

PAPER – 5 : COST MANAGEMENT

QUESTIONS

1. X Ltd. manufactures and distributes three types of car (the C1, C2, and C3). Each type of car has its own production line. The company is worried by extremely difficult market condition and forecasts losses for the forthcoming year.

Current operations:

The budgeted details for next year are as follows:

	C1	C2	C3
	Rs.	Rs.	Rs.
Direct materials	2,520	2,924	3,960
Direct labour	<u>1,120</u>	<u>1,292</u>	<u>1,980</u>
Total direct cost per car	<u>3,640</u>	<u>4,216</u>	<u>5,940</u>
Budgeted production (cars)	75,000	75,000	75,000
Number of production runs	1,000	1,000	1,500
Number of order executed	4,000	5,000	5,600
Machine hours	10,80,000	18,00,000	16,80,000

Annual overheads:

	Fixed	Variable
	Rs.'000	Rs.
Set ups	42,660	13,000 per production run
Materials handling	52,890	4,000 per order executed
Inspection	59,880	18,000 per production run
Machining	1,44,540	40 per machine hour
Distribution and warehousing	42,900	3,000 per order executed

Proposed JIT system

Management has hired a consultant to advise them on how to reduce costs. The consultant has suggested that the company adopts a just in time (JIT) manufacturing system. The introduction of JIT system would have the following impact on costs (fixed and variable):

Direct labour	Increase by 20%
Set ups	Decrease by 30%
Materials handling	Decrease by 30%
Inspection	Decrease by 30%
Machining	Decrease by 15%
Distribution & Ware housing	Eliminated

Required:

- (a) Based on the budgeted production levels, calculate the total annual savings that would be achieved by introducing the JIT system.

The following table shows the price/ demand relationship for each type of car per annum.

C1		C2		C3	
Price (Rs.)	Demand	Price (Rs.)	Demand	Price (Rs.)	Demand
5,000	75,000	5,750	75,000	6,500	75,000
5,750	65,000	6,250	60,000	6,750	60,000
6,000	50,000	6,500	45,000	7,750	45,000
6,500	35,000	7,500	35,000	8,000	30,000

Required:

- (b) Assuming that X Ltd. adopts the JIT system and that revised variable overhead cost per car remains constant (as per the proposed JIT system budget), calculate the profit – maximizing price and output level for each type of car.

Investigations have revealed that some of the fixed costs are directly attributable to the individual production lines and could be avoided if a line is closed down for the year. The specific fixed costs for each of the production lines, expressed as a percentage of the total fixed costs, are:

C1	4%
C2	5%
C3	8%

Required:

- (c) Determine the optimum production plan for the forthcoming year (based on the JIT cost structure and the prices and output levels you recommended in answer to requirement (b)).
- (d) Write a report to the management of X Ltd which explains the conditions that are necessary for the successful implementation of a JIT manufacturing system.

2. A budgeted profit statement of a company working at 75% capacity is provided to you below,

Sales	9,000 units at Rs. 32		Rs. 2,88,000
Less:	Direct materials	Rs. 54,000	
	Direct wages	72,000	
	Production overhead:		
	- fixed	42,000	
	- variable	18,000	
			1,86,000
	Gross profit		1,02,000
Less:	Administration, selling and distribution costs:		
	- fixed	36,000	
	- varying with sales volume	27,000	
			63,000
	Net profit		39,000

You are required to:

- (a) Calculate the breakeven point in units and in value.
- (b) It has been estimated that:
- (i) if the selling price per unit were reduced to Rs. 28, the increased demand would utilise 90% of the company's capacity without any additional advertising expenditure, and

- (ii) to attract sufficient demand to utilise full capacity would require a 15% reduction in the current selling price and a Rs. 5,000 special advertising campaign.

You are required to present a statement showing the effect of the two alternatives compared with the original budget and to advise management which of the three possible plans ought to be adopted, i.e., the original budget plan or (i) above or (ii) above.

- (c) An independent market research study shows that by spending Rs. 15,000 on a special advertising campaign, the company could operate at full capacity and maintain the selling price at Rs. 32 per unit.

You are required to:

- (i) Advise management whether this proposal should be adopted.

3. (a) The investment for a project is Rs. 20 cr. the sale price p.u. Rs.400 & variable cost is Rs.240. the fixed cost p.a. is Rs. 23,00,000. The required rate of return is 12%.

Find BEP for a life of 6 yrs.

- (b) If the project building period is 2 years with 60% of capital will be invested in 1st year, what is the project bep production & sale volume?

4. Selected information concerning sales and production for ABC Ltd. for July, 2006 are summarised as follows:

- (a) Estimated sales:

Product K: 40,000 units at Rs. 30.00 per unit

Product L: 20,000 units at Rs. 65.00 per unit

- (b) Estimated inventories, July 1, 2006:

		Rs.
Material A: 4,000 kgs.	Product K: 3,000 units at Rs. 17 per unit	51,000
Material B: 3,500 kgs.	Product L: 2,700 units at Rs. 35 per unit	<u>94,500</u>
	Total	<u>1,45,500</u>

There were no work in process inventories estimated for July 1, 2006.

- (c) Desired inventories at July 31, 2006:

		Rs.
Material A: 3,000 kgs.	Product K: 2,500 units at Rs. 17 per unit	42,500
Material B: 2,500 kgs.	Product L: 2,000 units at Rs. 35 per unit	<u>70,000</u>
	Total	<u>1,12,500</u>

There were no work in process inventories desired for July 31, 2006.

- (d) Direct materials used in production:

	Product K	Product L
Material A:	0.7 kgs. per unit	3.5 kgs. per unit
Material B:	1.2 kgs. per unit	1.8 kgs. per unit

- (e) Unit costs for direct materials:

Material A:	Rs. 4.00 per kg.
Material B:	Rs. 2.00 per kg.

(f) Direct labour requirements:

	Department 1	Department 2
Product K	0.4 hour per unit	0.15 hour per unit
Product L	0.6 hour per unit	0.25 hour per unit

(g)

	Department 1	Department 2
Direct labour rate	Rs. 12.00 per hour	Rs. 16.00 per hour

(h) Estimated factory overhead costs for July:

	Rs.
Indirect factory wages	2,00,000
Depreciation of plant and equipment	40,000
Power and light	25,000
Indirect materials	<u>34,000</u>
Total	<u>2,99,000</u>

Instructions:

1. Prepare a sales budget for July.
 2. Prepare a production budget for July.
 3. Prepare a direct materials purchases budget for July.
 4. Prepare a direct labour cost budget for July.
 5. Prepare a cost of goods sold budget for July.
5. ABC Ltd manufactures Product S for national distribution in India. The standard costs for the manufacture of Product S were as follows:

	Standard Costs	Actual Costs
Direct materials	1,500 kgs at Rs. 35	1,600 kgs at Rs. 32
Direct labour	4,800 hours at Rs. 11	4,500 hours at Rs. 11.80
Factory overhead	Rates per labour hour, based on 100% of normal capacity of 5,500 labour hours:	
	Variable cost, Rs. 2.40	Rs. 12,300 variable cost
	Fixed cost, Rs. 3.50	Rs. 19,250 fixed cost

Instructions:

1. Determine the quantity variance, price variance, and total direct materials cost variance for Product S.
 2. Determine the time variance, rate variance, and total direct labour cost variance for Product S.
 3. Determine the controllable variance, volume variance, and total factory overhead cost variance for Product S.
6. ABC Ltd. uses flexible budgets and standard costing for its single product PCM 30 produced at its factory at Solan. The following details relate to a particular months 'Actual' & also provide brief details of 'Standards' established,

Standard Quantity required for producing 1 unit of PCM 30	3 Kgs
Standard cost of the raw material	Rs 4.40 per kg
Cost of actual material purchased and used in the relevant month	Rs 3,36,000

Actual price paid for the raw material in the relevant month	Rs 4.20 per kg
Standard labour time required to produce 1 unit of PCM 30	30 minutes
Standard wage rate	Rs 5 per hour
Actual wage rate	Rs 5.40 per hour

Sufficient direct labour time, equivalent for producing 28,000 units of PCM 30 was utilised, although the actual production in the relevant month was only 25,000 units.

The company has a normal operating capacity of 15,000 hours per month and flexible overhead budgets are:

Hours of operation	12,500	14,000	15,000
Variable production overhead	Rs. 1,50,000	Rs. 1,68,000	Rs. 1,80,000
Fixed production overhead	2,70,000	2,70,000	2,70,000
Total	4,20,000	4,38,000	4,50,000

Actual fixed overheads incurred did not deviate from the budgeted amounts. However, the variable overheads incurred amounted to Rs 1,60,000 in the concerned month.

You are required to:

- (i) calculate the appropriate variances for material, labour and overhead;
- (ii) show the variances in a statement suitable for presentation to management, reconciling the standard cost with the actual cost of production.

7. A public company responsible for the supply of domestic gas has been approached by several prospective customers in a rural area adjacent to a high-pressure main. As a condition of its license to operate as a utility, the company is obliged to respond positively to current needs provided the financial viability of the company is not put at risk. New customers are charged Rs. 250 each for connection to the system.

Once a meter is installed, a standing charge of Rs.10 per quarter is billed. Charges for gas are levied at Rs.400 per 1,000 metered units.

A postal survey of the area containing, according to the rating authority, 5,000 domestic units, elicited a 40% response rate. 95% of those who responded confirmed that they wished to become gas users and expressed their willingness to pay the connection charge.

Although it is recognized that a small percentage of those willing to pay for connection may not actually choose to use gas, it is expected that the average household will burn 50 metered units per month. There will be some seasonal differences.

The company's marginal cost of capital is 17% pa and supplies of bulk gas cost the company Rs.0.065 per metered unit. Wastage of 15% has to be allowed to determine what the maximum capital project cost can be to allow the company to provide the service required.

8. A Company produces formulations having a shelf life of one year. The company has an opening stock of 15,000 boxes on 1/1/2006 and expects to produce 75,000 boxes as was in the just ended year of 2005. Expected sale would be 78,000 boxes. Costing department has worked out escalation in cost by 25% on variable cost and 12% on fixed cost for the year 2006.

Fixed costs are estimated at Rs.16,80,000. New price for 2006 is Rs.70/- per box while the sale price in 2005 was Rs. 60. Variable cost of the opening stock is Rs. 20 per box.

Find actual BEP.

9. ABC Ltd manufactures three prototype toy furniture products – chairs, benches and tables. The budgeted unit cost and resource requirements of each item is detailed below:

	Chair	Bench	Table
	Rs.	Rs.	Rs.
Timber cost	5.00	15.00	10.00
Direct labour cost	4.00	10.00	8.00
Variable overhead cost	3.00	7.50	6.00
Fixed overhead cost	<u>4.50</u>	<u>11.25</u>	<u>9.00</u>
	<u>16.50</u>	<u>43.75</u>	<u>33.00</u>
Budgeted volumes per annum	4,000	2,000	1,500

These volumes are believed to equal the market demand for these products.

The fixed overhead costs are attributed to the three products on the basis of direct labour hours.

The labour rate is Rs. 4.00 per hour.

The cost of the timber is Rs. 2.00 per square metre.

The products are made from a specialist timber. A memo from the purchasing manager advises you that because of a problem with the supplier, it is to be assumed that this specialist timber is limited in supply to 20,000 square metres per annum.

The sales manager has already accepted an order for 500 chairs, 100 benches and 150 tables which if not supplied would incur a financial penalty of Rs. 2,000. These quantities are included in the market demand estimates above.

The selling prices of the three products are:

	Rs.
Chair	20.00
Bench	50.00
Table	40.00

Requirements:

- Determine the optimum production plan and state the net profit that this should yield per annum.
 - Calculate and explain the maximum prices which should be paid per square metre in order to obtain extra supplies of the timber.
10. A Ltd. produces and markets a range of consumer durable appliances. It ensures after sales service through X Ltd. The big appliances are serviced at customer's residence while small appliances are serviced at workshop of X Ltd.

The material supplied to X Ltd. is charged at cost plus 10%. X Ltd. charges customers at 25% over the above price. For labour, the company receives 10% of the rate fixed for work done under the after-sales service agreement and 15% of the rate fixed in case of jobs not covered under the agreement from X Ltd. 60% by value of the total work undertaken by X Ltd. was for appliances and rest accounted for small appliances during the previous year.

The company decides to carry out all or some of the work itself and has chosen one area in the first instance. During the previous year the company earned a profit of Rs. 2,16,000 as detailed below from X Ltd. for the area chosen:

	Materials	Labour
	Rs.	Rs.
Under after –sales service agreement	60,000	1,00,000
For jobs not covered under the agreement	20,000	36,000

The company forecasts same value of work in that area for the ensuring period. The following three options are under consideration of the management:

- (1) To set up a local service Centre to provide service for small appliances only. The existing system is to continue for big appliances.
- (2) To set up a local services Centre to provide service for big appliances only. The existing system is to continue for small appliances.
- (3) To set up a local service Centre to provide service to all appliances. The existing system then stands withdrawn.

The relevant costs for carrying out jobs under the above options are as under:

	(Rs.'000)		
	Option –1	Option- 2	Option –3
Heat, rent, light etc.	125	50	150
Management costs	108	83	150
Service staff costs	230	440	750
Transport costs	25	220	230

You are required to find out the most profitable Option.

11. (a) Describe the concept of Back flushing as used in a JIT system. What problems need to be addressed before implementing such a concept? Briefly discuss.
(b) "Skimming pricing is a policy where the prices are kept high during the early period of a product's existence". Discuss briefly the reasons for following such a policy.
12. Discuss briefly your understanding of a Balanced Scorecard? What are its advantages?
13. (a) "Costs may be classified in a variety of ways according to their nature and the information needs of the management." Explain.
(b) Indicate the major areas of short-term decisions in which differential cost analysis is useful.
(c) "Relevant cost analysis helps in drawing the attention of managers to those elements of cost which are relevant for the decision." Comment.
14. (a) Indicate the possible disadvantages of treating divisions as profit centres
(b) Explain the role of bench marking in continuous improvement in an organisation.
15. ABC Ltd manufactures a product '1+7 ASCS' at its plant at Faridabad, the maximum capacity of which is 200 units per month. Details of raw material which go into the making of 1 unit of '1+7 ASCS' are provided to you below;

S. No.	Raw Material description	Standard quantity per finished unit (No)	Standard purchase price per unit (Rs 00)
1	A	1	6
2	B	2	5
3	C	3	4
4	D	4	3
5	E	5	2
6	F	6	1

Standard Fixed overheads are Rs 20,00,000 per month whereas the standard variable overhead rate has been estimated as equal to Rs 1,400 per unit of finished good. You are required to compute the

- (a) standard cost of the product

- (b) compute the production volume variance in case the company produces and sells only 100 units of finished goods in the concerned month.
- (c) compute the usage and material price variances considering the following actual data(actual production and sale: 100 units)

Raw material description	Actual quantity consumed (Nos)	Actual price(Rs 00)
A	102	7
B	201	6
C	310	5
D	415	4
E	540	3
F	610	2

16. A company manufactures several products of varying levels of designs and models. It uses a single overhead recovery rate based on direct labour hours. The overheads incurred by the company in the half of the year are as under:

	Rs.
Machine operation expenses	10,12,500
Machine maintenance expenses	1,87,500
Salaries of technical staff	6,37,500
Wages and salaries of stores staff	2,62,500

During this period, the company introduced activity based costing system and the following significant activities were identified:

- receiving materials and components
- set up of machines for production runs
- quality inspection.

It is determined that:

- The machine operation and machine maintenance expenses should be apportioned between stores and production activity in 20:80 ratio.
- The technical staff salaries should be apportioned between machine maintenance , set up and quality inspection in 30:40:30 ratio.

The consumption of activities during the period under review are as under:

- Direct labour hours worked	40,000
- Direct wage rate	Rs.6 per hour
- Production set-ups	2,040
- Material and component consignments received from suppliers	1,960
- Number of quality inspections carried out	1,280

The data relating to two products manufactured by the company during the period are as under:

	Products	
	P	Q
Direct material costs	Rs. 6,000	4,000
Direct labour hours	960	100
Direct material consignments received	48	52
Production runs	36	24

Number of quality inspections done	30	10
Quantity produced (units)	15,000	5,000

A potential customer has approached the company for the supply of 24,000 units of a component K to be delivered in lots of 3,000 units per quarter. The job will involve an initial design cost of Rs. 60,000 and the manufacture will involve the following per quarter:

Direct material costs	Rs. 12,000
Direct labour hours	300
Production runs	6
Inspections	24
Number of consignments of direct materials to be received	20

The company desires a mark up of 25% on cost.

Required:

- (i) Calculate the cost of product P and Q based on the existing system of single overhead recovery rate.
 - (ii) Determine the cost of product P and Q using activity based costing system.
 - (iii) Compute the sales value per quarter of component K using activity based costing system.
17. ABC Ltd makes and sells two products A and B, each of which passes through the same automated production operations. The following estimated information is available for period 1
- (i) Product unit data:

	A	B
Direct material cost (Rs.)	2	40
Variable production overhead cost (Rs)	28	4
Overall hours per product unit (hrs)	0.25	0.15
 - (ii) Production/ sales of products A and B are 1,20,000 units and 45,000 units respectively. The selling prices per unit for A and B are Rs. 60 and Rs. 70 respectively.
 - (iii) Maximum demand for each product is 20% above the estimated sales levels.
 - (iv) Total fixed production overhead cost is Rs. 14,70,000. This is absorbed by products A and B at an average rate per hour based on the estimated production levels.

Required:

- (a) Using net profit as the decision measure, show why the management of ABC Ltd argues that it is indifferent on financial grounds as to the mix of products A and B which should be produced and sold and calculate the total net profit for period 1.
- (b) One of the production operations has a maximum capacity of 3,075 hours which has been identified as a bottleneck which limits the overall production/ sales of products A and B. The bottleneck hours required per product unit for product A and B are 0.02 and 0.015 respectively.

All other information detailed in (a) still applies.

Required: Calculate the mix (units) of products A and B which will maximize net profit and the value (Rs.) of the maximum net profit.

- (c) The bottleneck situation detailed in (b) still applies. ABC Ltd has decided to determine the profit maximizing mix of products A and B based on the throughput Accounting principle of maximizing the throughput return per production hour of the bottleneck resource. This may be measured as:

$$\text{Throughput return per production hour} = \frac{(\text{selling price} - \text{material cost})}{\text{Bottleneck hours per unit}}$$

All other information detailed in (a) and (b) still applies, except that the variable overhead cost as per (a) is now considered to be fixed for the short / intermediate term, based on the value (Rs.) which applied to the product mix in (a).

Calculate the mix (units) of products A and B which will maximize net profit and the value of that net profit.

18. The following table gives the activities in a construction project and other relevant information.

Activity	Immediate Predecessor	Time (Days)		Direct Cost (Rs.)	
		Normal	Crash	Normal	Crash
A	-	4	3	60	90
B	-	6	4	150	250
C	-	2	1	38	60
D	A	5	3	150	250
E	C	2	2	100	100
F	A	7	5	115	175
G	D, B, E	4	2	100	240

Indirect cost vary as follows

Days	15	14	13	12	11	10	9	8	7	6
Cost (Rs)	600	500	400	250	175	100	75	50	35	25

- (i) Draw an arrow diagram for the project
(ii) Determine the optimum project duration.

19. IBM Ltd. Manufactures and sells computers peripherals to several retail outlets throughout the country. Amar is the manager of the printer division. Its two largest-selling printers are P1 & P2. The manufacturing cost of each printer is calculated using IBM's activity based costing system. IBM has one direct manufacturing cost category (direct materials) and the following five indirect manufacturing cost pools.

Indirect manufacturing cost pool	Allocation Base	Allocation Rate (Rs.)
1. Materials handling	No. of parts	Rs. 1.20 per part
2. Assembly management	Hours of assembly time	Rs. 40 per hour of assembly time
3. Machine insertion of parts	No. of machine inserted parts	Rs. 0.70 per machine inserted part
4. Manual insertion of parts	No. of manually inserted parts	Rs. 2.10 per manually inserted part
5. Quality testing	Hours of quality testing time	Rs. 25 per testing hour.

Product characteristics of P1 and P2 are as follows:

Product	P1	P2
Direct materials costs	Rs. 407.50	Rs. 292.10
Number of parts	85	46
Hours of assembly time	3.2	1.9
Number of machine – inserted parts	48	31
Number of manually inserted parts	36	15
Hours of quality testing time	1.4	1.1

A foreign competitor has introduced products very similar to P1 and P2. Given their announced selling prices, to maintain the company's market share and profits. Amar estimated the P1 to have manufacturing cost of approximately Rs. 680 and P2 to have a manufacturing cost of approximately Rs. 390. He calls a meeting of product designers and manufacturing personnel at the printer division. They all agreed to have the Rs. 680 and Rs. 390 figures become target costs for designed version of P1 and P2 respectively. Product designers examine alternative ways of designing printer with comparable performance but lower costs. They come up with the following revised designs for P1 and P2 (termed P1 – REV and P2 – REV, respectively)

Particulars	P1 – REV	P2 – REV
Direct materials cost	Rs. 381.20	Rs. 263.10
Number of parts	71	39
Hours of assembly time	2.1	1.6
Number of machine – inserted parts	59	29
Number of manually – inserted parts	12	10
Hours of quality testing time	1.2	0.9

Required:

- ◆ Compute the present costs of products P1 and P2 using ABC system.
 - ◆ Compute the manufacturing costs of P1 – REV and P2 – REV. How do they compare with the Rs. 680 and Rs. 390 target costs?
20. A manufacturer of the firm is investigating the inventory situation of his company. Distribution of daily demand is

Demand (units)	No. of Days
5	15
6	25
7	30
8	18
9	8
10	4

The lead time distribution in days is given below

Lead time	Probability
3	.2
4	.3
5	.35
6	.15

The ordering cost is Rs. 100 per order; the holding cost is Rs. 3 per unit per day and the shortage cost is Rs. 20 per unit, representing the loss in profits.

Using simulation determine the total inventory cost for specific reorder level and reorder quantity.

Assume the opening inventory is 25 units, the reorder level is 20 units and the reorder quantity is 40 units.

21. The occurrence of the rain in a day is dependent upon whether it rained on the previous day. If it rained on the previous day the rain distribution is given by

Event	Probability
No rain	.50
1 cm rain	.25
2 cm rain	.15
3 cm rain	.05
4 cm rain	.03
5 cm rain	.02

If it did not rained on the previous day the rain distribution is given by

Event	Probability
No rain	.75
1 cm rain	.15
2 cm rain	.06
3 cm rain	.04

Simulate the city's weather for 10 days and determine by simulation the total days without rain as well as the total rain fall during the period. Use the following random numbers

76 78 84 75 02 86 02 78 07 63

For simulation. Assume that for the first day of the simulation it had not rained before.

22. A Mutual Fund Company has Rs. 20 lakhs available for investment in government Bonds, blue chip stocks, speculative stocks and short-term deposits. The annual expected return and risk factor are given below:

Type of investment	Annual expected return (%)	Risk factor (0 to 100)
Government Bonds	14	12
Blue Chip Stocks	19	24
Speculative stocks	23	48
Short-term deposits	12	6

Mutual Fund is required to keep at least Rs. 2 lakhs in short-term deposits and not to exceed average risk factor of 42. Speculative stocks must be at most 20% of the total amount invested. How should mutual fund invest the funds so as to maximize its total expected annual return? Formulate this as a Linear Programming Problem. Do not solve it.

SUGGESTED ANSWERS/HINTS

1. (a) The annual cost savings are as follows:

	Rs.'000
Direct labour $0.2 (Rs. 1,120 + Rs. 1,292 + Rs. 1,980) \times 75,000$	+ 65,880
Variable set – ups $(30\% \times Rs. 13,000) \times 3,500$	- 13,650
Variable materials handling $(30\% \times 4,000 \times 14,600)$	- 17,520
Variable inspection $(30\% \times Rs. 18,000 \times 3,500)$	- 18,900
Variable machine $(15\% \times Rs. 40 \times 45,60,000)$	- 27,360
Variable distribution and warehousing $(Rs. 3,000 \times 14,600)$	- 43,800

Fixed cost (15% × Rs. 1,44,540) + Rs. 42,900] - 1,11,210

Total savings 1,66,560

(b) The total variable overhead costs allocated to each product is as follows:

	C1 (Rs.000)	C2 (Rs.000)	C3 (Rs.000)
Set up costs at Rs. 9,100 per			
Production run	9,100	9,100	13,650
Materials handling at Rs. 2,800			
Per order	11,200	14,000	15,680
Inspection at Rs. 12,600 per			
Production run	12,600	12,600	18,900
Machining at Rs. 34 per machine			
Hours	36,720	61,200	57,120
	69,620	96,900	1,05,350
Total output (000's)	75	75	75
Variable overhead per car (Rs.)	928.26	1,292.00	1,404.67
Direct materials per car (Rs)	2,520.00	2,924.00	3,960.00
Direct labour	1,344.00	1,550.40	2,376.00
Total variable cost per car	4,792.26	5,766.40	7,740.67

The above variable costs per car are now used to derive the following contributions for various price/ demand levels:

Selling Price (Rs.)	Demand	Unit Contribution (Rs.)	Total Contribution (Rs.'000)
C1 car			
5,000	75,000	207.74	15,581
5,750	65,000	957.74	62,253
6,000	50,000	1,207.74	60,387
6,500	35,000	1,707.74	59,771
C2 car			
5,750	75,000	- 16.40	- 1,230
6,250	60,000	483.60	29,016
6,500	45,000	733.60	33,012
7,500	35,000	1,733.60	60,676
C3 car			
6,500	75,000	- 1,240.67	- 93,050
6,750	60,000	- 990.67	- 59,440
7,750	45,000	9.33	420
8,000	30,000	259.33	7,780

The profit maximizing price and output levels are Rs. 5,750 and 65,000 demand for C1, Rs. 7,500 and 35,000 for C2 and Rs. 8,000 and 30,000 for C3.

(c)	C1 (Rs.'000)	C2 (Rs.'000)	C2 (Rs.'000)
Total contribution	62,253	60,676	7,780
Avoidable fixed costs	9,266	11,583	18,533
Contribution to general fixed costs & profit	52,987	49,093	- 10,753

The above analysis suggests (ignoring any qualitative factors) that C3 should be discontinued and that C1 and C2 are to be produced.

(d) The report should include the following points:

1. The need to avoid fluctuations in production rates since this will lead to excess work in progress.
2. A description of the pull/ Kanban system
3. The need to ensure a cell production layout and that workers have multiple skills.
4. Focus on eliminating non – value added activities
5. Focus on routine and preventative maintenance to avoid machine downtime.
6. Focus on reducing set – up times to a minimum
7. Establishment of JIT purchasing arrangements accompanied by establishing close relationships with suppliers.

2. (a) Contribution and Profitability Analysis

		Total	Per unit
Sales*		Rs 2,88,000	Rs 32
Less	Variable costs		
	Direct material	54,000	6
	Direct wages	72,000	8
	Production Overheads	18,000	2
	Admn , S & D OH	27,000	3
		1,71,000	19
Contribution		1,17,000	13
Less	Fixed Overheads		
	Production	42,000	
	Admn , S & D	36,000	
		78,000	
		39,000	

*Capacity utilisation : 75%

$$P/V \text{ Ratio} = (S - V)/S \times 100 = 40.625\%$$

$$BE \text{ Sales} = \text{Fixed costs} \div P/V \text{ Ratio}$$

$$= 78,000 \div 40.625\%$$

$$= \text{Rs } 1,92,000$$

$$\text{or } 1,92,000 \div \text{Rs } 32 = 6,000 \text{ Units}$$

(b)	Production	90% Capacity(10,800 Units)	100% Capacity(12,000 Units)
	Selling price per unit	Rs 28	Rs 27.20
	Variable cost per unit	19	19.00

Contribution per unit	9	8.20
P/V Ratio	31.143%	30.147%
Total contribution	97,200	98,400
Less Fixed Overheads	78,000	83,000
	19,200	15,400

The P/V Ratio has gone down to 31.143% in the case of alternative b(i) and to 30.147% in alternative b(ii). Therefore the company should follow the original plan as at (a) above

(c) (i)	Selling price per unit	Rs 32
	Less Variable costs	19
	Contribution per unit	13
	Total contribution (12,000 × Rs 13)	1,56,000
	Less fixed costs	93,000
	Profit	63,000

This proposal may be expected as there is a considerable increase in the profits.

3. (a) Investment = Rs 20 crores

	Rs.
Selling price/units	400
Variable cost/unit	<u>240</u>
Contribution p.u.	160

Fixed cost = 23 lakhs; Life – 6 years; Rate of return = 12%

BEP = $\{(20 \text{ cr.} \div 4.114) + 23 \text{ lakhs}\} \div 160 = 3,18,408 \text{ units}$

- (b) All cash flow are occur at the end of the year (assumption of DCF technique)

$\therefore$ Interest at $y_0 = 20 \text{ Cr.} + 12 \text{ Cr.} \times 12\%$

= Rs. 21.44 Cr.

$\therefore$ BEP = $\{(21.44 \text{ cr.} \div 4.1114) + 23 \text{ lakhs}\} \div 160$

= 3,40,299 units

4. 1.

ABC Ltd
Sales Budget
for the Month ending July 31, 2006

Product	Unit Sales Volume	Unit Selling Price Rs.	Total Sales Rs.
Product K	40,000	30.00	12,00,000
Product L	20,000	65.00	<u>13,00,000</u>
Total revenue from sales			<u>25,00,000</u>

- 2.

ABC Ltd.
Production Budget
for the Month ending July 31, 2006

	Units	
	Product K	Product L
Sales	40,000	20,000

Plus desired inventories at July 31, 2006	<u>2,500</u>	<u>2,000</u>
Total	42,500	22,000
Less: Estimated inventories, July 1, 2006	<u>3,000</u>	<u>2,700</u>
Total production	<u>39,500</u>	<u>19,300</u>

3.

ABC Ltd

Direct Materials Purchases Budget
for the Month ending July 31, 2006

	Direct Materials		
	Material A	Material B	Total
Units required for production:			
Product K (39,500 × lbs. per unit)	27,650 kgs*	47,400 *	
Product L (19,300 × lbs. per unit)	67,550 kgs**	34,740 **	
Plus desired units of inventory			
July 31, 2006	<u>3,000</u>	<u>2,500</u>	
Total	98,200 kgs.	84,640 kgs,	
Less estimated units of inventory			
July 1, 2006	<u>4,000</u>	<u>3,500</u>	
Total units to be purchased	94,200 kgs.	81,140 kgs.	
Unit price	<u>× Rs.4.00</u>	<u>× Rs.2.00</u>	
Total direct materials purchases	<u>Rs. 3,76,800</u>	<u>Rs. 1,62,280</u>	<u>Rs. 5,39,080</u>
*27,650 = 39,500 × 0.7 47,400 = 39,500 × 1.2			
**67,550 = 19,300 × 3.5 34,740 = 19,300 × 1.8			

4.

ABC Ltd

Direct Labour Cost Budget
for the Month ending July 31, 2006

	Department 1	Department 2	Total
Hours required for production:			
Product K (39,500 × hours per unit)	15,800*	5,925*	
Product L (19,300 × hours per unit)	<u>11,580**</u>	<u>4,825**</u>	
Total	27,380	10,750	
Hourly rate	<u>× Rs.12.00</u>	<u>× Rs.16.00</u>	
Total	Rs.3,28,560	Rs.1,72,000	<u>Rs. 5,00,560</u>
*15,800 = 39,500 × 0.4 5,925 = 39,500 × 0.15			
**11,580 = 19,300 × 0.6 4,825 = 19,300 × 0.25			

5.

ABC Ltd
Cost of Goods sold Budget
for the Month ending July 31, 2006

	Rs.	Rs.
Finished goods inventory, July 1, 2006		1,45,500
Direct materials:		
Direct materials inventory, July 1, 2006 (Note A)	23,000	
Direct materials purchases	<u>5,39,080</u>	
Cost of direct materials available for use	5,62,080	
Less: Direct materials inventory, July 31, 2006 (Note B)	<u>17,000</u>	
Cost of direct materials placed in production	5,45,080	
Direct labour	5,00,560	
Factory overhead	<u>2,99,000</u>	
Cost of goods manufactured		<u>13,44,640</u>
Cost of finished goods available for sale		14,90,140
Less: Finished goods inventory, July 31, 2006		<u>1,12,500</u>
Cost of goods sold		<u>13,77,640</u>

Note A:			Rs.
Material A	4,000 kgs.	at Rs. 4.00 per kg.	16,000
Material B	3,500 kgs.	at Rs. 2.00 per kg.	<u>7,000</u>
Direct materials inventory, July 1, 2006			<u>23,000</u>

Note B:			Rs.
Material A	3,000 kgs.	at Rs. 4.00 per kg.	12,000
Material B	2,500 kgs.	at Rs. 2.00 per kg.	<u>5,000</u>
Direct materials inventory, July 31, 2006			<u>17,000</u>

5.

Direct Materials Cost Variance

Quantity Variance:

Actual quantity	1,600 kgs	
Standard quantity	1500 kgs	
Variance – unfavourable	100 kgs × Std price, Rs 35	Rs. 3,500

Price Variance:

Actual price	Rs. 32.00 per kg	
Standard price	35	
Variance – favourable	Rs(300) per kg × Actual Qty, 1600	<u>(4,800)</u>
Total direct materials cost variance - favourable		Rs. <u>(1,300)</u>

2. Direct Labour Cost Variance

Time Variance:

Actual time	4,500 hours	
Standard time	4,800 hours	
Variance – favourable	(300 hours) × Std rate, Rs 11	Rs. (3,300)

Rate Variance:

Actual rate	Rs. 11.80	
Standard rate	11.00	
Variance – favourable	Rs 0.80 per hr × Actual time, 4500 hours	<u>3,600</u>
Total direct labour cost variance - unfavourable		Rs. <u>300</u>

3. Factory Overhead Cost Variance

Variable factory overhead – controllable variance:

Actual variable factory overhead cost incurred	Rs. 12,300	
Budgeted variable factory overhead for 4,800 hours	<u>11,520*</u>	
Variance – unfavourable		Rs. 780

Fixed factory overhead – volume variance:

Budgeted hours at 100% of normal capacity	5,500 hours	
Standard hours for actual production	<u>4,800</u>	
Productive capacity not used	700 hours	
Standard fixed factory overhead cost rate	× <u>Rs. 3.50</u> hours	
Variance – unfavourable		<u>2,450</u>
Total factory overhead cost variance – unfavourable		Rs. <u>3,230</u>

*4,800 hours × Rs. 2.40 = Rs. 11,520

6. (i) Standard Variable O.H. rate = Rs. 1,80,000 ÷ 15,000 = Rs. 12 per hr.

Standard Fixed OH rate = 2,70,000 ÷ 15,000 = Rs. 18 per hr.

Material Variances (Actual Production : 25,000 Units)

St Qty of RM /FG	Std Price of RM/kg	Std Qty of RM on Actual Production	Actual Qty of RM on Actual Production	Actual Price paid for RM	Usage Variance(Rs)	Price Variance(Rs)
(a)	(b)	(c)	(d)	(e)	(c – d) × b	(b – e) × d
3 kg	Rs 4.40	75,000 kgs	80,000	Rs 4.20	(22,000)	16,000

Labour Variances

St time / FG	Std rate per hour	Std time on Actual Production	Actual time on Actual Production	Actual rate per hour	Efficiency Variance(Rs)	Rate Variance(Rs)
(a)	(b)	(c)	(d)	(e)	(c – d) × b	(b – e) × d
30 min	Rs 5	12,500 hrs	14,000 hrs	Rs 5.4	(7,500)	(5,600)

Variable Overhead Variances

Actual variable overhead	= Rs. 1,60,000 (a)
(Rs. 4,30,000 – Rs. 2,70,000)	
Actual Hours worked at Standard V.O.H. rate	= Rs. 1,68,000 (b)
(28,000×0.5 hr×Rs. 12)	
Standard Variable O.H. for actual production	= Rs. 1,50,000 (c)
(25,000 units × 0.5 hr × Rs. 12)	
Variable O.H. Expenditure variance	= (a) – (b)
	= Rs. 1,60,000 –Rs. 1,68,000
	= Rs. 8,000 (F)
Variable O.H. Efficiency variance	= (b) – (c)
= Rs. 1,68,000 –Rs. 1,50,000	= Rs. 18,000 (A)

Fixed Overhead Variances

Actual fixed overhead incurred	= Rs. 2,70,000
Budgeted Fixed Overhead	= Rs. 2,70,000
Expenditure Variance	= Nil
Budgeted production	= 3 0,000 Units
Actual production	= 25,000 Units
Unutilised capacity	= 5,000 Units or 2,500 Hrs
Production volume variance	= 2,500 Hrs × Rs 18 per hr
	= (Rs 45,000)

(ii) Reconciliation

Standard Cost 25,000×Rs. 30.70			=7,67,500
Variances			
Materials	Favourable	<u>Adverse</u>	
Price usage	Rs. 16,000		
Usage		Rs. 22,000	
Labour			
Rate		5,600	
Efficiency		7,500	
Variable OH			
Expenditure	8,000		
Efficiency		18,000	
Fixed OH.			
Expenditure	-		
Volume		45,000	74,100 (A)
Actual cost			8,41,600

7. Note-1:

No. of customer $5,000 \times 40\% \times 95\% = 1,900$

Note-2:

Consumption of gas $1,900 \times 50 \times 12 \text{ mt.} = 11,40,000 \text{ mt.}$

Gas supply $11,40,000 \times (100 \div 85) = 13,41,176 \text{ mt}$

Note-3:

Cash inflow:

One time (y_0) = $250 \times 1,900$ Rs 4,75,000

Cash p.a. (in last year) Rs.

Rent $1,900 \times 4 \times 10/Q$ 76,000

Consumption charge $11,40,000 \times 0.4$ 4,56,000

5,32,000

Less: Cost of company $(13,41,176 \times 0.065)$ 87,176

Cash inflow P.a. 4,44,824

By following the concept of perpetuity

$\therefore (\text{Investment} - 4,75,000) \times 17\% = 4,44,824$

$\therefore \text{Investment Rs. } 30,91,612$

8.

	Last year 2005	Current year 2006
Opening stock	--	15,000
Production	75,000	75,000
Sales	--	78,000
Closing stock	15,000	12,000
	Rs.	Rs.
Sales price/unit	60	70
Less: Variable cost/unit	<u>20</u>	<u>25</u>
Contribution	40	45

Fixed cost $(16,80,000 \div 112) \times 100 = 15,00,000$

Contribution from the sale of opening stock $(70 - 20) = \text{Rs. } 50$

In 2006

	Rs.
Fixed cost	16,80,000
Less: Contribution from opening stock sales	<u>7,50,000</u>
Rest. Fix	9,30,000

Required production & sales = $9,30,000 \div 45 = 20,667 \text{ units}$

$\therefore \text{BEP (Actual)} = 15,000 + 20,667 = 35,667 \text{ units.}$

9. (a) Production plan and net profit

Timber required

	Square metres	Budgeted volume	Requirement (square metres)
	(a)	(b)	(a × b)
Chair	Rs(5 ÷ 2) = 2.5	4,000	10,000
Bench	Rs(15 ÷ 2) = 7.5	2,000	15,000
Table	Rs(10 ÷ 2) = 5.0	1,500	<u>7,500</u>
			<u>32,500</u>

Therefore, there is a shortfall of 12,500 square metres.

	Chair	Bench	Table
Unit contribution	Rs8.00	Rs17.50	Rs16.00
Timber requirement (square metres)	2.5	7.5	5.0
Contribution per square metre	Rs3.20	Rs2.33	Rs3.20
Ranking	1st =	3rd	1st =

Production plan

	Square metres	Contribution Rs
4,000 chairs (inclusive of 500 firm orders)	10,000.0	32,000.00
1,500 tables (inclusive of 150 firm orders)	7,500.0	24,000.00
333 benches (inclusive of 100 firm orders)	<u>2,497.5</u>	<u>5,827.50</u>
	<u>19,997.5</u>	61,827.50
Fixed overhead (Rs18,000 + Rs22,500 + Rs13,500)	<u>54,000.00</u>	
Profit	<u>7,827.50</u>	

- (b) Since the optimum production plan in part (a) indicates that demand for chairs and tables is satisfied by production, any additional timber would be utilized to manufacture benches.

Each square metre used on a bench contributes Rs2.33 (see part (a) after charging the present cost of timber (Rs2 per square metre).

Therefore the maximum price to be paid is Rs2.33 + Rs2 = Rs 4.33 per square metre.

Unsatisfied demand = (2,000 – 333) 1,667 benches.

∴ Timber required is 1,667 × 7.5 square metres = 12,502.5 square metres, less the 2.5 square metres still available from the original supplier = 12,500 square metres.

10. Statement showing value of total work undertaken by X Ltd. at customer's price.

	(Rs. '000)
Material cost (for appliances covered under agreement)	825
[Refer to working note 1(i)]	
Material cost (for appliances not covered under agreement)	275
[Refer to working note 2(i)]	
Labour cost (for appliances covered under agreement)	1,000

Labour cost (for appliances not covered under agreement)		240
[Refer to working note 2(ii)]		
Total receipts		<u>2,340</u>
Break up of receipts:		
Big appliances	60%	1,404
Small appliances	40%	936

Profitability Statement			(Rs.'000)
	Option 1	Option 2	Option 3
Income:			
Big appliances	129.6	1,404	1,404
(60%×Rs. 216)			
Small appliances	936	86.4	936
(40%×Rs. 216)			
Total receipts: (A)	<u>1,065.6</u>	<u>1,490.4</u>	<u>2,340</u>
Costs:			
Material	320	480	800
40%×(825+275)		60%×(825+275)	(825+275)
137.5%		137.5%	137.5%
Heat, rent, light etc.,	125	50	150
Management costs	108	83	150
Service staff costs	230	440	750
Transport costs	<u>25</u>	<u>220</u>	<u>230</u>
Total costs: (B)	808	1,273	2,080
Profit: [(A-B)]	<u>257.6</u>	<u>217.4</u>	<u>260</u>

Recommendation:

Option 3 is most profitable one.

Working Notes:

1. Material and labour cost (for appliances under after sales agreement):

	Rs.
(i) Cost of Material per unit charged to customer's by X Ltd.	137.50
(Rs. 100 +10% (Rs. 100+25%×Rs.110)	
cost of material charged to customer's by X Ltd.	
$\left(\frac{\text{Rs.60,000}}{\text{Rs.10}} \times \text{Rs.137.50} \right)$	8,25,000
(ii) Cost of labour charged to customers by X Ltd.	
$\left(\frac{\text{Rs.1,00,000}}{\text{Rs.10}} \times 100 \right)$	10,00,000

2. Material and labour cost (for appliances not covered under sales agreement):

Rs.

(i) Cost of material charged to customers by X Ltd.

$$\left(\frac{\text{Rs.}20,000}{\text{Rs.}10} \times \text{Rs.}137.50 \right) \quad 2,75,000$$

(ii) Cost of labour charged to customers by X Ltd.

$$\left(\frac{\text{Rs.}36,000}{\text{Rs.}15} \times 100 \right) \quad 2,40,000$$

11. (a) Back flushing in a JIT system

Traditional accounting systems record the flow of inventory through elaborate accounting procedures. Such systems are required in those manufacturing environment where inventory/WIP values are large. However, since JIT systems operate in modern manufacturing environment characterized by low inventory and WIP values, usually also associated with low cost variances, the requirements of such elaborate accounting procedures does not exist.

Back flushing requires no data entry of any kind until a finished product is completed. At that time the total amount finished is entered into the computer system which is multiplied by all components as per the Bill of materials (BOM) for each item produced. This yields a lengthy list of components that should have been used in the production process and this is subtracted from the opening stock to arrive at the closing stock to arrive at the closing stock/inventory.

The problems with back flushing that must be corrected before it works properly are:

- (i) The total production quantity entered into the system must be absolutely correct, if not, then wrong components and quantities will be subtracted from the stock.
- (ii) All abnormal scrap must be diligently tracked and recorded. Otherwise materials will fall outside the back flushing system and will not be charged to inventory.
- (iii) Lot tracing is impossible under the back flushing system. This is required when a manufacturer needs to keep records of which production lots were used to create a product in case all the items in a lot need be recalled.
- (iv) The inventory balance may be too high at all times because the back flushing transactions that relieves inventory usually does so only once a day, during which time other inventory is sent to the production process. This makes it difficult to maintain an accurate set of inventory records in the warehouse.

(b) Reasons for following skimming pricing policy

It is a policy where the prices are kept high during the early period of a product's existence. This can be synchronised with high promotional expenditure and in the latter years the prices can be gradually reduced. The reasons for following such a policy are as follows:

- (i) The demand is likely to be inelastic in the earlier stages till the product is established in the market.
- (ii) The gradual reduction in price in the latter years will tend to increase the sales.
- (iii) This method is preferred in the beginning because in the initial periods when the demand for the product is not known the price covers the initial cost of production.
- (iv) High initial capital outlays needed for manufacture, results in high cost of production. In addition to this, the producer has to incur huge promotional activities resulting in increased costs. High initial prices will be able to finance the cost of production particularly when uncertainties block the usual sources of capital.

12. The 'Balanced Scorecard' aims to provide information to management to assist in strategic policy formulation and achievement. It emphasizes the need to provide the user with a set of information which addresses all relevant areas of performance in an objective and unbiased fashion. For further details, please refer to chapter 14 of the Institute's Cost Management book.

13. (a) Cost classification is the process of grouping costs according to their characteristics. Costs are classified or grouped according to their common characteristics. Costs may be classified according to elements, according to functions or operations, according to their behaviour, according to controllability or according to normality.

The break up of the aggregate costs into relevant types, is an essential pre-requisite of decision making as well as of controlling costs. Classification of costs on different bases is thus necessary for various purposes. For the purpose of decision-making and control, costs are distinguished on the basis of their relevance to different type of decisions and control functions. The importance of distinguishing costs as direct or indirect lies in the fact that direct costs of a product or an activity can be accurately allocated while indirect costs have to be apportioned on the basis of certain assumptions. This is so because direct costs are controllable at the operational level whereas indirect costs are not amenable to such control.

(b) Cost information is required both for short-term and long-run managerial problems. Differential costs are of particular use in short-term problems which are non-repetitive, one-time, ad-hoc problems. The following are the most common short-term problems and areas where differential cost analysis may be deployed.

1. Accept - or - reject special order decisions.
2. Make - or - buy decisions.
3. Sell- or - process decisions.
4. Reduce - or - maintain price decisions.
5. Add - or - drop product decisions.
6. Operate - or shut down decisions.

(c) Relevant costs are pertinent or valid costs for a decision. These bear upon or 'influence decision' and are directly related to the decisions to be made. These are critical to the decision, and have significance for it. These are the costs which generally respond to managerial decision making, and have significance in arriving at correct conclusions. These costs are capable of making a difference in user-decisions and enter into a choice between alternative courses of action. In specific terms, relevant costs for decisions are defined as "expected future costs that will differ under alternatives".

Relevant costs are futuristic in nature. These are the costs that are expected to occur during the time period covered by the decision. These costs are different between alternatives being considered. Only costs that differ among decision alternatives are relevant to a decision.

14. (a) The possible disadvantages of treating divisions as profit centres are as follows:

1. Divisions may compete with each other and may take decisions to increase profits at the expense of other divisions thereby overemphasizing short term results.
2. It may adversely affect co-operation between the divisions and lead to lack of harmony in achieving organisational goals of the company. Thus it is hard to achieve the objective of goal congruence.
3. It may lead to reduction in the company's overall total profits.
4. The cost of activities which are common to all divisions may be greater for decentralised structure than for centralised structure. It may thus result in duplication of staff activities.

5. Top management 10sesc' Control by delegating decision making to divisional managers. There are risks of mistakes committed by the divisional managers which the top management, may avoid.
 6. Series of control reports prepared for several departments may not be effective from the point of view of top management.
 7. It may under utilise corporate competence.
 8. It leads to complications associated with transfer pricing problems.
 9. It becomes difficult to identity and define precisely suitable profit centres.
 10. It confuses division's results with manager's performance.
- (b) Bench marking is a technique which is being adopted as a mechanism for achieving continuous improvement. It is a continuous process of measuring a company's products, services or activities against the other best performing organizations either internal or external to the company. The objective is to ascertain how the processes and activities can be improved. The latest developments, best practices and model examples can be incorporated within various operations of the business of the company. It represents an ideal way of achieving high competitive standards.

15. (a) Standard Cost Sheet

Description	Cost per unit of Finished Good
Standard Raw Material Cost	Rs 5,600
Variable Overheads	Rs 1,400
Standard Fixed Overheads	Rs 10,000
Standard Cost per Unit of Finished Good	Rs 17,000

(b) Production Volume Variance

Unutilised capacity × Standard Fixed Cost per Finished Good

$$100 \times \text{Rs } 10,000 = \text{Rs } 10,00,000 \text{ Adverse}$$

(c) Usage and Material Price Variance (Actual Production : 100 Units)

Raw Mat	Std Qty/FG	StdQty on actual prod	Actual Qty on actual prod	Act Price per Ut of RM(Rs)	Std Price per Ut of RM(Rs)	Usage Variance(Rs)	Price Variance(Rs)
A	1	100	102	700	600	(1,200)	(10,200)
B	2	200	201	600	500	(500)	(20,100)
C	3	300	310	500	400	(4,000)	(31,000)
D	4	400	415	400	300	(4,500)	(41,500)
E	5	500	540	300	200	(8,000)	(54,000)
F	6	600	610	200	100	(1,000)	(61,000)
						(19,200)	(2,17,800)

16.

	P	Q
Cost per unit on single rate	Rs 4,144	1,97
Cost per unit on ABC (Rs.)	3.58	7.31
Selling price per unit of K	= Rs. 14.34	

(c) Return per bottleneck hour = (selling price – material cost)/ (Time on bottleneck resource)

Product A = Rs. 2,900 [(Rs. 60 – Rs. 2)/ Rs. 0.02 hours]

Product B = Rs. 2,000 [(Rs. 70 – Rs. 40)/ 0.015 hours]

Product A should be sold up to its maximum capacity of utilizing 2,880 bottleneck hours (1,44,000 units × 0.02 hours). This will leave 195 hours for product B thus enabling 13,000 units (195/0.015) to be produced.

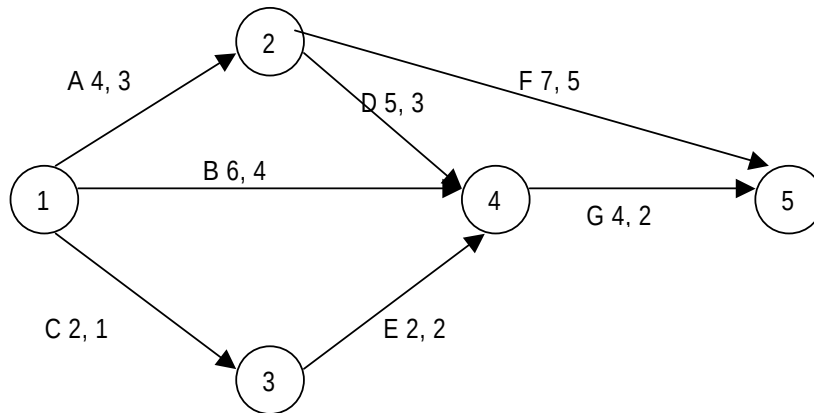
The maximum profit is calculated as follows:

	Rs.
Throughput return from product A (1,44,000 × Rs. 58)	83,52,000
Contribution from product B (13,000 × Rs. 30)	<u>3,90,000</u>
	87,42,000
Less: Variable overheads	35,40,000
Fixed overhead cost	<u>14,70,000</u>
Net profit	<u>37,32,000</u>

Note:

It is assumed that the variable overheads (e.g. direct labour) are fixed in the short term. They are derived from part (a) – [(120,000 × Rs. 28) + (45,000 × Rs. 4)]

18.



from the diagram we have:

Path	Length	
	Normal Time (days)	Crash Time (days)
1 – 2 – 5	11	8 (critical)
1 – 2 – 4 – 5	13 (critical)	8 (critical)
1 – 4 – 5	10	6
1 – 3 – 4 – 5	8	5

Thus the normal duration of completion is 13 days while the minimum (crash) completion time of the project is 8 days.

Cost slope: The per day cost slope for each activity can be obtained as follows:

$$\text{Cost slope} = (\text{Crash cost} - \text{Normal cost}) / (\text{Normal time} - \text{Crash time})$$

For activity A we have

$$\text{Cost slope} = (90 - 60) / (4 - 3) = \text{Rs. } 30 \text{ per day}$$

For the various activities the cost slopes are:

Activity	Node	Cost slope per day (Rs)
A	1 – 2	30
B	1 – 4	50
C	1 – 3	22
D	2 – 4	50
E	3 – 4	-
F	2 – 5	30
G	4 – 5	70

Crashing the step-wise crashing is given in the table 3 while the cost of completing the project in 13, 12 days is given in table 4

Table 3: Crashing the project

Crashing	Critical Path	Options	Cost	Decisions	Duration after crashing
I	1 – 2 – 4 – 5	1 – 2	30	Crash 1 – 2	12
		2 – 4	50		
		4 – 5	70		
II	1 – 2 – 4 – 5	2 – 4	50	Crash 2 – 4	11
		4 – 5	70		
III	1 – 2 – 4 – 5	2 – 4	50	Crash 2 – 4	10
		4 – 5	70		
IV	1 – 2 – 5	2 – 5, 4 – 5	100	Crash 2 – 5, 4 – 5	9
	1 – 2 – 4 – 5				
	1 – 4 – 5				
	1 – 2 – 5				
V	1 – 2 – 4 – 5	2 – 5, 4 – 5	100	Crash 2 – 5, 4 – 5	8
	1 – 4 – 5				

The length of various paths after each crashing is given here

Path	Normal Length	Length after crashing				
		I	II	III	IV	V
1 – 2 – 5	11	10	10	10	9	8
1 – 2 – 4 – 5	13	12	11	10	9	8
1 – 4 – 5	10	10	10	10	9	8
1 – 3 – 4 – 5	8	8	8	8	7	6

Table 4: Determination of Total cost

Project Duration (days)	Direct Cost	Indirect Cost	Total Cost (Rs)		
	Normal	Crashing	Total		
13	713	0	713	400	1113
12	713	30	743	250	993
11	713	80	793	175	968
10	713	130	843	100	943 (MIN)
9	713	230	943	75	1018
8	713	330	1043	50	1093

19.

	P1	P2
	Rs/unit	Rs./unit
Material	407.5	292.1
Overhead-Material handling	$85 \times 1.2 = 102$	$46 \times 1.2 = 55.2$
Assembly Management	$40 \times 3.2 = 128$	$40 \times 1.9 = 76$
Machine insertion	$48 \times 0.7 = 33.6$	$31 \times 0.7 = 21.7$
Manual insertion	$36 \times 2.1 = 75.6$	$25 \times 2.1 = 52.5$
Quality testing	$1.4 \times 25 = 35$	$1.1 \times 25 = 27.5$
Present cost	781.70	504.00
Target cost	680.00	390.00
	Revised P1	Revised P2
	Rs./unit	Rs./unit
Direct material	381.20	263.10
Overhead:		
Material handling	$(71 \times 1.2) = 85.2$	$(39 \times 1.2) = 46.8$
Assembly hour	$(2.1 \times 40) = 84.0$	$(1.6 \times 40) = 64.0$
Machine inspection	$(59 \times 0.7) = 41.3$	$(29 \times 0.7) = 20.30$
Manual inspection	$(12 \times 2.10) = 25.2$	$(10 \times 2.10) = 21.00$
Quality testing	$(1.2 \times 25) = 30.00$	$(0.9 \times 25) = 22.50$
Estimated cost	646.90	437.70
Target cost	680.00	390.00
	Achieved	not achieved

20. The random number intervals are determined in the first place as shown in table 1 and 2

Table 1: Random Number Intervals for Demand (units)

Demand	No. of Days	Prob.	Cum. Prob.	Random No. Interval
5	15	.15	.15	00-14
6	25	.25	.40	15-39
7	30	.30	.70	40-69

8	18	.18	.88	70-87
9	8	.08	.96	88-95
10	4	.04	1.00	96-99

Table 2: Random Number Intervals for Lead Time (in days)

Lead time	Probability	Cum. Probability	Random Number Interval
3	.2	.20	00-19
4	.3	.50	20-49
5	.35	.85	50-84
6	.15	1.00	85-99

Table 3: Simulation Worksheet

Trials	Opening Balance	Random No.	Demand	Closing Balance	Random No.	Lead Time	Ordering Cost	Holding Cost	Shortage Cost
1	25	69	7	18	81	5	100	54	
2	18	61	7	11				33	
3	11	83	8	3				9	
4	3	85	8	0					100
5	0	27	6	0					120
6	40	57	7	33				99	
7	33	81	8	25				75	
8	25	48	7	18	86	6	100	54	
9	18	67	7	11				33	
10	11	52	7	4				12	
11	4	23	6	0					40
12	0	11	7	0					100
13	0	59	5	0					140
14	40	3	5	35				105	
15	35	3	5	30				90	
16	30	74	8	22				66	
17	22	64	7	15	40	4	100	45	
18	15	70	8	7				21	
19	7	43	7	0					0
20	0	87	8	0					160
Total Cost							300	696	660

21. The random number intervals are determined in the first place as shown in table 1 and 2

Table 1 Random Number Intervals (rained previously)

Event	Probability	Cum. Probability	Random Number Interval
No rain	.50	.5	00-49
1 cm rain	.25	.75	50-74
2 cm rain	.15	.90	75-89
3 cm rain	.05	.95	90-94
4 cm rain	.03	.98	95-97
5 cm rain	.02	1.00	98-99

Table 2 Random Number Intervals (No. Rain previously)

Event	Probability	Cum. Probability	Random Number Interval
No rain	.75	.75	00-74
1 cm rain	.15	.90	75-89
2 cm rain	.06	.96	90-95
3 cm rain	.04	1.00	96-99

The rainfall can now be predicted in accordance with the random number generated

Table 3: Simulation Worksheet

Day	Random Numbers	Rainfall (cm)	Table References
1	76	1	Table 2
2	78	2	Table 1
3	84	2	Table 1
4	75	2	Table 1
5	02	No rain	Table 1
6	86	1	Table 2
7	02	No rain	Table 1
8	78	1	Table 2
9	07	No rain	Table 1
10	63	No rain	Table 2

Total days without rain are 4 and total rain is 9 cm

22. Let x_1 , x_2 , x_3 and x_4 denote the amount of funds to be invested in government bonds, blue chip stocks, speculative stocks and short term deposits respectively. Let Z denote the total expected return.

Since the Mutual Fund Company has Rs. 20 lakhs available for investment,

$$x_1 + x_2 + x_3 + x_4 \leq 20,00,000$$

Also, Mutual fund is required to keep at least Rs. 2 lakhs in short-term deposits

$$\text{Hence, } x_4 \geq 2,00,000$$

The average risk factor is given by

$$\frac{12x_1 + 24x_2 + 48x_4}{x_1 + x_2 + x_3 + x_4}$$

Since the average risk factor Mutual Fund should not exceed 42, we get the following constraint.

$$\frac{12x_1 + 24x_2 + 48x_3 + 6x_4}{x_1 + x_2 + x_3 + x_4} \leq 42$$

$$\text{Or, } 12x_1 + 24x_2 + 48x_3 + 6x_4 \leq 42(x_1 + x_2 + x_3)$$

$$\text{Or, } -30x_1 - 18x_2 + 6x_3 - 36x_4 \leq 0$$

Further, speculative stock must be at most 20% of the total amount invested, hence

$$x_3 \leq 0.20(x_1 + x_2 + x_3 + x_4)$$

$$\text{Or, } -0.2x_1 - 0.2x_2 - 0.2x_4 \leq 0$$

Finally, the objective is to maximize the total expected annual return, the objective function for Mutual Fund can be expressed as

$$\text{Maximize } Z = 0.14x_1 + 0.19x_2 + 0.23x_4$$

Summarizing equations (i) to (v), the linear programming model for the Mutual Fund company is formulated as below:

Objective function:

$$\text{Maximize } Z = 0.14x_1 + 0.19x_2 + 0.23x_3 + 0.12x_4$$

Subject to the constraints

$$x_1 + x_2 + x_3 + x_4 \leq 20,00,000$$

$$x_4 \geq 2,00,000$$

$$-30x_1 - 18x_2 + 6x_3 - 36x_4 \leq 0$$

$$-0.2x_1 - 0.2x_2 + 0.8x_3 - 0.2x_4 \leq 0$$

$$\text{Where } x_1 \geq 0, x_2 \geq 0, x_3 \geq 0 \text{ \& } x_4 \geq 0$$

PAPER – 6 : MANAGEMENT INFORMATION AND CONTROL SYSTEMS

QUESTIONS

1. Define the following terms:
 - (i) File Sharing Architecture
 - (ii) Client/Server
 - (iii) CASE Tools
 - (iv) Expert systems
 - (v) Schedule Feasibility
 - (vi) Back Doors
 - (vii) Piggybacking
 - (viii) Integrated Test Facility
 - (ix) Dynamic Analyser
 - (x) Snapshot Technique
2.
 - (a) Explain the significance of information in the management process.
 - (b) What are the major constraints in operating a MIS ?
3.
 - (a) What is Decision-Making? Describe the support provided by MIS in decision making.
 - (b) Discuss the importance of an Executive Information System, taking into perspective the recent business scenario.
4. Describe the major risks associated with client / server system.
5. Explain the term “Decision Support System”. How do decision support systems differ from traditional management information systems ?
6.
 - (a) Discuss in brief the transaction cycles which exist in all businesses?
 - (b) What is a data dictionary? Why is it important in systems analysis and design?
7. Distinguish between logical design and physical design. In which case is the analyst responsible for the design? What is the role of the programmer and the user?
8.
 - (a) Why should users be involved in the development process?
 - (b) What objectives guide input design? Briefly describe each.
9. What is a RFP? Discuss the factors which have to be considered for evaluation and selection of vendors' proposals.
10. Draw the system flow chart for a materials inventory control system and explain the factors involved in its design.
11.
 - (a) What do you mean by application controls? How are input, processing and output controlled?
 - (b) Explain in brief the broad classes of input controls.
12. Briefly describe the various checks that could be performed during the validation run.
13. What do you mean by Enterprise Resource Planning (ERP) ? Discuss the nature of ERP packages that are available in the market and the criteria applied in evaluating these packages ?
14. What is an Audit Trail? In what ways does an audit trail safeguard both data and the organization in an online environment?
15.
 - (a) Who and how can one apply to be a Certifying Authority ? Discuss, in brief, the duties of Certifying Authorities as stated in Chapter VI of Information Technology Act, 2000.

- (b) What do you mean by electronic governance as provided in the Information Technology Act? Discuss the provisions regarding attribution, receipt and dispatch of electronic records.
- 16. (a) What do you mean by information security ? What are the objectives of information security? Discuss the way in which it can be implemented.
- (b) Explain the role played by an Information Security administrator.
- 17. Discuss the various issues that are of primary concern for an auditor involved in information system audit.
- 18. What do you mean by the term "CASE Tools"? What are the different types of CASE tools available?
- 19. Define the following:
 - (i) System
 - (ii) CASE Workbenches
 - (iii) Product Data Management (PDM)
 - (iv) Decision Support System
 - (v) Business Process Reengineering
 - (vi) Computer Frauds
 - (vii) Threats to Operating System Integrity.

SUGGESTED ANSWERS/HINTS

1. (i) A File Sharing Architecture is one where the server downloads files from the shared location to the user's local machine. The required job is then run on the local machine. See Page 6.2 of the study material for more details.
- (ii) Client/Server refers to computing technologies in which the hardware and software components are distributed across a network. See Page 6.3 of the study material for more details.
- (iii) CASE (Computer Aided Software Engineering) Tools are software packages that aid people in systems development. See Page 7.39 and 19.1 of the study material for more details.
- (iv) Expert Systems are designed to replace the need for a human expert. They are particularly important where expertise is scarce and therefore expensive. It is a software that expresses knowledge in terms of facts and rules. The expert system should be able to learn i.e. change or add new rules. They are developed using very different programming languages such as PROLOG. They are of greater use at the tactical and strategic level.
- (v) Schedule Feasibility involves estimating how long it will take for a new or revised system to become operational. See Page 7.21 of the study material for more details.
- (vi) Back Doors or a trap door is a software program that contains unauthorised access to a system without going through the log-on procedure. See Page 13.6 of the study material for more details.
- (vii) Piggybacking involves tapping into a communication line and latching on to a legitimate user before he logs on to the system. See Page 15.10 of the study material for more details.
- (viii) Integrated Test Facility is a concurrent audit technique that places a small set of fictitious records into master files. See Page 17.14 of the study material for more details.
- (ix) A Dynamic Analyser produces code listing annotated with the number of times each statement was executed, when the program was run. See Page 19.8 of the study material for more details.

- (x) **Snapshot Technique:** This is a concurrent audit technique that examines the way the transactions are processed by marking selected transaction with a special code. See Page 17.15 of the study material for more details.
- 2. (a) **Management process** is an approach of management, which views management as what managers do. Managers in business organisations perform several functions, which help them in managing the affairs of their organisations. Broadly, they plan, organise, control and solve problems by taking suitable decisions. In order to perform their job efficiently, they make use of an important resource known as information along with other resources like men, money and machines.

Modern Managers rely less on intuition and more on their knowledge, competence, creative, analytical and conceptual skills. For proper handling of complex managerial problems and decision making, intuition alone is not enough. It is to be re-inforced by other aids, logical and systematic thinking, collection and analysis of facts, and application of certain tested techniques.

Information is a basic requirement for any problem solving and decision-making situation with which a modern manager is faced. It significantly determines the effectiveness of not only the final decision but also of the process of decision making itself. That is why decision making is sometimes regarded as the processing of converting information into action. This is also the reason why timely collection and processing of information is of such great importance today. All the concerns now have organised information system, mostly computer-based.

Information is useful to managers to recognise and define problem situations, to develop alternative courses and to select the best course of action. Information helps the managers to have a better view of the decision situations and to reduce the complexity and uncertainty surrounding them. With the availability of information, the problem situation becomes more controllable and manageable. It is the information, which makes the managers realise the need for taking decisions.

- (b) **Major constraints**, which come in the way of operating a management information system, are the following:
 1. There is non-availability of experts who can diagnose the objectives of the organisation and provide a desired direction for installing and operating information system. This problem may be overcome by grooming internal staff. The grooming of staff should be preceded by proper selection and training.
 2. Experts usually face the problem of selecting the sub-system of MIS to be installed and operated upon. The criteria, which should guide the experts here, may be the need and importance of a function for which MIS be installed first.
 3. Due to varied objectives concerned, the approach adopted by experts for designing and implementing business MIS is a non-standardised one. Though in this regard nothing can be done at the initial stage but by and by standardisation may be arrived at for the organisation in the same industry.
 4. Non-availability of cooperation from staff in fact is a crucial problem. It should be handled tactfully. This problem may be solved by educating the staff. This task should be carried out by organising lectures, showing films and also explaining to them the utility of the system. Besides this some persons should also be involved in the development and implementation of the system.
 5. There is high turnover of experts in MIS. Turnover in fact arises due to several factors like pay packet; promotion chances; future prospects, behaviour of top linking managers etc. Turnover of experts can be reduced by creating better working conditions and paying at least at par with other similar concerns.
 6. Difficulty in quantifying the benefits of MIS, so that it can be easily comparable with cost. This raises questions by departmental managers about the utility of MIS. They

forget that MIS is a tool, which is essential to fight out competition and the state of uncertainty that surrounds business today.

3. (a) Decision-making is a managerial process and function of choosing a particular course of action out of several alternative courses for the purpose of achieving the organisation's goals.

It involves committing the organization to specific courses of action and entails commitment of resources in specified ways.

Decisions can be categorised under two heads viz., structured and unstructured.

A highly structured decision can be pre-planned or pre-specified. It can be programmable, in the sense that unambiguous decision rules can be specified in advance. It does not always mean that the decision making is automatic, although many programmable decisions are automatic. The structured programmable decision tends to be routine and repetitive.

A highly unstructured decision cannot be preplanned or pre-specified. Such a decision is non-programmable. The unstructured decisions tend to occur frequently and tend to be non-routine.

MIS support in the case of structured and non-structured decision making cases differs as follows:

MIS support in the case of structured decisions: In the case of programmed decision, the organisation can prepare a decision rule or a decision procedure. This can be expressed by a set of steps to follow or a flow chart or a decision table, or a formula. The decision procedure should also specify the information to be acquired before applying the decision rules. These decisions can be handled by lower-level personnel. In fact, most of the highly structured decisions may be completely automated.

The structured decisions clearly specify the information requirements, unambiguous procedures for data entry, validation procedures to ensure correct and complete input, processing of the input using the decision logic, and output of the programmed decision in a form that is useful for action. A useful output should be clear as to how it is to be used and should contain enough data to assist the recipient to assess the reasonableness of the decisions. Here MIS supports fully the process of decision-making by making available the required information and procedures.

MIS support in the case of unstructured decisions: The data/information requirements of unstructured decisions are not completely known in advance. The MIS support requirements for unstructured data includes access to data and a variety of analysis and decision procedures that can be applied to obtain the solution of the problem.

- (b) An Executive Information System (EIS) is a tool that provides direct on-line access to relevant information in a useful and navigable format. An EIS is easy to navigate so that managers can identify broad strategic issues, and then explore the information to find the root causes of those issues.

The main purpose of an Executive Information System is to support managerial learning about an organization, its work processes, and its interaction with the external environment. Informed managers make better decisions.

EIS also allows timely access to information, as compared to traditional methods. This means, by the time a useful report is compiled, the strategic issues facing the manager remain unchanged and the report can be fully utilized. Timely access also influences learning. Another important purpose of EIS is its ability to direct management attention to specific areas of the organization or specific business problems.

The powerful focus of an EIS is due to the saying "what gets measured gets done". Managers are particularly attentive to concrete information about their performance when it is available to their superiors. This focus is very valuable to an organization if the information reported is important and represents a balanced view of the organisation's objectives.

Misaligned reporting systems can result in inordinate management attention to things that are not important or to things which are important but to the exclusion of other equally important things.

For details, refer to Chapter 5, Section 5.8.1 of the study material.

4. There are many risks involved in the transition from mainframe (or PC) to client/server system. These risks can be classified into four categories; technological, operational, economic, and political.

Technological Risks: The technological risk is quite simple – Will the new system work? The short-term aspect of this question is – will it literally work? But more important is the risk that in the long run the system may grow obsolete. That it will become obsolete is probably inevitable thus the question becomes – how soon will it become obsolete. To resolve this issue the firm and the IT consultant / division should understand system standards and market trends and use them in their decision making processes while deciding what system to incorporate into their organisation.

Operational Risks: These risks parallel the technological risks in both the short and long run. Respectively, they are: will you achieve the performance you need from the new technology and will the software that you chose be able to grow or adapt to the changing needs of the business. Once again sound planning and keeping an eye to the future are the only remedies for these risks.

Economic Risks: In the short run, firms are susceptible to hidden costs associated with the initial implementation of the new client/server system. Cost will rise in the short term since one needs to maintain the old system (mainframe) and the new client server architecture development. In the long run, the concern centers around the support costs of the new system.

Political Risks: Finally, political (people) risks involved in this transition are addressed. Here, the short-term question is-will end users and management be satisfied? The answer to this is definitely not if the system is difficult to use or is plagued with problems.

5. A Decision Support System (DSS) can be defined as a system that provides tools to managers to assist them in solving semistructured and unstructured problems in their own, somewhat personalised, way. A DSS is not intended to make decisions for managers, but rather to provide managers with a set of capabilities that enables them to generate the information required by them in making decisions. In other words, a DSS supports the human decision-making process, rather than providing a means to replace it.

The decision support systems are characterised by at least three properties:

1. They support semistructured or unstructured decision –making.
 2. They are flexible enough to respond to the changing needs of decision makers, and
 3. They are easy to use.
- (i) **Semistructured and Unstructured Decisions:** Structured decisions are those that are easily made from a given set of inputs. These types of decisions – such as deciding to issue a reminder notice if a bill is overdue or deciding to sell a stock under a given set of market conditions – can be programmed fairly easily. Unstructured decisions and semistructured decisions, however, are decisions for which information obtained from a computer system is only a portion of the total knowledge needed to make the decision.

The DSS is particularly well adapted to help with semistructured and unstructured decisions. However, it can be designed to support structured decision making as well.

- (ii) **Ability to adapt to changing needs:** Semistructured and unstructured decisions often do not conform to a predefined set of decision-making rules. Because of this, their decision support systems must provide for enough flexibility to enable users to model their own information needs. They should also be capable of adapting to changing information needs.

Flexibility in a DSS is of paramount importance. Information requests made to a DSS are often relatively unsystematic and distinctive.

- (iii) **Ease of learning and Use:** Since decision support systems are often built and operated by users rather than by computer professionals, the tools that accompany them should be relatively easy to learn and use. Such software tools employ user-oriented interfaces such as grids, graphics, non-procedural fourth – generation languages (4GL), natural English, and easily read documentation. These interfaces make it easier for users to conceptualise and perform the decision-making process.

6. (a) Accounting Information System includes variety of activities associated with an organisation's transaction processing cycles. A transaction processing cycle organizes transactions by an organisation's business processes. The nature and types of transaction processing cycles vary, depending on the information needs of a specific organization. Nevertheless, most business organizations have in common, transactions that may be grouped according to four common cycles of business activity. These cycles exist in all types of business – both profit –seeking and not – for- profit.

- (a) **Revenue cycle:** Firms sell their finished goods to customers through this cycle. It involves processing cash sales, credit sales, and receipt of cash following a credit sale.
- (b) **Expenditure cycle:** Events related to acquisition of goods and services from other entities in exchange for cash.
- (c) **Production cycle:** Events related to the transformation of resources into goods and services. It involves the planning, scheduling, and control of the physical product through the manufacturing process.
- (d) **Finance cycle:** Events related to the acquisition and management of capital funds, including cash. It might also include application systems concerned with cash management and control, debt management, and administration of employee benefit plans.

The transaction cycle model of an organization includes a fifth cycle – the Financial Reporting Cycle. It is not an operating cycle. It obtains accounting and operating data from other cycles and processes these data in such a manner that financial reports may be prepared.

The concept of transaction processing cycles provides a framework for analyzing an organisation's activities. It offers a systematic frame work for the analysis and design of accounting information systems. Although different organizations may not include the same application systems within a given transaction processing cycle, the cycle concept provides a basis for categorizing the flow of economic events that are common to all organizations.

- (b). A data dictionary stores descriptions of data items and structures, as well as system processes. Analysts use the contents of the dictionary to store details and descriptions of the system under analysis. The dictionary is also useful during systems design, when information about data length, aliases, and data use in specific processes must be available. In addition, the data dictionary stores validation information to guide analysts in specifying controls for the system's acceptance of data.

Among the reasons dictionary systems are important in analysis and design are the following:

- (i) Acts as a documentation and
- (ii) Is useful for file security.
- (iii) Helps in establishing an audit trail.
- (iv) Is useful for planning the flow of transaction data through the system.
- (v) Serves as an important aid in investigating or documenting internal control procedures.

For details, refer to Chapter 7, Section 7.6.6 of the study material

7. Design is concerned with translating systems requirements into ways of meeting these requirements. Logical design is the blueprint containing all the detailed specifications of the new system to meet system requirements. It contains the features of the new system: its outputs, inputs, files and databases, and procedures.

In contrast, physical design is the activity that follows logical design. It involves programmers translating the design specifications formulated by analysts in the logical design phase into program software, files, and a working system.

Analysts are responsible for the following:

- (i) To translate requirements data into detailed specifications (the means of meeting what the new or modified system must do). This activity should include output and input design.
- (ii) To act as a liaison (to clarify what the specifications are) between the logical design phase and the programmers involved in the physical design phase.

Programmers are responsible for translating the specifications produced in the logical design phase into program software, files and databases, and a working system.

Users are responsible for providing essential feedback to analysts, including that obtained from reviewing mock-up reports, input formats, system procedures, and system controls. User involvement not only paves the way for a smoother introduction of the new system, but also acquaints the user with the capabilities and limitations of the new system.

8. (a) Involving users in the development process provides valuable feedback and ensures that the users themselves understand the system's limitations and capabilities. Specifically, it enables users to share in the responsibility for the success or failure of the system developed for them. In addition, involving users secures their aid in detecting missing, unnecessary, or awkward system features and in pointing out errors in procedures, input and output specifications, data stores and other design features. Most important, user involvement often leads to productive changes in the specifications, thus preventing problems later in the development process.
- (b) Input design consists of developing specifications and procedures for data preparation, developing steps which are necessary to put transactions data into usable form for processing and data entry. The following objectives guide input design:
 - (i) Content (ii) Timeliness (iii) Media (iv) Format (v) Input volume.

For details, refer to Chapter 8, Section 8.3 of the study material.

9. Request for proposal (RFP) is a document in which systems requirements are summarised and sent to each prospective vendor. A letter of transmittal accompanies the RFP to explain to the vendor the nature of the problem, the objectives of the system, and the deadline for proposal submission.

The RFP provides a format for vendor responses and thus is a comparative basis for initial screening.

The factors which have to be considered for evaluation and selection of Vendor's proposals are:

- (i) Performance capability of each proposed system in relation to its costs: It is imperative that a vendor system be capable of processing the organizations data within the time frames desired by the management. There are many ways of measuring the performance including speed, response time, number of users supported and system testing.
- (ii) Costs and Benefits of each proposed system: The accountants on the design team will analyse the costs of every vendor's proposed system in relation to the system's anticipated performance benefits – i.e., they will perform a cost – benefit analysis for each proposed system. The accountants also investigate the differences between purchasing and leasing each vendor's system.
- (iii) Maintainability of each proposed system: It refers to the ease with which a proposed computer system can be modified. Because the costs of maintaining a large information

system are much more than the costs of initially acquiring or developing a system, therefore, evaluators should place considerable emphasis on this dimension.

- (iv) **Compatibility of each proposed system with existing systems:** Compatibility refers to the ability to implement and interface the new system with existing computer software and resources. Compatibility issues also involve the operating system, existing application software, or procedural concerns as well.
 - (v) **Vendor Support:** It includes such things as (1) training classes that familiarize employees with the operating characteristics of the new system, (2) help in implementing and testing the new system (3) assistance in maintaining the new system through a maintenance contract, and (4) backup systems for temporarily processing company data if required. The availability of “business hours only” versus “round the clock” support is another consideration. Most vendors charge extra for enhanced services.
10. The material inventory control system is the point at which materials enter the manufacturing accounting system. This system controls inventory and minimise the costs of purchasing and holding of inventory. The materials inventory control system interfaces directly with the accounts payable, general ledger, production planning, production scheduling and work-in-process control systems as shown in the following system flow chart:

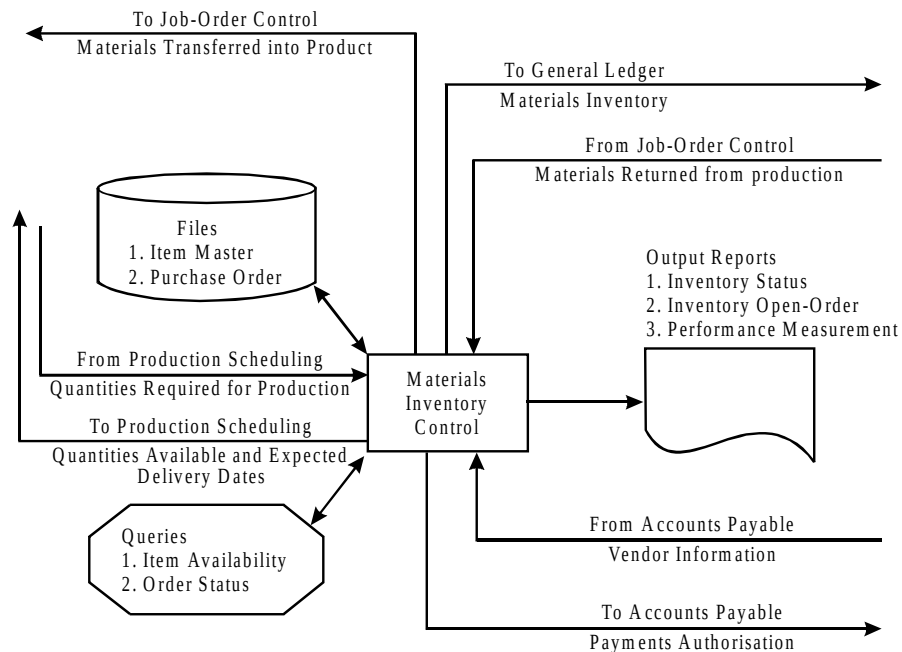


Figure : Materials Inventory Control System

The objectives of materials inventory control system are to provide accounts payable system with information about vendors and the receipt of goods. Vendor information is first required when sourcing decisions are made. When an order is received, the material inventory control system reports to accounts payable, which in turn, reports to authorise payment.

Materials inventory control provides the general ledger with certain accounting information such as the value of the purchases received, materials transferred into production and the inventory on hand. It generates aggregate journal entries under the following heads: materials inventory accounts payable, work in process and factory overhead control – indirect materials, which are sent to general ledger for the accounting transactions.

Information regarding direct and indirect materials requisitioned from the materials inventory control system is transferred to work-in-process system. Similarly, information about materials returned from the production department is recorded in materials inventory control. It also provides information concerning quantities available and expected delivery dates to the production scheduling system. This information is then used for scheduling production.

Inputs

There are two basic input files for the materials inventory control system. The items master file contains one record for each item of the inventory. Some of the data items contained in each record are: inventory item number, item description and specification, current quantity on hand, current quantity on order, current period receipts, year-to-date receipts, current period issues, year-to-date issues, standard cost and vendor identification.

The item master is updated when a purchase order is created or items are placed in the inventory.

The purchase order file contains information about new purchase orders. These results from reduced quantities in the inventory or anticipated production requirements. The following data items are found in each record of the purchase order file; inventory item number, item description and specification, vendor identification, quantity ordered, date of order, delivery date, shipping instructions, order status, purchase cost, purchase order number and item quantity actually received.

Reports

The materials inventory control system generally produces following reports on periodic basis:

- (i) An inventory status report contains the quantity of each item available on a particular date. The report provides the unit cost of an item and any costing technique such as FIFO, LIFO and average cost etc. can be used. The report also includes the beginning balance, transfers, receipts, adjustments and ending balance of each item.
- (ii) An open purchase order report contains information concerning the status of open purchase orders. It includes the item number, vendor identification, date of order, unit cost, quantity ordered, promised shipping date, and other status information.
- (iii) Performance measurement reports contain information concerning turnover, stock-outs, shrinkage, investment and other appropriate measurements related to management performance in inventory control.

The material inventory control system provides the facility of frequently answering the queries about item's availability. These queries result due to potential rush orders from customers or problems encountered during production. The item master file supplies the information regarding these queries. Queries are also received about the status of purchase orders. Delays by vendors frequently cause production delays and scheduling problems. The open purchase order report can be used to identify such problems. For example, if a vendor misses a shipping date, cost estimation and production scheduling departments can be notified so that production schedules can be adjusted. The system is designed to respond instantaneously to these queries so that constant monitoring and control can be exercised on material inventory.

11. (a) Application controls deal with exposures within specific applications, such as payroll, purchases, and cash disbursements systems. Application controls, which may be manual actions or procedures programmed into an application, fall into three broad categories; input controls, processing controls, and output controls.

Input Controls: The data collection component of the information system is responsible for bringing data into the system for processing. Input controls at this stage attempt to ensure that these transactions are valid, accurate, and complete. Data input procedures can be either source document-triggered (batch) or direct input (real-time).

Direct input can employ real-time editing techniques to identify and correct errors immediately and thus significantly reduces the number of errors that enter the system. On the other hand, source document input requires more human involvement and is more prone to clerical errors than direct input procedures.

Input controls are divided into the following broad classes:

- Source document controls
- Data coding controls
- Batch controls
- Validation controls
- Input error correction
- Generalised data input systems.

Processing Controls: After passing through the data input stage, transactions enter the processing stage of the system. Processing controls are divided into three categories: run-to-run controls, operator intervention controls, and audit trail controls.

Output controls: Output controls ensure that system output is not lost, misdirected, or corrupted and that privacy is not violated. Exposures of this sort can cause serious disruptions to operations and may result in financial losses to a firm.

The choice of controls employed to protect system output is influenced by the type of processing method in use. Generally, batch systems are more susceptible to exposure and require a greater degree of control than real-time systems. This section examines output exposures and controls for both methods.

For details, refer to Chapter 14 of the study material.

- (b). The data collection component of the Information system is responsible for bringing data into the system for processing. Input controls at this stage attempt to ensure that these transactions are valid, accurate and complete.

Input controls are divided into the following broad classes. These control classes are not mutually exclusive divisions. Some control techniques could fit logically into more than one class.

- (i) **Source Document controls:** 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 organization.

To control against this type of exposure, the organization must implement control procedures over source documents to account for each document as described below:

- Use prenumbered source documents
- Use source documents in sequence
- Periodically audit source documents

- (ii) **Data Coding controls:** Coding controls are checks on the integrity of data codes used in processing. A customer's account number, an inventory item number, and a chart of accounts number are all examples of data codes. Three types of errors can corrupt a data code and cause processing errors: transcription, single transposition and multiple transposition. Check digit can be used to ensure integrity of the code in subsequent processing.

- (iii) **Batch controls and hash totals:** They are an effective method of managing high volumes of transaction data through a system. The objective of batch control is to reconcile output produced by the system with the input originally entered into the system. Batch controls ensure that all records in a batch are processed, no records are processed more than once and an audit trail of transactions is created from input

through processing to output stage of the system. Hash totals uses non financial data to keep track of the records in a batch.

- (iv) **Validation controls:** Input validation controls are intended to detect errors in transaction data before the data are processed. Validation procedures are most effective when they are performed as close to the source of the transaction as possible. However, depending on the type of CBIS in use, input validation may occur at various points in the system. There are three levels of validation controls: field interrogation, transaction interrogation and file interrogation.
- (v) **Input Error Correction:** When errors are detected in a batch they must be corrected and the records resubmitted for reprocessing. This must be a controlled process to ensure that errors are dealt with completely and correctly. There are three common error handling techniques: immediate correction; create an error file, and reject the entire batch.
- (vi) **Generalised Data Input Systems:** To achieve a high degree of control and standardization over input validation procedures, some organizations employ a generalized data input system (GDIS). This technique includes centralized procedures to manage the data input for all the organisation's transaction processing systems.

For further details, the students are advised to refer to study paper, Chapter 14, Section 14.1.

12. The checks which could be performed during a validation run can be categorized as field checks and transaction checks.

Various field checks have been described below:

- (i) **Limit Check:** This is a basic test for data processing accuracy and may be applied to both the input and output data. The field is checked by the program against predefined limits to ensure that no input/output error has occurred or at least no input error exceeding certain pre-established limits has occurred.
- (ii) **Picture Check:** Under this check, only certain characters are allowed in a data field. The computer can test the field to determine that no invalid characters are used.
- (iii) **Valid code check:** If there are a limited number of valid codes, the code being read may be checked against pre-determined transaction codes, or table to ensure that it is one of the valid codes.
- (iv) **Check digit:** It is an extra digit that is computed from the code itself and placed along side it for subsequent checking. There are a number of check digit schemes but module-11 check digit scheme has been empirically established as the best to detect errors that are encountered commonly such as transcription, double transpiration and random errors.
- (v) **Arithmetic check:** Arithmetic is performed in different ways to validate the results of other computations or the value of selected data field.
- (vi) **Valid combinations of fields:** In addition to each of the individual fields being tested, combination of fields may be tested for validity.
- (vii) **Cross check:** It may be employed to verify fields appearing in different files to see that the results tally.
- (viii) **Valid field size, sign and composition:** If the code no. should be specified number of digits in length, the computer may be programmed to test that the field size is as specified. If the sign of the field must always be positive or always negative, a test may be made to determine that the field does indeed contain a proper composition of characters.

Various transaction checks are given below:–

- (i) **Sequence checks** are exercised to detect any missing transactions, off-serially numbered vouchers.

- (ii) Format completeness checks are used to check the presence and position of all the fields in a transaction.
- (iii) Redundant data checks are employed to check the validity of codes with reference to the description.
- (iv) Checks may be incorporated to ensure that transactions pertain to the correct period.
- (v) Combination checks may be exercised on various fields of a file.
- (vi) Passwords may be issued to check entry of data by unauthorised persons in on-line systems.
- (vii) Probability checks are used to avoid unnecessary rejection of data as data can, on occasions, exceed normal values in a range due to purely random causes.

In addition to above checks, hash totals and batch totals can also be applied to ensure that all the transactions have been transcribed correctly.

13. An Enterprise resource planning system is a fully integrated business management system covering functional areas of an enterprise like Logistics, Production, Finance, Accounting and Human Resources. It organises and integrates operation processes and information flows to make optimum use of resources such as men, material, money and machine. ERP is a global, tightly integrated closed loop business solution package and is multifaceted.

Evaluation of ERP packages are done based on the following criteria:

Flexibility: It should enable organisations to respond quickly by leveraging changes to their advantage, letting them concentrate on strategically expanding to address new products and markets.

Comprehensive: It should be applicable across all sizes, functions and industries. It should also have information and early warning systems for each function and enterprise-wide business intelligence system for informed decision making at all levels. It should be open and modular.

It should embrace an architecture that supports components or modules, which can be used individually, expandable in stages to meet the specific requirements of the business, including industry specific functionality. It should be technology independent and mesh smoothly with in-house/third-party applications, solutions and services including the Web.

Integrated: It should overcome the limitations of traditional hierarchical and function oriented structures.

Beyond the company: It should support and enable inter-enterprise business processes with customers, suppliers, banks, government and business partners and create complete logistical chains covering the entire route from supply to delivery, across multiple geographies, currencies and country specific business rules.

Best business practices: The software should enable integration of all business operation in an overall system for planning, controlling and monitoring and offer a choice of multiple ready-made business processes including best business practices that reflect the experiences, suggestions and requirements of leading companies across industries.

New technologies: It should incorporate cutting-edge and future-proof technologies such as object orientation into product development and ensure inter-operability with the Internet and other emerging technologies.

It should be Y2K and Euro compliant.

Other factors to be considered are:

- Global presence of package.
- Local presence.
- Market Targeted by the package.
- Price of the package.

- Obsolescence of package.
- Ease of implementation of package.
- Cost of implementation.
- Post-implementation support availability.

Some of the ERP packages available in market are:

(Baan): It offers credible tools for business process analysis linked to implementation of its software, and is launching workflow capabilities to build on this.

SSA: It only targets manufacturing companies. It offers good functionality for process, discrete and Kanban manufacturing, but not for project management. It lags in the areas of process-oriented implementation tools and workflow.

Mapics XA (Marcam Corporation): Mapics is a suit of 40 modules with 'good enough' functionality. It offers robustness easy implementation and reasonable value for money.

MFG/Pro (QAD): QAD's strength is in repetitive manufacturing. Originally designed to meet the MRP II criteria published by Oliver Wight.

Oracle Applications (Oracle): It offers the database, tools, implementation, applications and Unix operating systems running on a wide choice of hardware.

Prism (Marcam Corporation): Prism is a specialist process manufacturing solution for the AS/400. Its production model, which is akin to a flowchart, handles process industry problems elegantly.

R/3 (SAP): It offers a wide range of functions and its major shortcomings are yet to be identified.

System 21 (JBA): JBA develops and implements system 21.

SAP AG has developed an ERP package called SAP. It is a unique system that supports nearly all areas of business on a global scale.

SAP has a number of Application Modules in the package:

1. Financials.
2. Controlling
3. Investment Management
4. Treasury
5. Integrated Enterprise Management
6. Sales and Distribution.
7. Production Planning and Control
8. Materials Management
9. Human Resources Management
10. Internet and Intranet

Each of these modules has a number of components, each taking care of specific functionalities of any normal business.

14. Audit Trails are logs that can be designed to record activity at the system, application, and user level. When properly implemented, audit trails provide an important detective control to help accomplish security policy objectives.

The audit trail helps safeguard both data and the organization in an online environment in the following ways:

- (i) Detecting unauthorized access to the system;
- (ii) Facilitating the reconstruction of events; and

(iii) Promoting personal accountability.

For details, refer to Chapter 13, Section 13.2.5 of the study material.

15. (a) Regulation of certifying authorities (Chapter VI)

Chapter VI contains detailed provisions relating to the appointment and powers of the Controller and Certifying Authorities. It contains sections 17 to 34. Section 17 provides for the appointment of Controller and other officers to regulate the Certifying Authorities.

Duties of Certifying Authorities [Section 30]

- (1) This section provides that every Certifying Authority shall follow certain procedures in respect of Digital Signatures as given below:
 - (a) make use of hardware, software, and procedures that are secure from intrusion and misuse;
 - (b) provide a reasonable level of reliability in its services which are reasonably suited to the performance of intended functions
 - (c) adhere to security procedures to ensure that the secrecy and privacy of the digital signatures are assured and
 - (d) observe such other standards as may be specified by regulations.
- (2) Every Certifying Authority shall also ensure that every person employed by him complies with the provisions of the Act, or rules, regulations or orders made thereunder.
- (3) A Certifying Authority must display its licence at a conspicuous place of the premises in which it carries on its business and a Certifying Authority whose licence is suspended or revoked shall immediately surrender the licence to the Controller.
- (4) Section 34 further provides that every Certifying Authority shall disclose its Digital Signature Certificate which contains the public key corresponding to the private key used by that Certifying Authority and other relevant facts.

For detailed discussion, refer to chapter 16, page 16.9 of the study material.

- (b). Chapter III, Section 6 of the Information Technology Act, 2000 lays down the foundation of Electronic Governance. It provides that the filing of any form, application or other documents, creation, retention or preservation of records, issue or grant of any licence or permit or receipt or payment in Government offices and its agencies may be done through the means of electronic form. The appropriate Government has the power to prescribe the manner and format of the electronic records and the methods of payment of fee in that connection.

Attribution, Receipt And Despatch Of Electronic Records [Chapter IV]

Chapter IV of the Act deals with attribution, receipt and dispatch of electronic records. 'Attribution' with regard to a certain means 'to consider it to be written or made by someone.' Hence, this section lays down how an electronic record is to be attributed to the person who originated it. This is given in Section 11.

Section 12 provides for the manner in which acknowledgement of receipt of an electronic record by various modes shall be made.

Section 13 provides for the manner in which the time and place of despatch and receipt of electronic record sent by the originator shall be identified. It is provided that in general, an electronic record is deemed to be dispatched at the place where the originator has his place of business and received where the addressee has his place of business.

For the purposes of this section –

- (a) if the originator or the addressee has more than one place of business, the principal place of business shall be the place of business;

- (b) if the originator or the addressee does not have a place of business, his usual place of residence shall be deemed to be the place of business;
 - (c) "usual place of residence", in relation to a body corporate, means the place where it is registered.
16. (a) **Information Security:** This concept of security applies to all information. In this context, the valuable assets are the data or information recorded, processed, stored, shared, transmitted, or retrieved from an electronic medium. 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.

Security Objectives: The objective of information security is "the protection of the interests of those relying on information, and the information systems and communications that deliver the information, from harm resulting from failures of availability, confidentiality, and integrity".

For any organisation, the security objective is met when:

- information systems are available and usable when required (availability);
- data and information are disclosed only to those who have a right to know it (confidentiality); and
- data and information are protected against unauthorised modification (integrity). The relative priority and significance of availability, confidentiality, and integrity vary according to the data within the information system and the business context in which it is used.

To meet the security objective, and develop and maintain adequate controls in compliance with generally accepted core principles, ongoing and integrated approach is necessary. Executive management and especially chief executive officer support is essential for the successful development, design, implementation, and monitoring of security controls.

Once the design of the security standards, measures, practices and procedures has been approved, the solution should be implemented on a timely basis, and then maintained. The security standards, measures, practices and procedures will cover a number of subject areas including:

- (i) Managerial controls, such as span of control, separation of duties, background checks, and personnel awareness, training, and education to ensure that personnel act appropriately to prevent, detect, or correct problems.
- (ii) Identification and authentication controls to establish accountability and to prevent unauthorised persons from gaining access to the systems through, for example, passwords or smart tokens;
- (iii) Logical access controls to establish who or what has access to a specific type of information resources and the type of access permitted, such as read, write, update or delete;
- (iv) Accountability controls through management audit trails that maintain a record of all user and system activity;
- (v) Cryptography Controls over information transmitted and stored to ensure confidentiality, authenticity, integrity, and non-repudiation:

- (vi) Systems development life cycle process controls to ensure that is considered as an integral part of the process and explicitly considered during each phase of the process;
- (vii) Physical and environmental controls (encompassing physical access, fire detection and prevention, air-conditioning and power supply continuity, structural soundness, and the physical security of data transmission lines) to ensure that adequate measures are taken against threats emanating from the physical environment;
- (viii) Computer support and operations controls to ensure that these routine but critical activities (user support, software support, change management, configuration management, media controls, backups, documentation, and maintenance) enhance the overall level of security; and
- (ix) Business continuity planning controls to ensure that an organisation can prevent interruptions, and recover and resume processing in the event of a partial or total interruption to information systems availability.

(b) Role of an Information Security Administrator

An information security administrator is a person who is solely responsible for controlling and coordinating the activities pertaining to all security aspects of the organisation.

- (i) A security administrator attempts to ensure that the facilities in which systems are developed, implemented, maintained and operated are safe from threats that affect the continuity of installation and or result in loss of security.
- (ii) The security administrator sets policy, subject to board approval.
- (iii) He also investigates, monitors, advises employees, counsels management on matters pertaining to security.
- (iv) The security administrator is responsible for establishing the minimal fixed requirements for classification of information based on the physical, procedural and logical security elements. The need to protect these securities is also stressed. He assigns responsibilities to job classification and formulates what is to be done in case of exceptions.
- (v) The security administrator guides other information security administrators and users on the selection and application of security measures. He trains them on how to mark and handle processes, train security coordinators, select software security packages and solve problems.
- (vi) Investigate all security violations.
- (vii) Advises senior management on matter of information resource control.
- (viii) Consults on matters of information security.
- (ix) He is responsible of conducting security program, which is a series of ongoing, regular periodic evaluations of the facilities available.
- (x) He has to consider an extensive list of possible threats to the organisation. Also he prepares an inventory of assets, evaluates the existing controls and implements new controls.

The Information Security Administrator requires assistance from many experts in that particular field. He should see that whether these steps are performed on a regular basis. The results of the reviews are analysed and documented by him and advises the management on appropriate action in the light of the results.

17. Auditors involved in reviewing an information system should focus their concerns on the system's control aspects. They must look at the total systems environment not just the computerised segment. This requires their involvement from the time that a transaction is initiated until it is posted to the organisation's general ledger. Specifically, auditors must ensure that provisions are made for:

- An adequate audit trail so that transactions can be traced forward and backward through the system.
- Controls over the accounting for all data (i.e. transactions) entered into the system and controls to ensure the integrity of those transactions throughout the computerised segment of the system.
- Handling exceptions to and rejections from the computer system.
- Testing to determine whether the systems perform as stated.
- Control over changes to the computer system to determine whether the proper authorisation has been given.
- Authorisation procedures for system overrides.
- Determining whether organisation and Government policies and procedures are adhered to in system implementation.
- Training user personnel in the operation of the system.
- Developing detailed evaluation criteria so that it is possible to determine whether the implemented system has met predetermined specifications.
- Adequate controls between interconnected computer systems.
- Adequate security procedures to protect the user's data.
- Backup and recovery procedures for the operation of the system.
- Technology provided by different vendors (i.e. operational platforms) are compatible and controlled.
- Databases are adequately designed and controlled to ensure that common definitions of data are used throughout the organisation, that redundancy is eliminated or controlled and that data existing in multiple databases is updated concurrently.

This list affirms that the auditor is primarily concerned with adequate controls to safeguard the organisation's assets.

18. CASE stands for 'Computer Aided Software Engineering'. CASE Tools are automated software tools or commercial software products consisting of highly integrated applications that support a wide range of SDLC activities. This methodology was developed to increase the productivity of systems professionals, improve systems design quality, and expedite the SDLC.

CASE technology allows different types of tools to be assessed and compared. It provides a conceptual basis of understanding.

There are three categories of CASE tools.

- (i) Tools that support individual process tasks such as checking the consistency of a design, compiling a program, comparing test results and so on.
- (ii) Workbenches to support process phases such as specification, design etc. They consist of sets of tools with variable degree of integration.
- (iii) Environments support for all or part of software process. Includes several different work benches which are integrated in some way.

CLASSIFICATION OF CASE TOOLS

The figure 1 below lists this classification.

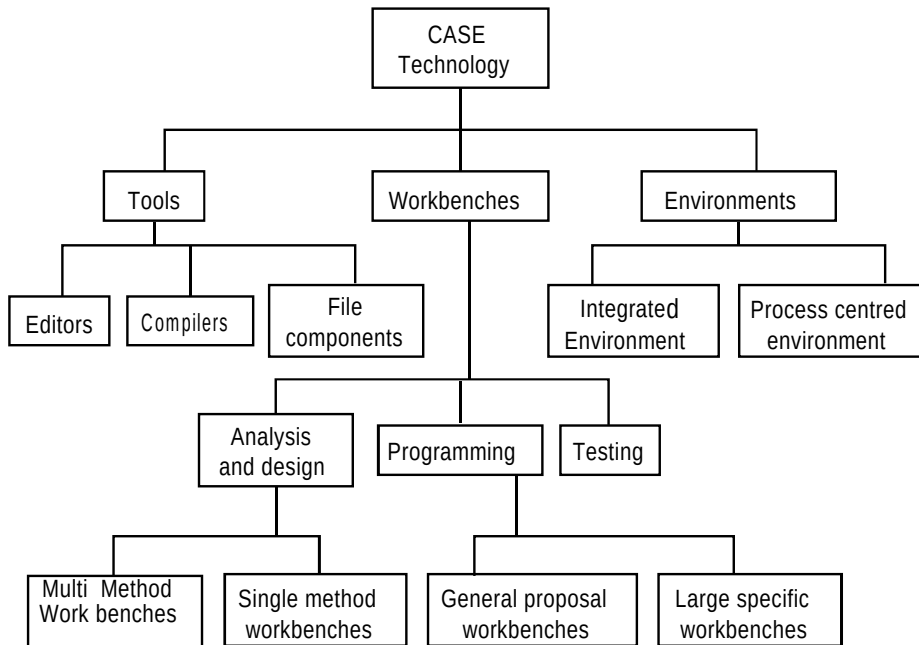


Figure 1 : Tools, Work benches and Environments

19. (i) **SYSTEM** : A system can be defined as an integrated set of components, or entities, that interact to achieve a particular function or goal. A system can be described by specifying its parts, the way in which they are related and the goals which they are expected to achieve. System can be abstract or physical. A general model of a physical system comprises of inputs, processing and outputs. All systems function within some kind of environment – a collection of elements that surround the system and often interact with it. A system and its environment can be described in many ways. Systems are composed of interrelated and inter- dependent sub -systems.

Examples-College class, business, etc.

- (ii) **CASE WORK BENCHES** : CASE work benches are available to support most software process activities. There are many types of CASE work benches.

1. **Software development work bench**: These work benches are used for analysis and design, programming and program testing.
2. **Cross development work bench**: These are work benches which support host target working where software is developed on one machine, for execution on some other system.
3. **Configuration management work bench**: Supports configuration management.
4. **Documentation work benches**: Supports production of high quality documents.
5. **Project management work benches**: Supports project management activities.

- (iii) **PRODUCT DATA MANAGEMENT (PDM)** : PDM supports in creating and managing product data throughout product lifecycle. SAP supports two basic scenarios in PDM environment.

- PDM keeps track of all master data.

- PDM organizes the design and change processes. This feature is known as engineering change management.
- PDM gives product structure information at a glance.
- PDM are supported for large product development projects in the R/3 project system

For further points, students are advised to refer to study paper, chapter 12, section 12.6.6

(iv) **DECISION SUPPORT SYSTEM (DSS)** : DSS are systems that provide managers with information to support unstructured decisions by retrieving and analyzing data. A DSS possesses interactive capabilities, assists in solving ad hoc queries, and provides data modeling facilities (usually through the use of spreadsheet models and / or statistical analysis programs) to support non-recurring, unstructured decision – making. The complex mathematical models used in DSS are designed to simulate behaviour of an organizational activity in an unpredictable situation. Such problems are often a feature in middle and top-level decision making processes.

(v) **Business Process Re-engineering or BPR** is the fundamental rethinking and radical redesign of processes to achieve dramatic improvement, in critical, contemporary measures of performance such as cost, quality, service and speed. Dramatic achievement means to achieve 80% or 90% reduction (in say, delivery time, work in progress or rejection rate) and not just 5%, 10% reduction. This is possible only by making major improvements and breakthroughs, and not small incremental changes.

Radical redesign means BPR is reinventing and not enhancing or improving. In a nutshell, a “cleanslate approach” of BPR says that “Whatever you were doing in the past is all wrong”, do not get biased by it or reassemble your new system to redesign it afresh. Fundamental rethinking means asking the question “why do you do what you do”, thereby eliminating business process altogether if it does not add any value to the customer. There is no point in simplifying or automating a business process which does not add any value to the customer. Thus, BPR aims at major transformation of the business process to achieve Dramatic improvement. Here, the business objectives of the Enterprise (e.g., profits, customer-satisfaction through optimal cost, quality, deliveries etc.) are achieved by “transformation” of the business processes which may, or may not, require the use of Information Technology (IT).

(vi) **Computer frauds** have been defined as / any illegal act for which knowledge of computer technology is essential for its perpetration, investigation or prosecution. Most specially, computer frauds include the following:

- Unauthorised theft, use, access, modification, copying and destruction of software or data
- Theft of money by altering computer records or the theft of computer time
- Theft or destruction of computer hardware
- Use or the conspiracy to use computer resources to commits a offence
- Intend to illegally obtain information or tangible property through the use of computer.

Using the computer, fraud perpetrators are able to steal more, in much less time and with much less efforts. For example, they can steal millions of rupees in less than a second. Perpetrators can commit a fraud and leave little or no evidence. Therefore, computer fraud is often much more difficult to detect than other types of frauds.

The definition of computer fraud would also include (but not be limited to) the following:

(a) Clearly recognisable frauds such as investment frauds, secret market frauds and pyramid schemes where a computer (usually via the Internet) is used as a new medium to convey an old message and the hapless victim is persuaded to part with money or credit card details.

- (b) Hacking in the generally recognised sense of unauthorised access and unauthorised modification to computers. This includes the malicious introduction of a virus, the malicious modification of e-mail or the vandalism of Web pages.
 - (c) Manipulation of computer systems to obtain money from an employer or a third party: Examples of this are diversion of payments and creation of false employees/suppliers. These frauds may require access to a system or part of a system from which the perpetrator is (or is supposed to be) excluded.
 - (d) Theft and/or destruction of confidential and sensitive information: This is an area where huge damage can be caused by employees and third parties who are able to gain access to confidential and sensitive information and pass it on to competitors or simply destroy it.
 - (e) Abuse of computer systems by employees: This involves an employee using the computer system for his or her own purposes. Employees can write personal letters or run businesses from their employer's computers. Employees can use e-mail systems and the Internet for private purposes.
 - (f) Software piracy by either using counterfeit or unlicensed software or by distributing counterfeit software by disk, CD or through the Internet.
- (vii) Threats to Operating System Integrity: Operating system control objectives are sometimes not achieved because of flaws in the operating system that are exploited either accidentally or intentionally.

Accidental threats include hardware failures that cause the operating system to crash. Operating system failures are also caused by errors in user application program that the operating system cannot interpret. Accidental system failures may cause whole segments of memory to be "dumped" to disks and printers, resulting in the unintentional disclosure of confidential information.

Intentional threats to the operating system are most commonly attempts to illegally access data or violate user privacy for financial gain. However, a growing form of threat is from destructive programs from which there is no apparent gain. These exposures come from three sources:

1. Privileged personnel who abuse their authority. Systems administrators and systems programmers require unlimited access to the operating system to perform maintenance and to recover from system failures. Such individuals may use this authority to access users' programs and data files.
2. Individuals, both internal and external to the organisation, who browse the operating system to identify and exploit security flaws.
3. An individual who intentionally (or accidentally) inserts a computer virus or other form of destructive program into the operating system.

PAPER – 7 : DIRECT TAXES

QUESTIONS

1. Define "Infrastructure capital company" and "Infrastructure capital fund" as per the Income-tax Act, 1961.
2. Discuss the meaning and tax treatment of anonymous donations received by charitable/religious trusts/institutions.
3. Are expenditure incurred by a company on account of stamp duty and registration fees for the issue of bonus shares allowable as revenue expenditure?
4. XYZ Ltd. donated a bus to a school where the employee's children were studying and debited the same to the Workmen and Staff Welfare Account. It claimed the expenditure as deduction on the ground that it was incurred wholly and exclusively for the purpose of the assessee's business. Discuss whether the contention of XYZ Ltd. is correct.
5. The assessee was a dealer in two-wheelers manufactured by TVS Suzuki Ltd. It was carrying on its business in leasehold premises. The assessee constructed a ground floor above the existing basement floor according to the specifications given by TVS Suzuki Ltd. to all its dealers. As per the stipulation in the lease deed, reimbursement of such expenditure from the owner of the premises was not possible. The assessee, therefore, claimed the expenses incurred for construction as revenue expenditure for the relevant assessment year. Can such expenditure be allowed as a revenue expenditure?
6. Ganesh, a resident individual, bought 1,000 equity shares of Rs.10 each of XYZ Ltd. at Rs.50 per share on 3.4.2006. He sold 700 equity shares at Rs.35 per share on 31.8.2006 and the remaining 300 shares at Rs.25 per share on 1.11.2006. XYZ Ltd. declared a dividend of 50%, the record date being 30.6.2006. Ganesh sold on 5.1.2007, a house from which he derived a long-term capital gain of Rs.75,000.

Compute the amount of capital gain arising to Ganesh for the assessment year 2007-08.

7. Where a holding company receives assets on voluntary liquidation of its subsidiary company by virtue of being a shareholder of the subsidiary company, would the value of assets received by the holding company on the date of distribution be liable to tax?
8. An additional compensation of Rs.5 lakhs, on account of compulsory acquisition of land by the State Government, was awarded to the assessee by the civil court. However, the same was not accepted by the State Government and it had preferred an appeal objecting to the enhancement. In such a case, can the said additional compensation received by the assessee be subject to capital gains tax?
9. Explain the provisions relating to fringe benefit tax which have been diluted by the Finance Act, 2006.
10. Discuss whether fringe benefit tax liability is attracted in respect of the following expenses -
 - (i) Expenditure on imparting in-house training to employees;
 - (ii) Expenditure incurred for the purpose of conferences of the agents or dealers or development advisors;
 - (iii) Brokerage and selling commission paid to direct selling agents;
 - (iv) Reimbursement of expenditure on books and periodicals to employees;
 - (v) Expenditure incurred by a lawyer on conveyance, tour and travel, which is reimbursed by the client.
11. Gamma Ltd. is an Indian company engaged in the manufacture and sale of cotton textiles. Its net profit for the year ending 31.3.2007 after debit/credit of the following items to the profit and loss account was Rs.62,00,000:

- (i) Legal fees of Rs.15,000 incurred in defending title to factory premises.
- (ii) Rs.3,00,000 paid to an employee in connection with his voluntary retirement.
- (iii) Payment of fringe benefit tax Rs.75,000.
- (iv) Interest of Rs.80,000 paid on arrears of sales tax
- (v) Advertisement charges of Rs.1,25,000 paid for the advertisement in souvenir published by a political party registered with the Election Commission of India.
- (vi) Income-tax paid on non-monetary perquisites provided to the employees Rs.1,20,000.
- (vii) Payment of Rs.7,00,000 towards retrenchment compensation for employees of one of the units closed down during the year.
- (viii) Capital expenditure of Rs.4,50,000 incurred for the purpose of promoting family planning amongst its employees.
- (ix) Payment of Rs.21,000 as banking cash transaction tax.
- (x) Compensation of Rs.25,000 received from supplier for delay in supply of raw materials.
- (xi) Dividend of Rs.50,000 received from a foreign company.

Compute the total income of Gamma Ltd. for the assessment year 2007-08.

Furnish explanations for the treatment of the various items given above.

12. Certain persons, though not legal owners of a property, are deemed to be owners for the purposes of sections 22 to 26 – Elucidate this statement.
13. Is it necessary that the Assessing Officer should record his reasons in writing for exercising the power to reduce the period for making the payment specified in the notice of demand issued under section 156?
14. In a case where penalty has been imposed for not deducting tax at source, can penalty also be imposed again for non-issuance of TDS certificate or non-filing of TDS return?
15. Can penalty be levied where a return is filed belatedly under section 139(4)?
16. Are the provisions for tax deduction under section 194H attracted in respect of discount given on sale of stamps by the Treasury to the stamp vendors, by treating them as agents of the Government for marketing stamp papers?
17. ABC Shipping Corporation Ltd. was carrying on the business of transporting coal. It entered into a contract with the State Electricity Board for transporting coal from various ports. Since the ships owned by the company were not sufficient for executing the contracts, the company hired ships from other shipping companies and paid hire charges for use of ships. The company did not deduct tax at source under section 194C from payment of hire charges to the shipping companies. Therefore, the Assessing Officer treated the company as an “assessee-in-default”. Discuss whether the action of the Assessing Officer is correct in law.
18. Kanpur club was a private club which provided entertainment to its members by offering accommodation, library, reading room etc. The club also earned income by letting out its marriage hall to non-members by making them as temporary members. It contended that the “doctrine of mutuality” would apply in such a case and hence, its income would not be taxable. Discuss the correctness or otherwise of the contention of the assessee-club.
19. Rajesh, an individual, has the following assets and liabilities on the valuation date 31.3.2007 -

Particulars	Rs. in lakhs
(i) Plot of land at Jhansi comprising an area of 1300 square meters on which building has been constructed without the approval of the appropriate authority	20
(ii) Building constructed on the said land, without the approval of the appropriate authority, exclusively used for carrying on his business	15

(iii)	Commercial complex at Pune	25
(iv)	Residential house at Agra let out for 320 days during the relevant previous year	12
(v)	Motor cars held as stock-in-trade	10
(vi)	Shares in private limited companies	7
(vii)	Cash in hand recorded in the books of account	3
(viii)	Fixed deposits with a bank	8
(ix)	Jewellery made of gold	4
	The company has taken the following loans -	
(a)	For construction of building at Jhansi	15
(b)	For marriage of daughter	5
(c)	For purchase of jewellery	2
(d)	For purchase of shares in private limited companies	5

The amounts stated against the assets, except cash in hand, are the values determined as per section 7 of the Wealth tax Act, 1957 read with Schedule III thereto. Compute the net wealth of Rajesh on the valuation date 31.3.2007. State the reasons for inclusion or exclusion of the various items

20. Can the Assessing Officer refer valuation of assets to the Departmental Valuation Officer for the purpose of making an assessment in a case where no return of wealth has been filed by the assessee?

SUGGESTED ANSWERS/HINTS

1. "Infrastructure capital company" means such company which makes investments by way of acquiring shares or providing long-term finance to -

- (1) any enterprise or undertaking wholly engaged -
 - (a) in the business referred to in section 80-IA(4) i.e. business of
 - (i) developing/operating and maintaining/developing, operating and maintaining any infrastructure facility fulfilling the specified conditions
 - (ii) providing telecom services, whether basic or cellular
 - (iii) developing, developing and operating or maintaining and operating an industrial park or special economic zone notified by the Central Government
 - (iv) generating, transmitting or distributing power or undertaking substantial renovation and modernization of the existing network of transmission or distribution lines.
 - (b) in the business referred to in section 80-IAB(1) i.e. any business of developing a SEZ.
- (2) an undertaking developing and building a housing project referred to in sub-section (10) of section 80-IB i.e. approved before 31.3.2007 by a local authority and commences or commenced development and construction on or after 1.10.98 and completes or completed development and construction within the time specified.
- (3) a project for constructing a hotel of not less than three-star category as classified by the Central Government or
- (4) a project for constructing a hospital with at least 100 beds for patients;

"Infrastructure capital fund" means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to -

- (1) any enterprise or undertaking wholly engaged in the business referred to in sub-section (4)

- of section 80-IA or sub-section (1) of section 80-IAB; or
- (2) an undertaking developing and building a housing project referred to in sub-section (10) of section 80-IB; or
 - (3) a project for constructing a hotel of not less than three star category as classified by the Central Government; or
 - (4) a project for constructing a hospital with at least 100 beds for patients.
2. As per the provisions of the Income-tax Act, 1961, tax exemption under section 10(23C) and section 11 are available to certain entities, as briefed in the table below, on fulfillment of the conditions prescribed under the relevant sections -

Entity	Applicable section
Charitable or religious trusts/institutions	11
Universities and other educational institutions	10(23C)(iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iiiae) and (via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)

Section 115BBC has been inserted by the Finance Act, 2006 to tax anonymous donations received by the above entities at 30%. The balance total income of these entities will be chargeable to tax as per the normal applicable rates. For this purpose, "anonymous donation" means any voluntary contribution referred to in section 2(24)(iia), where the person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed. However, this provision does not apply to a trust or institution created or established wholly for religious purposes.

Further, anonymous donations to partly charitable and partly religious institutions/trusts would be taxed only if such anonymous donation is made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution. Other anonymous donations received by such trusts/institutions are not taxable.

The exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section. For example, section 11(1)(d) of the Act provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year. However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

3. This issue has been settled by the Supreme Court in CIT v. General Insurance Corporation (2006) 286 ITR 232. The Supreme Court observed that there is no inflow of fresh funds or increase in capital employed on account of issue of bonus shares. There is merely a reallocation of company's fund on account of issue of bonus shares by capitalization of reserves. Therefore, the company has not acquired a benefit or advantage of enduring nature. The total funds available with the company will remain the same and there is no change in the capital structure of the company consequent to the bonus issue. Thus, issue of bonus shares does not result in the expansion of capital base of the company. Therefore, the expenditure incurred by the company on account of stamp duty and registration fees for the issue of bonus shares is allowable as revenue expenditure.

4. This issue came up before the Rajasthan High Court in CIT v. Rajasthan Spinning and Weaving Mills Ltd. (2006) 281 ITR 408. The High Court observed that the contention of the assessee, that such expenses were incurred for the welfare of the children of staff/workmen of the company as part of the employee welfare expenses for the purpose of securing efficient services of such employees, was true. Since the assessee had not acquired any asset, it was not a capital expenditure. Therefore, the expenditure was deductible.

Therefore, in this case, the contention of XYZ Ltd. is correct.

5. This question was answered by the Madras High Court in CIT v. Hari Vignesh Motors P. Ltd. (2006) 282 ITR 0338. The High Court observed that the assessee had undertaken the construction in view of the requirements of the business. The assessee did not acquire any capital asset by incurring the expenditure. As per the stipulation in the lease deed, reimbursement of such expenditure from the owner of the premises was also not possible. The High Court, therefore, held that the expenditure was revenue in nature and can be allowed as deduction.
6. The amount of capital gains arising to Ganesh has to be computed applying the provisions of section 94(7), which provides that "where:
- any person buys or acquires any securities or unit within a period of three months prior to the record date; and
 - such person sells or transfers -
 - such securities within a period of three months after such date; or
 - such unit within a period of nine months after such date; and
 - the dividend or income on such securities or unit received or receivable by such person is exempted,

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

For this purpose, "record date" means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend and "securities" includes stocks and shares.

Computation of capital gains of Mr. Ganesh for the assessment year 2007-08

Particulars	Rs.	Rs.
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares [See Note below]		
700 shares	7,000	
300 shares	7,500	14,500
Taxable long-term capital gains		<u>60,500</u>

Note - Computation of short-term capital gain on sale of shares of XYZ Ltd. by Mr. Ganesh

Date of purchase of shares		3.4.2006
Record date		30.6.2006
Date of sale of shares	31.8.2006	1.11.2006
Number of shares sold	700	300
Sale price per share	Rs.35	Rs.25

Particulars	Rs.	Rs.
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500
Less: Dividend income as per section 94(7) [700×10×50%] [See Note below]	3,500	-
Short-term capital loss on sale of shares	7,000	7,500

Note:

1. 700 shares are sold within 3 months of record date, hence related dividend income should be deducted from the loss as per section 94(7).
 2. In respect of sale of 300 shares after 3 months of record date, section 94(7) is not applicable. So, the dividend income of Rs.1,500 should not be deducted. Such dividend is exempt under section 10(34).
 3. Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.
7. This question was answered by the Gujarat High Court in CIT v. Brahmi Investments (P.) Ltd. (2006) 286 ITR 66. In this case, the High Court held that if a holding company had received assets on voluntary liquidation of its subsidiary company by virtue of being a shareholder of the subsidiary company, the value of assets received by the holding company on the date of distribution was liable to tax under section 46(2). Section 47(v), which provides that transfer of a capital asset by a subsidiary company to its 100% holding company (being an Indian company) would not be regarded as a transfer for the purpose of charge of capital gains tax, would not be applicable in this case.
8. The Madras High Court has, in CWT v. T. Girijammal (2006) 284 ITR 482, held that when the additional compensation awarded by the civil court had not been accepted by the State Government and it had preferred an appeal objecting to the enhancement, the said additional compensation received could not be treated as part of the compensation received for the transfer of the land until it is finally determined by the High Court or the Supreme Court. If the appeal of the State is allowed, the assessee is bound to refund the amount and hence, the same cannot be assessed in the assessee's hands before reaching finality.
- Therefore, in this case, the additional compensation received by the assessee cannot be subject to capital gains tax.
9. The Finance Act, 2006 has retained the Fringe Benefit Tax (FBT), however, with dilution of certain provisions, as explained hereunder -
- (a) Under section 115WB(1)(c) read with section 115WC(1)(b), any contribution by the employer to an approved superannuation fund for employees is liable to FBT in full for A.Y.2006-07. With effect from A.Y.2007-08, contributions by an employer to an approved superannuation fund upto Rs.1 lakh per employee would be exempt from levy of FBT. It may be noted that if the employer's contribution is more than Rs.1 lakh per employee in a year, only the contribution in excess of Rs.1 lakh would be subject to FBT.
 - (b) The value of fringe benefit in respect of "tour and travel (including foreign travel)" would now be 5% instead of 20%. However, it may be noted that this does not apply to conveyance, for which the value of fringe benefit would continue to be 20%. The effect is that, while the value of fringe benefit in respect of outstation tours and foreign tours has been reduced from 20% to 5%, the value of fringe benefit in respect of local conveyance continues to be 20%.
 - (c) The value of fringe benefit in respect of provision of hospitality [Clause (B) of section 115WB(2)] and use of hotel, boarding and lodging facilities [Clause (G) of section 115WB(2)] would now be 5% instead of 20% for employers engaged in the business of carriage of

passengers or goods by ship or by aircraft.

- (d) Under the proviso to clause (D) of section 115WB, certain expenditure on advertisement have been excluded from "Sales promotion including publicity". Now, expenditure on distribution of free samples of medicines or of medical equipment to doctors has been excluded from "sales promotion including publicity" and consequently, exempt from levy of FBT.
- (e) Further, expenditure by way of payment to any person of repute for promoting the sale of goods or services of the business of the employer has also been excluded from "sales promotion including publicity" and consequently, exempt from levy of FBT.
- (f) As per section 115WB(1)(a), "fringe benefits" means any consideration for employment provided by an employer by way of any privilege, service, facility or amenity, directly or indirectly, to his employees. However, section 115WB(3) clarifies that the privilege, service, facility or amenity does not include perquisites in respect of which tax is paid or payable by the employee. Further, w.e.f. A.Y.2007-08, any benefit or amenity in the nature of free or subsidized transport or any allowance provided by the employer for journeys by the employees from their residence to the place of work or vice versa is also excluded from the ambit of privilege, service, facility or amenity and consequently, exempt from levy of FBT.
10. (i) Expenditure on imparting in-house training to employees – No; However, FBT is payable on any expenditure on food and beverage, tour and travel, and lodging and boarding in connection with such in-house training
- (ii) Expenditure incurred for the purpose of conferences of the agents or dealers or development advisors - Yes; since expenditure incurred for the purposes of conference is liable to FBT irrespective of whether the conference is of agents or dealers or development advisors or any other persons.
- (iii) Brokerage and selling commission paid to direct selling agents - No; since they are in the nature of ordinary selling expenses.
- (iv) Reimbursement of expenditure on books and periodicals to employees – Yes; since it is in the nature of expenditure for the purposes of employee welfare.
- (v) Expenditure incurred by a lawyer on conveyance, tour and travel, which is reimbursed by the client - No; since the reimbursement is essentially a component of professional fee paid by the client to the lawyer
11. Computation of total income of Gamma Ltd. for the Assessment Year 2007-08

Particulars	Rs.
Net profit as per profit and loss account	62,00,000
Add: Inadmissible expenditure	
4/5 th of Rs.3,00,000 paid to an employee on his voluntary retirement	2,40,000
Fringe benefit tax u/s 40(a)(ic)	75,000
Advertisement charges of souvenir of political party u/s 37(2B)	1,25,000
Income-tax paid on non-monetary perquisites provided to employees	1,20,000
4/5 th of Rs.4,50,000, being capital expenditure for promoting family planning amongst employees [1/5 th is allowable as deduction u/s 36(1)(ix)]	3,60,000
	71,20,000
Less: Dividend received from a foreign company considered under 'Income from other sources'	
	50,000
Business income	70,70,000

Income from other sources

Dividend received from a foreign company	50,000
Gross total income	71,20,000
Less: Deduction u/s 80GGB	1,25,000
Total income	69,95,000

Explanations for the treatment of the various items in computing the total income of the company are furnished below -

- (i) Legal fees incurred in defending title to factory premises is an expenditure incurred wholly and exclusively for the purpose of business and is, therefore, allowable under section 37(1).
- (ii) Section 35DDA provides for amortisation of expenditure incurred under voluntary retirement scheme over a period of five years in equal instalments. The company is, therefore, entitled to a deduction of Rs.60,000, being one-fifth of Rs.3,00,000 paid to the employee in connection with his voluntary retirement, for the relevant assessment year.
- (iii) Fringe benefit tax paid is not allowable as deduction from business profits as per section 40(a)(ic). Hence, fringe benefit tax paid by the company is not deductible.
- (iv) Interest paid on arrears of sales tax is not penal in nature but is compensatory in character and is an allowable deduction under section 37(1) as held by the Supreme Court in *Lachmandas Mathurdas v. CIT* (2002) 254 ITR 799.
- (v) Section 37(2B) prohibits allowance of any expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet or the like published by a political party. As such, advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company.

However, under section 80GGB, expenditure incurred by an Indian company on advertisement in any publication, including a souvenir, by a political party is deemed to be a contribution of such amount to the political party and is, therefore, allowable as deduction in the hands of the company.

- (vi) Income-tax paid by an employer on non-monetary perquisites provided to the employees is not deductible as per section 40(a)(v).
- (vii) Retrenchment compensation paid to employees at the time of closure of one of the units of the business is allowable as deduction as per the decision of the Allahabad High Court in *CIT (Central) Kanpur vs. JK Cotton Spinning & Weaving Co. Ltd.* (2005) 145 Taxman 591.
- (viii) Capital expenditure incurred for the purpose of promoting family planning amongst employees is deductible over a period of 5 years as per the first proviso to section 36(1)(ix). Hence, only Rs.90,000 is deductible in the current year in respect of such expenditure incurred by the company.
- (ix) Banking cash transaction tax paid by the company is eligible for deduction in view of section 36(1)(xiii).
- (x) Compensation received from supplier for delay in supplying the raw materials is a trading receipt.
- (xi) Dividend received from a foreign company is assessable under the head "Income from other sources".

12. As per section 27, the following persons, though not legal owners of a property, are deemed to be the owners for the purposes of section 22 to 26.

- (i) Transfer to a spouse [Section 27(i)] – In case of transfer of house property by an

individual to his or her spouse otherwise than for adequate consideration, the transferor is deemed to be the owner of the transferred property.

Exception – In case of transfer to spouse in connection with an agreement to live apart, the transferor will not be deemed to be the owner. The transferee will be the owner of the house property.

- (ii) Transfer to a minor child [Section 27(i)] – In case of transfer of house property by an individual to his or her minor child otherwise than for adequate consideration, the transferor would be deemed to be owner of the house property transferred.

Exception – In case of transfer to a minor married daughter, the transferor is not deemed to be the owner.

Note - Where cash is transferred to spouse/minor child and the transferee acquires property out of such cash, then the transferor shall not be treated as deemed owner of the house property. However, clubbing provisions will be attracted.

- (iii) Holder of an impartible estate [Section 27(ii)] – The impartible estate is a property which is not legally divisible. The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate.

After enactment of the Hindu Succession Act, 1956, all the properties comprised in an impartible estate by custom is to be assessed in the status of a HUF. However, section 27(ii) will continue to be applicable in relation to impartible estates by grant or covenant.

- (iv) Member of a co-operative society etc. [Section 27(iii)] – A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a House Building Scheme of a society/company/association, shall be deemed to be owner of that building or part thereof allotted to him although the co-operative society/company/ association is the legal owner of that building.
- (v) Person in possession of a property [Section 27(iiiia)] – A person who is allowed to take or retain the possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act shall be the deemed owner of that house property. This would include cases where the –
 - (1) possession of property has been handed over to the buyer
 - (2) sale consideration has been paid or promised to be paid to the seller by the buyer
 - (3) sale deed has not been executed in favour of the buyer, although certain other documents like power of attorney/agreement to sell/will etc. have been executed

In all the above cases, the buyer would be deemed to be the owner of the property although it is not registered in his name.

13. The Delhi High Court, in *Agricultural Produce Marketing Committee v. Union of India* (2006) 155 Taxman 186, observed that the legal position regarding the competence of the Assessing Officer to reduce the period for payment of the outstanding dues is clearly stated in section 220. A plain reading of the proviso to section 220(1) makes it clear that while the assessing authority has the power to reduce the period for making the payment specified in the notice of demand under section 156, such reduction must be supported by valid reasons to be recorded in writing. Therefore, whenever the competent authority invokes its powers of reducing the period stipulated under section 220, it must take care not only to pass a proper order but also to support the same by cogent reasons.

In this case, the High Court has built in the principles of natural justice into the provisions of section 220(1), by interpreting that the “reason to believe” as required by the proviso to section 220(1), implies that such reasons should be cogent and should be recorded in writing.

14. The Allahabad High Court, in *CIT-II v. Sri Ram Memorial Education Promotion Society* (2006) 152 Taxman 257 and *CIT v. Sahara Airlines Ltd.* (2006) 152 Taxman 646, held that once penalty

under section 271C has been imposed on the assessee for not deducting the tax at source, penalty cannot be imposed under section 272A(c) and (g) for non-compliance of the provisions of sections 203 and 206. This is because, in a case where tax has not been deducted at source, the question of issuing the certificate of tax under section 203 or that of filing of return under section 206 would not arise at all. Therefore, the question of imposing penalty for violation of the provisions of sections 203 and 206 would also not arise.

15. Penalty is attracted under section 271F for failure to furnish return of income as required under section 139(1) before the end of the relevant assessment year. The time allowed for filing a belated return is up to one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier. If the belated return under section 139(4) is filed before the end of the relevant assessment year, penalty under section 271F is not attracted. However, if the same is filed after the end of the relevant assessment year, penalty under section 271F would be attracted.

16. In *Kerala State Stamp Vendors Association v. Office of the Accountant-General* (2006) 282 ITR 0007, the High Court held that stamp vendors cannot be treated as agents of the Government for marketing stamp papers. The discount given on sale of stamps by the Treasury to the stamp vendor is outside the scope of TDS provisions under section 194H.

The High Court observed that only commission and brokerage are subject to tax deduction under section 194H. Commission or brokerage is paid for services rendered in the course of sale. This implies services rendered by third parties like brokers or agents. It cannot mean services rendered by a buyer because a buyer is not rendering any service except buying. A price discount given by the seller to the buyer cannot be treated as commission or brokerage for services rendered in the course of buying and selling of goods. This is because the act of buying does not constitute rendering of any service. Therefore, stamp vendors cannot be treated as agents of the Government for marketing stamp papers and consequently, TDS provisions under section 194H are not attracted.

17. The facts of this case are similar to the case *CIT v. Poompuhar Shipping Corporation Ltd.* (2006) 282 ITR 0003, where the Madras High Court held that the hiring of ships for the purpose of using the same in assessee's business would not amount to a contract for carrying out any work as contemplated in section 194C and therefore, payment of hire charges would not attract tax deduction under section 194C. Therefore, in this case, the action of the Assessing Officer is not correct in law.
18. The concept of mutuality means that the contributors and the beneficiaries are identical. Since one cannot make a profit by dealing with oneself, there is no taxable profit involved wherever such concept applies. In this case, however, the principle of mutuality does not apply since non-members are made temporary members only for the purpose of letting out the marriage hall. This issue came up before the Kerala High Court, in *CIT v. Trivandrum Club* (2006) 153 Taxman 481. The High Court observed that the marriage hall was being rented out to non-members by making them temporary members only for the purpose of letting out the marriage hall and the amounts received from the non-members formed part of the income of the assessee-club. The principle of mutuality, therefore, would not apply in such a case.

Therefore, the contention of Kanpur club is not correct.

19. Computation of net wealth of Rajesh as on 31.3.2007

Particulars	Rs.
Plot of land at Jhansi [See Note (i)]	20,00,000
Cash in hand [See Note (vii)]	2,50,000
Jewellery [See Note (ix)]	4,00,000
	26,50,000

Less: Loan borrowed for purchase of jewellery [See Note (xii)]	2,00,000
Net wealth as on valuation date i.e.31.3.2007	<u>24,50,000</u>

Reasons for inclusion or exclusion of the various items are furnished below:

- (i) Plot of land at Jhansi on which building has been constructed without the approval of the appropriate authority is an asset under section 2(ea) and is, therefore, includible in the net wealth. Since the plot of land comprises an area of more than 500 square meters, it is not eligible for exemption under section 5(vi).
 - (ii) Building constructed on land at Jhansi without the approval of the appropriate authority is not a specified asset under section 2(ea) since it is used for business purposes by Rajesh. It is, therefore, not includible in the net wealth.
 - (iii) Commercial complex at Pune is excluded as it is not an asset.
 - (iv) Any residential property let out for a minimum period of 300 days in the previous year is not considered as an asset. Residential house at Agra is let out for more than 300 days. Therefore, it is excluded from net wealth.
 - (v) Motor cars held as stock-in-trade are not assets as per section 2(ea) and, therefore, excluded from net wealth.
 - (vi) Shares in private limited companies are not assets and, therefore, excluded from net wealth.
 - (vii) Cash in hand, in excess of Rs.50,000, of individuals constitutes an asset. Therefore, Rs.2,50,000, being cash in hand in excess of Rs.50,000, is included in net wealth.
 - (viii) Fixed deposits with a bank do not constitute an 'asset' within the meaning of section 2(ea) and is, therefore, excluded from net wealth.
 - (ix) Jewellery made of gold is an asset under section 2(ea) and is, therefore, included in the net wealth.
 - (x) Since building at Jhansi is used for business purposes and is, therefore, not an asset and has been excluded while computing the net wealth, the loan borrowed for its construction is not a deductible debt.
 - (xi) Only loans borrowed in relation to the 'assets' as per section 2(ea) are deductible. Hence, loan borrowed for marriage of daughter is not deductible.
 - (xii) Since jewellery has been included in the net wealth, loan borrowed for purchase thereof is deductible in computing the net wealth.
 - (xiii) Loan borrowed for purchase of shares in private limited companies is not deductible while computing net wealth as shares are not included in net wealth.
20. This question was answered by the Punjab & Haryana High Court in CWT v. Anil Tayal (HUF) (2006) 285 ITR 243. The High Court observed that the object of section 16A of the Wealth-tax Act, 1957 is to enable the Assessing Officer to refer the issue relating to the value of any asset to a Valuation Officer for the purpose of making assessment. The expression "in any other case" in clause (b) of section 16A(1) is wide enough to include a case where no return has been filed by the assessee. If a narrow view is taken that a reference under section 16A(1) can be made only where the return has been filed, then the expression "in any other case" in clause (b) of section 16A(1) and the expression "where no such return has been made" in sub-section (4) of section 16A would become redundant. Therefore, a reference under section 16A(1) could be made even where no return has been filed by the assessee under section 14 or section 15.

IMPORTANT NOTIFICATIONS / CIRCULARS ISSUED BETWEEN 1.5.2006 AND 31.10.2006

(1) Cost Inflation Index (CII) for F.Y. 2006-07

The Central Government has, vide notification no.270/2006 dated 19.9.2006 specified the cost inflation index for the financial year 2006-07. The CII for F.Y. 2006-07 is 519.

S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100
2.	1982-83	109
3.	1983-84	116
4.	1984-85	125
5.	1985-86	133
6.	1986-87	140
7.	1987-88	150
8.	1988-89	161
9.	1989-90	172
10.	1990-91	182
11.	1991-92	199
12.	1992-93	223
13.	1993-94	244
14.	1994-95	259
15.	1995-96	281
16.	1996-97	305
17.	1997-98	331
18.	1998-99	351
19.	1999-2000	389
20.	2000-01	406
21.	2001-02	426
22.	2002-03	447
23.	2003-04	463
24.	2004-05	480
25.	2005-06	497
26.	2006-07	519

[Notification no.270/2006 dated 19.9.2006]

(2) Notification No.127/2006 dated 1.6.2006 – Notified plan for deduction in respect of annuity plan of LIC

Notification No.	Date	In exercise of powers conferred by	Details
127/2006	1.6.2006	Section 80C(2)(xii)	Jeevan Akshay-III Plan of the LIC of India, as filed by the LIC with the IRDA, as the annuity plan of the LIC for the purposes of section 80C(2)(xii)

- (3) Notification Nos. 142 & 143/2006 dated 29.6.2006 – Notified Bonds for the purpose of exemption of capital gains under section 54EC

The Central Government has notified bonds of National Highways Authority of India (NHAI) and Rural Electrification Corporation Limited (RECL), to be issued during the financial year 2006-07, redeemable after three years, as “long-term specified asset” for the purpose of exemption under section 54EC i.e. capital gains would be exempt to the extent of investment in these notified bonds.

The CBDT has, vide Order F.No.142/09/2006-TPL, dated 30.6.2006, extended the limitation period of six months for making investment under section 54EC of capital gains arising from the transfer of a long-term capital asset to –

- (i) 30.9.2006, in case of persons where the long-term capital asset was transferred between 29.9.2005 and 31.12.2005 (both dates inclusive);
- (ii) 31.12.2006, in case of persons where the long-term capital asset was transferred between 1.1.2006 and 30.6.2006 (both dates inclusive).

- (4) Notification No.187/2006 dated 20.7.2006 – Conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to section 36(1)(viii)

Rule 6ABAA has been inserted in the Income-tax Rules, 1962 which specifies the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to clause (viii) of sub-section (1) of section 36. The conditions specified therein are -

- (a) it is owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;
- (b) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility similar in nature to an infrastructure facility referred to in the Explanation to section 80-IA(4)(i);
- (c) it has started or starts operating and maintaining such infrastructure facility on or after 1st April, 1995.

- (5) Notification No. 188/2006, dated 20.7.2006 – Notification of public facilities as infrastructure facility for the purpose of section 36(1)(viii)

The following public facilities have been notified by the CBDT as infrastructure facility for purposes of section 36(1)(viii)-

- (1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962
- (2) Mass Rapid Transit system
- (3) Light Rail Transit system
- (4) Expressways
- (5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers
- (6) Bus and truck terminals
- (7) Subways
- (8) Road dividers
- (9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system
- (10) Multilevel Computerised Car Parking.

- (6) Notification No. 267/2006 dated 14.9.2006 – Notification of approved investment under section 11(5)

A new clause (v) has been inserted in rule 17C of the Income-tax Rules, 1962 so as to include as an approved investment under section 11(5), investment by a recognized Stock Exchange, in the equity shares of a company promoted by it to acquire the membership rights of other stock exchanges, where at least 51% of the paid-up share capital is held by the Stock Exchange and the balance is held by its members. The amendment is made effective retrospectively from 26th November, 1999.

- (7) Circular No.6/2006 dated 23.6.2006 - Issue of TDS Certificate under section 203 of the Income-tax Act in cases of Truck/Goods-carriage operators

As per the provisions of section 203 of the Income-tax Act, read with rule 31 of Income-tax Rules, every person deducting tax in accordance with the provisions of the Act shall, within a period of one month from the end of the month during which the tax was deducted, furnish to the person from whose income/payment the tax has been deducted, a certificate to the effect that tax has been deducted, specifying the amount so deducted, the rate at which the tax has been deducted and such other particulars as have been prescribed.

Having regard to the trade-practice prevailing in the road-transport industry, where the truck or such other goods carriages is booked by the consignor but the payment is made by the consignee on delivery of the goods, the CBDT has, through this circular, reiterated the provisions of section 203, as mentioned above, and advised the consignee to issue TDS certificate within the prescribed time and in favour of such truck/goods-carriage operators.

In case of any failure in timely issue of certificate or in case of issue of certificate in favour of any person other than the person from whose payment tax has been deducted at source, the provisions of section 272A(2)(g) shall be attracted, under which, penalty of one hundred rupees for every day during which the failure continues is leviable.

This circular has been issued to overcome the following difficulties –

- a) Non-issue of the certificate by the consignee within the prescribed time.
- b) Issue of certificate in favour of the consignor of the goods instead of the truck / goods carriage operators.

- (8) Circular No.7/2006 dated 17.7.2006 - Clarification regarding deduction of interest under section 43B in view of clarificatory amendments to section 43B through the Finance Act, 2006

Section 43B was amended by the Finance Act, 2006 inserting therein two clarificatory Explanations, namely, Explanation 3C and Explanation 3D. Both the Explanations clarify that any sum payable by the assessee as interest on any loan or borrowing or advance shall be allowed as deduction if such interest has been actually paid and any interest which has been converted into a loan or borrowing or advance but has not been actually paid shall not be allowed as deduction in the computation of income. The clarificatory explanations only reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment.

The manner in which the converted interest will be allowed as deduction has been clarified in this circular. The unpaid interest, whenever actually paid to the bank or 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.

- (9) Circular No. 8/2006, dated 6.10.2006 - Clarification regarding the meaning of the expression “the produce of animal husbandry” used in sub-clause (ii) of clause (f) of rule 6DD of the Income-tax Rules, 1962

The CBDT had, vide Circular No. 4/2006, dated 29th March, 2006 on the above subject, clarified that the expression “the produce of animal husbandry” used under rule 6DD(f)(ii) would include livestock and meat and in a case where payment exceeding rupees twenty thousand is made to a producer of the products of animal husbandry (including livestock, meat, hides and skins)

otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft for the purchase of such produce, no disallowance would be attracted under section 40A(3) read with rule 6DD. It was further clarified that the above exception will not be available in respect of payment for the purchase of livestock, meat, hides and skins from a person who is not proved to be the producer of these goods and is only a trader, broker or any other middleman by whatever name called.

This circular (Circular No.8/2006) gives a clarification as to -

- (i) who are the producers of livestock and meat and
- (ii) the evidence required to be furnished in this regard by the persons making the payments.

The CBDT is of the view that any person, by whatever name called, who buys animals from the farmers, slaughters them and then sells the raw meat carcasses to the meat processing factories or to the traders/retail outlets would be considered as a producer of livestock and meat.

The benefit of rule 6DD of the Income-tax Rules, 1952 shall be available to the person referred to in the above para subject to furnishing of the following :

- (i) A declaration from the person receiving the payment that he is a producer of meat;
- (ii) A confirmation that the payment, otherwise than by an account payee cheque or account payee bank draft, was made on his insistence; and
- (iii) A further confirmation from a veterinary doctor certifying that the person specified in the certificate is a producer of meat and that slaughtering was done under his supervision.

- (10) Circular No.10/2006 dated 16.10.06 - Clarification regarding filing of return of income by the coffee growers being individuals covered by Rule 7B of the Income tax Rules, 1962.

The CBDT, vide Circular No. 10/2003 dated 24th December, 2003, had provided that an individual deriving income from growing and curing of coffee, who is not covered by the first proviso to section 139(1), would not be required to file a return of his income if his income from growing and curing of coffee was Rs. 2 lakhs or less. The Finance Act, 2005 has subsequently raised the exemption limit for individual taxpayers from Rs. 50,000 to Rs.1 lakh from the Assessment year 2006-07. The exemption limit in the case of an individual, being a woman resident in India and below the age of 65 years, has been increased to Rs. 1,35,000. In the case of an individual, being a resident in India, who is of the age of 65 or more at any time during the previous year, the exemption limit has been raised to Rs. 1,85,000. Therefore, the CBDT has reconsidered the matter of filing of return by the individual coffee growers in order to provide further relief to them and it is clarified that:

- (i) An individual deriving income from growing and curing of coffee would not be required to file his return, if the aggregate of 25% of his income from growing and curing of coffee and income under all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the exemption limit (1st slab of the rates of Income-tax) prescribed for individual tax payers in the First Schedule of the Finance Act of the relevant year. Therefore, taking Assessment Year 2006-07 as an example,

(a)	An individual derives income from growing and curing of coffee	=	Rs. 4,00,000
	Other income	=	Nil
	Taxable income under Rule 7B(1) of the IT Rules, 1962 is 25% of Rs. 4,00,000	=	Rs. 1,00,000
	No return is required to be furnished.		

(b)	An individual derives income from growing and curing of coffee	=	Rs. 3,00,000
	Other income	=	Rs. 25,000

Taxable income under Rule 7B(1) of the IT Rules, 1962 = Rs. 1,00,000
 is 25% of Rs.3,00,000 + Rs.25,000
 No return is required to be furnished.

(c) A woman resident in India below the age of sixty five years derives income from growing and curing of coffee = Rs. 5,40,000
 Other income = Nil
 Taxable income under Rule 7B(1) of the IT Rules, 1962 = Rs. 1,35,000
 is 25% of Rs. 5,40,000
 No return is required to be furnished.

(d) An individual being a resident in India, who is of the age of sixty five years or more at any time during the previous year relevant to the Assessment Year 2006-07 derives income from growing and curing of coffee = Rs. 7,40,000
 Other income = Nil
 Taxable income under Rule 7B(1) of the IT Rules, 1962 = Rs.1,85,000
 is 25% of Rs.7,40,000
 No return is required to be furnished.

(ii) An individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory or other flavouring ingredients, would not be required to file the return of income if the aggregate of 40% of his income from growing, curing, roasting and grounding of coffee with or without mixing chicory or other flavouring ingredients and income under all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the exemption limit (1st slab of rates of Income tax) prescribed in the First Schedule of the Finance Act of the relevant year. Consequently for the A.Y. 2006-07:

(a) An individual derives income from growing, curing, roasting and grounding of coffee with or without mixing chicory or other flavoured ingredients = Rs. 2,50,000
 Other income = Nil
 Taxable income under Rule 7B(1A) of the IT Rules, 1962 = Rs. 1,00,000
 is 40% of Rs. 2,50,000
 No return is required to be furnished.

(b) An individual derives income from growing, curing, roasting and grounding of coffee with or without mixing chicory or other flavoured ingredients = Rs. 2,00,000
 Other income = Rs. 20,000
 Taxable income under Rule 7B(1A) of the IT Rules, 1962 = Rs. 1,00,000
 is 40% of Rs.2,00,000 + Rs.20,000
 No return is required to be furnished.

(c) A woman resident in India below the age of sixty five years derives income from growing, curing, roasting and grounding of coffee with or without mixing chicory or other = Rs. 3,37,500

flavoured ingredients

Other income = Nil

Taxable Income under Rule 7B(1) of the IT Rules, 1962 is = Rs. 1,35,000
40% of Rs. 3,37,500

No return is required to be furnished.

- (d) An individual being a resident in India, who is of the age of sixty five years or more at any time during the previous year relevant to the assessment year 2006-07 derives income from growing, curing, roasting and grounding of coffee with or without mixing chicory or other flavoured ingredients = Rs. 4,62,500

Other income = Nil

Taxable Income under Rule 7B(1) of the IT Rules, 1962 is = Rs. 1,85,000
40% of Rs.4,62,500

No return is required to be furnished

Note – It may be noted that though the illustration in this circular is based on the rates of tax applicable for A.Y.2006-07, the same is relevant even for A.Y.2007-08, since the rates of tax have not undergone a change.

PAPER – 8 : INDIRECT TAXES

QUESTIONS

1. M/s. Alpha Pipes Ltd. is engaged in the manufacture of m.s. galvanized pipes. The Excise Department has asked M/s. Alpha Pipes Ltd. to include the cost of galvanization in the assessable value of the m.s. galvanized pipes for the purposes of determination of excise duty. M/s. Alpha Pipes Ltd. claims that as the process of galvanization does not amount to manufacture, the cost of galvanization is not includible in the assessable value of the said pipes made from H.R. coils.

Briefly discuss whether the stand taken by M/s. Alpha Ltd. is correct with reference to the provisions of the Central Excise, 1944.

2. On account of a prolonged strike in the factory of the ABC Ltd., it is decided to cut down the expenditure incurred on labour, packing, inventory advertising etc. One of the bulk buyers of the ABC Ltd.'s products starts advertising the products purchased from ABC Ltd. in order to boost its sales. The Assistant Commissioner of Excise contends that ABC Ltd. has gradually transferred the expenditure on sales promotion/advertisement of its products to the said buyer and thus, such expenditure should be treated as additional consideration and should be included in the assessable value of the ABC Ltd.'s products.

Examine the situation with the help of any decided case law.

3. M/s. Pure Prints processes grey fabric on its own account as well as the grey fabrics that are received from others (the merchant manufacturers) on job charge basis. For paying excise duty on the grey fabrics received from the merchant manufacturers, M/s. Pure Prints values the processed goods on the basis of the cost of grey fabrics plus the processing charges as well as its manufacturing expenses and profits relying upon the Supreme Court's decision in Ujagar Prints 1989 (39) ELT 493 (S.C.).

A duty demand is raised against M/s. Pure Prints on the ground that M/s. Pure Prints and the merchant manufacturers are all firms and companies having a common management and control. Some of these group firms or companies sell grey fabric to M/s. Pure Prints who, after processing the fabrics, sells the same to some of the other group firms or companies. The latter ultimately sell the processed fabrics to independent dealers. The Assistant Commissioner of Excise claims that the price charged by the trader firms or companies from the independent dealers should be the assessable value of the processed fabrics.

Give your opinion on the issue.

4. Write a brief note on "submission of list of records" under rule 22(2) of the Central Excise Rules, 2002.
5. In what circumstances additional evidence can be produced by an appellant before the Commissioner (Appeals) of Central Excise?
6. Explain the procedure for valuing excisable goods that are to be sold from depot/branch or premises of a consignment agent under the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.
7. With reference to the Central Excise Act, 1944 and the rules made thereunder, comment on the following:
 - (i) P, a non-resident has sought an advance ruling as to whether the process intended to be undertaken by him would attract excise duty.
 - (ii) Indian Ordnance Factories are exempt from filing Annual Information Return.
 - (iii) CENVAT credit cannot be denied on explosives used for blasting the mines in order to excavate limestone which in turn is used in the manufacture of cement in the factory situated at some distance away from the mines.

8. Discuss the procedures and facilities for large tax payer as provided vide Rule 12BB of the Central Excise Rules, 2002.
9. Discuss whether adjudication proceedings shall conclude in respect of a person who voluntarily deposits the full excise duty demanded along with interest and penalty equal to 25% of the excise duty.
10. With reference to the Central Excise Act, 1944, briefly explain the provisions in respect of provisional attachment of property.
11. 'A' imported certain inputs for manufacture of final product. A small portion of the imported inputs were damaged in transit and could not be used in the manufacture of the final product. An exemption notification was in force providing exemption in respect of specified raw materials imported into India for use in manufacture of specified goods, which was applicable to the imports made by 'A' in the present case.

Discuss whether 'A' could claim the benefit of the aforesaid notification in respect of the entire lot of the inputs imported including those that were damaged in transit.

12. Write a brief note on the speaking order issued under section 17 of the Customs Act, 1962.
13. Mention the orders against which appeal lies to the Supreme Court under section 130E of the Customs Act.
14. Write a brief note on "remission of duty in case of volatile goods" under section 70 of the Customs Act, 1962.
15. With reference to the Customs Act, 1962, briefly discuss the provisions in respect of appointment of customs ports, airports, etc.
16. With reference to the Customs Act, 1962, discuss giving reasons whether the following statements are true or false:
 - (i) Interest is payable by the importer/exporter on the duty difference when the duty paid during the provisional assessment is less than the duty determined in the final assessment.
 - (ii) If an officer of customs empowered in this behalf by general or special order of the Commissioner of Customs has reason to believe that any person in India or within the Indian customs waters has furnished false declaration/documents, he may arrest such person.
 - (iii) Penalty is leviable on a person who knowingly or intentionally signs any declaration, statement or document which is false or incorrect in any material particular, in the transaction of any business for the purposes of the Customs Act.
 - (iv) The title to imported goods in respect of which an offence appears to have been committed can be relinquished.
17. With reference to the Customs Act, 1962, discuss whether the applications involving evasion of duty by fraudulent means and misdeclaration can be entertained by the Settlement Commission?
18. Explain the reverse charge mechanism prescribed for levying service tax on import of services vide new section 66A introduced by the Finance Act, 2006.
19. The Finance Act, 2006 has substituted section 67 which provides for the valuation of taxable services with a new section. Briefly explain the new provisions.
20. With reference to the Finance Act, 1994 write short notes on:
 - (a) Sponsorship services provided to any body corporate or firm, other than sponsorship of sports events
 - (b) Sale of space or time for advertisement, other than in print media
 - (c) Transport of persons by cruise ship

SUGGESTED ANSWERS/HINTS

1. The facts of the case are similar to the case of *Siddhartha Tubes Ltd. v. CCE, Indore* – 2006 (193) ELT 6 (SC) wherein the Apex Court has held that galvanization cost is includible in assessable value of m.s. galvanized pipes even though 'galvanization' does not amount to manufacture. The Apex Court explained that the concepts of 'manufacture' and 'valuation' were two different and distinct concepts and the present case related to valuation. The Supreme Court stated that m.s. galvanized pipes were manufactured out of H.R. coils after passing through various processes (including galvanization). Such a process added to the quality of the product and increased the value of pipes. Process of galvanization was incidental to the manufacture of pipes and, therefore, cost of that process was rightly included in the assessable value.

Therefore, the stand taken by M/s. Alpha Pipes Ltd. is not correct in law.

2. The facts of the case are similar to the case of *Alembic Glass Industries Ltd. v. CCE*. 2006 (201) ELT 161 (SC) wherein the Supreme Court has observed that where advertisement cost is incurred by the manufacturers/customers compulsorily or mandatorily and where manufacturer has enforceable right against the customers to insist on incurring of such advertisement expenditure by the customers, the advertisement cost would be includible in the assessable value.

The Apex Court stated that there was no finding that the appellant had any enforceable legal right. However, circumstances under which the buyer gave an assurance of bulk purchase and commenced advertising the appellant's product indicated that it was a package outlay for the revival of the appellant's factory arrived at between them as a part of cost reduction exercise of the appellant. There was no material to conclude that there was any tacit understanding between the appellant and the buyer. The factual position showed that the transaction was on principal to principal basis. Hence, the Supreme Court held that there was no scope for making any addition in the assessable value.

Therefore, the contention of the Assistant Commissioner of Excise is not correct.

3. The issue under consideration in this case is whether the principle of valuation enunciated in the case of *Ujagar Prints* can be applied in the case of related job worker too. The facts of the case are similar to the case of *CCE, Indore v. S. Kumars Ltd.* 2005 (190) ELT 145 (SC) wherein the Supreme Court has observed that 'deemed price' principle of *Ujagar Prints* 1989 (39) ELT 493 (S.C.) does not apply to processor who is not independent. In other words, it applies only in cases where job work is done for an unrelated raw material supplier. In this case, the merchant manufacturers and the purchasing traders were merely extensions of the processor (assessee). The processor was not a mere processor but also a merchant manufacturer who purchased/manufactured the raw material, processed it and sold it himself in the wholesale market. In such a situation, the profit was not that of a processor but of a merchant manufacturer and a trader.

Thus, where the raw material supplier and the job worker are 'related persons' as defined in section 4, then valuation of the processed goods would be made on the basis of the price at which the raw material supplier sells the processed goods (after receiving them from the job-worker) to the unrelated buyer.

4. As per rule 22(2) of the Central Excise Rules, 2002, every assessee and first stage dealer and second stage dealer should submit to the officer empowered to visit and inspect under rule 22(1) a list in duplicate, of:
 - (i) all the records prepared and maintained for accounting of transaction in regard to receipt, purchase, manufacture, storage, sale or delivery of goods including inputs and capital goods;
 - (ii) all the records prepared and maintained for accounting of transaction in regard to payment for input services and their receipt or procurement; and
 - (iii) all the financial records and statements including trial balance or its equivalent.

5. Rule 5 of the Central Excise (Appeals) Rules, 2001 provides that the appellant shall not be entitled to produce before the Commissioner (Appeals) any evidence, whether oral or documentary, in addition to evidence produced by him during the course of the proceedings before the adjudicating authority. However, additional evidence can be produced in the following circumstances –

- (a) where the adjudicating authority has refused to admit evidence which ought to have been admitted, or
- (b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by adjudicating authority, or
- (c) where the appellant was prevented by sufficient cause from producing, before the adjudicating authority any evidence which is relevant to any ground of appeal, or
- (d) where the adjudicating authority has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

The Commissioner (Appeals) has to record the reasons for admitting the additional evidence in writing. Further, the adjudicating authority or an officer authorized by the said authority has to be allowed a reasonable opportunity:

- (a) to examine the evidence or document or to cross examine any witness produced by the appellant; or
- (b) to produce any evidence or any witness in rebuttal of the additional evidence.

The power of the Commissioner (Appeals) to direct the production of any document, or the examination of any witness, to enable him to dispose of the appeal is independent of the above provisions relating to additional evidence and his powers will not be affected by the said provisions.

6. As per rule 7 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 where the excisable goods are

- not sold by the assessee at the time and place of removal but are transferred to a depot, premises of a consignment agent or any other place or premises (hereinafter referred to as 'such other place') from where they are to be sold after their clearance from the place of removal and
- where the assessee and the buyer of the said goods are not related and
- the price is the sole consideration for the sale,

the value shall be the normal transaction value of such goods sold from such other place at or about the same time and, where such goods are not sold at or about the same time, at the time nearest to the time of removal of goods under assessment.

7. (i) P can obtain the advance ruling. The Finance Act, 2006 has expanded the scope of the advance ruling by adding a new clause (f) in section 23C of the Central Excise Act, 1944 to provide that the advance ruling can be obtained in respect of determination of the liability to pay duties of excise on any goods under this Act.
- (ii) The assesses who pay less than Rs.100 lakhs as excise duty from account current during the financial year to which the Annual Financial Information Statement relates were exempt from filing of such annual information return vide Notification No. 35/2004-CE (N.T.) dated 01.11.2004. Notification No.17/2006-CE (N.T.) dated 01.08.2006 has rescinded the above-mentioned notification and has extended the benefit of exemption of not filing Annual Information Return to Indian Ordnance Factories, Department of Defence Production and Ministry of Defence while keeping intact the exemption in case of assessee who pay duty of excise less than 100 lakh rupees from account current during the financial year to which Annual Financial Information Statement relates.
- (iii) The Supreme Court has held in the case of Vikram Cement v. CCEx., Indore 2006 (194) ELT 3 (SC) that CENVAT credit on inputs being explosives used for blasting mines to produce

limestone for use in manufacture of cement/clinkers in factory situated at some distance away from mines could not be denied on the ground that they were not used as inputs within the factory.

The above-mentioned decision has overruled the contrary opinion of the Supreme Court in the case of J.K. Udaipur Udyog Ltd. 2004 (171) E.L.T. 289 (SC). In this case, the credit on explosives used for blasting mines was disallowed on the ground that the same were not used within the factory but in a mine which could not qualify to be a factory.

Further, it may be noted that in Vikram Cement v. CCE 2006 (197) ELT 145 (SC), it has been held that CENVAT credit is available only when mines are captive mines i.e. they constitute one integrated unit with the main cement factory. Credit would not be available if the supplies from the mine are made to various cement factories of different assesseees.

8. The provisions of rule 12BB of the Central Excise Rules, 2002 providing for procedures and facilities for the large taxpayer are:

(1) A large taxpayer may remove excisable goods (intermediate goods), except motor spirit, commonly known as petrol, high speed diesel and light diesel oil without payment of duties of excise under the cover of a transfer challan or invoice from any of his registered premises (sender premises) where such goods are produced, manufactured or warehoused to his other registered premises (recipient premises) for further use in the manufacture or production of such other excisable goods (subject goods). However, the large taxpayer cannot remove the intermediate goods without payment of duty to the premises of a first or second stage dealer. Such removal of intermediate goods without payment of duty from the sender premises to recipient premises shall be subject to the conditions that-

(a) the subject goods are manufactured or produced using the said intermediate goods and cleared on payment of appropriate duties of excise leviable thereon within a period of 6 months, from the date of receipt of the intermediate goods in the recipient premises; or

(b) the subject goods are manufactured or produced using the said intermediate goods and exported out of India, under bond or letter of undertaking within a period of 6 months, from the date of receipt of the intermediate goods in the recipient premises,

and that any other conditions prescribed by the Commissioner of Central Excise, Large Taxpayer Unit in this regard are satisfied.

The transfer challan or invoice shall be serially numbered and shall contain the registration number, name, address of the large taxpayer, description, classification, time and date of removal, mode of transport and vehicle registration number, quantity of the goods and registration number and name of the consignee.

However, if the subject goods manufactured or produced using the said intermediate goods are not cleared on payment of appropriate duties of excise leviable thereon or are not exported out of India within the said period of 6 months, duties of excise payable on such intermediate goods shall be paid by the recipient premises with interest in the manner and rate specified under section 11AB of the Act. The duty payable shall be the duty payable on the date and time of removal of the intermediate goods from the sender's premises. If the large taxpayer fails to pay such amount, it shall be recovered along with interest in the same manner as provided under section 11A and section 11AB respectively of the Act.

Further, if any duty of excise is payable on such intermediate goods and if the said duty is not payable on such subject goods, the said duty of excise as equivalent to the total amount payable on such intermediate goods along with interest under section 11AB of the Act shall be paid by the recipient premises. The duty payable shall be the duty payable on the date and time of removal of the intermediate goods from the sender's premises. If the large taxpayer fails to pay such amount, it shall be recovered along with interest in the same manner as provided under section 11A and section 11AB respectively of the Act.

It may be noted that the provisions of this sub-rule shall not be applicable if the recipient premises is availing following notifications:

- (i) No. 32/99-CE, dated 08.07.1999;
- (ii) No. 33/99-CE, dated 08.07.1999;
- (iii) No. 39/2001-CE, dated 31.07.2001;
- (iv) No. 56/2002-CE, dated 14.11.2002;
- (v) No. 57/2002-CE, dated 14.11.2002;
- (vi) No. 56/2003-CE, dated 25.06.2003; and
- (vii) No. 71/2003-CE, dated 09.09.2003

Also, the provisions of this sub-rule shall not apply in respect of a EOU or a unit located in a EHTP or STP.

(2) Where a registered premises of a large taxpayer manufacturing excisable goods has paid to the credit of Central Government any duty of excise in excess of duty of excise payable on account of arithmetical error, the said large taxpayer may adjust the excess duty so paid by him, against his duty liability for the subsequent period subject to the limitations prescribed under rule 3(7)(b) of the CENVAT Credit Rules, 2004.

However, such adjustment shall be admissible only if the said registered premises has not passed on the incidence of such excess duty so paid to any other person, and the consignee does not avail credit of such duty under the CENVAT Credit Rules, 2004.

(3) Any notice issued but not adjudged by any of the Central Excise Officer administering the Act or rules made thereunder immediately before the date of grant of acceptance by the Chief Commissioner of Central Excise, Large Taxpayer Unit, shall be deemed to have been issued by Central Excise Officers of the said Unit.

(4) A large taxpayer shall submit the monthly returns, as prescribed under these rules, for each of the registered premises.

(5) A large taxpayer, on demand, may be required to make available the financial, production, stores and CENVAT credit records in electronic media, such as, compact disc for the purposes of carrying out any scrutiny and verification as may be necessary.

(6) A large taxpayer may, with intimation of at least 30 days in advance, opt out to be a large taxpayer from the first day of the following financial year.

(7) The provisions of other rules of Central Excise Rules, 2002 in so far as they are not inconsistent with the provisions of this rule shall mutatis mutandis apply in case of a large taxpayer.

9. The Taxation Laws Amendment Act, 2006 has inserted a new sub-section (1A) in section 11A of the Central Excise Act, 1944. The new sub-section provides an option to the person or his agent to whom a notice has been served by the Central Excise Officer for short/non levy or short/non payment or erroneous refund of excise duty by reason of fraud, collusion, or any wilful mis-statement or suppression of facts, or contravention of any of the provisions of the Central Excise Act or the rules made thereunder with an intent to evade payment of excise duty.

Such person or his agent may pay the excise duty in full or in part as may be accepted by him, including the interest payable thereon under section 11AB and penalty equal to 25% of the excise duty specified in the notice or the excise duty so accepted by such person within 30 days of the receipt of the notice.

Further, a proviso has been inserted in sub-section (2) of section 11A which lays down that where such person has paid the excise duty in full together with interest and penalty, the proceedings in respect of such person and other persons to whom notices have been served shall be deemed to have been concluded in respect of the matters stated therein. The proceedings shall conclude notwithstanding anything contained in sections 9, 9A and 9AA.

10. A new section 11DDA has been inserted by the Taxation Laws Amendment Act, 2006 in the Central Excise Act, 1944 which provides for provisional attachment of the property. The provisions of this section are:

- (1) During the pendency of any proceeding under section 11A or section 11D, the Central Excise Officer may provisionally attach any property belonging to the person on whom notice is served under sub-section (1) of section 11A or sub-section (2) of section 11D, as the case may be, in accordance with the rules made in this behalf under section 142 of the Customs Act, 1962.
- (2) Such an attachment shall be done only when the Central Excise Officer is of the opinion that the attachment is necessary for the purpose of protecting the interests of revenue. However, a previous approval of the Commissioner of Central Excise, by order in writing, is a prerequisite for such provisional attachment.
- (3) Such an attachment can be done for a period of 6 months. This period will commence from the date of the order of the Commissioner of Central Excise permitting such provisional attachment.
- (4) However, this period may be extended by the Chief Commissioner of Central Excise by such further period or periods as he thinks fit. The reasons for such an extension shall be recorded in writing. It is to be noted that the total period of extension in any case shall not exceed 2 years.
- (5) If an application for settlement of a case under section 32E is made to the Settlement Commission, the period commencing from the date on which such an application is made and ending with the date on which an order under section 32F(1) is made shall be excluded from the extended period mentioned in point (4).

11. The facts of the case are similar to the case of BPL Display Devices Ltd. v. CCEx., Ghaziabad (2004) 174 ELT 5 (SC) wherein the Supreme Court has held that the benefit of the notifications can not be denied in respect of goods which are intended for use for manufacture of the final product but cannot be so used due to shortage or leakage.

The Apex Court has held that no material distinction can be drawn between loss on account of leakage and loss on account of damage. The benefit of said exemption cannot be denied as inputs were 'intended for use' in the manufacture of final product but could not be so used due to shortage/leakage/damage. It has been clarified by the Supreme Court that words "for use" have to be construed to mean "intended for use".

Therefore, 'A' can claim the benefit of the notification in respect of the entire lot of the inputs imported including those that were damaged in transit.

12. Section 17 of the Customs Act, 1962 governs the provisions in respect of assessment. A new sub-section (5) has been inserted after sub-section (4) in section 17 vide the Taxation Laws Amendment Act, 2006. The new sub-section (5) lays down that where any assessment done under sub-section (2) is contrary to the claim of the importer or exporter regarding valuation of goods, classification, exemption or concessions of duty availed consequent to any notification and in cases other than those where the importer or the exporter, as the case may be, confirms his acceptance of the said assessment in writing, the proper officer shall pass a speaking order within 15 days from the date of assessment of the bill of entry or the shipping bill, as the case may be.

13. As per section 130E of the Customs Act, an appeal shall lie to the Supreme Court from-

- (a) any judgment of High Court delivered
 - (i) in an appeal made under section 130, or
 - (ii) on a reference made under section 130 by the Appellate Tribunal before 01.07.2003, or
 - (iii) on a reference made u/s 130 A,

if the High Court certifies the case to be fit for appeal to the Supreme Court. Such certification can be done by the High Court on its own motion or on an oral application made by or on behalf of the aggrieved party, immediately after passing of the judgement.

- (b) any order of the Appellate Tribunal having relation to the determination of rate of customs duty or value of goods, among other things.

14. Section 70 of the Customs Act, 1962 provides for the remission of duty in case of shortage of volatile goods, which are warehoused. The Assistant/Deputy Commissioner of Customs is empowered to remit the import duty leviable on such deficiency, if following conditions are satisfied:

- (i) the goods should be found deficient in quantity at the time of removal from the warehouse;
- (ii) the deficiency should be on account of natural loss, i.e. evaporation etc.
- (iii) these provisions under section 70(1) are applicable only to such specified warehoused goods as notified under section 70(2) e.g. aviation fuel, motor spirit etc. petroleum products kept in tanks, liquid helium gas kept in containers, wine etc. kept in casks.

15. Section 7 of the Customs Act, 1962 contains the provisions in respect of appointment of customs ports, airports, etc. Section 7 lays down that the Board may, by notification in the Official Gazette, appoint -

- (a) the ports and airports which alone shall be customs ports or customs airports for the unloading of imported goods and the loading of export goods or any class of such goods;
- (b) the places which alone shall be inland container depots for the unloading of imported goods and the loading of export goods or any class of such goods;
- (c) the places which alone shall be land customs stations for the clearance of goods imported or to be exported by land or inland water or any class of such goods;
- (d) the routes by which alone goods or any class of goods specified in the notification may pass by land or inland water into or out of India, or to or from any land customs station from or to any land frontier;
- (e) the ports which alone shall be coastal ports for the carrying on of trade in coastal goods or any class of such goods with all or any specified ports in India.

16. (i) True. Section 18 of the Customs Act has been amended by the Taxation Laws Amendment Act, 2006. A new sub-section (3) has been inserted in section 18 to levy interest on the duty difference between the provisional and final assessment of duty. Sub-section (3) provides that the importer or exporter shall be liable to pay interest, on any amount payable to the Central Government, consequent to the final assessment order. The interest shall be payable at the rate fixed by the Central Government under section 28AB. This interest shall be payable from the first day of the month in which the duty is provisionally assessed till the date of payment thereof.

- (ii) True. Section 104 of the Customs Act grants the power of arrest to officer of customs. Sub-section (1) of section 104 has been substituted by a new sub-section vide the Taxation Laws Amendment Act, 2006. The new sub-section lays down that if an officer of customs empowered in this behalf by general or special order of the Commissioner of Customs has reason to believe that any person in India or within the Indian customs waters has committed an offence punishable under section 132 or section 133 or section 135 or section 135A or section 136, he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest. Thus, arrest can also be made in the cases of furnishing false declaration/documents, obstructing customs officers in exercising their powers and making preparation to export any goods in contravention of the provisions of the Customs Act. Further, any officer of customs permitting or doing or abstaining from doing or concealing or conniving at any act or thing whereby any fraudulent export is effected or any duty of customs leviable on any goods is or may be evaded can also be arrested.

(iii) True. Section 114AA has been inserted by the Taxation Laws Amendment Act, 2006 which lays down that if a person knowingly or intentionally

- makes,
- signs or uses, or
- causes to be made,
- signed or used,

any declaration, statement or document which is false or incorrect in any material particular, in the transaction of any business for the purposes of the Customs Act, shall be liable to a penalty.

(iv) False. The Finance Act, 2006 has inserted a proviso in section 23(2) of the Customs Act, 1962 to ensure that the provisions relating to relinquishment of title to imported goods are not available to the owner of such imported goods, regarding which an offence appears to have been committed under this Act or any other law for the time being in force.

17. This issue has been addressed by the High Court in the case of Tata Teleservices (Maharashtra) Ltd. v. Union of India 2006 (201) ELT 529 (Bom.) in the following manner:

The assessee had evaded duty and had applied for settlement in the Settlement Commission. The contention of the department was that the companies or the persons, who evaded the customs duty fraudulently, could not avail of the benefit of approaching the Settlement Commission. It was submitted by the department that the Settlement Commission had a limited jurisdiction of accepting only the cases of short levy on account of misclassification or otherwise and not other cases.

The High Court observed that the Settlement Commission had wide jurisdiction to entertain all kinds of settlement claim applications, with liberty to reject the same even at preliminary stage, depending upon the nature, circumstances and complexity of a case. However, a case would be accepted by the Settlement Commission only if the mandatory requirements of:

- (i) filing Bill of Entry/Shipping Bill and issuance of a show cause notice in relation to such a Bill of Entry/Shipping Bill
- (ii) making a full and true disclosure of duty liability which was not disclosed earlier before the proper officer and the manner in which such liability had been incurred and additional amount of customs duty accepted to be payable by the assessee and
- (iii) furnishing such other particulars as may be specified by the rules including the particulars of such dutiable goods in respect of which the assessee admits short levy on account of misclassification or otherwise of goods

have been fulfilled.

The High Court observed that the jurisdiction of the Settlement Commission was not restricted only to cases of short levy on account of misclassification or otherwise. The object of introducing Chapter XIVA to the Customs Act, 1962 was to resolve all disputes so as to collect revenue for the department. The High Court held that if interpretation of section 127B was restricted to mean only bona fide cases, then there would be no scope of unearthing revenue. It was pointed out by the High Court that earlier part of section 127B *ibid* laid down the jurisdiction and only the latter part dealt with the rules whereby certain details were to be provided. Therefore, it was held by the High Court that the argument with regard to short levy due to misclassification or otherwise was purely a procedural one and there was no need to decide the same.

18. A new section 66A has been inserted with effect from 18.04.2006 after section 66 vide the Finance Act, 2006, which provides a separate mechanism for levying service tax on services received from outside India. Consequently, the explanation below clause (105) in section 65, which levied service tax on services received from outside India, has been deleted. New section 66A provides that:

(1) Where any service specified in clause (105) of section 65 is,—

- (a) provided or to be provided by a person who has established a business or has a fixed establishment from which the service is provided or to be provided or has his permanent address or usual place of residence, in a country other than India, and
- (b) received by a person (recipient) who has his place of business, fixed establishment, permanent address or usual place of residence, in India,

such service shall be a taxable service. Such service shall be treated as if the recipient had himself provided the service in India. Accordingly all the provisions of Chapter V of the Finance Act, 1994 shall apply to such services.

- (2) However, a service received by an individual for a purpose other than for use in any business or commerce shall not be a taxable service.
- (3) If the provider of the service has his business establishment both in that country and elsewhere, the country, where the establishment of the provider of service directly concerned with the provision of service is located, shall be treated as the country from which the service is provided or to be provided.
- (4) Where a person is carrying on a business through a permanent establishment in India and through another permanent establishment in a country other than India, such permanent establishments shall be treated as separate persons for the purposes of this section. In other words, permanent establishment in India and the permanent establishment outside India shall be treated as two separate legal persons for taxation purposes.
- (5) A person carrying on a business through a branch or agency in any country shall be treated as having a business establishment in that country.
- (6) In relation to a body corporate, the place where it is incorporated or otherwise legally constituted shall be its usual place of residence.

19. The new section 67 (effective from 18.04.2006) provides that:

- (1) If the consideration for a taxable service is in terms of money, the value of such service shall be the gross amount charged by the service provider for such service provided or to be provided by him.
- (2) If the consideration for a taxable service is not wholly or partly in terms of money, then the value of such service shall be such amount in money, with the addition of service tax charged, is equivalent to the consideration.
- (3) If the consideration for a taxable service is not ascertainable, the value of such service shall be the amount as may be determined in the prescribed manner.
- (4) Consideration includes any amount that is payable for the taxable services provided or to be provided.
- (5) Where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.
- (6) The gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.
- (7) Subject to the provisions mentioned in points (1), (2), (3), (5) and (6) above, the value of a taxable service shall be determined in such manner as may be prescribed.
- (8) A consequential amendment has been made in section 94 by inserting clause (aa) after clause (a). Section 94 contains the matters on which the Central Government may, by notification in the Official Gazette, make rules. The clause (aa) empowers Central Government to make rules for the determination of amount and value of taxable service under section 67.

- (9) Money includes any currency, cheque, promissory note, letter of credit, draft, pay order, travellers cheque, money order, postal remittance and other similar instruments but does not include currency that is held for its numismatic value.
- (10) Gross amount charged includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment.
20. (a) Sponsorship service provided to any body corporate or firm, other than sponsorship of sports events has been introduced by the Finance Act, 2006 with effect from 01.05.2006. Sponsorship includes naming an event after the sponsor, displaying the sponsor's company logo or trading name, giving the sponsor exclusive or priority booking rights, sponsoring prizes or trophies for competition; but does not include any financial or other support in the form of donations or gifts, given by the donors subject to the condition that the service provider is under no obligation to provide anything in return to such donors [Section 65(99a)].

The scope of this taxable service includes any service provided or to be provided to any body corporate or firm, by any person receiving sponsorship, in relation to such sponsorship, in any manner, but does not include services in relation to sponsorship of sports events [Section 65(105)(zzzn)].

- (b) The service of sale of space or time for advertisement, other than in print media has been introduced by the Finance Act, 2006 with effect from 01.05.2006. The scope of this taxable service includes any service provided or to be provided to any person, by any other person, in relation to sale of space or time for advertisement, in any manner; but does not include sale of space for advertisement in print media and sale of time slots by a broadcasting agency or organisation.

Explanation 1.—For the purposes of this sub-clause, “sale of space or time for advertisement” includes,—

- (i) providing space or time, as the case may be, for display, advertising, showcasing of any product or service in video programmes, television programmes or motion pictures or music albums, or on billboards, public places, buildings, conveyances, cell phones, automated teller machines, internet;
- (ii) selling of time slots on radio or television by a person, other than a broadcasting agency or organisation; and
- (iii) aerial advertising

Explanation 2.—For the purposes of this sub-clause, “print media” means “book” and “newspaper” as defined in sub-section (1) of section 1 of the Press and Registration of Books Act, 1867 [Section 65(105)(zzzm)].

- (c) The service of transport of persons by cruise ship has been introduced by the Finance Act, 2006 with effect from 01.05.2006. The scope of this taxable service includes any service provided or to be provided to any person, by any other person, in relation to transport of such person embarking from any port or other port in India, by a cruise ship.

Explanation.—For the purposes of this sub-clause, “cruise ship” means a ship or vessel used for providing recreational or pleasure trips, but does not include a ship or vessel used for private purposes or a ship or vessel of, or less than, 15 net tonnage [Section 65(105)(zzzv)].

IMPORTANT NOTIFICATIONS/CIRCULARS ISSUED BETWEEN 01.05.2006 TO 31.10.2006

Students may note that the Study Material for Indirect taxes contains all the relevant amendments made by Finance Act, 2006. Further, Circulars/Notifications issued up to 30.04.2006 have also been incorporated therein. The following are the amendments which have been made till 31.10.2006. It may carefully be noted that for the students appearing in May 2007 the amendments made by Notifications, Circulars etc. up to 31.10.2006, as detailed hereunder, are relevant.

I. CENTRAL EXCISE

1. The Finance Act, 2006 had amended the Third Schedule to the Central Excise Act, 1944 so as to cover the following goods in the said schedule:

- (i) toothbrush
- (ii) plant growth regulator and
- (iii) parts, components and assemblies of automobiles

However, the said amendment was to take effect from a date to be notified in the Official Gazette. Notification No. 12/2006 CE (NT) dated 29.05.2006 has notified 01.06.2006 as the date from which the said amendment will take effect. Thus, from 01.06.2006 these products will be valued on maximum retail price basis.

2. The assesses who pay less than Rs.100 lakhs as excise duty from account current during the financial year to which the Annual Financial Information Statement relates were exempted from filing of such annual information return vide Notification No. 35/2004-CE (N.T.) dated 01.11.2004. Notification No.17/2006-CE (N.T.) dated 01.08.2006 has rescinded the above-mentioned notification and has extended the benefit of exemption of not filing Annual Information Return to Indian Ordnance Factories, Department of Defence Production and Ministry of Defence while keeping intact the exemption in case of assessee who pay duty of excise less than 100 lakh rupees from account current during the financial year to which Annual Financial Information Statement relates.
3. In rule 8 of the Central Excise Rules, 2002, sub-rule (3A) has been substituted vide Notification No. 13/2006 CE (NT) dated 01.06.2006. The new sub-rule provides that if the assessee defaults in payment of duty beyond 30 days from the due date then he shall pay excise duty for each consignment at the time of removal, without utilizing the CENVAT credit. He shall continue to pay duty consignment-wise (from PLA) till the date he pays the outstanding amount including interest thereon. In the event of any failure, it shall be deemed that such goods have been cleared without payment of duty and the consequences and penalties as provided in these rules shall follow.

The old sub-rule provided that the assessee would lose the facility to pay the duty in monthly instalments if he made a default in payment of duty by due date and the same is discharged beyond a period of 30 days from the due date. This forfeiture would start from the date of communication of the order passed by the Assistant/Deputy Commissioner of Central Excise in this regard. The forfeiture of the facility would continue for a period of two months or till such date on which all dues including interest thereof are paid, whichever is later. Further, during this period the assessee would not be able to utilize the CENVAT credit for the payment of duty on final products. He would compulsorily pay the excise duty for each consignment by debit to the account current and in the event of any failure, it would be deemed that such goods have been cleared without payment of duty and the consequences and penalties as provided in these rules would follow.

Thus, the requirement of the order passed by the Assistant/Deputy Commissioner and limitation of period of 2 months for paying consignment-wise duty has been done away with in the new sub-rule.

LARGE TAX PAYER UNITS

The Finance Minister in his Budget Speech 2005-06 announced the proposal to set up Large Taxpayer Units (hereinafter referred to as LTUs) in the country in line with the international practice, which would service large taxpayers paying excise duty, corporate tax/income-tax and service tax under a single window. LTU is a trade facilitative measure seeking to address and deliver appropriate solutions to the unique compliance issues that may arise. The establishment of LTU is a step to achieve excellence in the formulation and implementation of Service Tax and Excise initiatives by creating a climate for voluntary compliance by providing guidance and building of mutual trust. It is envisaged that this approach will improve India's business climate, and will reassure the trade that their taxation related concerns would be dealt with in a fair and transparent manner.

The Government has decided to implement the LTU scheme in a phased manner. The first Large Taxpayer Unit has been set up at Bangalore. LTUs will also be established in a phased manner in Chennai, Delhi, Kolkata, and Mumbai. The Chief Commissioner, Central Excise and Service Tax will head the LTU in Bangalore.

Conceptually, LTU is a self-contained tax office that provides single point interface with the tax administration to the large taxpayers who pay direct and indirect taxes above the threshold limit as specified in the Notification No. 20/2006 C.E (NT) dated 30.09.2006 (discussed in point 3 later). It is a single office that would deal with central excise/service tax/ income tax/ corporate tax issues of all units holding a single PAN. Once a taxpayer acquires the status of LTU, the entire jurisdiction of central excise, service tax and income tax matters shall stand transferred to the said LTU in respect of all his manufacturing units, service providing premises, and other registered premises located throughout the country. Some of such activities are as given below: -

- (a) Filing of returns
- (b) Filing of refund/rebate claims
- (c) Audit, Adjudication and Appeals
- (d) Filing of intimation, permissions
- (e) Visit to units
- (f) Acceptance of proof of export

A LTU will be headed by a Chief Commissioner (either from CBDT or from CBEC). The Chief Commissioner, LTU is expected to undertake following functions-

- (a) overall administration of LTU;
- (b) co-ordination between the direct tax and the indirect tax wings of LTU;
- (c) distribution of work amongst the LTU officers;
- (d) monitoring of revenue collection;
- (e) quality Assurance Checks/ taxpayer feedback system;
- (f) devising effective taxpayer assistance system;
- (g) review of the orders passed by the Commissioners as adjudicating authority (as a member of Review Committee);
- (h) issuance of trade notices/ circulars to bring about uniformity in tax administration as well as determination of amount of tax payable;
- (i) coordination with the Boards (CBEC and CBDT), Directorates and with other field formations in the matters such as audit verification, revenue recoveries, etc.

The Chief Commissioner, LTU will intimate the jurisdictional Central Excise, Service Tax and Income Tax Commissioners regarding the transfer of the specified units from his jurisdiction to the LTU. There will be Commissioners posted in LTU, who would be holding executive and appellate charges. The powers and duties would be similar to that of other field commissioners. However, they are required to play a pro-active role in ensuring the fulfilment of objectives of a LTU. The Commissioners of Direct and Indirect Taxes are expected to work in a coordinated manner. Other Group 'A', 'B', 'C' officers along with supporting staff will be posted by CBDT and CBEC. The Chief Commissioner, LTU will assign a Client Executive for each taxpayer from among the Additional/Joint/Deputy/Asstt. Commissioner posted in LTU, and the said Client Executive will be the single point interface with the large taxpayer for all purposes.

The officers posted in LTU will have all India jurisdiction in respect of all registered premises of a large taxpayer registered in that particular LTU. The erstwhile Central Excise or Service Tax commissionerate officers will have concurrent jurisdiction. However, the interaction with these units will be limited to specific functions requiring physical presence of the officers for purposes as warehousing, sealing or any other work as assigned by the LTU.

1. Following amendments have been made in the Central Excise Rules, 2002 vide Notification No. 18/2006 CE (NT), dated 30.09.2006 so as to incorporate the concept of large tax payer.

(i) In rule 2, after sub-rule (e), another sub-rule has been inserted to define "large taxpayer" as a person who-

(i) has one or more registered premises under the Central Excise Act, 1944; or

(ii) has one or more registered premises under Chapter V of the Finance Act, 1994;

and is an assessee under the Income Tax Act, 1961, who holds a Permanent Account Number issued under section 139A of the said Act, and satisfies the conditions and observes the procedures as notified by the Central Government in this regard.

(ii) Rule 12BB has been inserted after Rule 12AA which lays down the procedure and facilities for the large taxpayer. The provisions of this rule are:

(1) A large taxpayer may remove excisable goods (intermediate goods), except motor spirit, commonly known as petrol, high speed diesel and light diesel oil without payment of duties of excise under the cover of a transfer challan or invoice from any of his registered premises (sender premises) where such goods are produced, manufactured or warehoused to his other registered premises (recipient premises) for further use in the manufacture or production of such other excisable goods (subject goods). However, the large taxpayer cannot remove the intermediate goods without payment of duty to the premises of a first or second stage dealer. Such removal of intermediate goods without payment of duty from the sender premises to recipient premises shall be subject to the conditions that-

(a) the subject goods are manufactured or produced using the said intermediate goods and cleared on payment of appropriate duties of excise leviable thereon within a period of 6 months, from the date of receipt of the intermediate goods in the recipient premises; or

(b) the subject goods are manufactured or produced using the said intermediate goods and exported out of India, under bond or letter of undertaking within a period of 6 months, from the date of receipt of the intermediate goods in the recipient premises,

and that any other conditions prescribed by the Commissioner of Central Excise, Large Taxpayer Unit in this regard are satisfied.

The transfer challan or invoice shall be serially numbered and shall contain the registration number, name, address of the large taxpayer, description, classification, time and date of removal, mode of transport and vehicle registration number, quantity of the goods and registration number and name of the consignee.

However, if the subject goods manufactured or produced using the said intermediate goods are not cleared on payment of appropriate duties of excise leviable thereon or are not exported out of India within the said period of 6 months, duties of excise payable on such intermediate goods shall be paid by the recipient premises with interest in the manner and rate specified under section 11AB of the Act. The duty payable shall be the duty payable on the date and time of removal of the intermediate goods from the sender's premises. If the large taxpayer fails to pay such amount, it shall be recovered along with interest in the same manner as provided under section 11A and section 11AB respectively of the Act.

Illustration 1

Excise duty is payable on intermediate goods, namely, electronics goods, manufactured by factory A which are removed without payment of duties of excise for use in the manufacture of subject goods, namely, machines, in factory B of the large taxpayer. In case such machines are not exported or are removed without payment of duties of excise, then factory B shall pay duties of excise payable on the electronic goods so cleared along with interest.

Further, if any duty of excise is payable on such intermediate goods and if the said duty is not payable on such subject goods, the said duty of excise as equivalent to the total amount payable on such intermediate goods along with interest under section 11AB of the Act shall be paid by the recipient premises. The duty payable shall be the duty payable on the date

and time of removal of the intermediate goods from the sender's premises. If the large taxpayer fails to pay such amount, it shall be recovered along with interest in the same manner as provided under section 11A and section 11AB respectively of the Act.

Illustration 2

National Calamity Contingent duty is payable on intermediate goods namely, polyester yarn manufactured by factory A. Such yarn is removed without payment of duty of excise for use in the manufacture of subject goods, namely, grey fabrics in factory B of a large taxpayer, (on which such National Calamity Contingent duty is not payable), then factory B shall pay an amount equivalent to the National Calamity Contingent duty that would have been payable on the polyester yarn along with interest under section 11AB of the Act.

It may be noted that the provisions of this sub-rule shall not be applicable if the recipient premises is availing following notifications:

- (i) No. 32/99-CE, dated 08.07.1999;
- (ii) No. 33/99-CE, dated 08.07.1999;
- (iii) No. 39/2001-CE, dated 31.07.2001;
- (iv) No. 56/2002-CE, dated 14.11.2002;
- (v) No. 57/2002-CE, dated 14.11.2002;
- (vi) No. 56/2003-CE, dated 25.06.2003; and
- (vii) No. 71/2003-CE, dated 09.09.2003

Also, the provisions of this sub-rule shall not apply in respect of a EOU or a unit located in a EHTP or STP.

(2) Where a registered premises of a large taxpayer manufacturing excisable goods has paid to the credit of Central Government any duty of excise in excess of duty of excise payable on account of arithmetical error, the said large taxpayer may adjust the excess duty so paid by him, against his duty liability for the subsequent period subject to the limitations prescribed under rule 3(7)(b) of the CENVAT Credit Rules, 2004.

However, such adjustment shall be admissible only if the said registered premises has not passed on the incidence of such excess duty so paid to any other person, and the consignee does not avail credit of such duty under the CENVAT Credit Rules, 2004.

(3) Any notice issued but not adjudged by any of the Central Excise officer administering the Act or rules made thereunder immediately before the date of grant of acceptance by the Chief Commissioner of Central Excise, Large Taxpayer Unit, shall be deemed to have been issued by Central Excise officers of the said Unit.

(4) A large taxpayer shall submit the monthly returns, as prescribed under these rules, for each of the registered premises.

(5) A large taxpayer, on demand, may be required to make available the financial, production, stores and CENVAT credit records in electronic media, such as, compact disc or for the purposes of carrying out any scrutiny and verification as may be necessary.

(6) A large taxpayer may, with intimation of at least 30 days in advance, opt out to be a large taxpayer from the first day of the following financial year.

(7) The provisions of other rules of Central Excise Rules, 2002 in so far as they are not inconsistent with the provisions of this rule shall mutatis mutandis apply in case of a large taxpayer.

2. Following amendments have been made in CENVAT Credit Rules, 2004 vide Notification No. 19/2006 CE (NT), dated 30.09.2006 so as to incorporate the concepts of large tax payer.

- (i) In rule 2, sub-rule (na) has been renamed as sub-rule (naa) so that sub-rule (na) can define "large taxpayer" to have the meaning assigned to it in the Central Excise Rules, 2002.

- (ii) Rule 12A has been inserted after Rule 12 in the CENVAT Credit Rules, 2004 which lays down the procedure and facilities for the large taxpayer. The provisions of rule 12A are as under:

(1) A large taxpayer may remove inputs (except motor spirit, commonly known as petrol, high speed diesel and light diesel oil) or capital goods, as such, on which CENVAT credit has been taken without payment of an amount specified in rule 3(5) of the CENVAT Credit Rules, 2004 under the cover of a transfer challan or invoice from any of his registered premises (sender premises) to his other registered premises (recipient premises) other than a premises of a first or second stage dealer for further use in the manufacture or production of final products in the recipient premises. Such removal shall be subject to the conditions that-

(a) the final products are manufactured or produced using the said inputs and cleared on payment of appropriate duties of excise leviable thereon within a period of 6 months, from the date of receipt of the inputs in the recipient premises; or

(b) the final products are manufactured or produced using the said inputs and exported out of India, under bond or letter of undertaking within a period of 6 months, from the date of receipt of the inputs in the recipient premises,

and that any other conditions prescribed by the Commissioner of Central Excise, Large Taxpayer Unit in this regard are satisfied.

The transfer challan or invoice shall be serially numbered and shall contain the registration number, name, address of the large taxpayer, description, classification, time and date of removal, mode of transport and vehicle registration number, quantity of the goods and registration number and name of the consignee.

However, if the final products manufactured or produced using the said inputs are not cleared on payment of appropriate duties of excise leviable thereon or are not exported out of India within the said period of 6 months from the date of receipt of the input goods in the recipient premises, or such inputs are cleared as such from the recipient premises, an amount equal to the credit taken in respect of such inputs by the sender premises shall be paid by the recipient premises with interest in the manner and rate specified under rule 14 of these rules. The first recipient premises may take CENVAT credit of such amount paid by it as if it was a duty paid by the sender premises who removed such goods on the basis of a document showing payment of such duties.

Also, if such capital goods are used exclusively in the manufacture of exempted goods, or such capital goods are cleared as such from the recipient premises, an amount equal to the credit taken in respect of such capital goods by the sender premises shall be paid by the recipient premises with interest in the manner and rate specified under rule 14 of these rules.

If a large taxpayer fails to pay any of such amount, it shall be recovered along with interest in the manner as provided under rule 14 of these rules.

It may be noted that the provisions of this sub-rule shall not be applicable if the recipient premises is availing following notifications:

- (i) No. 32/99-CE, dated 08.07.1999;
- (ii) No. 33/99-CE, dated 08.07.1999;
- (iii) No. 39/2001-CE, dated 31.07.2001;
- (iv) No. 56/2002-CE, dated 14.11.2002;
- (v) No. 57/2002-CE, dated 14.11.2002;
- (vi) No. 56/2003-CE, dated 25.06.2003; and
- (vii) No. 71/2003-CE, dated 09.09.2003

Also, the provisions of this sub-rule shall not apply in respect of an EOU or a unit located in a EHTP or STP.

(2) CENVAT credit of the specified duties taken by a sender premises shall not be denied or varied in respect of any inputs or capital goods, removed as such under sub-rule (1) on the ground that the said inputs or the capital goods have been

- (i) removed without payment of an amount specified in rule 3(5) of these rules; or
- (ii) used in the manufacture of any intermediate goods removed without payment of duty under sub-rule (1) of rule 12BB of Central Excise Rules, 2002.

For the purpose of this sub-rule intermediate goods shall have the same meaning assigned to it in sub-rule (1) of rule 12BB of the Central Excise Rules, 2002.

(3) A large taxpayer may transfer, CENVAT credit available with one of his registered manufacturing premises or premises providing taxable service to his other such registered premises by,-

- (i) making an entry for such transfer in the record maintained under rule 9;
- (ii) issuing a transfer challan containing registration number, name and address of the registered premises transferring the credit as well as receiving such credit, the amount of credit transferred and the particulars of such entry as mentioned in clause (i),

and such recipient premises can take CENVAT credit on the basis of such transfer challan as mentioned in clause (ii):

It may be noted that such transfer or utilisation of CENVAT credit shall be subject to the limitations prescribed under rule 3(7)(b).

It may be noted that the provisions of this sub-rule shall not be applicable if the registered manufacturing premises is availing following notifications:

- (i) No. 32/99-CE, dated 08.07.1999;
- (ii) No. 33/99-CE, dated 08.07.1999;
- (iii) No. 39/2001-CE, dated 31.07.2001;
- (iv) No. 56/2002-CE, dated 14.11.2002;
- (v) No. 57/2002-CE, dated 14.11.2002;
- (vi) No. 56/2003-CE, dated 25.06.2003; and
- (vii) No. 71/2003-CE, dated 09.09.2003

(4) A large taxpayer shall submit a monthly return, as prescribed under these rules, for each of the registered premises.

(5) Any notice issued but not adjudged by any of the Central Excise Officer administering the Act or rules made thereunder immediately before the date of grant of acceptance by the Chief Commissioner of Central Excise, Large Taxpayer Unit, shall be deemed to have been issued by Central Excise Officers of the said Unit

(6) Provisions of these rules, in so far as they are not inconsistent with the provisions of this rule shall mutatis mutandis apply in case of a large taxpayer.

3. Notification No. 20/2006 CE (NT), dated 30.09.2006 has notified the following persons to be eligible to opt as large taxpayer:

- (i) Any person engaged in the manufacture or production of goods, except the goods falling under chapter 24 or Pan Masala falling under chapter 21 of the First schedule of the Central Excise Tariff Act, 1985, or
- (ii) a provider of taxable service,

who has paid during the financial year 2004-05 or during the financial year preceding the year of filing of application for large tax payer-

- (a) duties of excise of more than Rs.500 lakhs in cash or through account current; or
- (b) service tax of more than Rs.500 lakhs in cash or through account current; or
- (c) advance tax of more than Rs.1000 lakhs, under the Income Tax Act, 1961,

and is presently assessed to income tax or corporate tax under the Income Tax Act, 1961, under the jurisdiction of Chief Commissioner of Income Tax – I, Bangalore (other than revenue district of Tumkur) and Chief Commissioner of Income Tax – II, Bangalore (other than district of Kolar).

Further, following procedures have also been notified which are to be followed to be eligible to opt as large tax payer:

A large taxpayer who satisfies the conditions mentioned above may file an application in the prescribed form duly completed in all respects to the Chief Commissioner of Central Excise, Large Taxpayer Unit for the city where the large taxpayer is presently assessed to income tax or corporate tax indicating his willingness to be a large taxpayer.

A person willing to operate as large taxpayer shall furnish details of each of the premises already registered under the Central Excise Act, 1944 including the premises of first and second stage dealers and each of the premises registered under Chapter V of the Finance Act, 1994 including the premises of input service distributor.

The Chief Commissioner of Central Excise, Large Taxpayer Unit may after due verification of the application form, grant the acceptance in writing. The process of acceptance would not normally take more than 7 days.

Existing registrations under the Central Excise Act, 1944 or Chapter V of the Finance Act, 1994 shall continue. However, in case a new factory or service provider, input service distributor or first or second stage dealer which becomes liable to be registered, after opting as large taxpayer, the application for such new registration shall be made before the Chief Commissioner of Central Excise, Large Taxpayer Unit.

4. Notification No.23/2006 CE (N.T.) dated 12.10.2006 has notified revised formats of ER-1 and ER-3 returns under rule 12 of the Central Excise Rules, 2002 and rule 9(7) of CENVAT Credit Rules, 2004. The notification has come into force from 01.11.2006. The revision of the formats of ER-1 and ER-3 has been necessitated following the setting up of the first Large Taxpayer Unit (LTU) in Bangalore. However, the revised ER 1 return form is applicable for all assessees (large taxpayers and others), although the additional details to be provided by a large taxpayer, have been separately indicated. The new format of ER-1 return is applicable from the month of October, 2006, i.e. in respect of the return to be filed in November, 2006. The new ER-3 return would be applicable for the returns to be filed for the quarter October- December, 2006 to be filed in January, 2007.

II. CUSTOMS

1. Notification No.80/2006-Cus (N.T.) dated 13.07.2006 has amended the Customs and Central Excise Duties Drawback Rules, 1995. These rules have been rechristened as Customs, Central Excise Duties and Service Tax Drawback Rules, 2006 and have been accordingly amended to provide for the drawback of service tax paid on taxable services used as input services in the manufacture or processing of export goods.

The new drawback rates shall now also take into account the incidence of service tax paid on taxable services which are used as input services in the manufacturing or processing of export goods. The exporters should not avail of the refund of this tax through any other mechanism while claiming the all industry rate of drawback.

III. SERVICE TAX

1. Notification No. 7/2006 ST dated 01.03.2006 exempting taxable services, provided or to be provided to any person, by Reserve Bank of India, from the whole of service tax leviable thereon has been superseded by Notification No. 22/2006 ST, dated 31.05.2006. This notification exempts the

- (i) taxable services provided or to be provided to any person, by the Reserve Bank of India;
 - (ii) taxable services provided or to be provided by any person, to the Reserve Bank of India when the service tax for such services is liable to be paid by the Reserve Bank of India under sub-section (2) of section 68 of the said Finance Act read with rule 2 of the Service Tax Rules, 1994;
 - (iii) taxable services received in India from outside India by the Reserve Bank of India under section 66A of the Finance Act, 1994.
2. Following amendments have been made in Notification No. 1/2006 ST dated 01.03.2006 which grants partial exemptions from service tax to certain specified services:
- (i) Abatement granted to erection, commissioning or installation service under a contract for supplying a plant, machinery or equipment and erection, commissioning or installation thereof has been extended to structures as well. This amendment is in view of the modification made in the definition of erection, commissioning or installation service by the Finance Act, 2006 [Notification No. 21/2006 ST, dated 23.05.2006].
 - (ii) Business auxiliary service, in relation to production or processing of parts and accessories used in the manufacture of cycles, cycle rickshaws and hand-operated sewing machines, for, or on behalf of, the client, has been granted an abatement of 30% from the gross amount charged for such service. This abatement is available when the gross amount charged from the client is inclusive of the cost of inputs and input services, whether or not supplied by the client.
- However, the exemption is not available in cases where –
- (i) the CENVAT credit of duty paid on inputs or capital goods or the CENVAT credit of service tax on input services, used for providing such taxable service has been taken under the provisions of the Cenvat Credit Rules, 2004; or
 - (ii) the service provider has availed the benefit under Notification No. 12/2003-ST, dated 20.06.2003 [Notification No. 23/2006 ST, dated 02.06.2006].
3. Notification No. 25/2006-ST dated 13.07.2006 exempts the taxable services provided or to be provided by a practicing chartered accountant, a practicing cost accountant and a practicing company secretary respectively, in his professional capacity, to a client, relating to representing the client before any statutory authority in the course of proceedings initiated under any law for the time being in force, by way of issue of notice, from the whole of service tax leviable thereon.
4. When Service Tax (Determination of Value) Rules, 2006 were notified on 19.04.2006, Rule 6(2)(iii) inter alia provided that the rail fare collected by “air travel agent” in respect of service provided by him does not form part of the taxable service. This error has now been rectified vide Notification No. 24/2006 ST, dated 27.06.2006 which has substituted the words “air travel agent” with the words “rail travel agent”.
5. With effect from 01.10.2006, Notification No. 27/2006-ST dated 21.09.2006 has made it compulsory for the assessee, who has paid service tax of Rs.50,00,000 or above in the preceding financial year or has already paid service tax of Rs.50,00,000 in the current financial year, to deposit the service tax liable to be paid by him electronically, through internet banking.
6. Following amendments have been made in the Service Tax Rules, 1994 vide Notification No. 28/2006-ST dated 30.09.2006 to incorporate the concept of large taxpayer.
- (i) In rule 2, after sub-rule (ccc), sub-rule (cccc) has been inserted which defines “large taxpayer” to have the meaning assigned to it in the Central Excise Rules, 2002.
 - (ii) Rule 10 has been inserted after Rule 9 which lays down the procedure and facilities for the large taxpayer. The provisions of this rule are discussed below:
- Notwithstanding anything contained in these rules, the following shall apply to a large taxpayer,-

- (1) A large taxpayer shall submit the returns, as prescribed under these rules, for each of the registered premises. A large taxpayer who has obtained a centralized registration under rule 4(2), shall submit a consolidated return for all such premises.
 - (2) A large taxpayer, on demand, may be required to make available the financial, stores and CENVAT credit records in electronic media, such as, compact disc or tape for the purposes of carrying out any scrutiny and verification, as may be necessary.
 - (3) A large taxpayer may, with intimation of at least 30 days in advance, opt out to be a large taxpayer from the first day of the following financial year.
 - (4) Any notice issued but not adjudged by any of the Central Excise Officer administering the Act or rules made thereunder immediately before the date of grant of acceptance by the Chief Commissioner of Central Excise, Large Taxpayer Unit, shall be deemed to have been issued by Central Excise officers of the said unit.
 - (5) Provisions of these rules, in so far as they are not inconsistent with the provisions of this rule shall mutatis mutandis apply in case of a large taxpayer."
7. Circular No. 83/1/2006-ST dated 04.07.2006 has clarified that services such as transfer of money through money orders, operation of savings accounts, issue of postal orders provided by the Department of Posts are not liable to service tax under banking and other financial services. Banking and other financial services are defined under section 65(12). Such services provided to a customer by a banking company or a financial institution including a non-banking financial company or any other body corporate or any other person to a customer are liable to service tax under section 65(105)(zm). The expression 'any other person' appearing in section 65(105)(zm) is to be read ejusdem generis with the preceding words. The expression 'other financial services' appearing under section 65(12)(a)(ix) is a residuary entry and includes those services which are normally rendered by banks or financial institutions.
- Hence, banking and other financial services provided by a banking company or a financial institution or a non-banking financial company or any other service provider similar to a bank or a financial institution are liable to service tax under section 65(105)(zm) of the Finance Act, 1994. Department of Posts is not similar to a bank or a financial institution and hence does not fall within the category of any other similar service provider.
8. Circular No. 84/2/2006-ST dated 19.09.2006 has clarified that any club or association that enjoys exemption under the provisions of Income Tax Act on the ground of being a public charitable institution does not automatically get excluded from levy of service tax under section 65(105)(zzze) read with section 65(25a) of the Finance Act, 1994 as exemption under the Income Tax Act on the ground of being a public charitable institution is of no consequence to levy of service tax. Levy of service tax is entirely governed by the provisions contained in the Finance Act, 1994 and the rules made thereunder.
9. Circular No. 85/3/2006-ST dated 17.10.2006 has clarified following issues in respect of levy of service tax on international journey by aircraft:

S.No	Issue	Clarification
1	In the case of international journey commencing from an Indian airport involving stopover/transfer at intermediate airports outside India before reaching the destination (say Mumbai-Dubai-London-New York), whether service tax would be leviable on the value indicated in the ticket or on the value attributable to the first sector (Mumbai-Dubai)?	International journey is from Mumbai to New York. Stopover/transfer at intermediate airports is incidental or part of the main journey. Stop over/transfer at intermediate airports outside India is of no relevance or consequence for levy of service tax under section 65(105)(zzzo) read with section 66 of the Finance Act, 1994. Service tax is leviable on the total value of the ticket representing the consideration of a single composite service.

2.	In case the international journey also includes travel in a domestic sector as part of the international journey (say Delhi-Mumbai-London), whether service tax is leviable excluding the value attributable to the domestic sector or on the total value of the ticket treating the domestic sector as integral part of international journey?	Service tax is leviable on the total value of the ticket.
3.	In the case of round trip/return ticket, whether service tax is leviable on the total value of the ticket or only half the value of the ticket?	Service tax is leviable on the total value of the ticket.
4.	In the case of journey commencing from an airport outside India and completed at an airport outside India but including a sector wherein the passenger disembarks and subsequently embarks at an Indian airport as part of international journey (say Sydney-Mumbai-Dubai-Singapore-Sydney), whether service tax is leviable for Mumbai-Dubai sector only or on the total value of the ticket?	Service tax is not leviable in such cases.
5.	Whether ticket issued outside India for an international journey commencing from India (say Delhi-London) is leviable to service tax?	Service tax is payable by the service provider for the taxable service provided. Place of purchase/issue of ticket is of no relevance or consequence to determine the levy of service tax under section 65(105)(zzzo) read with section 66 of the Finance Act, 1994.

RECENT AMENDMENTS IN DIRECT TAXES AND INDIRECT TAXES

Students are advised to study thoroughly the Supplementary Study Paper-2006 on Direct taxes and Indirect taxes for the Final Course. This contains the amendments made by the Finance Act, 2006 as well as the relevant Notifications/Circulars issued up to 30.04.2006. This Supplementary Study Paper is available at various branch and regional sales counters of the Institute. This is very important since considerable weightage is being given to the latest amendments in the examinations.

Students may note that the Board of Studies has come out with a publication "Select Cases in Direct and Indirect Taxes [2006] – An Essential Reading for Final Course". This contains important recent judgements of Supreme Court, High Court and Appellate Tribunal in both Direct Taxes and Indirect Taxes. For amendments made in direct taxes vide Taxation Laws Amendment Act, 2006 students should refer to article "Amendments made by the Taxation Laws (Amendment) Act, 2006" published in October 2006 issue of the Students Newsletter, "The Chartered Accountant Student". In respect of amendments made in indirect taxes, students should refer to article "Taxation Laws Amendment Act, 2006: A Guide to Indirect Taxes" published in January 2007 issue of Students Newsletter, "The Chartered Accountant Student".



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

FINAL (NEW) COURSE

SYLLABUS

GROUP I

- Paper – 1 : Financial Reporting
- Paper – 2 : Strategic Financial Management
- Paper – 3 : Advanced Auditing and Professional Ethics
- Paper – 4 : Corporate and Allied Laws

GROUP II

- Paper – 5 : Advanced Management Accounting
- Paper – 6 : Information Systems Control and Audit
- Paper – 7 : Direct Tax Laws
- Paper – 8 : Indirect Tax Laws

PAPER – 1 : FINANCIAL REPORTING
(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain ability to analyze financial statements including consolidated financial statements of group companies and financial reports of various types of entities,
- (b) To gain ability to apply valuation principles,
- (c) To familiarise with recent developments in the area of financial reporting,
- (d) To gain ability to solve financial reporting and valuation cases.

Contents:

1. Accounting Standards, Accounting Standards Interpretations and Guidance Notes on various accounting aspects issued by the ICAI and their applications.
2. Overview of International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS), Interpretations by International Financial Reporting Interpretation Committee (IFRIC), Significant difference vis-a-vis Indian Accounting Standards.
Understanding of US GAAP,
Applications of IFRS and US GAAP.
3. Corporate Financial Reporting - Issues and problems with special reference to published financial statements.
4. Accounting for Corporate Restructuring (including inter-company holdings).
5. Consolidated Financial Statements of Group Companies Concept of a Group, purposes of consolidated financial statements minority interest, Goodwill, Consolidation procedures – Minority interests, Goodwill, Treatment of pre- acquisition and post-acquisition profit.
Consolidation with two or more subsidiaries, consolidation with foreign subsidiaries.
Consolidated profit and loss account, balance sheet and cash flow statement.
Treatment of investment in associates in consolidated financial statements.
Treatment of investments in joint ventures in consolidated financial statements.
6. Accounting and Reporting of Financial Instruments
Meaning, recognition, derecognition and offset, compound financial instruments
Measurement of financial instruments
Hedge accounting
Disclosures
7. Share based payments
Meaning, Equity settled transactions, Transaction with employees and non- employees
Determination of fair value of equity instruments
Vesting conditions
Modification, cancellation and settlement
Disclosures
8. Financial Reporting by Mutual funds, Non-banking finance companies, Merchant bankers, Stock and commodity market intermediaries.
9. Valuation
(a) Concept of Valuation

- (b) Valuation of Tangible Fixed Assets
- (c) Valuation of Intangibles including Brand Valuation and Valuation of Goodwill
- (d) Valuation of Liabilities
- (e) Valuation of Shares
- (f) Valuation of Business

10. Developments in Financial Reporting

- (a) Value Added Statement
- (b) Economic Value Added, Market Value Added, Shareholders' Value Added
- (c) Human Resource Reporting
- (d) Inflation Accounting

Note: If either old Accounting Standards (ASs), Accounting Standards Interpretations (ASIs), Guidance Notes (GNs), Announcements and Limited Revisions to ASs are withdrawn or new ASs, GNs, Announcements and Limited Revisions to AS are issued by the Institute of Chartered Accountants of India in place of existing ASs, ASIs, GNs, Announcements and Limited Revisions to AS, the syllabus will accordingly include/exclude such new developments in the place of the existing ones with effect from the date to be notified by the Institute.

PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objective:

To apply financial management theories and techniques for strategic decision making.

Contents:

1. Financial Policy and Corporate Strategy
 - Strategic decision making framework
 - Interface of Financial Policy and strategic management
 - Balancing financial goals vis-à-vis sustainable growth.
2. Project Planning and Capital Budgeting
 - Feasibility study
 - Cash flow Projections – Impact of taxation, depreciation, inflation and working capital
 - Capital Budgeting Decisions - Certainty Equivalent approach, Evaluation of Risky Investment Proposals, Risk and Return analysis, Simulation and decision tree analysis, Sensitivity analysis, Capital Rationing, Adjusted Net Present Value, Replacement decisions, Application of Real Options in capital budgeting, Impact of inflation on capital budgeting decisions
 - Preparation of Project Report
 - Social cost benefit analysis.
3. Leasing decision including cross border leasing
4. Dividend Decisions
 - Dividend theories, Determinants of dividend policies.
5. (a) Indian Capital Market including role of various primary and secondary market institutions

- (b) Capital Market Instruments
 - Financial derivatives – stock futures, stock options, index futures, index options
 - Option valuation techniques : Binomial model, Black Scholes Option Pricing Model, Greeks – Delta, Gamma, Theta, Rho and Vega
 - Pricing of Futures – Cost of carry model
 - Imbedded derivatives
- (c) Commodity derivatives
- (d) OTC derivatives -Swaps, Swaptions, Forward Rate Agreements (FRAs), Caps, Floors and Collors.
- 6. Security Analysis
 - Fundamental analysis - Economic analysis, Industry analysis and Company Analysis
 - Bond valuation, Price Yield relationship, Bond Price forecasting – application of duration and convexity, Yield curve strategies
 - Technical Analysis – market cycle model and basic trend identification, different types of charting, support and resistance, price patterns, moving averages, Bollinger Bands, momentum analysis.
- 7. Portfolio Theory and Asset Pricing
 - Efficient Market Theory – Random walk theory ; Markowitz model of risk return optimization
 - Capital Asset Pricing Model (CAPM)
 - Arbitrage Pricing Theory (APT)
 - Sharpe Index Model
 - Portfolio Management - Formulation, Monitoring and Evaluation
 - Equity Style Management
 - Principles and Management of Hedge Funds
 - International Portfolio Management.
- 8. Financial Services in India
 - Investment Banking
 - Retail Banking
 - On Line Share Trading
 - Depository Service.
- 9. (a) Mutual Funds: Regulatory framework, formulation, monitoring and evaluation of various schemes of Mutual funds, Money market mutual funds.
 - (b) Exchange Traded Funds.
- 10. Money Market operations
- 11. (a) Foreign Direct Investment, Foreign Institutional Investment.
 - (b) International Financial Management
 - Raising of capital abroad - American Depository Receipts, Global Depository Receipts, External Commercial Borrowings and Foreign Currency Convertible Bonds
 - International Capital Budgeting
 - International Working Capital Management.
- 12. Foreign Exchange Exposure and Risk Management
 - Exchange rate determination, Exchange rate forecasting

Foreign currency market

Foreign exchange derivatives – Forward, futures, options and swaps

Management of transaction, translation and economic exposures

Hedging currency risk.

13. Mergers, Acquisitions and Restructuring

Meaning of mergers and acquisition, categories, purposes

Process of mergers and acquisition – Identification and valuation of the target, acquisition through negotiation, due diligence, post – merger integration

Legal and regulatory requirements

Merger and Acquisition agreement

Reverse merger

Potential adverse competitive effects of mergers

Corporate Takeovers: Motivations, Co-insurance effect, Cross-border takeovers, Forms of takeovers, Takeover defenses

Going Private and Other Control Transactions: Leveraged Buyouts (LBOs), Management Buyouts (MBOs), Spin Offs and Asset Divestitures

Corporate Restructuring : Refinancing and rescue financing, reorganizations of debtors and creditors, Sale of assets, targeted stock offerings, downsizing and layoff programmes, negotiated wage give-backs, employee buyouts.

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

(One Paper- Three hours - 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain expert knowledge of current auditing practices and procedures and apply them in auditing engagements,
- (b) To develop ability to solve cases relating to audit engagements.

Contents:

1. Auditing Standards, Statements and Guidance Notes

Auditing and Assurance Standards (AASs); Statements and Guidance Notes on Auditing issued by the ICAI; Significant differences between Auditing and Assurance Standards and International Standards on Auditing.

2. Audit strategy, planning and programming

Planning the flow of audit work; audit strategy, planning programme and importance of supervision: review of audit notes and working papers; drafting of reports; principal's ultimate responsibility; extent of delegation; control over quality of audit work; reliance on the work of other auditor, internal auditor or an expert.

3. Risk Assessment and Internal Control

Evaluation of internal control procedures; techniques including questionnaire, flowchart; internal audit and external audit, coordination between the two.

4. Audit under computerized information system (CIS) environment

Special aspects of CIS Audit Environment, need for review of internal control especially procedure controls and facility controls. Approach to audit in CIS Environment, use of computers for internal

and management audit purposes: audit tools, test packs, computerized audit programmes; Special Aspects in Audit of E-Commerce Transaction.

5. Special audit techniques
 - (a) Selective verification; statistical sampling; Special audit procedures; physical verification of assets, direct confirmation of debtors and creditors
 - (b) Analytical review procedures
 - (c) Risk-based auditing.
6. Audit of limited companies

Statutory requirements under the Companies Act 1956; Audit of branches: joint audits; Dividends and divisible profits % financial, legal, and policy considerations.
7. Rights, duties, and liabilities of auditors; third party liability.
8. Audit reports; qualifications, notes on accounts, distinction between notes and qualifications, detailed observations by the statutory auditor to the management vis-a-vis obligations of reporting to the members.
9. Audit Committee and Corporate Governance
10. Audit of Consolidated Financial Statements, Audit Reports and Certificates for Special Purpose engagements; Certificates under the Payment of Bonus Act, import/export control authorities, etc.; Specific services to non-audit clients; Certificate on Corporate Governance.
11. Special features of audit of banks, insurance companies, co-operative societies and non-banking financial companies.
12. Audit under Fiscal Laws, viz, Direct and Indirect Tax Laws.
13. Cost audit
14. Special audit assignments like audit of bank borrowers, audit of stock and commodity exchange intermediaries and depositories; inspection of special entities like banks, financial institutions, mutual funds, stock brokers.
15. Special features in audit of public sector companies. Directions of Comptroller and Auditor General of India under Section 619; Concepts of propriety and efficiency audit.
16. Internal audit, management and operational audit Nature and purpose, organisation, audit programme, behavioural problems; Internal Audit Standards issued by the ICAI; Specific areas of management and operational audit involving review of internal control, purchasing operations, manufacturing operations, selling and distribution, personnel policies, systems and procedures. Aspects relating to concurrent audit.
17. Investigation and Due Diligence.
18. Concept of peer review
19. Salient features of Sarbanes – Oxley Act, 2002 with special reference to reporting on internal control.
20. Professional Ethics

Code of Ethics with special reference to the relevant provisions of The Chartered Accountants Act, 1949 and the Regulations thereunder.

PAPER – 4 : CORPORATE AND ALLIED LAWS

(One paper – Three hours – 100 marks)

Section A : Company Law (70 Marks)

Level of Knowledge: Advanced knowledge

Objective:

To be able to analyze and apply various provisions of the Companies Act in practical situations

Contents:

1. The Companies Act, 1956, Rules and Regulations thereunder in its entirety with specific reference to
 - (a) Accounts and audit
 - (b) Dividend
 - (c) Directors - powers, managerial remuneration
 - (d) Meetings, powers of the Board and related party transactions
 - (e) Inspection and Investigation
 - (f) Compromises, Arrangements and Reconstructions
 - (g) Prevention of Oppression and Mismanagement
 - (h) Revival and Rehabilitation of Sick Industrial Companies
 - (i) Corporate Winding up and Dissolution
 - (j) Producer Companies
 - (k) Companies incorporated outside India
 - (l) Offences and Penalties
 - (m) E-governance
2. Corporate Secretarial Practice – Drafting of Resolution, Minutes, Notices and Reports

Section B : Allied Laws (30 Marks)

Objective:

To develop ability to analyse the requirements of laws stated in the Section.

Contents:

3. An overview of the following laws –
 - (a) The Securities and Exchange Board of India Act, 1992, Rules, Regulations and Guidelines issued thereunder.
 - (b) The Securities Contracts (Regulation) Act, 1956
 - (c) The Foreign Exchange Management Act, 1999
 - (d) The Competition Act, 2002
 - (e) The Banking Regulation Act, 1949, The Insurance Act, 1938. The Insurance Regulatory and Development Authority Act, 1999. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
 - (f) The Prevention of Money Laundering Act, 2002
4. Interpretation of Statutes, Deeds and Documents.

PAPER – 5 : ADVANCED MANAGEMENT ACCOUNTING

(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objective:

To apply various management accounting techniques to all types of organizations for planning, decision making and control purposes in practical situations.

To develop ability to apply quantitative techniques to business problems

1. Cost Management

- (a) Developments in the business environment; just in time; manufacturing resources planning; (MRP); automated manufacturing; synchronous manufacturing and back flush systems to reflect the importance of accurate bills of material and routings; world class manufacturing; total quality management.
- (b) Activity based approaches to management and cost analysis
- (c) Analysis of common costs in manufacturing and service industry
- (d) Techniques for profit improvement, cost reduction, and value analysis
- (e) Throughput accounting
- (f) Target costing; cost ascertainment and pricing of products and services
- (g) Life cycle costing
- (h) Shut down and divestment.

2. Cost Volume Profit Analysis

- (a) Relevant cost
- (b) Product sales pricing and mix
- (c) Limiting factors
- (d) Multiple scarce resource problems
- (e) Decisions about alternatives such as make or buy, selection of products, etc.

3. Pricing Decisions

- (a) Pricing of a finished product
- (b) Theory of price
- (c) Pricing policy
- (d) Principles of product pricing
- (e) New product pricing
- (f) Pricing strategies
- (g) Pricing of services
- (h) Pareto analysis

4. Budgets and Budgetary Control

The budget manual, Preparation and monitoring procedures, Budget variances, Flexible budgets, Preparation of functional budget for operating and non-operating functions, Cash budgets, Capital expenditure budget, Master budget, Principal budget factors.

5. Standard Costing and Variance Analysis

Types of standards and sources of standard cost information; evolution of standards, continuous - improvement; keeping standards meaningful and relevant; variance analysis; disposal of variances.

- (a) Investigation and interpretation of variances and their inter relationship
- (b) Behavioural considerations.
- 6. Transfer pricing
 - (a) Objectives of transfer pricing
 - (b) Methods of transfer pricing
 - (c) Conflict between a division and a company
 - (d) Multi-national transfer pricing.
- 7. Cost Management in Service Sector
- 8. Uniform Costing and Inter firm comparison
- 9. Profitability analysis - Product wise / segment wise / customer wise
- 10. Financial Decision Modeling
 - (a) Linear Programming
 - (b) Network analysis - PERT/CPM, resource allocation and resource leveling
 - (c) Transportation problems
 - (d) Assignment problems
 - (e) Simulation
 - (f) Learning Curve Theory
 - (g) Time series forecasting
 - (h) Sampling and test of hypothesis

PAPER – 6 : INFORMATION SYSTEMS CONTROL AND AUDIT

(One Paper – Three hours – 100 marks)

Level of knowledge: Advanced knowledge

Objective:

To gain application ability of necessary controls, laws and standards in computerized Information system.

Contents:

- 1. Information Systems Concepts
 - General Systems Concepts – Nature and types of systems, nature and types of information, attributes of information.
 - Management Information System – Role of information within business
 - Business information systems –various types of information systems – TPC, MIS, DSS, EIS, ES
- 2. Systems Development Life Cycle Methodology
 - Introduction to SDLC/Basics of SDLC
 - Requirements analysis and systems design techniques
 - Strategic considerations : Acquisition decisions and approaches
 - Software evaluation and selection/development
 - Alternate development methodologies- RAD, Prototype etc
 - Hardware evaluation and selection

Systems operations and organization of systems resources

Systems documentation and operation manuals

User procedures, training and end user computing

System testing, assessment, conversion and start-up

Hardware contracts and software licenses

System implementation

Post-implementation review

System maintenance

System safeguards

Brief note on IS Organisation Structure

3. Control objectives

(a) Information Systems Controls

Need for control

Effect of computers on Internal Audit

Responsibility for control – Management, IT, personnel, auditors

Cost effectiveness of control procedure

Control Objectives for Information and related Technology (COBIT)

(b) Information Systems Control Techniques

Control Design: Preventive and detective controls, Computer-dependent control, Audit trails, User Controls (Control balancing, Manual follow up)

Non-computer-dependent (user) controls: Error identification controls, Error investigation controls, Error correction controls, Processing recovery controls

(c) Controls over system selection, acquisition/development

Standards and controls applicable to IS development projects

Developed / acquired systems

Vendor evaluation

Structured analysis and design

Role of IS Auditor in System acquisition/selection

(d) Controls over system implementation

Acceptance testing methodologies

System conversion methodologies

Post implement review

Monitoring, use and measurement

(e) Control over System and program changes

Change management controls

Authorization controls

Documentation controls

Testing and quality controls

Custody, copyright and warranties

Role of IS Auditor in Change Management

- (f) Control over Data integrity, privacy and security
 - Classification of information
 - Logical access controls
 - Physical access controls
 - Environmental controls
 - Security concepts and techniques – Cryptosystems, Data Encryption Standards (DES), Public Key Cryptography & Firewalls
 - Data security and public networks
 - Monitoring and surveillance techniques
 - Data Privacy
 - Unauthorised intrusion, hacking, virus control
 - Role of IS Auditor in Access Control
- 4. Audit Tests of General and Automated Controls
 - (a) Introduction to basics of testing (reasons for testing);
 - (b) Various levels/types of testing such as: (i) Performance testing, (ii) Parallel testing, (iii) Concurrent Audit modules/Embedded audit modules, etc.
- 5. Risk assessment methodologies and applications: (a) Meaning of Vulnerabilities, Threats, Risks, Controls, (b) Fraud, error, vandalism, excessive costs, competitive disadvantage, business, interruption, social costs, statutory sanctions, etc. (c) Risk Assessment and Risk Management, (d) Preventive/detective/corrective strategies
- 6. Business Continuity Planning and Disaster recovery planning: (a) Fundamentals of BCP/DRP, (b) Threat and risk management, (c) Software and data backup techniques, (d) Alternative processing facility arrangements, (e) Disaster recovery procedural plan, (f) Integration with departmental plans, testing and documentation, (g) Insurance
- 7. An over view of Enterprise Resource Planning (ERP)
- 8. Information Systems Auditing Standards, guidelines, best practices (BS7799, HIPPA, CMM etc.)
- 9. Drafting of IS Security Policy, Audit Policy, IS Audit Reporting - a practical perspective
- 10. Information Technology Act, 2000

PAPER – 7: DIRECT TAX LAWS

(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain advanced knowledge of the provisions of direct tax laws,
- (b) To acquire the ability to apply the knowledge of the provisions of direct tax laws to various situations in actual practice.

Contents:

- I. The Income-tax Act, 1961 and Rules thereunder (90 marks)
- II. The Wealth-tax Act, 1957 and Rules thereunder (10 marks)

While covering the direct tax laws, students should familiarise themselves with considerations relevant to tax management. These may include tax considerations with regard to specific

management decisions, foreign collaboration agreements, international taxation, amalgamations, tax incentives, personnel compensation plans, inter-relationship of taxation and accounting, with special reference to relevant accounting standards and other precautions to be observed to maximise tax relief. Further, they should have a basic understanding about the ethical considerations in tax management and compliance with taxation laws.

Note – If new legislations are enacted in place of the existing legislations relating to income tax and wealth tax, the syllabus will accordingly include such new legislations in the place of the existing legislations with effect from the date to be notified by the Institute.

PAPER – 8 : INDIRECT TAX LAWS

(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain expert knowledge of the principles of the laws relating to central excise customs and service tax,
- (b) To acquire the ability to apply the knowledge of the provisions of the above-mentioned laws to various situations in actual practice.

Contents:

Section A : Central Excise (40 marks)

Central Excise Act, 1944 and the related Rules, Circulars and Notifications; Central Excise Tariff Act, 1985 and the related Rules.

Section B : Service tax & VAT (40 marks)

Law relating to service tax as contained in the Finance Act, 1994 as amended from time to time and the related Rules, Circulars and Notifications.

Issues related to Value Added Tax:

1. Backdrop for State-Level VAT in India
2. Taxonomy of VAT
3. Input tax credit, tax invoices
4. Small dealers and composition scheme
5. VAT procedures
6. VAT in relation to incentive schemes, works contract, lease transactions and hire purchase transactions.
7. VAT and Central Sales Tax

Section C : Customs (20 marks)

Customs Act, 1962 and the related Rules, Circulars and Notifications; Customs Tariff Act, 1975 and the related Rules.

While covering the above laws, students should familiarize themselves with the inter-relationship of accounting with excise, customs and service tax and also the ethical considerations involved in the compliance of these laws.

Note – If new legislations are enacted in place of the existing legislations relating to central excise, customs and service tax, the syllabus will accordingly include such new legislations in place of the existing legislations with effect from the date to be notified by the Institute. Students shall not be examined with reference to any particular State VAT Law.

TRANSITION SCHEME FOR FINAL STUDENTS

The transition scheme for the Final Course students, who have passed Professional Education (Examination-II), and are under articles, is as under:

- ◆ On completion of 2 years of training, such students are eligible to appear in the Final Examination, so long as the same is held under the existing syllabus i.e., upto November, 2009.

In the event of a candidate not being eligible to appear till the last Final Examination to be held in November 2009 under the existing syllabus, will be required to appear in the Final Examination under the New syllabus, but only during the last six months of articleship training (articleship training period being 3 years only).

Introduction of Final Course under New Syllabus and other related Issues

- (i) Final Course under New syllabus is introduced. Admission to the Final (New) Course under the Regulation 29B of the Chartered Accountants (Amendment) Regulations, 2006 will commence on and from February 1, 2007.
- (ii) Existing students of Final (old) course may switch over to Final (New) course and continue with the existing scheme of articleship, if any, which they are undergoing. They will be provided a new set of study materials at a cost of Rs.1100.
- (iii) Students, who have passed the Professional Education (Examination-II) / Intermediate Examination but not yet joined Final course and also not completed the articleship training, may join the Final (New) Course.
 - ◆ Students who have undergone Professional Education (Course-II) with articleship but not yet completed the same, will continue the articleship under the same scheme which they are undergoing presently. They will be allowed to appear in the Final Examination under the new syllabus pending last six months of articleship training on or before the last day of the month preceding the month in which the examination is held.
 - ◆ Students who have undergone Professional Education (Course-II), without articleship, will undergo three years of articleship training and they will be allowed to appear in the Final Examination under the new syllabus pending last six months of articleship training on or before the last day of the month preceding the month in which the examination is held.

They will be required to pay fees as given below:

Final Course – Without articleship Rs.8500

With articleship Rs.9000 (including articulated registration fee of Rs.500)

In addition, students have to pay Rs.500 on account of registration fee with Board of Studies and Rs.500 on account of Students' Association fee if these fees are not paid earlier.

- (iv) Students who have passed Professional Education (Examination-II) / Intermediate Examination and who have completed articleship training may join Final (New) course under Regulation 29B of the Chartered Accountants (Amendment) Regulations, 2006 and appear in the first Final (New) Course Examination to be held in November, 2008. They will be required to pay a fee of Rs.8500.
- (v) Admission to Final (old) course under Regulation 29A of the Chartered Accountants Regulations, 1988 will continue till October 31, 2007. Students who will join the same are required to pay the following fees:

Final Course	– Without articleship	Rs.4000
	– With articleship	Rs.4600
- (vi) First Final Examination (New) Course will be held in November, 2008 and Last Final Examination (Old) Course will be held in November, 2009.
- (vii) Students shall complete 100 Hours Information Technology Training/250 Hours Compulsory Computer Training before taking admission to Final (Old) or Final (New) Course.

APPLICABILITY OF VARIOUS PUBLICATIONS FOR FINAL EXAMINATION TO BE HELD IN MAY 2007

Paper 1 : Advanced Accounting

- I. Statements and Standards
 1. Framework for the Preparation and Presentation of Financial Statements
 2. Accounting Standards – AS 1 to AS 29 [including revised AS 15 (2005)].
- II. Guidance Notes on Accounting Aspects
 1. Guidance Note on Treatment of Reserves Created on Revaluation of Fixed Assets.
 2. Guarantees and Counter-Guarantees Given by Companies.
 3. Guidance Note on Treatment of Expenditure during Construction Period.
 4. Guidance Note on Accrual Basis of Accounting.
 5. Guidance Note on Accounting Treatment for Excise Duty.
 6. Guidance Note on Accounting for Depreciation in Companies.
 7. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
 8. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
 9. Guidance Note on Accounting for Securitisation.
 10. Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options (2003).
 11. Guidance Note on Accounting for Corporate Dividend Tax.
 12. Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.
 13. Guidance Note on Accounting for Employee Share-based Payments.
 14. Guidance Note on Accounting for Fringe Benefits Tax.
 15. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.

Paper 3 : Advanced Auditing

- I. Professional Topics/Subjects
 1. Code of Ethics
- II. Statements and Standards
 1. Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.
 2. Auditing and Assurance Standards AAS 1 to AAS 34
 3. Statement on Qualifications in Auditor's Report
 4. Statement on the Companies (Auditor's Report) Order, 2003 [2005 Edition].
- III. Guidance Notes/Study Guide/Monograph

Guidance Notes on Auditing Aspects:

 1. Guidance Note on Independence of Auditors
 2. Internal Control Questionnaire.
 3. Guidance Note on Accountant's Report on Profit Forecasts and / or Financial Forecasts.
 4. Guidance Note on Audit Reports and Certificates for Special Purposes
 5. Guidance Note on Audit of Fixed Assets.

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

Chartered Accountants (Amendment) Act, 2006 is applicable for May, 2007 Final Examination, Questions on Professional Ethics may be asked in accordance with the Chartered Accountants (Amendment) Act, 2006. Chapter 17 of Advanced Auditing of Final (Old) Course study material should be accordingly read with appropriate amendments.

A supplementary study material is released covering Chapter 17 of Advanced Auditing study materials. The supplementary study material can also be downloaded from the website www.icaai.org>students>Courses (Course Curriculum)>Final>Supplementary study materials.

Paper 4 : Corporate Laws and Secretarial Practice

April, 2006 edition (revised as on February, 2006) is relevant for May, 2007 Examination. Amendments in the SEBI (DIP) Guidelines 2000 as amended up to February, 2006 may be made applicable.

Paper 7 : Direct Taxes

1. Study Material for Direct Taxes (as amended by Finance Act, 2006) – June 2006 edition. The relevant assessment year is A.Y.2007-08.
2. Select cases in Direct and Indirect Taxes (2006) – An Essential reading for the Final Course.[Portions relating to Direct Taxes]
3. Final Course – Supplementary Study Paper – 2006 Direct Taxes and Indirect Taxes – Amendments made by the Finance Act, 2006. [Portions relating to Direct Taxes]. This publication is relevant for those who have any earlier edition (prior to June 2006 edition) of the Direct Taxes study material.

Note – For the purposes of setting the questions in direct taxes, study material for A.Y.2007-08 containing the law as amended by the Finance Act, 2006 should be taken into account. This study material contains amendments made by notifications/circulars/other legislations up to 30.04.2006. The amendments made between 1.05.2006 and 31.10.2006 would be published in the Revision Test Papers for May 2007 examination. All these amendments are relevant for May 2007 examination.

Paper 8 : Indirect Taxes

1. Study Material for Indirect Taxes (as amended by Finance Act, 2006).
2. Select cases in Direct and Indirect Taxes (2006) – An Essential reading for the Final Course [Portions relating to Indirect Taxes]
3. Final Course – Supplementary Study Paper – 2006 Direct Taxes and Indirect Taxes – Amendments made by the Finance Act, 2006 [Portions relating to Indirect Taxes]. This publication is relevant for those who have any earlier Indirect Taxes Study Material (prior to the one as amended by Finance Act, 2006).

Note – For the purposes of setting the questions in indirect taxes, study material containing the law as amended by the Finance Act, 2006 should be taken into account. This study material contains amendments made by notifications/circulars/other legislations up to 30.04.2006. The amendments made between 1.05.2006 and 31.10.2006 would be published in the Revision Test Papers for May 2007 examination. All these amendments are relevant for May 2007 examination.

RECENT PUBLICATIONS OF THE BOARD OF STUDIES

	English	Hindi	Postal Charges	
			By Registered Parcel	
			English	Hindi
	Rs.	Rs.	Rs.	Rs.
I. STUDY MATERIALS				
COMMON PROFICIENCY TEST (CPT)				
Fundamentals of Accounting	200	140		
Mercantile Laws	50	40		
General Economics	100	70		
Quantitative Aptitude	250	150		
Self Assessment CD	<u>40</u>	<u>40</u>		
	<u>640</u>	<u>440</u>	145	145
PROFESSIONAL COMPETENCE COURSE (PCC)				
Group I				
Advanced Accounting Vol. I & Vol. II	500			
Auditing and Assurance	175			
Law, Ethics and Communication	<u>275</u>			
	<u>950</u>		215	
Group II				
Cost Accounting & Financial Management	300			
Taxation	200			
Information Technology	150			
Strategic Management	<u>100</u>			
	<u>750</u>		180	
Both Groups	1700		395	
FINAL (NEW COURSE)				
Group I				
Financial Reporting	600			
Strategic Financial Management	260			
Advanced Auditing and Professional Ethics	520			
Corporate and Allied Laws	<u>200</u>			
	<u>1580</u>		320	
Group II				
Advanced Management Accounting	240			
Information Systems Control and Audit	150			
Direct Tax Laws	340			
Indirect Tax laws	<u>290</u>			
	<u>1020</u>		225	
Both Groups	2600		540	
Information Technology Training Course Material				
Information Technology Training Programme	500		90	
- Modules I & II				

II. COMPILATIONS OF SUGGESTED ANSWERS

Professional Education (Course-II)

Auditing (May, 2000 to May, 2005)	40	40
Income Tax and Central Sales Tax (May, 1996 to Nov. 2005)	40	40
Final		
Advanced Auditing (May, 2000 to May, 2005)	60	40
Direct Taxes (May 2000 to Nov. 2005)	60	40

III. SUGGESTED ANSWERS FOR NOV. 2006

Professional Education (Course –I)

Professional Education (Course –II) (Group I & II)

Final (Group I & II)

Each Suggested Answer is priced Rs.40 per volume plus Postal charges for Registered parcel Rs.40.

IV. REVISION TEST PAPERS FOR MAY 2007

Professional Education (Course –I)	40	40
Professional Education (Course –II) (Group I & II)	80	55
Final (Group I & II)	80	55

V. PROSPECTUS

1. Common Proficiency Test – A Simplified Entry to the Chartered Accountancy Course	100	40
2. Professional Competence Course – First Stage of Theoretical Education of the Chartered Accountancy Course inclusive of conversion form		
– With Form Nos. 102 and 103	100	40
– Without Form Nos. 102 and 103	50	40

VI. MISCELLANEOUS

1. Select cases Direct and Indirect Taxes - 2006	40	40
--	----	----

2. Information Brochure about Common Proficiency Test – A Simplified Entry to the Chartered Accountancy Course Both in English and Hindi
3. Information Brochure about Professional Competence Course – First Stage of Theoretical Education of the Chartered Accountancy Both in English and Hindi
4. Information Brochure on 100 Hours Information Technology Training
5. Information Brochure about Chartered Accountancy - Global Career Opportunities through a premier Professional Institute Both in English and Hindi

Available free of cost in all Decentralised Offices and Branches of the Institute

VII. COMPACT DISCS (CDs) New Series

1. Membership in Company	- PE-II	50	40
2. Capital Gains (Part I and Part II)	- Final	50	40
3. Insurance Claims	- PE-I / CPT	50	40
4. Hire Purchase and Instalment Payment	- PE-II/PCC	50	40
5. Taxation of Salaries	- PE-III/ PCC	50	40