

**TIME: 3 hours**

**Maximum Marks: 100**

**Question No. 1 is compulsory**

**Answer any four from the rest.**

**Working Notes should form part of the answer.**

**1**

**a) What is Cost Analysis? How it is useful in Decision Making?**

**b) List out the assumptions of Break Even Analysis.**

I. .

c) Fitwell Ltd a large manufacturing company has three factories namely factory 'A' factory 'B' and factory 'C'. All the three factories produce the same product which is sold at Rs. 375 per unit. The factory wise estimates of operating results for 1986 are as under:

|                                                | <b>A</b>   | <b>B</b>   | <b>C</b>   | <b>Rs. in lacs</b> |
|------------------------------------------------|------------|------------|------------|--------------------|
|                                                | <b>Rs.</b> | <b>Rs.</b> | <b>Rs.</b> | <b>Total</b>       |
| Sales                                          | 300        | 1200       | 600        | 2100               |
| Costs:                                         |            |            |            |                    |
| Raw material                                   | 75         | 350        | 145        | 570                |
| Direct labour                                  | 75         | 280        | 140        | 495                |
| Factory overheads –variable                    | 20         | 110        | 55         | 185                |
| Fixed                                          | 40         | 120        | 60         | 220                |
| Selling & distribution<br>Overheads – variable | 23         | 70         | 40         | 133                |
| Fixed                                          | 15         | 50         | 30         | 95                 |
| Administrative OH                              | 20         | 90         | 40         | 150                |
| Head office expenses                           | 12         | 50         | 30         | 150                |
| Total                                          | 280        | 1120       | 540        | 1940               |
| Profit                                         | 20         | 80         | 60         | 160                |
|                                                |            |            |            |                    |

When the above estimates were under finalisation, the company's legal departments advised that the lease of factory 'A' was due to expire on 31<sup>st</sup> December, 1985 and that it could be renewed by enhancing the lease rent by Rs. 12 lacs per annum. Since this enhancement will have a heavy impact on the profitability of the company, the management will have a heavy impact on the profitability of the company; the management is constrained to examine the proposals which are as under:

I. Renew the lease and bear the impact

II. Close down factory 'A' sell off the plant, machinery and stocks and liquidate all liabilities including the staff and worker's retrenchment compensation from the sale proceed which are sufficient for this purpose.

In order however to maintain the customer relations the total planned output of the factory 'A' will be transferred to EITHER Factory 'B' OR factory 'C'. Plant capacity is available at both the factories to take over the manufacture. The additional cost involved in the manufacture of the extra output so transferred in factories 'B' and 'C' are estimated as under:

|                                                                                                                                  | Factory A       | Factory B       |
|----------------------------------------------------------------------------------------------------------------------------------|-----------------|-----------------|
| (A) additional fixed overheads due to increased capacity utilisation (per annum)                                                 | Rs. 50 lacs     | Rs. 40 lacs     |
| (B) additional freight, selling and other overheads to produce and distribute the output to the present customers of factory 'A' | Rs. 25 per unit | Rs. 35 per unit |

You are required to prepare comparative statements of profitability in the aforesaid alternative courses of action and give your recommendations.

2

a. **Difference between Marginal Costing and Absorption Costing.**

b. **Define the 'Sunk Cost'.**

c. The following data have been obtained from the records of a machine shop for an average month:

**BUDGET**

|                                                         |                              |
|---------------------------------------------------------|------------------------------|
| Number of working days                                  | 25                           |
| Working hours per day                                   | 8                            |
| Number of direct workers                                | 16                           |
| Efficiency                                              | One standard hr per clock hr |
| Down time                                               | 20%                          |
| Over heads                                              | Rs.                          |
| Fixed                                                   | 15360                        |
| Variable                                                | 20480                        |
| The actual data for the month of September are as under |                              |
| Overheads                                               |                              |
| Fixed                                                   | 16500                        |
| Variable                                                | 14500                        |
| Net operator hours worked                               | 1920                         |
| Standard hours produced                                 | 2112                         |
| There was a special holiday in September 1985           |                              |

Required to present a special report to departmental manager:

- (i) Showing the three costs ratios you have chosen
- (ii) Setting out the analysis of variances.

3

(a) **How are cost variance dispose off in a standard costing system?**

(b) **In standard costing certain ratios are used to illustrate the effective use of the reasons of the company. Define any three of these ratios.**

(c) Sterling Enterprises has prepared a draft budget for the next year as follows:

|                                |             |
|--------------------------------|-------------|
|                                | 10000 units |
| Sales Price Per unit           | Rs. 30      |
| Variable cost pre unit:        |             |
| Direct material                | Rs. 8       |
| Direct labour (2 hrs × Rs. 3)  | 6           |
| Variable OH (2 hrs × Rs. 0.50) | 1           |
|                                | 15          |
| Contribution per unit          | 15          |
| Budgeted contribution          | 150000      |
| Budgeted fixed cost            | 140000      |
| Budgeted profit                | 10000       |

The Board of Directors is dissatisfied with this budget, and ask a working party to come up with an alternate budget with a higher profit figures.

The working party reports back with the following suggestion which will lead to a budgeted profit of Rs. 25000. The company should spend Rs. 28500 on advertising and put the sales price up to Rs. 32 per unit. It is expected that sales volume would also rise, in spite of the price increase, to 12000 units. In order to achieve the extra production capacity. However, the work force must be able to reduce the time taken to make each unit of the product. It is proposed to offer a pay and productivity deal, in which the wage rate per hour is increased to Rs. 4. The hourly rate for variable overhead will be unaffected.

Prepare a revised budget giving effect to the above suggestions.

4

(a) Critically examine “It is prudent to hold large inventories in an inflationary economy”.

(b) Explain the concept of activity based costing. How ABC system supports corporate strategy?

(c) A company has 10 direct workers, who work for 25 days a month of 8 hours per day. The estimated down time is 25% of the total available time. The company received an order for a new product. The first unit of the new product requires 40 direct labour hours to manufacture the product. The company expects 80% (index is – 0.322) learning curve for this type of work. The company uses standard absorption costing and the cost data are as this type of work.

|                   |                              |
|-------------------|------------------------------|
| Direct material   | Rs. 60 per unit              |
| Direct labour     | Rs. 6 per direct labour hour |
| Variable overhead | Rs. 1 per direct labour hour |
| Fixed overheads   | Rs. 1700 per month           |

Required:

- (i) Calculate the cost per unit of the first order of 30 units
- (ii) if the company receives a repeat order for 20 units, what price will be quoted to yield a profit of 25% on selling price.

5

**(a) Discuss the scope of cost reduction in the area of works services.**

**(b) State three applications of direct costing**

**(c)** PYE Ltd produces and markets a very popular product called P. the company is interested in presenting its budget for the second quarter of 1993.

The following information's are made available for this purpose:

- a) it expects to sell 50,000 bags of P during the second quarter of 1993 at the selling price of Rs. 9 per bag.
- b) Each bag of P requires 2.5 kgs. Of a raw material called Q and 7.5 kgs. Of raw material called R
- c) Stock levels are planned as follows

|                      | <b>Begin. of quarter</b> | <b>End of quarter</b> |
|----------------------|--------------------------|-----------------------|
| finished bags        | 15000                    | 11000                 |
| Raw Material P (Nos) | 32000                    | 26000                 |
| Raw material (Q)     | 57000                    | 47000                 |
| Empty bags           | 37000                    | 28000                 |

- d) Q costs Rs. 1.20 per kg R costs 20 paise per kg and empty bag costs 80 paise each.
- e) it requires 9 minutes of direct labour time of produce and fill one bag of P. labour cost is Rs. 5 per hour.
- f) Variable manufacturing costs Re.0.45 per bag. Fixed manufacturing costs Rs.30,000 per quarter
- g) Variable selling & distribution expenses are 5% of sales and fixed administration and selling expenses are Rs. 25,000 per quarter.

You are required to:

- I. Prepare a production budget for the said quarter.
- II. Prepare a raw material purchase budget for Q, R, and empty bags for the said quarter in quantity as well as in rupees.

III. Compute the budgeted variable cost to produce one bag of P

IV. Prepare a statement of budgeted net income for the said quarter and show both per unit and total cost

6. (a) The Secretary of a school is taking bids on the City's four school bus routes. Four companies have made the bids as detailed in the following table:

| Bids (in Rs) |         |         |         |         |
|--------------|---------|---------|---------|---------|
|              | Route 1 | Route 2 | Route 3 | Route 4 |
| Company 1    | 4,000   | 5,000   | --      | --      |
| Company 2    | --      | 4,000   | --      | 4,000   |
| Company 3    | 3,000   | --      | 2,000   | --      |
| Company 4    | --      | --      | 4,000   | 5,000   |

Suppose each bidder can be assigned only one route. Use the assignment model to minimize the school's cost of running the four bus routes.

(b) One of the activities in a PERT project has an expected duration of 12 weeks with a standard deviation of 2 weeks. The most likely time estimate of this activity is 12 weeks, Calculate the optimistic and pessimistic time estimates for this activity.

(c) What are Pseudo-random numbers?

PRIME ACADEMY  
28<sup>th</sup> SESSION MODEL EXAM  
COST MANAGEMENT  
SUGGESTED ANSWERS

1

a) Cost analysis is the break up / classification of the aggregate costs into relevant types. Such an analysis of cost is an essential pre-requisite of controlling costs as well as of decision making.

Identifiability of cost (direct cost) with such units of products of operations is one such basis of cost classification. The importance of distinguishing costs as direct or indirect lies in the fact that direct costs have to be apportioned on the basis of certain assumptions. Thus, it is helpful for management if costs are classified on the basis of their identifiability with the units of products, processes or work orders. This is so because direct costs are controllable at the operational level where as indirect costs are not amenable to such control.

For the purpose of decision making and control, costs are distinguished on the basis of their relevance to the different types of decision and control functions. Thus, expenditure which has taken place, is irrecoverable in a situation, is regarded as Sunk Cost. Cost incurred as a result of past decisions which cannot be altered by another decision at a subsequent date is known as Sunk Cost. Thus, for decision with future implications, a sunk cost is an irrelevant cost. If a decision has to be made whether to replace the existing plant is to be regarded as a sunk cost as it is irrelevant to the question of its replacement. The decisive factor would be the difference in income which will result from the installation of a new plant, and the expected rate of return on the new investment.

Costs which are relevant are only to be taken into account and all such costs are analysed accordingly. Present and future cash expenditure connected with a decision is the result of proper cost analysis.

a) The assumptions underlying break even analysis as follows

- I. All costs can be classified into fixed and variable components.
- II. Both revenue and cost functions are linear over the range of activity under consideration.
- III. Prices of output and input remain unchanged.
- IV. Productivity of the factors of production will remain the same.
- V. The state of technology and the process of production will not change.
- VI. There will be no significant change in the level of inventory.
- VII. The company manufactures a single product.
- VIII. In the case of a Multi – Product Company, the sales mix will remain unchanged.

b) Fitwell Ltd a large manufacturing company has three factories namely factory 'A' factory 'B' and factory 'C'. All the three factories produce the same product which is sold at Rs. 375 per unit. The factory wise estimates of operating results for 1986 are as under:

|                                                | <b>A</b>  | <b>B</b>   | <b>C</b>   | <b>Rs. in lacs</b> |
|------------------------------------------------|-----------|------------|------------|--------------------|
|                                                | <b>Rs</b> | <b>Rs.</b> | <b>Rs.</b> | <b>Total</b>       |
| Sales                                          | 300       | 1,200      | 600        | 2,100              |
| Costs:                                         |           |            |            |                    |
| Raw material                                   | 75        | 350        | 145        | 570                |
| Direct labour                                  | 75        | 280        | 140        | 495                |
| Factory overheads –variable                    | 20        | 110        | 55         | 185                |
| Fixed                                          | 40        | 120        | 60         | 220                |
| Selling & distribution<br>Overheads – variable | 23        | 70         | 40         | 133                |
| Fixed                                          | 15        | 50         | 30         | 95                 |
| Administrative OH                              | 20        | 90         | 40         | 150                |
| Head office expenses                           | 12        | 50         | 30         | 150                |
| Total                                          | 280       | 1,120      | 540        | 1,940              |
| Profit                                         | 20        | 80         | 60         | 160                |
|                                                |           |            |            |                    |

When the above estimates were under finalisation, the company's legal departments advised that the least of factory 'A' was due to expire on 31<sup>st</sup> December, 1985 and that it could be renewed by enhancing the lease rent by Rs. 12 lacs per annum. Since this enhancement will have a heavy impact on the profitability of the company, the management will have a heavy impact on the profitability of the company; the management is constrained to examine the proposals which are as under:

I. Renew the lease and bear the impact

II. Close down factory 'A' sell off the plant, machinery and stocks and liquidate all liabilities including the staff and worker's retrenchment compensation from the sale proceed which are sufficient for this purpose.

in order however to maintain the customer relations the total planned output of the factory 'A' will be transferred to EITHER Factory 'B' OR factory 'C'. Plant capacity is available at both the factories to take over the manufacture. The additional cost involved in the manufacture of the extra output so transferred in factories 'B' and 'C' are estimated as under:

|                                                                                                                                  | Factory A       | Factory B       |
|----------------------------------------------------------------------------------------------------------------------------------|-----------------|-----------------|
| (A) additional fixed overheads due to increased capacity utilisation (per annum)                                                 | Rs. 50 lacs     | Rs. 40 lacs     |
| (B) additional freight, selling and other overheads to produce and distribute the output to the present customers of factory 'A' | Rs. 25 per unit | Rs. 35 per unit |

**Fitwell limited**  
**Impact on profit of continuance of production by renewing the lease**

|                                  | <b>FACTORIES</b> |                  |                  |                      |
|----------------------------------|------------------|------------------|------------------|----------------------|
|                                  | <b>A<br/>Rs.</b> | <b>B<br/>Rs.</b> | <b>C<br/>Rs.</b> | <b>Total<br/>Rs.</b> |
| <b>Sales (a)</b>                 | <b>300</b>       | <b>1200</b>      | <b>600</b>       | <b>2100</b>          |
| Costs:                           |                  |                  |                  |                      |
| Raw material                     | 75               | 350              | 145              | 570                  |
| Direct labour                    | 75               | 280              | 140              | 495                  |
| Factory overheads (variable)     | 20               | 110              | 55               | 185                  |
| Selling & Distribution overheads |                  |                  |                  |                      |
| Variables                        | 23               | 70               | 40               | 133                  |
| Total variables <b>(b)</b>       | <b>193</b>       | <b>810</b>       | <b>380</b>       | <b>1383</b>          |
| <b>Contribution (a – b)</b>      | <b>107</b>       | <b>390</b>       | <b>220</b>       | <b>717</b>           |
| Factory overheads (fixed)        | 40               | 120              | 60               | 220                  |
| Selling & distribution (fixed)   | 15               | 50               | 30               | 95                   |
| Administration overheads         | 20               | 90               | 40               | 150                  |
| Head office expenses             | 12               | 50               | 30               | 92                   |
| Additional lease rent            | 12               | -                | -                | 12                   |
| Total fixed overheads            | 99               | 310              | 160              | 569                  |
| <b>Profit (c)</b>                | <b>8</b>         | <b>80</b>        | <b>60</b>        | <b>148</b>           |

**Working notes:**

| <b>(a) variable and fixed costs when the production of factory 'A' is transferred to factory 'B'</b> |              |                        |             |
|------------------------------------------------------------------------------------------------------|--------------|------------------------|-------------|
|                                                                                                      | Rs. in lacs  |                        |             |
|                                                                                                      | Sales        | Variable costs         | Fixed costs |
| B                                                                                                    | 1,200        | 810.00                 | 310         |
| A                                                                                                    | 300          | 202.50<br>(see note 1) | -           |
| Additional costs                                                                                     |              | 20.00<br>(see note 2)  | 50          |
| <b>Total</b>                                                                                         | <b>1,500</b> | <b>1,032.50</b>        | <b>360</b>  |
| <b>(b) variable and fixed costs when the production of factory 'A' is transferred to factory 'C'</b> |              |                        |             |
|                                                                                                      | Sales        | Variable costs         | Fixed costs |
| C                                                                                                    | 600          | 380                    | 160         |
| A                                                                                                    | 300          | 190<br>(see note 3)    | -           |
| Additional costs                                                                                     |              | 28<br>(see note 4)     | 40          |
| <b>Total</b>                                                                                         | <b>900</b>   | <b>598</b>             | <b>200</b>  |



### Comparative Statements of Profitability

|                | When production of factory A is transferred to factory B |          |              | When production of factory A is transferred to factory C |          |              |
|----------------|----------------------------------------------------------|----------|--------------|----------------------------------------------------------|----------|--------------|
|                | A<br>Rs.                                                 | B<br>Rs. | Total<br>Rs. | C<br>Rs.                                                 | D<br>Rs. | Total<br>Rs. |
| Sales          | 1500.50                                                  | 600      | 2100.00      | 1200                                                     | 900      | 2100         |
| Variable costs | 1032.50                                                  | 380      | 1412.50      | 810                                                      | 598      | 1408         |
| Contribution   | 467.50                                                   | 220      | 687.50       | 390                                                      | 302      | 692          |
| Fixed costs    | 360.00                                                   | 160      | 520.00       | 310                                                      | 200      | 510          |
| Profit         | 107.50                                                   | 60       | 167.50       | 80                                                       | 102      | 182          |

Since, transfer of production of factory 'A' to factory 'C' yields highest profit, i.e Rs. 182 lacs, this course is recommended.

Notes:

- I.  $810 / 1200 \times 300 = 202.5$  lacs
- II. Additional units = 80000 units  
additional V.C =  $80000 \times \text{Rs. } 25 = 20$  lacs
- III.  $380 / 600 \times 300 = 190$  lacs
- IV.  $(80000 \times \text{Rs. } 35) = 28$  lacs.

2)

#### a. Difference between Marginal Costing and Absorption Costing.

| S.No | Marginal Costing                                                                                                                                                  | Absorption Costing                                                                                                                                                                                    |
|------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1    | Only one variable costs are considered for pricing decision making                                                                                                | Both fixed and variable costs are considered for product pricing and inventory valuation                                                                                                              |
| 2    | Fixed costs are regarded as period costs. The profitability of different products is judged by their P/V ratio                                                    | Fixed costs are charged to the cost of production. Each products bears a reasonable shares of fixed costs and thus the profitability of a product is influenced<br>By an apportionment of fixed costs |
| 3    | Costs data presented highest the total contribution of each product                                                                                               | Cost data are presented on a conventional pattern. Net profit of each product is determined after subtracting the fixed costs are along with the variable cost.                                       |
| 4    | The difference in the magnitude of opening stock and closing stocks does not affect the unit cost of production.                                                  | The difference in the magnitude of opening and closing stock affects the unit cost of production due to the impact of the related fixed cost.                                                         |
| 5    | The classification of the expenses is based on behaviour of expenses as fixed and variable.                                                                       | The classification of expenses is based on the a functional basis                                                                                                                                     |
| 6    | Contribution from various products is used as a fund which fixed are deducted to get profit & hence there will be no under or over absorption of fixed overheads. | Fixed expenses are distributed over produce on a pre determined basis and as expenses fixed expenses are constant this procedure will lead to under or over recovery of fixed overheads.              |
| 7    | Marginal costing aids decision making                                                                                                                             | Absorption costing distort decision making                                                                                                                                                            |

b. **Define the ‘Sunk Cost’.**

Costs which do not change under given circumstances and do not play any role in decision making process are known as sunk costs. They are historical costs incurred in the past. In other words, these are the costs which have been incurred by a decision made in the future. These costs are however, best basis of preceding future costs. Amortisation of past expenses is the clearest kind of sunk cost.

c. The following data have been obtained from the records of a machine shop for an average month:

**BUDGET**

|                                                         |                              |
|---------------------------------------------------------|------------------------------|
| Number of working days                                  | 25                           |
| Working hours per day                                   | 8                            |
| Number of direct workers                                | 16                           |
| Efficiency                                              | One standard hr per clock hr |
| Down time                                               | 20%                          |
| Over heads                                              | Rs.                          |
| Fixed                                                   | 15360                        |
| Variable                                                | 20480                        |
| The actual date for the month of September are as under |                              |
| Overheads                                               |                              |
| Fixed                                                   | 16500                        |
| Variable                                                | 14500                        |
| Net operator hours worked                               | 1920                         |
| Standard hours produced                                 | 2112                         |
| There was a special holiday in September 1985           |                              |

Required to present a special report to departmental manager:

(i) Report to departmental manager showing the cost ratios

(a) Efficiency ratio:

$$\frac{\text{Standard hours produced}}{\text{actual hours worked}} = \frac{2112}{1920} \times 100 = 110\%$$

(b) Activity ratio

$$\frac{\text{Standard hours produced}}{\text{Budgeted std. hours}} = \frac{2120}{2560} \times 100 = 82.50\%$$

(c) Standard capacity usage ratio:

$$\frac{\text{Budgeted hours}}{\text{Max. Possible hrs}} = \frac{2560}{3200} \times 100 = 80\%$$

(d) Actual capacity utilisation ratio

$$\frac{\text{Actual hours}}{\text{Budgeted hours}} = \frac{1920}{2560} \times 100 = 75\%$$

(e) Calendar ratio:

$$\frac{24}{25} \times 100 = 96\%$$

(ii) Report to the Departmental Manager setting out the Analysis of Variances

$\frac{\text{Rs.15360}}{2560} = \text{Rs. 6}$   
Standard fixed overhead rate pre hour:

| <b>A. fixed overheads</b>                                             |                                                             | <b>Rs.</b> |
|-----------------------------------------------------------------------|-------------------------------------------------------------|------------|
| (a) charged to production                                             | $2,112 \times \text{Rs. 6}$                                 | 12,672     |
| (b) actual hours $\times$ std. rate                                   | $1920 \times \text{Rs. 6}$                                  | 11,520     |
| (c) revised budgeted hours $\times$ std. hrs                          | $24 \times 8 \times 16 \times 80 / 100 \times \text{Rs. 6}$ | 14,746     |
| (d) original budgeted overheads                                       |                                                             | 15,360     |
| (e) actual overheads                                                  |                                                             | 16,500     |
| Variances                                                             |                                                             | <b>Rs.</b> |
| Efficiency                                                            | (a-b)                                                       | 1,152 (F)  |
| Capacity variance                                                     | (b-c)                                                       | 3,226 (A)  |
| Calendar variance                                                     | (c-d)                                                       | 614 (A)    |
| Volume variance                                                       | (a-d)                                                       | 2,688 (A)  |
| Expenditure variance                                                  | (d-e)                                                       | 1,140 (A)  |
| Total variance                                                        | (a-e)                                                       | 3,828 (A)  |
| <b>B. variable overheads</b>                                          |                                                             | <b>Rs.</b> |
| Std. variable rate per hour $\text{Rs. } 20480 / 2560 = \text{Rs. 8}$ |                                                             |            |
| (a) charged to production                                             | $2112 \times \text{Rs. 8}$                                  | 16,896     |
| (b) actual hours $\times$ std. rate                                   | $1920 \times \text{Rs. 8}$                                  | 15,360     |
| (c) actual overheads                                                  |                                                             | 14,500     |
| <b>variances</b>                                                      |                                                             |            |
| efficiency variance                                                   | (a-b)                                                       | 1,536 (F)  |
| Expenditure variance                                                  | (b-c)                                                       | 860 (F)    |
| Total variance                                                        | (a-c)                                                       | 2,396 (F)  |
| NOTE: F stands for Favorable A stands for adverse                     |                                                             |            |
| <b>Working notes:</b>                                                 |                                                             |            |
| Maximum possible hours $(25 \times 8 \times 16)$                      |                                                             | 3,200      |
| Budgeted hours : 3200 less 20% down time                              |                                                             | 2,560      |
| Actual hours                                                          |                                                             | 1,920      |
| Budgeted std. hours                                                   |                                                             | 2,560      |
| Standard hours produced                                               |                                                             | 5,112      |
| Budgeted working days b                                               |                                                             | 25         |
| Actual working days                                                   |                                                             | 24         |

**3) (a)** There is no unanimity of opinion among Cost Accountants regarding the disposition of variances. The following are commonly used for their disposition:

1. transfer all variances to profit & loss A/C. under this method, stock of work in progress, finished stock and cost of sales are maintained at standard cost and variances arising are transferred to profit & loss A/C
2. Distributing variances on pro – rata basis over the cost of sales, work in progress and finished goods stocks by using suitable basis.
3. Write off quantity variance to profit & loss A/C and spread price variance over C cost of sales, work in progress and finished goods. The reason behind apportioning price variance to inventories and cost of sales is that they represent costs although they are derived as variances.

**(b)** Definition of ratios used in standard costing:

**I. Efficiency ratio**

Represents the standard hour's equivalent to work produced expressed as a percentage of actual hours spent in producing the work.

**II. Activity ratio**

is the number of standard hours equivalent to work produced, expressed as a percentage of the budgeted standard hours.

**III. Standard capacity usage ratio**

is the relationship between the budgeted number of working hours and the maximum possible working hours in a budget period

**IV. Actual capacity usage ratio**

is the relationship between the actual number of working hours and the budgeted number of working hours in a period.

**V. Calendar ratio**

is the relationship between the actual number of working days in a period and the number of working days in relative budget period.

(c) Sterling Enterprises has prepared a draft budget for the next year as follows:

|                                |     |             |
|--------------------------------|-----|-------------|
|                                |     | 10000 units |
| Sales Price Per unit           |     | Rs. 30      |
| Variable cost pre unit:        | Rs. |             |
| Direct material                | 8   |             |
| Direct labour (2 hrs × Rs. 3)  | 6   |             |
| Variable OH (2 hrs × Rs. 0.50) | 1   | 15          |
| Contribution per unit          | Rs. | 15          |
| Budgeted contribution          | Rs. | 150000      |
| Budgeted fixed cost            | Rs. | 140000      |
| Budgeted profit                | Rs. | 10000       |

The Board of Directors is dissatisfied with this budget, and ask a working party to come up with an alternate budget with a higher profit figures.

The working party reports back with the following suggestion which will lead to a budgeted profit of Rs. 25000. The company should spend Rs. 28500 on advertising and put the sales price up to Rs. 32 per unit. It is expected that sales volume would also rise, in spite of the price increase, to 12000 units. In order to achieve the extra production capacity. However, the work force must be able to reduce the time taken to make each unit of the product. It is proposed to offer a pay and productivity deal, in which the wage rate per hour is increased to Rs. 4. The hourly rate for variable overhead will be unaffected.

Working notes:

|                                             |         |         |
|---------------------------------------------|---------|---------|
|                                             | Rs.     | Rs.     |
| (I) the revised target contribution will be |         |         |
| Target profit (A)                           |         | 25,000  |
| Original budgeted fixed cost                | 140,000 |         |
| Advertising cost                            | 28,500  |         |
| Total fixing cost (B)                       |         | 168,500 |
| Revised target contribution (A+B)           |         | 193,500 |
|                                             |         |         |
| (II) the target variable cost will be:      |         |         |
| Budgeted sales revenue (A) (12000 × Rs. 32) |         | 384,000 |
| Target contribution (B)                     |         | 193,500 |
| Target variable cost (A-B)                  |         | 190,500 |
|                                             |         |         |

|                                                                                                                                                                                    |  |            |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|------------|
| (III) the target labour and variable overhead costs will be:                                                                                                                       |  |            |
| Of the above target variable costs, some are direct material costs, and the rest consist of labour and variable overhead (based on hourly rate of Rs. 4 and Rs. 0.50 respectively) |  |            |
|                                                                                                                                                                                    |  | Rs.        |
| Target variable cost                                                                                                                                                               |  | 190500     |
| Less: material cost (12000 × Rs. 8)                                                                                                                                                |  | 96000      |
| Target labour and variable overhead costs                                                                                                                                          |  | 94500      |
| (IV) The target production time per unit will be:                                                                                                                                  |  |            |
| Sales unit                                                                                                                                                                         |  | 12000      |
| Target labour and variable OH cost per unit 94500 / 12000                                                                                                                          |  | Rs. 7.875  |
| Rate per hour (Rs. 4 + Rs. 0.50)                                                                                                                                                   |  | Rs. 4.50   |
| Target production time–labour & overhead (Rs. 7.875 /Rs. 4.50)                                                                                                                     |  | 1.75 hours |
| A time of 1.75 hours per unit will be required to achieve a profit of Rs. 25000                                                                                                    |  |            |

#### Revised Budget

|                                                |       |              |
|------------------------------------------------|-------|--------------|
| Number of units sold                           |       | 12000        |
|                                                | Rs.   | Rs.          |
| Sales price per unit                           |       | 32           |
| Variable cost per unit:                        |       |              |
| Material                                       | 8     |              |
| Direct labour (1.75 hrs × Rs. 4)               | 7     |              |
| Variable overhead (1.75 hrs × Rs. 0.50)        | 0.875 | 15.875       |
| Contribution per unit                          |       | 16.125       |
| Budgeted contribution (12000 × Rs. 16.125 (A)) |       | 193500       |
| Budgeted fixed costs (140000 +28500) (B)       |       | 168500       |
| Budgeted profit (A-B)                          |       | <b>25000</b> |

4)

(a)

In an inflationary economy, prices rise rapidly. Holding large inventories will affect the inventory carrying cost including interest on funds blocked. However, there are other risks like obsolescence, deterioration in quality, and limited shelf-life in case of certain Materials etc. In addition to these risks, cheaper substitutes may be available at a later date. New sources of supply may be available at competitive rate or else price may fall. Hence speculation should be avoided.

The funds so blocked may be invested for expansion or diversification, which may result into higher profitability than the benefit arising from holding large inventory. Hence normal level of inventory may be held to avoid stock-out leading to loss of production.

In view of above points all inventory control techniques may be applied for deciding the amount to be invested in inventory. Inflationary economy is one factor. There are several other considerations for deciding the quantum of inventory.

(b) ABC is an accounting methodology that assigns costs to activities rather than products and services. This enables resources and overhead costs to be more accurately assigned to products and services that consume them when compared to traditional methods where either labour or machine hrs are considered as absorption basis over cost centers. In order to correctly associate costs with products and services, ABC assigns cost to activities based on their resources. It then assigns cost to 'Cost objects', such as products and customers, based on their use of activities. ABC can track the flow of activities in organization by creating a link between the activity and the cost objects.

ABC supports corporate strategy in many ways such as:

- o ABC system can effectively support the management by furnishing data, at the operational level and strategic level. Accurate product costing will help the management to compare the profits of various customers, product lines and to decide on price strategy etc. · Information generated by ABC system can also encourage management to redesign the products.
- o ABC system can change the method of evaluation of new process technologies, to reduce setup times, rationalization of plant lay out in order to reduce or lower material handling cost, improve quality etc.
- o ABC system will report on the resource spending.
- o ABC analysis helps managers' focus their attention and energy on improving activities and the actions allow the insights from ABC to be translated into increased profits.
- o Performance base accurate feedback can be provided to cost centre managers.
- o Accurate information on product costs enables better decisions to be made on pricing, marketing, product design and product mix.

(c)

1) **By the theory of learning curve**

$$Y_x = KX^s$$

here X is the cumulative number of units or lots produced, Y is the cumulative average unit time of those X units. K is the average time of the first unit or lot, s is the improvement exponent or the learning coefficient or the index of learning.

taking log on both sides of relation (i) we have

$$Y_x = \log K + s \log X$$

2) **Time required for 30 units order** (when the time required for the first unit is 40 hours)

$$\log 40 + (-0.3322) \log 30 = 1.6027 + (-0.322)(1.4771) = 1.6021 - 0.4756 = 1.1264$$

$$\text{anti log of } 1.1264 = 13.38$$

$$\text{hence hrs required pre unit} = 13.38$$

$$\text{total time required per unit} = 30 \text{ units} \times 13.38 \text{ hours} = 401.40$$

- 3) **Time required for 50 units order** (when the time req. for first unit is 40hrs)  
 $\log 40 + (-0.322) \log 50 = 1.6021 + (-0.322) 1.6990 = 1.055$   
 $\text{anti log of } 1.055 = 11.35$   
 hence hours required per unit 11.35 hours  
 total time required for 50 units =  $11.35 \text{ hours} \times 50 \text{ unit} = 567.5 \text{ hours}$
- 4) **Fixed overhead recovery rate per labour hour**  

|                                                                         |      |
|-------------------------------------------------------------------------|------|
| total labour hours (10 men $\times$ 25 days $\times$ 8 hours)           | 2000 |
| less: 25% down time (in hours)                                          | 500  |
| total effective time                                                    | 1500 |
| total fixed OH per months Rs.                                           | 7500 |
| fixed OH recovery rate per labour hour<br>(Rs.) [Rs. 7500 / 1500 hours] | 5    |

| <b>(i) computation of cost per unit of the first order of 30 units</b>     |         |
|----------------------------------------------------------------------------|---------|
|                                                                            | Rs.     |
| Direct material (30units $\times$ Rs. 60))                                 | 1800.00 |
| Direct labour (401.4 hours $\times$ Rs. 6)                                 | 2408.40 |
| Variable overheads (401.4 hours $\times$ Re.1)                             | 401.40  |
| Fixed overheads                                                            | 2007.00 |
| Cost per unit (Rs. 6616.80 / 30units )                                     | 220.56  |
| <b>(ii) cost per unit, when a repeat order for 20 units is also placed</b> |         |
| Direct material (20 units $\times$ 60)                                     | 1200.00 |
| Direct labour [(567.5 hours $\times$ 401.40 hours) $\times$ Rs. 6]         | 996.60  |
| Variable overheads [166.1 hours $\times$ Re.1]                             | 166.10  |
| Fixed overheads [166.1 hours $\times$ Rs. 5]                               | 830.50  |
| Total cost of 20 additional units                                          | 3193.20 |
| Cost per unit [Rs. 3,193.20 / 20 units]                                    | 159.66  |
| <b>(iii) price to be quoted to yield a profit of 25% on selling price</b>  |         |
| If selling price is Rs. 100 then profit is Rs. 25 and cost is Rs. 75       |         |
| Hence, selling price per unit = $100 / 75 \times 159.66$<br>= Rs. 212.88   |         |



5)

**(a) Scope of cost reduction in the area of works services:**

The scope for cost reduction in the area of works services may be discussed as under:

- I. Keeping records of consumption of power and coal to analyse the potential of cost reduction.
- II. A detailed study of the influence of power factor and maximum demand upon electricity charges and avoidance of waste by power generation, etc.
- III. Boiler house instrumentation as an aid to efficient utilisation of coal.
- IV. Introduction of preventive maintenance plans to avoid frequent breakdown and the resultant loss of production.
- V. Consideration of maintenance cost bill viz –a-viz plant replacement cost to effect long run economies.
- VI. Introduction of quality control techniques to ensure the maintenance of quality of products.
- VII. Study and review of clerical procedures and systems to avoid duplication of work, elimination of unnecessary reports and making effective use of the information recorded for formulating policies, planning and control.

**(b) Three applications of direct costing are as follows**

- 1) Stock valuation
- 2) Minimum quantity to be produced to recover pattern or mould cost.
- 3) close down decisions – like closing down of a department or shop

**(c)**

**(i) Production Budget P for the second quarter**

|                             | <b>Bags (Nos)</b> |
|-----------------------------|-------------------|
| Budgeted sales              | 50,000            |
| Add: desired closing stocks | 11,000            |
| Total requirements          | 61,000            |
| Less: opening stock         | 15,000            |
| Required production         | 46,000            |



- 6 (a):** Since some of the companies have not made bids for certain routes, let us assign very high bid M for all such routes, the assignment model becomes as given below:

| Bids      |         |         |         |         |
|-----------|---------|---------|---------|---------|
|           | Route 1 | Route 2 | Route 3 | Route 4 |
| Company 1 | 4000    | 5000    | M       | M       |
| Company 2 | M       | 4000    | M       | 4000    |
| Company 3 | 3000    | M       | 2000    | M       |
| Company 4 | M       | M       | 4000    | 5000    |

Apply assignment algorithm to the above mentioned problem.  
The optimum solution is

| Bids      |         |         |         |         |
|-----------|---------|---------|---------|---------|
|           | Route 1 | Route 2 | Route 3 | Route 4 |
| Company 1 | 0       | 0       | M       | M       |
| Company 2 | M       | 0       | M       | 0       |
| Company 3 | 1000    | M       | 0       | M       |
| Company 4 | M       | M       | 0       | 0       |

The assignment is as given below:

|           |       |         |               |
|-----------|-------|---------|---------------|
| Company 1 | ----- | Route 1 | 4000          |
| Company 2 | ----- | Route 2 | 4000          |
| Company 3 | ----- | Route 3 | 2000          |
| Company 4 | ----- | Route 4 | 5000          |
|           |       |         | -----         |
|           |       |         | <u>15,000</u> |

Thus, the minimum cost of running the four bus routes is Rs 15,000.

- 6 (b):** Most likely time estimate =  $t_m = 12$  weeks.

$$\text{Expected duration} = t_E = \frac{t_o + 4t_m + t_p}{6} = 12 \text{ weeks}$$

Subtracting the value of  $t_m$  in the above equation, we get = 24       $t_p + t_o = 24$

$$\text{we are also given that standard deviation} = \frac{t_p - t_o}{6} = 2 \text{ weeks}$$

$$\text{By substituting the above } t_p = 18 \\ t_o = 6$$

thus, optimistic time for the activity is 6 weeks and the pessimistic time estimate is 18 weeks.

- 6 (c):** The methods commonly used to generate random numbers are not random processes. Random numbers are called pseudo-random numbers when they are generated by some deterministic process but they qualify the predetermined statistical test for randomness. The sequence of numbers generated by such process is completely determined by the input data or the first random number used for the method.

**TIME: 3 hours**

**Maximum Marks: 100**

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

1. (a) What are the conditions to be satisfied before a Certifying Authority can issue a Digital Signature Certificate? What are the duties of subscribers to Digital Signature Certificate under the IT Act, 2000? **(10 Marks)**  
  
(b) You are appointed as a systems auditor for an organisation to carry out the audit of the program development and acquisition process. Prepare an audit framework for the said audit process. **(10 Marks)**
2. (a) Explain any five of the eight core principles of information security. **(10 Marks)**  
(b) Explain the term CASE Tools. Describe Testing Work Bench **(10 Marks)**
3. (a) “There are many reasons why organisation’s fail to meet system’s development objectives”- Explain **(10 Marks)**  
  
(b) Why is personnel training important for successful implementation of information system? What type of training to be imparted to system operator, users? **(10 Marks)**
4. (a) Explain briefly the steps involved in ERP Implementation **(10 Marks)**  
(b) Discuss the various output control methods **(10 Marks)**
5. (a) “All businesses should assess the adequacy of the controls to protect their information system assets against fraud”- Comment.? **(10 Marks)**  
(b) Distinguish between Programmed and Non-Programmed decisions **(5 Marks)**  
(c) Explain briefly the sources of personnel information systems **(5 Marks)**
6. (a) How are audit trails preserved in a computerised environment? **(10 Marks)**  
(b) Define and distinguish Transaction File, Master File and Reference File **(5 Marks)**  
(c) Explain the terms **(5 Marks)**
  - i. System Entropy
  - ii. Open and closed systems

7. Write Short Notes on any four of the following:

**(4 x 5 = 20 Marks)**

- a.** Systems Manual
- b.** Structured Walk-Through as a method of program debugging
- c.** Callback Devices
- d.** Operator intervention controls
- e.** Risk in end-user Development approach

PRIME ACADEMY  
28<sup>th</sup> SESSION MODEL EXAM  
MANAGEMENT INFORMATION AND CONTROL SYSTEMS  
SUGGESSTED ANSWERS

**1(a)**

S.35 of the IT Act, 2000 provides that no digital signature certificate shall be granted unless the Certifying Authority is satisfied that-

- (a) the applicant holds the private key corresponding to the public key to be listed in the Digital Signature Certificate;
- (b) the applicant holds a private key, which is capable of creating a digital signature;
- (c) the public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by the applicant:

The application is to be made in the prescribed format along with the stipulated fees.

S.36 also states that while issuing a digital signature certificate, the CA should certify that it has complied with the provisions of the Act, rules & regulations and also with the other conditions mentioned in the digital signature certificate.

**Duties of Subscribers under the IT Act, 2000**

S.40, S.41 & S.42 deal with the duties of the subscribers.

**1. S.40 Generating key pair**

On acceptance of the Digital Signature Certificate the subscriber shall **generate a key pair using a secure system.**

**2. S.41. Acceptance of Digital Signature Certificate**

A subscriber shall be deemed to have accepted a Digital Signature Certificate if he publishes or authorises the publication of a Digital Signature Certificate--

- (a) to one or more persons,
- (b) in a repository, or

Otherwise demonstrates his approval of the Digital Signature Certificate in any manner.

By accepting a Digital Signature Certificate that subscriber certifies to all who reasonably rely on the information contained in the Digital Signature Certificate that--

- (a) the subscriber holds the private key corresponding to the public key listed in the Digital Signature Certificate and is entitled to hold the same;
- (b) all representations made by the subscriber to the certifying authority and all material relevant to the information contained in the digital signature certificate are true;
- (c) all information in the Digital Signature Certificate that is within the knowledge of the subscriber is true.

### 3. S.42. Control of private key

The subscriber shall take all reasonable care to retain control over his private key corresponding the public key listed in his digital signature certificate.

1(b)

#### Errors in program development/acquisition



Inadvertent program errors

Due to misunderstanding system  
Specifications or careless program.



Unauthorised program errors

Deliberate insertions into the  
programs

Both the above problems can controlled by requiring management and user authorisation , approval through testing and proper documentation

#### Role of IS auditor in systems development:

- Should be restricted to independent review of the systems development activities. He should not be involved in developing the system (to maintain his independence)
- During review, the auditor should gain understanding of the development procedures and **discuss the same with** management, users and IS department. He should also **review the** policies, procedures and documentation etc.
- **To test development controls :**
  - ❖ Interview managers and users
  - ❖ Examine the development approvals
  - ❖ Review minutes of development team meetings
  - ❖ Review thoroughly the **test documents** to ensure that all changes were tested before implementation
  - ❖ Review of test data and test results to see how problems were sorted out.
- Sometimes strong processing controls can compensate for inadequate development controls.(called as **compensating controls**)

#### If compensating processing controls relied on:

- 1. Auditor should **carry out compliance tests** like independent processing of test data. If this evidence cannot be obtained, auditor has to conclude that material weakness in internal control exists and risks of errors and frauds are unacceptably high.

## 2(a) EIGHT CORE PRINCIPLES OF INFORMATION SECURITY

- |                       |                     |
|-----------------------|---------------------|
| 1. Accountability     | 5. Integration      |
| 2. Awareness          | 6. Reassessment     |
| 3. Multidisciplinary  | 7. Timeliness       |
| 4. Cost Effectiveness | 8. Societal Factors |

### 1. *Accountability*

#### **Meaning:**

- It refers to **making responsibility and accountability explicit** among data owners, process owners, technology providers and users.
- This accountability **should be formalised and communicated to the respective persons.**

#### **Issues/ points to be considered**

1. Specifying as to who would **own data and information**
2. Identification of **user access to systems**
3. How activities are to be tracked used **management audit trail** (so that responsibility can be fixed for various activities)
4. Who should be assigned responsibility for **maintenance of data and information**
5. How to enable investigative and remedial procedures to **deal with a breach or attempted security breach** (Ex: Failed log-in attempts)

### 2. *Awareness*

#### **Meaning:**

- Awareness of risks and security measures should be created among information/data owners and process owners **who are genuinely interested to learn the existence of risks facing the organisation and the security measures taken to counter them.**

#### **Issues/ points to be considered**

1. Care should be taken to **disclose such details as would not compromise security** (i.e. giving detailed information may itself lead to a risk)
2. All **parties who have the right to know should be apprised** and not restricted to end users alone.
3. Good practice is to **build awareness as part of new employee induction/joining**
4. Awareness once created **should be maintained on a continual basis**.(i.e. it is not just a one time effort; should be periodic)



### 3. *Multidisciplinary:*

#### **Meaning:**

- Security should address **both technological and non-technological issues** (administrative, organisational, legal issues).
- Technical standards should be backed by code of practice, audit, regulatory requirements and training and education.

#### **Issues / points to be considered**

1. The value of asset and its sensitivity to business should be identified.
2. The impact of organisational and technological changes on the administration of security should be studied
3. What are the technologies available to meet security objectives (biometrics, VPN, Encryption etc.)?
4. What are the regulatory requirements and industry standards/bench-mark as regards security issues?
5. How to manage advanced security techniques ? (this is critical since security technique if mismanaged could generate a risk. For **Ex:** if one does not know how to open/close a electronic bolt lock)

### 4. *Cost Effectiveness:*

#### **Meaning:**

- Level of security and associated costs should be compatible with the value and benefit of information .

#### **Issues / points to be considered**

1. The dependency level on an information asset should be understood.
2. Value of data and information based upon level of confidentiality or sensitivity
3. What are the threats, how severe are they and their probability of occurrence should be understood
4. The safeguards to minimise the threats and their related costs
5. How to balance between providing a safeguard and the associated costs?

5. **Integration:**

**Meaning:**

- There should be an **internal co-ordination** of security measures, practices and procedures and **co-ordination with that of the third party service providers** so that a coherent/comprehensive system of security is created.
- It would be possible only if all related cycles of information processing, sharing and storing are covered.

**Issues/ points to be considered**

1. Security policy and management **should form part of overall management of the organization.**
2. Security systems should be developed concurrently with information systems or there should be harmonization / synchronisation of all security processes to provide a consistent security framework.
3. Review of interrelated systems to ensure that their security levels are compatible
4. Review of risk relating to third party on whom the organisation process depends (**Ex:** ISPs, Courier companies, BPO companies ).

6. **Re-assessment:**

**Meaning:**

- The **information systems and their security requirements keep changing.** Hence **security should be reassessed periodically** to ensure that they are update and comprehensive to cover changes.

**Issues/ points to be considered**

1. If there is an increase in dependence on information systems, might require an updation to BCP (**Ex:** If manual accounts are converted to system based accounts, BCP should be suitably altered to provide for such changes)
2. If there is any changes to information systems & their infrastructure, might require a change in the security policy (**Ex:** If stand alone systems converted into a LAN, security policy should be modified to provide for network level security as well)
3. If there are new threats, might require better safeguards
4. New technologies provide better security
5. Change in organisational structure and legislation may require change in security levels (**Ex:** If a DBA /Network administrator is appointed, access controls should be suitably changed)

7. *Timeliness:*

**Meaning:**

- Security procedures should **provide for timely monitoring and response** to attempted/real security breaches
- With use of real time systems, damage **of an attack happen rapidly** and hence **require quick reaction.**

**Issues/ points to be considered**

1. Present day business transactions are instantaneous and irrevocable and hence require adequate real-time response
2. **Automated tools** (like network monitors) are available for real-time and after the fact monitoring
3. Security breaches should be escalated (reported) to appropriate levels quickly to facilitate prompt action.

8. *Societal Factors*

**Meaning:**

- Information systems security should be so provided **that it respects the rights and interests of others**

**Issues/ points to be considered**

1. Ethical use and disclosure of data and information obtained from others
2. Fair (unbiased) representation of data or information to others
3. Providing for **secure destruction of data or information that is sensitive but no longer required. Ex:** Medical records of a deceased patient.

2(b)

- CASE stands for **COMPUTER AIDED SOFTWARE ENGINEERING**
- **Software engineering** is concerned with **creation and building of software**
- 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        | <ul style="list-style-type: none"> <li>• <b>Manages the running &amp; reporting</b> of program tests.</li> <li>• Involves <b>keeping track of test data, expected results, program facilities tested.</b></li> </ul> |
| 2.    | Test data generator | <ul style="list-style-type: none"> <li>• <b>Generates test data.</b> This is done by selecting sample data from dbase or by using patterns to generate random data</li> </ul>                                        |
| 3.    | Oracle              | <ul style="list-style-type: none"> <li>• Generates predictions of expected results</li> </ul>                                                                                                                        |

| S.No. | TOOL              | MEANING                                                                                                                                        |
|-------|-------------------|------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.    | File compactor    | <ul style="list-style-type: none"> <li>• Compares results of program test vs. results of previous tests and reports differences</li> </ul>     |
| 5.    | Report generator  | <ul style="list-style-type: none"> <li>• Helps in <b>report definition &amp; generation</b> for test results</li> </ul>                        |
| 6.    | Dynamic analysers | <ul style="list-style-type: none"> <li>• Adds codes to a program to <b>keep track of number of times each statement is executed</b></li> </ul> |
| 7.    | Simulators        | <ul style="list-style-type: none"> <li>• <b>Ex:</b> Target simulation, user interface simulators, I/O simulators etc.</li> </ul>               |

**3(a) Some** reasons which can be attributed for failure of systems development objective are:

**1. Lack of senior management effort and involvement:**

- Developers and users watch as to which projects are getting senior manager attention. They would shift focus from projects they feel is not getting the required attention of top management.
- Also it is the top management which commits resources to the projects and controls its progress.

**2. Shifting user needs (called as scope creep- due to lack of software baselining)**

- User requirements for information systems keep changing. More changes imply more requests for systems development and more development projects.
- Also if changes occur during development effort, there would be no baseline and developers find it very difficult to provide for every change request.

**Ex:** Say a accounts software is in the process of development. A user request comes asking for additional report generation not stated in earlier requirement specification. When this development is being done another user may come with further requests and so on, there is no end to it.

**3. Development of unstructured or strategic systems.**

- The requirements, specification and objectives of strategic systems are difficult to define and hence it would be difficult to determine if development effort is successful or not.(Ex: Expert Systems)

**4. New technologies**

- When management tries to leverage new technology to its competitive advantage, it may face a problem that personnel are not familiar with the technology.

**Ex:** An organisation may want to achieve good results by implementing an ERP package, but may face a problem if users' do not know how to use the package.

**5. Lack of standard project management and systems development methodologies.**

- Lack of formal project management methodologies makes it difficult to stick to time schedules/budget schedules.

**6. Over-worked or under-trained development efforts.**

- Systems development team is over-worked due to constant requests
- Most of the company's do not invest in employee training and hence the employees are not up-date on current technologies.

**7. Resistance to change**

- Any development effort is countered by resistance to change.
- If employees perceive that as a result of business process re-engineering their power position will be affected or that there may be "down-sizing/retrenchment" they will work against the development effort.

**Example:** When computerisation was introduced in banks, in the early stages it faced lot of resistance from employee unions who felt it would adversely affect their job security.

**8. Lack of user participation**

- If users are not involved in the development efforts, they may not feel responsible for the success of the projects. Also there may be resistance to change.
- Hence user involvement is critical to the success of the project.

**9. Inadequate testing and user training.**

- If new systems are not tested properly, they may not meet the business objectives. Also it may give rise to control risks.

End user training on the new system is critical since any system is as effective as the user who uses it.

### 3(b) Importance of training

- A system can succeed or fail depending on how it is operated or used. Hence quality of training received by various personnel (systems operators and other users ) decides the success or failure of the implementation effort.

(**Ex:** An ERP package's success depends on how well the end users are trained in its usage and maintenance)

**How is training imparted? :** Training is imparted through classes and through hands-on learning techniques for both hardware and software.

**Who are the people to be trained ?:** Training should be imparted to :



#### Training of systems operators

- System operators are responsible for keeping equipment running + providing support services.
- Training should cover all types of operations ; both routine and extra-ordinary.
- Areas of training should include :
  - How to switch on a new equipment
  - What are the normal operations of the new system
  - What are the common malfunctioning/problems that might arise, how to recognise them and what action is to be taken (**trouble shooting**).
  - Who are the contact persons in case of unusual problems, how to get in touch with them (**Ex:** Vendor help desk number etc.)

#### Training of users

- It may involve **use of equipment** i.e. how to operate the system.
- They may be trained in **trouble-shooting**. This involves identification as to whether a problem is caused due to software or is it a hardware problem.
- They are also trained in **data handling**. This includes data editing, data coding, designing queries and deleting records.

Users are trained in **system maintenance activities** like preparing disks, loading papers in printers and changing printer cartridges/ribbons.

**4(a) Steps in ERP implementation (Each step to be explained in brief)**

- i. Identifying needs for implementing ERP package
- ii. Evaluation of the present/existing business condition( called as “As is” condition)
- iii. Deciding on the desired/expected condition ( called as “Would be” condition after ERP implementation)
- iv. Reengineering business processes (BPR) to achieved desired results
- v. Evaluation of the various ERP packages- to assess their suitability.
- vi. Deciding on a suitable ERP
- vii. Installing the required hardware and networks for the selected ERP
- viii. Deciding on the implementation consultants who would assist in the implementation efforts.

**4(b)**

**Meaning :** Refers to controls that ensure that system outputs are not:

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

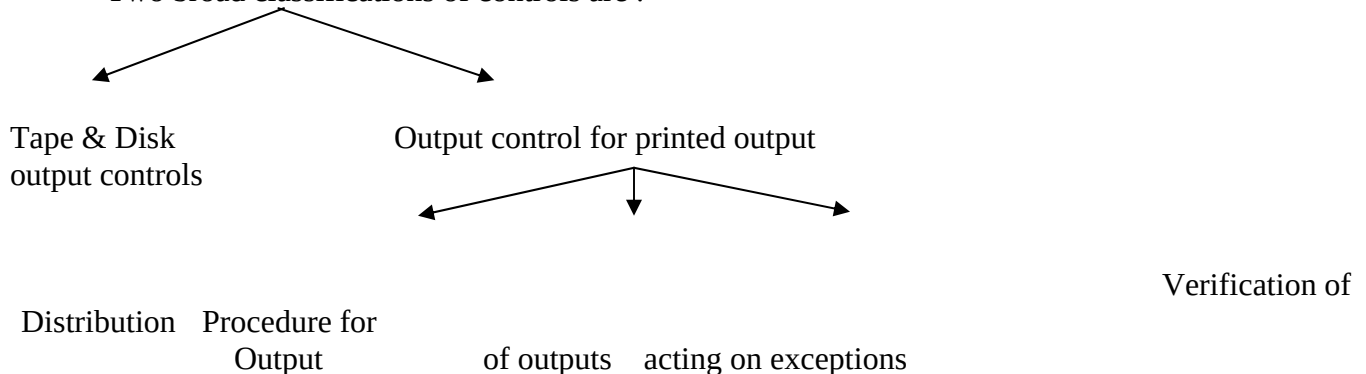
**Ex:** If the cheques issued by a company are lost, it may loose its credibility. If patient medical records are disclosed , may result in legal liability.

***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 :



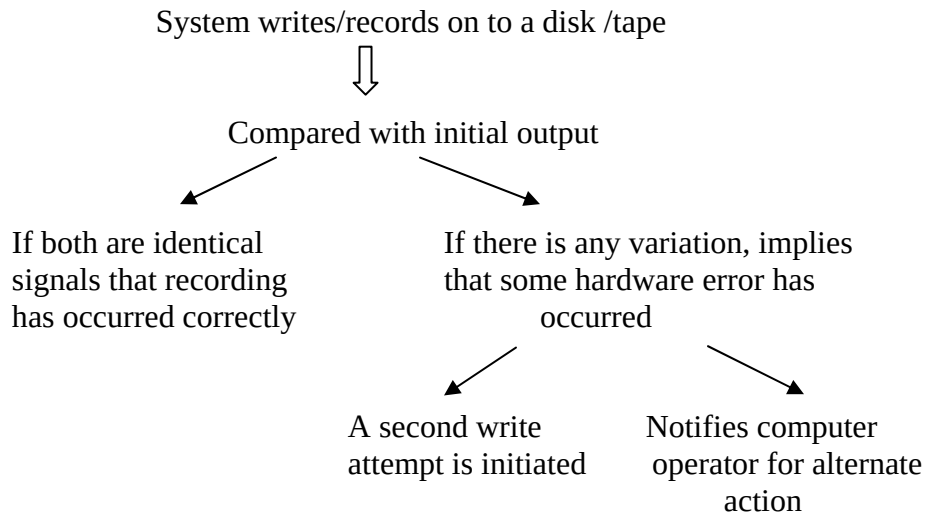
## 1. *Tape & Disk Output controls*

- 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:**



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.

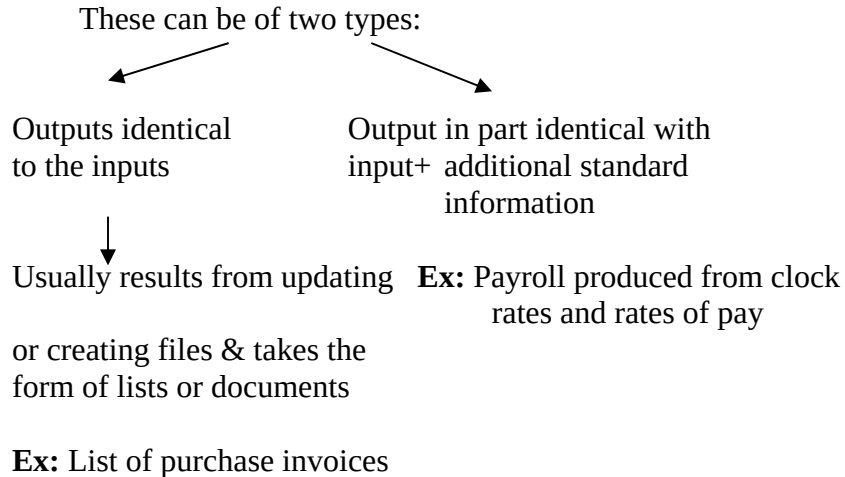
## 2. *Controls over printed output*

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



### ii. Outputs indirectly related to input:

These would include output generated by programs taking into account:

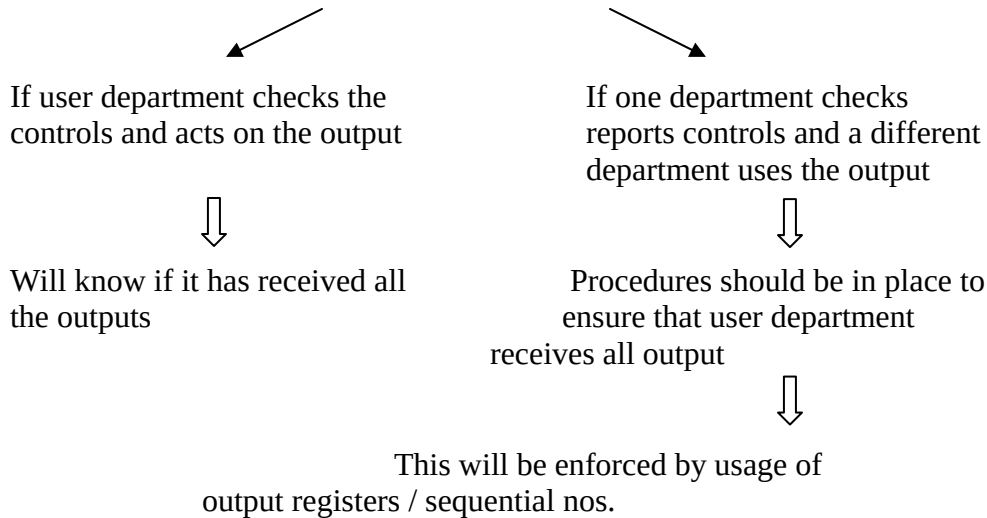
- Current input data
- Previous or latest input data
- All input for a given period of time

**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.
- Primary sources of threats are :
  1. Failure of networking equipments (like switches, bridges, hubs, routers )

Subversive threats where an attacker intercepting message as it moves over the communication channels.

5(a)

- a. Companies are becoming increasingly dependent on computers either stand alone or networked.
- b. Companies have started subscribing to **electronic payment systems**. Ex: ECS, Credit card payments etc.
- c. With the growth of E-Commerce, more systems on the internet and hence a higher risks of hacking

*How are computer frauds different from other conventional frauds?*

- **Easily hidden & Hard to find:** Unlike conventional frauds, there may be no recognizable audit trail & frauds are hidden in enormous volumes of data.
- **Evidence hard to find / difficult to legally prove:** In computer frauds, evidence are hard to find and difficult to prove as per relevant statutes .
- **Easily committed and may not be obvious:** It involves manipulation of invisible data. Just a few key strokes may be needed, with remote access this problem is increased (as we cannot physically see a person committing fraud).

Also with increase in media capacity, huge amounts of data can be written within a short time. This increases the speed of fraud.

5 (b)

i. **Programmed decisions:**

- **Meaning:** Refer to decisions which are made on problems and situations by referring to predetermined set of precedents, procedures, techniques and rules.
- **Characteristic:** Well-structured in advance and time-tested for validity, consistent over situations and time.
- When a problem/issue requires decision making, the relevant pre-determined rule/ procedure applied and hence decision arrived at.
- Such decisions are made in respect of familiar, routine, recurring problems which are amenable to structured solutions by applying well-known operating procedures.
- Organisations create a repository/collection of such rules and procedures based on manager's previous experience and familiarity.

**Note:** Structured/ programmed decision does not necessarily mean simple problems. Organisations can also solve complex problems through structured decisions.

**ii. Non- programmed decisions:**

- **Meaning:** Decisions made on situations and problems which are novel and non-repetitive and about which not much information is available.
- They are non-programmed implying that they are not made by applying any standard procedures, rules or guidelines.
- They are solved by using the managerial intelligence, experience and judgment
- No single best solution may be available as the decision environment is uncertain. The solutions and decisions may be unique or unusual.

**Note:** In real business situations most of the decisions share a feature of programmed and non-programmed decisions

**5(c) Sources of Personnel Information:**

Majority of personnel information is generated in the accounting information system through payroll, human resource accounting and cost estimation for wages negotiations.

**Payroll processing:** Such systems take inputs from swipe card data, job tickets and clock cards. Some inputs help mapping an employee service to particular project/department for better cost allocation.

The payroll system generates some outputs like pay slips, pay cheques, absenteeism report, overtime reports analysis, total man hours worked. Such statistical analysis provides basis for measuring departmental efficiencies.

Cost estimation for wage negotiations:

This involves decisions on various fronts like pay hike, paid holidays, overtime rates and employee benefit contributions.

The personnel department provides data in the form of personnel files and job specifications. The personnel files would contain information about educational background, past experience, state of health and medical history and physical traits . The job specification details the requirement for each job in terms of training and experience.

Another source of information are departmental heads/supervisors who are in a position to evaluate the performance of their team members based on parameters like personality, attitude, character, leadership and group working ability.

External source of personnel information include manpower agencies, labour unions, government placement cells and HR Consulting firms.

**6(a)**

1. Preservation of audit trail is an important objective of the process control.
2. In manual systems , every transaction can be traced from its source to its destination
3. In computerised environment, audit trails are fragmented and difficult to follow.

Hence every operation should be documented.

**Methods of preserving audit trails in a computerised environment**

| <b>S. No.</b> | <b>Technique</b>                  | <b>Meaning</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|---------------|-----------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1.            | Transaction logs                  | <ul style="list-style-type: none"><li>• Every successfully processed transaction should be logged. This acts as a journal</li><li>• Reasons for creating transaction logs :<ol style="list-style-type: none"><li>1. Acts as a permanent record of successfully processed information.</li><li>2. Not all records in the validated transaction file are processed → the rejected entries are placed in an error file</li></ol></li></ul> <b>Transaction log records + Records in error file = Total number of records in a batch.</b> |
| 2.            | Transaction listing               | <ul style="list-style-type: none"><li>• System should print a hard copy of the transaction listing of all successful transactions. It is given to appropriate users for reconciliation with the inputs.</li></ul>                                                                                                                                                                                                                                                                                                                    |
| 3.            | Log of automatic transactions     | <ul style="list-style-type: none"><li>• Some transactions are triggered internally by the system (<b>Ex:</b> ERP package placing purchase orders if inventory falls below safety stock levels , requires no manual intervention)</li><li>• All such internally generated transactions should be placed in a transaction log to provide for audit trail.</li></ul>                                                                                                                                                                    |
| 4.            | Listing of Automatic transactions | <ul style="list-style-type: none"><li>• End user should receive a detailed listing of all internally generated transactions. This acts as a control over automatically generated transactions (<b>Ex:</b> at the end of the day, the purchase department may generate a listing of the automatically generated purchase orders to see if it is in order)</li></ul>                                                                                                                                                                   |
| 5.            | Unique transaction identifiers    | <ul style="list-style-type: none"><li>• Refers to unique numbers given to each transaction to enable tracing it in a large database of thousands / millions of records.</li><li>• In systems using physical source documents - the source document number can be assigned to transactions</li><li>• In real time systems – where no source documents exist. System should generate a unique number for every transaction.</li></ul>                                                                                                  |
| 6.            | Error listing                     | <ul style="list-style-type: none"><li>• Listing of errors are given to users. This helps in error correction and resubmission.</li></ul>                                                                                                                                                                                                                                                                                                                                                                                             |

**6(b) Transaction Files:** These are files which represent collection of transaction inputs. These are only of temporary interest to the management. They are important only for audit trail purposes. Ex: Sales journal data

**Master File :** These are files which are relatively permanent of nature. These are of interest to the management. Ex: Customer Account

**Reference file/ table file:** These refer to the various look-up files like master price list, tax rates, customer codes etc. They are necessary for data processing.

**6(c)**

**i. System Entropy:**

Entropy refers to a process of degeneration/degradation of systems. Entropy prevented through inputs to repair, replenish and maintain systems. Such maintenance inputs are called as **“Negative Entropy”**

**ii. Open and closed systems**

**Open Systems:**

Interacts with the external environment, receives input and gives output. Tends to adapt to changes in external environment for survival and growth

**Closed Systems:**

- Self contained
- Donot interact with environment
- Tend to degenerate

**7: a. Systems Manual :**

The deliverable of the Design phase is a document containing description of the activities to be carried out with diagrammatic representations like flowcharts. This document is called as systems manual/job specification manual.

**Contents of a Systems Manual**

- An overview of the existing system in place
- Information and process flows of the existing system
- The outputs and the intended recipients of the existing system
- A description of the proposed system
- Data and process flows of the proposed system
- Outputs and departments for which they are intended
- Input layout and departments responsible for various inputs
- Description of the various files to be maintained- temporary files, permanent files etc. and the contents of each file
- A program listing which would constitute the new system

- Estimates as regards the probable time involved in development (expressed in terms of computer hours, man days etc.)
- Proposed controls and audit trails to be enabled in the new system

## b. Structured Walk-Through as a method of Program Debugging

**Meaning:** It is the **mental execution** of the program by the programming team. (Team may include programmers other than those who have developed the program)

### *How is structured walkthrough done?*

The programming team going to do the walkthrough gets a basic idea of the program by examining the source text



Then an mental execution of the program covering all its logical path (branches / menus of the program)



Any errors surfacing in a logical path is noted



Interface of the module with other modules – either for input or for output is examined



All errors are consolidated and then given to the programmer(s) who have written the program (called as author of the program )

**Ex:** A group of programmers carrying out a structured walkthrough of the income-tax module of payroll software – first get an idea about the program by looking at the source code text



Then do an mental execution of the program → what happens if a salary of a person is in the range 0 – 1,00,000, > 1,50,000/- etc., may find an error that program does not provide for tax calculation when salary is exactly 1,50,000/- ( at the boundary of class intervals)



Such errors are noted



Check for interaction with HR module for input and accounts module for output → errors like debit/credit to wrong general ledger etc., if any are noted.



All errors are consolidated → given to author of the program for necessary correction

### ***Advantages of structured walkthroughs:***

1. **Many errors in program logic are identified** even before testing is carried out.
2. Programmers other than those who developed the program become familiar with the working of the system. This helps in case any maintenance activity is to be carried out in future.
3. While checking interface with other modules, some errors in those modules may also surface and be corrected.

### **c. Callback Devices**

- They are used as a security measure typically for remote log-in (**Ex:** sales persons from different regions trying to log-into the main server at head office)
- Most important aspect of network security is to keep the intruder off and prevent entry into the LAN. It is better to prevent unauthorised access than to impose security after he has entered the LAN.

A call -back device requires dial-in-user to enter a password and identify himself



System will then break the connection, check the user-id and password and performs an user authentication.

If the caller is authorised  
Call-back device dials the callers number to establish a new connection and allow access to the LAN

If the caller is not authorised  
Call-back device will not call back and hence he will never be allowed to enter the LAN

- Hence this method limits access only from authorised terminals or authorised telephone numbers.
- Prevents intruder from masquerading as legitimate user.

### **d. Operator intervention controls**

- System may sometimes require operator intervention to initiate some actions like :
  - Entering control totals for a batch of records
  - Providing parameter values
  - Activating program from a different point (other than from start point) while re-entering semi-processed error records.
- Operator intervention increases chances of human errors. Hence systems with limited operator's intervention are less prone to processing error.



Operator intervention cannot be eliminated. However they can be reduced by logical derivation of parameter values, program start points etc.

**e. Risks in end-user Development approach:**

- With increased availability of low-cost technology like micro computers and rapid application development tools (RAD, Object Oriented Programming), it is end users who are responsible for systems development and not the EDP department.
- The systems development methodology followed by end user may differ from the formal procedures as in traditional approach.

**Risks in end-user development**

- **Decline in standards & controls** since in end-user development paper walk-through unlikely to be carried out and standards and policies are unlikely to be enforced with the same seriousness as done when an analyst is involved.
- **Requirement specification may not be comprehensive** as users may not have the competency as that of an analyst to capture the accurate requirement specification.
- **Reduction in quality assurance and stability of the system** due to lack of adequate requirement specification.
- **Increase in unrelated & incompatible systems** (called as lack of standardisation)

Each department would choose their own software and hardware leading to incompatibility- i.e. system of one department would not be able to communicate with that of other. Hence management would not be able to implement corporate wide data base.

- **Difficult to access a common database** as different systems run varied applications.

**DS****TIME: 3 hours****Maximum Marks: 100****Answer ALL questions**

1. Walls Ltd is engaged in the business of manufacturing of goods in India for domestic market. The audited profit and loss account for the year ended 31<sup>st</sup> March 2009 is as follows.

|                                            | Rs.              |                                                        | Rs.              |
|--------------------------------------------|------------------|--------------------------------------------------------|------------------|
| Cost of goods sold                         | 1,378,100        | Sales                                                  | 4,270,500        |
| Office Expenses                            | 130,000          | Rent from                                              |                  |
| Salary to employees                        | 1,280,000        | - Quarters given to works                              | 60,000           |
| Expenditure on scientific research         | 84,000           | - Commercial Property<br>(rented to a foreign company) | 130,000          |
| Bad debts                                  | 10,000           | Sale proceeds of Gold                                  |                  |
| Advertisement Expenditure                  | 227,000          | (not being stock in trade)                             | 260,000          |
| Travelling Expenses                        | 320,000          | Amount received from<br>persons                        |                  |
| Interest                                   | 82,000           | using the guest house                                  | 10,000           |
| Advance Fringe Benefit Tax                 | 30,000           |                                                        |                  |
| Income and Wealth Tax                      | 86,400           |                                                        |                  |
| Sales Tax, Excise Duty and Customs<br>duty | 176,000          |                                                        |                  |
| Municipal Taxes                            |                  |                                                        |                  |
| - On quarters given to workers             | 16,000           |                                                        |                  |
| - On Commercial Property                   | 12,000           |                                                        |                  |
| Repairs                                    |                  |                                                        |                  |
| - On quarters given to workers             | 12,000           |                                                        |                  |
| - To Commercial Property                   | 7,000            |                                                        |                  |
| - To Factory                               | 10,000           |                                                        |                  |
| Insurance                                  | 36,000           |                                                        |                  |
| Land Revenue                               |                  |                                                        |                  |
| - On quarters given to workers             | 2,000            |                                                        |                  |
| - To Commercial Property                   | 6,000            |                                                        |                  |
| Depreciation                               | 186,000          |                                                        |                  |
| Other expenses                             | 110,710          |                                                        |                  |
| Net Profit                                 | 529,290          |                                                        |                  |
|                                            | <b>4,730,500</b> |                                                        | <b>4,730,500</b> |

### **Other information**

1. Cost of goods sold includes the following
  - (a) Goods of Rs.3,80,000 purchased from AB Ltd in which a director's wife holds 70% of capital. The same goods are purchased from market at Rs.2,86,000
  - (b) Goods worth Rs.90,000 is purchased by bearer cheque
2. Salary to employees includes
  - (a) Rs.30,000 of employees' contribution of which Rs.17,500 is paid within the due date
  - (b) Rs.28,600 is bonus paid on 13<sup>th</sup> September 2009
  - (c) Rs.40,000 paid outside India without deducting tax at source
  - (d) Rs.6,100 being capital expenditure for promoting family planning amongst employees
3. Expenditure on scientific research includes Rs.30,000 being cost of land and Rs.16,000 paid to an approved National Laboratory for undertaking scientific research under an approved program.
4. Advertisement expenditure includes Rs.22,000 paid in cash
5. Out of Rs.1,60,000 being expenditure incurred on foreign tour, Rs.9,000 is incurred in Indian rupees and the balance in foreign currency. This expenditure is for an 8 day tour to Germany of which 2 days is spent for personal touring.
6. The interest includes an amount of Rs.15,000 payable to IDBI which is paid on December 6<sup>th</sup> 2009
7. The payment details of various taxes are as given below
  - (a) Income / Wealth Tax – May 31<sup>st</sup> 2009
  - (b) Sales Tax – December 13<sup>th</sup> 2009
8. Insurance includes a sum of Rs.4,000 paid towards the commercial building
9. Other expenses include Rs.6,000 towards repair of the guest house and also Rs.4,000 towards expenses not deductible u/s.37(1)
10. Indexed cost of acquisition of gold – Rs.2,41,000

Determine the total income of the company for the assessment year 2009-10. Substantiate your answer with suitable explanation wherever necessary.

**(20 Marks)**

2. (a) Mr.Vijay submitted the following information relevant for the previous year ending on March 31<sup>st</sup> 2009

| Particulars                                                                                                                   | Amount – Rs. |
|-------------------------------------------------------------------------------------------------------------------------------|--------------|
| Profit of business carried on in India                                                                                        | 90,000       |
| Loss of business B carried on India                                                                                           | (-) 30,000   |
| Profits of Business C carried on in Tokyo (income is earned and received in Tokyo and business is controlled from Tokyo)      | 52,000       |
| Loss of business D carried on in Tokyo (Though the profits are not received in India the business is controlled from Chennai) | (-) 46,000   |
| Unabsorbed depreciation of business D                                                                                         | 63,000       |
| Income from property situated in India                                                                                        | 22,000       |
| Income from property situated in Singapore (received in Singapore)                                                            | 1,92,000     |

Determine the income of Mr.Vijay for the assessment year 2009-10 on the assumption that he is:

(i) Resident and ordinarily resident in India

(ii) Resident but not ordinarily resident in India

(iii) Non-resident in India. **(9 Marks)**

**(b)** What are the powers of the authorized officer during a search proceeding. **(7 Marks)**

3. Examine the correctness of the following statements by explaining the provisions of the Income Tax Act

- (a) Income arising by way of enhancement of value of agricultural produce in order to make those produces fit for market is also to be treated as agricultural income.
- (b) Transfer by a subsidiary company of its assets to its parent company in a scheme of amalgamation amounts to distribution of dividend to the extent of accumulated profits under section 2(22)(a) and (c)
- (c) The existence of the relationship of husband and wife at the time of transfer alone is sufficient enough to attract the clubbing provisions
- (d) The deduction u/s.80QBB can be claimed by a co-author of the book assuming he satisfies all the other conditions for claiming such deduction.
- (e) For the maintainability if applications pertaining to more than one year before the settlement commissioner u/s.245C, the assessee has to declare an additional income of Rs.3,00,000 for each such year

- (f) The Income Tax officer has the power to levy any amount as penalty without giving the opportunity of being heard
- (g) The best judgment assessment of FBT is not done u/s.144 but under a separate section.
- (h) Tax need not be deducted at source u/s194I on the payment of rent arrears.

**(8x2=16Marks)**

**4. (a)** Write short notes on any **two** of the following

- (i) Section 10BA Special Provisions in respect of export of certain articles or things
- (ii) Section 47A – Withdrawal of exemption
- (iii) Section 94 – Avoidance of tax by certain transactions in securities

**(2 x 4 = 8 Marks)**

**(b)** Image Limited gives the following particulars for the previous year 2008-09 for you to compute the interest if any payable u/s.115WJ

| <b>Particulars</b>                                  | <b>Amount – Rs.</b> |
|-----------------------------------------------------|---------------------|
| Advance tax paid on June 10 <sup>th</sup> 2008      | 1,56,000            |
| Advance tax paid on September 12 <sup>th</sup> 2008 | 2,50,000            |
| Advance tax paid on December 9 <sup>th</sup> 2008   | 15,000              |
| Advance tax paid on March 13 <sup>th</sup> 2009     | 20,000              |
| Advance tax paid on March 27 <sup>th</sup> 2009     | 25,000              |
| Tax liability as per return of Fringe Benefit Tax   | 11,15,270           |
| Tax liability as per assessment order u/s.115WE(2)  | 16,10,780           |

**(5 Marks)**

**(c)** Mr. John sublets his property taken on rent to Oswal Ltd. The property is sublet along with furniture and fixtures and Mr. John receives the following amounts as consideration for the subletting during the financial year 2008-09

|                                                                |               |
|----------------------------------------------------------------|---------------|
| Arrears of rent for the period 01.09.2004 to 31.03.2005        | - Rs. 70,000  |
| Rent for the period 01.04.2008 to 31.03.2009                   | - Rs.1,20,000 |
| Furniture hire charges for the period 01.04.2008 to 31.03.2009 | - Rs. 12,000  |
| Non-Refundable deposit received during the year                | - Rs. 50,000  |

What is the liability of Oswal Ltd for deduction of tax at source?

**(3 Marks)**

**5. (a)** Discuss:

- (i) Explanation 1 to section 32(1) provides for depreciation on building not owned by the assessee but in respect of which the assessee holds a lease or other rights of occupancy. What is the meaning of “Other Rights” in this context and will this include tenancy rights?

(ii) The assessee has inherited a property from his father during the previous year 2002-03. The property was originally acquired by assessee's father in the previous year 1993-04. Is the assessee right in claiming that he would index the cost from 1993-04 at the time of sale?

**(2 x 2 = 4 Marks)**

**(b)** As assessment was completed by the assessing officer u/s.143(3) on the basis of the return submitted and other information furnished by the assessee. The assessing officer accepted the cost of land after waiting for a reasonable period for report of the valuation officer to whom a reference was made. Subsequent to receiving the valuation report it is revealed that there is a variation of Rs.3 lakhs. On the basis of this valuation report the Commissioner issued a notice u/s.263 to set aside the completed assessment. Justify the action of the Commissioner.

**(3 Marks)**

**(c)** Elaborate the meaning of Advance Ruling under the Income Tax Act.

**(3 Marks)**

**(d)** Sam Traders is a partnership firm consisting of the father and three major sons. The partnership deed provided that after the death of father the business shall be continued by the sons, subject to the condition that the firm shall pay 25% of the profits to the mother. Father died in March 2008. In the previous year ending 31<sup>st</sup> March 2009 the reconstituted firm paid Rs.50,000 (equivalent to 25% of the profits) to the mother and claimed the amount as deduction from its income. Discuss the validity of the following claims.

**(3 Marks)**

**(e).** Compute the Book Profit of Zee Ltd with the following information given for the year ended March 31<sup>st</sup> 2009

Net Profit of the company – Rs.14,56,500

**Credit side of the Profit & Loss account includes**

Sale Proceeds (Domestic sales – Rs.22,23,900. Sale proceeds (Export sales) – Rs.5,76,100. Amount withdrawn from general reserve – Rs.2,00,000. Amount withdrawn from revaluation reserve – Rs.1,50,000.

**Debit side of the Profit & Loss account includes**

Depreciation (Normal) – Rs.6,16,000. Depreciation (due to revaluation) – Rs.2,70,000. Salaries and wages – Rs.2,10,000. FBT – Rs.10,000. Income Tax – Rs.3,50,000. Customs duty (not yet paid) – Rs.17,500. Proposed dividend – Rs.60,000. Consultation fee paid – Rs.21,000. Other Expenses – Rs.1,39,000

**(3 Marks)**

**6 (a).** Mr.Sudhakar, a person of Indian origin was working in London from 1992. He returned to India for permanent settlement during May 2007 when he remitted money to India. Following particulars are furnished for the valuation date 31<sup>st</sup> March 2009. You are required to compute the taxable wealth of Mr.Sudhakar. Substantiate the inclusion and exclusions.

| Sl.No | Particulars                                                                                                                                                                                       | Amount Rs.   |
|-------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|
| 1     | Building constructed on a freehold land and let out for 260 days. Net maintainable rent (Rs.60,000) and Market value<br>(Excess of unbuilt area over specified area is 20% of the aggregate area) | Rs.20,00,000 |

|    |                                                                                                                   |                            |
|----|-------------------------------------------------------------------------------------------------------------------|----------------------------|
| 2  | Jewelry<br>(i) Bought in February 2007 out of money remitted to India from London<br>(ii) Purchased in March 2002 | Rs.6,00,000<br>Rs.1,50,000 |
| 3  | Motor car used in business of running them on hire                                                                | Rs.4,00,000                |
| 4  | Value of interest in urban land held by a firm in which he is partner                                             | Rs.7,00,000                |
| 5  | Bonds held in companies                                                                                           | Rs.2,50,000                |
| 6  | Vacant plot of 450 sq.mts (purchased on December 2001) market value                                               | Rs.9,00,000                |
| 7  | Urban land purchased in the year 2006 out of withdrawal from NRE account                                          | Rs.10,00,000               |
| 8  | Cash in hand (Out of sale proceeds of agricultural land)                                                          | Rs.85,000                  |
| 9  | Shares held in Private Limited Company                                                                            | Rs.3,00,000                |
| 10 | Loan borrowed for sister's marriage                                                                               | Rs.2,75,000                |

**(10 Marks)**

**(b).** Write short notes on wealth escaping assessment.

**(3 Marks)**

**(c).** Mr.Rajan is a member of a co-operative society and he is allotted a house under the house building scheme. During the previous year 2008-09, Mr.Rajan transfers his membership to his brother. Discuss the taxability of the property in the hands of Mr.Rajan for the assessment year 2009-10.

**(3 Marks)**

PRIME ACADEMY  
28<sup>th</sup> SESSION MODEL EXAM  
DIRECT TAXES  
SUGGESSTED ANSWERS

1.

| Particulars                                                                                                                 | Amount – Rs.    |
|-----------------------------------------------------------------------------------------------------------------------------|-----------------|
| Net profit as per Profit and Loss account                                                                                   | 5,29,290        |
| Adjustments                                                                                                                 |                 |
| Advance Fringe Benefit Tax                                                                                                  | (+) 30,000      |
| Income Tax and Wealth Tax                                                                                                   | (+) 86,400      |
| Excess cost of purchasing goods from AB Ltd (not allowed u/s.40A(2))                                                        | (+) 94,000      |
| Payment of Rs.90,000 by bearer cheque (i.e.100% of Rs.90,000)                                                               | (+) 90,000      |
| Employees contribution to PF not paid within due date (treated as income)                                                   | (+) 12,500      |
| Salary paid outside India without deducting tax at source (disallowed by virtue of section 40(a))                           | (+) 40,000      |
| Capital expenditure on family planning (1/5 <sup>th</sup> is deductible over a period of 5 years)                           | (+) 4,880       |
| Cost of land (not deductible u/s.35)                                                                                        | (+) 30,000      |
| Payment to approved National Laboratory (1.25 of Rs.16,000)                                                                 | (-) 4,000       |
| Advertisement expenditure – (100% disallowed)                                                                               | (+) 22,000      |
| Travelling expenses disallowed – $(6/8 * Rs.1,60,000) = Rs.1,20,000$ . Hence amount disallowed Rs.1,60,000 less Rs.1,20,000 | (+) 1,20,000    |
| The interest payable to IDBI paid after the due date                                                                        | (+) 15,000      |
| Sales Tax paid after the due date for furnishing the return                                                                 | (+) 6,000       |
| Municipal Taxes on commercial property given on rent                                                                        | (+) 12,000      |
| Repairs of commercial property given on rent                                                                                | (+) 7,000       |
| Insurance on commercial property given on rent                                                                              | (+) 4,000       |
| Land revenue paid on commercial property given on rent                                                                      | (+) 6,000       |
| Expenses not deductible u/s.37(1)                                                                                           | (+) 4,000       |
| Rent on property given on rent to foreign company                                                                           | (-) 1,30,000    |
| Sale proceeds of Gold                                                                                                       | (-) 2,60,000    |
| <b>Income under the head “Profits and Gains from business or Profession” – (A)</b>                                          | <b>7,19,070</b> |

| Income from House Property                             | Amount – Rs.  |
|--------------------------------------------------------|---------------|
| Gross annual value (being rent of commercial property) | 1,30,000      |
| Less : Municipal Taxes                                 | 12,000        |
| Net Annual Value                                       | 1,18,000      |
| Less : Deduction u/s.24                                |               |
| Standard Deduction (30% of Rs.1,18,000)                | 35,400        |
| <b>Income from House Property – (B)</b>                | <b>82,600</b> |

| Capital Gains                        | Amount – Rs.  |
|--------------------------------------|---------------|
| Sale proceeds of Gold                | 2,60,000      |
| Less : Indexed cost of acquisition   | 2,41,000      |
| <b>Long Term Capital Gains – (C)</b> | <b>19,000</b> |
|                                      |               |
|                                      |               |

Gross Total Income – (A + B + C)

Rs.8,20,670

Less : Deduction u/ch. VIA

Rs. Nil

Total Income

Rs.8,20,670

=====



2.

| Particulars                                    | Resident and ordinarily resident Rs. | Resident but not ordinarily resident Rs. | Non-resident Rs. |
|------------------------------------------------|--------------------------------------|------------------------------------------|------------------|
| Business Income                                |                                      |                                          |                  |
| Business A                                     | 90,000                               | 90,000                                   | 90,000           |
| Business B                                     | (-) 30,000                           | (-) 30,000                               | (-) 30,000       |
| Business C – Note 1                            | 52,000                               | Nil                                      | Nil              |
| Business D – Note 2                            | (-) 46,000                           | (-) 46,000                               | Nil              |
| Unabsorbed depreciation of Business D – Note 2 | (-) 63,000                           | (-) 63,000                               | Nil              |
| <b>Business Income/Loss</b>                    | <b>3000</b>                          | <b>(-) 49,000</b>                        | <b>60,000</b>    |
| Income from property situated in India         | 22,000                               | 22,000                                   | 22,000           |
| Income from property situated in Singapore     | 1,92,000                             | Nil                                      | Nil              |
| <b>Gross Total Income</b>                      | <b>2,17,000</b>                      | <b>(-) 27,000</b>                        | <b>82,000</b>    |
| Less : Deduction under chapter VIA             | Nil                                  | Nil                                      | Nil              |
| <b>Total Income</b>                            | <b>2,17,000</b>                      | <b>(-) 27,000**</b>                      | <b>82,000</b>    |

**Note 1** – U/s.5 of the Income Tax Act incidence of tax depends on the both the residential status as well as the place and time of the accrual or receipt of the income. In the given case the income from business C is earned and received in Tokyo and the business is also controlled from Tokyo. Hence the income is taxable only in the case of resident and ordinarily resident in India

**Note 2** – The income not received in India though the business is controlled from India is not taxable in the hands of non-resident. Hence any loss arising from such business is also not allowed to be set-off. Similar treatment is applicable for unabsorbed depreciation also.

\*\* The loss of Rs.27,000 will be carried forward.

2(b)

The powers exercisable by an authorised officer are:

1. Enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that books of accounts or other documents, money, bullion, jewelry or other valuable article or thing is kept.
2. Break open the lock of any door, box, locker, safe and cupboard or other receptacle for exercising the powers conferred in (1) above where the keys thereof are not available.
3. Search any person who has got out of or is about to get into, or is in the building, place, vessel, vehicle or aircraft if the authorised officer has reason to suspect that such person has secreted about his person any such books of accounts or other documents, money, bullion, jewellery or other valuable article or thing.
4. Require any person who is found to be in possession or control of any books of account or other documents maintained in the form of electronic record to afford the necessary facility to inspect such books of accounts or other documents.

5. Seize (including constructive seizure) any such books of accounts, other documents, money, bullion, jewellery or other valuable article or thing not being stock in trade found as a result of such search.
6. Place marks of identification on any books of accounts or other documents or make, or cause to be made, extracts or copies therefrom.
7. Make an inventory of any such money, bullion, jewellery or other valuable article or thing.
8. Examine on oath any person who is found in possession or control of any books of accounts, documents, valuable article or thing etc.

3.

(a) This statement is correct. Sometimes it becomes difficult to find ready market of the crop as harvested. In order to make the produce a commodity which is saleable it becomes necessary to perform some kind of process on the produce. The income arising by way of enhancement of value of such produce by performing such process to make the raw produce fit for market is also agricultural income. However the following conditions must be satisfied

- (i) The process must be one which is ordinarily employed by a cultivator or receiver of rent in-kind and
- (ii) The process must be applied to render the produce fit to be taken to market.

(b) This statement is correct. Transfer by a subsidiary company of its assets to its parent company in a scheme of amalgamation amounts to distribution of dividend to the extent of accumulated profits under section 2(22)(a) and (c)

(c) This statement is not correct. Existence of relationship of husband and wife is mandatory both at the time of transfer and at the time when the income is accrued. So any transfer which happen before marriage will not attract clubbing provisions.

(d) This statement is correct. The deduction u/s.80QQB is available even to the co-author or the joint author of the book. The conditions to be satisfied are

- (i) The book authored should be a work of literary, artistic or scientific nature.
- (ii) The tax payer is a resident in India
- (iii) The tax payer's income includes the income of royalty or copy right fees or lump sum consideration received for transfer of copy right in a book.
- (iv) The tax payer should obtain a certificate in Form No.10CCD.

(e) This statement is not correct. For the maintainability of applications pertaining to more than one year before the settlement commissioner u/s.245C, it is sufficient if the assessee declares an additional income of Rs.3,00,000 for all the years put together

(f) This statement is incorrect. Under section 274 no order imposing penalty shall be made unless the assessee has been heard or has been given a reasonable opportunity of being heard. Further the income tax officer cannot pass a penalty order for an amount exceeding a sum of rupees Ten Thousand except with the prior approval of the Joint Commissioner of Income Tax.

(g) This statement is correct. A best judgment assessment is contemplated by section 115WF where there is a failure on the part of the assessee to furnish a return of income u/s.115WD either voluntarily (whether belated or revised or otherwise) or in response to a notice u/s.115WD(2). Best judgment assessment is also contemplated for a failure to comply with a notice u/s.115WE(2) or for a failure to comply with a direction of special audit u/s.142(2A). Apart from the fact that section 115WL specifically provides that the other provisions of the Act shall in so far as may be apply to an assessment under this Chapter, the fact that section 115WF provides for a best judgment assessment for failure to comply with a direction of special audit also makes it clear that a special audit can be directed even with regard to completing an assessment of fringe benefits. However, it is felt that where a special audit is directed in the course of assessment of income, a non compliance thereof cannot lead to a best judgment assessment of fringe benefits. Section 115WF also provides that an assessment under this section cannot be made unless a show cause has been given to the assessee except where a notice u/s.115WD has already been issued prior to making the assessment. Though the language used is that a best judgment assessment can be made without giving the assessee an opportunity to show cause in a case where a notice u/s.115WD(2) has been issued, it is felt that no such order can be made without the valid service of the notice u/s.115WD(2). Of course if an opportunity is to be given, the service of the notice u/s.115WD(2) need not be proved. It may be noted that like in section 144 there is no express provision for refund where an assessment is made u/s.115WF.

(h) The statement is incorrect. Section 194I does not make a any distinction between rent and arrears of rent. Hence the arrears of rent whether paid or credited to the account of the payee is liable for tax deduction at source.

4. (a)

**(i) Section 10BA Special Provisions in respect of export of certain articles or things**

**Nature and Period of Deductions**

Deduction is available in respect of Profits and Gains derived by the assessee from such Industrial Undertaking. No deduction however can be claimed under this section beyond the assessment year 2009-2010

**Quantum of Deduction**

Profits derived by the undertaking x Export Turnover of the undertaking / Total Turnover of the undertaking

**Conditions Prescribed**

The Industrial Undertaking to be eligible for deduction under sections 10A and 10B should satisfy the following conditions

1. It should not be formed by splitting up or the reconstruction of a business already in existence.
2. It should not be formed by the transfer to a new business of machinery or plant previously used for any purpose. The value of machinery or plant previously used for any purpose can however be upto 20% of the total value of machinery or plant of the undertaking. Machinery or plant used outside India on which depreciation has not been claimed in India will not be treated as machinery or plant previously used.
3. If manufactures or produces article or thing without the use of imported raw material

4. 90% or more of the sales is by way of export of the eligible articles or things.
5. It employs 20 or more workers during the previous year in the process of manufacture or production
6. The undertaking does not claim deduction under sections 10A or 10B

#### **General**

1. The sale proceeds of articles or things exported out of India should be received in or brought into India by the assessee in convertible foreign exchange within a period of 6 months from the end of the previous year or within such further periods as the competent authority may allow in this behalf.
2. The deduction under section 10BA shall be admissible only if the assessee furnishes along with the return of income a report in a prescribed form given by a Chartered Accountant certifying that the deduction has been claimed correctly.
3. Export turnover means the amount brought into India by the assessee in convertible foreign exchange, but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India.
4. Total turnover means the turnover as per books but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India.

#### **(ii) Section 47A – Withdrawal of exemption**

- 1) If tax on capital gains has been exempt U/S 47 in case of transfer of a capital asset by a holding company to its subsidiary or vice-versa, the capital gains so exempt shall be chargeable to tax in the year of transfer if:
  - i) the holding company does not continue to hold the whole of the share capital of the subsidiary for a period of 8 years from the date of transfer or
  - ii) The transferee company converts the capital asset into stock-in-trade within a period of 8 years from the date of transfer.
- 2) If the condition stipulated regarding the succession of proprietary concern or firm by the company whereby capital gain tax is not levied are not complied with, the benefits availed by the sole proprietor or the firm, as the case may be, shall be deemed to be profit and gains of the successor company chargeable to tax in the year in which the condition in section 47 is violated.

**(iii) Section 94 - Avoidance of tax by certain transactions in securities**

If the owner of securities sells or transfers the same and reacquires it the interest payable to the original transferee shall be deemed as the income of the original transferor. This will not apply if it can be shown that there was no avoidance of tax or that the avoidance was exceptional and not systematic and that there was no such avoidance in the three years preceding the previous year. The Assessing Officer may require the original owner to furnish details of transactions in respect of all securities in writing giving the original owner not less than 28 days to furnish particulars.

Section 94(7) provides that if

Any person buys or acquires any securities or unit within a period of three months prior to the record date; such person sells or transfer such securities or unit within a period of three months after such date; the dividend or income on such securities or unit received or receivable by such person is exempt,

then, the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax.

4(b)

Computation of Interest u/s.115WJ(5)

| Particulars                                                                                                                           | Amount - Rs.    |
|---------------------------------------------------------------------------------------------------------------------------------------|-----------------|
| Tax paid during the assessment year 2009-10 - (a)                                                                                     | 4,66,000        |
| Tax liability as per assessment order - (b)                                                                                           | 16,10,180       |
| 90% of assessed Tax - 90% of (b) = (c)                                                                                                | 14,49,702       |
| Short fall in tax (b) minus (a)                                                                                                       | 11,44,180       |
| <b>Interest u/s.115WJ(5) from 1<sup>st</sup> April 2009 to the date of order i.e. April 6<sup>th</sup> 2010 - 13 months @ 1% p.m.</b> | <b>1,48,733</b> |
| Tax liability as per return of Fringe Benefit Tax - (x)                                                                               | 11,15,270       |
| 15% of (x)                                                                                                                            | 1,67,291        |
| Advance tax paid up to June 15 <sup>th</sup> 2008                                                                                     | 1,56,000        |
| Short fall of first installment                                                                                                       | 11,200          |
| <b>Interest on short fall</b>                                                                                                         | <b>336</b>      |
| 45% of (x)                                                                                                                            | 5,01,872        |
| Advance tax paid up to September 15 <sup>th</sup> 2008                                                                                | 4,06,000        |
| Short fall of second installment                                                                                                      | 95,800          |
| <b>Interest on short fall</b>                                                                                                         | <b>2,874</b>    |
| 75% of (x)                                                                                                                            | 8,36,452        |
| Advance tax paid up to December 15 <sup>th</sup> 2008                                                                                 | 4,21,000        |
| Short fall of third installment                                                                                                       | 4,15,400        |
| <b>Interest on short fall</b>                                                                                                         | <b>12,462</b>   |
| 100% of (x)                                                                                                                           | 11,15,270       |
| Advance tax paid up to March 15 <sup>th</sup> 2008                                                                                    | 4,41,000        |
| Short fall of fourth installment                                                                                                      | 6,72,200        |
| <b>Interest on short fall</b>                                                                                                         | <b>6,742</b>    |

4(c)

Oswal Ltd is liable to deduct tax at source on the entire sum of Rs.2,52,00. CBDT vide circular No.718 dated 22<sup>nd</sup> August 1995 has clarified queries relating to deduction of tax in respect of rent payments to the effect that TDS is required on non-refundable deposits. Similarly section 194I does not make a distinction between rent and arrears of rent and hence tax has to be deducted on the arrears of rent also. The payment of furniture hire charges is done under the tenancy agreement for use of furniture and hence falls within the purview of the term rent. So this is also subject to TDS u/s.194I.

5(a)

(i) The term “Other right of occupancy” mentioned in explanation 1 to section 32(1) will mean any right similar to a lease and will certainly include tenancy rights also. It will also include rights of occupancy arising in the case of ownership flats in cooperative societies / companies / AOPs or rights arising under similar agreements or arrangements. The basic requirement will be that the right must be a right of occupancy and not any other type of right and it must be an enforceable one.

(ii) According to section 49 if the asset is acquired by an assessee by way of gift or will then the cost of acquisition will be the cost to the previous owner. Indexed cost of acquisition means an amount which bears to the cost of acquisition the same proportion as the cost inflation index for the year in which the asset is transferred bears to the cost inflation index for the **first year in which the asset was held by the assessee** or 1<sup>st</sup> April 1981 whichever is later. Hence the assessee in the given case can index only from the year 2002-03 and not from 1993-94.

5(b) The Commissioner of Income tax u/s.263 may call for the records of any assessee and initiate the proceedings only when the order passed by the assessing officer is erroneous and prejudicial to the interest of the revenue. The word “record” used in section 263(1) would mean records as it stands at the time of examination by the Commissioner and not as it stands at the time of order passed by the assessing officer. This view was upheld by the Supreme Court in *CIT vs. Shree Manjunathesware Packing & Camphore Works* (1998) 231 ITR 335. Hence the Commissioner is not justified in issuing a notice u/s.263 on the basis of the valuation report.

5(c)

Section 245N (a) – Advance Ruling means –

(i) a determination by the Authority in relation to a transaction which has been undertaken or proposed to be undertaken by a non-resident applicant or

(ii) a determination by the authority in relation to the tax liability of non-resident arising out of a transaction which has been undertaken or proposed to be undertaken by a resident applicant with such non-resident and such determination shall include the determination of any question of law or of fact specified in the application

(iii) a determination or decision by the authority in respect of an issue relating to computation of total income which is pending before any income tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or of fact relating to such computation of total income

5(d) The concept of “Diversion of income at Source overriding title” is well recognized under tax laws. In the given case the amount of Rs.50,000 equivalent to 25% of share of profits paid to mother stands diverted at source by the charge in her favour created in accordance with the terms of the deed of partnership. Such an income never reaches the assessee and gets diverted to the other person. Even if the assessee receives any such income it is received only for and on behalf of the person who possesses the overriding title. *CIT vs. Nariman B Barach & Sons (1980) 130 ITR 863*. There fore in the case of Sam Traders Rs.50,000 paid to partners mother should be excluded.

5(e)

| Particulars                                | Amount - Rs.     |
|--------------------------------------------|------------------|
| Net profit as per P&L account              | 14,56,500        |
| Add                                        |                  |
| Depreciation (Rs.6,16,000 + Rs.2,70,000)   | 8,86,000         |
| Income Tax                                 | 3,50,000         |
| Proposed Dividend                          | 60,000           |
| Less:                                      |                  |
| Amount withdrawn from general reserve      | (-) 2,00,000     |
| Depreciation normal                        | (-) 6,16,000     |
| Amount with drawn from revaluation reserve | (-) 1,50,000     |
| <b>Book profits</b>                        | <b>17,86,500</b> |

6(a)

Computation of Net wealth of Mr.Sudhakar

| Particulars                                                                       | Amount - Rs.     |
|-----------------------------------------------------------------------------------|------------------|
| Building – Note 1                                                                 | 10,50,000        |
| Jewelry – (Rs.6,00,000 + Rs.1,50,000)                                             | 7,50,000         |
| Motor car used in business of running them on hire                                | 4,00,000         |
| Vacant plot of 450 sq.mts (purchased on December 2001) market value               | 9,00,000         |
| Urban land purchased in the year 2006 out of withdrawal from NRE account          | 10,00,000        |
| Cash in hand (Out of sale proceeds of agricultural land) – In excess of Rs.50,000 | 35,000           |
|                                                                                   | <b>41,35,000</b> |
| Add : Deemed wealth u/s.4                                                         |                  |
| Value of interest in urban land held by a firm in which he is partner             | 7,00,000         |
| <b>Gross Wealth</b>                                                               | <b>48,35,000</b> |
| Less : Exempt u/s.5                                                               |                  |
| Jewelry                                                                           | 6,00,000         |
| Motor car                                                                         | 4,00,000         |
| Urban land purchased in the year 2006 out of withdrawal from NRE account          | 10,00,000        |
| Vacant plot                                                                       | 9,00,000         |
| <b>Net wealth</b>                                                                 | <b>19,35,000</b> |

## Note

|                                                                                            |                     |
|--------------------------------------------------------------------------------------------|---------------------|
| 1. Net maintainable rent                                                                   | Rs..60,000          |
| Capitalised assuming the property is constructed on a free Hold land (60,000 X 12.5)       | Rs.7,50,000         |
| Add : 40% of Rs.7,50,000 (since excess of unbuilt area over Specified area is 20%) premium | Rs.3,00,000         |
|                                                                                            | -----               |
| <b>Value for wealth tax purposes</b>                                                       | <b>Rs.10,50,000</b> |
|                                                                                            | =====               |

Since building is used for residential purposes for less than 300 days it is chargeable to tax.

2. Motor car used in business for running them in hire is exempt from tax.

3. Every assessee individual or HUF is entitled to avail exemption of one house or part of a house or a house plot not exceeding 500 sq.mts. Hence the plot of land measuring 450 sq.mts is exempt.

4. The urban land bought of money standing to the credit of the NRE account is exempt u/s.5(v) of the Wealth Tax Act.

5. In the case of a person of Indian origin who returns to India for permanent settlement any asset acquired out of moneys remitted in to India at any time within one year before the date of return shall qualify for exemption. Hence jewelry bought in February 2007 out of money remitted from London is exempt from wealth tax.

### 6(b) Wealth escaping assessment – Section 17

If the assessing officer has reason to believe that the net wealth chargeable to tax in respect of which any person is assessable has escaped assessment for any assessment year, he may serve a notice on such person notice requiring him to furnish a return in the prescribed form. The notice shall be issued only after recording reasons for the issue of the notice and the return shall be required to be furnished within such period as may be specified in the notice.

The assessing officer is empowered to assess or reassess such net wealth other than the net wealth which is the subject matter of any appeal reference or revision which is chargeable to tax and has escaped assessment.

6(c) Where an assessee is a member of a cooperative society for whom a house was allotted under the house building scheme and where he subsequently ceases to be the member of the society and transfers his membership to his spouse or others he could not be treated as the owner if the property. Therefore the property shall not be assessed to wealth tax in the hands of the assessee subsequent to such transfer. This is held so in the case of *Ram Saran Das Tandon vs CWT 2007 292 ITR 546 (All)*. Hence in the given case the property can not be assessed to wealth tax in the hands of Mr.Rajan.



## IS

Time: 3 Hrs.

Total Marks: 100

**Answer Question No.1, 6, 9 are Compulsory and Answer any Two from Part A and One from Part B**

### 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.

**(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.

**(c)** With reference to Central Excise Act, 1944 and the rules thereunder, 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.

**(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, *interalia*, 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+6+6+4 = 20 marks)**

**2.** An Assessee cleared various manufactured final products during Mar.2008. The duty payable for Mar.2008 on his final products was as follows :- BED : Rs.2,00,000; Education Cess : 2%; SHE Cess : 1%. During the month, he received various inputs on which total duty paid by suppliers of inputs was as follows:- Basic Excise Duty : Rs.50,000; Education Cess : Rs.1000; SHE Cess : Rs.500. Excise Duty paid on Capital Goods received during the month was as follows: - Basic Duty: Rs.12,000, Education Cess : Rs.240; SHE Cess : Rs.120. Service Tax paid on Input Services was as follows :- Service Tax : Rs.10,000; Education Cess : Rs.200; SHE Cess : Rs.100; How much duty the assessee will be required to pay for GAR-7 Challan for the month of Mar.2008, if assessee had no opening balance in his PLA account? What is last date for payment?

**(15 Marks)**

**3. (a)** With reference to the Central Excise Act, 1944 and the Rules made there under write a brief note on the circumstances when personal penalty could be imposed on a director of a company or a partner of a firm or an employee or a transporter. **(4 marks)**

**(b)** M/s MM & Co. a machinery manufacturer effected clearances from its factory with effect from 1.4.2006 by payment of duty under protest and had also filed an appeal against the order for payment of duty . On 15.5.2006 one of its customers M/S BB & Co. had purchased the machines from M/S MM & Co. on 23.5.2007 the appeal filed by M/S MM& Co. was decided in favour of M/s MM & Co. pursuant to the said order in the appeal filed by M/S MM & Co., its customer M/S BB & Co. filed a refund claim on 1.6.2007 claiming refund of duty suffered by M/S BB & Co. . This claim for refund of duty was rejected by the department on the ground of ‘ unjust enrichment ‘ as well as on the ground of ‘ limitation ‘. Explain briefly with reference to section 11B of the central Excise Act 1944 whether the action of the department is correct in law.

**(5 marks)**

**(c)** Explain briefly the following with reference with reference to the provisions of the central Excise Rules, 2002 and relevant notification issued there under with regard to e- payment of duty : The threshold limit for mandatory e- payment of duty - (i) How and in what manner the time of payment would be reckoned under the e-payment system ? (ii) The due dates for payment of duty under the e- payment scheme in respect of an assessee. **(3 x 2 = 6 marks)**

**4. (a)** (i) Define retail sale price in the light of provision of Section 4A of Central Excise Act, 1944 (ii) What are the conditions under which MRP based valuation shall apply under Central Excise (iii) What legal / penal actions can be taken in case the retail sale price is not mentioned or is unduly tampered after the removal? (b) Asha Ltd., supplies raw material to a job worker Kareena Ltd. After completing the job-work, the finished product of 5,000 packets are returned to Asha Ltd. putting the retail sale price as Rs. 20 on each packet. The product in the packet is covered under MRP provisions and 40% abatement is available on it. Determine the assessable value under Central excise law from the following details : \* Cost of Raw material supplied Rs. 30,000/- \* Job worker’s charges including profit Rs. 10,000/- \* Transportation charges for sending the raw material to the job worker Rs. 3,000/- \* Transportation charges for returning the finished packets to Asha Ltd. Rs. 3,000/- **(12+3 = 15 marks)**

**5 (i)** Explain the circumstances in which a refund claim could be admitted and what are the consequences of rejection of refund claim under Central Excise Act? (ii) Explain the significance of ‘relevant date’ as far as claim for refund of duty under the Central Excise Act is concerned. (iii) Discuss whether the provisions relating to ‘Unjust Enrichment’ shall be applicable to the following matters (pertaining to refund of excise duty) – Duty paid as pre-deposit for filing an appeal (iv) Does the refund of penalty attract bar of unjust enrichment?

**(4+4+4+3 = 15 Marks)**

## **Part B**

**6. (a)** Explain briefly with reference to the provisions of the Customs Act, 1962 any two of the following: (i) Adjudicating Authority (ii) Customs area (iii) Smuggling **(4 marks)**

**(b)** State briefly the provisions of refund on anti-dumping duty in certain cases. **(2 marks)**

**(c)** Assessable value of an item imported is Rs.1,00,000/-. Basic Customs duty is 20% and additional duty of customs is 16%, education cess is 2% on duty. Compute the amount of total customs duty payable. Also state the amount of credit available to importer and how can it be utilized by him. **(4 marks)**

**(d)** Your client loaded a Machine on the vessel for export. He has paid import duty and central excise duty on the components used in the manufacture. The vessel set sail from Mumbai, but runs into trouble and sinks in the Indian territorial waters. The customs department refuses to grant duty drawback for the reason that the goods have not reached their destination. Advise your client citing case law, if any. **(4 marks)**

**(e)** India Car Co. is manufacturing passenger cars and has entered into a joint venture agreement and collaboration with Videshi Car Co. - - India Car Co. imported from Videshi Car Co. a shipment of 24 CKD packs (completely knocked down condition) of passenger car components. They filed Bill of Entry for clearing the goods, which were claimed to be components of motor cars. They also claimed benefit of a Notification exempting components, including components of motor cars in semi-knocked down packs and completely knocked down packs. The Adjudicating Authority held that the imported components being complete cars in CKD packs, had the essential character of the finished product and as such the consignment were to be treated as Motor Cars and not components. It was also held that India Car Co. was not entitled to the benefit of the notification as the notification was only for components. The questions for consideration are : (i) Whether the CKD packs imported into the country could be considered to be Motor Cars for the purpose of classification and clearance? (ii) Whether India Car Co. was entitled to the benefit of exemption notification? **(6 marks)**

**7. (a)** Explain briefly with reference to the provisions of the Customs act , 1962 whether the owner of the warehoused goods has the right to relinquish his title to such goods after the expiration of the warehousing period or the extended warehousing period as the case may be and also state whether any charges shall become payable upon such relinquishment. **(5 marks)**

**(b)** State briefly an five illustrative cases under the Customs, Central Excise Duties and service – tax Drawback Rules, 2006, where the all industry Drawback rates will not apply. **(5 marks)**

**(c)** State briefly the provisions of the customs Act , 1962 relating to payment of interest in case of provisional assessment. **(5 marks)**

**8. (a)** Enumerate the penalties in respect of improper exportation of goods under Section 114 of Customs Act.

**(b)** State the difference between transit and transshipment of goods under the provisions of Customs Act.

**(c)** State the ingredients in the case of seizure under Section 123 of Customs Act.

**(d)** Explain the provisions under Section 15 of the Customs Act for determining the rate of duty and tariff valuation of imported goods. **(3+4+4+4 = 15 marks)**

### **PART—C**

**9. (a)** Export of Services Rules, 2005 were made effective from March 15, 2005. Answer the following questions with reference to the said Rules : (i) What are the three categories of taxable services dealt with under Rule 3 ? (ii) What are the three options available to exporter of taxable services under these Rules for claiming exemption or rebate of service tax? **(3 x 2 = 6 marks)**

**(b)** With reference to the Finance Act, 1994 as amended and the rules made thereunder relating to service tax, state whether registration is required or not in the case of the following persons or class of persons : (i) Small service provider whose aggregate value of taxable service is Rs. 3,50,000 per annum (ii) Indian based recipient of taxable services provided from abroad by a non-resident not having any place of business in India. **(1 x 2 = 2 marks)**

**(c)** State whether in the following cases service tax is payable, with reason (i) Temporary transfer of any intellectual property right. (ii) Canteens in office run by the canteen contractor providing service directly to employees/workmen. (iii) Business auxiliary service provided by commission agents in relation to sale of agricultural produce. **(3 Marks)**

**(d)** M/s TCCL, providing management consultancy to its client, do not maintain any separate accounts and have paid Rs. 1,00,000 as service tax and excise duty towards input services and input material/capital goods used by them. They have used the inputs for partially exempted and partially taxable services. They are now providing the output services for which current tax liability is Rs. 1,40,000. How much credit out of Rs. 1,00,000 can be availed by them for paying output service tax liability, if they do not maintain any separate accounts. **(4 Marks)**

**PRIME ACADEMY**  
**28<sup>th</sup> SESSION MODEL EXAM**  
**INDIRECT TAXES**  
**SUGGESSTED ANSWERS**

**Part A**

**1(a)**

**(i) Wholesale Dealer :**

Persons carrying on wholesale trade or dealers in Excise require registration only if they intend to issue Cenvatable issue. Otherwise, they are exempt from Excise Registration.

**(ii) Factory :**

Sec.2(e) of Central Excise Act states that 'factory' means any premises including the precincts thereof, wherein or in any part of which, excisable goods other than salt are manufactured or wherein in any part of which any manufacturing process conduction with production of these is carried on or is ordinarily carried on.

**(iii) Dutiability of Waste and Scrap :**

Waste and Scrap is practically treated as final product for excise purposes. Defective product not usable as such are waste and scrap. Waste and Scrap can be goods, but dutiable only if manufactured and are mentioned in Tariff. However, no duty on waste and scrap if final product is exempt.

**1(b)**

- (i)** No. The statement is false. In view of CBEC Circular No.665/56/2002-Cs. Dated 25.9.2002 and also the decision of the Tribunal in Bharat Forge Vs. CCE – 2004(165) ELT 339 (CESTAT) – Cenvat Credit is available on capital goods used in manufacture of exempt intermediate product, if final product is dutiable.
- (ii)** The Statement is partially correct. As per Rule 3(4)(b) of Cenvat Credit Rules, the manufacturer can clear the inputs as such provided he pays the amount equal to the credit availed. Here, for excise purposes, the criteria is only on clearance and not on sale and hence, the word sale is not correct and it should be on clearance and the moment the item is cleared from the factory, the excise levy would be attracted.

- (iii) (1) The statement is incorrect. Manufacturer is not eligible to take Cenvat Credit on trial run. The same view is held in CCE Vs. English Electric Company – 1997 (97) ELT 293 (CEGAT) that R&D exercise is not input and is not eligible as inputs as the process is not integrally connected with the manufacturing process.
- (iii) (2) This statement is also not correct. Building material used for factory building are not eligible. The same view has been held in JK Cotton Spinning & Weaving Mills case.

**1(c)**

- (i) Yes. As per Rule 9(2) of Central Excise Rules, Persons who manufacture excisable goods which are unconditionally exempt from Excise Duty are exempt from excise registration. Hence, persons who manufacture excisable goods chargeable to 'nil' rate of duty do not require excise registration.
- (ii) Central Government Undertakings manufacturing excisable goods need to register under Excise.
- (iii) EOU units procuring goods from DTA or supplying goods to DTA are required to be registered. EOU Unit having no inter-linkage with domestic economy through sale or purchase of goods need not register.

**1(d)**

In view of the definition of Wholesale Package – it includes packages containing 10 or more than 10 retail packages where the retail packages are labeled as required under the rules – rule 2(x) and such packages also contain declaration as specified in rule 29 of Standard of Weights and Measures (Packaged Commodities) Rules, 1977 e.g., name and address of the manufacturer/packer, identity of commodity and number of retail packages contained in such wholesale package or net quantity. *Such package is not required to indicate MRP. Hence, provisions of MRP do not apply.* In this case also, since the Cardboard boxes are part of the wholesale packages only and it contain the details as required and hence, are not covered by the provisions of MRP and the activity does not amount to manufacture.

**2**

Education Cess payable on final products is Rs.4,000 (2% on 2,00,000) and SHE Cess is Rs.2,000 (1% on Rs.2,00,000)

The Cenvat Credit available for Mar.2008 is as follows:

| Description                                                            | Basic Duty<br>(RS) | Service Tax<br>(RS) | Education Cess<br>(RS) | SHE Cess<br>(RS) |
|------------------------------------------------------------------------|--------------------|---------------------|------------------------|------------------|
| Inputs                                                                 | 50,000             | -                   | 1,000                  | 500              |
| Capital Goods<br>(50% will be<br>eligible and<br>balance next<br>Year) | 6,000              | -                   | 120                    | 60               |
| Input Service                                                          | -                  | 10,000              | 200                    | 100              |
| Total                                                                  | 56,000             | 10,000              | 1,320                  | 660              |

Credit of RS 6,000 ( RS 56,000 + RS 10,000) can be utilized for the basic duty credit and education and SHE Cess can be utilized only for payment of education and SHE Cess on final products only.

Hence, duty payable through GAR-7 Challan for Mar.2008 is as follows :

|                                            | Basic Duty (Rs.) | Edn. Cess (Rs.) | SHE Cess (Rs.) |
|--------------------------------------------|------------------|-----------------|----------------|
| (A) Duty payable                           | 2,00,000         | 4,000           | 2,000          |
| (B) Cenvat Credit                          | 66,000           | 1,320           | 660            |
| (C) Net amount<br>payable by Cash<br>(PLA) | 1,34,000         | 2,680           | 1,340          |

Last date for payment is 31<sup>st</sup> Mar. 2008.

3(a)

Any person who acquires procession of or in any way concerned in transporting, removing, depositing, keeping, concealing, selling or purchasing in any manner deals with any excisable goods which he knows or has reason to believe or liable to confiscation under the Act or rules shall be liable to penalty upto the duty payable on such goods or Rs.2,000 whichever is greater – Rule 26(1) of Central Excise Rules. Rule 26 imposes personal liability of penalty. Thus, a director or partner or an employee or transporter will be personally liable to penalty, if he is personally involved in clandestine

removal. There is a case law that penalty cannot be imposed on partner, if penalty is imposed on firm.

Penalty on Managing Director under Rule 209A can be imposed only if there is finding that the person concerned acquired possession of or otherwise physically dealt with, excisable goods with knowledge or belief that such goods are liable to confiscation.

### 3(b)

The action of the department is not correct. With regard to filing of refund claim - it can be lodged within one year from 'relevant date' in the prescribed form. It can be lodged by the manufacturer if he has not passed on the burden to the buyer or by a buyer, if he has not passed on the incidence to another person.

'Relevant Date' for calculation of one year period under Sec.11B – in the case of refund claim filed by purchaser, the date of purchase of goods. In the instant case, the date of purchase of goods is 15.5.2006 and technically, it is 14.5.2007 is the last date for filing refund claim.

But, this date is not applicable in cases where duty becomes payable consequence of judgement, decree, order or direction of appellate authority and the one year period will be counted from the date of order and in the instant case, the order date is 23.5.2007 and hence, filing of refund claim on 1.6.2007 is not barred by limitation. Further, initially, payment of duty made by the manufacturer at the time of clearance is 'Under Protest' payment and as per Sec.11B, if the duty is paid under protest, the limitation aspect itself will not apply.

As far as Unjust Enrichment is concerned, had the refund claim been filed by M/s.MM & Co., then the limitation aspect will apply. Here, the claim being filed M/s.BB & Co., the purchaser of the goods, who has to show that the machineries are still lying with them and the amount is shown as recoverable in their books and Unjust Enrichment will also not apply and they are rightly entitled for refund.

### 3(C)

E-payment is a mode of payment in addition to conventional methods of payment offered by the banks under specific security norms of Reserve Bank of India. This scheme facilitates anytime, anywhere payment and an instant cyber receipt is generated once the transaction is complete. It provides for convenience of making online payment of Central Excise and Service Tax through Bank's Internet banking service. About 28 banks are authorized for this purpose.

Proviso to Rule 8(i) makes e-payment mandatory for payment of duty by all assessees who have paid excise duty of Rs.50 lakhs or more in cash during the preceding financial year (i.e) w.e.f 1.4.2007.



- (i) Time of payment : This is 24 X 7 facility. Payment can be made anytime from anywhere. All payments effected upto 8 p.m. will be accounted for the day as that day's receipt. Payment effected after 8.00 p.m. will be accounted as the next working day's receipt.
- (ii) The due date for payment of duty under e-payment for the assesses is 6<sup>th</sup> of next month (i.e) for the clearances effected / services provided during the month of January, payment of duty can be effected on 6<sup>th</sup> of Feb. (5<sup>th</sup> for normal route). But, for the month of March, even for e-payment the last date of payment is 31<sup>st</sup> March.

**4(a)(i)**

**Retail Sale Price :-** As per Weights and Measures Act, retail price indicated on the retail package should be inclusive of all taxes. In case of scheduled drugs covered under DPCO (Drugs (Price Control) Order, 1995, the retail price to be indicated was required to be exclusive of taxes. However, with effect from 2.10.2006, even in case of drugs, price on retail package is required to be inclusive of taxes, local or otherwise.

Till 2.10.2006, drug prices were required to be indicated inclusive of local taxes. Sec.4A provision can be made applicable in either case.

**4(a)(ii)**

It has been clarified that provisions in respect of payment of duty on MRP are applicable only in cases where specific notification has been issued and manufacturer is statutorily required to put MRP under Weights & Measures Act. The provisions do not apply in cases where manufacturer voluntarily affixes MRP on product. CBEC Circular No.411/44/98-Cx. Dated 31.7.98. CBEC has further clarified in Circular NO.737/53/2003-Cx. Dated 19.8.2003 that when goods covered under Sec.4A are supplied in bulk to large buyer (not in retail), valuation is required to be done under Sec.4. Provisions of Sec.4A will apply only where manufacturer is legally obliged to print MRP on the packages of goods. Thus there can be instances where the same commodity would be partly assessed on basis of Sec.4A and partly on basis of Transaction Value under Sec.4.

**4(a)(iii)**

Sec.4A(4)(b) provides that if a manufacturer tampers with, obliterates or alters retail sale price declared on the package of such goods, after removal from place of manufacture, the goods are liable to confiscation. In such case, the 'retail sale price' will be ascertained in the prescribed manner and duty will be payable as per the retail price so determined.

The provision applies only if such tempering, altering or obliteration is done by 'manufacturer'. Thus, if someone else does it, the goods will not be liable to confiscation. Usually, once goods are cleared from the factory, manufacturer has little control over what is done to goods.

**4(b)**

Provisions of Sec.4A are overriding provisions, i.e, if a product is covered under the provisions of Sec.4A, valuation will be on the basis of provisions of Sec.4A and not on the basis of material cost plus job charges.

Hence, in this case, Assessable Value is Rs.12 per piece (after allowing 40% abatement from MRP). The assessable value is Rs.60,000 (5000 X 12),

**5(i)**

Refund claim could be filed for any reason during normal period of limitation and in cases of duty payment 'under protest' time limit aspect will not apply. The refund claim will be scrutinized by range office. Scrutiny should be completed within 2 weeks and report should be submitted to AC/DC. Claim will also be scrutinized in division office and if there is deficiency the same should be intimated to the applicant within 15 days.

Any rejection of refund claim and sanction of refund claim should be made only through an Order-in-Original. If the refund claim is rejected through an order, there is appealable remedy and the assessee can seek legal remedies through higher adjudicating authorities.

**5(ii)**

'Relevant Date' has been defined in Explanation B to Sec.11B as under :-

- In case of exports (a) when the ships or aircrafts leaves India (b) if the goods are exported by land, the date on which the goods leave India frontier (c) if export is by post, the date of despatch of goods by post office to a place outside India.
- If compounded levy scheme is applicable, if assessee pays the full duty and if rate is subsequently reduced by Government, then date on which notification regarding reduction of rate is published.
- In case of refund claim filed by purchaser, date of purchase of the goods.
- If duty is exempted by a special order under Sec.5A(2) the date of issue of such order.
- If duty was paid on provisional basis, the date of adjustment of duty after final assessment of duty,
- In other cases, date of payment of duty
- Where duty becomes refundable as a consequence of judgement, decree, order or direction of appellate authority, CESTAT or any Court, date of such judgement, decree or direction.

**5(iii)**

No. The provisions of Unjust Enrichment shall not be applicable in cases of refund of excise duty under Sec.11B of CEA '44 and customs duty under Sec.27(2) of Customs Act. Hence, the duty paid as pre-deposit will not be attracted by Unjust Enrichment provisions.

5(iv)

No. As per provisions to Sec.11B(2), penalty or fine imposed, bar of unjust enrichment does not apply.

### **Part B**

6(a)(i)

#### **Adjudicating Authority :**

As per Sec.2(1) of Customs Act 'Adjudicating Authority' means any authority competent to pass any order or decision under Customs Act, but does not include CBEC, Commissioner (Appeals) or Tribunal (CESTAT).

6(a)(ii)

#### **Customs Area :**

Customs area means all area of Customs Station and includes any area where imported goods or exported goods are ordinarily kept pending clearance by Customs Authorities. (Sec.2(11) of Customs Act). Thus, 'Customs Area' could include some area even outside the 'Customs Station' which means (a) Customs Port; (b) Customs Airport and (c) Land Customs Station

6(a)(iii)

#### **Smuggling :**

Smuggling in relation to any goods means any act or omission which will render such goods liable for confiscation under Sec.111 or 113 (Sec.2(39)). Thus, improper importation attempting improper export will amount to 'smuggling'. Thus, 'smuggling' is much broader term than we normally understand.

6(b)

#### **Provisions of Refund of Anti-Dumping Duty in certain cases :**

If importer proves that anti-dumping duty imposed is more than the actual margin of dumping, he will be entitled to refund – Sec.9AA of Customs Act, 1975.

In Caprihans India Vs. CC (2001 (129) ELT 162 (CEGAT)), it was held that anti-dumping duty collected is not a 'duty of customs' leviable under Customs Act. It was also held that if anti dumping duty collected on

provisional duty is higher than the final duty fixed, the difference is refundable. Provisions of unjust enrichment or time limit for filing claim specified in Sec.27 of Customs Act does not apply. If refund is not made within 3 months from finalization of the anti-dumping duty, compensation by way of interest @ 12% is payable to importer.

6(c)

**Calculation of Customs Duty Payable by the Importer :**

|                                                |                     |
|------------------------------------------------|---------------------|
| <b>Assessable Value of an Item :</b>           | <b>Rs.1,00,000</b>  |
| <b>Basic Customs Duty at 20%</b>               | <b>Rs.20,000</b>    |
| <b>CVD at 16.32% or 19.584% of Rs.1,00,000</b> | <b>Rs.19,584</b>    |
| <b>Education Cess @ 2% or 0.79168%</b>         | <b>Rs.791.68</b>    |
| <b>Total Customs Duty Payable is</b>           | <b>Rs.40,375.68</b> |
| <b>Amount of Credit that can be utilized</b>   | <b>Rs.19,584</b>    |

Though the CVD amount can be utilized (provided the importer is a manufacturer), if the item of import is raw material or component viz., input then it can be availed as Credit in his Cenvat account. However, if the imported item is a Capital Goods, then he can avail only Rs.9,792 in this financial year and the balance amount can be availed as credit only in the next financial year.

6(d)

Duty Drawback is a facility which is granted on Customs Duty and Excise Duty on manufacture to the exporter. But, Sec.75 of Customs Act, 1962 provides for disallowance of duty drawback in certain cases and in the list – realization of sale proceeds of export goods is a main criteria for granting drawback and if sale proceeds is not realized within the time stipulated by RBI, then the drawback is subject to disallowance.

In the present case, the goods has not reached the destination or the goods has not even crossed Indian Territorial Waters and hence, goods cannot be said to have exported and the question of realization of export proceeds from end customer arise. It is a benefit granted for export community and when the export itself has not taken place, the question of granting the benefit does not arise at all. The department is right in disallowing the credit.

6(e)(i)

As per Rule 2(a) any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule) presented unassembled or dis-assembled.

This rule lays emphasis on the essential character of the goods. Thus goods which have the essential character of finished goods will be classified under the same heading in which final product has to be classified.

In the given case, the passenger components as such cannot be treated as finished product as it is in a completely knocked down condition. The basic requirement of incomplete or unfinished article should have the essential character of finished goods is missing here.

Unless manufacturing and further activity is carried out on the Passenger Car Components, the final product viz., Motor Car will not come into existence. Otherwise, the components as such does not have the essential character of finished goods as it has to undergo manufacturing process and only after the said process, final product will be manufactured. Therefore, the CKD packs which were cleared has to be classified only as Components of Motor Cars and cannot be considered as Motor Cars as such for the purpose of clearance. In fact, in the decision of TELCO Vs. CC 1990 (50) ELT T-B2, it was held that synchrocones are components of automobiles. Forgings for synchrocones cannot be treated as parts of automobiles in view of extensive operations to be carried on, on the forgings. In view of that it cannot be said that they have the essential character of finished product. The said decision is squarely applicable to this case.

**6(e)(ii)**

Yes. India Car is entitled for claiming exemption under Notification as the said exemption is applicable if the components of motor cars are imported in semi-knocked down and completely knocked down condition. Whatever is imported in this case is CKD packs of Motor Cars only and as the condition stipulated in the notification is fulfilled, the company is entitled to claim exemption.

**7(a)**

As per Customs provisions, the owner of warehoused goods can relinquish the title of goods any time before order for home clearance is made. He will be required to pay rent, interest, other charges and penalties that may be payable, but will not be payable. However, it has been consistently held that when duty is not payable, question of payment of duty does not arise.

In view of the aforesaid provisions, it is clear that the owner of the Warehoused goods has the right to relinquish his title to such goods after the expiration of the warehousing period and also even after extension of the warehousing period.

**7(b)**

All Industry Drawback rates do not apply to following – para 7 Notification No.81/2006-Cus (NT) dated 13.7.2006:

1. Goods manufactured in Customs Bonded Warehouse
2. Manufactured in discharge of obligation against Advance Licence Scheme (However, excise portion of duty drawback is allowed).
3. Goods imported against Duty Free Replenishment Certificate (DFRC) (However, excise portion of drawback rate is allowable).
4. Exports by EOU or SEZ Unit
5. Goods exported after obtaining rebate of excise duty on inputs under rule 18 of Central Excise Rules
6. Goods exported without payment of duty under rule 19(2). (However, Customs portion of drawback rate will be allowable).
7. Goods manufactured or exported under DEPB Scheme

**7(c)**

Sec.18(3) of Customs Act provided that if differential amount is found to be payable, it will be paid with interest at rate prescribed under Sec.28AB of Customs Act, from the first day of the month in which duty is provisionally assessed till date of payment.

Sec.18(4) of Customs Act provides that if any amount is refundable after final assessment (subject to doctrine of unjust enrichment), interest will be payable if refund is not granted within 3 months. Interest will be at the rate specified under Sec.27A of Customs Act.

**8(a)**

Sec.114 provides following penalty for attempt to improper export (i) if goods are prohibited for export under any law, not exceeding the value of goods or Rs.5,000 whichever is higher (ii) if goods are liable to export duty, but not prohibited goods, penalty not exceeding duty sought to be evaded or Rs.5,000 whichever is higher (iii) In case of other goods, penalty not exceeding the value of goods, as declared by exporter, or as value determined under Customs Act, whichever is greater.

**8(b)**

1. While Transit goods continue to be on same vessel, Transshipment goods are transferred to another vessel.
2. Transit goods are transited without payment of duty to any place out of India or any Customs Station. Transshipment goods may be to any major port or airport in India.
3. No bond is required for Transit of goods while Bonds needs to be executed for transshipment of goods.
4. While no requirement of production of certificate from Customs Officer for transit of goods, after execution of bond a Certificate from Customs Officer has to be submitted within one month that goods have been properly transferred is required for transshipment of goods.
5. No 'Bill of Transit' is present in Transit, 'Bill of Transshipment' is required to be submitted to Customs Officer for transshipment of goods.

## **PART—C**

### **9(a)(i)**

**Three categories of Taxable Services dealt with under Rule 3 ;-**

- (i) Immovable property is situated abroad**
- (ii) Services performed outside India**
- (iii) Recipient located outside India**

### **9(a)(ii)**

**Export of Services has three Options :**

- (a) Export without payment of service tax and utilize Cenvat Credit for payment of Service Tax and other services.**
- (b) Export without payment of service tax and claim rebate of service tax paid on input services and excise duty paid on inputs**
- (c) Pay service tax on exported services and claim rebate (and in this route, utilization of input credit is possible).**

### **9(b)**

- (i) As the Service Tax exemption limit is Rs.8,00,000 – a small scale service provider whose aggregate value of taxable service is Rs.3,50,000 per annum need not have to obtain Service Tax Registration**
- (ii) If a Service Receiver is not having any place of business in India in cases of services provided from abroad – first whether the category falls within the ambit of the Category C of Import of Services Rules – location of Service Recipient in India needs to be looked into. Anyhow, in this case, since the service receiver does not have an office, the question of registration under Service Tax does not arise at all.**

### **9(c)**

- (i) Yes. Under 65(55b) of the Finance Act, 'Intellectual Property Service' includes transferring temporarily. Hence, it is taxable.**
- (ii) No. With effect from 16.6.2005, outdoor caterer means any person a caterer entered in providing services in connection with catering at a place other than his own, but including a place provided by way of tenancy or otherwise by the person receiving such service.**

**If the service is provided to employees / workmen, then the canteen will not come within the new definition, since the place is not provided by the person receiving the service.**

(iii) No. Services of commission agents in relation to sale or purchase of agricultural produce are exempt from service tax vide Notification No.13/2003-ST dated 26.3.2003. Though till 8.7.2004, services of all commission agents were exempt, presently the exemption applies only to commission agents in relation to sale or purchase of agricultural produce.

9(d)

If an assessee does not maintain separate accounts, he can utilize Cenvat only upto 20% of tax payable on taxable output service. Mr.TCCL can utilize credit of Rs.28,000 of his input service for payment of output service and balance of Rs.1,12,000 he needs to pay in cash. However, he is entitled to avail Credit of Rs.72,000 in his Service Tax (Receivable) account and it may remain in his account. He can utilize the same in future, only if any opportunity arises.