PAPER – 5 : COST MANAGEMENT

Answer all the questions.

Working notes should form part of the answer

Question 1

(a) X Ltd. is engaged in the production of four products: A, B, C and D. The price charged for the four products are Rs.180, Rs.175, Rs.130 and Rs.180 respectively, Market research has indicated that if X Ltd can reduce the selling prices of its products by Rs.5, it will be successful in getting bulk orders and gain a significant share of market of those products. The company's profit markup is 25 per cent on cost of the product. The relevant information of products are as follows:

Products	A	B	C	D
Output in units	600	500	400	600
Cost per unit:				
Direct material (in Rs.)	40	50	30	60
Direct labour (in Rs.)	28	21	14	21
Machine hours (per unit)	4	3	2	3

The four products are usually produced in production runs of 20 units and sold in batches of 10 units. The production overhead is currently absorbed by using a machine hour rate, and the total of the production overheads for the period has been analysed as follows:

	(Rs.)
Machine department costs	52,130
Setup costs	26,250
Stores receiving	18,000
Inspection/Quality Control	10,500
Material handling and dispatch	23,100

The cost drivers to be used for the overhead costs are as follows:

Cost	Cost drivers
Setup costs	Number of production runs
Store receiving	Requisitions raised
Inspection/Quality control	Number of production runs
Materials handling and dispatch	Order executed

The number of requisitions raised in the stores was 100 for each product and the number of orders executed was 210, each order being for a batch of 10 units of a product.

You are required:

(i) To compute the target cost for each product.

(ii) To compute total cost of each product using activity based costing.

(iii) Compare target cost and activity based cost of each product and comment whether the price reduction is profitable or not. (12 Marks)

(b) A company is launching a new product and has made estimates of the time for the various activities associated with the launch as follows:

Activity	Predecessor	Times (Days) Optimistic	Most likely	Pessimistic
A	None	1	3	5
B	None	3	4	5
C	A, B	1	3	11
D	B	3	3	9
E	A	1	2	3
F	C	2	5	14
G	E, F	2	3	4
H	D, F	2	2	2
I	G, H	10	10	10

Required:

(i) Draw the network diagram.

(ii) Calculate the expected time and variance of each activity.

(iii) Find out the expected length of critical path and its standard deviation.

(iv) Find the probability that the launching will be completed in 27 days.

(v) Find the duration, which has 95% probability of completion. (8 Marks)

(c) The following information is provided by a firm. The factory manager wants to use appropriate average learning rate on activities, so that he may forecast costs and prices for certain levels of activity.

(i) A set of very experienced people feed data into the computer for processing inventory records in the factory. The manager wishes to apply 80% learning rate on data entry and calculation of inventory.

(ii) A new type of machinery is to be installed in the factory. This is patented process and the output may take a year for full fledged production. The factory manager wants to use a learning rate on the workers at the new machine.

(iii) An operation uses contract labour. The contractor shifts people among various jobs once in two days. The labour force performs one task in 3 days. The manager wants to apply an average learning rate for these workers.

You are required to advise to the manager with reasons on the applicability of the learning curve theory on the above information. (4 Marks)

Answer

(a) (i) The target cost of each product after reduction is computed as follows:

Product	Present Price (Rs)	Proposed Price (Rs)	Target Cost (Rs) (with 25% Margin)
A	180	175	140
B	175	170	136
C	130	125	100
D	180	175	140

(ii) Statement showing cost/unit of Driver as per ABC

Cost	Amount	Driver	No.	Cost/unit of Driver
Set-ups	26,250	Production runs	105*	Rs.250.00
Stores receiving	18,000	Requisition	400**	Rs.45.00
Inspection/Quality	10,500	Production runs	105	Rs.100.00
Handling/Dispatch	23,100	Orders	210	Rs.110.00
Machine Department	52,130	Machine Hrs.	6,500	Rs.8.02

* Production runs = (600/20) + (500/20) + (400/20) + (600/20) = 105

** Requisitions = 100 for each product or 400 total

Machine hours = 2,400 + 1,500 + 800 + 1,800 = 6,500 hours.

Statement showing Total Cost and Cost Per Unit as per ABC

Item	A Rs.	B Rs.	C Rs.	D Rs.
Direct Material	24,000	25,000	12,000	36,000
Direct Labour	16,800	10,500	5,600	12,600
Set-up	7,500	6,250	5,000	7,500
Stores receiving	4,500	4,500	4,500	4,500
Inspection/Quality	3,000	2,500	2,000	3,000
Handling/Dispatch	6,600	5,500	4,400	6,600
Machine Dept. Cost	19,248	12,030	6,416	14,436
Total Cost	81,648	66,280	39,916	84,636
Output (Units)	600	500	400	600
Cost per unit	136.08	132.56	99.79	141.06

(iii) Comparison of Actual Cost and Target Cost

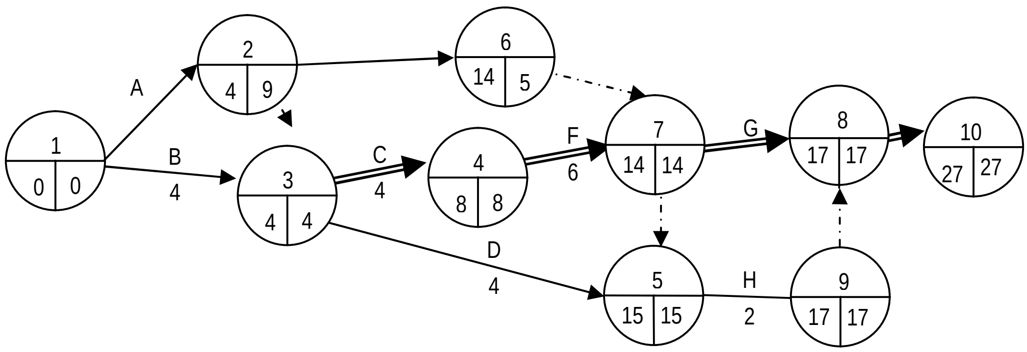
Cost	A	B	C	D
	Rs.	Rs.	Rs.	Rs.
Actual	136.08	132.56	99.79	141.06
Target	140.00	136.00	100.00	140.00
Difference	(-) 3.92	(-) 3.44	(-) 0.21	(+) 1.06

Comment:

The total actual cost of A, B and C product is less than the target cost so there is no problem in reducing the cost of these product by Rs.5 from the present price. It will increase the profitability of the company but the cost of D is slightly more than the target cost, it is therefore, suggested that the company should either control it or redesign it.

(b) (i) Network Diagram

Critical Path B → C → F → G → Z



(ii) Calculation of Expected Time, Standard Deviation and Variance of Activities

Activity	Expected Time $t_e = \frac{t_0 + 4t_m + t_p}{6}$	Standard Deviation $S = \frac{t_p - t_o}{6}$	Variance σ^2
A (1-2)	$\frac{1+12+5}{6} = 3$	$\frac{5-1}{6} = 0.67$	0.44
B (1-3)	$\frac{3+16+5}{6} = 4$	$\frac{5-3}{6} = 0.33$	0.11

C (3-4)	$\frac{1+12+11}{6}=4$	$\frac{11-1}{6}=1.67$	2.78
D (3-5)	$\frac{3+12+9}{6}=4$	$\frac{9-3}{6}=1.00$	1.00
E ((2-6)	$\frac{1+8+3}{6}=2$	$\frac{3-1}{6}=0.33$	0.11
F (4-7)	$\frac{2+20+14}{6}=6$	$\frac{14-2}{6}=2.00$	4.00
G (6-8)	$\frac{2+12+4}{6}=3$	$\frac{4-2}{6}=0.33$	0.11
H((5-9)	$\frac{2+8+2}{6}=2$	$\frac{2-2}{6}=0$	0
I (8-10)	$\frac{10+40+10}{6}=10$	$\frac{10-10}{6}=0$	0

(iii) S.D. of Critical Path

$= \sqrt{\text{Total of variance of Critical Activities}}$

$= \sqrt{0.44+2.78+4+0.11+0}$

$= \sqrt{7.33}$

= 2.71

(iv) Probabilities of completion of job in 27 days.

X = 27 Days

$Z = \frac{27-27}{2.71}=0$

For Z = 0 the probability is 0.5 from the table of area under normal curve or 50%.

(v) For 95% of area the corresponding Z value is 1.64 (from the table).

Therefore,

$1.64 = \frac{X-27}{2.71}$

X = 27 + 4.44 = 31.44 Days

(c) The learning curve does not apply to very experienced people for the same job, since time taken can never tend to become zero or reduce very considerably after a certain range of output. This is the limitation of the learning curve.

(i) Data entry is a manual job so learning rate theory may be applied. Calculation of inventory is a computerized job. Learning rate applies only to manual labour.

(ii) Learning rate should not be applied to a new process which the firm has never tried before.

(iii) The workers are shifted even before completion of one unit of work. Hence learning rate will not apply.

Question 2

(a) The following information relates to a manufacturing concern:

Standard	Rs.
Material A 24,000 kgs @ Rs.3 per kg.	72,000
Material B 12,000 kgs @ Rs.4 per kg	48,000
Wages 60,000 hours @ Rs.4 per hour	2,40,000
Variable overheads 60,000 hours @ Re.1 per hour	60,000
Fixed overheads 60,000 hours @ Rs.2 per hour	1,20,000
Total Cost	5,40,000
Budgeted profit	60,000
Budgeted sales	6,00,000
Budgeted production (units)	12,000
Actual	**Rs.**
Sales (9,000 units)	4,57,500
Material A consumed 22,275 kgs.	62,370
Material B consumed 10,890 kgs.	44,649
Wages paid (48,000 hours)	1,91,250
Fixed Overhead	1,20,900
Variable overhead	45,000
Labour hours worked	47,700
Closing work in progress	900 units
Degree of completion:	
Material A and B	100%
Wage and overheads	50%

You are required to:

(i) Calculate all the material and labour variances.

(ii) Calculate variable overhead expenditure and efficiency variances, fixed overhead expenditure and volume variances and sales price and sales volume variances.

(10 Marks)

(b) Mr. X has taken a shop on lease and made a down payment of Rs.2,50,000. Additionally, the rent under lease amount is Rs.96,000 per annum. If lease agreement is cancelled by Mr. X, then the initial payment is forfeited. Mr. X plans to use the shop for the shop for the general stores business, and has estimated operations for the next year as follows:

Sales	Rs.25,00,000	
Less: value added tax (VAT)	Rs.2,80,000	
Sales after VAT		22,20,000
Cost of goods sold		
Wages and wages related cost	12,50,000	
Rent including down payment	2,76,000	
Rent including down payment	3,46,000	
Rates, lighting and insurance	2,80,000	
Audit, legal and general expenses	50,000	22,02,000
Net profit before tax		18,000

In the business, Mr. X will be devoting of half time, however no provision has been made for his remuneration/salary. Mr. X also has an option to sublet the shop to his friend for a monthly rent of Rs.18,000, if he does not use the shop himself.

You are required to:

(i) Identify the sunk and opportunity cost in the above problem.

(ii) State most profitable decision, which should be taken by Mr. X, supporting with appropriate calculation. (5 Marks)

(c) Explain four P's of quality improvement principles. (4 Marks)

Answer

(a) (i) Statement of Equivalent Production in Units

Particulars	Materials		Wages & Overheads	
	% age	Units	% age	Units
Units Completed	100%	9000	100%	9000
Closing W.I.P.	100%	900	50%	450
Equivalent Units		9900		9450

Material Variances

	Standard qty for actual output ** x std price		Actual qty X actual price	
Material A	19,800 @ 3	= 59,400	22,275@2.8*	= 62,370
Material B	9,900 @ 4	= 39,600	10,889 @4.1*	= 44,649
	29,700	99,000	33,165	1,07,019

*Actual Cost / Actual Quantity

** Standard Quantity for actual output = (std qty/ budgeted prod) x actual output

MCV = TSC – TAC

= 99,000 – 1,07,019 = 8,019 (A)

MPV = AQ (SP – AP)

A	= 22,275 (3 – 2.80) =	4,455 (F)
B	= 10,890 (4 – 4.10) =	1,089 (A)
		3,366 (F)

MUV = SP (SQ – AQ)

A	= 3 (19,800 – 22,275) =	7,425 (A)
B	= 4 (9,900 – 10,890) =	3,960 (A)
		11,385 (A)

MMV = SP (RSQ – AQ)

A	= 3 {19,800 ÷ 29,700 × 33,165 – 22,275} =	495 (A)
B	= 4 {9,900 ÷ 29,700 × 3,165 – 10,890} =	660 (F)
		165 (F)

MYV = S. C Per Unit (S. O. For Actual Mix – A. O.)

= 99,000 ÷ 9,900 {9,900 ÷ 29,700 × 33,165 – 9,900}

= 10 (11.055 – 9,900) = 11,550 (A)

Labour Variances:

LCV = TSC – TAC

= 2,40,000 ÷ 12,000 × 9,450 – 1,91,250 = 2,250 (A)

LRV = AH (SR – AR)

= 48,000 {4 – (1,91,250 ÷ 48,000)} = 750 (F)

LITV = No. of Idle hours × SR

= 48,000 – (47,500 ÷ 4) = 1,200 (A)

LEV = SR (SH – AH)

= 4 {(60,000 ÷ 12,000) × 9,450 – 47,700} = 1,800 (A)

(ii) Variable Overhead Variances

VOC = Recovered Overheads – Actual Overheads

= 9,450 × 5 – 45,000 = 2,250 (F)

V.O (Exp.) V = Standard V.O. – Actual V.O.

= 47,700 × 1 – 45,000 = 2,700 (F)

V.O. (Eff.) V = Recovered Overheads – Standard Overheads

= 9,450 × 5 – 47,700 = 450 (A)

Fixed Overheads Variances

FOCV = Recovered Overheads – Actual Overheads

= (1,20,000 ÷ 12,000) × 9,450 – 1,20,900 = 94,500 – 1,20,900

= 26,400 (A)

F.O.(Exp.) V = Budgeted Overheads – Actual Overheads

= 1,20,000 – 1,20,900 = 900 (A)

FOVV = Recovered Overheads – Budgeted Overheads

= 95,500 – 1,20,000 = 25,500 (A)

Sales Variances

Sales Price Variance = Actual Unit Sold (SP – AP)

= 9,000 {50 – (4,57,500 ÷ 9,000)} = 7,500 (F)

Sales Volume Variance (Contribution Loss)

= S. R. of Profit (Budgeted Qty. – Actual Qty.)

= (60,000 ÷ 12,000) (12,000 – 9,000) = 15,000 (A)

(b) (i) The down payment of Rs.2,50,000 represents a sunk cost.

The lost profit from subletting the shop of Rs.1,20,000 per annum arrived as:

(18,000 × 12) – 96,000 = 1,20,000 is an example of an opportunity cost.

The salary amount is not given is also an opportunity cost lost.

(ii) The relevant information for running the shop is:

	(Rs.)
Net Sales	22,20,000
Less: Costs (22,02,000 – 2,50,000) (sunk cost excluded for decision making purpose)	19,52,000
Gross Margin	2,68,000
Less: Opportunity cost from subletting	1,20,000
Profit	1,48,000

As profit is more than opportunity cost, the most profitable decision is to carry on business in the shop.

(c) The Four P's quality improvement principles are as below:

1. People: It will quickly become apparent that some individuals are not ideally suited to the participatory process. Lack of enthusiasm will be apparent from a generally negative approach and a tendency to have prearranged meeting which coincide with the meetings of TOM teams.
2. Process: The rhetoric and inflexibility of a strict Deming approach will often have a demotivating effect on group activity.
3. Problem: Experience suggests that the least successful groups are those approaching problems that are deemed to be too large provide meaningful solutions within a finite time period.
4. Preparation: A training in the workings of Deming- like processes is an inadequate preparation for the efficient implementation of a quality improvement process.

Question 3

(a) At a small store of readymade garments, there is one clerk at the counter who is to check bills, receive payments and place the packed garments into fancy bags. The arrival of customer at the store is random and service time varies from one minute to six minutes, the frequency distribution for which is given below:

Time between arrivals (minutes)	Frequency	Service Time (in minutes)	Frequency
1	5	1	1
2	20	2	2
3	35	3	4
4	25	4	2
5	10	5	1
6	5	6	0

The store starts work at 11 a.m. and closes at 12 noon for lunch and the customers are served on the "first came first served basis".

Using Monte Carlo simulation technique, find average length of waiting line, average waiting time, average service time and total time spent by a customer in system.

You are given the following set of random numbers, first twenty for arrivals and last twenty for service:

64	04	02	70	03	60	16	18	36	38
07	08	59	53	01	62	36	27	97	86
30	75	38	24	57	09	12	18	65	25
11	79	61	77	10	16	55	52	59	63

(9 Marks)

(b) What is Margin of safety? How, margin of safety can be improved? (5 Marks)

(c) Explain briefly stages involved in the process of Bench marking. (5 Marks)

Answer

(a) From the frequency distribution of arrivals and service times, probabilities and cumulative probabilities are first worked out as shown in the following table:

Time between arrivals	Frequency	Probability	Cum. Prob.	Service Time	Frequency	Prob.	Cum. Prob.
1	5	0.05	0.05	1	1	0.10	0.10
2	20	0.20	0.25	2	2	0.20	0.30
3	35	0.35	0.60	3	4	0.40	0.70
4	25	0.25	0.85	4	2	0.20	0.90
5	10	0.10	0.95	5	1	0.10	1.00
6	5	0.05	1.00	6	0	0.00	1.00
Total	100				10		

The random numbers to various intervals have been allotted in the following table:

Time between arrivals	Probability	Random numbers allotted	Service Time	Probability	Random numbers allotted
1	0.05	00-04	1	0.10	00-09
2	0.20	05-24	2	0.20	10-29
3	0.35	25-59	3	0.40	30-69
4	0.25	60-84	4	0.20	70-89
5	0.10	85-94	5	0.10	90-99
6	0.05	95-99	6	0.00	-

Simulation Work Sheet

Random Number	Time till next arrival	Arrival Time a.m.	Service begins a.m.	Random number	Service time	Service Ends a.m.	Clerk Waiting time	Customer waiting Time	Length of waiting line
64	4	11.04	11.04	30	3	11.07	04	-	-
04	1	11.05	11.07	75	4	11.11	-	2	1
02	1	11.06	11.11	38	3	11.14	-	5	2
70	4	11.10	11.14	24	2	11.16	-	4	2

03	1	11.11	11.16	57	3	11.19	-	5	2
60	4	11.15	11.19	09	1	11.20	-	4	2
16	2	11.17	11.20	12	2	11.22	-	3	2
18	2	11.19	11.22	18	2	11.24	-	3	2
36	3	11.22	11.24	65	3	11.27	-	2	1
38	3	11.25	11.27	25	2	11.29	-	2	1
07	2	11.27	11.29	11	2	11.31	-	2	1
08	2	11.29	11.31	79	4	11.35	-	2	1
59	3	11.32	11.35	61	3	11.38	-	3	1
53	3	11.35	11.38	77	4	11.42	-	3	1
01	1	11.36	11.42	10	2	11.44	-	6	2
62	4	11.40	11.44	16	2	11.46	-	4	2
36	3	11.43	11.46	55	3	11.49	-	3	2
27	3	11.46	11.49	52	3	11.52	-	3	1
97	6	11.52	11.52	59	3	11.55	-	-	-
86	5	11.57	11.57	63	3	12.00	2	-	-
20	57				54		6	56	26

Average queue length = $\frac{\text{Number of customers in waiting line}}{\text{Number of arrivals}} = \frac{26}{20} = 1.3$

Average waiting time per customer = $\frac{56}{20}$ = 2.8 minutes

Average service time = $\frac{54}{20}$ = 2.7 minutes

Time a customer spends in system = 2.8 + 2.7 = 5.5 minutes.

(b) Margin of Safety: The margin of safety refers to sales in excess of the break even point of sales. It represents the difference between sales at given activity level and sales at Break even point. A low margin of safety usually indicates high fixed overheads so that the profits are not made until there is a high level of activity of absorb the fixed costs. A margin of safety provides strength and stability to a concern.

Steps to increase margin of safety :

1. Increase in Selling Price; provided the demand is inelastic so as to absorb the increased prices.
2. Increase in Sales Volume: by increasing sales volume provided capacity is available.
3. Change in Product Mix: By the substitution or introduction of a product mix such that more profitable lines are introduced. Consequently, the contribution will

increase and it will increase the margin of safety.

4. Reduction in fixed expenses: The reduction in fixed expenses will reduce the break even sales. As a result, margin of safety will improve.

5. Reduction in variable cost: The reduction in variable cost will increase the contribution. As a result, the margin of safety will improve

(c) Process of Benchmarking: The process of benchmarking requires a Company to identify the areas i.e. processes, activity etc. which are central to its business and then selects the top-performing companies in those areas.

The benchmarking process is comprised of following stages. These stages are:

1. Planning:

(i) Determination of benchmarking goal statement: This requires identification of areas to be benchmarked. In practice, one should start with the identification of those areas which have to be really good to be really successful.

(ii) Identification of best performance: Once the benchmarked goal statement are defined, the step is seeking the best of the breed of best of the best.

(iii) Establishment of the benchmarking or process improvement team: Ideally this should include the persons who are most knowledgeable about the internal operations and will be directly affected by changes due to benchmarking.

(iv) Defining the relevant benchmarking measurement: Relevant measures will not include the measures used by the organisation today but they will be refined measures that comprehend the true performance differences.

2. Collection of data and information:

The data gathering for benchmarking could be done through national/international clearing houses, mail surveys, suppliers, company visits, telephone, interviews etc. In recent years national and international clearing houses have been set up.

3. Analysing the findings: The analysing of finding of step (2) requires following:

(i) Review the findings and produce tables, charts and graphs to support the analysts.

(ii) Identify gaps in performance between our organisation and better performers.

(iii) Seek explanations for the gaps in performance. The performance gaps can be positive, negative or zero.

(iv) Ensure that comparisons are meaningful and credible.

(v) Communicate the findings to those who are affected.

(vi) Identify realistic opportunities for improvements.

4. Recommendations: This involves:

   Making recommendation: This requires:

   (i) Deciding the feasibility of making the improvements in the light of the conditions that apply within own organisation.

   (ii) Agreement of the improvements that are likely to be feasible.

   (iii) Producing a report on the Benchmarking in which the recommendations are included.

   (iv) Obtaining the support of key stakeholder groups for making the changes needed.

   (v) Developing action plan(s) for implementation.

5. Monitoring and reviewing: This involves:

   (i) Evaluating the benchmarking process undertaken and the results of the improvements against objectives and success criteria plus overall efficiency and effectiveness.

   (ii) Documenting the lessons learnt and make them available to others.

   (iii) Periodically re-considering the benchmarks

Question 4

(a) An agro-products producer company is planning its production for next year. The following information is relating to the current year:

Products/Corps	A1	A2	B1	B2
Area occupied (acres)	250	200	300	250
Yield per acre (ton)	50	40	45	60
Selling price per ton (Rs.)	200	250	300	270
Variable cost per acre (Rs.)				
Seeds	300	250	450	400
Pesticides	150	200	300	250
Fertilizers	125	75	100	125
Cultivations	125	75	100	125
Direct wages	4,000	4,500	5,000	5,700

Fixed overhead per annum (Rs.) 53,76,000.

The land that is being used for the production of B1 and B2 can be used for either crop, but not for A1 and A2. The land that is being used for A1 and A2 can be used for either crop, but not for B1 and B2. In order to provide adequate market service, the company must produce each year t least 2,000 tons each of A1 and A2 and 1,800 tons each of B1 and B2.

You are required to:

(i) Prepare a statement of the profit for the current year.

(ii) Profit for the production mix by fulfilling market commitment.

(iii) Assuming that the land could be cultivated to produce any of the four products and there was no market commitment, calculate: Profit amount of most profitable crop and break-even point of most profitable crop in terms of acres and sales value. (11 Marks)

(b) An oil refinery can blend three grades of crude oil to produce quality A and quality B petrol. Two possible blending processes are available. For each production run, the older process uses 5 units of crude Q, 7 units of crude P and 2 units of crude R and produces 9 units of A and 7 units of B. The newer process uses 3 units of crude Q, 9 unit of crude P and 4 units of crude R to produce 5 units of A and 9 units of B.

Because of prior contract commitments, the refinery must produce at least 500 units of A and at lease 300 units of B for the next month. It has ,1,500 units of crude Q, 1,900 units of crude P and 1,000 of crude R. For each unit of A, refinery receives Rs.60 while for each unit of B, it receives Rs.90

Formulate the problem as linear programming model so as to maximize the revenue.

(4 Marks)

(c) Explain the term degeneracy in a transportation problem. (4 Marks)

Answer

(a) (i) Calculation of selling price and contribution per acre:

Products	A1	A2	B1	B2	Total
Yield per acre in (tones)	50	40	45	60	
Selling price per tones (Rs.)	200	250	300	270	
Sales revenue per acre (Rs.)	10,000	10,000	13,500	16,200	
Variable cost per acre (Rs.)	4,700	5,100	5,950	6,600	
Contribution per acre (Rs.)	5,300	4,900	7,550	9,600	
Area (acres)	2,50	200	300	250	
Total contribution (Rs.)	13,25,000	9,80,000	22,65,000	24,00,000	69,70,000
Less: Fixed Cost					53,76,000
Profit (Rs.)					15,94,000

(ii) Profit Statement for recommended mix

Products	A1	A2	B1	B2	Total
Contribution per acre	5300	4900	7550	9600	
Rank	1	2	2	1	

Minimum Sales Requirement in acres		2000/40 = 50	1800/45 = 40		
Recommended Mix (in Acres)	400	50	40	510	
Total Contribution (Rs.)	21,20,000	2,45,000	3,02,000	48,96,000	75,63,000
Less: Fixed Cost					53,76,000
Profit					21,87,000

(iii) Most profitable crop: Production should be concentrated on B2 which gives highest contribution per acres Rs.9,600.

Overall contribution if complete land is used for B2 (1,000 × 9,600) = Rs.96,00,000

Less: Fixed Cost = Rs.53,76,000

Profit: = Rs.42,24,000

Break even point in acres for B2 = 5376000 ÷ 9600 = 560 acres

Break even point in sales value = 560 × (270 × 60) = Rs.90, 72,000

(b) Maximize Z $= 60\,(9x_1 + 5x_2) + 90\,(7x_1 + 9x_2)$

$= 1170x_1 + 1110x_2$

Subject to $9x_1 + 5x_2 \geq 500$ commitment for A

$7x_1 + 9x_2 \geq 300$ commitment for B

$5x_1 + 3x_2 \leq 1500$ availability of Q

$7x_1 + 9x_2 \leq 1900$ availability of P

$2x_1 + 4x_2 \leq 1000$ availability of R

and $x_1 \geq 0$, $x_2 \geq 0$.

(c) If a basic feasible solution of transportation problem with m origins and n destinations has fewer than m + n – 1 positive xij (occupied cells) the problem is said to be a degenerate transportation problem. Such a situation may be handled by introducing an infinitesimally small allocation e in the least cost and independent cell.

While in the simple computation degeneracy does not cause any serious difficulty, it can cause computational problem in transportation problem. If we apply modified distribution method, then the dual variable ui and vj are obtained from the Cij value to locate one or more Cij value which should be equated to corresponding Cij + Vij.

Question 5

(a) B Ltd. makes industrial power drills, which is made by the use of two components A (electrical and mechanical components and B (plastic housing). The following table shows the cost of plastic housing separately from the cost of the electrical and mechanical components:

	A Electrical and Mechanical Components Rs.	B Plastic Housing Rs.	A & B Industrial Drills Rs.
Sales 1,00,000 units @ Rs.100			1,00,00,000
Variable Costs:			
Direct materials	44,00,000	5,00,000	49,00,000
Direct Labour	4,00,000	3,00,000	7,00,000
Variable factory overhead	1,00,000	2,00,000	3,00,000
Other Variable Costs	1,00,000	-	1,00,000
Sales commission @10% of sales	10,00,000	-	10,00,000
Total variable costs	60,00,000	10,00,000	70,00,000
Contribution	-	-	30,00,000
Total fixed costs	22,20,000	4,80,000	27,00,000
Operating income			3,00,000

Answer the following questions independently:

(i) During the year, a prospective customer offered Rs.82, 000 for 1,000 drills. The drills would be manufactured in addition to the 1,00,000 units sold. B Ltd. would pay the regular sales commission rate on the 1,000 drills. The Chairman rejected the order because “it was below our costs”. Calculate operating income if B Ltd. accepts the offer.

(ii) A supplier offers to manufacture the yearly supply of 1,00,000 units plastic housing components for Rs.13.50 each. Assume that B Ltd. would avoid Rs.3,50,000 of the costs assigned to plastic housing if it purchases. Calculate operating income if B Ltd. decides to purchase the plastic housing from the supplier.

(iii) Assuming that B Ltd. could purchase 1,20,000 units (plastic housing components) for Rs.13.50 each and use the vacated plant capacity for the manufacture of deluxe version of drill of 20,000 units (and sell them for Rs.130 each in addition to the sales of the 1,00,000 regular units) at a variable cost of Rs.90 each, exclusive of housings and exclusive of the 10% sales commission. All the fixed costs pertaining to the plastic housing would continue, because these costs are related to the manufacturing facilities primarily used. Calculate operating income of B Ltd. purchases the plastic housings and manufacture the deluxe version of drills.

(8 Marks)

(b) LMV Limited manufactures product Z in departments A and B which also manufacture other products using same plant and machinery. The information of product Z is as follows:

Items	Department A (Rs.)	Department B (Rs.)
Direct material per unit	30	25
Direct labour per unit (Rs.10 per hour)	30	40
Overhead rates:		
Fixed	8 per hour	4 per hour
Variable	6 per hour	3 per hour
Value of Plant and Machinery	25 lakhs	15 lakhs

Overheads are recovered on the basis of direct labour hours. Variable selling and distribution overheads relating to product Z are amounting to Rs.30, 000 per month. The product requires a working capital of Rs.4, 00,000 at the target volume of 1,500 units per month occupying 30 per cent of practical capacity.

You are required:

(i) To calculate the price of product Z to yield a contribution to cover 21 percent rate of return on investment.

(ii) Set the minimum selling price of the product if (1) the product is well established in the market; (2) the product is first time launched in the market. (7 Marks)

(c) "Sunk costs are irrelevant in decision-making, but irrelevant costs are not sunk cost." Explain with examples. (4 Marks)

Answer

(a) (i) The costs of filling the special order of 1000 drills:

	Rs.
Direct Materials	49,000
Direct Labour	7,000
Variable Factory Overhead	3,000
Other Variable Cost	1,000
Sales commission @ 10% of Rs.82,000	8,200
Total Variable Costs	68,200
Selling Price	82,000
Contribution	13,800

Operating income would have been Rs.3,00,000 + Rs.13,800 = Rs.3,13,800, if B Ltd had accepted the order.

(ii) Assuming that B Ltd. could have avoided Rs.3,50,000 of the fixed costs by not making the housings and that the other fixed costs would have continued, we can summarize the alternatives as follows:

	Make	Buy
Purchase Cost		Rs.13,50,000
Variable Costs	Rs.10,00,000	
Avoidable fixed Costs	Rs.3,50,000	.
Total relevant Costs	Rs.13,50,000	Rs.13,50,000

If the facilities used for plastic housings became idle, the B Ltd. would be indifferent whether to make or buy. The present operating income would be unaffected.

(iii) The effect of purchasing the plastic housings and using the vacated facilities for the manufacture of a deluxe version of its drill is as follows:

Increase in sales 20,000 units @ Rs.130		26,00,000
Increase in Variables cost 20,000 units, @Rs.90	18,00,000	
Plus: Sales commission, 10% of Rs.26,00,000	2,60,000	20,60,000
Contribution on 20,000 units		5,40,000
Housings: 1,20,000 rather than 1,00,000 would be needed Buy 1,20,000 @ Rs.13.50	16,20,000	
Less: Make 1,00,000 @ Rs.10 (only the variable costs are relevant)	10,00,000	
Excess cost of outside purchase		6,20,000
Loss on making deluxe units		Rs.80,000

Conclusion: Operating income would decline to Rs.2, 20,000 (3, 00,000 – 80,000).

(b) (i) Statement showing price of Product Z

Direct Material	Deptt. A	30	
	Deptt. B	25	55
Direct Labour	Deptt. A	30	
	Deptt. B	40	70
Variable overhead	Deptt. A 3×6	18	
	Deptt B 4×3	12	30
Variable selling and distribution overhead 30,000/1,500			20
Total Variable Cost per unit			175

Total hours required for a target of 1,500 units of product Z

Deptt. A1500 × 3	4500 hours
Deptt. B1500 × 4	6000 hours
	10500 hours

10500 hours represent 30% capacity

So total capacity per month 10500 / 0.30 = 35000 hours.

Yearly capacity is 35000 × 12 = 420000 hours.

Fixed capital employed in both department = 40.00 Lakhs

(25 lakhs + 15 Lakhs)

Expected return	= 0.21 × 40,00,000	= 840000
Contribution per hour	= 840000 / 4200000	= 2.00 per hour
Working Capital	= 0.21 × 400000	= 84000
Contribution per unit 84000 / 18000 unit		= 4.67 per unit

Total contribution required	Rs.
To cover fixed cost 3 hours of A and 4 of B = 7 × 2	= 14.00
To working capital	= 4.67
	18.67

Fixed charges recovery is based on usage. Full capacity is not being used by product Z and departments are also producing other products using same plant and machinery. Price of Product = Variable cost + contribution required = 175 + 18.67 = 193.67 per unit.

(ii) Price of product when product is well established in market:

Variable Cost	175
Fixed Cost (24 + 16)	40
Total price	215

The product is first time launched in the market, and then variable cost Rs.175 should form the basis for price fixation.

(c) The sunk cost is one for which the expenditure has taken place in the past. This cost is not affected by a particular decision under the consideration. Sunk costs are always results of decision taken in past. Investment in plant and machinery as soon as installed, its cost is sunk cost and is not relevant for decision making. The relevant cost is a cost appropriate in adding to make specific management decisions. A relevant cost is a future cost which differ with alternatives and one which is expected to be incurred and not a sunk cost which has already been incurred. If the cost remain constant between different alternatives, treated as irrelevant cost however that is not a sunk cost. Sunk costs are based on past, always irrelevant for decision making. Relevant cost must be an incremental or avoidable cost. For example fixed over heads which are allocated by head office are not relevant, but incremental or avoidable fixed overheads are relevant.

PAPER – 6 : MANAGEMENT INFORMATION AND CONTROL SYSTEMS

Answer all the five questions.

Question 1

(a) Explain the terms "system stress" and "system change".

(b) Briefly describe the components of transaction processing system.

(c) Explain the effect of applying Computer technology to information system.

(d) What are the objectives of the inventory control applications? (5+5+7+3= 20 Marks)

Answer

(a) System stress and system change: Systems, whether they be living or artificial systems, organisational systems, information systems, or systems of controls, change because they undergo stress. A stress is a force transmitted by a system's supra-system that causes a system to change so that the supra system can better achieve its goals. In trying to accommodate the stress, the system may impose stress on its subsystems and so on. There are two basic forms of stresses which can be imposed on a system separately or concurrently namely:

(1) A change in the goal set of the system. New goals may be created or old goals may be eliminated.

(2) A change in the achievement levels desired for existing goals. The level of desired achievement may be increased or decreased.

When a supra-system exerts stress on a system, the system will change to accommodate the stress or it will become pathological i.e., it will decay and terminate when there is a change, it can be structural change or process change.

For example, the goal set for a computer system may change if a requirement is imposed by management (the supra-system) for system data to be shared among multiple users rather than be available only to a single user.

(b) Components of transaction processing system: The principal components of a transaction processing system include inputs, processing, storage, and outputs. These components or elements are part of both manual and computerized systems. The major components of a transaction processing system are:

(i) Inputs: These are source documents such as customer orders, sales slips, invoices and purchase orders etc. Source documents, such as customer orders, sales slips, invoices, purchase orders, and employee time cards, are the physical evidence of inputs into the transaction processing system. They serve several purposes:

- Capture data
- Facilitate operations by communicating data and authorising another operation in the process

- Standardize operations by indicating what data require recording and what actions need to be taken
- Provide a permanent file for future analysis, if the documents are retained.
- Source documents are typically forms carefully designed for ease of use and accurate data capture.

(ii) Processing: This involves use of journals and registers to provide a permanent and chronological record of inputs. Some special journals e.g. sales journal, purchase journal etc are also used. Processing involves the use of journals and registers to provide a permanent and chronological record of inputs. The entries are done either by hand in simple manual systems (journalised) or by a data entry operator using a PC. Journals are used to record financial accounting transactions, and registers are used to record other types of data not directly related to accounting.

(iii) Storage: Ledgers and files provide storage of data. All accounting transactions must be reflected in the general ledger. It generates a trial balance to test the accuracy of the entire record prior to record keeping. Ledgers and files provide storage of data in both manual and computerized systems. The general ledger, the accounts/ vouchers payable ledger, and the accounts receivable ledger are the records of financial account. They provide a summary of a firm's financial accounting transactions. All accounting transactions must be reflected in the general ledger. A debit –credit entry is input for every transaction. Traditionally, this process has been called posting. The general ledger generates a trial balance to test the accuracy of the entire prior record keeping.

(iv) Computer Processing: Processing converts data into information. A ledger may be processed to generate a listing of transactions; or to generate financial statements etc. When computers are used for processing, two different modes of processing accounting transactions are possible. These modes are batch processing and direct processing. Batch processing is conceptually very similar to a traditional manual accounting system. Batches of transactions are accumulated as a transaction file. Transaction files are printed to provide documentation of inputs to the accounting system. Transaction files are subsequently posted to ledgers by computer programs. The ledgers are then periodically processed to generate financial statements. The flow of processing in a batch processing computer system is essentially same as in a traditional manual system- source documents to journals (transaction files), journal to ledgers, and ledgers to financial statements.

(v) Outputs: Any document generated in a system is an output. It can be both an output as well as an input. Some of the outputs are trial balance, financial reports, pay cheques etc. There is a wide variety of outputs from a transaction processing system. Any document generated in the system is an output. Some documents are both output and input (e.g., a customer invoice is an output from the order-entry application system and also an input document to the customer). Other common outputs of a transaction processing system are the trial balance, financial reports, operational reports, pay cheques, and voucher cheques (payments to vendors).

(c) Effect of applying Computer technology to information system: The computer technology applied to information system will effect the information system in following ways:

(i) Speed of processing and retrieval of data increases: Manual systems, howsoever well organised, often fail to match the demand for information for decision making. Computers with its unbelievably fast computational capability and systematic storage of information with random access facility provide relevant information with minimum loss of time.

(ii) Scope of use of information system has expanded: The importance and utility of information system in business organisations is realised by most of the concerns, especially after the induction of computers for MIS development. Systems experts in business organisations developed areas and functions, where computerised MIS could be used to improve the working of the concern. This type of applications hitherto is not feasible under the manual system. It is now possible to use an on-line real-time system to provide information to various users sitting at a remote distance from a centrally located computer system.

(iii) Scope of analysis widened: The use of computers can provide multiple type of information accurately and in no time to decision makers. Information provided by a computer equips an executive to carry out a thorough analysis of the problems and to arrive at the final decision.

(iv) Complexity of system design and operation increased: The need for highly processed and sophisticated information based on multitudes of variables has made the designing of the system quite complex.

(v) Integrates the working of different information sub-system: A suitable structure of management information system may be a federation of information sub-system, viz., production, material, marketing, finance, engineering and personnel. Each of these sub-systems is required to provide information to support operational control, management control and strategic planning. Such information may be made available from a common-data-base. The common data base meets out the information requirements of different information subsystems by utilizing the services of computers for storing, analyzing and providing the information.

(vi) Increase the effectiveness of information systems: Prior to the use of computer technology for information purposes, it was difficult to provide the relevant information to business executives in time even after incurring huge expenses. The use of computer technology has overcome this problem. It is now possible to provide timely, accurate and desired information for the purpose of decision making.

(vii) More comprehensive information: The use of computer for MIS enabled systems provides more comprehensive information to executives on business matters.

(d) Objectives of the inventory control applications: The objectives of the inventory control applications are:

   (i) To provide high quality service to customers by utilizing fast; accurate and efficient method of filling customer orders and avoiding “stock outs”.

   (ii) To minimize the amount of money invested in inventory and money required to cover inventory “carrying cost”.

   (iii) To provide management with information needed to help achieve the two preceding objectives.

Question 2

(a) What are the basic information requirements of production planning and control systems?

(b) Explain the advantages and also the disadvantages of parallel conversion from manual to computerized system.

(c) Explain the characteristics of client/server technology.

(d) What is meant by Information security? (5+5+8+2= 20 Marks)

Answer

(a) The basic information requirements of Production Planning and Control Systems are:

   (i) Firm’s policy with regard to production of various products.

   (ii) Sales order, sales forecast, stock position and order backlog.

   (iii) Available labour force with their capabilities.

   (iv) Standards of labour time, material, machine time and over-head costs etc.

   (v) Schedule of meeting the sales orders, region wise, territory wise etc.

   (vi) Quality norms for materials to be used for the finished products.

   (vii) Break-up of the jobs and their resource requirements.

(b) The advantages of parallel conversion from manual to computerized system are:

   (i) There is a possibility of checking new data against old data in order to catch any errors in processing the new system.

   (ii) It offers a feeling of security to users, who are not forced to make an abrupt change to the new system.

   The disadvantages of parallel conversion from manual to computerized system are:

   (i) The cost of running two systems at the same time.

   (ii) The burden on employees of virtually doubling their workload during conversion.

   (iii) Unless the system being replaced is a manual one, it is difficult to make comparisons between out put of the new system and the old one.

(iv) It is understandable that employees who are faced with a choice between two systems will continue using the old one because of their familiarity with it.

(c) The characteristics of client/server technology are:

(i) Client/server architecture consists of a client process and a server process that can be distinguished from each other.

(ii) The client portion and the server portion can operate on separate computer platforms.

(iii) Either the client platform or the server platform can be upgraded without having to upgrade the other platform.

(iv) The server is able to service multiple clients concurrently, in some systems, clients can access multiple servers.

(v) The client/server system includes some sort of networking capability.

(vi) A significant portion of the application logic resides at the client end.

(vii) Action is usually initiated at the client end, not the server end.

(vii) A user friendly graphical user interface generally resides at the client end.

(viii) A structured query language (SQL) capability is characteristic of the majority of client/server systems.

(ix) The database server should provide data protection and security.

(d) Information security relates to the protection of the data or information recorded, processed, stored, saved, transmitted or retrieved from an electronic medium against loss, disclosure, damage, inaccessibility or alteration. The data or information is protected against harm from threats that will lead to its loss, inaccessibility, alteration, or wrongful disclosure. The protection is achieved through a layered series of technological and non-technological safeguards, such as physical security measures, user identifiers, passwords, smart cards, biometrics, firewalls, etc.

Question 3

(a) Describe the five characteristics of the types of information used in executive decision making.

(b) What are the risks involved in the end-user computing?

(c) Give an example for the source document fraud. How will you control against this type of exposure?

(d) What are the important factors which should be considered by the system analyst while designing user output? (5X4= 20 Marks)

Answer

(a) The five characteristics of the types of information used in executive decision making are:

(i) Lack of structure: Most of the decisions made by executives are relatively unstructured. For instance, what general direction should the company take? Or what type of advertising campaign will best promote the new product line? These types of decisions are not as clear-cut as deciding how to debug a computer program or how to deal with an overdue account balance. Also it is not always obvious which data are required or how to weigh available data to reach a decision.

(ii) High degree of uncertainty: Executives work in a decision space that is often characterized by a lack of precedents and where results are not scientifically predictable from actions.

(iii) Future orientation: Strategic planning decisions are made in order to shape future events. As conditions change, organisations must change also. It is the executive's responsibility to make sure that the organization keeps pointed toward the future.

(iv) Informal sources: Executives rely heavily on informal sources for key information like the media, business meetings, tours etc. some other important information sources of information are meetings, tours around the company's facilities to chat with employees, brainstorming with a trusted colleague or two, and social events.

(v) Low level of detail: Most important executive decisions are made by observing broad trends. This requires the executives to be more aware of the large overview than the tiny items.

(b) The risks involved in the end-user computing are:

(i) A decline in standards and controls. When an analyst is in-charge of developments, walk-through will be done and standards and policies will be enforced; these things are unlikely to be carried out to the same degree with end-user computing.

(ii) Inaccuracy of specification requirements. The end user will not have the experience of an analyst in completing an accurate specification and system requirements.

(iii) Due to the lack of adequate specifications, there would be a reduction in the quality assurance and stability of the system.

(iv) An increase in unrelated and incompatible systems. Departments would choose their own software and hardware and incompatibility of systems would result.

(v) Difficulties in accessing could arise for users trying to access a central system, such as the corporate database, with a proliferation of different systems and applications.

(c) In systems that use physical source documents to initiate transactions, careful control must be exercised over these instruments. Source document fraud can be used to remove assets from the organisation. The example of source document fraud can be an individual with access to purchase orders and receiving reports could fabricate a purchase transaction to a non-existent supplier. If these documents were entered into the data processing stream, along with a fabricated vendor's invoice, the system could process these documents as if a legitimate transaction had taken place. In the absence of other compensating controls to detect this type of fraud, the system would create an account payable and subsequently write a cheque for payment.

To control against these types of source document frauds, the following measures can be taken:

(i) Use pre-numbered source documents, coming from the printer with a unique sequential number on each document. Source document numbers permit accurate accounting of document usage and provide an audit trail for tracing transactions through accounting records.

(ii) Use source documents in sequence. Source documents should be distributed to the users and used in sequence. This requires that adequate physical security be maintained over the source document inventory at the user site. When not in use, documents should be locked away. At all times, access to source documents should be limited to authorised persons.

(iii) Periodically audit the source documents and compare the number of documents used with those remaining in inventory plus those voided due to errors. Documents not accounted for should be reported to management.

(d) The important factors which should be considered by the system analyst while designing user output are:

(i) Content: It refers to the actual pieces of data included among the outputs provided to users. For example, the contents of a weekly report to a sales manager might consist of sales person's name, sales calls made by each sales person during the week, and the amount of each product sold by each salesperson to each major client category. Systems designers generally put too much content into managerial reports instead of two little which leads to waste of time to isolate the required information. Hence, only the required information should be included in various outputs.

(ii) Form: It refers to the way that content is presented to users. It can be quantitative non-quantitative, text, graphics, video and audio. The form of output should be decided keeping in view the requirements of the users.

(iii) Out put volume: It is the amount of data output required at any one time. It is better to use high-speed printer or a rapid-retrieval display unit, which are fast and frequently used output devices in case the volume is heavy. Unusually heavy output volume normally causes concern about paper cost. In such a case, alternative methods of output display such as COM (Computer Output Microfiche) may be considered. The choice of output medium/device should be decided based on the volume of output.

(iv) Timeliness: It refers to when users need output. Some outputs are required on a regular periodic basis perhaps daily, weekly, monthly, at the end of a quarter or annually. Others are generated on request. A sales manager, for example, may be requiring a weekly sales report. Other users, such as airline agents, require both real- time information and rapid response times in order to render better client service. Hence, the system designer might require that display information be provided to the airline agents within a few seconds at least 95% of the time.

(v) Media: It refers to the physical device used for input, storage or output. The system designer should select a medium which is best suited to the user requirements. A variety of output media are available in the market these days which include paper, video display, microfilm, magnetic tape/disk and voice output. Many of these media are available in different forms. The system designer can select a medium, which is best suited to the user requirements.

(vi) Format: It refers to the manner in which data are physically arranged. Output format is data output on a printed report or on a display screen. The format of the output should be properly designed; it should be intelligent and decision impelling.

Question 4

(a) Briefly discuss some of the design tools that are available now-a-days.

(b) What are the key characteristics of a true ERP-enterprise resource planning solution?

(c) What are the different levels of integration of 'Case' tools?

(d) Give some techniques used to preserve audit trails in a computer based information systems environment. (5X4= 20 Marks)

Answer

(a) Some of the design tools that are used for programming are:

(i) Program flow chart: Program flow chart is among the most common program design tools that managers and users encounter when reviewing the design work of the system development project. It depicts the logical steps through which a computer program must proceed when solving a problem. It is a widely used program design tool.

(ii) Pseudo code: When reviewing the work done by a program designer, users may also need to review narrative descriptions of program logic. Pseudo code, like program flow charts, pseudo-code represents program logic; however it presents program logic in English like statements. It is generally preferred by programmers since it represents program code more closely.

(iii) Structure Chart: It looks similar to corporate organization chart, which are useful for organizing problems. It organizes each of the program tasks into well defined modules. The higher-level modules represent control portions of the program; the lowest level modules do the actual task of the program. Unlike either flow charts or pseudo code, the structure chart does not give any detail of the actual program logic and the order in which various tasks are executed. Instead they show how all the logical functions of the program fit together as a whole.

(iv) 4 GL Tools: Fourth generation language tools automate many of the manual tasks by using 4GL tools. These tools ensure that the work done with them is consistent with the other work performed by the system team. The automation of manual task and internal consistency checks are two reasons due to which productivity gains result from using 4GL tools.

(v) Object oriented programs and design tools: These tools provide a means of enhancing programmer productivity and of reducing the application backlogs common in many organisations. With the help of this design tool, the programmer prepares a model that describes object, classes and their relationships to one another. This design is often taken from a data flow diagram (DFD).

(b) The key characteristics of an enterprise resource planning solution are:

(i) Flexibility: An ERP system should be flexible to respond to the changing needs of an enterprise. The client server technology enables ERP to run across various database back ends through Open Database Connectivity (ODBC).

(ii) Modular and open: ERP system should have open system architecture. This means that any module can be interfaced or detached whenever required without affecting the other modules. It should support multiple hardware platforms for the companies having heterogeneous collection of systems. It must support some third party add-ons also.

(iii) Comprehensive: It should be able to support variety of organizational functions and must be suitable for a wide range of business organizations.

(iv) Beyond the company: It should not be confined to the organizational boundaries, rather support on-line connectivity to the other business entities of the organisation.

(v) Best business practices: It must have a collection of the best business processes applicable world-wide. An ERP package imposes its own logic on a company's strategy, culture and organisation.

(c) The different levels of integration of 'CASE' tools are:

(i) Platform integration: Platform integration means that the tools or work benches to be implemented run on the same platform where platform means a single computer/ operating system or a network of systems. Tools run on the same hardware/ operating system platform.

(ii) Data integration: Tools operate using a shared data model. The result from one tool can be passed on as input to another tool.

There are a number of different levels of data integration:

- Shared files: All tools recognize a single file format. The most general purpose shareable file format is where files are made of lines of characters.
- Shared data structures: The tools make use of shared data structures which usually include program or design language information.
- Shared repository: The tools are integrated around an object management system which includes a public share data model describing the data entities and relationships which can be manipulated by the tools.

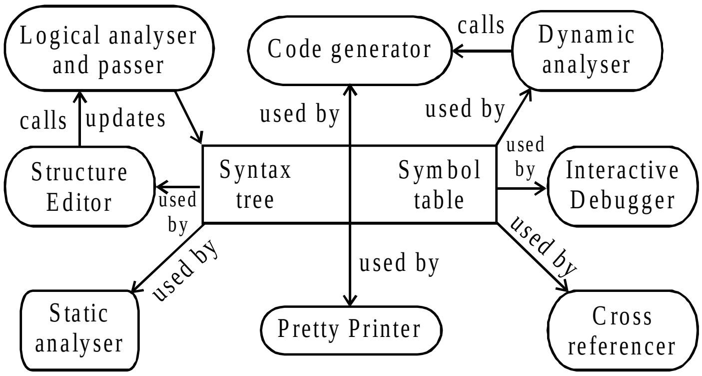


Figure: Integration through shared Data Structure

(iii) Presentation integration: Tools offer a common user interface, style and a set of common standards for user interaction.

There are three different levels of presentation integration.

- Window system integration: Tools which are integrated at this level use the same underlying window system and present a common interface for window manipulation commands.
- Tools which are integrated at this level use the same form of commands for comparable functions.
- Interaction Integration: This is related with a direct manipulation interface where the user interacts with a graphical or textual view of the entity.

(iv) Control integration: Tools may activate and control the operation of other tools. One tool is able to start and stop other tools. The tool can also call the sources of another tool in the system.

(v) Process integration: It is guided by a process model. Activities and deliverables are identified, a coordination strategy defined and tools required to support activities are specified.

(d) The techniques used to preserve audit trails in a computer based information systems environment are:

(i) Transaction logs: Every transaction successfully processed by the system should be recorded on a transaction log which serves as a journal. It is a permanent record of transactions.

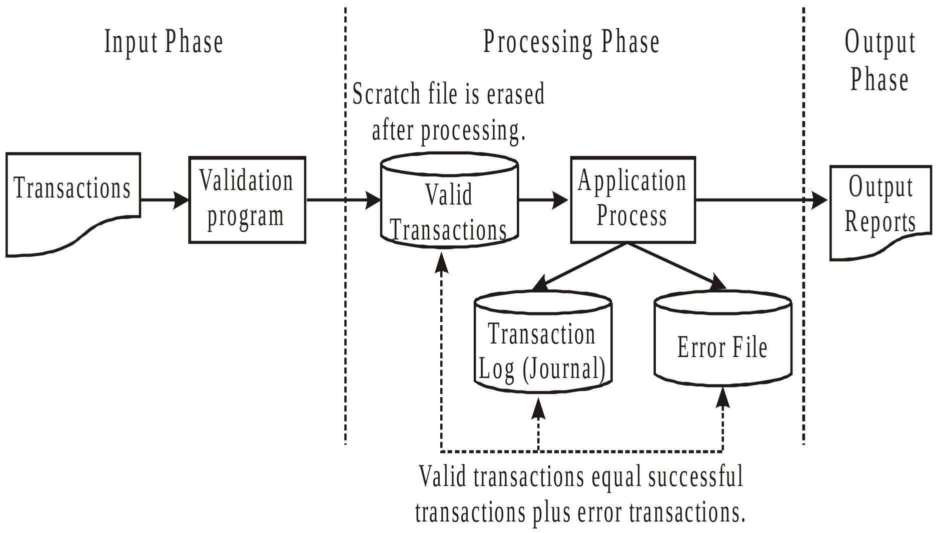


Figure: Transaction Log to Preserve the Audit Trail

There are two reasons for creating a transaction log. First, the transaction log is a permanent record of transactions. The validated transaction file produced at the data input phase is usually a temporary file. Once processed, the records on this file are erased (scratched) to make room for the next batch of transactions. Second, not all of the records in the validated transaction file may be successfully processed. Some of these records may fail tests in the subsequent processing stages. A transaction log should contain only successful transactions – those that have changed account balances. Unsuccessful transactions should be placed in an error file. The transaction log and error files combined should account for all the transactions in the batch. The validated transaction file may then be scratched with no loss of data.

(ii) Transaction listings: The system should produce a (hard copy) transaction listing of all successful transactions. These lists should be used by users for reconciliation with input.

(iii) Log of Automatic Transactions: Some transactions are triggered internally by the system. An example of this is when inventory drops below a preset reorder point, and the system automatically processes a purchase order. To maintain an audit trail of these activities all internally generated transactions must be placed in a transaction log.

(iv) Listing of automatic transactions: To maintain control over automatic transactions processed by the system, the responsible end user should receive a detailed listing of all internally generated transactions.

(v) Unique transaction identifiers: Each transaction processed by the system must be uniquely identified with a transaction number. This number may be pre-printed on the documents in batch processing or system generated in real-time systems.

(vi) Error listing: A listing of all error records should go to the appropriate user to support error correction and resubmission.

Question 5

(a) What are the objectives of audit trail?

(b) Explain the characteristics of the Internet which are likely to attract fraudsters.

(c) The audit methods that are effective for manual audits prove ineffective in many 'IS' audits. Can you explain the reasons?

(d) Define the following terms:

(i) Computer resources

(ii) Digital Signatures

(iii) Private key

(iv) Public key

(v) Key pair. (5X4= 20 Marks)

Answer

(a) The objectives of an audit trail are:

(i) Detecting unauthorized access to the system: A real time audit trail is used to protect the system from outsiders who are trying to breach system controls and to report on changes in system performance that may indicate infestation by a virus or worm. Depending upon how much activity is being logged and reviewed; real-time detection can impose a significant overhead on the operating system, which can degrade operational performance. After-the-fact detection logs can be stored electronically and reviewed periodically or as needed. When properly designed, they can be used to determine if unauthorized access was accomplished, or attempted and failed.

(ii) Reconstructing events: Audit analysis can be used to reconstruct the steps that led to events such as system failures, security violations by individuals or application processing errors. Knowledge of the conditions that existed at the time of a system failure can be used to assign responsibility and to avoid similar situations in the future. It can also play important role in accounting control. For example, by maintaining a record of all changes to account balances, the audit trail can be used to reconstruct accounting data files that were corrupted by a system failure.

(iii) Personal Accountability: Audit trail can be used to monitor user activity at the lowest level of detail. This capability is a preventive control that can be used to influence behavior.

(b) The characteristics of the Internet which are likely to attract fraudsters are:

(i) It is unregulated in so far as who may set up a site. No license fees are payable to any central authority and no form of vetting could be carried out on those persons or entities setting up sites.

(ii) An Internet site can be set up anywhere in the world at very low cost and can reach anywhere else at low cost. This means that fraudsters now have “global reach” and can access a far larger market of potential victims than ever before. As fraudsters are always looking for new victims, this is a very attractive feature.

(iii) An impressive site with links to established companies may be no more than an empty shell designed to attract and trap the unwary.

(iv) The glamour and novelty of the Internet and the spurious credibility claimed by a site may cause otherwise prudent investors to become involved in fraudulent schemes.

(v) A site may operate outside the legal jurisdiction of the country in which the victim of the fraud resides. A company which gives itself a UK Internet address need have absolutely no legal or commercial connection with the jurisdiction.

(c) The audit methods that are effective for manual audits prove ineffective in many Information System audits because of these factors:

(i) Electronic evidence: Essential evidence is not physically retrievable by most auditors, and it is not readable in its original electronic form.

(ii) Terminology: The tools and techniques used in automated applications are described in terms that are difficult for the non-EDP auditors to understand.

(iii) Automated processes: The methods of processing are automated rather than manual, making it difficult for the non-EDP auditors to comprehend processing concepts and the logic of these concepts.

(iv) New risks and controls: Threats to computer systems and the countermeasures to those threats are new to non-EDP auditors and the magnitude of the risks and the effectiveness of the controls are not understood.

(v) Reliance on Controls: In manual systems, the auditor can place some reliance on hard-copy evidence, regardless of the adequacy of the controls. But in automated systems, the electronic evidence is only as valid as the adequacy of controls.

(d) (i) Computer Resource: “Computer resource” means computer, computer system, computer network, data, computer data base or software.

(ii) Digital signature: “digital signature” means authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of section 3 of IT Act, 2000.

(iii) Private key: “private key” means the key of a key pair used to create a digital signature.

(iv) Public key: “public key” means the key of a key pair used to verify a digital signature and listed in the Digital Signature Certificate.

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

PAPER – 7 : DIRECT TAXES

Answer all questions.

Question 1

Laxmi Tea Limited is engaged in growing and manufacturing tea in Assam and West Bengal. The company's profit and loss account for the year ended 31st March, 2009 shows a net profit of Rs.550 lacs after debiting or crediting the following amounts:

(a) Depreciation Rs.40 lacs.

(b) Interest amounting to Rs.2 lacs on term loan from a bank for purchase of machinery for one of its tea factories.

(c) Repairs to factory building amounting to Rs.15 lacs for which a sum of Rs.10 lacs was withdrawn from Tea Deposit account maintained with National Bank for Agricultural and Rural Development (NABARD) as per section 33AB of the Income-tax Act.

(d) Profit from sale of green tea leaves plucked in own gardens Rs.20 lacs.

(e) Rs.5 lacs on account of stamp duty and registration fees for the issue of bonus shares.

(f) Rs.10 lacs, being sales tax dues of earlier years determined during the year on disposal of appeals by the appellate authority, for which the company has furnished a bank guarantee to the Commercial Tax Authority.

(g) Rs.5 lacs written off as bad in respect of a trade debt transferred from Saraswati Tea Limited in previous year 2005-06 pursuant to a scheme of amalgamation approved by the jurisdictional High Court.

(h) Rs.2 lacs contributed to Employees' Welfare Trust.

(i) Interest on inter-corporate deposit Rs.1 lac and Rs.1.50 lacs for February, 2009 and March, 2009, respectively, for which tax deducted at source was paid to the Central Government in June, 2009.

Following additional information are furnished by the management:

(i) Depreciation as per Tax Audit Report under section 44AB Rs.55 lacs.

(ii) One financial institution converted arrear interest of Rs.10 lacs into a new loan in financial year 2006-07, which is repayable in five annual instalments. The company has paid Rs.2 lacs towards the instalment due for the financial year 2008-09 in February, 2009.

The Suggested Answers for Paper 7: - Direct Taxes are based on the provisions applicable for A.Y. 2009-10, which is the assessment year relevant for November, 2009 examination.

(iii) A sum of Rs.250 lacs deposited in NABARD on 15th June, 2009 as per the provision of Section 33AB.

Compute total income of the company for the Assessment Year 2009-10 stating the reasons for each item. Ignore provision relating to Minimum Alternate Tax. (16 Marks)

Answer

Computation of total income of Laxmi Tea Ltd. for the A.Y.2009-10

	Particulars	Amount in Rs.	
A.	Profit and Gain from Business and Profession		
	Net profit as per Profit & Loss Account		5,50,00,000
	Add: Items debited but to be considered separately or to be disallowed		
	Depreciation as per accounts	40,00,000	
	Repairs to factory building to the extent of amount spent by withdrawal from Tea Deposit Account (Note 2)	10,00,000	
	Sales tax not paid (Note 4)	10,00,000	
	Contribution to Employees' Welfare Trust disallowed under section 40A(9) (Note 6)	2,00,000	
	Interest on inter-corporate deposit for February, 2009 for which tax deducted at source was deposited in June 2009 disallowed under section 40(a)(ia) (Note 7)	1,00,000	63,00,000
			6,13,00,000
	Less: Amount credited to profit & loss account but not chargeable to tax		
	Profit on sale of green tea leaves plucked in own gardens is agricultural income and the same is exempt under section 10(1)		20,00,000
			5,93,00,000
	Less: Deductions allowable while computing business income		
	Depreciation as per Income-tax Rules	55,00,000	
	Payment of new loan converted from arrear interest (Note 8)	2,00,000	57,00,000
			5,36,00,000
	Deduction under section 33AB for making deposit in an account with NABARD as per scheme approved by the Tea Board, being lower of the following two amounts:		
	Amount deposited	2,50,00,000	

40% of the profit from business of growing and manufacturing tea computed under the head "profits and gains from business and profession" before making this deduction (Rs.5,36,00,000 x 40%)	2,14,40,000	2,14,40,000
		3,21,60,000
Less : 60% of above, being agricultural income as per Rule 8		1,92,96,000
Business income		1,28,64,000
Gross Total Income		1,28,64,000
Less : Deduction under Chapter VIA		Nil
Total Income		1,28,64,000

Notes:

1. As per section 36(1)(iii), interest paid in respect of capital borrowed for the purpose of business or profession is allowed as deduction. The term loan was taken for purchasing machinery for use in a tea factory. Thus, the term loan was used for the purpose of business. Hence, interest on term loan is allowable as deduction. As interest has already been debited to the profit and loss account, no adjustment is required. It is assumed that–

   (i) the new machinery was not acquired for extension of the business of the company; and

   (ii) the interest has been actually paid.

2. As per section 33AB(6), where any amount standing to the credit of the assessee in the account maintained with NABARD is utilized by the assessee for the purpose of any expenditure in connection with eligible business in accordance with the scheme approved by the Tea Board, such expenditure shall not be allowed as deduction. Therefore, the amount of Rs.10 lacs withdrawn and utilized for incurring expenditure on repair to factory building is to be disallowed.

3. The Supreme Court, in the case of CIT vs. General Insurance Corporation (2006) 286 ITR 232, observed that there is no inflow of fresh funds or increase in capital employed on account of issue of bonus shares. There is only reallocation of company's fund on account of issue of bonus shares by capitalization of reserves. The company has not acquired any benefit of enduring nature. There is no increase in capital base of the company. Therefore, stamp duty and registration fee in connection with issue of bonus shares is allowable as revenue expenditure under section 37(1).

4. According to section 43B, any tax, duty, cess or fee (by whatever name called) is allowed as deduction if they are actually paid on or before the due date of filing return of income under section 139(1) irrespective of the method of accounting followed by the assessee. In the case of CIT vs. Udaipur Distillery Company Limited (2004) 268 ITR 305 (Raj), it was held that actual payment requires that amount must flow from the assessee to the

public exchequer as such as specified in section 43B. Mere furnishing of bank guarantee by the assessee towards sales tax dues does not mean actual payment of sales tax dues. Therefore, sales tax liability determined on appeal shall be disallowed under section 43B for non-payment.

5. Under section 36(1)(vii) read with section 36(2), an assessee can claim deduction in respect of bad debt, provided the amount of such debt has been taken into account in computing total income of the assessee and it is written off in the books of account of the assessee. In the case of CIT vs. T.Veerabhadra Rao, K.Koteswara Rao & Co. (1985) 155 ITR 152 (SC), the Apex Court held that the successor of a business is entitled to write off the predecessor's debt as a bad debt and claim deduction if the other conditions are fulfilled. This is so because the benefit of deduction in respect of bad debt is not accrued to the assessee by way of personal relief but relates to the business. Therefore, the assessee company is entitled to deduction under section 36(1)(vii) read with section 36(2) in respect of debt transferred from the amalgamating company, Saraswati Tea Limited.

6. As per section 40A(9), any contribution made by the assessee as an employer to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act or other institution for any purpose shall be disallowed, except where such contribution is paid to a recognised provident fund or approved superannuation fund or approved gratuity fund. Therefore, contribution to the Employees' Welfare Trust is to be disallowed.

7. Section 40(a)(ia) seeks to disallow interest paid to any resident, if tax is not deducted at source or, after deduction, tax is not deposited to the Central Government on or before the last date of the previous year i.e., on or before 31st March.

   It may be noted that if tax has been deducted during the last month of the previous year, i.e., in March, and paid on or before the due date for filing return of income under section 139(1), then, interest shall not be disallowed. However, if tax has been deducted during any other month of the previous year (i.e., from April to February) but paid after the end of the previous year i.e., after 31st March, interest shall be allowed as deduction in the previous year in which such tax is paid.

   In view of the above provision, interest of Rs.1 lac pertaining to February, 2009 shall be allowed as deduction only in the assessment year 2010-11, as the tax has been paid in the previous year 2009-10.

   Interest of Rs.1.50 lacs pertaining to March, 2009 shall be allowed in the assessment year 2009-10 itself, as tax has been paid on or before due date for filing return of income for assessment year 2009 -10.

8. As per Explanation 3C to section 43B, a deduction of any sum, being interest payable on any loan or borrowing from a public financial institution shall be allowed, if such interest

has been actually paid and such interest which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

The manner in which the converted interest will be allowed as deduction has been clarified vide Circular No.7/2006 dated 17.7.2006. The unpaid interest, whenever actually paid to the financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid. Accordingly, the sum of Rs.2 lacs, being installment paid in February, 2009 shall be allowed as deduction while computing business income of P.Y.2008-09.

Question 2

(A) ABC Ltd., incorporated as a public limited company for construction of ships, is to file its first return for the year ended 31.3.2009. The management is confused as to the admissibility of the following expenses incurred and therefore, asks you to explain how the same would be dealt with while preparing the return to be filed for A.Y. 2009-10:

(a) Payments made for preparing feasibility report is Rs.25 lacs, for conducting market surveys is Rs.15 lacs and for underwriting commission on shares is Rs.85 lacs, besides fees and expenses of Rs.70 lacs for incorporation of company. The capital employed in the business is Rs.3,500 lacs.

(b) Amount of Rs.15 lacs paid to a local mafia (DON) for the excavation of inhabitants who were occupying the land to be used as a yard.

(c) Interest of Rs.150 lacs paid on loans taken for purchase of plant and machinery out of which Rs.130 lacs is for the period till such machines were commissioned.

(d) The amount of discount @ 2% on 5 year debentures of face value of Rs.1,000 lacs issued at par and were subscribed in full.

(e) Interest of Rs.400 lacs on the term loan taken from financial institution was accounted upto 31.3.2009 on accrual basis. The payment terms allowed a moratorium on interest for the period upto 30.6.2009. The interest of Rs.200 lacs outstanding on 31.3.2009 was paid by the company on 3.10.2009. (8 Marks)

(B) Aerochem, a partnership firm, transfers a piece of land situated in Thane district on 17.8.2008 for Rs.50 lacs. The land, purchased on 6.3.1980 for Rs.1 lac, was registered on 3.4.1983 on payment of stamp duty of Rs.20,000. Expenses on land development and construction of boundary wall incurred in August, 1983 were of Rs.1,50,000. The charges for the transfer of land paid to the broker were 2½% of the sale consideration. Fair market value of the land as on 1.4.81 was Rs.1,50,000. The firm invested Rs.30 lacs on 1.12.2008 in the bonds issued by National Highways Authority of India redeemable after a period of 48 months. Compute the amount of capital gain chargeable to tax for Assessment Year 2009-10 with the help of cost inflation index for F.Y. 1983-84 and

2008-09 of 116 and 582, respectively. Also, give in brief, the reasons and the provisions of the Act for each of the items dealt with. (7 Marks)

Answer

(A) (a) The expenditure incurred is in the nature of preliminary expenses and the total of such expenses is Rs.195 lacs. These expenses are to be amortized under section 35D over a period of 5 years in equal installments. The proviso to section 35D(3) restricts the total allowable expenses to 5% of the capital employed and therefore, the company is entitled to amortise under section 35D, out of the total expenses of Rs.195 lacs, an amount of only Rs.175 lacs, being @ 5% of Rs.3,500 lacs, over a period of 5 years equally. Therefore, Rs.35 lacs is allowable in the A.Y.2009-10 under section 35D.

(b) The amount paid to a local mafia for the excavation of inhabitants who were occupying the land to be used as a yard is a payment in the nature of an offence and is prohibited by law. Therefore, it is not allowable as business expenditure under section 37.

(c) The interest of Rs.130 lakh paid on a loan taken for the acquisition of plant and machinery, relating to the period before commissioning of such plant and machinery, should be capitalized. Interest of Rs.20 lakh, attributable to the period after the machinery is put to use, is eligible for deduction under section 36 subject to the provisions of section 43B.

(d) The Apex Court, in the case of Madras Industrial Investment Corporation vs. CIT (1997) 225 ITR 802, has held that discount on issue of debentures is of revenue nature and it will be allowed on proportionate basis over the life of the debentures. In this case, the discount on debentures amounts to Rs.20 lacs, being 2% of Rs.1,000 lacs. The company can, therefore, claim an amount of Rs.4 lacs (i.e., one-fifth of Rs.20 lacs) as an expenditure in the return for A.Y. 2009-10.

(e) As per section 43B, interest due to a financial institution is allowable, if such interest is paid on or before the due date of filing of return under section 139(1). Interest of Rs.200 lacs not paid up to 30.9.2009, being the due date of filing of return under section 139(1), is, therefore, not allowable as deduction for the P.Y.2008-09.

(B) Computation of Capital Gains chargeable to tax for A.Y.2009-10

Particulars	Rs.	Rs.
Gross sale consideration of the land		50,00,000
Less: Expenses on transfer of land paid to a broker @ 2.5% of the sale value [See Note 1]		1,25,000
Net Sale Consideration		48,75,000

Less: Indexed cost of acquisition and improvement.		
A) 1,50,000 x 582/100 [See Notes 2 & 4]	8,73,000	
B) 1,70,000 x 582/116 [See Notes 3 & 4]	8,52,931	17,25,931
		31,49,069
Less: Investment in bonds of NHAI eligible for exemption under section 54EC [See Note 5]		30,00,000
Capital Gains		1,49,069

Notes:

(1) Brokerage paid is allowable as deduction under section 48(i) as held by Rajasthan High Court in the case of Sah Roop Narain vs. CIT (1987) 32 Taxman 453.

(2) Cost of acquisition of the capital asset can be claimed as deduction under section 48 while computing capital gains. As per section 55(2)(b)(i), the cost of acquisition in case of a capital asset acquired before 1.4.81 shall be the actual cost of acquisition or the fair market value as on 1.4.81, at the option of assessee. Accordingly, in this case, the cost of acquisition would be the fair market value of the land on 1.04.81, as the same is beneficial to the assessee.

(3) Cost of improvement of the capital asset can also be claimed as deduction under section 48. The cost of improvement, in this case, would include the expenditure of Rs.1,50,000 on land development and construction of boundary wall and expenditure of Rs.20,000 on payment of stamp duty. Therefore, the total cost of improvement would be Rs.1,70,000.

(4) Since the asset transferred is a long-term capital asset, indexation benefit would be available and the indexed cost of acquisition and indexed cost of improvement are allowable as deduction while computing capital gains.

(5) Under section 54EC, exemption is available for investment, made within a period of 6 months from the date of transfer, in bonds of NHAI or RECL, redeemable after 3 years. In this case, the transfer took place on 17.8.2008 and the investment was made in bonds of NHAI, redeemable after 4 years, on 1.12.2008, which is within the 6 month period. Therefore, the investment of Rs.30 lacs qualifies for exemption under section 54EC.

Question 3

(a) Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions. (3 Marks)

(b) Mr. Korani transferred 2,000 debentures of Rs.100 each of Wild Fox Ltd. to Mrs. Rekha Korani on 3.10.07 without consideration. The company paid interest of Rs.30,000 in

September, 2008 which was deposited by Mrs.Korani with Kartar Finance Co. in October, 2008. Kartar Finance Co. paid interest of Rs.3,000 upto March, 2009. How would both the interest income be charged to tax in A.Y. 2009-10? (3 Marks)

(c) Sea Port Shipping Line, a non-resident foreign company operating its ships on the Indian Ports during the previous year ended on 31.3.2009, had collected freight of Rs.100 lacs, demurrages of Rs.20 lacs and handling charges of Rs.10 lacs inclusive of an amount of Rs.40 lacs collected in US dollars for the cargo booked for JNPT (Mumbai) from Antwerp. The expenses of operating its fleet during the year for the Indian Ports were Rs.110 lacs. The company denies its liability to tax in India. Examine. (3 Marks)

(d) A search was conducted under section 132 in the business premises of Harish on 15th December, 2008. At that time, assessments under section 143(3) for assessment years 2006-07 and 2007-08 and reassessment proceeding under section 147 for assessment year 2005-06 were pending before the Assessing Officer.

(i) What are the assessment years for which notice can be issued for making post-search assessment?

(ii) What would be the fate of pending assessments and reassessment?

(iii) What would be the effect, if the post-search assessment orders are annulled by the Income-tax Appellate Tribunal? (3 Marks)

Answer

(a) The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, 1961 are absence of national boundaries, non-requirement of physical presence of goods and non-requirement of physical delivery in e-commerce transactions. Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

(b) As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any income on such accretion should not be clubbed.

Therefore, applying the provisions of section 64(1)(iv), Rs.30,000, being the interest on debentures received by Mrs. Korani in September, 2008 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2007.

However, the interest of Rs.3,000 upto March 2009 earned by Mrs. Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

(c) The provisions of section 44B would apply in this case. This section provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7½% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession"

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India.

(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive tax scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax @ 7½% on the total receipts of Rs.130 lacs i.e., Rs.9.75 lacs.

(d) (i) The notice under section 153A can be issued for six assessment years preceding the assessment year relevant to the previous year in which the search is conducted. In this case, the search is conducted in the previous year 2008-09, the relevant assessment year for which is A.Y.2009-10. Therefore, notice can be issued for the six preceding assessment years i.e. for assessment years 2003-04 to 2008-09.

(ii) As per section 153A, the assessment or reassessment relating to any assessment year, falling within the above period of six assessment years, pending on the date of initiation of the search under section 132, shall abate. In other words, they will cease to be applicable. Therefore, the assessments under section 143(3) for assessment years 2006-07 and 2007-08 and the reassessment proceeding under section 147 for assessment year 2005-06 shall abate.

(iii) Section 153A provides that where the post-search assessment order is annulled in any appeal or any other legal proceeding, the abated assessment and reassessment proceedings shall stand revived. Therefore, the assessments under section 143(3) relating to assessment years 2006-07 and 2007-08 and the reassessment proceeding relating to assessment year 2005-06, which abated on initiation of search, shall stand revived.

Question 4

(a) Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.

(i) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.

(ii) The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).

(iii) The assessee deliberately has failed to make the payment of the tax collected under section 206C. (5 Marks)

(b) Ankur, the owner of a land situated in Kerala used for growing thereon different types of fruits, paddy, vegetables and flowers, received from Yahoo Movies Ltd., Chennai, an amount of Rs.5 lacs as rent towards the use of this land for shooting of a film. The amount so received was accounted by him in the books as revenue derived from land and claimed to be exempt under section 10(1). He now wants to confirm from you whether the amount has been correctly treated by him as agricultural income. (4 Marks)

(c) Fun India Limited has a carried forward credit of Rs.2 lacs under section 115JAA(3A) of the Income-tax Act from assessment year 2008-09. In the previous year 2008-09, the company's total income and book profit under section 115JB are Rs.5 lacs and Rs.8 lacs, respectively. Compute the tax payable by the company for assessment year 2009-10 and the amount to be carried forward under section 115JAA. (4 Marks)

Answer

(a) (i) Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which prosecution can be launched under section 275B and such person shall be punishable with rigorous imprisonment for a term which may extend to two years and shall also be liable to fine.

(ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which prosecution can be launched under section 276D and such person shall be punishable with rigorous imprisonment for a term which may extend to one year or with a fine of Rs.4 to Rs.10 for every day during which the default continues or with both.

(iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which prosecution can be launched under section 276BB and such person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.

(b) The income received by Mr. Ankur from a filmmaker for allowing them to shoot a film in the agricultural land owned by him is not in the nature of agricultural income because it was neither received by him against the sale of agricultural produce obtained nor for carrying out the normal agricultural operations on the land. The amount paid was only for the purpose of shooting of a film on such land.

To claim exemption for agricultural income under section 10(1), the conditions contained in section 2(1A) (a) to (c) have to be first complied with/fulfilled by the assessee. The Madras High Court in the case of B. Nagi Reddi v. CIT (2002) 258 ITR 719, following the judgment of Apex Court in the case of Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466, has held, on identical facts, that the income derived for allowing a shooting of film in the agricultural land cannot be treated as agricultural income, as it has no nexus with the land, except that it was carried out on agricultural land.

(c) According to section 115JAA, the tax credit to be allowed under the section is the difference between the minimum alternate tax paid under section 115JB and the tax payable by the assessee on his total income computed as per the other provisions of the Income-tax Act.

The amount of tax credit determined as aforesaid can be carried forward for seven assessment years. The brought forward tax credit shall be allowed to be set off in any assessment year to the extent of the difference between the tax on total income and minimum alternate tax which would have been payable under section 115JB for that assessment year.

Computation of tax payable by Fun India Limited for A.Y. 2009-10 and MAT credit to be carried forward to A.Y.2010-11

	Particulars	Rs.
A.	Total income	5,00,000
B.	Book profit	8,00,000
C.	Tax on A (30.9% of Rs.5,00,000)	1,54,500
D.	Tax on B (10.3% of Rs.8,00,000)	82,400
E.	Difference between C and D	72,100
F.	Tax credit brought forward from assessment year 2008-09	2,00,000
G.	MAT credit set-off (Being lower of E and F)	72,100
H.	Tax payable for A.Y.2009-10 (C - G)	82,400
I.	MAT credit to be carried forward to A.Y.2010-11 (F - G)	1,27,900

Question 5

(a) A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter-III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:

(i) Rural reconstruction and upliftment of the masses through Cottage Industry.

(ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over others. (5 Marks)

(b) An assessee who had been served with an order of assessment passed under section 143(3) read with section 147 on 1.1.2009 had filed an application against this order before the CIT as per section 264 on 11.1.2009. However, the CIT refused to entertain the application on the pretext of premature application. Assessee seeks your opinion.

(3 Marks)

(c) "X", while making payment to a non-resident for providing technical services on a world bank aided project "Net of Tax", had deducted tax as per rates prescribed but says that the payee is not entitled for the TDS certificate since the tax was not to be borne by the payee as per agreement. Examine. (3 Marks)

Answer

(a) As per section 2(15), "Charitable purpose" includes relief of the poor, education, medical relief and the advancement of any other object of general public utility. However, the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity.

(i) The Supreme Court has, in Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010, observed that "cottage industry" is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

(ii) The welfare of industrial workers with a stipulation that the workers of settler of trust have preference over others would also constitute "charitable purpose" within the meaning of section 2(15). The Patna High Court has, in CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

(1) the trust is created for a charitable purpose; and

(2) no part of the income of such trust enures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because "relative" means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The High Court concluded that it was immaterial that any employee of the settlor of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settler cannot disentitle the trust from claiming exemption under section 11.

(b) An assessee, who is aggrieved by the order of the Assessing Officer under section 143(3) read with section 147 passed on 1.1.2009, had moved an application for revision of order under section 264 on 11.1.2009. The order passed by the Assessing Officer under section 143(3) read with section 147 is an order appellable before the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e. upto 31.1.2009. This time limit had not expired on 11.1.2009 and the assessee had also not waived his right of appeal while filing the application for revision on 11.1.2009 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under section 264 by the assessee will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless the assessee has waived his right of appeal. In the present case, the time limit had not expired on 11.1.2009 and the assessee had also not waived the right of appeal while filing the application for revision before the Commissioner of Income-tax on 11.1.2009 under section 264. Therefore, the Commissioner's refusal to entertain such application is correct.

(c) Section 195A provides that where under an agreement, the tax chargeable on any income is to be borne by the person by whom the income is payable, then, for the purpose of deduction of tax at source, such income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under the agreement. The CBDT has, vide Circular No.785 dated 24.11.99, clarified that even in those cases where the tax has been borne by the payer of income under an agreement, the payer is under a legal obligation to furnish a TDS Certificate as per the provisions of section 203 of the Income-tax Act, 1961. Therefore, the contention of Mr. X that the payee is not entitled for the TDS certificate is incorrect.

Question 6

(a) Raj & Family is a HUF in which Mrs. Raj has impressed upon a house property owned by her for the common hotchpot of the family. Examine whether the personal property of Mrs. Raj so blended by her can be treated as a property of HUF. (4 Marks)

(b) Examine the correctness of the statement that "there exists no difference in the treatment of income claimed under section 10 with those claimed under Chapter VI-A of the Income-tax Act". (2 Marks)

(c) A petition for stay of demand was filed before ITAT by XYZ Ltd. in respect of a disputed demand for which appeal was pending before it, on which stay was granted by the ITAT vide order dated 1.1.08. The bench could not function thereafter till 1.2.09 and therefore, the disputed matter could not be disposed off. The Assessing Officer attached the bank account on 16.1.09 and recovered the amount of Rs.15 lacs against the arrear demand of Rs.25 lacs. The assessee requested the Assessing Officer to refund back the amount as it holds stay over it. The Assessing Officer rejected the contention of the assessee. Now the assessee seeks your opinion. (3 Marks)

(d) X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of transactions of Rs.300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of Rs.30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion. (5 Marks)

Answer

(a) The Apex Court has, in the case of Pushpa Devi v. CIT (1977) 109 ITR 730, held that "to blend" means to share along with others and not to surrender one's interest in favour of others to the exclusion of oneself. If a Hindu female, who is a member of an undivided family, impresses her absolute, exclusive property with the character of joint family property, she creates new claimants to her property to the exclusion of herself because, not being coparcener, she has no right to demand a share in the joint family property by asking for a partition. The expression "blending" is inapposite in the case of a Hindu female who puts her separate property, be it the absolute property or limited estate, in the joint family stock.

Therefore, applying the decision of the above case to the case on hand, Mrs. Raj cannot blend her personal property with the character of joint family property because the right to blend is limited to coparceners as per principle laid down by the Apex Court.

Note – With effect from 9.9.2005, due to the amendment of the Hindu Succession Act, the daughter of a coparcener shall, by birth, become a coparcener in her own right in the same manner as a son. However, this amendment would not affect the answer, since in this case, Mrs. Raj is not the daughter of a coparcener of the HUF, Raj & Family, but is the wife of one of the coparceners.

(b) The statement is incorrect. Section 10 lists out the items of income which do not form part of total income. Thus, such income are fully or partly exempt from tax. Items of income which are exempt under section 10 shall not form part of any head of income. Therefore, the income which are claimed as exempt under section 10 are excluded from gross total income, in the sense, they are not included in the computation of gross total income. However, for claiming deduction under Chapter VIA, the income must be included under the respective head of income for computation of gross total income and thereafter, deduction can be claimed under the respective section as specified in Chapter VI-A to arrive at the total income. In short, section 10 provides for exemption of income whereas Chapter VI-A provides for deductions from gross total income.

(c) The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay. Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. Section 254(2A) provides that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days, even if the delay in disposing of the appeal is not attributable to the assessee. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

In the present case, the period of 365 days has expired on 31.12.2008, after which date the order of stay stands vacated. Accordingly, the recovery of Rs.15 lacs against the arrear demand of Rs.25 lacs made by the Assessing Officer is in order.

(d) The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds shares carrying more than 26% of the voting power in X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price. The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Since X Ltd. has entered into an international transaction as defined in section 92B, any amount added or disallowed in computing the total income under section 92C(4), shall be deemed to represent income in respect of which particulars have been concealed or inaccurate particulars have been furnished which makes it liable for penalty under section 271(1)(c) read with Explanation 7. The penalty would be 100% to 300% of the amount of tax sought to be evaded.

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of Rs.1 lakh.

Question 7

(a) The assessee had failed to deposit the amount of tax under section 140A amounting to Rs.10,000 but filed his return of income in time. The Assessing Officer, besides charging of interest as per section 234B and section 234C, also issued show cause notice to levy a penalty of Rs.2,000. The assessee claimed that there is no provision in the Act to impose penalty for non-payment of tax under section 140A. (3 Marks)

(b) The income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income tax department on a particular issue in case of one assessee, Alpi for assessment year 2006-07 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2007-08, similar issue arose in the assessments of Alpi and her sister Palki, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal in respect of A.Y.2007-08 against the orders of the Commissioner (Appeals) for Alpi and her sister Palki? (3 Marks)

(c) Cash of Rs.25 lacs was seized on 12.9.2008 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.08 to release such cash after explaining the sources thereof, which was turned down by the department. The assessee seeks your opinion on, the following issues:

(i) Can the department withhold the explained money?

(ii) If yes, then to what extent and upto what period? (3 Marks)

Answer

(a) The failure on the part of the assessee to pay the whole or any part of the self-assessment tax under section 140A of the Income-tax Act makes him an assessee-in-default within the meaning of section 140A(3). The Assessing Officer can levy a penalty on the assessee-in-default by virtue of provisions of section 221(1) of the Income-tax Act and the maximum penalty which can be levied upon the assessee is to the extent of amount of tax remaining unpaid. Therefore, the issue of show cause notice levying a penalty of Rs.2,000 on the assessee, for non-payment of self-assessment tax of Rs.10,000 under section 140A, is in order.

(b) The Finance Act, 2008 has inserted a new section 268A with retrospective effect from 1st April, 1999. Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 286A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y.2007-08 both for Alpi and Palki.

(c) The proviso to section 132B(1)(i) provides that where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Chief Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, Wealth-tax Act etc. out of such asset. Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer within the 30 day period (i.e., before 31st October, 2008), the amount of existing liability may be recovered out of the asset and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

Note - It may be noted that one of the conditions mentioned above for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in this case, it has been given that the assessee's application for release of the asset, explaining the sources thereof, was turned down by the Department. It is possible to take a view that the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset. In such a case, the above condition is not satisfied, and the asset (namely, cash) cannot be released.

Question 8

(a) The owner of a house property, located at New Delhi, given on rent asks you to determine the value thereof on valuation date 31.3.2009 from the following information:

(i) The annual value of property assessed by Delhi Development Authority is Rs.10 lacs.

(ii) The rent fixed is Rs.80,000 p.m., out of which Rs.5,000 is for the furniture.

(iii) DDA has levied taxes @ 5% of rent of property which are being paid by the tenant.

(iv) The cost of repairing the house is also borne by the tenant.

(v) The tenant has given a refundable deposit of Rs.5 lacs on which he is entitled to receive a simple interest @10% p.a.

(vi) The tenant is also required to make payment of yearly lease rent of Rs.10,000 to the society.

(vii) The unexpired period of lease on the valuation date is 35 years. (6 Marks)

(b) Examine the correctness of the following taking into consideration the provisions of Wealth-tax Act :

(i) The Commissioner of Wealth-tax is not empowered to reduce or waive penalty unless it is approved by the Chief Commissioner or Director General.

(ii) Penalty for concealment of wealth can be imposed where the value of assets disclosed by the assessee is Rs.4,00,000 but determined by the W.T.O. at Rs.6,00,000. (4 Marks)

Answer

(a) Computation of value of the house property on valuation date 31.3.2009

Particulars	Rs.
Actual Rent received is Rs.75,000 p.m. because the rent of furniture does not constitute rent for the building (Rs.75,000 x 12)	9,00,000
Add: (i) Taxes borne by the tenant, being 5% of rent received	45,000

(ii)	Repairs since borne by the tenant, hence 1/9th of actual rent received	1,00,000
(iii)	15% of amount of deposit of Rs.5 lacs less interest paid @ 10% (75,000 – 50,000)	25,000
(iv)	Obligation of landlord for payment of lease rent met by tenant. Actual amount paid is to be added.	10,000
Annual Rent		10,80,000

The annual rent so worked out has to be compared with the assessed annual value of DDA and the higher value of the two has to be adopted as Gross Maintainable Rent (GMR). The assessed annual value is Rs.10,00,000 whereas the annual rent works out to Rs.10,80,000. Therefore, the annual rent is higher and shall be adopted for calculating the Net Maintainable Rent.

Particulars		Rs.
Computation of Net Maintainable Rent		
Gross Maintainable Rent (GMR), being the annual rent		10,80,000
Less: (i) Municipal Taxes levied by DDA	45,000	
(ii) 15% of GMR	1,62,000	2,07,000
Net Maintainable Rent		8,73,000
Capitalised value of NMR		
Where the unexpired period of lease is less than 50 years but more than 15 years, the value is equal to NMR × 8 i.e., Rs.8,73,000 x 8.		69,84,000

Therefore, the value of house property on valuation date 31.3.2010 is Rs.69,84,000.

(b) (i) Under section 18B of the Wealth-tax Act, the Commissioner is vested with the power to reduce or waive the penalty suo moto or on an application made by the assessee, if he is satisfied that the assessee has –

(1) voluntarily and in good faith made full and true disclosure of the particulars of his wealth, prior to detection of the same by the Assessing Officer;

(2) co-operated in any enquiry relating to the assessment of his net wealth; and

(3) has also made satisfactory arrangements for the payment of tax or interest payable in consequence of an order passed by the Assessing Officer for the relevant assessment year.

However, no order reducing or waiving the penalty, in the above case, shall be made by the Commissioner without the prior approval of the Chief Commissioner or Director General, if the concealed net wealth in respect of which the penalty was imposed or imposable for any relevant assessment year exceeds Rs.5 lakh.

(ii) The levy of penalty under section 18(1)(c) of the Wealth-tax Act is in respect of concealment of wealth or furnishing inaccurate particulars of wealth. Explanation 4 to section 18 clarifies that an assessee would be deemed to have furnished inaccurate particulars of his wealth if the value of assets disclosed by him is less than 70% of the value as determined in an assessment under section 16 or 17, unless he proves that the value of assets as disclosed by him is the correct value. In the case of this assessee, the value of the assets determined by the Wealth-tax Officer is Rs.6 lakh whereas the value disclosed by the assessee is only Rs.4 lakh. Since the value disclosed by the assessee i.e., Rs.4 lakh is less than Rs.4.2 lakh, being 70% of the value determined by the Wealth-tax Officer, penalty under section 18(1)(c) is attracted in this case, unless the assessee proves that the value of assets disclosed by him is the correct value.

PAPER – 8 : INDIRECT TAXES

Attempt all questions.

PART – A

Question 1

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

   (i) Adjudicating authority

   (ii) Excisable goods (2 x 2 = 4 Marks)

(b) Mention the last date of filing the following returns under the Central Excise Rules, 2002:

   (i) ER-4 for the financial year 2009-10

   (ii) ER-7 for the financial year 2009-10 (1 x 2 = 2 Marks)

(c) Distinguish between compounded levy scheme and duty based on annual production capacity under central excise. (4 Marks)

(d) WM Ltd. is manufacturing a product which is captively consumed to produce a final product, which is exempt from the payment of excise duty. The intermediary product is having a distinct market of its own. The company is of the view that since the final product is exempt, no duty liability arises on intermediary product also. The department objected the view of the assessee.

   Discuss, with reference to a decided case law, if any, whether the view of company is justifiable? (5 Marks)

(e) An assessee sold certain goods to PQR Company Limited for Rs.20,000 on 09.09.2009. The buyer is a related person as defined under section 4(3)(b) of the Central Excise Act, 1944. The buyer did not sell the goods but used it as intermediary product. The cost of production of the goods was Rs.16,000. What should be the assessable value?

   What should be the assessable value, if the goods were sold to unrelated person for Rs.20,000, who also used it as intermediary product?

   You may assume that the price charged from the buyer is excluding excise duty and other taxes. (5 Marks)

The Suggested Answers for Indirect Taxes (Paper 8) are based on the provisions as amended by the Finance Act, 2008 and Notifications/Circulars issued up to 30.04.2009 which are relevant for November 2009 examinations.

Answer

(a) (i) Section 2(a) of the Central Excise Act, 1944 defines adjudicating authority to mean any authority competent to pass any order or decision under this Act. However, it does not include the following:

(a) CBEC constituted under the provisions of Central Board of Revenue Act, 1963;

(b) Commissioner of Central Excise (Appeals);

(c) Appellate Tribunal.

(ii) Excisable goods have been defined vide section 2(d) of the Central Excise Act, 1944. It means goods specified in the First Schedule and the Second Schedule to the Central Excise Tariff Act, 1985 as being subject to duty of excise and includes salt. An explanation has been added in this definition with effect from 10.5.2008 which states that for the purposes of this clause "goods" includes any article material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable.

(b) (i) ER-4 for the preceding financial year to which it relates is filed annually by 30th November of the succeeding year [Rule 12(2) of the Central Excise Rules, 2002]. Therefore, the last date for filing ER-4 for the financial year 2009-10 shall be 30.11.2010.

(ii) ER-7 for the financial year to which it relates is filed by the 30th April of the succeeding financial year [Rule 12(2A) of the Central Excise Rules, 2002]. Therefore, the last date for filing ER-7 for the financial year 2009-10 shall be 30.04.2010.

(c) Compounded levy scheme: Under compounded levy scheme, the manufacturer has to pay the prescribed duty for a specified period on the basis of certain factors relevant to production, like size of equipment employed, production capacity or some other criteria [Rule 15 of Central Excise Rules, 2002].

Compounded levy scheme is presently applicable to stainless steel pattas/patties and aluminum circles. It is an optional scheme, i.e. the manufacturer can opt to pay duty as per normal rules.

Duty based on production capacity: In case of certain products, Central Government, by notification, can specify that duty on such notified products will be levied and collected on the basis of annual production capacity of the factory. [Section 3A(1) of the Central Excise Act, 1944].

Excise duty on pan masala and gutkha is payable on the basis of annual production capacity under section 3A. The scheme is compulsory.

(d) The duty of excise is a duty on manufactured goods which are movable and marketable. If any manufactured goods satisfies the movability and marketability conditions, it would become dutiable even if it is an intermediate product and the final product is not dutiable. Therefore, in the given case the intermediate product would be dutiable even though it is captively consumed and the final product is not dutiable as it has a distinct market of its own and is marketable.

The Supreme Court's view in the case of White Machine Vs. CCEx Delhi 2008(224) ELT 347 was also the same. In the above case, the assessee manufactured C.I. Castings which were captively consumed for production of C.I Chilled Rolls. These Chilled Rolls were exempt from duty. The Apex Court opined that since the final product was exempt, the C.I Castings would become dutiable if they satisfied the marketability condition.

Therefore, the company's view is not justifiable and the Department's view is acceptable.

(e) The proviso to rule 9 of the Central Excise Valuation (Determination of Excisable Goods) Rules, 2000 lays down that in a case where the related person does not sell the goods but uses or consumes such goods in the production or manufacture of articles, the value thereof shall be determined in the manner specified in rule 8.

Rule 8 provides that where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods.

Therefore, when the goods are sold to a related person, the assessable value shall be 110% of Rs.16,000 (Rs.16,000 + Rs.1,600) i.e., Rs.17,600. However, when the goods are sold to unrelated buyer, the assessable value will be Rs.20,000.

Question 2

(a) M/s. XYZ Ltd. shifted its factory from Sitapura to Rampur and transferred all the available inputs and capital goods to the new site. The inputs, capital goods and the balance of unutilised CENVAT credit were duly received and accounted for in the registers of the new unit.

The said balance of unutilised CENVAT credit transferred was Rs.8,00,000. However, the quantum of CENVAT credit attributable to the inputs and capital goods so transferred to the new site was Rs.6,00,000 only. The Department raised the plea that the assessee was entitled to transfer only Rs.6,00,000 of CENVAT credit and not the entire balance of unutilized credit of Rs.8,00,000.

Explain, with the help of a decided case law, if any, whether Department's plea is justified in law? (4 Marks)

(b) What are the circumstances under which the certificate of registration can be revoked or suspended under Central Excise? (3 Marks)

(c) To whom should the matter be referred in a case where the Committee of Chief Commissioners of Central Excise differs in its opinion as to the legality or propriety of the decision or order of the Commissioner of Central Excise and how will the matter be settled under section 35E(1) of the Central Excise Act, 1944 ? (3 Marks)

(d) Discuss in brief the powers of Settlement Commission to grant immunity from prosecution. (3 Marks)

(e) What is the difference between short levy and short payment? (2 Marks)

Answer

(a) As per rule 10 of the CENVAT Credit Rules, 2004, if a manufacturer of the final product shifts his factory to another site with the specific provision for transfer of liabilities of such factory, he shall be allowed to transfer the CENVAT credit lying unutilized in his accounts to the new site if the stock of inputs as such or in process, or the capital goods is also transferred along with the factory or business premises and the inputs, or capital goods, on which credit has been availed of, are duly accounted for to the satisfaction of Assistant/Deputy Commissioner of Central Excise.

The Madras High Court in the case of CCE, Pondicherry vs. CESTAT 2008 (230) ELT 209 (Mad.) has also affirmed this position. In this case, the High Court has held that erstwhile Rule 8 of the CENVAT Credit Rules, 2002 (new rule 10 of the CENVAT Credit Rules, 2004) does not provide that the assessee could transfer the CENVAT credit corresponding only to the quantum of inputs or capital goods transferred to the new factory.

Thus, the plea of Department is not justified presuming that M/s. XYZ Ltd. shifted its factory from Sitapura to Rampur with the specific provision for transfer of liabilities of such factory and the inputs or capital goods on which credit has been availed of are duly accounted for to the satisfaction of Assistant/Deputy Commissioner of the Central Excise.

(b) The certificate of registration under the Central Excise Act, 1944, can be suspended or revoked by the Deputy Commissioner or the Assistant Commissioner of Central Excise under the following circumstances.

(i) when the assessee or any person under his employment has committed any breach of any condition of the Central Excise Act or any rules made there under.

(ii) the assessee or a person under his employment has been convicted of an offence under Section 161 read with section 109 or section 116 of the Indian Penal Code.

(c) The Finance Act, 2008 has added a proviso to section 35E(1) to cover a case where the Committee of Chief Commissioners of Central Excise differs in its opinion as to the legality or propriety of the decision or order of the Commissioner of Central Excise. In such a case the Committee shall state the point or points on which it differs and make a reference to the Board which after considering the facts of the order, if is of the opinion that the decision or order passed by the Commissioner of Central Excise is not legal or proper may direct such Commissioner or any other Commissioner to apply to Appellate Tribunal for determination of such points arising out of decision or order.

(d) The Settlement Commission, subject to certain provisions, has the power to grant immunity from prosecution in respect of the case covered by the settlement, if the applicant has co-operated with the Commission and has made full and complete disclosure. If the payment is not made as per the settlement order or any particulars are concealed or any false evidence is given, the immunity is withdrawn [Sub-sections (2) and (3) of section 32K].

Immunity can be granted only in respect of prosecution for any offence under the Central Excise Act and not in respect of prosecution for any offence under the Indian Penal Code or any other Central law. However, the immunity from prosecution for any offence under the Indian Penal code or any other central law can be granted in cases filed upto 31-05-2007 [Section 32K(1) of the Central Excise Act].

If prosecution has already been launched before submission of application for settlement, the immunity cannot be granted [Proviso to section 32K(1) of the Central Excise Act].

(e) Short levy: Short levy arises when the charge itself is done at a lower rate. It may arise out of wrong classification.

Short payment : Short payment arises out of a short levy or short payment of a correct levy. It is a case of less payment of excise duty than what is due.

Question 3

(a) M/s. Silver Enterprises is manufacturing packing material namely printed cartons of paper and paper board with brand name of another company. Its turnover for the year 2008-09 was Rs.2 crore and in the year 2009-10 it is expected to increase by 50%.

The firm has approached you as a consultant whether it is eligible for concession under Notification No. 8/2003 dated 01.03.2003 as amended. Is exemption available to the firm? If yes, what is the limit of turnover, for which the exemption is available for both the years, i.e. 2008 - 09 and 2009 -10? (5 Marks)

(b) Which reasons shall not be considered as special and adequate for awarding sentence of imprisonment for a term of less than six months as per section 9(3) of the Central Excise Act, 1944? (4 Marks)

(c) How can the goods kept in a warehouse for the purpose of export be diverted for home consumption? Explain briefly. (4 Marks)

(d) Can the Department file an appeal in respect of same assessee, if in respect of some years, no appeal was filed involving identical dispute? (2 Marks)

Answer

(a) Yes, the SSI exemption will be available to M/s. Silver Enterprises as Notification No. 8/2003 CE dated 01.03.2003 has been amended w.e.f. 01.09.2008 to provide that SSI exemption will be available to packing material including printed cartons of paper or paper board affixed with brand name of another company. It has been presumed that the turnover of M/s. Silver Enterprises for the year 2007-08 was less than Rs.400 lakh.

For the year 2008-09, the exemption will be available for turnover of first Rs.90 lakh from 01.09.2008 onwards.

Since, in the year 2008-09, the turnover of M/s. Silver Enterprises is Rs. 2 crore which is less than Rs.400 lakh, it is eligible for small scale exemption in the year 2009-10. For the year 2009-10, turnover upto Rs.150 lakh will be fully exempt, if M/s. Silver Enterprises does not avail CENVAT on inputs.

(b) As per section 9(3) of the Central Excise Act, 1944, for the purposes of section 9(1) or 9(2), the following shall not be considered as special and adequate reasons for awarding a sentence of imprisonment for a term of less than six months, namely:

(i) the fact that the accused has been convicted for the first time for an offence under this Act;

(ii) the fact that in any proceeding under this Act, other than a prosecution, the accused has been ordered to pay a penalty or the goods in relation to such proceedings have been ordered to be confiscated or any other action has been taken against him for the same act which constitutes the offence;

(iii) the fact that the accused was not the principal offender and was acting merely as a carrier of goods or otherwise was a secondary party in the commission of the offence:

(iv) the age of the accused (too young or too old)

(c) The goods kept in a warehouse for being exported can be diverted for home consumption in the following manner:

(i) With the permission of the Deputy or Assistant Commissioner of Central Excise, the goods can be cleared for home consumption on invoice prepared under rule 8 on payment of duty, interest and any other charges on TR-6 challans. Necessary entries are to be made in the export warehouse register maintained by the exporter in the warehouse.

(ii) Credit will be permitted in the Running Bond Account equivalent to the duty involved in the goods so diverted, which shall not exceed amount of duty debited on the basis of ARE-3 on which such goods were received in the warehouse.

(iii) Goods can also be diverted for home consumption even after clearance of goods from warehouse under ARE- 1. The documents will be cancelled as per Notification No. 46/2001 CE (NT) dated 26.6.2001 as amended. The intimation of such cancellation is to be given to Deputy/Assistant Commissioner having jurisdiction over the warehouse. Credit in Running Bond Account will be permitted in the same manner as mentioned above.

(iv) The exporter has to pay an interest @ 24% p.a on the amount of duty payable on such goods from the day of clearance from the factory of production or any other premises approved till the date of payment of duty and clearance.

(d) It has been held by the Supreme Court in the case of C.K Gangadharan v. CIT, Cochin, 2008 (228) ELT 497 (SC) that merely because in some cases Revenue has not preferred an appeal that does not operate as a bar for the Revenue to prefer an appeal in another case where there is just cause for doing so or it is in public interest to do so or for a pronouncement by the higher Court when divergent views are expressed by the different High Courts. However, the Supreme Court in the case of CIT vs. J.K. Charitable Trust 2008 (232) ELT 769 (SC 3 members bench) has held that if in respect of some years, in respect of same assessee, no appeal was filed involving an identical dispute, revenue can be precluded from filing an appeal if the fact situation in subsequent years remains the same.

PART – B

Question 4

(a) Briefly explain the following with reference to the Customs (Determination of Value of Imported Goods) Rules, 2007:

(i) Goods of the same class or kind

(ii) Computed value (3 + 3 = 6 Marks)

(b) Mr. Vasu, the assessee, was summoned under section 108 of the Customs Act, 1962, to give his statement in an inquiry. He filed the application for anticipatory bail in the District and Sessions Court which was disposed on the ground of being premature. However, he later moved to the High Court, which granted him anticipatory bail with a direction to the authorities that he should not be arrested without giving a seven day's prior notice to him.

The Revenue contended that the order passed by the High Court was illegal and erroneous. Explain, with the help of a decided case law, if any, whether the stand taken by the Revenue is sustainable in law? (5 Marks)

(c) Goods manufactured or produced in India, which were earlier exported and thereafter imported into India will be treated at par with other goods imported into India. Is the proposition correct or any concession is provided on such import? Discuss briefly.

(5 Marks)

(d) Ascertain whether the exporter is entitled to duty drawback in the following independent cases and if yes, what is the quantum of such duty drawback:

(i) FOB value of goods exported is Rs.50,000. Rate of duty drawback on such export of goods is 1%.

(ii) FOB value of 2,000 kgs goods exported is Rs.2,00,000. Rate of duty drawback on such export is Rs.30 per kg. Market price of goods is Rs.50,000 (in wholesale market) (2 + 2 = 4 Marks)

Answer

(a) (i) As per rule 2(1)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, goods of the same class or kind, means imported goods that are within a group or range of imported goods produced by a particular industry or industrial sector and includes identical goods or similar goods.

(ii) As per rule 2(1)(a) of the said rules, computed value means the value of imported goods determined in accordance with rule 8.

As per rule 8, subject to the provisions of rule 3, the value of imported goods shall be based on a computed value, which shall consist of the sum of –

(a) the cost or value of materials and fabrication or other processing employed in producing the imported goods;

(b) an amount for profit and general expenses equal to that usually reflected in sales of goods of the same class or kind as the goods being valued which are made by producers in the country of exportation for export to India;

(c) the cost or value of all other expenses under sub-rule (2) of rule 10.

(b) The stand taken by the Revenue is valid. A similar issue has been dealt by the Supreme Court in the case of Union of India v. Padam Narain Aggarwal 2008 (231) ELT 397, wherein the Apex Court has observed that the power to arrest by a Custom Officer under section 104 of the Customs Act, 1962 is statutory in character and cannot be interfered with.

Supreme Court pronounced that the direction to issue 10 days prior notice before arrest even in case of a non-bailable offence could not be said to be legal or in consonance with law. Firstly, the order passed by the High Court was a blanket one and granted protection to respondents in respect of any non- bailable offence. Secondly, it illegally obstructed, interfered and curtailed the authority of Custom Officers from exercising statutory power of arresting a person said to have committed a non-bailable offence by imposing a condition of giving 10 days' prior notice, a condition not warranted by law. Hence, the order of the High Court was set aside.

Therefore, in the given case, it can be concluded that the stand taken by the revenue is sustainable in law.

(c) The given proposition is correct i.e., goods produced in India, which were earlier exported and thereafter imported into India will be treated at par with other goods imported into India [Section 20 of the Customs Act, 1962]. However, the following concessions are being provided in this regard:

(i) Maximum import duty will be restricted to duty drawback or rebate availed at the time of export – Notification No. 94/96 Cus. dated 16.12.1996.

(ii) Where the goods were originally exported for repairs, the duty on re-importation is restricted to the fair cost of repairs (including cost of materials used in repairs, insurance and freight charges, both ways) done abroad, whether such costs are actually incurred or not.

The above two concessions are given subject to the condition that:

(a) the re-importation is done within 3 years or 5 years if time is extended.

(b) the exported goods and re-imported goods must be the same.

In case of point (ii), the ownership of the goods should also not have changed.

However, these concession are not applicable in case of exports from EPZ or EOU and if repair amounts to re-manufacture - Notification No. 94/96 Cus dated 16.12.1996.

(iii) When exported goods come back for repairs and re-export, the re-imported goods can avail exemption from paying of import duty subject to the following conditions:

(i) the re-importation is for repairs only

(ii) the time limit is 3 years

(iii) the goods must be re-exported after repairs

(iv) the time limit for export is 6 months (extendable to one year).

Notification No. 158/95 Cus. dated 14.11.1995.

(d) (i) As per rule 8(1) of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, no amount of drawback shall be allowed if the rate of drawback is less than 1% of the FOB value, except where the amount of drawback per shipment exceeds Rs.500. Further, as per section 76(1)(c) of the Customs Act, 1962 drawback is not allowed where the drawback due in respect of any goods is less than Rs.50.

In the given case, since the rate of duty drawback is not less than 1% and drawback due is Rs.500 (1% of FOB value) which is more than Rs.50, duty drawback shall be allowed.

(ii) Section 76(1)(b) of the Customs Act, 1962 inter alia provides that no drawback shall be allowed in respect of any goods, the market price of which is less than the amount of drawback due thereon. In this case, the market price of the goods is Rs.50,000, which is less than the amount of duty drawback, i.e. 2,000 kgs x Rs.30 = Rs.60,000. Hence, no drawback shall be allowed.

Question 5

(a) Assessable value of certain goods imported from USA is Rs.10,00,000. The packet contains 10,000 pieces with maximum retail price of Rs.200 each. The goods are assessable under section 4A of the Central Excise Act, 1944, after allowing an abatement of 40%. The excise duty rate is 8% ad valorem. Calculate the amount of additional duty of customs under section 3(1) of the Customs Tariff Act, 1975 assuming basic customs duty @ 10% ad valorem. (4 Marks)

(b) What are the provisions made under the Customs Act, 1962 regarding control of customs over the warehoused goods? (4 Marks)

(c) What are the orders that are appealable to the High Court under the Customs Act, 1962? Can the delay in filing an appeal be condoned by the High Court? (4 Marks)

(d) What are the provisions made under the Customs Act, 1962, regarding personal hearing and order under advance ruling? (4 Marks)

Answer

(a) As the goods are assessable under section 4A of the Central Excise Act, 1944, additional duty of customs will be payable on the basis of maximum retail price printed on the packing; less abatement as permissible [proviso to section 3(2) of the Customs Tariff Act.]

	Rs.
Maximum retail price Rs.200 x 10,000	20,00,000
Less : Abatement 40%	8,00,000
Assessable value under section 3(2)	12,00,000
Additional duty of customs @ 8%	96,000
Add : Education cess @ 2%	1,920
Secondary and higher education cess @ 1%	960
Additional customs duty payable	98,880

(b) Section 62 of the Customs Act, 1962 provides for the control of customs over the warehoused goods. The provisions are discussed as follows:

(i) All warehoused goods shall be subject to the control of the proper officer.

(ii) No person shall enter a warehouse or remove any goods therefrom without the permission of the proper officer.

(iii) The proper officer may cause any warehouse to be locked with the lock of the customs department and no person shall remove or break such lock.

(iv) The proper officer shall have access to every part of a warehouse and power to examine the goods therein.

(c) As per section 130(1) of the Customs Act, 1962, an appeal can be made to the High Court against the order of the Tribunal if the case involves substantial question of law, except in cases relating to rate of duty and valuation.

Sub-section (2) of section 130 inter alia lays down that an appeal can be made to the High Court within 180 days from the date on which the order appealed against is received by the Commissioner of Customs or the other party. There is no provision in the Act to condone the delay in filling an appeal. This view has been confirmed in CC v. Hongo India (2009) 236 ELT 417 (SC 3 member bench). Hence, the High Court cannot condone the delay in filing an appeal.

(d) The provisions regarding personal hearing and order under advance ruling are contained in section 28-I of the Customs Act, 1962. Section 28-I inter alia provides that if an application for advance ruling is received, the authority of advance ruling will examine the material submitted by the applicant or obtained by the authority and issue an order either allowing or rejecting the application. However, no application shall be rejected unless an opportunity has been given to the applicant of being heard.

Where an application is allowed, personal hearing can be given before the pronouncement of the advance ruling, if requested by the applicant. Such hearing can be given to the applicant himself or to his duly authorised representative.

Authority then pronounces its advance ruling within ninety days of the receipt of the application. Copy of the order, signed by members of authority and certified in the prescribed manner is sent to the applicant and the Commissioner.

PART – C

Question 6

(a) State with reasons in brief, whether service tax is payable in the following cases:

(i) Services provided to Special Economic Zone (SEZ) unit and SEZ developer, except where services are wholly consumed within SEZ.

(ii) Services provided by SEZ to DTA (Domestic Tariff Area).

(iii) Services provided by Indian agents undertaking marketing in India of goods of a foreign seller. (2 x 3 = 6 Marks)

(b) Briefly state the concept of export of taxable services under rule 3 of the Export of Services Rules, 2005. (3 Marks)

(c) Ascertain whether the refund of service tax paid on input services can be claimed in the following case:

Total credit of service tax on input services	Rs. 6,000	
Total turnover of output service	Rs.30,000	
Output service exported	Rs.20,000	(3 Marks)

(d) Explain the provisions of best judgement assessment provided under section 72 of the Finance Act, 1994 as amended. (3 Marks)

Answer

(a) (i) With effect from 03.03.2009, service tax is payable on the services provided to SEZ unit or SEZ developer irrespective of whether services are wholly consumed within SEZ or not. However, the SEZ unit or SEZ developer can get the refund of service tax paid by them by filing a refund claim as per the procedure prescribed in Notification No. 9/2009-ST dated 03.03.2009.

(ii) Yes. CBE&C vide Circular No. 105/08/2008 ST dated 16.09.2008 has clarified that a special economic zone unit will be liable to pay service tax on services provided by it to a domestic tariff area unit.

(iii) Rule 2 of the Export of Services Rules, 2005 inter alia provides that the provision of any taxable service specified in sub-rule (1) is treated as export of service when such service is provided from India and used outside India.

In this regard, CBE&C vide Circular No. 111/05/2009 ST dated 24.2.2009 has clarified that 'used outside India' means 'benefit should accrue outside India'. A service can be treated as exported even if all relevant activities take place in India, so long as the benefit of these services accrue outside India.

Thus, services provided by Indian agents undertaking marketing in India of goods of a foreign seller are 'export of service' on the presumption that the services provided by Indian agents are exported in accordance with Export of Services Rules, 2005 and hence service tax is not payable on them.

(b) As per rule 3 of the Export of Services Rules, 2005, the following are export of services:-

(i) When the service is provided in respect of immovable property which is situated outside India.

(ii) When the service is performed outside India.

(iii) When the service is provided from India but the recipient of service is outside India.

(c) Rule 5 of CENVAT Credit Rules, 2004 inter alia provides that the CENVAT credit in respect of the input services used in providing output services which are exported shall be allowed to be utilized towards payment of service tax on taxable output services. However, where such adjustment is not possible, the refund of credit shall be allowed.

In this case the service tax liability on taxable services of Rs.10,000 (Rs.30,000 - Rs.20,000) is Rs.1030 @10.3%. Therefore, there is an excess credit of Rs.4,970 (Rs.6,000 – Rs.1,030) which can not be utilized. Thus, the refund of such credit can be claimed. However, the refund will be restricted to the extent of ratio of export turnover to the total turnover for the given period, i.e. Rs.4,000 [Rs.6,000 x (Rs.20,000/Rs.30,000)].

(d) Section 72 provides that best judgement assessment can be done by the Central Excise Officer if :

(i) the assessee fails to furnish the return under section 70;

(ii) the assessee files the return but fails to assess service tax as per the provisions of the Finance Act, 1994 and rules made thereunder.

For making best judgement assessment, the Central Excise Officer may ask the assessee to produce such accounts, documents or other evidence as he may deem necessary. After taking into account all the relevant material, the Central Excise Officer shall make the assessment of the value of taxable service to the best of his judgement and determine the sum payable by, or refundable to, the assessee. He shall pass the order in writing, after giving an opportunity of being heard to the assessee.

SUMMARY OF EXAMINERS' COMMENTS ON THE PERFORMANCE OF CANDIDATES

PAPER – 5 : COST MANAGEMENT

General Comments

The overall performance of the candidates was unsatisfactory. It was observed that examinees lacked conceptual clarity. Many examiners are of the opinion that examinees do not take this subject very seriously. Examinees need to understand various techniques and tools used in Cost Management to perform better in this subject.

Specific Comments

Question 1.(a) This practical question part related to Activity Based costing. Most of the candidates confused target cost with traditional costing system, thus the comparison between target costing and ABC was also defective.

(b) In this practical problem related to PERT-CPM, network diagram was not properly drawn by many of the examinees. Dummy activities were not properly conceived by many of the students. Standard deviation and probalities of completion of job was also not calculated correctly by many of them.

(c) This question related to the application of learning curve was not properly answered by many of the examinees.

Question 2.(a) This practical question related to standard costing and variance analysis was attempted by many examinees. Many of them failed to prepare the statement of equivalent production in units correctly and consequently calculation of material, labour, overhead and sales variance calculation had been wrong.

(b) This practical question related to the decision making was attempted well by many of the examinees. However, some of them has not treated 'opportunity cost' properly while solving this problem.

(c) This theoretical question related to total quality management was poorly answered by many of the candidates.

Question 3.(a) This question part related to 'Simulation' was attempted by many of the students. However, most of them were not able to calculate 'average queue length', 'waiting times', 'service time' accurately.

(b) This theory part related to 'Margin of safely' and the improvement of it was attempted fairly well by the examinees.

(c) Answer to this theory question our benchmarking was poorly exhibited by the students. Examinees failed to brief various stages involved in the process.

Question 4.(a) This numerical question related to the 'Product Mix Decision' was well answered by the students. However, 'profit for the production mix' could not be calculated accurately by many of them. In some cases 'most profitable crop' and 'break even point' of most profitable crop was calculated wrongly.

(b) This numerical question related to linear programming was solved correctly by many of the candidates.

(c) To answer this theory question related to transportation problem the understanding of the concept the 'degeneracy' was not clear. The performance of the examinees was average.

Question 5.(a) This numerical question related to 'Costing of service sector' was not attempted well by the examinees. Many candidates were not able to calculate 'operating income' accurately.

(b) The performance on numerical question part of 'pricing of a product' was poor.

(c) This theory question part related to sunk cost was fairly well attempted by the examinees.

PAPER – 6: MANAGEMENT INFORMATION AND CONTROL SYSTEMS

General Comments

The question paper was simple, direct and comprehensive. The question paper had no choice and the examinees were supposed to answer all the questions. The examiners were of the view that the examinees are expected to write the answers precisely and to the point. Hence, they advised the examinees to read the study material and reference material thoroughly so that they can write complete and to-the-point answers.

Specific Comments

Question 1.(a) Many of the examinees' answers indicated lack of understanding of "System Stress" and "System Change".

(b) Many of the examinees failed to explain the major components of transaction processing system instead, the examinees explained Transaction Processing System cycle.

(c) Most of the candidates answered the question on the effect of applying computer technology to information system vaguely without being specific.

(d) Many of the examinees failed to list the objectives of the inventory control system.

Question 2.(a) Many of the examinees explained only the functions of production planning and control systems instead of the basic requirements of the production planning and control systems.

(b) Most of the examinees explained only one advantage of parallel conversion from manual to computerized system.

(c) Some of the examinees explained the components of the client/server technology instead of the characteristics of client/server technology.

(d) Most of the examinees failed to write the precise answer for the meaning of information security. The definition of information security should address the safeguard and protection of all data and information relating to the organization.

Question 3.(a) Most of the examinees explained about the steps involved in executive decision making instead of the characteristics of the types of information used in executive decision making.

(b) Most of the candidates could not write about the risks involved in the end-user computing.

(c) Many of the examinees did not give correct example of the source document fraud.

d) Many of the candidates have answered the question on the factors to design user output well.

Question 4.(a) Some of the candidates mixed-up the answer on program design tools with system development tools.

(b) Many of the candidates explained the uses of ERP instead of the characteristics of an ERP solution.

(c) This question on different level of integration of CASE tools has been well answered.

(d) Most of the candidates answered this question by listing various techniques for concurrent audit instead of techniques for preserving audit trails.

Question 5.(a) Most of the examinees explained about the procedure of audit trail instead of writing the objectives of audit trail.

(b) Most of the candidates mixed up the characteristics of Internet which are likely to attract fraudsters with the uses of Internet.

(c) Many of the candidates could not give reasons why the audit methods that are effective for manual audits prove ineffective in many IS audits.

(d) Most of the candidates attempted this question but the answers for various basic terms included in IT Act 2000 were not up to the mark.

PAPER – 7 : DIRECT TAXES

General Comments

Most of the candidates do not possess the required expert knowledge in income-tax. Further, some of the candidates lack conceptual understanding. Therefore, their answers were vague and based on surmises and conjectures. Lengthy answers dealing with irrelevant points were common. Many candidates have not given proper notes in support of their answers. The presentation of answers was also very poor in many cases.

Specific Comments

Question 1.(i) Many candidates were not aware of the provisions of section 33AB(6) that expenditure incurred out of withdrawal from Tea Deposit account is not allowable as deduction.

(ii) Some candidates were not aware that profit from sale of tea leaves has to be treated as agricultural income.

(iii) The landmark Supreme Court ruling holding that stamp duty and registration fee in connection with issue of bonus shares are revenue expenditure is not known to many candidates.

(iv) The requirement of depositing the tax on or before 31st March of the year in respect of tax deducted between April and February and before the due date of filing of return in respect of tax deducted in March, for claiming deduction of the expenditure in the relevant previous year, is not known to many candidates.

(v) Very few candidates were aware that when arrears of interest is converted into a loan, subsequent repayment of the same is allowable as deduction.

Question 2.(a) Some of the candidates were not aware that as per the provisions of section 35D, the expenditure to be amortised has to be restricted to 5% of capital employed. Very few candidates were aware that discount on issue of debentures has to be amortised over the life of the debentures.

(b) Some of the candidates were confused regarding the treatment of stamp duty paid during a later year i.e., whether the same can be treated as cost of improvement.

Question 3.(a) Many candidates were not aware of the reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income of e-commerce transactions.

(b) A very few candidates were aware that income on the asset transferred has to be clubbed but if there is accretion to the asset, any income on such accretion should not be clubbed.

(c) Some candidates were not aware of the provisions of section 44B and hence, were not able to answer the question correctly.

Question 4.(a) Many candidates were not aware of the relevant provisions of the Income-tax Act for launching prosecution in case of the defaults mentioned in the question.

(b) Most of the candidates have not mentioned that the conditions contained in section 2(1A) have to be complied with/fulfilled by the assessee for claiming exemption of agricultural income under section 10(1).

(c) A few candidates have deducted total income from book profit and considered the balance as tax payable.

Question 5.(a) Although many candidates have explained the meaning of “charitable purpose” correctly, they were not able to explain whether rural reconstruction and upliftment of the masses through cottage industry and welfare of industrial workers with a stipulation that the workers of the settlor of trust have got preference over others, constituted “charitable purpose”.

(b) Most of the candidates were not aware of the conditions specified under section 264(4) and were, therefore, not able to answer the question correctly.

(c) A very few candidates were aware of the CBDT Circular No.785 dated 24.11.99 which clarifies that even in those cases where tax has been borne by the payer of income, he is under a legal obligation to furnish a TDS Certificate as per the provisions of section 203 of the Income-tax Act, 1961.

Question 6.(a) Most of the candidates were not aware that the right to blend is limited to coparceners and were hence, not able to answer the question correctly.

(c) This question is based on a recent amendment in section 254(2A), which some candidates were not aware of.

(d) Many candidates were not able to state that X Ltd. and Yen Ltd. are associated enterprises. Consequently, they were not aware of the penal provisions attracted in case of the defaults mentioned in the question.

Question 7.(a) Most of the candidates were not able to apply the provisions of section 140A(3) and section 221(1) and were hence, not able to answer the question correctly.

(b) This question is based on section 268A, inserted by the Finance Act, 2008, which some candidates were not aware of.

(c) Very few candidates were aware of the conditions prescribed in the proviso to section 132B(1)(i).

Question 8.(a) Some of the candidates have not added back lease rent paid by the tenant to arrive at the annual rent.

(b) The candidates have not clearly brought out the fact that the approval of the Chief Commissioner or Director General is required only if the conditions specified in section 18B are not satisfied or, where the conditions are satisfied, when the concealed net wealth exceeds Rs.5 lakh.

PAPER – 8 : INDIRECT TAXES

General comments

The performance in the paper was not satisfactory. Candidates do not answer all parts of a question at one place making valuation difficult for examiners. The presentation skills of the candidates need to be improved as the handwriting of many candidates was not legible. Candidates lack in-depth study of the subject as they write lot of irrelevant matter in the answers.

Specific comments:

Question 2.(b) Candidates in most of the cases wrongly mentioned that in the event of cessation of business/death of the owner, certificate of registration can be revoked.

Question 3.(a) Many candidates were not aware about SSI exemption available to branded packing materials.

(b) Candidates in most of the cases explained the situations under which imprisonment can be sentenced instead of giving the reasons not considered as special and adequate for awarding sentence of imprisonment for a term of less than six months.

Question 4.(a) Few candidates could not explain the terms as per Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

(b) Few candidates wrongly mentioned that power to arrest is not statutory but subject to certain conditions and that High Court enjoys the power to award anticipatory bail to provide protection to any importer.

(d) Many candidates were not able to calculate the correct amount of drawback under two cases. In part (ii), many candidates wrongly allowed proportional drawback since market price was lower than the drawback.

Question 5.(b) Many candidates did not know how to calculate additional duty of customs under section 3(1) of the Customs Tariff Act 1975 when goods are assessable under section 4A of the Central Excise Act, 1944.

(b) Some candidates did not present the provisions made for control over warehoused goods correctly. Instead they mentioned the provisions not relevant to the question.

(c) Large number of candidates did not discuss the concessions available on re-import of goods completely.

(d) Answers to the question regarding personal hearing and order under advance ruling were quite poor.

Question 6.(c) Amount of refund of service tax paid, although very easy to calculate, was made complicated unnecessarily by some candidates.

(d) A few candidates explained the best judgement assessment as provided under Income-tax Act, 1961 instead of explaining the provisions as provided under the Finance Act, 1994.