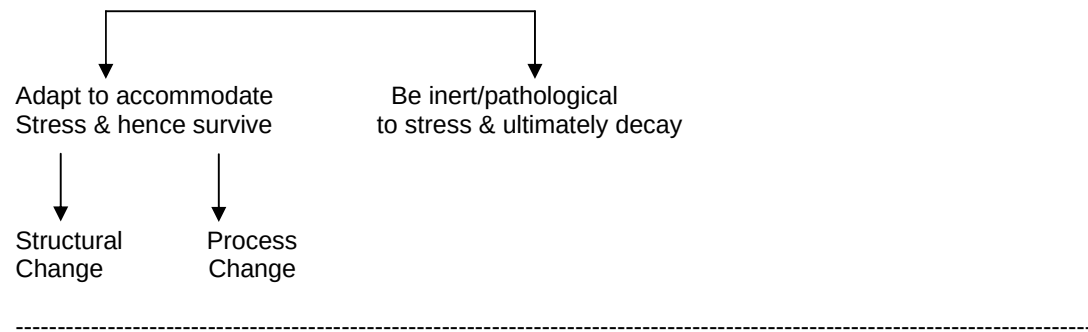
Each level of system trying to accommodate stress – may impose stress on its sub-system and so on.....

P



Impact of Stress on a system: The impact of stress varies depending on whether a system reacts or does not react to stress.





PRIME ACADEMY
25th SESSION MODEL EXAM
FINAL

Total No of Questions: 7

Time Allowed: 3 Hours

Total No of Printed Pages:4

Max. Mark:100

DX

Answer all Questions

1. For the assessment year 2007-08 Ms.Jaya (date of birth 19th September, 1941) furnishes the following information

<i>Particulars</i>	<i>Amount in Rs</i>
Gross Agricultural Income	2,21,000
Expenditure for earning Agricultural income	1,000
Non Agricultural income	3,50,000

Determine the tax liability of Ms. Jaya for the assessment year 2007-08 on the assumption that she contributes Rs.60,000 towards public provident fund and pays insurance premium of Rs.20,000 on her life insurance policy (Sum assured Rs.150,000)

Will your answer be different if Ms. Jaya stayed in India for only 56 days during the previous year relevant to the assessment year 2007-08? Also analyse your answer if the agricultural lands are situated out of India.

(12 marks)

- 2.a X traders, a partnership firm, for the assessment year 2005-06, filed its return of income on an income of Rs.40,000. the assessment was completed on an income of Rs.1,20,000 in the month of June 2006. The additions included (a) profit on suppressed sales of Rs.40,000, (b) disallowances in expenses of Rs.40,000. The assessment became final as no appeal was preferred. Penalty proceedings were initiated on the charge of concealment of income of suppressed profits. After considering the explanation to the notice to penalty, penalty was levied on the charge that inaccurate particulars were furnished. X traders contends that the order of penalty is bad in law. Is the contention justified?

(6 marks)

- 2.b The following issues arise in connection with the deduction of tax at source under chapter XVII-B. Discuss the liability for tax deduction in these cases:

1. X, an employee of the central government receives arrears of salary for the earlier three years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.
2. A TV channel pays Rs.11,00,000 on July 1, 2006 as prize money to the winner of a quiz programme "Who will be a Millionaire"?
3. State Bank of India pays Rs.50,000 per month as rent to the central government for a building in which one of its branches is situated.
4. A television company pays Rs.50,000 to a cameraman for shooting of a documentary film.
5. A state government pays Rs.20,000 as commission to one of its agent on sale of lottery tickets.
6. A turf club awards a jackpot of Rs.5,00,000 to the winner of one of its races.

(6 marks)

3. From the following profit & loss account of Raja for the year ended 31-3-07, compute his gross total income for the assessment year 2007-08

Particulars	Amount Rs	Particulars	Amount Rs
Opening stock	4,00,00	Sales	40,00,000
Purchases	30,00,000	Closing stock	4,80,000
Salaries	8,00,000	Income from house property	80,000
Rent, rates & taxes	1,20,000	Dividend from an Indian company	9000
Legal charges	40,000		
Miscellaneous expenses	20,000		
Provision for bad debts	30,000		
Provision for gratuity	20,000		
Provision for income tax	40,000		
Salary to Mrs. Raja	36,000		
Depreciation	40,000		
Net profit	23000		
	45,69,000		45,69,000

Additional information

- Purchases include Rs.1,00,000 paid in cash to cultivator for purchase of an agricultural produce.
- Purchases also include Rs.1,00,000 paid by way of compensation to a supplier as the assessee was unable to take the delivery of goods due to lack of storage space and finances.
- Opening stock was over valued by 25% and closing stock was undervalued by 25%.
- Salary includes Rs.15,000 paid as customary bonus on the occasion of diwali over and above the bonus payable under the payment of bonus act, 1956.
- Rent, rates & taxes include Rs.10,000 on account of disputed sales tax demand. Rs.3000 on account of municipal taxes for property let out. It also includes Rs.5000 as customs penalty paid during the year.
- An amount of Rs.20,000 from a customer was written off from the provision for bad debts
- An employee retired on 28-3-07. Gratuity payable to him was Rs.20,000. A provision was created for the same this year and it was paid 2-4-07.
- Mrs. Raja is a law graduate and actively working in the assessee's firm.

(12 marks)

4. Balance Sheet of Pallav India (P) Ltd. as on 1/4/06

Liabilities	Amount Rs	Assets	Amount Rs
Equity share capital of Rs.10 each	5,00,000	Land(acquired 17-5-95)	5,00,000
Reserves	8,00,000	Building (WDV as per IT Act (Market value Rs.15,00,000))	7,00,000
Loans	4,00,000	Machinery (WDV as per IT Act) (Market value Rs.5,00,000)	3,00,000
		Investments (acquired on 18-8-98)	2,00,000
Creditors	3,00,000	Current Assets	3,00,000
	20,00,000		20,00,000

Company went into liquidation on the date of balance sheet and all current assets realized at book value. Further, land and investments are sold for Rs.20,00,000 and Rs.3,00,000 respectively. The realized money were first applied in payment of outside liabilities including dividend tax and then balance money together with building and machinery was divided among shareholders. Viral a holder of 20000 equity shares got machinery worth Rs.5,00,000 and balance in cash on 31-3-07. Viral acquired shares for Rs.3,50,000 on 15-8-05. Compute capital gain.

(12 MARKS)

5. X Ltd. Is a company carrying on business in the construction and sale of residential flats. It furnishes the following data and requests you to compile wealth tax and determine the tax payable for assessment year 2007-08:

Particulars	Market value Rs
1. Land in an area within 2 kms. from Raipur, construction is permissible	3,00,000
2. Land in Urban area (construction is not permitted)	2,00,000
The company borrowed for the same Rs.1,00,000	
3. Land in urban area (held as stock-in-trade since 2000)	4,00,000
4. Indian Motor cars used by the director for personal purpose	1,00,000
5. Foreign motor car used for office purpose	2,00,000
6. Jewellery held as investment	8,00,000
7. Jewellery used for the office purpose	3,00,000
The company borrowed for the same Rs.2,00,000	
8. Aircraft not used for commercial purpose	60,00,000
9. bank balance	3,10,000
10. Cash in hand (Amount as per cash book Rs.10,000)	3,00,000
11. Residential flat provided to employees (salary of them does not exceed Rs.5,00,000)	10,00,000
12. Resident provided to Managing Director (salary exceeds Rs.5,00,000)	10,00,000
The company borrowed for the same Rs.4,00,000	
13. Residence provided to whole time director (salary Rs.4,20,000, however the directors owns 33% equity share capital of the company)	15,00,000
The company borrowed for the same Rs.7,00,000	

(12 marks)

- 6A. The assessment of X Ltd. For the assessment year 2004-05 was completed under section 143(3) on June 30, 2006. There was an audit objection that interest on borrowals ought to have been disallowed partly as there was diversion of borrowed funds to sister concerns without charge of interest. X Ltd. Did not accept the audit objection on these facts.

1. What are the options open to revenue to deal with audit objection.
2. Can the assessment be reopened

(7 marks)

- 6B. X, a tennis professional and a non-Indian citizen, participated in India in a tennis tournament and won the prize money of Rs.1,50,000. He contributed articles on the tournament in a local newspaper for which he was paid Rs.10,000. He was also paid Rs.50,000 by a soft drink company for appearance in a television advertisement. Although his expenses in India were met by the sponsors, he had to incur Rs.30,000 towards his travel costs to India. He was a non-resident for tax purposes in India. What would be his tax liability in India for assessment year 2007-08? Is he required to file his return of income under section 139(1)?

(6 marks)

- 6C.** As the company secretary of X Ltd. an Indian company, ascertain from the following particulars the minimum amount advance tax payable by way of different instalments to ensure that interest liability under section 234C is not attracted:

Particulars	Rs.
Business income	2,00,000
Long term capital gain on sale of government securities on October 10, 2006	20,000
Winning from lottery on December 31, 2006 (out of which tax deducted at source is Rs.31,365)	1,00,000

(7 marks)

- 7A.** What are the methods provided in the income tax act to determine price, where provisions of transfer pricing are applicable?

(10 marks)

- 7B.** What are the conditions that to be satisfied for applying transfer pricing?

(5 marks)

- 7C.** A Ltd., an Indian company, sells computer monitor to its 100 per cent subsidiary X Ltd. In United States @ \$ 50 per piece . A Ltd. Also sells its computer monitor to another company Y Ltd., in United States @ \$ 80 per piece. Total income of A Ltd for the assessment year 2007-08 is Rs.12,00,000 which includes sales made for 100 computer monitors @ \$ 50to X Ltd. Compute the arm's length price and taxable income of A Ltd. The rate of one dollar may be assumed to be equivalent to Rs.49 for the sake of simplicity.

(5 marks)

PRIME ACADEMY
SUGGESTED ANSWERS

FINAL – DIRECT TAXES

- 1) (i) Computation of Total Income of Ms. Jaya for the Assessment Year 2007-08.

<i>Particulars</i>	<i>Amount If agricultural lands are in India.</i>	<i>Amount If agricultural lands are out of India.</i>
Non agricultural income	3,50,000	3,50,000
Income from Agricultural lands	Exempt	2,20,000
Gross total income	3,50,000	5,70,000
Less: Deduction u/s 80C	80,000	80,000
Total Income	2,70,000	4,90,000

Note: Agricultural income is exempt only if agricultural lands are situated in India.

- (ii) Computation of total tax liability:

<i>Particulars</i>	<i>Working</i>	<i>Amount If agricultural lands are in India.</i>	<i>Amount If agricultural lands are out of India.</i>
Tax on Total income including agricultural income	1,85,000*0%+ 65,000*20%+ 2,40,000*30% 1,85,000*0%+ 65,000*20%+ 2,40,000*30%	85,000	85,000
Less: Tax on (Basic Exemption and Agricultural Income)	1,85,000*0%+ 65,000*20%+ 1,55,000*30%	59,500	000
Tax liability before education cess		25,500	85,000
Add: Education cess @ 2% of 25,500		510	1,700
Tax Liability		26,010	86,700

iii) Yes the answer will be different if Miss Jaya has stayed in India for only 56 days during the previous year relevant to the assessment year 2007-08 as she is the Non Resident for that year her basic exemption will be only one lac as against 185000/- as above even though there will be no change in her Total Income for that year. Accordingly the tax calculation will be as follows:

<i>Particulars</i>	<i>Working</i>	<i>Amount If agricultural lands are in India.</i>	<i>Amount If agricultural lands are out of India.</i>
Tax on Total income including agricultural income	1,00,000*0%+50,000*10% +1,50,000*20%+2,40,000*30%	97,000	97,000
Less: Tax on (Basic Exemption and Agricultural Income)	1,00,000*0%+50,000*10% +1,00,000*20%+70,000*30%	46,000	N.A.
Tax liability before education cess		51,000	97,000
Add: Education cess @ 2% of 51,000		1,020	1940
Tax Liability		52,020	98,940

2.a In the present problem, the penalty proceedings were initiated on the basis of concealment of income by suppressing profits. But finally the penalty was levied on charge of furnishing of inaccurate particulars of income. i.e. Notice is issued for concealment but penalty is levied on furnishing inaccurate particulars, hence the order is bad in law.

The contention of X traders is justified on the basis of judgement in *A.M. Shah & Company. CIT [1991] 238ITR 415 (Guj.)*, where in it was held that, the basis for issue of notice and for imposition of penalty should be the same.

2b If an employee receives a portion of his salary in arrears, he can claim relief in term of section 89 read with rule 21A. If the employee furnishes information in Form No. 10E to the employer, relief under section 89 should be given to the concerned employee while deducting tax at source under section 192.

-The rate at which TDS is to be deducted is the slab rates applicable to such assessee.

-Surcharges is 10 per cent of tax and education cess is 2 per cent on the total amount of tax and surcharge for the assessment year 2007-08.

X is liable for deduction of tax on the entire amount under section 192 during the current year but he can claim relief under section 89.

1. As per Section 194B, The TV channel is required to deduct income tax at the time of payment of payment of Rs.11,00,000, at the following rate:

- The rate applicable is 30%
- Plus Surcharge is 10% (If payment exceeds Rs.10,00,000)
- Plus Education Cess 02% (on total Tax and Surcharge of 33% for AY 2007-08)
- The total Rate applicable is 33.66%

Therefore the TV channel has to deduct Rs.3,70,260 (33.66% of Rs.11,00,000) under section 194B at the time of payment of Rs. 11,00,000/- and the balance of Rs.7,29,740/- to be paid to the winner.

2.In the case of Winner:

The winner should declare the total amount of Rs.11, 00,000/- as his income from winnings. After calculating the tax on total income, the tax deducted (Rs. 3, 70,260/-) can be adjusted from such tax payable. Only the balance tax after such adjustment, if any, to be paid.

3. As per section 196, there is no requirement to deduct income-tax, at source on income by way of 'rent' if the payee is the government.

4. As per section 194J, the television company shall deduct tax at source at the time of making payment to the cameraman at the rate of 5.1% Rs.2,550 (5.1% of Rs.50,000) shall be tax deduction at source under section 194J.

5. As per section 194G, the payer shall deduct income-tax at the rate of 10.2% at the time of making payment of any income by way of commission - Rs.2,040 (10.2% of Rs.20,000) shall be tax deduction at source under section 194G.

6. As per section 194BB, the payer shall deduct income tax at source at the rate of 30.60% at the time of making payment of any income by way of winnings from horse races, exceeding Rs.2,500.Rs.1,53,000 (30.6% of Rs.5,00,000) shall be tax deduction at source under section 194BB.

3 Computation of gross total income of Raja for the Assess Year 2007-08

Particulars	Note	Details	Amount
1) Profit and gains of business or profession			
Net profit as per books of account			23,000
Add: Expenditure disallowed but debited to P/L A/c			
Disputed sales tax demand	6	10,000	
Municipal tax	7	3,000	
Custom penalty	8	5,000	
Provision for bad debts	9	30,000	
Provision for income tax	12	40,000	88,000
			1,11,000
Less: Expenditure allowed but not debited in P/L A/c:			
Bad debts	9	20,000	
Less: Income not taxable but credited P/L A/c:			
Dividend received from companies		9,000	
Less: Income taxable under other heads but credited to P/L A/c			
Income from house property		80,000	1,09,000
			2,000
Adjustment of stock			
Add: Under valuation of closing stock	4	160,000	
Add: Over valuation opening stock	3	80,000	2,40,000
			2,42,000
2) Income from house property			
Gross annual value (actual rent received)		80,000	
Less: Municipal Taxes		3000	
Net annual value (NAV)		77,000	
Less: Standard deduction u/s 24(a) 30% OF NAV		23,100	53,900
3) Income from other sources			
Dividend [Exempt u/s 10(34)]			NIL
Gross Total Income			2,95,900

NOTE:

- Since the payment of Rs. 1,00,000/- is made in cash to agriculturist, the provision of section 40A(3) do not attract.
- Payment of compensation to supplier is a business expenditure and shall be allowed.
- Over valuation of opening stock by 25%
 Stock at over valued figure (i.e. at 125%) = 4,00,000
 Stock at cost (i.e. at 100%) = Rs.3,20,000 (i.e. Rs.4,00,000/125%)
 Overvaluation of stock = Rs.80,000 (i.e. Rs.4,00,000 – Rs.3,20,000)
- Under valuation of closing stock by 25%
 Stock at undervalued figure (i.e. at 75%) = 4,80,000
 Stock at cost (i.e. at 100%) = Rs.6,40,000 (i.e. Rs.4,80,000/75%)
 Undervaluation of stock = Rs.1,60,000 – Rs.4,80,000)
- Voluntary bonus to employee shall be allowed as expenditure, since it is a business decision.
- Disputed sales tax demand is not allowed assuming it is still not paid, as per sec 43B. However such dues are allowed in the year, in which such dues are paid.
- Municipal tax paid is allowed under the head income from house property.
- Any payment for infringement of law is not allowed as deduction
- Provision for bad debt is not allowed. However, the same debt is allowed as bad debt at the time of actual written off.
- Since the gratuity is paid before due date of filing of return, the same is allowed.
- Payment to relative not being in excess shall be allowed as deduction. Further Mrs. Raja is possessing technical or professional qualification. Hence, clubbing provision u/s 64(1) may not be attracted.
- Income tax is disallowed u/s 40(a).

4 Computation of capital gain for the assessment year 07-08 in the hands of Pallav India (P) Ltd.

As per section 46(1), at the time of liquidation of company, any transfer by way of distribution of assets to its shareholder is not treated as transfer for the purpose of capital gain. However, if any asset is sold in the market the same shall be liable to capital gain. In the given case the company sold land and investments in the market hence for such transfer it shall be liable to capital gain (calculated as under).

Computation of capital gain for the assessment year 2007-08 in the hands of Pallav India (P) Ltd.

Particulars	Working	Details	Amount in Rs
<u>In case of Land</u>			
Sale consideration			20,00,000
Less: Expenses of transfer			Nil
Net Sale Consideration			20,00,000
Less: i) Indexed cost of acquisition	Rs.5,00,000*519 / 281	923488	
ii) Indexed cost of improvement		Nil	923488
Long Term Capital Gains(A)			10,76,512
<u>In case of Investments</u>			
Sale consideration			3,00,000
Less: expenses of transfer			Nil
Net Sale consideration			3,00,000
Less: i) Indexed cost of acquisition	Rs.2,00,000*519 / 351	295726	
ii) Indexed cost of improvement		Nil	295726
Long Term capital Gain(B)			4274
Total Long Term Capital Gain (A+B)			10,80,786
Tax on long term capital gain @ 20% + 10% surcharge + 2% education cess			2,42,528

Statement showing cash position of the company

Receipts	Amount	Payments	Amount
Realisation of current assets	3,00,000	Loan	4,00,000
Land	20,00,000	Creditors	3,00,000
Investment	3,00,000	Dividend Tax (note 1)	1,12,200
		Long term capital gain tax	2,42,528
		Balance	15,45,272
	26,00,000		26,00,000

Note 1: Dividend tax

Tax u/s 115-O [12.5% of Reserve# (Rs.8,00,000)]

Rs.1,00,000

Add: Surcharge [10% of tax u/s 1150]

Rs. 10,000

Add: Education cess @ 2%

Rs. 2200

Total

Rs.1,12,200

For the purpose of dividend u/s 2(22)(c), reserve up to liquidation date shall be considered.

Statement showing amount received by Viral from the company

Worth of assets lying with the company after payment of outside liabilities:

Building

Rs.15,00,000

Machinery	Rs. 5,00,000
Cash (as shown above)	<u>Rs.15,45,272</u>
Total worth available for 50,000 shares	<u>Rs.35,45,272</u>
Worth to be received by viral for 20,000 shares (Rs.3545272/50,000)*20,000	<u>Rs.14,18,109</u>

Form of receipts

Amount received in form of machinery	Rs.5,00,000
Balance received in cash	Rs.9,18,109

Computation of capital gain of the Assessment Year 2007-08 in the hands of Viral

Particulars	Details	Amount
Sale consideration		10,98,109*
Less: expenses on transfer		Nil
Net sale consideration		10,98,109
Less: i) Cost of acquisition	3,50,000	
ii) Cost of improvement	Nil	3,50,000
Short term Capital Gains		7,48,109

Notes

*Sale consideration

Asset received by viral for 20,000 shares	Rs.14,18,109
Less: Dividend u/s 2(22)© being (Rs.8,00,000/50,000)*20,000	<u>Rs. 3,20,000.</u>
Sale Consideration	<u>Rs.10,98,109</u>

\$ While computing the period of holding of such asset the period after the date of commencement of liquidation shall be excluded, hence, share held by viral shall treated as short term capital asset.

5 Computation of net wealth of X Ltd. For the assessment year 2007-08

Particulars	Working	Amount	Amount
Land in urban area	Since construction is permissible on the land	3,00,000	
Land in urban area	Not an assets u/s 2(ea) as construction is not permitted on such land	NIL	
Land in urban area	Not an assets as held as stock-in-trade for less than 10 years	NIL	
Indian Motor cars used by the director for personal purpose		1,00,000	
Foreign motor car used for office purpose		2,00,000	
Jewellery held as investment		8,00,000	
Jewellery used for office purpose		3,00,000	
Aircraft not used for commercial purpose	Since not used for commercial purpose	60,00,000	
Bank balance	Not an assets u/s 2(ea)(vi)	NIL	
Cash in (Amount as per cash book Rs.10,000)	In excess of amount recorded in books	2,90,000	
Residential flat provided to employees	As salary of employees does not exceed Rs.5,00,000	NIL	
Residence provided to managing director	As salary of managing director exceeds Rs.5,00,000	10,00,000	
Residence provided to a whole time director	As salary of whole time director does not exceed Rs.5,00,00	NIL	
GROSS WEALTH			89,90,000
Less: Loan taken to purchase		2,00,000	

the jewellery			
Less: Loan taken to purchase the residence for M.D.		4,00,000	(6,00,000)
NET WEALTH			83,90,000
Less: Basic exemption			(15,00,000)
TAXABLE WEALTH			68,90,000
WEALTH TAX @ 1% of Rs.68,90,000			68,900

Note: Debt incurred for the assets, which have not been regarded as wealth, have been left out of consideration.

6A

1. In CIT v. Shree Manjunathesware Packing Products & Camphor Works [1991] 231 ITR 53, the supreme court that the revisional power conferred on the commissioner under section 263 is of wide amplitude. It enable the commissioner to call for and examine the recorded of any proceeding. It empowers the commissioner to make or cause to be made such enquiry as he deems necessary in order to find out if any order passed by the assessing officer is erroneous insofar as it is prejudicial to the interest of the revenue. After examining the record and after making or causing to be made an enquiry, if he considers the order to be erroneous, then he can pass the order thereon as the circumstances of the case justify.

In the present problem, in view of the aforesaid missions, the commissioner can call for the records of the case and analyse if there is any error in not partly disallowing the interest on borrowed funds under section 36(1)(iii). In case he finds any such error has been committed, he can issue a notice to the assessee and pass appropriate orders.

2. For section 147. In Garden Silk Mills (P)Ltd. V.CIT[1999] 237 ITR 668 (Guj.), it was held that mere change of opinion does not confer jurisdiction on the assessing officer to initiate proceedings for reassessment merely by resorting to Explanation 1 to section 147. For applying Explanation 2 section 147, it must be on material and it should have nexus for holding such opinion contrary to what has been expressed earlier.

In the present problem, in view of the aforesaid provisions, the assessment cannot be reopened under section 147 on the basis of an audit objection__ see Rajnath Leasing & Finance Ltd. v. Asstt. CIT[1995] 129 CTR (Guj.)377.

6B Computation of tax liability of X6b

Particulars	Rs.
Tax on income of Rs.2,10,000 under section 115BBA (i.e., Rs.1,50,000 + 10,000 + 50,000 @ 10%)	21,000
Add: Surcharge not applicable in case net income does not exceeds Rs.10,00,000 for the assessment year 2007-08)	NIL
Tax and surcharge	21,000
Add: Education cess @ 2% of tax and surcharge	420
Tax liability	21,420

It is not necessary for X to furnish his return income under section 139(1) by virtue of section 115BBA(2).

6C Computation of minimum advance tax payable On June 15, 2006

Particulars	Rs.
Business income	2,00,000

Tax payable (@33.66%)	67,320
Minimum advance tax payable on Jun 15, 2006 [12% of Rs.67,320]	8,080
On October 15, 2006	
Minimum advance tax payable on September 15, 2006 [(36% of Rs.67,320) – (Rs.8,080)]	16,160
On December 15, 2006	
Business income	2,00,000
Long term capital gain	20,000
Taxable income	2,20,000
Tax payable [(33.66% of Rs.2,00,000) + (22.44% of Rs.20,000)]	71,808
Minimum advance tax payable on December 15, 2006 [(75% of Rs.71,808) – (Rs.8,080) – (Rs.16,160)]	29,620
On March 15, 2007	
Business income	2,00,000
Long term capital gain	20,000
Winnings from lottery	1,00,000
Taxable income	3,20,000
Tax payable [(33.66% of Rs.3,00,000) – (22.44% of Rs.20,000)]	1,05,468
Minimum advance tax payable on March 15, 2007 [(100% of Rs.1,05,468) - (Rs.8,080) - (Rs.16,160) – (Rs.29,620) – (Rs.31,365)]	20,240

7A) The arm's length price shall be determined by any of the following method:

- comparable uncontrolled price method ;
- resale price method'
- cost plus method;
- profit split method;
- transactional net margin method;
- such other method as may be prescribed by the Board.

a. **COMPARABLE CONTROLLED PRICE METHOD** – Under this method,

- the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, (i.e., a transaction between enterprises other than associated enterprises whether resident or non resident) or a number of such transactions, is identified
- such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;
- the adjusted price arrived at under (b) supra is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

b. **RESALE PRICE METHOD** – Under this method,

- the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;
- such resale price is reduced by the amount of normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transaction;
- the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
- the adjusted price arrived at under (d) (supra) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

c. **COST PLUS METHOD** – Under this method,

- a. the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;
- b. the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;
- c. the normal gross profit mark-up referred to in (b) supra is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions which could materially affect such profit mark-up in the open market;
- d. the costs referred to in (a) supra are increased by the adjusted profit mark-up arrived at under (c) supra;
- e. the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise.

D, **PROFIT SPLIT METHOD** – This method is applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. As per profit split method, which____

- a. the combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined;
- b. the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risk assumed by each enterprise on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprise performing comparable functions in similar circumstances;
- c. the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under (b) (supra);
- d. the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction:

However, the combined net profit referred to in (a) supra may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under (b) and (c) supra, and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction.

e). **TRANSACTIONAL MARGIN** – According to transactional net margin method_

- a. the net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- b. the net profit margin released by the enterprise or by any unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- c. the net profit margin referred to in (b) (supra) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the

- enterprise entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- d. the net profit margin realized by the enterprise and referred to in (b) (supra) is established to be the same as the net profit margin referred to in (c) (supra);
- e. the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

7B) CONDITIONS FOR APPLICABILITY OF ARM'S LENGTH PRICE IN THE INTERNATIONAL TRANSACTION

CONDITION 1-TWO OR MORE ENTERPRISES – International transaction is subjected to the arm's length price only in case of transaction between two entities called associate enterprises.

ENTERPRISES – MEANING OF [SEC. 92F(iii)] – Enterprise means a person who engages or has been engaged or proposed to engage in the following activities:

- a. any activity relating to the production, storage, supply, distribution, acquisition or control of articles or goods;
- b. Know-how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights;
- c. any activity relating to the provision of services of any kind;
- d. carrying out any work in pursuance of a contract (e.g., construction contract);
- e. investment activity;
- f. activity relating to provision of loan;
- g. business of acquiring, holding, underwriting or dealing with shares, debenture or other securities of any body corporate.

* A person would be an enterprise if it carries on the specified activity / business directly or through one or more of its units divisions or subsidiaries.

CONDITION 2- ENTERPRISES SHOULD BE REGARDED AS ASSOCIATE ENTERPRISES [SEC. 92A(1)] – The provisions regarding taxation of international transactions [section 92 to 92F] apply in case the two enterprises are associated enterprises.

An enterprise would be regarded as an associated enterprise of another enterprise, if:

- a. it participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- b. in respect of it on or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Clause (a) of section 92A(1) is about participation by one enterprise into other enterprise. While clause (b) of the said section is about participation by a third enterprise into both the enterprises.

Two enterprises shall be deemed to be associated enterprises for the purposes of section 92A(1) if, at any time during the previous year,____

- i. one enterprise holds (directly or indirectly) shares carrying not less than twenty-six per cent of the voting power in the other enterprise [clause a]; or
- ii. any person or enterprise holds (directly or indirectly) shares carrying not less than twenty-six per cent of the voting power in each of such enterprises [clause b]; or
- iii. a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise [clause c]; or
- iv. one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise [clause d]; or
- v. more than half of the board of directors or members of the governing board, or one more executive directors or executive members of the governing board of the enterprise, are appointed by the other enterprise [clause e]; or

- vi. more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons [clause f]; or
- vii. the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights [clause g]; or
- viii. ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise [clause h]; or
- ix. the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise [clause i]; or
- x. where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual [clause j]; or
- xi. where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative [clause k]; or
- xii. where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals [clause l]; or
- xiii. there exists between the two enterprises, any relationship of mutual interest, as may be prescribed [clause m].

CONDITION 3 – INTERNATIONAL TRANSACTION SHOULD BE CARRIED OUT BY THE ASSOCIATED ENTERPRISES –

- a. A transaction between two or more associated enterprises in nature of a) purchase, sale, or lease of intangible property or b) provision of services c) lending or borrowing money.
- b. A transaction between two or more associated enterprises (either or both are non-residents) having a bearing on the profits, income, losses or assets of such associated enterprises.
- c. Mutual agreement or arrangement between two or more associated enterprises for (a) allocation or apportionment of, or (b) contributing to, any cost or expense incurred (or to be incurred) regarding a benefit, service or facility provided (or to be provided) to any one or more of such associated enterprise.

7C) A Ltd., an Indian Company, sells computer monitor to its 100 per cent subsidiary X Ltd. in United States @ \$50 per piece. X Ltd. also sells its computer monitor to another company Y Ltd. in United States @ \$ 80 per piece. Total income of A Ltd. for the assessment year 2007-08 is Rs.12,00,000 which includes sales made for 100 computer monitor @ \$50 to X Ltd. Compute the arm's length price and taxable income of A Ltd. The rates of one dollar may be assumed to be equivalent to Rs.49 for the sake of simplicity.

Particulars	Rs.
Arm's length price (\$ 80 X 100 Rs.49)	3,92,000
Income Tax of A Ltd.	
Income as per books of account	12,00,000
Less: Sale consideration 100 monitor sold to X Ltd. (recorded price)	(-) 2,45,000

Add: Sale consideration at arm's length price	(+) 3,92,000
Taxable income	13,47,000

As no income is deemed to accrue or arise in India, nothing is taxable in the hands of X Ltd.

PRIME ACADEMY
25th SESSION MODEL EXAM
FINAL

Total No. of Questions: 12

Time Allowed: 3 Hours

Total No. of Printed Pages:5

Max. Marks:100

IX

Question No.1 is compulsory. Answer any 3 from Part A, any 2 from Part B and 1 from Part C

PART—A

1(a) Briefly explain any two of the following with reference to the provisions of Central Excise Act, 1944 :

- (i) Wholesale dealer
- (ii) Factory
- (iii) Dutiability of Waste and Scrap. **(4 Marks)**

1(b) With reference to Cenvat Credit Rules, 2004, discuss giving reason whether the following statements are True or False:

- (i) Credit of duties of excise on inputs will not be available if inputs are used in intermediate product, which is exempt from duty, even though the final product is dutiable
- (ii) A manufacturer can sell the inputs on which Cenvat has already been availed of, as they are, provided he pays the amount equal to the credit availed.
- (iii) A manufacturer is eligible for Cenvat Credit in the cases stated below:
 - (1) Inputs used in trial runs
 - (2) Materials used for maintaining factory building **(6 Marks)**

1(c) With reference to Central Excise Act, 1944 and the rules there under, whether the following persons require registration or not? Explain briefly :

- (i) Persons, who manufacture excisable goods chargeable to 'nil' rate of duty
- (ii) Central Government undertakings manufacturing excisable goods
- (iii) 100% EOU. **(6 Marks)**

1(d) ABC Company imported medicines in pallets with one big box containing assorted medicines in smaller units which were, then, repacked in thermo Cole boxes of different sizes which again were put into cardboard boxes. The cardboard boxes were in turn labelled containing, *inter alia*, the name of the medicine, the name of the manufacturer, the quantity, batch no., manufacturing date, expiry date and name of the marketing agency. The department relying upon note 5 to chapter 30, claimed that the activities as aforesaid amounts to manufacture i.e. bulk pack to retail pack. Decide whether the above activities tantamount to manufacture **(4 Marks)**

2(a) Briefly explain any **two** of the following with reference to the provisions of the CENVAT Credit Rules, 2004:

- (i) Job work
- (ii) Principal manufacture
- (iii) Captive Consumption
- (iv) Exempted Product under Excise

(5 marks)

2(b) Answer in brief the following questions relating to provisions made under rule 6 of the Central Excise (Removal of Goods at Concessional Rate of Duty for manufacture of Excisable Goods) Rules, 2001 :

- (i) What will be the consequences in case the goods received at concessional rate are not used for the intended purpose ?
- (ii) Whether a manufacturer receiving the subject goods can return such goods to the original manufacturer. (iii) When will the subject goods be deemed as not having been used for the intended purpose.

(2 x 3 = 6 marks)

2(c) Discuss briefly whether refund effected by the Central Excise Department pursuant to orders of court in respect of a bank guarantee towards disputed excise duty encashed by the department, would be subject to the provisions of Section 11B of the Central Excise Act, 1944 relating to "unjust enrichment."

(4 marks)

3(a) Explain the provision regarding maintenance of daily stock account of stored goods under rule 10(1) of Central Excise Rules.

(4 Marks)

3(b) Write a short note on the procedure in respect of exported goods subsequently re-imported and returned to factory

(5 Marks)

3(c) Comment on the following: (i) Excise department cannot challenge the responsibility of MRP printed on the package (ii) If any excisable goods are exempted from duty of excise absolutely, the manufacturer of such goods will be bound to avail of the exemption (iii) SSI units whose turnover exceeds Rupees 90 lakhs per annum have to give a declaration in the prescribed form (iv) Annual Financial Information Statement (ER-4) is required to be submitted by the assessee paying duty of Rs. 4 crores or above per annum through PLA

(4 Marks)

3(d) What is CT-1 certificate?

(2 Marks)

4(a) Write a note on duty payment 'Under Protest' with reference to the Central Excise Act, 1944 and the rules made thereunder

(3 Marks)

4(b) What are the orders that are appealable to Supreme Court under Central Excise Act, 1944?

(3 Marks)

4(c) Explain briefly the provisions relating to 'Special Audit' in certain cases under Section 14A of the Central Excise Act, 1944.

(5 Marks)

- 4(d)** What is Consumer Welfare Fund? How is this fund utilized? **(4 marks)**
- 5(a)** State briefly against whom prosecution may be launched in the case of “offences by companies” under Section 9AA of the Central Excise Act, 1944 **(3 Marks)**
- 5(b)** Write short notes on the following with reference to the Central Excise Act, 1944 and the Rules made thereunder:
- (i) Duty payment “under protest” **(3 Marks)**
 - (ii) “Refund claim” under Section 11B **(3 Marks)**
- 5(c)** State in brief the provisions relating to “Invoice” under Rule 11 of the Central Excise Rules, 2002 **(6 Marks)**
- 6(a)** Explain briefly the expression “Place of Removal” with reference to the Central Excise Act, 1944. **(3 Marks)**
- 6(b)** Write a short note on the ‘Rules for the Interpretation’ of the schedule to the Central Excise Tariff Act, 1985 **(5 Marks)**
- 6(c)** Explain the penal provisions under the Central Excise Act, 1944 and the Central Excise Rules, 2002 in the following cases:
- (i) Rule 25 of the Central Excise Rules, 2002
 - (ii) Sec. 11AC of Central Excise Act, 1944 **(7 Marks)**
- 7(a)** How are the following goods classified under the Central Excise Tariff Act, 1985? (i) Incomplete or unfinished goods having the essential characteristics of finished goods. (ii) Finished goods that are removed in an unassembled condition or in a disassembled condition such as semi-knocked down or completely knocked down condition. **(5 Marks)**
- 7(b)** Briefly discuss the provisions of the Central Excise Act, 1944 and the Rules regarding ordering of Provisional Assessment and finalisation of such Assessment. **(5 Marks)**
- 7(c)** Explain briefly the provisions of Rule 19 of the Central Excise Rules, 2002 regarding Exports without payment of duty other than to Nepal and Bhutan. **(5 Marks)**

Part - B

- 8(a)** What is the crucial/relevant date for determination of rate of duty under Customs Act in following cases?
- (i) Clearance of Baggage **(2 Marks)**
 - (ii) Goods cleared for home consumption from a warehouse under Section 68 of the Customs Act **(2 Marks)**
 - (iii) Goods entered for export under Section 50 **(2 Marks)**
- 8(b)** Write short notes on the following with reference to the Customs act, 1962 :
- (i) Interest on drawback **(3 Marks)**
 - (ii) Power to arrest **(3 Marks)**
- 8(c)** Briefly discuss the provisions of the Customs act, 1962 regarding rejection of an application for advance ruling **(3 Marks)**

- 9(a)** State whether the principle of “unjust enrichment” applies to refund of export duty under the Customs Act, 1962
(2 Marks)
- 9(b)** Write short notes on the following with reference to the Customs Act, 1962:
- (i) Duty on pilfered goods (2 Marks)
 - (ii) Reimportation of goods (2 Marks)
- 9(c)** XYZ Co. the assessee has claimed before the Customs Authority that since the exports of goods in its case attracted no duty, the value for purposes of Customs Act, 1962 to be declared shall be the value of the goods, which he expects to receive on sale of goods in the overseas market. Briefly discuss giving reasons whether the stand taken by XYZ Co. is correct.
(3 Marks)
- 9(d)** State in brief the features of “Special Economic Zone” with reference to the Customs Act, 1962
(6 Marks)
- 10(a)** An exporter obtained inputs on payment of Customs duty and has availed CENVAT credit. Advise whether he could avail Duty Draw Back also under Section 75 of the Customs Act, 1962, if imported inputs are used in the manufacture of goods, which are then exported.
(4 Marks)
- 10(b)** An importer has imported certain goods, which are not eligible for import as per Import Policy. The offending goods have been confiscated. The importer wishes to re-export the goods. Can permission be given for re-export? State briefly what are the other consequences of such import
(6 Marks)
- 10(c)** (i) Explain whether the costs and services as given in Rule 9 of the Customs Valuation Rules, 1988 are to be added to the value of the identical goods or similar imported goods under Rule 5 & 6 respectively
(ii) Explain briefly: Every detention is not seizure, but seizure always includes detention in Customs Law
(5 Marks)

PART – C

- 11(a)** (i) Certain abatement /exemption of the gross amount charged, has been notified, for computing the value of some taxable services. What are the conditions to be fulfilled to avail such partial exemption?
(ii) What is the percentage of abatement granted in the following cases?
- (i) Services provided by a tour operator
 - (ii) Services provided by an outdoor caterer supplying food also
 - (iii) A Commercial concern providing construction service where the gross amount charged includes the value of goods and material
 - (iv) Goods transport agency providing taxable service and paying service tax itself (6 Marks)
- 11(b)** Enumerate the specified services, other than accounting and auditing, provided by a practicing

- 11(c)** Hotel Marudhar Palace charges 10% of the bill amount as service charges and Department has asked them to pay Service tax on it. The assessee has submitted that the amount @ 10% collected from customers is subsequently disbursed among the staff, therefore it is not part of their income and cannot be included in the gross amount charged by them. Examine the case and advise suitably

(3 Marks)

- 12(a)** Answer any **four** of the following with reference to the Finance Act, 1994 as amended, relating to applicability of Service tax :

- (i) Jobbing transactions entered into on principal to principal basis between members of the same Stock Exchange.
- (ii) Service to a policyholder by an insurer carrying on Life Insurance business
- (iii) Activity of printing and publishing Telephone Directories, Yellow Pages or Business Directories.
- (iv) Services rendered in relation to merger and acquisition of a management consultant.
- (v) Services rendered regarding legal or taxation consultancy by a Chartered Accountant.

(8 Marks)

- 12(b)** Answer any two of the following with reference to the provisions of the Finance Act, 1994 as amended relating to Service Tax

- (i) Are services provided in the State of Jammu and Kashmir liable for Service tax?
- (ii) What are the due dates for filing of returns under the Service Tax Law?
- (iii) Does the doctrine of 'unjust enrichment' apply to payment under the Service Tax Law?

(4 Marks)

- 12(c)** Briefly discuss the provisions of the Finance Act, 1994 as amended, relating to Service tax with respect to any **one** of the following taxable services :

- (i) Consulting Engineer

Credit Rating Agency.

(3 Marks)

PRIME ACADEMY

SUGGESTED ANSWERS

FINAL - INDIRECT TAX

PART - A

- 1(a) (i) Wholesale Dealer

With reference to the provisions of Central Excise Act, 1944: a wholesale dealer means any person who purchases excisable goods for resale to customers or retail traders. If the dealers purchases goods directly from manufacturer or job worker are to be called as Ist stage dealers. The dealers who are purchasing goods from Ist stage dealer is to be called as IInd stage dealer. Wholesale Dealer is not liable to payment of Excise Duty.

ii) Factory

Factory is any place registered under the Central Excise Act 1944 by a manufacturer from wherein, the manufacturer intends to process or manufacture any excisable goods under the said act. It can be any place, premise so registered. It would include such place wherein dutiable goods are to be stored. As such it would include the place of consignor, or an agent or a wholesaler from where goods would be cleared after paying the necessary duty.

iii) Dutiability of waste or scrap

Earlier only those goods that were the result of manufacture was liable to duty. But though waste and scrap or not manufactured as such, but only result in the course of manufacture, the same will be subject to duty. Duty is payable on the transaction value, if the waste or scrap or marketable or unusable in the production of other excisable goods. But if the same is used for captive consumption without a break in the manufacturing process the same can be used within the factory in the other manufacture without any payment of duty as such.

1.(b) (i) False Intermediate product which is exempt from duty can be used in the production of final product, that is dutiable and the input credit can be availed.

ii) True. When inputs are cleared as such or partially processed, he can sell the inputs provide he pays the amount equal to the credit availed or does a reversal of the earlier credit made.

iii) 1. True. Provided the inputs used in trial sums, is for manufacturing a dutiable final product. Trial sums, if they are very much necessary for the production, also amount of manufacturing.

2. True. Materials used for maintaining factory building is also allowed. So paints, grease, oil etc used are eligible CENVAT credits.

1.(c) (i) Persons, who manufacture excisable goods, changeable to 'NIL' rate of duty.

As a special provision, such person who manufacture ONLY excisable goods, changeable to 'NIL' rate of duty need not necessarily get themselves registered.

ii) Central government undertakings manufacturing excisable goods should register.

It is applicable to all government undertakings, public sector undertakings, undertakings under the central and state governments.

iii) 100% EOU should register themselves, when manufacturing excisable goods and when goods are sometimes cleared for DTA (Domestic Consumption) they will have to pay 25% of customs duty normally payable plus the central excise duty on such goods.

1.(d) The above activity does not result in manufacture. Manufacture should result in a distinct product different from the raw materials used. Here it was only repacking. As such the medicines were only repacked and no value addition is being done. But this is only if the smaller units, by themselves have the same details such as the name of medicine, manufacturing date, expiry date etc as is normally needed to be printed on the medicine packs. For only then they are marketable. But if they were repacked and labeled only because these details were earlier not printed on the boxes, then this activity would be classified as manufacture because only after this do the packets become marketable. So it depends whether the smaller packets were also readily marketable or not.

2. (a) Provisions of the CENVAT credit Rules, 2004:-

(i) Job Work:

Generally in the case of a job worker, in terms of notification of 214/86, where the principal manufacturer submits a declaration to the superintendent of central excise, that the goods being sent to the jobworker will be received back in his factory and that he would be paying the excise duty on the final product, then the job-worker is exempt from payment of duty;

However, the job worker, may on his own accord, undertake to make payment of duty in certain cases.

Where the job-worker does not make payment of excise duty, there is no question of availing an input credit for the purpose of set - off

(ii) Principal manufacture:

As per sec2 of the CENVAT credit Rules 2004, Principal manufacture is nothing but the manufacture done by the prime workers of the company and there read to be employer-employee relationship between them.

(iii) Captive consumption:

As per the relevant sections of the CENVAT credit rules 2004, captive consumption is nothing but during manufacture an item will emerge which will have the capability of marketability and salability. The item emerged during the manufacture is called captive consumption.

(iv) Exempted product under excise:-

The general rule in respect of an exempted product under excise is that, credit of duties of input will not be available unless the final product in which the inputs are incorporated is dutiable.

Exempted product is one which is exempt from the payment of excise duty by means of a specific exemption notification. The fact remains that exempted products might still be excisable goods but have been exempted from payment of duty as aforesaid.

Since the product is exempt, no excise duty is payable in respect thereof and therefore credit of duties of input used in the manufacture of such exempted products is not available.

2(b) As per Rule of the central excise (Removal of goods at concessional rate of Duty for manufacture of excisable goods), Rules 2001:-

(i) in case the goods received at concessional rate are not used for the intended purpose it is a violation of the aforesaid rules

Since the Rules/ Conditional based upon which the exemption is given, is not satisfied the aforesaid good will be chargeable to the rate of duty normally applicable to the said category of goods.

(ii) A manufacturer receiving the subject goods can return such goods to the original manufacturer if they are defective and if they are not of the required standard or quality required of such goods. In respect of returned goods, he should get goods of required quality from the supplier.

(iii) The Subject goods would be deemed as not having been used for the intended purpose if:-

- (i) they have been lost / destroyed during the course of transportation between the factory of the supplier and the factory of the buyer.
- (ii) If the goods are damaged inside the premises of the assessee's factory.

2(C) Section 11B of the central Excise Act provided for refund of duty only in the following 6 cases:-

- (i) Export of excisable goods on payment of excise duty (Rule 18, Central Excise Rules)
- (ii) CENVAT credit in respect of inputs used in the manufacture of excisable goods that are exported.
- (iii) Amount paid through PLAA/c in certain cases.
- (iv) Where the manufacturer had not passed on the incidence of duty.
- (v) Where the buyer has not passed on the incidence of duty.
- (vi) In any other case, as may be notified by the Govt in the official Gazette.

Unjust enrichment occurs when after the incidence of excise duty having been passed on to the buyer, the manufacturer gets a refund of duty.

3(a) Daily stock Account (Rule 10(1))

Every registered manufacturer, procurer, producer or dealer or agent under Rule 9 of the central excise Rules 2002, shall maintain daily stock account containing therein:

a) input of goods into factory

- b) issue of materials for manufacture of production.
- c) Materials returns to supplier as defective materials
- d) final products complete
- e) wastages of inputs on daily basis.

The responsibility of maintaining daily stock account.

Every first page and last page in a day shall be verified and signed by the managing director, of company secretary or any chief officer of the company.

When the proper officer makes enquiry the daily stock account has to be produced before him. The daily stock account has to be maintained even in respect of non-dutiable goods

3(b) Procedure in respect of export good subsequently re-imported and returned to factory.

- i) Duty is not payable by the manufacturer if goods are removed from factory for the purpose of export. But if the goods are returned to home country. The Customs duty has to be paid by the re-importer.
- ii) The exemption from duty is available only if there is existence of valid export. In the case of re-import; the export is ceased to exist the customs duty has to be paid with interest @ 15.p.a from the date of removal of goods from factory upto the date of payment of duty.
- iii) After re-import of goods, if manufacturer makes subsequent removal from the factory for the purpose of export, he may claim cenvat credit for the same.
- iv) If the goods are removal to any domestic Tariff area of consumed itself, the duty has to be paid on the date of removal from the factory. In this case the exporter can claim customs duty paid on goods as cenvat credit.

3(C)

- i) Printing of MRP on the package of goods is necessary for the purpose of fulfillment of formalities under the essential commodities and services Act, The Excise Department cannot therefore challenge the responsibility of MRP printed on the package.
- ii) Exemption from payment of excise duty is compulsory if the duty of excise is exempt as per notification issued U/s 5 of the Central Excise Act, 1944,. There is no warring or exemption by the manufacturer. So if any excisable goods are exempted from duty of excise absolutely the manufacturer of such goods will be bound to avail of the exemption.
- iii) For SSI units registration under Rule 9 of the central Excise Rules 2002 is not necessary if they produce declaration to the department in the prescribed form. The Declaration is not necessary if SSI units total turnover of last year and current year does not exceeds Rs.40Lakhs and not Rs.90Lakhs.

- iv) Annual Financial information statement (E Rules) is required to be submitted by the assessee paying duty of Rs100 lakhs or above per annum through PLA and not Rs.4 Crores.

3(d) CT-1 Certificate:

When the goods are removed from factory without payment of duty to bonded waterbuses, the manufacturer has to obtain certificate in form no. CT.1, on production of certificate – CT-1, removal of goods to warehouses or from one warehouse to another warehouse or for export is possible without attracting payment of duty of excises

4.(a) Duty payment ‘under protest’

Under the Central Excise Act,1944, duty has to be paid against each removable of the excisable goods. But sometimes, there may be a situation where in the assessee claims a different rate of duty, classifying the subject goods differently, from the departments classification.

In such a situation, the assessee has to pay the duty assessed by the department to avoid paying interest and invoking penalty action. But the assessee has to clearly mark the goods under which a protest is made by him as ‘Duty under Protest’. This he has to do in all the monthly or quarterly return that he has to submit.

Once the matter is referred to the concerned officials and a final decision is got, the assessee has to pay as above.

But suppose the appealable period is over or the assessee does not make any attempt to appeal or losses in his claim, he can no longer claim the benefit of paying duty under protest.

4.(b) Appealable orders

- 1) If the duty assessed is the subject matter of appeal.
- 2) Can appeal against the orders of the Commissioner of Central Excise
- 3) If the duty payment is more than Rs.50,000/-

4.(c) Special Audit under section 14A of the Central Excise Act,1944

- i) The Commissioner may depending upon the nature of goods.
- ii) Methods of Accounting followed.
- iii) Complexity of Calculation
- iv) Considering the duty assessed may if he so decides call for a special audit under section 14 A.

This special audit will be in addition to any audit that has been previously conducted. The chief commissioner may appoint any qualified cost accountant to carry out this special audit. The assessee is bound to assist the cost accountant in executing the said audit. All cost expenses and fees to the cost Accountant is fixed by the department, but should be paid by the assessee. In case of non failure, the same can be collected as arrears due. The cost accountant has to complete the special audit with reasonable time(Usually within 180 days)

4.(d) Consumer Welfare Fund

Any amount collected in excess of actual duty or tax collected should be paid into the central government account. Since Indirect tax, the incidence or burden of tax is shifted to the ultimate consumer, the bar of Undue enrichment comes into play.

So in case of any refund claim or excess payment etc, if the same is refunded, while the burden of tax is borne by one person, the refund will go to a person who has passed on the tax burden. Son in such cases the amount is paid into a separate fund called 'consumer welfare fund'. Amount from this fund is used for the betterment of the general public awareness programs, camps etc are conducted, so that the common man benefits at large.

5.(a) Offences by companies

In case of any offence by the companies, the prosecution procedure will be against the board of directors, managers or others who were responsible for the running of the company. Every person who was responsible for the acts of the company are personally liable. But if they can prove to the satisfaction of the department that such acts were carried out which were beyond their control or such acts were committed when they are physically not present to administrates the activities, then they are spared from prosecution.

5.(b) (i)Duty payment under Protest

Excise duty is payable on every removal. But sometimes, there may be a difference of opinion on the amount or rate of duty to be changed. In such a case, the assessee would still be advised to pay the duty to avoid interest payment and to avoid penalty payment. For this, the assess would have to clearly mark against the duty paid as 'Under Protest'. This he has to do so after giving a written information to commissioner. He should mark the monthly and the quarterly return as the case may be as 'Under Protest'. The assess however loses if the period for appeal is over or if the approval is decided against him. Secondly if no attempt to appeal was made by the assessee then he loses all. The benefit to pay duty under protest lapses.

ii)Refund claim under section 11B

A refund claim has to be made within one year from the date of payment of duty. This refund claim should be made by the assessee. He will not be eligible for a refund simply if a letter is sent.

Refund will be available only if the assess proves that the burden of tax borne by him has not been passed on to the buyer. Buyer can claim only when he is able to prove, that tax burden has not been passed on to someone else. Refund is actually due to him, on account of excess payment or due to taking cenvat credit on inputs used. If goods are exported, he rebate allowed is also treated as refund.

5.(c) Invoice

Under Rule II of the central Excise Rules 2002.

Goods can be moved from a factory or place of removal only under proper documents. It can be in the form of Invoice / bill or Challan. The invoice should have the following details:

Name and address
Registration No.
Date
Nature of goods to be removed
Quantity
Serial no.
Name of consignee
Consignee's Address
Value of Goods
Duty paid to the goods
Name of transport agency
Vehicle no.

All such details should be clearly specified in the Invoice.

6(a) "Place of Removal"

With reference to Central Excise Act 1944, the duty of excise is payable as on the date and place of removal. It is the place from which excisable goods are removed at the time and place of removal, if goods are removed from factory the factory shall be the place of removal. If the goods are removed from the bonded warehouse, the place of removal shall be that warehouse.

6(b) "Rules for the interpretation" of the schedules to the central excise tariff Act 1985.

Schedules to the central Excise Tariff Act, 1985 is structured to chapters, heading, Sub-headings and then entries.

- (i) The goods shall be firstly categorized under chapters. Within that chapter → next heading to the identified and then subheading within the sub headings entries are to be identified
- (ii) If there are two or more entries for the same goods the first one shall be preferred
- (iii) If the goods containing two or more specific goods the goods which is dominant in the product shall be considered and entry for that goods into preferred. For e.g In the case of Gold watch entry shall be preferred for watch and not for gold. For e.g In the case of pen stand with clock, the entry has to be preferred for pen stand and not for clock.
- (iv) In the case of goods packed in the container, the substance goods shall be preferred for searching entry. The duty on container shall be the rate applicable on the substance goods
For example. Photo camera within a leather cover. The rate applicable for leather cover (container) is rate which is mentioned for camera in the tariff schedule.
- (v) If any particular goods which have some specific nature identified with the general description the others entry under the sub headings shall be preferred.
- (vi) In the case goods at stage of incomplete, semi knocked down or completely knocked down goods the rate shall be on goods in they are completed in nature

- (vii) The entry for subsidiary goods which are for convenience of main product the main product's rate shall be applicable. For e.g/ paint for a car shall be charged at the rate applicable to a car not entry for paint.
- (viii) The goods shall be firstly categorized under chapters. Within that chapter →leading next to the identified and then subheading within the sub headings entries are to be identified
- (ix) If there are two or more entries for the same goods the first one shall be preferred
- (x) If the goods containing two or more specific goods the goods which is dominant in the product shall be considered and entry for that goods into preferred. For e.g In the case of Gold watch entry shall be preferred for watch and not for gold. For e.g In the case of pen stand with clock, the entry has to be preferred for pen stand and not for clock.
- (xi) In the case of goods packed in the container, the substance goods shall be preferred for searching entry. The duty on container shall be the rate applicable on the substance goods
For example. Photo camera within a leather cover. The rate applicable for leather cover (container) is rate which is mentioned for camera in the tariff schedule.
- (xii) If any particular goods which have some specific nature identified with the general description the others entry under the sub headings shall be preferred.
- (xiii) In the case goods at stage of incomplete, semi knocked down or completely knocked down goods the rate shall be on goods in they are completed in nature
- (xiv) The entry for subsidiary goods which are for convenience of main product the main product's rate shall be applicable. For e.g/ paint for a car shall be charged at the rate applicable to a car not entry for paint.

6(c)

- (i) Penalty under rule 25 of the Central Excise Rules 2002:
According to Rules 25 of the Central Excise Rules 2002 If any person removed the goods which is excise goods on which duty of excise is payable without payment of duty, and if the any officer or inspector under the Central Excise Act knows about this removal may confiscate the removed goods. The confiscation of goods applicable I the case of removal of goods by the manufacture who has not got registration under rules of the Central Excise Rules 2002, removal without payment of duty without following procedures with respect to transfer to warehouse or for export.

The Assesses shall pay the duty with 15% p.a. penal interest payable from the date of removal of goods upto the date of payment.

The confiscated goods would be returned to the manufacturer , if the manufacture pays at least 25% of duty and penalty and make a declaration for payment of remaining duty and with secrecy.

If the assesses decided not to pay excise duty, the confiscated goods would be retained by the government for payment of duty. Penalty would be recoverable from the manufacture as on the case Recovery of Revenue Act rules.

(ii) Section 11 AC of Central Excise Act 1944

If any assesses under the Central Excise Act 1944

- a) Remove any excisable goods without payment of duty or short paid.
 - b) Suppress any material fact detrimental to the reverse of government or make false statement, or
 - c) Contravenes any of the provisions of this Act, or rules made there under
- He should be punishable for imprisonment and fine, provided show cause notice shall be issued before any penal proceeding are taken.
- The time limit for issuing show cause notice is one year from the date of offence in the case of ordinary offence.
- Show cause notice time limit is 5 years in the case of offence involving suppression of material facts or making of false statements, and making transfer of properties to avoid payment of duty.
- The show cause notice shall contain the amount duty and penalty amount and a statement that why action under the Act cannot be taken appoint you
- If Assesses paid any part of the amount another show cause notice will be issued for amount not paid.
- If full amount paid by the assessee the SCN will be withdrawn for penal amount.

- 7.(a)
- i) Incomplete or Unfinished goods having the essential characteristics of finished goods. Treated as Finished goods of the same characteristics, when such incomplete or unfinished goods have the necessary characteristics of finished goods, they are classified as the concerned finished goods. So classification is based on the characteristics exhibited by such unfinished goods. When they are identified with similar goods they are generally classified as such identified finished goods.
 - ii) Finished goods that are removed in an unassembled condition or in a disassembled condition as semi knocked down or completely knocked down condition. Here again such goods would be classified as finished goods that would emerge on assembling the same. For example when parts of a car is in an unassembled form the same can be identified as motor car since the unassembled parts all pertain to one who finished good – here the motor car .

7.(b) Provisional Assessment

Sometimes the assessee may not be able to clearly assess the duty to be paid because of the nature of the goods involved or due to any other reason. He may then request the authorities to provisionally assess the goods. The officer may if he is satisfied that the assessee is not able to assess the duty under self assessment he may assess the goods provisionally. Based on the documents and information furnished a provisional assessment can be done. But the officer may to protect his interest and safeguard the revenue, ask the assessee to execute B2 bond. Once the provisional assessment is over, the assessee can remove his goods. Then after final assessment, the assessee may be either asked to pay the enhanced amount of duty together with interest on the unpaid amount. No penalty would be charged if the same is paid within 30 days and no right

of appeal is asked. The Bond executed will be cancelled, in case of reduction of duty the same is refunded to the assessee.

7.(c) Provisions of Rule 19 of the Central Excise rules 2002.

Rule 19 deals with export of goods without payment of duty other than to Nepal or Bhutan

As per the aforesaid rule, the exporter clears the excisable goods for export without payment of excise duty. The exporter gives a letter of undertaking (LUT) to the government/Central Excise Department stating the value of exports that he is likely to make for a particular year.

On the invoice, the exporter is required to affix the seal, "Export of goods without payment of duty". Every time the goods are exported, "LET" Export seal is affixed on the invoice by the customs Authority.

The value in respect of the "LET" export invoice would be reduced from value of "LUT" every time the export is made. In case of any default on the part of the exporter, he would have to furnish a bond and make payment of the duty.

PART - B

8.(a) (i) Clearance of baggage

The date of clearance given by the customs authority.

ii) Goods cleared for home consumption from a warehouse under section 68 of customs act. The date of goods are actually authorized for clearance.

iii) Goods entered for export under section 50.
The date of Bill of lading or (Let Export) date.

8.(b) (i) Interest on drawback

Interest on duty draw back shall be credited to the consumer welfare fund account, if the duty has passed on to the buyer. Interest on duty drawback is applicable at 6% per annum, from the 1st day of month next following the month of Import / Export.

ii) Power to arrest

Customs officer are empowered with certain powers, one such power is the power to arrest. He can arrest any person without a warrant, if he suspects a person to be in possession of some smuggled goods or specified goods. He can arrest the person, after prefix the person for such arrest. Arrested person may be produced before the magistrate court nearby. The person so arrested can be subjected to search or X – ray screening if they suspect he is secreted anything in his body. Qualified medical practitioners can be approached to relieve such selected items.

8.(c) Rejection of an application for advance ruling:

- 1)An application for advance ruling can be rejected if there are previous case laws decided on the same matter.
- 2)If the duty is less than Rs.50,000/-
- 3)If there is any pending case in the tribunal, the application can be rejected.
- 4)If any earlier case was pending by the same assessee.

9.(a) Unjust Enrichment

This bar hits customs too. If the export duty has been clearly passed on to the buyer then here again the principle of Unjust enrichment applies. But if the assessee can clearly prove that the export duty was borne by him and that he has not passed on this tax burden, then the exporter is eligible for refund of export duty if other claims are justified. Since the department does not want any unjust enrichment it has the consumers welfare fund wherein all such amount is deposited and used for the benefit of common man.

9.(b) (i) Duty on Pilfered goods

Pilfered goods are goods lost.

- 1)Only pilfered goods after unloading but before clearance.
- 2)Pilfered goods are only a part of large consignment.
- 3)There must be place for the pilfered goods in the consignment.
- 4)Pilfered goods are not restored to the importer.

Here remission of duty is possible . But if pilfered goods are after clearance no remission is allowed because they are still available for consumption somewhere.

ii)Reimportation of Goods

Sometimes goods are exported only to be reimported. Sometimes they are exported for some further processes or repairs and are then reimported. If that is the case, the goods have to suffer both customs duty at the time of export and import. But if the officers are convinced that the same is exported and this reimportation will be within 6 months, then the assessee can claim duty drawback.

- 9.(c) In case value of goods don't attract duty, then the value of goods exported would be the value of similar or identical goods sold in the local market. If such similar or identical goods are not available for valuation, then the customs officer can value the goods on a reasonable basis to the extent they can. If suppose there is no evidence or no way to value the goods, then the cost of production can be taken into account. Only if there are no way that the customers authority can genuinely access the value of goods the stand of the assessee company can be taken. So first the valuation should be done by the customers authority in the best possible way, last they should accept the assessee stand.

9.(d) Special Economic Zone

- a) Created like in China.
- b) Enjoy special benefits
- c) Sale to and from SEZ does not attract duty and service tax
- d) They have to maintain separate accounts
- e) Developers have to get prior permission to establish SEZ.
- f) Units should also get special permission and should adhere to all the provisions stipulated
- g) Cannot claim input credit
- h) All the goods produced are exempt from duty and tax
- i) Can clear goods for DTA(Domestic Consumption)
- j) Exports do enjoy duty free
- k) Subsidised electricity, water and outer infrastructure facilities are provided.

10(a) It is stated that CENVAT credit had been availed on imported inputs. Therefore CVD and SAD would have been availed as credit under CENVAT credit Rules. This leaves only basic custom duty which is not Cenvatable. Therefore the importer can avail the BASIC CUSTOMS Duty as Duty Draw Back under section 75 of the Customs Act 1962.

(b) Permission for re export of goods can be given by DGFT-Customs if proper justification is given by the imports. Ignorance coupled with no intention to defraud the Govt. alone have can give relief. Re Export can be permitted subject to payment of fines and penalties. Penalty will be equivalent to the value of the goods (maximum) or Rs.5,000 whichever is greater. In case of prohibited goods it is the value of the goods On appeal higher appellate forum can reduce the same.

(c) (i) Where value of identical or similar goods could not be identified or determined in terms of rule 5&6, cost of services, cost of transport, loading /un loading charges, insurance etc., to be apportioned to the level of commercial quantity of the goods imported.

(ii) Goods can be seized by customs only when the imported goods are liable for confiscation due to violation of customs provisions. But customs law also detain the goods or order for detention for reasons other than confiscation may be due to procedural information also. Such detention is not seizable. Detention happens before clearance of such goods. Seizure can not happen without detention seizure includes detention but converse is not true.

PART - C

11(a) (i) There are two conditions

1. cost of goods / material sold in the course of rendering the service should not be claimed as abatement for the value.
2. CENVAT credit of duty paid on goods service tax paid on input services should not be availed as credit under the CENVAT credit rules.

(ii) Percentage of abatement

- | | | |
|-------|-----|---|
| (i) | 60% | (Tour operator -90% - For accommodation arrangement only) |
| (ii) | 50% | (Outdoor caterer) |
| (iii) | 60% | (Construction services) |

(iv) 75% (Goods transport agencies)

- 11(b) Specified services, other than accounting and auditing provided by a practicing chartered accountant is liable to service tax.
- (i) Certification and attestation function other than audit
 - (ii) Income tax return preparation and filing
 - (iii) Representing on behalf of the client before statutory authority notice having used on the assesses
 - (iv) Consultancy provided in his professional capacity.

- 11(C) Service Tax shall be levied on the gross value charged for service rendered or to be rendered provided such service to an taxable service
In the given case, the Hotel has collected 10% of the bill amount as service charge and disburses the same among the staffs. But such amount is received as an consideration for the service rendered by the Hotel to its customers which shall also be included in the gross value.

Any amount that is collected from the customer shall be the gross value and according service tax shall be levied on the gross value subsequent disbursement is not relevant.

The contention of the Hotel Marudhar palace is not valid and service tax shall be paid on such charges collected.

12.(a)

- i) No Service tax is applicable since jobbing transactions entered into on principal to principal basis.
- ii) Service to a policy holder by an insurer carrying on Life insurance business – Service tax is applicable.
- iii) Service tax is applicable for the activity of printing and publishing Telephone directories, yellow pages or business Directories. However Advertisement in print media does not attract service tax.
- iv) Service rendered by the management consultant is taxable services. Therefore service is payable on services rendered in relation to merger and acquisition of a management consultant. Therefore the management consultant shall receive service tax for services rendered by him.
- v) Services rendered regarding legal or taxation consultancy by a 6 A – from Finance Act 2007, all the services of Chartered Accountant is liable to service tax. Earlier representative services were outside the tax net.

12.(b)

- i) Service tax is applicable to the whole of India, but except to services provided in the state of Jammu & Kashmir. Since it has been expressly excluded in the definition any services provided in the state of Jammu & Kashmir is not liable for service tax.
- ii) Due dates for filing returns under Service Tax laws:

- 1) Payment of service tax in respect of month should be made by the 5th of the subsequent month
- 2) Service tax returns are required to be filed on a half yearly basis.

iii) Yes, the doctrine of 'Unjust Enrichment' applies to payment under the service Tax Law too. Here again the service tax being an Indirect Tax, it is paid by the receiver of the service to the provider of taxable service. Thereafter the same is paid into central government. So in case a refund is made it will result in unjust enrichment. Because though the payer is someone, the receiver of refund will be the provider who has not borne the tax effect. But if refund is claimed as a result of refunding the amount to the receiver for non providing of service together with the service tax collected, then unjust enrichment doesn't come into play. So unjust enrichment will be there whenever the tax has been shifted. Hence consumer welfare fund.

12.(c) i) Consulting Engineer

An Engineer is any person who possess the requisite qualification obtained under Board of Education set up for this purpose. Any person whose name is registered with IAE Indian Association of Engineers is a qualified Engineer. Such an Engineer can render service to anybody. His device can be with regard to redesigning or designing, repairing or renewing or buying in a new building, machinery, software etc. Software engineers are not covered by service tax.net. Hardware engineers are covered by service tax net. Even consultations offered is subject to service tax.

ii) Credit rating Agency

Services provided or to be provided by a credit rating agency are liable to service tax.

A credit rating agency refers to any agency which undertakes credit rating in respect of any financing or debt arrangement of a company or in respect of any investment proposed to be made by a company. Credit rating may also be undertaken in respect of a loan arrangement; wherever the performance of the asset in the particular arrangement would be assessed.

