

Test Series: February, 2015

MOCK TEST PAPER - 1
INTERMEDIATE (IPC): GROUP – I
PAPER – 1: ACCOUNTING
SUGGESTED ANSWERS/HINTS

1. (a) As per AS 2 'Valuation of Inventories', for inclusion in the cost of inventory, allocation of fixed production overheads is based on the normal capacity of the production facilities.

In this, case finished stock has been valued at a standard cost of ` 1.8 lakhs per computer which incidentally synchronizes with the value computed on the basis of absorption costing as under:

		(` in lakhs)
Materials		400
Direct Labour		250
Variable production overheads		150
Fixed production overheads	290	
Less: Interest	<u>(100)</u>	<u>190</u>
Total cost		<u>990</u>

Number of computers produced = 550 computers (Assumed to be normal production)

Cost per computer ` 990 lakhs/550 computers = ` 1.80 lakhs

Policy of the company to value closing stock on the basis of standard costing is not as per AS 2. As per AS 2, the techniques

of standard cost method may be used for convenience if the result approximates to the actual cost. However, standard cost should be regularly reviewed, if necessary, and be revised in the light of the current conditions. In the instant case, the cost of inventory can be conveniently calculated as per absorption costing. Therefore, there is no reason to adopt standard costing method.

(b) (i) Depreciation to be charged in the Profit and Loss Account

	₹
Depreciation on old Machinery	31,600
[20% on ₹ 6,32,000 for 3 months (01.4.14 to 30.6.14)]	
Add: Depreciation machinery acquired on 01.06.2014	20,000
(₹ 1,20,000 x 20% x 10/12)	
Depreciation on Machinery after adjustment of Exchange	<u>1,04,850</u>
[20% of ₹ (6,32,000 - 1,89,000 + 2,56,000) for 9 months]	
Total Depreciation to be charged in Profit and Loss A/c	<u>1,56,450</u>

(ii) Loss on exchange of Machinery

	₹
Book value of machinery as on 01.04.2014	1,89,000

Less: Depreciation for 3 months	<u>(9,450)</u>
WDV as on 30.06.2014	1,79,550
Less: Exchange value	<u>(1,75,000)</u>
Loss on exchange of machinery	<u>4,550</u>

(c)

Item of Fixed Assets	Amount (`)	Amount Debited to P&L in 2013- 14	Narration	Book Value as on 31.3.2014
Office Equipment				
Balance as on 1.4.13	1,20,000			
Less: Retired from use (Book value on 1.4.2013)	<u>20,000</u>			
	1,00,000			
Less: depreciation for 2013-14 @ 15% WDV	<u>15,000</u>	15,000	Depreciation	
Balance as on 31.3.2014	<u>85,000</u>			85,000
Office Equipment (Retired from use)				
Book Value as on 1.4.2013	20,000			
Less: Book Value as on 31.3.2014 (at NRV)	<u>2,000</u>			2,000
Loss on retirement charged to P&L	<u>18,000</u>	18,000	Loss on retirement of asset	
Office equipment having book value of ` 20,000 as on 1.4.2013 has been retired from use. It has been recorded at Net Realisable				

Value (NRV) as the NRV is lower than the book value.				
Plant and Machinery				
Book Value as on 1.4.2013	7,20,000			
Add: Machine purchased on 01.08.2013	<u>60,000</u>			
	<u>7,80,000</u>			
	<u>0</u>			
Less: Depreciation				
Original machine for whole year				
72,000				
New machine for 8 months		76,000	Depreciation	
<u>4,000</u>	<u>76,000</u>			
Balance as on 31.3.2014	<u>7,04,000</u>			7,04,000
	<u>0</u>			
The new machine has been recorded at the Fair Market Value of the securities issued as it is more clearly evident				
		<u>1,09,000</u>		<u>7,91,000</u>

(d)

		₹ (Crores)
	Cost of construction incurred upto 31.03.2014	120
Add:	Estimated future cost	<u>45</u>
	Total estimated cost of construction	<u>165</u>

	Degree of completion ($120/165 \times 100$)	72.73%
	Revenue recognized (72.73% of 150)	109 (approx)
	Total Foreseeable loss ($165 - 150$)	15
Less:	Loss for current year ($120 - 109$)	<u>11</u>
	Expense loss to be provided for	<u>4</u>

**2. Trading and Profit and Loss Account of Mr. Rajeev
for the year ended 31st December, 2014**

To Opening Stock		8,000	By Sales	74,400
To Purchases		45,600	By Closing stock	7,000
To Freight inwards		3,000		
To Gross profit c/d		<u>24,800</u>		
		<u>81,400</u>		<u>81,400</u>
To Sundry expenses (W.N.6)		14,200	By Gross profit b/d	24,800
To Discount allowed			By Discount received	800
–				
Debtors	1,500		By Miscellaneous income	500
Bills	<u>125</u>	1,625		

Receivable				
To Depreciation on furniture		650		
To Net Profit		<u>9,625</u>		<u> </u>
		<u>26,100</u>		<u>26,100</u>

Balance Sheet as on 31st December, 2014

<i>Liabilities</i>		<i>Amount</i>	<i>Assets</i>		<i>Amount</i>
Capital as on 1st January, 2014	18,800		Furniture	6,000	
Less: Drawings (W.N.5)	(8,000)		Additions during the year	1,000	
	10,800			7,000	
Add: Net Profit	9,625	20,425	Less : Depreciation	(650)	6,350
Sundry creditors		15,000	Closing Stock		7,000
Outstanding expenses		1,800	Sundry debtors		20,800
			Bills receivable		1,750
			Cash in hand and at bank		625
			Prepaid expenses		700

		37,225			37,225
					5

Working Notes:

(1) Capital on 1st January, 2014

Balance Sheet as on 1st January, 2014

<i>Liabilities</i>		<i>Assets</i>	
Capital (Balancing figure)	18,800	Furniture (w.d.v.)	6,000
Creditors	11,000	Stock at cost	8,000
Outstanding expenses	2,000	Debtors	16,000
		Cash in hand and at bank	1,200
		Prepaid expenses	600
	31,800		31,800

(2) Purchases made during the year

Creditors Account

To Cash and bank A/c	39,200	By Balance b/d	11,000
To Discount received A/c	800	By Debtors A/c	400
To Bills Receivable A/c	2,000	By Purchases A/c (Bal.fig.)	45,600
To Balance c/d	15,000		
	57,000		57,000

(3) Sales made during the year

Opening stock	8,000
Purchases	45,600
Freight inwards	3,000
	56,600
Less: Closing stock	(7,000)
Cost of goods sold	49,600
Add: Gross profit (@ 50% on cost)	24,800
	74,400

(4) Debtors on 31.12.2014

Debtors Account

To Balance b/d	16,000	By Cash and bank A/c	58,500
To Sales A/c	74,400	By Discount allowed A/c	1,500
To Creditors A/c (bill dishonoured)	400	By Bills receivable A/c	10,000
		By Balance c/d (Bal.fig.)	20,800
	90,800		90,800

(5) Additional drawings by Mr. Rajeev

Cash and Bank Account

To Balance b/d	1,200	By Freight inwards A/c	3,000
To Sundry debtors A/c	58,500	By Furniture A/c	1,000

To Bills Receivable A/c	6,125	By Expenses A/c	14,500
To Miscellaneous income A/c	500	By Creditors A/c	39,200
		By Drawings A/c (` 7,000+` 1,000)	8,000
		By Balance c/d	625
	66,325		66,325

(6) Amount of expenses debited to Profit and Loss A/c

Expenses Account

To Prepaid expenses A/c (on 1.1.2014)	600	By Outstanding expenses A/c (on 1.1.2014)	2,000
To Bank A/c	14,500	By Profit and Loss A/c (Balancing figure)	14,200
To Outstanding expenses A/c (on 31.12.2014)	1,800	By Prepaid expenses A/c (on 31.12.2014)	700
	16,900		16,900

(7) Bills Receivable on 31.12.2014

Bills Receivable Account

To Debtors A/c	10,000	By Creditors A/c	2,000

		By Bank A/c	6,125
		By Discount on bills receivable A/c	125
		By Balance c/d (Bal.fig.)	<u>1,750</u>
	<u>10,000</u>		<u>10,000</u>

3. (i) Calculation of equity shares to be issued to Neel Ltd. and Gagan Ltd.

<i>Profits of</i>	<i>Neel</i>	<i>Gagan</i>
I year	2,62,800	2,75,125
II year	<u>2,12,200</u>	<u>2,49,875</u>
Total	<u>4,75,000</u>	<u>5,25,000</u>

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profitability

	<i>Neel</i>	<i>Gagan</i>
24,000 x 475/1000	11,400 equity shares	
24,000 x 525/1000		12,600 equity shares

Calculation of 12% Preference shares to be issued to Neel Ltd. and Gagan Ltd.

	<i>Neel</i>	<i>Gagan</i>
Net assets (Refer working note)	8,40,000	9,24,000
8% return on Net assets	67,200	73,920
12% Preference shares to be issued	56,000	
$\frac{₹67,200 \times 100}{12} = ₹5,60,000 @ ₹10 \text{ each}$	shares	
$\frac{₹73,920 \times 100}{12} = ₹6,16,000 @ ₹10 \text{ each.}$		61,600
		shares

(ii) Total Purchase Consideration

	<i>Neel</i>	<i>Gagan</i>
Equity shares @ of ₹ 25 each	2,85,000	3,15,000
12% Preference shares @ of ₹ 10 each	<u>5,60,000</u>	<u>6,16,000</u>
Total	<u>8,45,000</u>	<u>9,31,000</u>

Working Note

Calculation of Net assets as on 31.3.2014

	<i>Neel</i>	<i>Gagan</i>
Plant and machinery	5,25,000	6,75,000

Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
Less: Current liabilities	<u>(6,23,500)</u>	<u>(5,57,600)</u>
	<u>8,40,000</u>	<u>9,24,000</u>

(b) Memorandum Trading A/c for the period from 1.10.14 to 1.12.14

To Opening stock $\left(59,400 \times \frac{100}{90} \right)$	66,000	By Sales	2,80,000
To Purchases (1,50,000 – 10,000)	1,40,000	By Closing stock (Bal. fig)	61,000
To Wages (66,000 – 1,000)	65,000		
To Gross profit (1/4 on sales)	<u>70,000</u>		<u> </u>
	<u>3,41,000</u>		<u>3,41,000</u>

Calculation of Insurance Claim

Stock on the date of fire 31.12.2014	61,000

Less: Stock salvaged	<u>(6,000)</u>
Stock destroyed by fire	<u>55,000</u>

Claim subject to average clause

$$= \left(\frac{50,000}{61,000} \right) \times 55,000 = ₹ 45,082$$

Net claim for loss of stock policy = ₹ 45,082

4. (a)

Revaluation Account

Date		Particulars		Date		Particulars	
2014				2014			
April	To	Plant & Machinery	12,000	April	By	Land and building	12,000
	To	Inventory of goods	4,000		By	Sundry creditors	4,000
	To	Provision for bad and doubtful debts	1,100		By	Cash & Bank - Joint life Policy surrendered	15,100
	To	Capital accounts (profit on revaluation transferred)					
		Mr. A (2/7)					
		4,000					
		Mr. B (3/7)					
		6,000					
		Mr. C (2/7)					
		<u>4,000</u>	<u>14,000</u>				
			<u>31,100</u>				<u>31,100</u>

(b)

Partners' Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
	(')	(')	(')		(')	(')	(')
To A's Capital A/c - goodwill	-	2,000	6,000	By Balance b/d	40,000	60,000	40,000
To Cash & bank A/c - (50% dues paid)	26,000	-	-	By Revaluation A/c	4,000	6,000	4,000
To A's Loan A/c - (50% transfer)	26,000	-	-	By B & C's Capital A/cs - goodwill	8,000	-	-
To Balance c/d	-	70,000	70,000	By Cash & bank A/c-amount brought in (Balancing figures)		6,000	32,000
	<u>52,000</u>	<u>72,000</u>	<u>76,000</u>		<u>52,000</u>	<u>72,000</u>	<u>76,000</u>
	0	0	0		0	0	0

(c)

Cash and Bank Account

T Balance b/d	14,000	By A's Capital A/c - 50% dues paid	26,000
o	0		0
T Revaluation A/c – surrender value of joint life policy	15,100	By Balance b/d	41,100
			0

T o	B's Capital A/c	6,000		
T o	C's Capital A/c	<u>32,00</u> <u>0</u>		<u>67,10</u> <u>0</u>
		<u>67,10</u> <u>0</u>		

(d) **Balance Sheet of M/s B & C as on
01.04.2014**

<i>Liabilities</i>			<i>Assets</i>		
Partners' Capital accounts			Land and Building	60,00 0	
Mr. B	70,00		Add:		
Mr. C	0	1,40,00	Appreciation	<u>12,00</u>	72,000
	<u>70,00</u> <u>0</u>	0	20%	<u>0</u>	
Mr. A's Loan			Plant & Machinery	40,00 0	
Account Sundry Creditors		26,000 16,000	Less:		
			Depreciation	<u>12,00</u>	28,000
			30%	<u>0</u>	
			Inventory of goods	24,00 0	
			Less: devalued	<u>4,000</u>	20,000
			Sundry Debtors	22,00 0	

		Less: Provision for bad debts 5%	<u>1,100</u>	20,900
		Cash & Bank balances		<u>41,100</u>
	<u>1,82,00</u>			<u>1,82,00</u>
	<u>0</u>			<u>0</u>

Working Notes:

Adjustment for Goodwill:	
Goodwill of the firm	<u>28,000</u>
Mr. A's Share (2/7)	8,000
Gaining ratio of B & C;	
B = $1/2 - 3/7 = 1/14$	
C = $1/2 - 2/7 = 3/14$	
B:C = 1:3	

Therefore, B will bear = $1/4 \times 8,000$ or ` 2,000

C will bear = $3/4 \times 8,000$ or ` 6,000

5. **Income and Expenditure Account** **for the year ended 31st March, 2014**

<i>Expenditure</i>		<i>Income</i>	
To Secretary's salary	12,000	By Subscription	17,100
To Salaries to staff	25,000	By Sale of old newspapers	2,500

To Charities	1,000	By Interest on securities	
		2,000	
To Printing and stationeries	600	Add: amount due	2,400
		<u>400</u>	
To Postage expenses	120	By Proceeds of sport and concerts	4,020
To Rates and taxes	1,500	By Advertisement in the year book	5,000
To Upkeep of land	2,000	By Deficit: Excess of	24,880
To Sports materials written off	10,000	expenditure over Income	
To Telephone expenses	3,480		
To Depreciation on furniture	<u>200</u>		<u> </u>
	<u>55,900</u>		<u>55,900</u>

Balance Sheet of Omega Recreation Club

as on 31st March, 2014

<i>Liabilities</i>			<i>Assets</i>		
Capital fund			Land		10,000
Opening balance	36,680		Furniture	2,000	

Less: Excess of expenditure over income	<u>24,880</u>		Less: Depreciation	<u>200</u>	1,800
				10,000	
	11,800		Sports materials		
			Less: written off	<u>10,000</u>	-
Add: Legacies	<u>4,000</u>	15,800	Investment in securities		20,000
Endowment fund		20,000			
Subscription received in advance		400	Subscriptions receivable		1,000
			Interest due		400
			Cash in hand and at bank		<u>3,000</u>
		<u>36,200</u>			<u>36,200</u>

Working Notes:

(1) Balance Sheet of Omega Recreation Club as on 31st March, 2013

<i>Liabilities</i>		<i>Assets</i>	
Capital fund (balancing figure)	36,680	Land	10,000
Subscriptions received in advance	500	Furniture	2,000

		Arrears of subscription	2,000
		Investments in securities	20,000
		Cash in hand and at bank	<u>3,180</u>
	<u>37,180</u>		<u>37,180</u>

(2) Subscription pertaining to the year ended 31st March, 2014:

Subscriptions received during the year	18,000
<i>Add:</i> Outstanding subscription on 31.3.2014	<u>1,000</u>
	19,000
<i>Add:</i> Received in advance as on 31.3.2013	<u>500</u>
	19,500
<i>Less:</i> Outstanding subscription as on 31.3.2013	<u>(2,000)</u>
	17,500
<i>Less:</i> Received in advance as on 31.3.2014	<u>(400)</u>
	<u>17,100</u>

6. (a) **Journal Entries in the Books of ABC Ltd.**

<i>Particulars</i>			
8% Preference share capital A/c	Dr.	6,00,000	
To Preference shareholders A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital]			
Preference shareholders A/c	Dr.	4,20,000	
To 11% Debentures A/c			4,20,000
[Being the issue of debentures to preference shareholders]			
9% Debentures A/c	Dr.	12,00,000	
To Debenture holders A/c			12,00,000
[Being transfer of 9% debentures to debenture holders A/c]			
Debenture holders A/c	Dr.	12,00,000	
To Plant & machinery A/c			9,00,000
To Capital reduction A/c			3,00,000
[Settlement of debenture holders by allotment of plant & machinery]			

Trade payables A/c	Dr.	5,92,000	
To Inventory A/c			5,00,000
To Capital reduction A/c			92,000
[Being settlement of creditors by giving stocks]			
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c			3,00,000
[Being fresh issue of debentures]			
Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c			1,50,000
[Being settlement of bank overdraft]			
Capital reduction A/c	Dr.	5,72,000	
To Investment A/c			13,000
To Profit and loss A/c			4,05,000
To Capital reserve A/c			1,54,000
[Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]			

**(b) B in Account Current with A
for the period ending on 30th June, 2012**

Date	Particulars	Amount	Days	Products	Date	Particulars	Amount	Days	Products
2012		₹			2012		₹		
Jan.1	To Balance b/d	600	182	1,09,200	Jan.18	By Sales Returns	125	164	20,500
Jan. 11	To Sales A/c	520	171	88,920	Feb. 11	By Bank A/c	400	140	56,000
Apr 29	To Sales A/c	615	62	38,130	Feb. 14	By B/R A/c (due date: March 17)	300	105	31,500
June 30	To Interest A/c	15.75			May 15	By Cash A/c	700	46	32,200
					June 30	By Balance of products			96,050
						By Balance c/d	225.75		
		1,750.75		2,36,250			1,750.75		2,36,250

Calculation of interest:

$$\text{Interest} = \frac{96,050}{366} \times \frac{6}{100} = ₹ 15.75$$

7. (a) The proposals will be evaluated and vendor will be selected considering the following criteria:
1. Quantum of services provided and whether the same matches with the requirements of the Hospital.
 2. Reputation and background of the vendor.
 3. Comparative costs of the various propositions.
 4. Organizational set up of the vendor particularly technical staffing to obtain services without inordinate delay.

5. Assurance of quality, confidentiality and secrecy.
6. Data storage and processing facilities.

(b) (i) Loans and advances given and interest earned

- | | | |
|-----|--------------|---------------------|
| (1) | to suppliers | operating Cash flow |
| (2) | to employees | operating |
| | Cash flow | |

(ii) Investment made in subsidiary company and dividend received

Investing Cash flow

(iii) Dividend paid for the year

Financing Cash Outflow

(iv) TDS on interest income earned on investments made

Investing Cash Outflow

(v) TDS on interest earned on advance given to suppliers

Operating Cash Outflow

(vi) Insurance claim received of amount loss of fixed asset by fire

Extraordinary item to be shown under a separate heading as 'Cash inflow from operating activities'.

(c) Capital Redemption Reserve A/c	Dr.	30,000
Securities Premium A/c	Dr.	40,000
Capital Reserve (Realized in cash)	Dr.	40,000
General Reserve A/c	Dr.	40,000
To Bonus to Shareholders		1,50,000
(Being issue of bonus shares by utilization of various Reserves, as per resolution dated)		
Bonus to Shareholders A/c	Dr.	1,50,000

To Equity Share Capital	1,50,000
(Being Capitalization of Profit)	

(d) As per AS 9, 'Revenue Recognition', revenue from sale of goods should be recognised when:

- (i) the seller has transferred the property in the goods to the buyer for a consideration and the transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer and the seller retains no effective control of the goods transferred; and
- (ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the present case, the goods, as well as the risks and rewards of ownership have been transferred to the Steel plants. Since, the invoice raised by Abhishek Ltd. is for the full price (though it receives only 90% of the invoice value in the year of sale and 10% is kept as 'Retention Money'), Abhishek Ltd. should recognise revenue at the full invoice price, i.e., 100% of the sales price. The company should make a separate provision for the balance 10% amount to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

Therefore, the practice adopted of recognising only 90% of sales price as revenue by Abhishek Ltd. is not in consonance with AS 9.

(e) Calculation of net profit u/s 198 of the Companies Act, 2013

Balance from Trading A/c	40,25,365
Add: Subsidies received from Government	<u>2,73,925</u>
	42,99,290
Less: Administrative, selling and distribution expenses	8,22,542

Director's fees	1,34,780	
Interest on debentures	31,240	
Depreciation on fixed assets as per Schedule II		<u>5,75,345</u>
Profit u/s 198		<u>27,35,383</u>

Maximum Managerial remuneration under Companies Act, 2013 =
 11% of
 $\frac{11}{100} \times 27,35,383 = ₹ 3,00,892$

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – I

PAPER – 2 : BUSINESS LAWS, ETHICS AND COMMUNICATION

SUGGESTED ANSWERS/HINTS

1. (a) According to section 74 of the Indian contract Act, 1872, “where a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach, can claim whether or not actual damages or loss is proved to have been caused thereby, from the other party, a reasonable compensation not exceeding the amount so named, or as the case may be the penalty stipulated for.

In the given case, Mr. Anand contracts with Mr. Birendra that, if he practices as a surgeon within Calcutta, he will pay Birendra Rs. 5000. Anand starts practising as a surgeon in Calcutta. According to the provisions, party complaining of the breach, can claim whether or not actual damages or loss is proved to have been

caused thereby, from the other party, a reasonable compensation not exceeding the amount so named in the contract.

Accordingly, Birendra is entitled to such compensation, not exceeding Rs. 5,000 as the courts considers reasonable.

- (b)** Under section 102 (2) (b) in the case of any meeting other than an AGM, all business transacted thereat shall be deemed to be special business.

Further under section 102 (1) a statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting:

- (i) the nature of concern or interest, financial or otherwise, if any, in respect of each items, of every director and the manager, if any or every other key managerial personnel and relatives of such persons; and
- (ii) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Thus, the objection of the member is valid since the complete details about the issue of sweat equity should be sent with the notice. The notice is, therefore, not a valid notice under Section 102 of the Companies Act, 2013.

- (c)** Corporate Social Responsibilities (CSR) is an integrated combination of policies, programs, education, and practices which extend throughout a corporation's operations and into the communities in which they operate, about how companies voluntarily manage the business processes to produce an overall positive impact on society. CSR can mean different things to different people:

- for an employee it can mean fair wages, no discrimination, acceptable working conditions etc.

- for a shareholder it can mean making responsible and transparent decisions regarding the use of capital.
- for suppliers it can mean receiving payment on time.
- for customers it can mean delivery on time, etc.
- for local communities and authorities it can mean taking measures to protect the environment from pollution.
- for non-governmental organisations and pressure groups it can mean disclosing business practices and performance on issues ranging from energy conservation and global warming to human rights and animal rights, from protection of the rainforests and endangered species to child and forced labour, etc.

For a company, however, it can simply be seen as responding to the needs and concerns of people who can influence the success of the company and/or whom the company can impact through its business activities, processes and products.

(d) Various forms of formal communication- Formal Communication in the working environment can be in any of the following forms-

- (i) Downward communication- A communication from superior to subordinate
- (ii) Upward Communication- A communication from subordinate to superior
- (iii) Horizontal /Lateral communication- A communication between co-worker with different areas of responsibility

Potential Benefits- (i) Downward communication may lead to prevention or correction of employee errors, greater job satisfaction and improved morale.

- (ii) Upward communication may preclude new problems and provide solution of old ones and increased acceptance of

management decisions.

- (iii) Horizontal/Lateral communication may increase co-operation among employees with different duties and enhancing the greater understanding of the organization's mission.

2. (a) (i) (1) **Incorrect.** There are following two conditions under which, this Act will be applied on the public sector establishments(PSEs)-

- If in any accounting year an establishment in public sector sells any goods produced or manufactured by it or renders any services ,in competition with an establishment in private sector, and
- The income from such sale or services or both is not less than twenty percent of the gross income of the establishment in public sector for that year,

then, the provisions of this Act shall apply in relation to such establishment in public sector as they apply in relation to a like establishment in private sector[Sub-section(1)].

Save as otherwise provided in Sub-section (1), nothing in this Act shall apply to the employees employed by any establishment in the public sector [Sub-section (2)].

(2) **Incorrect.** As per section 18 of the Payment of Bonus Act, 1965, where in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, then the employer can lawfully deduct the amount of loss from the amount of bonus payable by him to the employee in respect of that accounting year only in order to compensate lose. In this case, the employee shall get the balance, if there be any, but not completely denied from getting the bonus.

(ii) **Nominations for gratuity:** Normally, the gratuity is paid to the employee by his employer, where his services are terminated due to any reason in his lifetime, but after the death of the said employee, the earned gratuity is to be paid to his successors and to avoid any type of complications and controversies, the provision of the nomination by the employee to get the gratuity, in case of his death is made. The provisions are as below:

(1) Nomination in favour of one or more family members:

If an employee has a family at the time of making nomination, the nomination shall be made in favour of one or more members of his family, and any nomination made by such employee in favour of a person who is not a member of his family shall be void.

(2) Nomination by the employee having no family but subsequently acquiring family:

If at the time of making a nomination the employee has no family, the nomination may be made in favour of any person or persons but if the employee subsequently acquires a family, such nomination shall forthwith become invalid and the employee shall make, within such time as may be prescribed, a fresh nomination in favour of one or more members of his family.

(3) In the case of death of nominee:

If a nominee predeceases the employee, the interest of the nominee shall revert to the employee who shall make a fresh nomination, in the prescribed form, in respect of such interest.

(4) Modification in nomination by the employee:

A nomination may, subject to the provisions of Sub-Sections (3) and (4) be modified by an employee at any time, after giving to his employer a written notice in such form and in

such a manner as may be prescribed, of his intention to do so.

(b) Importance of ethical behaviours at work place: An organization, whether a business or a government agency, is first and foremost a human society. If an employer does not take steps to create a work environment where the employees have a clear, common understanding of what is right and wrong, and feel free to discuss and ask questions about ethical issues and report violations, significant problems could arise, including:

Increased risk of employees making unethical decisions

Increased tendency of employees to report violations to outside regulatory authorities (whistle blowing) because they lack an adequate internal forum

Inability to recruit and retain top people

Diminished reputation in the industry and the community

Significant legal exposure and loss of competitive advantage in the marketplace.

(c) Kinesics or Body language: It must be noted, though it is known to almost all, that all our bodily movements, gestures, postures etc., are guided by our feelings and thought processes. The nodding of our head, blinking of our eyes, waving of our hands, shrugging of our shoulders etc., are expressions of our thought and feelings. All these movements are the signals that our body sends out to communicate. That is why this area of study has been called 'body language'. Just as language uses sets of symbols to convey meaning, our body, consciously as well as unconsciously, conveys messages, attitudes, moods, status relationships etc. Nervousness, anger, fear, scorn, determination, horror, sympathy, pity, lack of understanding, disinterestedness, resentment can be much better expressed through the body language than through words.

3. (a) (i) Section 40 of the Negotiable Instruments Act, 1881 deals with the discharge of endorser's liability. According to the law, where the holder of a negotiable instrument, without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity.

As per the given facts, the bill A puts in suit against E, strikes out an endorsement made by C & D, without the E consent.

According to the said provision, the holder, A of a negotiable instrument, without the consent of the endorser E, destroys or impairs the endorser's remedy against a prior parties (i.e., C & D), the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity.

Since, an endorser (E) is discharged from liability to the holder (A), therefore, A is not entitled to recover anything from Endorser E.

(ii) (1) **Incorrect.** As per section 85(1) of the NI Act, banker shall be liable to bear the loss. If a cheque is forged and the banker makes a payment on the cheque, he cannot debit the account of his customer.

(2) **Incorrect.** As per the provision of the Negotiable Instruments Act, 1881 this is not a material alteration as a promissory note in which no date of payment is specified will be treated as payable on demand. Hence adding the words "on demand" does not alter the business effect of the instrument.

- (b) (1) **Incorrect.** Environmental consideration have become a part of corporate strategy, which means incorporating environmental issues in the process of developing a product, in new investments and in the organisational set up. A good environmental practice improves corporate performance. In many industries it has been found that environmental friendly practices have resulted in more

saving; for example the process of recycling the waste. Thus environmental considerations play a key role in corporate strategy. Markets of new millennium will be able to create wealth if they respond to the challenges of sustainable development, as unsustainable products will become obsolete.

(2) **Correct:** The success of the business depends very much on fairness and honesty in the business. Fairness and honesty are at the heart of the business ethics and relate to the general values of decision makers. At a minimum, business professionals and persons are expected to follow all applicable laws and regulation. Even then, they are expected not to harm customers, employees, clients or competitors knowingly through deception, misrepresentation, coercion or discrimination. The fairness and honesty pay in the long run; they secure the stability of the business and overall reputation in the business world. Therefore we may say that fairness and honesty are the pillars of success in the business.

(c) **Developing Critical thinking:** To develop critical thinking, following factors may be taken into consideration-

1. **Open-minded:** Readiness to accept and explore alternative approaches and ideas.
2. **Well informed:** Knowledge of the facts and what is happening on all fronts.
3. **Experimental:** Thinking through 'what if' scenarios to create probable options and then test the theories to determine what will work and what will not be acceptable.
4. **Contextual:** Keeping in mind the appropriate context in the course of analyses. Apply factors of analysis that are relevant or appropriate.
5. **Reserved in making conclusion:** Knowledge of when, a conclusion is a 'fact' and when it is not only true conclusions

support decisions.

4. (a) Company for charitable purposes (Section 8 of the Companies Act, 2013): According to Section 8 of the Companies Act, 2013 the procedure to be followed to give effect to the said proposal is as follows:

1. Mr. Vihan, and the six other persons with him should first prepare and sign the MOA and AOA .
2. The company may either be limited by shares or by guarantee and must be mentioned in the Memorandum of Association(MOA).
3. The object of the proposed company must be for promoting commerce, arts, science, sports, education, research, social welfare religion, charity protection of environment or any such other useful object.
4. The Articles of Association(AOA) will include a clause prohibiting the distribution of dividend.
5. All the profits of the company should be applied on the promotion of its objects as mentioned above and incorporated in the MOA and the AOA.
6. The association of persons (Mr. Vihan and his friends) should apply to the Central Government seeking a license for the formation of the proposed company.
7. The Central Government will on being satisfied of the facts of the case, issue a license to the Association of Persons(AOP) and may impose any conditions which it deems fit.
8. On receipt of the license from the Central Government, the Association of Persons (AOP) shall apply to the Registrar in the prescribed form with the required documents for registration of the company.
9. The registration process of the company with the Registrar of

companies will start with the approval of the name of the proposed company for which three options will be submitted to the Registrar in the prescribed format with the prescribe fee.

10. The Registrar will provide the names available and one will be finally chosen by the promoters for use.
 11. After getting the name from the ROC, the draft MOA and AOA must be got approved by Regional Director who has been delegated the powers by the Central Government.
 12. Three copies of a approved MOA and AOA along with the registration and filing fee, documents like form 1, 18, 32 and consent etc. must be submitted.
 13. A power of attorney in favour of Practicing CA/CS/CMA or an advocate for presentation before ROC to make corrections and collect incorporation certificate must also be filed on non judicial stamp paper.
 14. The company becomes operative on receipt of the certificate of incorporation.
- (b) (1) **Incorrect:** The consumer does not purchase goods and health services for personal purposes only, because on certain occasions various items are purchased for public welfare and development of the society as a whole. Further, under the Competition Act, 2002, a consumer is also one who may purchase goods for commercial purposes also.
- (2) **Correct:** The Competition Act, 2002 intends to protect the interests of consumers by establishing a commission to prevent practices having adverse effect on competition and to promote and sustain competition in markets. The commission is empowered to prohibit certain agreements which are considered as anti-competitive in nature, abuse of dominant position and regulation of combinations likely to cause appreciable adverse effect on competition.

- (c) When two or more persons meet together and talk/ discuss on any business or non business matter, it is known as negotiation. When same persons discuss specific proposals in order to come to a mutually accepted solutions; whether it is with an employer, family member or business partner. It can be said that negotiation is a common way of settling things in business.

Steps in the negotiation process

1. Preparing
2. Arguing
3. Signaling
4. Packaging
5. Bargaining
6. Closing and arguing

5. (a) **Anticipatory breach of contract:** Anticipatory breach of contract occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived. In such a situation the promisee can claim compensation by way of loss or damage caused to him by the refusal of the promisor. For this, the promisee need not wait till the time stipulated in the contract for fulfillment of the promise by the promisor is over.

In the given problem Rubby Textiles has indicated its unwillingness to supply the cotton shirts on 1st November 2014 itself when it has time upto 31st December 2014 for performance of the contract of supply of goods. It is therefore called anticipatory breach of contract. Thus Retail Garments show room can claim damages from Rubby Textiles immediately after 1st November, 2014, without waiting upto 31st December 2014. The damages will be calculated at the rate of ` 50 per shirt i.e. the difference between ` 350/- (the price

prevailing on
1st November) and ` 300/- the contracted price.

- (b) Under section 62 (1) (c) of the Companies Act, 2013 where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, either for cash or for a consideration other than cash, such shares may be offered to any persons, if it is authorised by a special resolution and if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

In the present case, Mars India Ltd is empowered to allot the shares to Sunil in settlement of its debt to him. The issue will be classified as issue for consideration other than cash must be approved by the members by a special resolution. Further, the valuation of the shares must be done by a registered valuer.

- (c) Specimen of press release announcing a new business location
------(Name and
address of company)

- To serve you better with even more space, we are moving to a new facility on vikas marg, just near to V3S Mall, Delhi.
- To celebrate the expansion, we are offering up to 75 percent off our regular prices during the week of Feb 22-28, 2015.
- For preferred customers like you, we are holding a presale on Feb 13, 2015.
- Come and get the best buys while they last.

6. (a) (I) (i) **Incorrect:** OPC and Private Ltd Company is not a synonymous though OPC is a form of private ltd. company with certain differences. According to section 3(1)(c) of the Companies Act, 2013, OPC is a private limited company with the minimum paid up share capital of Rs. 1 lakh and has at least one member. Here

the member can be the sole member and director. Whereas Private Ltd company constitutes of 2 or more persons with minimum paid up share capital of Rs 1 lakh or such higher paid up share capital as may be prescribed under the articles.

- (ii) **Correct:** Implied contracts are those contracts where the offer and acceptance thereof, of the parties thereto is not expressly made with the two parties but are made by the conduct and behaviour of the parties. In the present case, when the ATM is installed by a bank, it is construed as an offer to its customers to use its services. This is an implied offer where the bank does not make offer to its customers individually with each one of them. Similarly, when a person withdraws cash from the ATM machine, he by his conduct accepts the offer of the bank thereby completing the agreement and since this agreement is legally enforceable in terms of section 10 of the Indian Contract Act, 1872 it results in a legal contract which is implied in nature.

(II) (i) A person representing three member companies will be counted as 3 in the computation of the quorum. There is no restriction on a member company in appointing a person as a representative who has already been nominated to represent another company member. Each company will be treated as personally present even if the representative is the same person.

- (ii) For the purpose of quorum, joint shareholders will be collectively regarded as one shareholder.

- (iii) The single member present at the meeting will be counted as one in the computation of the quorum.

- (b) The Competition Act, 2002 intends to protect the interests of consumers by establishing a commission to prevent practices

having adverse effect on competition and to promote and sustain competition in markets. The commission is empowered to prohibit certain agreements which are considered as anti-competitive in nature, abuse of dominant position and regulation of combinations likely to cause appreciable adverse effect on competition.

(c) This AGREEMENT OF PARTNERSHIP is made in city ofon day of20.....betweenof(hereinafter called the FIRST PARTY) and of (hereinafter called the SECOND PARTY) on the terms and conditions set forth herein;

The parties aforementioned mutually agree:

1. That the name of the partnership shall be
2. The partnership shall commence on theday of20.....for the.....purpose of carrying on the business of
3. The partnership shall continue foryears unless determined earlier by notice in writing.
4. The capital of the partnership shall be ` which shall be contributed in equal shares by the parties.
5. The share of the parties in profits and losses shall be equal.
6. Proper and regular account of the affairs and transactions of the partnership shall be maintained and kept at the principal place of business of the partnership.
7. Death of a partner shall not operate as dissolution of the partnership.
8. Any dispute arising out of this partnership shall be referred for adjudication to the arbitration of the President of the Bar Association whose decision shall be final and binding on all parties.

In witness whereof the parties of aforementioned have signed this deed of partnership.

WITNESS

Signature

1., 2.....

(Parties)

7. (a) Amendments have been made to the Employees' Deposit Linked Insurance Scheme from time to time, in order to ensure increasing support to millions of workmen covered under the Insurance Schemes.

The latest amendment has been introduced vide Notification issued by the Ministry of Labour and Employment, Government of India. This amendment has made a huge change and incorporates the following benefits.

According to the Notification No. G.S.R. 610(E), dated 22nd August, 2014, as per the Employees' Deposit Linked Insurance (Amendment) Scheme, 2014, wage limit upto which contribution can be paid under the scheme has been revised from rupees six thousand five hundred to rupees fifteen thousand. And the insurance benefit under the EDLI scheme has been increased by 20% in addition to the existing admissible benefits.

- (b) Some of the advantages of E filing under MCA 21 are:

1. Expeditious incorporation of companies;
2. Simplified and ease of convenience in filing of Forms/ Returns ;
3. Better compliance management
4. Total transparency through e-Governance
5. Customer centric approach
6. Increased usage of professional certificate for ensuring authenticity and reliability of the Forms / Returns

7. Building up a centralised database repository of corporate operating
 8. Enhanced service level fulfillment
 9. Inspection of public documents of companies anytime from anywhere
 10. Registration as well as verification of charges anytime from anywhere
 11. Timely redressal of investor grievances
 12. Availability of more time for MCA employees for monitoring and supervision
- (c) Under Section 118 (5) of the Companies Act, 2013 there shall not be included in the Minutes of a meeting, any matter which, in the opinion of the Chairman of the meeting:
- (i) is or could reasonably be regarded as defamatory of any person;
 - (ii) is irrelevant or immaterial to the proceeding; or
 - (iii) is detrimental to the interests of the company;

Further under section 118 (6) the chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the Minutes on the grounds specified in sub-section (5) above.

Hence, in view of the above, the Chairman has absolute discretion on the inclusion or exclusion of any matter in the minutes for aforesaid reasons.

- (d) **The principle of Integrity:** The dictionary meaning of integrity is veracity. Accordingly, the principle calls upon all accounting and finance professionals to adhere to honesty and straight forwardness while discharging their respective professional duties.

In addition the following acts of responsibility would help to comply with the Integrity principle,

- ◆ Avoid being involved in activities which would impair the goodwill of the organisation
- ◆ Communicate adverse as well as favourable information with those concerned
- ◆ Refuse any gift or favour which could influence actions taken or to be taken
- ◆ Refuse to get involved in any activity which would adversely affect the achievement of an organisations objective.
- ◆ Avoid conflicts and advise related parties on apparent conflicts which could arise in the future.

(e) THIS DEED OF LEASE of land made on.....day of.....betweens/o.....r/o.....(hereinafter called the 'lessor') ands/o..... r/o..... (hereinafter called the 'lessee')

Whereas both the lessor and the lessee agree to the following terms and conditions:

1. That the lessor agrees to lease out the land numbering located inin the District of.....to the lessee with effect from.....for a period of years on payment of monthly rent..... of `.....payable on the fifth day of each month in advance.
2. That the lessee agrees to take the aforesaid piece of land on lease. He shall pay the rent hereby reserved in the manner hereinbefore stated.
3. That the responsibility to pay all rates, taxes and charges which are payable or may so become at a future date in respect with the leased land, shall rest upon the lessor.
4. That the lessee shall deliver the peaceful vacant possession of the leased land to the lessor at the termination of the period of lease.

5. Lessee intending to vacate the leased land at an early date, shall give notice of his intention to the lessor to vacate the leased land at the expiry of the period stated in the notice.
6. Default in payment of rent for four consecutive months shall entitle the lessor to enter upon the said land and determine the lease.

IN WITNESS WHEREOF, the lessor and the lessee have signed this deed on the day and year above stated.

Witness.....

Lessor.....

Witness.....

Lessee.....

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – I

PAPER – 3: COST ACCOUNTING AND FINANCIAL MANAGEMENT

Suggested Answers/ Hints

1. (a) Store Ledger of Aditya Ltd. (Weighted Average Method)

Date	Receipts			Issues			Balance of Stock		
Feb.	Qty (kg.)	Rate (Rs.)	Amount (Rs.)	Qty (kg.)	Rate (Rs.)	Amount (Rs.)	Qty (kg.)	Rate (Rs.)	Amount (Rs.)
1	-	-	-	-	-	-	1,200	475.00	5,70,000
5	-	-	-	975	475.00	4,63,125	225	475.00	1,06,875
6	3,500	460.00	16,10,000	-	-	-	3,725	460.91	17,16,875
7	-	-	-	2,400	460.91	11,06,175	1,325	460.91	6,10,700

9	475	460.91	2,18,932	-	-	-	1,800	460.91	8,29,632
15	1,800	480.00	8,64,000	-	-	-	3,600	470.45	16,93,632
17	-	-	-	140	480.00	67,200	3,460	470.07	16,26,432
20	-	-	-	1,900	470.07	8,93,133	1,560	470.06	7,33,299
28	-	-	-	180*	470.06	84,611	1,380	470.06	6,48,688

* 180 kgs. is abnormal loss shown as issue and it will be transferred to Costing Profit & Loss A/c.

(b) Calculation of Profit made in the month of August 2014 by selling 14,000 units.

	Amount per unit (Rs.)	Amount (Rs.)
Sales Revenue	<u>18.00</u>	<u>2,52,000</u>
Less: Variable Costs:		
- Direct Material	8.00	1,12,000
- Direct Labour	3.50	49,000
- Variable Overhead	<u>2.50</u>	<u>35,000</u>
Contribution	4.00	56,000
Less: Fixed Overhead	<u>2.00</u>	<u>28,000</u>
Profit	2.00	28,000

(i) To maintain the same amount of profit i.e. Rs. 28,000 in September 2014 also, the company needs to maintain a contribution of Rs. 56,000.

Let, number of units to be sold in September 2014 is 'x', then the contribution will be

$$\text{Rs. } 18x - [(\text{Rs. } 8 \times 1.10) + \text{Rs. } 3.5 + (\text{Rs. } 2.5 \times 1.05)]x = \text{Rs. } 56,000$$

$$\text{Rs. } 18x - (\text{Rs. } 8.8 + \text{Rs. } 3.5 + \text{Rs. } 2.625)x = \text{Rs. } 56,000$$

$$\text{Or, } x = \frac{\text{Rs. } 56,000}{\text{Rs. } 3.075} = 18,211.38 \text{ units or}$$

18,212 units.

(ii) Margin of Safety

	August 2014	September 2014
Profit	Rs. 28,000	Rs. 28,000
P/V Ratio	$\frac{\text{Rs.4}}{\text{Rs.18}} \times 100$	$\frac{\text{Rs.3.075}}{\text{Rs.18}} \times 100$
Margin of Safety $\left(\frac{\text{Profit}}{\text{P / V Ratio}} \times 100 \right)$	Rs.1,26,000 $\left(\frac{28,000}{400} \times 18 \times 100 \right)$	Rs.1,63,902.44 $\left(\frac{28,000}{307.5} \times 18 \times 100 \right)$

(c) Calculation of Receivable Collection Period

$$\text{Receivable s collection period} = \frac{\text{Average receivable s}}{\text{Credit sales per day}}$$

$$\text{Receivable s collection period} = \frac{\text{Rs. 30,00,000}}{\text{Rs. 4,00,00,000} / 365 \text{ days}}$$

$$= 27 \text{ days}$$

(d) Calculation of Effective Annual Interest Rate

Effective Interest Rate (EAR) is calculated as follows:

$$\text{EAR} = \left(1 + \frac{r}{m} \right)^m - 1$$

$$\text{EAR} = \left(1 + \frac{0.16}{4} \right)^4 - 1$$

$$= 1.1699 - 1 = 0.1699 = 16.99\%.$$

2. (a) Working Notes:

$$(a) \text{ Standard input} = \frac{\text{Actual output}}{90\%} = \frac{2,250 \text{ kg.}}{90\%} = 2,500 \text{ kg.}$$

$$\text{Standard input of material- A} \quad 2,500 \text{ kg.} \times 40\% \\ = 1,000 \text{ kg.}$$

$$\text{Standard input of material- B} \quad 2,500 \text{ kg.} \times 60\% \\ = 1,500 \text{ kg.}$$

$$(b) \text{ Actual input} = (\text{Opening Stock} + \text{Purchases} - \text{Closing Stock}) \\ \text{Actual input of material- A} \quad (40 \text{ kg.} + 800 \text{ kg.} - 20 \text{ kg.}) = 820 \text{ kg.}$$

$$\text{Actual input of material- B} \quad (50 \text{ kg.} + 1,800 \text{ kg.} - 15 \text{ kg.}) \\ = \underline{1,835 \text{ kg.}}$$

$$\text{Total actual input} \\ \underline{2,655 \text{ kg.}}$$

(c) Standard Cost

$$\text{Material- A} \quad 1000 \text{ kg.} @ \text{ Rs. 5.00 per kg} \\ = \text{Rs. 5,000}$$

$$\text{Material- B} \quad 1500 \text{ kg.} @ \text{ Rs. 4.00 per kg} \\ = \underline{\text{Rs. 6,000}}$$

$$\underline{\text{Rs. 11,000}}$$

(d) Actual Cost

$$\text{Material- A} \quad 40 \text{ kg.} @ \text{ Rs. 5.00 per kg} = \text{Rs. 200}$$

$$780 \text{ kg.} @ \text{ Rs. 6.00 per kg} = \underline{\text{Rs. 4,680}} = \text{Rs. 4,880}$$

$$\text{Material- B} \quad 50 \text{ kg.} @ \text{ Rs. 4.00 per kg} = \text{Rs. 200}$$

$$1,785 \text{ kg.} @ \text{ Rs. 4.20 per kg} = \underline{\text{Rs. 7,497}} = \underline{\text{Rs. 7,697}}$$

$$\underline{\text{Rs. 12,577}}$$

(i) Material Price Variance = Actual Quantity (Std. Rate – Actual Rate)

$$\begin{aligned}
 \text{Material- A} &= 40 \text{ kg (Rs. 5.00 - Rs. 5.00)} &= \\
 &&&\text{Nil} \\
 &780 \text{ kg (Rs. 5.00 - Rs. 6.00)} &= \text{Rs. 780 (A)} \\
 \text{Material- B} &= 50 \text{ kg. (Rs. 4.00 - Rs. 4.00)} &= \\
 &&&\text{Nil} \\
 &1785 \text{ kg (Rs. 4.00 - Rs. 4.20)} &= \text{Rs. 357 (A)} \\
 &&&\underline{\text{Rs. 1,137 (A)}}
 \end{aligned}$$

(ii) Material Usage Variance = Std. Rate (Standard Quantity – Actual Quantity)

$$\begin{aligned}
 \text{Material- A} &= \text{Rs. 5.00 (1,000 kg. – 820 kg)} &= \\
 &&&\text{Rs. 900 (F)} \\
 \text{Material- B} &= \text{Rs. 4.00 (1,500 kg. – 1835 kg.)} &= \\
 &&&\underline{\text{Rs. 1,340 (A)}} \\
 &&&\underline{\text{Rs. 440 (A)}}
 \end{aligned}$$

(iii) Material Yield Variance = Std. Rate (Std. Quantity – Revised Std. Quantity)

$$\begin{aligned}
 \text{Material- A} &= \text{Rs. 5.00 (1,000 kg. – 2,655 x 40\%)} \\
 &= \text{Rs. 5.00 (1,000 kg. – 1,062 kg.)} \\
 &= \text{Rs. 310 (A)} \\
 \text{Material- B} &= \text{Rs. 4.00 (1,500 kg – 2,655 x 60\%)} \\
 &= \text{Rs. 4.00 (1,500 kg. – 1,593 kg.)} \\
 &= \underline{\text{Rs. 372 (A)}}
 \end{aligned}$$

Rs. 682 (A)

(iv) Material Mix Variance = Std. Rate (Revised Std.
Quantity – Actual

Quantity)

Material- A= Rs. 5.00 (2,655 x 40% - 820 kg.)

= Rs. 5.00 (1,062 kg. – 820 kg) = Rs. 1,210

(F)

Material- B= Rs. 4.00 (2,655 x 60% - 1,835 kg.)

= Rs. 4.00 (1,593 kg. – 1,835 kg.) = Rs. 968 (A)

Rs. 242 (F)

(v) Material Cost Variance = Std. Cost – Actual cost
= Rs. 11,000 - Rs. 12,577 = Rs.

1,577 (A)

2. (i) Cover for Preference and Equity Dividends

Profit after tax

Preference dividend + Equity dividend

$\frac{15,00,000}{5,00,000 + 7,00,000} = 1.25$

(ii) Earnings per share

Net profit after preference dividend

Number of equity shares

$\frac{10,00,000}{70,000} = \text{Rs } 14.29$

(iii) Price Earnings Ratio

Market price per share

Earning per share

$$\frac{200}{14.29} = 14 \text{ times}$$

(iv) Net Funds Flow

	<i>Rs.</i>
Profit after tax	15,00,000
Add : Depreciation	<u>6,00,000</u>
Net Funds Flow	<u>21,00,000</u>

3. (a) Schedule of costs

	Amount (Rs.)	Amount (Rs.)
Cost incurred: Opening balance		8,00,000
During the year Material consumed:		
Opening Stock	80,000	
Add: Material delivered during the year	<u>15,90,00</u>	
	<u>0</u>	
	16,70,00	
	<u>0</u>	
Less: Closing stock	<u>40,000</u>	16,30,000
Wages		14,95,000
Hire of plant		2,86,000
Other expenses		2,30,000
Material discrepancy (Actual)		15,000
General overheads 5% of Rs. 57,20,000	2,86,000	
Less: Absorbed at the beginning of the year	<u>35,000</u>	<u>2,51,000</u>
		47,07,000

Estimated further cost to complete	<u>5,72,000</u>
Estimated Total Cost	52,79,000
Contract Price	<u>65,00,000</u>
Estimated Total Profit	12,21,000

(i) Profit to be transferred to Profit and loss account:

$$\text{Estimated Profit} \times \frac{\text{Value of work certified}}{\text{Contract price}} \times \frac{12 \text{ months}}{15 \text{ months}}$$

$$= \text{Rs. } 12,21,000 \times \frac{57,20,000}{65,00,000} \times \frac{12}{15} = \text{Rs. } 8,59,584$$

(ii) If contract price was Rs. 80 lakhs and if no estimate has been made of costs to completion.

Value of work certified at the end of year = Rs. 57,20,000 i.e. 71.5% of contract value. In such a case notional profit has to be calculated instead of estimated profit.

Value of work certified Rs.
57,20,000

Add: Cost of work not certified Rs.
1,20,000

58,40,000

Less: Cost of work upto the end of year
47,07,000

Notional Profit Rs.
11,33,000

Recommendation in (i) above would be affected as follows:

Profit to be credited to Profit and loss A/c. for the year just ended.

$$\frac{2}{3} \times \text{Notional profit} \times \frac{12 \text{ months}}{15 \text{ months}}$$

$$\frac{2}{3} \times \text{Rs. } 11,33,000 \times \frac{12}{15} = \text{Rs. } 6,04,267$$

[It has been assumed that cash received is equals to value of work certified]

(b) Funds Flow Statement for the year ended 31st July, 2014

		(Rs.)
Sources		
Working capital from operations	1,71,000	
Sale of fixed asset	4,000	
Sale of investments	45,000	
Share capital issued	<u>50,000</u>	
Total Funds Provided		<u>2,70,000</u>
Uses		
Purchase of fixed assets	1,20,000	
Purchase of investments	40,000	
Payment of debentures (at a premium of 10%)	55,000	
Payment of dividend	15,000	
Payment of taxes	<u>27,500</u>	
Total Funds Applied		<u>2,57,500</u>
Increase in Working Capital		12,500

Working Notes:

(a) Funds from Operations:

	Rs.
Profit and loss balance on 31 st July, 2014	1,00,000
Add: Depreciation	40,000
Loss on sale of asset	1,000

Misc. expenditure written off	2,500
Transfer to reserve	25,000
Premium on redemption of debentures	5,000
Provision for dividend	17,000
Provision for taxation	<u>30,500</u>
	2,21,000
Less: Profit and loss balance on 31 st July, 2013	<u>50,000</u>
Funds from Operations	<u>1,71,000</u>

- (b) Depreciation for the year 2014 was Rs. 40,000. The accumulated depreciation on 31st July, 2013 was Rs. 1,00,000 of which Rs. 15,000 was written off during the year on account of sale of asset. Thus, the balance on 31st July, 2014 should have been Rs. 85,000. Since the balance is Rs. 1,25,000, the company would have provided a depreciation of Rs. 40,000 (i.e. Rs. 1,25,000 – Rs. 85,000) during the year 2014.
- (c) Fixed assets were of Rs. 5,00,000 in 2013. With the sale of a fixed asset costing Rs. 20,000 (i.e. Rs. 5,000 + Rs. 15,000) this balance should have been Rs. 4,80,000. But the balance on 31st July, 2014 is Rs. 6,00,000. This means fixed assets of Rs. 1,20,000 were acquired during the year.
- (d) Profit on the sale of investment, Rs. 5,000 has been credited to capital reserve account. It implies that investments were sold for Rs. 45,000 (i.e. Rs. 40,000 + Rs. 5,000).
- (e) The provision for taxation during the year 2014 is Rs. 30,500 [i.e. Rs. 38,000 – (Rs. 35,000 – Rs. 27,500)].
- (f) Bad debts written off against the provision account have no significance for funds flow statement, as they do not affect working capital.

4. (a) Primary Distribution Summary

Item of cost	Basis of	Total	Production Dept.	Service Dept.
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	apportionment	(Rs.)	M (Rs.)	N (Rs.)	O (Rs.)	P (Rs.)	Q (Rs.)
Lease rental	Floor space (6 : 5 : 8 : 2 : 4)	35,000	8,400	7,000	11,200	2,800	5,600
Power & Fuel	HP of Machines × Working hours (93: 144 : 72)	4,20,00 0	1,26,40 8	1,95,72 8	97,864	-	-
Factory supervisor's wages*	Working hours (31 : 40 : 30)	6,400	1,964	2,535	1,901	-	-
Electricity	Light points (21: 26: 16 : 9 : 8)	5,600	1,470	1,820	1,120	630	560
Depreciation on machinery	Value of machinery (6 : 5 : 7 : 2 : 3)	16,100	4,200	3,500	4,900	1,400	2,100
Depreciation on building	Floor space (6 : 5 : 8 : 2 : 4)	18,000	4,320	3,600	5,760	1,440	2,880
Payroll expenses	No. of employees (48: 52: 45: 15: 25)	21,000	5,448	5,903	5,108	1,703	2,838
Canteen expenses	No. of employees (48: 52: 45: 15: 25)	28,000	7,265	7,870	6,811	2,270	3,784
ESI and PF contribution	Direct wages (864: 832: 765: 180: 265)	58,000	17,244	16,606	15,268	3,593	5,289
		6,08,10 0	1,76,71 9	2,44,56 2	1,49,93 2	13,83 6	23,05 1

* Wages to factory supervisor is to be distributed to production departments only.

Let 'P' be the overhead of service department P and 'Q' be the overhead of service department Q.

$$P = 13,836 + 0.15 Q$$

$$Q = 23,051 + 0.10 P$$

Substituting the value of Q in P we get

$$P = 13,836 + 0.15 (23,051 + 0.10 P)$$

$$P = 13,836 + 3,457.65 + 0.015 P$$

$$0.985 P = 17,293.65$$

$$\therefore P = \text{Rs. } 17,557$$

$$\begin{aligned} \therefore Q &= 23,051 + 0.10 \times 17,557 \\ &= \text{Rs. } 24,806.70 \text{ or Rs. } 24,807 \end{aligned}$$

Secondary Distribution Summary

Particulars	Total	M	N	O
	(Rs.)	(Rs.)	(Rs.)	(Rs.)
Allocated and Apportioned overheads as per primary distribution	5,71,213	1,76,719	2,44,562	1,49,932
P (90% of Rs.17,557)	15,801	5,267	6,145	4,389
Q (85% of Rs.24,807)	<u>21,086</u>	<u>9,923</u>	<u>6,202</u>	<u>4,961</u>
		1,91,909	2,56,909	1,59,282

Overhead rate per hour

	M	N	O
Total overheads cost (Rs.)	1,91,909	2,56,909	1,59,282
Working hours	1,240	1,600	1,200
Rate per hour (Rs.)	154.77	160.57	132.74

(b) Calculation of Net Cash flows

Contribution = $(3.00 - 1.75) \times 50,000 = \text{Rs. } 62,500$

Fixed costs = $40,000 - (1,25,000 - 30,000)/5 = \text{Rs. } 21,000$

<i>Year</i>	<i>Capital (Rs.)</i>	<i>Contribution (Rs.)</i>	<i>Fixed costs (Rs.)</i>	<i>Adverts (Rs.)</i>	<i>Net cash flow (Rs.)</i>
0	(1,00,000)				(1,00,000)
1	(25,000)	62,500	(21,000)	(10,000)	6,500
2		62,500	(21,000)	(15,000)	26,500
3		62,500	(21,000)		41,500
4		62,500	(21,000)		41,500
5	30,000	62,500	(21,000)		71,500

Calculation of Net Present Value

<i>Year</i>	<i>Net cash flow (Rs.)</i>	<i>10% discount factor</i>	<i>Present value (Rs.)</i>
0	(1,00,000)	1.000	(1,00,000)
1	6,500	0.909	5,909
2	26,500	0.826	21,889
3	41,500	0.751	31,167
4	41,500	0.683	28,345
5	71,500	0.621	44,402
			31,712

The net present value of the project is Rs. 31,712.

5. (a) The Ascent Ltd. has been maintaining separate books of account for Cost Accounting and Financial Accounting purposes. As per the advice of the Audit Committee, the books of account for the above two purposes will be integrated into one i.e. Integrated System of Accounting will be followed. Few pre-requisites for the above purpose are as follows:
- (i) The management's decision about the extent of integration of the two sets of books.
 - (ii) A suitable coding system must be made available so as to serve the accounting purposes of financial and cost accounts.
 - (iii) An agreed routine, with regard to the treatment of provision for accruals, pre-paid expenses, other adjustments necessary for preparation of interim accounts.
 - (iv) Perfect coordination should exist between the staff responsible for the financial and cost aspects of the accounts and an efficient processing of accounting documents should be ensured.
- (b) As requested by the Management Trainee, the following points of distinction between the Cost Control and Cost Reduction can be explained to him:
- (1) Cost Control aims at maintaining the costs in accordance with the established standards. While Cost Reduction is concerned with reducing the costs.
 - (2) Cost Control seeks to attain lowest possible cost under existing conditions, while Cost Reduction recognizes no condition as permanent, since a change will result in lower cost.
 - (3) In case of Cost Control, emphasis is on past and present, while in case of Cost Reduction, it is on present and future.

- (4) Cost Control is a preventive while Cost Reduction is corrective.
- (5) Cost Control ends when targets are achieved, while Cost Reduction has visible end.

(c) Relevance of Time Value of Money in Financial Decisions

A rupee today is more valuable than a rupee after a year due to several reasons:

Risk: There is uncertainty about the receipt of money in future.

Preference for Present Consumption: Most of the persons and companies in general, prefer current consumption to future consumption.

Inflation: In an inflationary period, a rupee today represents a greater real purchasing power than a rupee a year hence.

Investment Opportunities: Most of the persons and the companies have a preference for present money because of availabilities of opportunities of investment for earning additional cash flow.

Many financial problems involve cash flows accruing at different points of time. For evaluating such cash flows an explicit consideration of time value of money is required.

(d) Major Considerations in Capital Structure Planning

Three factors, i.e., risk, cost and control determine the capital structure of a particular business undertaking at a given point of time. The finance manager attempts to design the capital structure in such a manner that his risk and costs are the least and the control of the existing management is diluted to the least extent. However, there are also subsidiary factors like marketability of the issue, maneuverability and flexibility of the capital structure and timing of raising the funds which affect the capital structure planning. These considerations help the finance manager in determining the proportion in which he can raise funds

from various sources. Risk is of cash insolvency and of variation in the expected earnings available to the equity shareholders. Since a business should be at least capable of earning enough revenue to meet its cost of capital and finance its growth. Hence, along with risk as a factor, the finance manager has to consider the cost aspect carefully while determining the capital structure.

6. (a) Working Notes:

Calculation of Cost and Sales

Particulars	For 60,000 units Rs.	Per unit Rs.
Raw Materials	1,80,000	3.00
Direct Wages	30,000	0.50
Overheads	60,000	1.00
Cost of Sales	2,70,000	4.50
Profit (balancing figure)	<u>30,000</u>	<u>0.50</u>
Sales	<u>3,00,000</u>	<u>5.00</u>

Computation of Current Assets and Current Liabilities

1.	Raw Material inventory – 2 months consumption = Rs. 1,80,000×2/12		= Rs. 30,000
2.	Work-in-progress inventory – 1 month production		
	Raw material = $\frac{\text{Rs. 1,80,000}}{12}$ (100%)	Rs. = 15,000	
	Direct Wages = $\frac{\text{Rs. 30,000}}{12} \times \frac{50}{100}$	= 1,250	

	(50%)		
	Overheads = $\frac{\text{Rs. } 60,000}{12} \times \frac{50}{100}$ (50%)	= 2,500	= Rs. 18,750
3.	Finished goods inventory – 3 months production = Rs. 2,70,000×3/12		= Rs. 67,500
4.	Debtors – 3 months (Cost of Sales) = Rs. 2,70,000×3/12		= Rs. 67,500
5.	Creditors – 2 months raw material consumption = Rs. 1,80,000×2/12		= Rs. 30,000

**Statement of Working Capital Requirement
forecast**

Particulars	Holding period months	Amount Rs.
Current Assets		
Raw Materials	2	30,000
Work-in-Progress	1	18,750
Finished Goods	3	67,500
Debtors	3	<u>67,500</u>
		1,83,750
Less: Current Liabilities	2	<u>30,000</u>

Working Capital		<u>1,53,750</u>
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(b) Calculation of quantity produced

	Process- A (Ltr.)	Process- B (Ltr.)	Process- C (Ltr.)
Input	4,50,000	1,44,000	2,16,000
Normal Loss	(90,000)	(7,200)	(21,600)
	<u>(20% of 4,50,000 ltr.)</u>	<u>(5% of 1,44,000 ltr.)</u>	<u>(10% of 2,16,000 ltr.)</u>
	<u>3,60,000</u>	<u>1,36,800</u>	<u>1,94,400</u>
Production of Gasoline	<u>1,44,000</u>	<u>136,800</u>	--
Production of HSD	2,16,000	--	1,94,400

(i) Statement of apportionment of joint cost on the basis of sale value at split-off point

	Gasoline	HSD
Output at split-off point (Ltr.)	1,44,000	2,16,000
Selling price per Ltr. (Rs.)	64	41
Sales value (Rs.)	92,16,000	88,56,000
Share in Joint cost (128:123)	87,71,200	84,28,575
	$\left(\frac{\text{Rs. } 1,71,99,775}{251} \times 128 \right)$	$\left(\frac{\text{Rs. } 1,71,99,775}{251} \times 123 \right)$

(ii) Statement of cost per Litre.

	Gasoline	HSD
Output (Ltr.)	1,36,800	1,94,400
Share in joint cost (Rs.)	87,71,200	84,28,575
Cost per Ltr. (Rs.) (Joint cost)	64.11	43.36
Further processing cost (Rs.)	10,80,000	1,35,000
Further processing cost per Ltr. (Rs.)	<u>7.89</u>	<u>0.69</u>

Total cost per Ltr. (Rs.)	72.00	44.05
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(iii) Statement of profit

	Gasoline	HSD
Output (Ltr.)	1,36,800	1,94,400
Sales (Ltr.)	1,32,000	1,88,000
Closing stock (Ltr.)	4,800	6,400
	(Rs.)	(Rs.)
Sales @ Rs.68 and Rs.46 for Gasoline and HSD respectively	89,76,000	86,48,000
Add: closing stock (Ltr.) (at full cost)	3,45,600	2,81,920
Value of production	93,21,600	89,29,920
Less: Share in joint cost	87,71,200	84,28,575
Further processing	10,80,000	1,35,000
Profit/ (Loss)	(5,29,600)	3,66,345

7. (a) The suggestive remedial steps that will be helpful for Yanni Ltd. to minimize the labour turnover are as follows:

- (a) Exit interview: An interview to be arranged with each outgoing employee to ascertain the reasons of his leaving the organization.
- (b) Job analysis and evaluation: to ascertain the requirement of each job and allot appropriate job to appropriate persons.
- (c) Organisation should make use of a scientific system of recruitment, placement and promotion for employees.
- (d) Organisation should create healthy atmosphere, providing education, medical and housing facilities for workers.
- (e) Committee for settling workers grievances.

(b) Distinction between Deep Discount Bonds (DDBs) and Zero Coupon Bonds (ZCBs)

Deep discount bonds are in the form of zero interest bonds. These bonds are sold at a discounted value and on maturity face value is paid to the investors. In such bonds, there is no interest payout during lock-in period. IDBI was first to issue a deep discount bonds in India in January 1992. The bond of a face value of Rs.1 lakh was sold for Rs. 2,700 with a maturity period of 25 years.

Whereas, on the other hand, zero coupon bond does not carry any interest but it is sold by the issuing company at a discount. The difference between discounted value and maturing or face value represents the interest to be earned by the investor on such bonds.

(c) Difference between fixed and flexible budgets are as follows:

S.No.	Fixed Budget	Flexible Budget
1.	It does not change with actual volume of activity achieved. Thus it is rigid	It can be re-casted on the basis of activity level to be achieved. Thus it is not rigid.
2	It operates on one level of activity and under one set of conditions	It consists of various budgets for different level of activity.
3	If the budgeted and actual activity levels differ significantly, then cost ascertainment and price fixation do not give a correct picture.	It facilitates the cost ascertainment and price fixation at different levels of activity.
4.	Comparisons of actual and budgeted targets are meaningless particularly when there is	It provided meaningful basis of comparison of actual and budgeted targets.

	difference between two levels.	
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(d) Global Depository Receipts (GDRs)

Global Depository Receipts are negotiable certificates denominated in US dollars which represent a Non-US company's publicly traded local currency equity shares. GDRs are created when the local currency shares of an Indian company are delivered to depository's local custodian bank against which the depository bank issues depository receipts in US dollars. The GDRs may be traded freely in the overseas market like any other dollar-expressed security either on a foreign stock exchange or in the over-the-counter market or among qualified institutional buyers.

(e) The followings are the few practical applications of Marginal Costing that can be elaborated to Rahul:

- (i) Pricing Policy:** Since marginal cost per unit is constant from period to period, firm decisions on pricing policy can be taken particularly in short term.
- (ii) Decision Making:** Marginal costing helps the management in taking a number of business decisions like make or buy, discontinuance of a particular product, replacement of machines, etc
- (iii) Ascertaining Realistic Profit:** Under the marginal costing technique, the stock of finished goods and work-in-progress are carried on marginal cost basis and the fixed expenses are written off to profit and loss account as period cost. This shows the true profit of the period.
- (iv) Determination of production level:** Marginal costing helps in the preparation of break-even analysis which shows the effect of increasing or decreasing production activity on the profitability of the company.

Test Series: February, 2015

MOCK TEST PAPER– 1
INTERMEDIATE (IPC) – GROUP – I
PAPER – 4: TAXATION
SUGGESTED ANSWERS/HINTS

1. (a) Computation of Total Income and tax liability of Mr. Rajeev for the A.Y. 2015-16

Particulars	Rs.	Rs.
Income from Salaries		
Basic Salary (Rs. 15,000 x 12)		1,80,000
Dearness Allowance (Rs. 12,000 x 12)		1,44,000
Commission on Turnover (0.5% of Rs. 50 lacs)		25,000
Bonus		50,000
Gratuity (Note 1)		30,000
Employer's contribution to recognized provident fund		
Annual contribution [20% of Rs. 1,80,000]	36,000	
Less: Exempt (Note 2)	<u>33,240</u>	2,760
Interest credited in recognized provident fund account @15% p.a.	15,000	
Less: Exempt upto 9.5% p.a.	<u>9,500</u>	5,500
Gift of gold ring worth Rs. 10,000 on 25 th wedding anniversary by employer (See Note 3)		10,000

requisite value of music system given for personal use (being 10% of actual cost) i.e. 10% of Rs. 85,000		<u>8,500</u>
		4,55,760
Profits and Gains of Business or Profession		
ase of 2 trucks on contract basis against fixed charges of Rs. 6,500 p.m. In this case, presumptive tax provisions of section 44AE will apply i.e. Rs. 7,500 p.m. for each of the two trucks (7,500 x 2 x12). He cannot claim lower profits and gains since he has not maintained books of account.		1,80,000
Income from Other Sources		
erest on bank FDRs	5,860	
erest from debentures	7,540	
idend on shares [Exempt under section 10(34)]	<u>Nil</u>	<u>13,400</u>
Gross total Income		6,49,160
Deductions under Chapter VI-A		
Section 80C		
remium on life insurance policy	15,370	
vestment in NSC	30,000	
R of SBI for 5 years	50,000	
mployee's contribution to recognized provident fund	<u>30,000</u>	1,25,370
Section 80D - Mediclaim Insurance	12,500	12,500
Section 80G (Note 4)	<u>10,600</u>	<u>10,600</u>
al Income		<u>5,00,690</u>
rk on total income		

Income-tax	25,138
Less: Education cess @ 2%	503
Less: Secondary and higher education cess @ 1%	<u>251</u>
Total Tax Payable	<u>25,892</u>
Tax Payable (rounded off)	25,890

Notes:

1. Gratuity received during service is fully taxable.
2. Employer's contribution in the recognized provident fund is exempt up to 12% of the salary i.e. 12% of (Basic Salary + DA for retirement benefits + Commission based on turnover)

$$= 12\% \text{ of } (\text{Rs. } 1,80,000 + (50\% \text{ of Rs. } 1,44,000) + \text{Rs. } 25,000)$$

$$= 12\% \text{ of } 2,77,000 = \text{Rs. } 33,240$$
3. An alternate view possible is that only the sum in excess of Rs. 5,000 is taxable in view of the language of *Circular No.15/2001 dated 12.12.2001* that such gifts upto Rs. 5,000 in the aggregate per annum would be exempt, beyond which it would be taxed as a perquisite. As per this view, the value of perquisite would be Rs. 5,000. In such a case the Income from Salaries would be Rs. 4,50,760.
4. Deduction under section 80G is computed as under:

Particulars	Rs.
Contribution to PM National Relief Fund (100%)	5,100
Contribution to institution approved under section 80G (50% of Rs. 11,000) (amount contributed Rs. 11,000 or 10% of Adjusted Gross Total Income i.e. Rs. 51,129, whichever is lower)	<u>5,500</u>
Total deduction	<u>10,600</u>

Adjusted Gross Total Income = Gross Total Income –
Deductions under section 80C and 80D = Rs. 6,49,160 – Rs.
1,37,870 = Rs. 5,11,290.

(b) Computation of taxable service of A One Decorators

Particulars	Rs.
Advance received by an account payee cheque (Note 1)	3,00,000
Amount received through credit card (Note 1)	6,00,000
Amount received by a pay order (Note 2)	<u>2,00,000</u>
Value of taxable service	<u>11,00,000</u>

Calculation of service tax liability of A One Decorators

Particulars	Rs.
Service tax @ 12% on Rs. 11,00,000	1,32,000
Add: Education cess @ 2% on service tax	2,640
Add: Secondary and higher education cess @ 1% on service tax	<u>1,320</u>
Total service tax payable	<u>1,35,960</u>

Notes:

1. Gross amount charged, *inter-alia*, includes payment by cheque and through credit card.
 2. Money, *inter alia*, means pay order.
- (c)** If imported goods are similar to goods covered under section 4A of the Central Excise Act, 1944, CVD is payable on basis of MRP printed on the packing less abatement as permissible.

Particulars	Amount (Rs.)
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	)
Maximum retail price [1000 pieces × 250]	2,50,000
Less: Abatement @ 30%	75,000
Assessable value	1,75,000
CVD @ 12% of Rs. 1,75,000 [Education cesses on CVD are exempted]	21,000

2. (a) **Computation of gross total income of Mr. Suraj for the A.Y.2015-16**

Particulars	Rs.	Rs.
Salaries		
Income from salary	3,00,000	
Less: Loss from house property set-off against salary income as per section 71	<u>(40,000)</u>	2,60,000
Profits and gains of business or profession		
Income from sugar business	50,000	
Less: Brought forward loss from iron-ore business set-off as per section 72(1)	<u>(50,000)</u>	Nil
Balance business loss of Rs. 70,000 of P.Y.2008-09 carried forward to A.Y.2016-17		
Capital gains		
Long term capital gain	40,000	
Less: Short term capital loss set-off	<u>(40,000)</u>	Nil
Balance short-term capital loss of Rs.		

20,000 to be carried forward		
Short-term capital loss of Rs. 10,000 under section 111A also to be carried forward		
Income from other sources		
Winnings from lottery	50,000	
Winnings from card games	6,000	
Bank interest	<u>5,000</u>	<u>61,000</u>
Gross Total Income		<u>3,21,000</u>
Losses to be carried forward to A.Y.2016-17		
Loss of iron-ore business	70,000	
Short term capital loss (Rs. 20,000 + Rs. 10,000)	30,000	

Notes:

- The following income are exempt under section 10 –
 - Dividend income [Exempt under section 10(34)], assuming that dividend is received from a domestic company.
 - Agricultural income [Exempt under section 10(1)].
 - Long-term capital gains on which STT is paid [Exempt under section 10(38)].
- It is presumed that loss from iron-ore business relates to P.Y.2008-09, the year in which the business was discontinued.

(b) Computation of the value of taxable service and the service tax payable

Particulars	Amount (Rs.)
Advances received from clients for which no service has been rendered so far (Note-1)	9,00,000
Demurrage charges recovered for use of the services beyond the agreed period (Note-2)	80,000

Security deposits forfeited for damages done by service receiver owing to his negligence in the course of receiving a service (Note-2)	3,20,000
Payment received from MNO Ltd. (Note-3)	<u>2,00,000</u>
Total	<u>15,00,000</u>
Value of taxable service = Rs. $15,00,000 \times \frac{100}{112.36}$	13,34,995
Service tax liability = Rs. $15,00,000 \times \frac{12.36}{112.36}$	1,65,005

Notes:

- Advances received in October, 2014 shall be taxable in the month of receipt of advance only [Rule 3 of the Point of Taxation Rules, 2011]
- As per rule 6 of the Service Tax Valuation (Determination of Value) Rules, 2006,
 - Demurrage charges recovered for use of the services beyond the period agreed upon are includible in the value of taxable service.
 - Accidental damages are excluded from the value of taxable services provided such damages are due to unforeseen actions and are not related to provision of services. However since in the given case, damages are due to negligence of the service receiver in the course of receiving the service, forfeited security deposits relating to such damages shall be includible in the value of taxable service.
- Excess payment made as a result of a mistake, if not returned, but retained by the service provider, becomes a part of the taxable value of services. Hence, entire Rs. 2,00,000 would form part of value of taxable services.

(c) **Computation of CST payable by Mr. Shanti Prasad**

Particulars	Rs.	Rs.
Total inter-state sales		95,60,000
Less: Freight shown separately in the invoices [Note-2]	3,00,000	
Less: Installation and commissioning charges shown separately [Note-3]	1,25,000	4,25,000
Turnover including CST		91,35,000
CST payable = $91,35,000 \times \frac{2}{102}$ (B) [Note-4]		1,79,118

Notes:

1. Dharmada and cost of packing material are includible while calculating turnover.
2. Freight charges of Rs. 1,10,000 are not deductible while calculating the turnover as they are not shown separately in invoices. Remaining amount of freight, shown separately in the invoices, is deductible.
3. Installation and commissioning charges are deductible while calculating the turnover since shown separately in the invoices.
4. The CST on transactions covered by valid 'C' Form is 2% or the sales tax rate within the State, whichever is lower. Since, in this case, the State sales-tax rate is higher than 2%, the rate of CST is taken as 2%.

3. (a)

	Taxable/Not Taxable	Amount liable to tax (Rs.)	Reason

(i)	Taxable	7,00,000	As per section 9(1)(iii), salaries payable by the Government to a citizen of India for service rendered outside India shall be deemed to accrue or arise in India. Therefore, salary paid by Central Government to Mr. Gagan for services rendered outside India would be deemed to accrue or arise in India since he is a citizen of India.
(ii)	Taxable	5,00,000	As per section 9(1)(v)(c), interest payable by a non-resident on moneys borrowed and used for the purposes of business carried on by such person in India shall be deemed to accrue or arise in India in the hands of the recipient.
(iii)	Partly Taxable	8,500	The interest on Post Office Savings Bank Account, would be exempt under section 10(15)(i), only to the extent of Rs. 3,500 in case of an individual account. The remaining Rs. 8,500, being less than Rs. 10,000, would be allowed as deduction under section 80TTA from Gross Total Income.
(iv)	Not Taxable	-	Royalty paid by a resident to a non-resident in respect of a business carried outside India would not be taxable in the hands of the non-resident provided the

			same is not received in India. This has been provided as an exception to deemed accrual mentioned in section 9(1)(vi)(b).
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3. (b) Under section 44BBA, in case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to 5% of the aggregate of the following amounts shall be deemed to be his business income:

- (a) the amount paid or payable, whether in or out of India, to the assessee on account of carriage of passengers, goods etc. from any place in India; and
- (b) the amount received or deemed to be received in India by the assessee on account of carriage of passengers, goods etc. from any place outside India.

Hence, the income of Mr. Sahil chargeable to tax in India under the head "Profits and Gains of business or profession" is determined as under:

Particulars	Rs.
(i) For carrying passengers from Mumbai	50,00,000
(ii) For carrying passengers from Canada, amount received in India	75,00,000
(iii) For carrying goods from Mumbai	25,00,000
Total	1,50,00,000

Hence, income from business computed on presumptive basis as per section 44BBA is Rs. 7,50,000, being 5% of Rs. 1,50,00,000.

Note: No deduction is allowable in respect of any expenditure incurred for the purpose of the business.

- (c) **Computation of CENVAT credit available with Durable Manufacturing Ltd.**

Particulars	Amount
-------------	--------

	(Rs.)
Raw materials used in the factory of Durable Manufacturing Ltd.	65,000
Goods used in the guest house primarily for the stay of the newly recruited employees. [Note 1]	Nil
Inputs used for making structures for support of capital goods [Note 1]	Nil
Capital goods used as parts and components for use in the manufacture of final product [Note 2]	
	<u>70,000</u>
Total CENVAT credit available	<u>1,35,000</u>

Notes:

1. As per the definition of inputs, there is specific exclusion with regard to the following:-
 - (i) goods used in a guest house when the same are used primarily for personal use or consumption of any employee.
 - (ii) goods used for making of structures for support of capital goods.

Thus, CENVAT credit cannot be claimed in respect of the above goods.
 2. Though definition of inputs specifically excludes capital goods, capital goods used as parts or components in the manufacture of a final product are included therein. Thus, CENVAT credit will be available on the same.
- (d) Since the manufacturer charged only Rs. 16,545 and he is not able to recover any extra amount from customer, this amount is required to be treated as price-cum-duty. Hence, differential duty payable by him will be computed as under:

Particulars	Rs.
Price-cum-duty	16,545
Excise duty @ 12.36% [Rs. 16,545 x 12.36/112.36]	1,820.01
Excise duty (rounded off)	1,820
Differential excise duty to be paid [Rs. 1,820 – Rs. 1,545 (duty already paid)]	275

4. (a) Computation of taxable income of Mrs. Sonakshi for A.Y. 2015-16

Particulars	Rs.	Rs.
Income from Salaries		
Basic salary (Rs. 60,000 x 12)		7,20,000
Dearness Allowance (40% of basic salary)		2,88,000
Perquisite value of Concessional Accommodation taken on hire. Lower of:	1,08,000	
(i) actual rent (Rs. 15,000 x 12)	0	
Rs. 1,80,000		
(ii) 15% of salary (15% of Rs. 7,20,000)		
Rs. 1,08,000		
(assuming that dearness allowance does not form part of pay for retirement benefits)		
Less: Rent recovered (Rs. 2,000×12)		84,000
	<u>24,000</u>	
Perquisite value of concessional loan [Rule 3(7)(i)] [Rs. 20,000 (10% of Rs. 2,00,000) – Rs. 10,000]		<u>10,000</u>
Gross Salary		11,02,000
Less: Deduction under section 16(iii) - Professional tax paid		<u>6,000</u>

Net Salary		10,96,000
Income from house property		
Gross Annual Value (GAV) (Rental income has been taken as GAV in the absence of other information)	1,80,000	
Less: Deduction under section 24		
(a) 30% of Rs. 1,80,000 Rs. 54,000		
(b) Interest on loan Rs. 1,75,000	2,29,000	(49,000)
Gross Total Income		10,47,000
Less: Deductions under Chapter – VIA		
80C – Repayment of housing loan		1,00,000
Total Income		9,47,000

Computation of tax liability for A.Y. 2015-16

Tax on Rs. 9,47,000	Rs.
Upto Rs. 2,50,000	Nil
250,001 -5,00,000 - 10%	25,000
5,00,001 – 9,47,000 - 20%	89,400
	1,14,400
Add: Education cess @ 2%	2,288
Secondary and higher education cess @ 1%	1,144
Total Tax Liability	1,17,832
Total Tax Liability (Rounded off)	1,17,830

Note: Mrs. Sonakshi cannot claim benefit of self-occupation (i.e., taking the annual value as nil and claiming a higher loss of Rs. 2,00,000) in respect of the house property owned and occupied by her, since the same has been given on rent to her employer, who has allotted the same as residence for Mrs. Sonakshi.

- (c) In respect of any taxable services provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in the taxable territory, person liable to pay service tax is the recipient of such service, i.e. service tax has to be paid under reverse charge mechanism. Hence, in the given case, service tax is to be paid by Akshita of Sikkim.

Further, rule 7 of the Point of Taxation Rules, 2011 provides that the point of taxation in respect of the persons required to pay tax under reverse charge mechanism, shall be the date on which payment is made provided payment for the same is made within a period of 3 months of the date of invoice, otherwise the point of taxation will be the date immediately following the said period of three months.

In the light of the aforesaid provisions, point of taxation will be as follows:-

Case-I: Since the payment has been made within 3 months from the date of invoice, point of taxation shall be the date of payment i.e. 27.12.2014.

Case-II: Since the payment has not been made within a period of 3 months from the date of invoice, point of taxation will be the date immediately following the said period of 3 months i.e. 08.01.2015.

(d) Computation of Net VAT liability of Tirumala

Particulars	Rs.	Rs.
Output VAT (70,00,000 × 12.5%) [A]		8,75,000
Input VAT [B]		
Raw material 'A' (40,00,000 × 50% × 4%)	80,000	

[Refer Note]		
Raw material 'B' (20,00,000 × 1%)	<u>20,000</u>	<u>1,00,000</u>
Net VAT payable by Tirumala [A] – [B]		<u>7,75,000</u>

Note: Input tax credit is allowed only in respect of the raw material used in manufacture of taxable goods and hence, the same has been restricted to the extent of 50%.

5. (a) Non-deduction of tax at source on any payment on which tax is deductible as per the provisions of Chapter XVII-B would attract disallowance under section 40(a)(ia). Therefore, non-deduction of tax at source on salary payment on which tax is deductible under section 192 and non-compete fees and directors' remuneration on which tax is deductible under section 194J, would attract disallowance@30% of sum paid under section 40(a)(ia). Therefore, the amount to be disallowed under section 40(a)(ia) while computing business income for A.Y.2015-16 is as follows –

	Particulars	Amount paid in Rs.	Disallowance u/s 40(a)(ia) @ 30% of sum paid (Rs.)
(1)	Salary [tax is deductible under section 192]	15,00,000	4,50,000
(2)	Non-compete fees to Mr. Sagar [tax is deductible under section 194J]	70,000	21,000
(3)	Directors' remuneration [tax is deductible under section 194J without any threshold limit]	25,000	7,500
	Disallowance under section 40(a)(ia)		4,78,500

If the tax is deducted and paid in the next year i.e., P.Y.2015-16, the amount of Rs. 4,78,500 would be allowed as deduction while computing the business income of A.Y.2016-17.

(b) Computation of total income of Mr. Yatin for A.Y. 2015-16

Particulars	Rs.	Rs.	Rs.
Capital Gains			
Short term capital gains (on sale of flat)			
(i) Sale consideration	3,60,000		
(ii) Stamp duty valuation	<u>3,70,000</u>		
Consideration for the purpose of capital gains as per section 50C (stamp duty value, since it is higher than sale consideration)		3,70,000	
Less: Cost of acquisition [As per section 49(4), cost to be taken into consideration for 56(2)(vii) will be the cost of acquisition]		<u>3,40,000</u>	30,000
Long term capital loss on sale of equity shares of S Pvt. Ltd			
Sale consideration		2,80,000	
Less: Indexed cost of acquisition(Rs. 3,50,000 × 1024/519)		<u>6,90,559</u>	
Long term capital loss to be carried forward		4,10,559	
(See Note 1 below)			

Income from other sources:			
Gift from friends by way of immovable property on 30.11.2014 [See Note 3 below].			3,40,000
Gift received from a close friend (unrelated person) [See Note 2 below]			75,000
Total income			<u>4,45,000</u>

Notes:

1. In the given problem, unlisted shares of S Pvt. Ltd. have been held for more than **36 months** and hence, constitute a long term capital asset. The loss arising from sale of such shares is, therefore, a long-term capital loss. As per section 70(3), long term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss cannot be set-off against short-term capital gains. However, such long-term capital loss can be carried forward to the next year for set-off against long-term capital gains arising in that year.
 2. Any sum received from an unrelated person will be deemed as income and taxed as income from other sources if the aggregate sum received exceeds Rs. 50,000 in a year [Section 56(2)(vii)].
 3. Receipt of immovable property without consideration would attract the provisions of section 56(2)(vii).
- (c)** As per section 65B(44) of Finance Act, 1994, a service is an activity carried out by one person for another person in lieu of a consideration. Further, Explanation 3 to section 65B(44) provides *inter alia* that an establishment of a person located in taxable territory and another establishment of such person located in non-taxable territory are treated as establishments of distinct persons.

Also, as per explanation 4 to the said section, a person carrying on a business through a branch in any territory is treated as having an establishment in that territory.

Therefore, services provided by Chandigarh branch to Head Office at Gujarat will not be 'service' in terms of section 65B(44) since both the establishments namely, Branch office and Head office are located in the taxable territory and are thus, one and the same person. However, when services are provided by Head Office at Gujarat to Malaysia branch (located in non-taxable territory), the two establishments are treated as establishments of distinct persons and thus, the services provided in this case will constitute 'service' under service tax law.

- (d) Where an assessee has paid to the credit of Central Government any amount in excess of the amount required to be paid towards service tax liability for a month/quarter, the assessee may adjust such excess amount paid by him against his service tax liability for the succeeding month/quarter. Such adjustment is subject to the condition that the excess amount paid is on account of reasons not involving interpretation of law, taxability, valuation or applicability of any exemption notification.

Since Mr. Manan Mittal has paid the excess amount on account of a clerical error, he can adjust the excess payment of Rs. 2,25,000 against his service tax liability for the succeeding quarter.

6. (a) Computation of taxable capital gain of Mr. Manish for A.Y.2015-16

Particulars	Rs.	Rs.
Factory building		
Sale price of building	8,00,000	
Less: WDV as on 1.4.2014	<u>8,74,800</u>	
Short-term capital loss on sale of building		(-) 74,800

Land appurtenant to the above building		
Sale value of land	40,00,000	
Less: Indexed cost of acquisition (Rs. 11,50,000 $\times$ 1024/447)	<u>26,34,452</u>	
Long-term capital gains on sale of land		<u>13,65,548</u>
Chargeable long term capital gain		<u>12,90,748</u>

Investment under section 54EC

In this case, both land and building have been held for more than 36 months and hence, are long-term capital assets. Exemption under section 54EC is available if the capital gains arising from transfer of a long-term capital asset are invested in long-term specified assets like bonds of National Highways Authority of India and Rural Electrification Corporation Ltd., within 6 months from the date of transfer. As per section 54EC, the amount to be invested for availing the maximum exemption is the net amount of capital gain arising from transfer of long-term capital asset, which is Rs. 12,90,748 (rounded off to Rs. 12,91,000) in this case.

Notes:

1. Where advance money has been received by the assessee, and retained by him, as a result of failure of the negotiations, section 51 will apply. The advance retained by the assessee will go to reduce the cost of acquisition. Indexation is to be done on the cost of acquisition so arrived at after reducing the advance money forfeited i.e. Rs. 12,00,000 – Rs. 50,000 = Rs. 11,50,000. It may be noted that in cases where the advance money is forfeited during the previous year 2014-15 or thereafter, the amount forfeited would be taxable under the head "Income from Other Sources" and such amount will not be deducted from the cost of acquisition of such asset while calculating capital gains.

2. Factory building on which depreciation has been claimed, is a depreciable asset. Profit / loss arising on sale is deemed to be short-term capital gain/loss as per section 50, and no indexation benefit is available.
 3. Land is not a depreciable asset, hence section 50 will not apply. Being a long-term capital asset (held for more than 36 months), indexation benefit is available.
 4. As per section 74, short term capital loss can be set-off against any income under the head "Capital gains", long-term or short-term. Therefore, in this case, short-term capital loss of Rs. 74,800 can be set-off against long-term capital gain of Rs. 13,65,548.
- (b) Continuous supply of service means *inter alia* any service which is provided, or agreed to be provided continuously or on recurrent basis, under a contract, for a period exceeding three months with the obligation for payment periodically or from time to time.

Therefore, the above situation is a case of continuous supply of service as repair and maintenance services provided by Sahil Caretakers have been provided on a quarterly basis, under a contract, for a period of one year with the obligation for quarterly payment.

In terms of rule 4A of Service Tax Rules, 1994, in case of continuous supply of service, every person providing such taxable service has to issue an invoice, bill or challan, as the case may be, within 30 days of the date when each event specified in the contract, which requires the service receiver to make any payment to service provider, is completed.

Therefore, since the contract requires X to make payment on completion of services provided in each quarter, Sahil Caretakers should issue quarterly invoices latest by May 4, August 1, November 2 and February 2 (within 30 days of April 4, July 2, October 3, and January 3).

- (c) Under Compounded Levy Scheme, assessee has an **option** to pay excise duty on the basis of specified factors relevant to production of goods covered under the scheme (size of equipment employed, number and types of machines used for manufacture etc.) at specified rates. The prescribed duty has to be paid by the assessee for a specified period.

Therefore, since Compounded Levy Scheme is an **optional scheme**, LMN Co. can pay *ad valorem* duty under section 4 even if goods manufactured by it are covered under Compounded Levy Scheme.

However, duty based on production capacity is **mandatory** i.e., duty cannot be paid in any other manner in respect of the goods notified under this scheme. Therefore, if goods manufactured by LMN Co. get notified under production capacity based duty scheme, it will not be able to pay duty under section 4 and will have to compulsorily pay duty based on its production capacity.

7. (a) In this case, the individual contract payments made to Mr. Ramprakash does not exceed Rs. 30,000. However, since the aggregate amount paid to Mr. Ramprakash during the P.Y.2014-15 exceeds Rs. 75,000 (on account of the last payment of Rs. 28,000, due on 1.3.2015, taking the total from Rs. 70,000 to Rs. 98,000), the TDS provisions under section 194C would get attracted. Tax has to be deducted@1% on the entire amount of 98,000 from the last payment of Rs. 28,000 and the balance of Rs. 27,020 (i.e. Rs. 28,000 – Rs. 980) has to be paid to Mr. Ramprakash.
- (b) Since Mr. Vikas has income only under the heads “Income from house property” and “Income from other sources”, he does not fall under the category of a person whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force. Therefore, the due date of filing return for A.Y.2015-16 under section 139(1), in his case, is 31st July, 2015. Since Mr. Vikas had

submitted his return only on 12.9.2015, the said return is a belated return under section 139(4).

As per section 139(5), only a return furnished under section 139(1) or in pursuance of a notice under section 142(1) can be revised. A belated return under section 139(4) cannot be revised. Therefore, Mr. Vikas cannot revise the return of income filed by him under section 139(4), to claim deduction under section 80TTA, even though the time limit of one year from the end of the relevant assessment year has not elapsed.

(c) Computation of service tax liability of Mr. S for the quarter July-September, 2014

Particulars	Rs.
Basic fare in case of domestic bookings	1,00,000
Service tax @ 0.6% [A] Refer Note 1	600.00
Basic fare in case of international bookings	3,06,000
Service tax @ 1.2% [B] Refer Note 1	3,672
Total service tax payable [A] + [B] (rounded off)	4,272
Add: Education cess @ 2%	85.44
Add: Secondary and higher education cess @ 1%	<u>42.72</u>
Total service tax payable inclusive of education cesses (rounded off)	<u>4,400</u>

Notes:

1. Rule 6(7) of Service Tax Rules, 1994 provides an option to an air travel agent to pay service tax at special rates of 0.6% and 1.2% of 'basic fare' in case of domestic and international bookings for air travel respectively.
2. Since the given basic fare is in terms of rule 6(7) of service Tax rules, 1994, service tax has been computed as a percentage of such basic fare and other charges, fee and

taxes have been ignored.

The option once exercised, applies uniformly in respect of all the bookings for air travel made by the air travel agent and cannot be changed during a financial year under any circumstances. Therefore, Mr. S cannot pay service tax @ 12% for the quarter July – September, 2014 and will have to discharge his service tax liability for the said quarter by paying service tax at the special rates mentioned above. However, he can change the option and pay service tax @ 12% from financial year 2015-16.

- (d) No, MNO Manufacturers Ltd. is not liable to pay duty in the given case. If any goods are pilfered after the unloading thereof but before the proper officer has made an order for clearance for home consumption, the importer shall not be liable to pay duty on such goods.

However, where such goods are restored to the importer after the pilferage, the importer becomes liable to pay duty. Thus, MNO Manufacturers Ltd. will be liable to pay duty if goods are restored to it.

Test Series: February, 2015

MOCK TEST PAPER - 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) Based on sales, research and development cost (assumed that entire cost of Rs. 225 lakhs is development cost) is allocated as follows:

Year	Research and Development cost allocation (Rs. in lakhs)
1	$225/1,500 \times 600 = 90$
2	$225/1,500 \times 450 = 67.5$
3	$225/1,500 \times 300 = 45$
4	$225/1,500 \times 150 = 22.5$

- (ii) If at the end of the 3rd year, the circumstances do not justify that further benefit will accrue in the 4th year, then the company has to charge the unamortised amount i.e. remaining Rs. 67.5 lakhs [$225 - (90 + 67.5)$] as an expense immediately.
- (b) Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring fixed assets should be adjusted in the carrying amount of the respective fixed assets as Path Ltd. has exercised the option and it is long term foreign currency monetary item.

Thus, the entire exchange loss due to variation of Rs. 20 lakhs on 31.03.2015 on payment of US \$ 10 lakhs, should be added to the carrying amount of fixed assets and not to the cost of goods sold.

Calculation of Exchange loss:

Foreign currency loan (in Rs.) = $(50 \text{ lakhs } \$ \times \text{Rs. } 60) = \text{Rs. } 3,000 \text{ lakhs}$

Exchange loss on outstanding loan on 31.03.2015 = Rs. 40 lakhs
 $\text{US } \$ \times (62.00 - 60.00) = \text{Rs. } 80 \text{ lakhs.}$

So, Rs. 80 lakhs should also be added to cost of fixed asset with corresponding credit to outstanding loan in addition to Rs. 20 lakhs on account of exchange loss on payment of instalment. The total cost of fixed asset to be increased by Rs. 100 lakhs.

Total depreciation to be provided for the year 2014-15 = 20% of
 $(\text{Rs. } 3,000 \text{ lakhs} + 100 \text{ lakhs}) = \text{Rs. } 620 \text{ lakhs.}$

- (c) (i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 2013-14 by not recognising the subsidy? The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that (i) the enterprise will comply with the conditions attached to them and (ii) the subsidy will be received. Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2014 after approval of accounts, non-recognition of grant in 2013-14 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 2013-14.

- (ii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life.

Alternatively, the same may be treated as Deferred Income and allocated over the remaining useful life in the proportion in which depreciation is charged.

(d) (i) Determination of nature of lease

Fair value of asset = Rs. 7,00,000

Unguaranteed residual value = Rs. 70,000

$$\text{Present value of residual value at the end of 4}^{\text{th}} \text{ year} = \text{Rs. } 70,000 \times 0.683$$

$$= \text{Rs. } 47,810$$

$$\begin{array}{l} \text{Present value of lease payments recoverable} \\ \text{Rs. } 7,00,000 - \text{Rs. } 47,810 \end{array} =$$

$$6,52,190$$

The percentage of present value of lease payment to fair value of the asset is

$$= (\text{Rs. } 6,52,190 / \text{Rs. } 7,00,000) \times 100 = 93.17\%$$

Since, it substantially covers the major portion of lease payment and life of the asset, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income

$$\begin{array}{l} \text{Annual lease payment} = \text{Rs. } 6,52,190 / 3.169 \\ = \text{Rs. } 2,05,803 \text{ (approx.)} \end{array}$$

$$\begin{array}{l} \text{Gross investment in the lease} = \text{Total minimum lease payment} \\ + \text{unguaranteed residual value} \\ = (\text{Rs. } 2,05,803 \times 4) + \text{Rs. } 70,000 \\ = \text{Rs. } 8,23,212 \\ + \text{Rs. } 70,000 \\ = \text{Rs. } 8,93,212 \end{array}$$

Unearned finance income = Gross investment – Present value of minimum lease payment and unguaranteed residual value.

= Rs. 8,93,212 – Rs. 7,00,000 (Rs. 6,52,190 + Rs. 47,810)

= Rs. 1,93,212.

2. (a)

Centura Bank Limited

Profit and Loss account for the year ended 31st March, 2014

		Schedule No.	Year ended 31.3.2014
			Rs.
I.	<u>Income</u>		
	Interest earned	13	74,03,000
	Other income	14	<u>9,10,000</u>
			<u>83,13,000</u>
II.	<u>Expenditure</u>		
	Interest expended	15	40,74,000
	Operating expenses	16	9,10,000
	Provisions and contingencies (W.N.2)		<u>26,00,000</u>
			<u>75,84,000</u>
III	<u>Profit</u>		
	Net profit for the year		7,29,000
	Profit brought forward		<u>-</u>
			<u>7,29,000</u>
IV	<u>Appropriations</u>		
	Transfer to Statutory Reserve		1,82,250
	Proposed dividend		2,00,000

Balance carried over to balance sheet	<u>3,46,750</u>
	<u>7,29,000</u>

Schedule 13 – Interest earned

	Rs.
Interest and discount earned (W.N.1)	<u>74,03,000</u>
	<u>74,03,000</u>

Schedule 14 - Other Income

	Rs.
Commission, exchange and brokerage	3,80,000
Profit on sale of investment	4,00,000
Rent	<u>1,30,000</u>
	<u>9,10,000</u>

Schedule 15-Interest Expended

	Rs.
Interest paid on deposits	<u>40,74,000</u>
	<u>40,74,000</u>

Schedule 16-Operating Expenses

	Rs.
Payment and provisions for employees	4,00,000
Rent and taxes paid	1,80,000
Depreciation on bank's property	60,000
Directors' fees and allowances	60,000
Auditors' fees	10,000
Law charges	80,000

Postage and Telegrams	<u>1,20,000</u>
	<u>9,10,000</u>

Working Notes:

		Rs.
1. Calculation of interest earned		
Interest and discount received		74,11,000
Add: Rebate on bills discounted as on 31 st March, 2013		<u>24,000</u>
		74,35,000
Less: Rebate on bills discounted as on 31 st March, 2014		<u>(32,000)</u>
		<u>74,03,000</u>
2. Provisions and Contingencies		
Provision for doubtful debts:		
Doubtful debts due to insolvency of a customer (50% of Rs. 20 lakhs)	10,00,000	
Provision for other debts	<u>3,00,000</u>	13,00,000
Provision for income tax		<u>13,00,000</u>
		<u>26,00,000</u>

(b) Accounting treatment of the fund received by an Electricity Company from consumer towards capital expenditure / service line contributions can be given as follows:

- (i) Amount received from consumer towards capital/service line contributions is accounted as liability and subsequently recognised as income over the life of the asset;

- (ii) Amount received from consumer towards capital/service line contributions is accounted as reserves as the amount is not refundable and reported under the head Reserves and Surplus without transferring any proportionate amount to the income statement over the life of asset;
- (iii) Amount received from consumer towards capital/service line contributions is accounted as Capital Reserve as the amount is not refundable and subsequently proportionate amount is transferred to income statement during the expected life of asset to match against depreciation on total cost of such asset;
- (iv) Amount received from consumer towards capital/service line contributions is accounted as reduction in the cost of Non-current Asset and depreciation may be provided on such reduced cost.

3.

**Journal Entries
in the books of OMG& Co.**

<i>Particulars</i>		<i>Dr. (Rs.)</i>	<i>Cr. (Rs.)</i>
Goodwill A/c	Dr	1,00,00	
	.	0	
Building A/c	Dr	2,00,00	
	.	0	
Machinery A/c	Dr	4,50,00	
	.	0	
Furniture A/c	Dr	40,000	
	.		
Stock A/c	Dr	2,40,00	
	.	0	
Debtors A/c	Dr	3,20,00	
	.	0	

Cash at Bank A/c	Dr	60,000	
	.		
Cash in hand A/c	Dr	40,000	
	.		
Due from M & Co. A/c	Dr	2,00,00	
	.	0	
To Creditors A/c			2,40,00
			0
To Bank Loan A/c			1,60,00
			0
To O's Capital A/c			8,17,50
			0
To M's Capital A/c			4,32,50
			0
(Being the Assets and Liabilities of O & Co. taken over)			
Goodwill A/c	Dr	82,000	
	.		
Machinery A/c	Dr	4,00,00	
	.	0	
Furniture A/c	Dr	12,000	
	.		
Stock A/c	Dr	2,80,00	
	.	0	
Debtors A/c	Dr	4,00,00	
	.	0	
Cash at Bank A/c	Dr	1,80,00	
	.	0	
Cash in hand A/c	Dr	20,000	
	.		

Advances A/c	Dr	1,20,000	
	.	0	
To Creditors A/c			2,32,000
To Due to O & Co. A/c			2,00,000
To M's Capital A/c			7,08,000
To G's Capital A/c			3,54,000
(Being the Assets and Liabilities of M & Co. taken over)			
O's Capital A/c	Dr	91,000	
	.		
M's Capital A/c	Dr	60,667	
	.		
G's Capital A/c	Dr	30,333	
	.		
To Goodwill A/c	Dr		1,82,000
	.		
(Being Goodwill written off)			
Bank A/c	Dr	3,69,833	
	.		
To O's Capital A/c			3,38,500
To G's Capital A/c			31,333
(Being the Cash brought in by O and G to make capitals proportionate)			

M's Capital A/c	Dr	3,69,833	
To Bank A/c			3,69,833
(Being the excess capital withdrawn by M)			
Due to O & Co. A/c	Dr	2,00,000	
To Due from M & Co. A/c			2,00,000
(Being the elimination of mutual indebtedness of the merged firms O & co., and M & co.)			

Balance Sheet of M/s OMG& Co. as at 31st March, 2014

<i>Liabilities</i>	<i>Rs.</i>		<i>Rs.</i>
Capitals:		Building	2,00,000
O	10,65,000	Machinery	8,50,000
M	7,10,000	Furniture	52,000
G	3,55,000	Stock	5,20,000
Creditors	4,72,000	Debtors	7,20,000
Bank Loan	1,60,000	Advances	1,20,000
		Cash at Bank	2,40,000
		Cash in hand	60,000
	27,62,000		27,62,000

Working Notes:

- Statement showing the Computation of Purchase Consideration**

<i>Particulars</i>		<i>O & Co.</i>	<i>M & Co.</i>
		<i>Rs.</i>	<i>Rs.</i>
A.	Assets		
	Goodwill	1,00,000	82,000
	Building	2,00,000	-
	Machinery	4,50,000	4,00,000
	Furniture	40,000	12,000
	Stock	2,40,000	2,80,000
	Debtors	3,20,000	4,00,000
	Cash at Bank	60,000	1,80,000
	Cash in hand	40,000	20,000
	Due from M & Co.	2,00,000	-
	Advances	-	1,20,000
		16,50,000	14,94,000

B.	Liabilities		
	Creditors	2,40,000	2,32,000
	Due to O & Co.	-	2,00,000
	Bank Loan	1,60,000	-
		4,00,000	4,32,000
C.	Purchase consideration (A-B)	12,50,000	10,62,000

2. Statement showing the Computation of Proportionate Capitals

Particulars	Rs.
A. M/s OMG & Co. (Rs. 12,50,000+Rs. 10,62,000)	23,12,000
B. Less: Goodwill Adjustment	(1,82,000)
C. Total Capital of new Firm	21,30,000
D. O's proportionate Capital (Rs. 21,30,000 x 3/6)	10,65,000
E. M's proportionate Capital (Rs. 21,30,000 x 2/6)	7,10,000
F. G's Proportionate Capital (Rs. 21,30,000 x 1/6)	3,55,000
	21,30,000

3. Statement showing the Computation of Capital Adjustments

Particulars	O	M	G	Total
	Rs.	Rs.	Rs.	Rs.
Balance transferred from O and co. (W.N. 4)	8,17,500	4,32,500	-	12,50,000
Balance transferred from M and Co. (W.N.5)	-	7,08,000	3,54,000	10,62,000
	8,17,500	11,40,500	3,54,000	23,12,000
Less: Goodwill written off in the ratio of (3:2:1)	(91,000)	(60,667)	(30,333)	(1,82,000)
(a) Existing Capital	7,26,500	10,79,833	3,23,667	21,30,000
(b) Proportionate Capital	10,65,000	7,10,000	3,55,000	21,30,000

(c)	Amount to be brought in (paid off) (a-b)	3,38,500	(3,69,833)	31,333	-
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4. Capital Accounts (in the Books of O & Co.)

Particulars	O	M	Particulars	O	M
	Rs.	Rs.		Rs.	Rs.
To Capital A/c – M/s OMG& Co.	8,17,500	4,32,500	By Balance b/d	4,80,000	3,20,000
(Transfer)			By Reserve (3:1)	75,000	25,000
			By Goodwill (3:1)	75,000	25,000
			By Realisation A/c*		
			-Profit (3:1)	1,87,500	62,500
	<u>8,17,500</u>	<u>4,32,500</u>		<u>8,17,500</u>	<u>4,32,500</u>
	00	00			0

*For Building Rs. 1,00,000 and Machinery Rs. 1,50,000.

5. Capital Accounts (in the Books of M & Co.)

Particulars	M	G	Particulars	M	G
	Rs.	Rs.		Rs.	Rs.
OMG& Co. (Transfer)	7,08,000	3,54,000	By Balance b/d	4,00,000	2,00,000
			By Reserve (2:1)	2,00,000	1,00,000
			By Goodwill (2:1)	54,667	27,333
			By Realisation A/c*		
			-Profit (2:1)	53,333	26,667
	<u>7,08,000</u>	<u>3,54,000</u>		<u>7,08,000</u>	<u>3,54,000</u>
	00	00		0	00

*For Machinery Rs. 80,000.

4. (i) **Calculation of number of equity and preference shares**

	Rs.
Fixed assets	6,40,000
Inventory	3,85,000
Bills receivable	<u>15,000</u>
Purchase consideration	<u>10,40,000</u>

Amount discharged by issue of preference shares = Rs.
2,55,000

No. of preference shares to be allotted =
 $\frac{2,55,000}{100} = 2,550 \text{ shares}$

Amount discharged by allotment of equity shares = Rs.
10,40,000 – Rs. 2,55,000

7,85,000 = Rs.

Paid up value of equity share = Rs.
8

Hence, number of equity shares to be issued = $\frac{7,85,000}{8} =$
98,125 shares

(ii)

In the books of Alia Ltd.

Realisation Account

	Rs.		Rs.
To Fixed assets	4,82,000	By Provision for bad and doubtful debts	4,000
To Inventory	3,87,500	By Trade payable	1,33,000
To Trade receivables	95,000	By Provision for taxation	1,10,000

To	Bank account: Liquidation expenses	4,000	By	Burger Ltd. account (Purchase consideration)	10,40,000
	Bills payable	19,000	By	Bank account: Sundry debtors	75,000
	Tax liability	1,11,000			
	Sundry creditors	1,05,500			
To	Equity shareholders (profit transferred)	<u>1,58,000</u>			
		<u>13,62,000</u>			<u>13,62,000</u>

Cash/Bank Account

<i>Dr.</i>			<i>Cr.</i>
	<i>Rs.</i>		<i>Rs.</i>
To Balance b/d	1,64,500	By Realisation account:	
To Realisation account:		Liquidation expenses	4,000
Sundry debtors	75,000	Bills payable	19,000
		Tax liability	1,11,000
		Sundry creditors	<u>1,05,500</u>
		(Balancing figure)	
	<u>2,39,500</u>		<u>2,39,500</u>

Equity Shareholders Account

<i>Dr</i>			<i>Cr.</i>
	<i>Rs.</i>		<i>Rs.</i>
T 10% Preference		B Equity share capital	6,00,00

o shares in Burger Ltd.	2,55,000	y account	0
T Equity shares in Burger Ltd.	7,85,000	B Contingency reserve	1,56,000
		B Profit and loss account	1,26,000
		B Realisation account(Profit)	<u>1,58,000</u>
	<u>10,40,000</u>		<u>0</u>
			<u>10,40,000</u>
			<u>00</u>

Burger Limited Account

Dr.	Rs.		Cr. Rs.
To Realisation account	10,40,000	By 10% Preference shares in Burger Ltd.	2,55,000
	_____	By Equity shares in Burger Ltd.	<u>7,85,000</u>
	<u>10,40,000</u>		<u>10,40,000</u>

(iii) Journal Entries in the books of Burger Ltd.

Particulars	Amount (Rs.)	Amount (Rs.)
Business purchase account Dr.	10,40,000	
To Liquidator of Alia Ltd. account		10,40,000
(Being the amount of purchase consideration payable to liquidator of Alia Ltd. for assets taken over)		
Fixed assets account Dr.	6,40,000	
Inventory account Dr.	3,85,000	

Bills receivable account	Dr.	15,000	
To Business purchase account			10,40,000
(Being assets taken over)			
Liquidator of the Alia Ltd. account	Dr.	10,40,000	
To 10% Preference share capital account			2,55,000
To Equity share capital account			7,85,000
(Being the allotment of 10% fully paid up preference shares and equity shares of Rs. 10 each, Rs. 8 each paid up as per agreement for discharge of purchase consideration)			

5. (a) Pune Branch Account

Particulars		Rs.	Particulars	Rs.	Rs.
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	Cash paid by debtors directly to H.O.	2,000	
To Goods sent to Branch Account		80,000	Received from Insurance Company	<u>1,000</u>	1,68,000
To Bank (expenses)			By Goods sent to branch (return of goods by the		1,000

Rent	2,000		branch to H.O.)		
Salaries	2,400		By Closing		
Petty Cash	1,000		Balances:		
Insurance	<u>600</u>	6,000	Stock		5,000
To Net Profit		78,950	Petty Cash		650
			Debtors		4,900
			Furniture (2,000 – 10% depreciation)		1,800
			Prepaid insurance (1/4 x Rs. 600)		150
		1,81,600			1,81,600

Working Note:

Calculation of petty cash balance at the end:	Rs.
Opening balance	500
Add: Cash received form the Head Office	<u>1,000</u>
Total Cash with branch	1,500
Less : Spent by the branch	<u>850</u>
Closing balance	<u>650</u>

(b) Departmental Trading & profit and Loss Account for the year ending on 31.12.2014

Particulars	A	B	Particulars	A	B
	Rs.	Rs.		Rs.	Rs.
To Opening Stock	40,000	-	By Sales	2,00,000	71,000
To Purchases	2,00,000	20,000	By Transfer of goods (A to B)	50,000	-
To Wages	10,000	1,000	By Closing stock	30,000	10,000
To Transfer of Goods (A to	-	50,000			

B)					
To Gross Profit c/d	30,000	10,000			
	2,80,000	81,000		2,80,000	81,000
To Adm. & Selling Exp. (4:1)	12,000	3,000	By Gross Profit b/d	30,000	10,000
To Profit	18,000	7,000			
	30,000	10,000		30,000	10,000

General Profit and Loss Account

Particulars	Rs.	Particulars	Rs.
To Stock Reserve		By Profit A	
(Loading on unsold		18,000	
Stock at Dept. B]		B	25,000
10,000x 1/5]	2,000	<u>7,000</u>	
To Net Profit	23,000		
	25,000		25,000

6. (a)

Journal Entries

			Rs.	Rs.
1.1.14	Bank A/c	Dr	12,00,00	
to	Employees compensation	Dr	21,60,00	
28.2.14	expense A/c			
	To Equity Share Capital A/c			2,40,000

31.3.14	To Securities Premium A/c (Allotment of 24,000 equity shares of Rs.10 each at a premium of Rs.130 per share to the employees)	Dr. .	21,60,000	31,20,000
	Profit and Loss A/c			
	To Employees Compensation Expense A/c (For transfer of employees compensation expense to profit and loss account)			21,60,000

(b) **Journal Entries in the books of Shubha Limited**

		Dr. (Rs.)	Cr. (Rs.)
1.4.13	Own debentures A/c Dr. To Bank A/c	49,450	49,450
1.9.13	Own debentures A/c Dr. Interest on own debentures A/c Dr. [30,000 x 8% x $\frac{5}{12}$] To Bank A/c	29,250 1,000	30,250
30.9.13	Interest on debentures A/c Dr.	12,000	

31.3.14	To Bank A/c		8,800
	To Interest on own debentures A/c		3,200
	Interest on debentures A/c Dr.	12,000	
	To Bank A/c		8,800
	To Interest on own debentures A/c		3,200
	8% Debentures A/c Dr.	80,000	
	To Own debentures A/c		78,700
	To Profit on cancellation of Debentures A/c		1,300
	Interest on own debentures A/c Dr.	5,400	
	To Profit and Loss A/c (3,200+3,200-1,000)		5,400
	Profit and Loss A/c (12,000+12,000) Dr.	24,000	
	To Interest on debentures A/c		24,000
	Profit on cancellation of debentures A/c Dr.	1,300	
	To Capital reserve A/c		1,300

(c) **Schedule 2 : Claims Incurred**
(Net)

Particulars	Rs.
Claims paid on direct business	69,00,000
Add: Re-insurance accepted (W.N. 1)	5,51,000

Less: Re-insurance ceded (W.N. 2)	<u>(1,99,000)</u>
Net claims paid	72,52,000
Add: Claims outstanding at the end of the year	95,000
Less: Claims outstanding at the beginning of the year	<u>(89,000)</u>
Total claims incurred	<u>72,58,000</u>

Working Note:

Reinsurance accepted and ceded

	Rs.
1. Claims paid under re-insurance	5,54,000
Add: Outstanding as on 31.3.2014	12,000
Less: Outstanding as on 1.4.2013	<u>(15,000)</u>
Reinsurance accepted	<u>5,51,000</u>
2. Claims received from re-insurance	2,01,000
Add: Outstanding as on 31.3.2014	38,000
Less: Outstanding as on 1.4.2013	<u>(40,000)</u>
Reinsurance ceded	<u>1,99,000</u>

7. (a) Since the company is not appealing against the addition of Rs. 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 13. The amount paid under protest can be kept in the books as an advance and disclosed along with the contingent liability of Rs. 2.10 crore.
- (b) Investments other than investment properties are not qualifying assets as per AS 16 "Borrowing Costs". Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale. Even where the investment properties

meet the definition of 'qualifying asset', for the capitalisation of borrowing costs the other requirements of the standard such as that borrowing cost should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization as per paragraphs 17 and 18 of AS 16 have to be complied with.

(c) Journal Entries

		(Rs.)	
		Dr.	Cr.
Equity shares buy back A/c	Dr.	6,00,000	
To Bank A/c			6,00,000
(Being Buy back of 10,000 shares @ Rs. 60)			
Equity share capital A/c	Dr.	1,00,000	
Securities premium A/c	Dr.	5,00,000	
To Equity shares buy back A/c			6,00,000
(Being cancellation of equity shares bought back)			
Revenue reserves A/c	Dr.	1,00,000	
To Capital redemption reserve A/c			1,00,000
(Being amount equal to nominal value of shares bought back transferred to capital redemption reserve, as required by Companies Act, 2013)			

(d) Statement of Net Liability of Underwriters (Number of Shares)

	Gross Liability	Marked application	Unmarked applications in the	Total (2) +	Credit for C's Surplus	Total (4) +	Net Liability
--	-----------------	--------------------	------------------------------	-------------	------------------------	-------------	---------------

		s	ratio of gross liability	(3)	(10:6)	(5)	(1) - (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
A	20,000	16,000	1,000	17,000	438	17,438	2,562
B	12,000	5,700	600	6,300	262	6,562	5,438
C	8,000	8,300	400	8,700	(700)	8,000	-
	40,000	30,000	2,000	32,000	-	32,000	8,000

Note: The applications are for 32,000 shares out of which those for 30,000 are marked. Hence unmarked applications are for 2,000 shares.

(e) Adjusted net profit for the current year

	Rs.
Net profit for the current year	85,50,000
Add: Interest expense for the current year	6,00,000
Less: Tax relating to interest expense (30% of Rs. 6,00,000)	<u>(1,80,000)</u>
Adjusted net profit for the current year	<u>89,70,000</u>

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$$= \frac{1,00,000 \times 100}{10} = 10,00,000 \text{ Equity shares}$$

Weighted average number of equity shares used to compute diluted earnings per share

$$= [(20,00,000 \times 12) + (10,00,000 \times 9^{**})] / 12 = 27,50,000 \text{ shares}$$

$$\text{Diluted earnings per share} = \frac{89,70,000}{27,50,000 \text{ shares}} = \text{Rs. 3.26 per share}$$

****** Interest on debentures for full year amounts to Rs. 8,00,000 (i.e. 8% of Rs. 1,00,00,000). However, interest expense amounting Rs.

6,00,000 has been given in the question. It may be concluded that debentures have been issued during the year and interest has been provided for 9 months.

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 6: AUDITING AND ASSURANCE

SUGGESTED ANSWERS/HINTS

1. (a) (i) As per SA-260 “Communication with Those Charged with Governance”, the auditor shall communicate the following significant findings from the audit, with those charged with governance:
 - (1) The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;

-
- (2) Significant difficulties, if any, encountered during the audit;
 - (3) Unless all of those charged with governance are involved in managing the entity:
 - (a) Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and
 - (b) Written representations the auditor is requesting; and
 - (4) Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
- (ii) As per SA-230 on "Audit Documentation", the form, content and extent of audit documentation depend on the following factors:
- (1) The size and complexity of the entity.
 - (2) The nature of the audit procedures to be performed.
 - (3) The identified risks of material misstatement.
 - (4) The significance of the audit evidence obtained.
 - (5) The nature and extent of exceptions identified.
 - (6) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
 - (7) The audit methodology and tools used.
- (b) (i) **The Discipline of Behavioural Science is Closely Linked with the Subject of Auditing:** The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that

the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

(ii) Inspection as Audit Procedure to Obtain Audit Evidence:

Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a stock or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed

contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

2. (i) **Incorrect:** The expenditure incidental to the creation and floating of a company includes stamp duties, registration fees, legal costs, accountant's fees, cost of printing, etc. Underwriting commission and brokerage paid for shares and debentures should not be included under the head preliminary expenses. Therefore, PQR Ltd. should include stamp duty as preliminary expense but exclude underwriting commission.
- (ii) **Incorrect:** As per AS-2 on Valuation of Inventories, in determining the cost of inventories, it is appropriate to exclude abnormal amounts of wasted materials, labour or other production costs and recognise them as expenses in the period in which they are incurred. Therefore, it is not appropriate to include abnormal amounts of wasted materials cost in the cost of inventories.
- (iii) **Incorrect:** Internal check has been defined as "checks on day-to-day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". Internal check is a part of the overall internal control system and operates as a built-in device as far as the staff organisation and job allocation aspects of the control system are concerned.
- (iv) **Correct:** As per AS-26 on Intangible Assets, computer software for a computer controlled machine tool that cannot operate without

that specific software is an integral part of the related hardware and it is treated as a fixed asset. Therefore, computer software which is the integral part of the related hardware should be treated as fixed asset.

(v) **Incorrect.** The auditor appointed under section 139 of the Companies Act, 2013 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government.

(vi) **Incorrect:** According to the Research Committee of the Institute, a question often arises as to whether indebtedness arises in cases where in accordance with the terms of his engagement by a client (e.g. resolution passed by the general meeting) the auditor recovers his fees on a progressive basis as and when a part of work is done without waiting for the completion of the whole job. Where in accordance with such terms, the auditor recovers his fees on a progressive basis, he cannot be said to be indebted to the company at any stage.

In view of the above, Mr. Rajat cannot be said to be indebted to the company.

(vii) **Correct:** Examination in depth implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure.

(viii) **Incorrect:** Inherent and control risks differ from detection risk in that they exist independently of an audit of financial information. Inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or

classes of transactions, regardless of whether an audit is conducted. Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce an acceptable level of detection risk, thereby reducing audit risk to an acceptably low level.

(ix) Correct: Section 141(3)(b) of the Companies Act, 2013 evidently excludes an officer or employee of the company to be qualified for appointment as auditor of a company. Therefore, the statement that an officer is not qualified for appointment as Auditor of a Company is correct.

(x) Correct: Operational Audit involves examination of all operations and activities of the entity. The objects of operational audit include the examination of the control structure and of the relation of department controls to general policies. Therefore, the statement given is correct.

3. (a) Accounting Estimates: According to the SA 540, “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures”, accounting estimate means an approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. SA 540 addresses only accounting estimates involving measurement at fair value, the term “fair value accounting estimates” is used.

Because of the uncertainties inherent in business activities, some financial statement items can only be estimated. Further, the specific characteristics of an asset, liability or component of equity, or the basis of or method of measurement prescribed by the financial reporting framework, may give rise to the need to estimate a financial statement item. Some financial reporting

frameworks prescribe specific methods of measurement and the disclosures that are required to be made in the financial statements, while other financial reporting frameworks are less specific.

Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

- Accounting estimates arising in entities that engage in business activities that are not complex.
- Accounting estimates that are frequently made and updated because they relate to routine transactions.

For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded.

Additional examples of accounting estimates are:

- Allowance for doubtful accounts.
- Inventory obsolescence.
- Warranty obligations.
- Depreciation method or asset useful life.
- Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
- Outcome of long term contracts.
- Financial Obligations/Costs arising from litigation settlements and judgments.

(b) Factors which cause Risk: As Per SA 200 “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion.

An independent audit whether performed in terms of applicable financial reporting framework or in terms of the engagement, the auditor has to be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable for the preparation of financial statements. Since the entire process of auditing is based on the assessment of judgements made by the management of the entity as well as evaluation of internal controls, the audit suffers certain inherent risks. Factors which may cause such risk in conducting an audit are discussed below:

- (i) *Exercising judgement on the part of the auditor:* The auditor’s work involves exercise of judgement, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgements and estimates made by management in preparing the financial statements.
- (ii) *Nature of audit evidence:* Much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. The auditor normally relies upon persuasive evidence rather than conclusive evidence. Even in

circumstances where conclusive evidence is available, the cost of obtaining such evidence may far exceed the benefits.

- (iii) *Inherent limitations of internal control:* Internal control can provide only reasonable, but not absolute, assurance on account of several inherent limitations such as potential for human error, possibility of circumstances of control through collusion, etc.

On account of above, it is quite clear that an audit suffers from control risk on account of inherent limitations of internal control and detection risk on account of test nature of audit and judgement and estimates involved in formulating accounting policies.

- (c) **Despite Several Disadvantages, Audit Programme is Required to Start an Audit:** Despite of several disadvantages, the audit programme is required to start an audit due to the following considerations-

- (i) The audit programme lists down areas of audit before commencement.
- (ii) The audit timing is built therein; thereby it becomes a schedule of audit plan.
- (iii) The staff who are entrusted with the audit assignment is also specified. It is a plan of resource allocation of the firm.
- (iv) It specifies the procedures to be checked during the audit.
- (v) As the audit work is split into various elements of procedures to be performed, the audit programme acts as a guiding chart or check list during the performance of audit.
- (vi) Since the staff in charge of each work is specified and they sign the programme, it extracts the responsibility from the audit assistants.

(vii) The working papers of the audit staff can be reviewed against the audit programme which helps a base of reference for evaluation of the performance before reporting on the financial statements.

(viii) It also helps in preparing a diary of the performance and plan and also base for billing the clients for the time and manpower involved in the audit.

4. (a) The Auditor should Gather Information about the CIS Environment that is Relevant to the Audit Plan, Including Information as to:

(i) How the CIS function is organized and the extent of concentration or distribution of computer processing throughout the entity.

(ii) The computer hardware and software used by the entity.

(iii) Each significant application processed by the computer, the nature of the processing (e.g. batch, on-line), and data retention policies.

(iv) Planned implementation of new applications or revisions to existing applications.

(v) When considering his overall plan the auditor should consider matters, such as:

(a) Determining the degree of reliance, if any, he expects to be able to place on the CIS controls in his overall evaluation of internal control.

(b) Planning how, where and when the CIS function will be reviewed including scheduling the works of CIS experts, as applicable.

(c) Planning auditing procedures using computer-assisted audit techniques.

(b) (i) Vouching of Purchases Through Invoice: While vouching entries for purchases with the invoices, the following points should be specially observed-

- (1) that the date of invoice falls within the accounting period;
- (2) that the invoice is made out in the name of the client;
- (3) that the supplier's account has been credited with the full amount of the invoice and that the deduction in the amount of the invoice, if any, has been made on a proper basis;
- (4) that the goods purchased are those that are regularly dealt in by the concern or required for the process of manufacture carried on by it and that the price payable has been correctly arrived at;
- (5) that the cost of purchases has been debited to an appropriate nominal account or accounts;
- (6) that the invoice is signed by the accountant to show that he has verified it as well as the store-keeper to indicate that the delivery of goods have been taken by him. If the invoice relates to the purchase of a technical store or a chemical, the price whereof is dependent on its quality, a copy of the report of a technical person showing that the article purchased is of the specification for which the order has been placed; and
- (7) that the manager or some other official, competent to sanction payment, has authorised its payment.

(ii) Patterns, Dies, Loose Tools, etc.: Several entities have large investments in such assets which have a relatively short useful life and low unit cost. Evidently, it is a difficult matter, under the circumstances, to prepare a separate account for each such asset although a careful control over such property is necessary.

On these considerations, some entities charge off small tools and other similar items to Production Account as and when they are purchased and do not place any value on the unused stock on the Balance Sheet. Nevertheless, a record of issues and receipts of tools to workmen is kept, as a check on the same being pilfered and a memorandum stock account of dies and patterns is also maintained. In other concerns, the cost of tools, dies, etc. purchased is debited to appropriate assets account, and an inventory of the unused items at the end of the year is prepared and valued; the sum total of opening balance and purchase reduced by the value of closing stock, as disclosed by the inventory, is charged off to Production Account in respect of such assets. On the other hand, some concerns carry such assets at their book values at the end of the first year and charge off the cost of all the purchases in the subsequent year to the Production Account on the plea that they represent cost of replacement.

The most satisfactory method, however, is that of preparing an inventory of serviceable articles, at the close of each year, and revaluing the assets on this basis, the various articles included in the inventory being valued at cost. It should be seen that the inventory does not include any worn out or defective articles the life of which has already run out.

(iii) Refund of General Insurance Premium paid: The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds-

- (a) Ascertain the reasons for refund of insurance premium.
- (b) Examine insurance policy or cover note to find out the amount of premium.

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- (c) Verify advice of refund received from the insurance company. When refund is admitted, the insurance company sends the advice. This will be evidence as a covering letter to the cheque for the refund. Sometimes, a cheque is issued after a receipt is sent in advance to the insurance company.
 - (d) Scrutinise correspondence between the insurance company and the client.
 - (e) Check entries in the bank book or the bank statement. If necessary, the counterfoil of the pay-in-slips can also be verified.
5. (a) (i) **Modification of Opinion:** The auditor shall modify the opinion in the auditor's report when-
- (1) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
 - (2) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.
- (ii) **Disclaimer of opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
- The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the

uncertainties and their possible cumulative effect on the financial statements.

(iii) Adverse Opinion: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

(iv) Qualified Opinion: The auditor shall express a qualified opinion when-

(1) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(2) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

(b) Planning Audit of an N.G.O.: While planning the audit of an N.G.O, the auditor should concentrate on the following-

(i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.

(ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 1976, Societies Registration Act, 1860, Income Tax Act, 1961 etc. and the Rules related to the statutes.

(iii) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.

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- (iv) Reviewing the NGO's Organisation chart, Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
 - (v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
 - (vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
 - (vii) Setting of materiality levels for audit purposes.
 - (viii) The nature and timing of reports or other communications.
 - (ix) The involvement of experts and their reports.
 - (x) Review the previous year's Audit Report.

- 6. (a) Ceiling on Number of Company Audits:** Section 141(3)(g) of the Companies Act, 2013 states that the following persons shall not be eligible for appointment as an auditor of a company i.e. a person who is in full time employment elsewhere; or a person, or a partner of a firm holding appointment as its auditor, if such person, or partner is at the date of such appointment, or reappointment holding appointment as auditor of more than twenty companies.

In the given case, Mr. K, a partner in the firm KBC & Co., is in whole-time employment elsewhere, therefore, he will be excluded in determining the number of company audits that the firm can hold. If Mr. B and Mr. C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by KBC & Co., is forty, and in the given case company is already holding forty audits, therefore, KBC & Co. can't accept the offer for audit of ABC Ltd.

(b) Board's Powers to Appoint an Auditor: As per Section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-

- (i) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days.

If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

- (ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next thirty days.

In the given case, casual vacancy has been created due to resignation of the existing auditor(s) of X Ltd. However, the Board of Directors appointed Mr. Hari as the auditor of the company.

Therefore, the appointment of Mr. Hari made by the Board of Directors of X Ltd. is void as, in the case of casual vacancy due to resignation of the auditor, the vacancy can be filled by the Board of Directors within thirty days and such appointment should be approved by the company at a general meeting to be convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

(c) Restrictions on Powers of Statutory Auditors: Section 143 of the Companies Act, 2013 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence, any such resolution even if passed by entire body of shareholders is *ultra vires* and therefore void.

7. (a) Impairment of Assets: Besides charging annual depreciation on assets by the reason of normal wear and tear, effluxion of time and obsolescence to reinstate the correct value of the assets considering the future cash flows that the assets can generate, impairment loss needs to be provided. The difference between the carrying amount of an asset and recoverable amount is termed as impairment loss. The treatment of impairment loss is similar to depreciation except the fact that it can be reinstated in future, if the recoverable amount of the asset exceeds the carrying amount. The auditor must ensure that provisions of AS 28 “Impairment of assets” are followed.

(b) Application of Securities Premium Account: According to section 52 of the Companies Act, 2013, the securities premium account may be applied by the company—

- (i) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (ii) in writing off the preliminary expenses of the company;
- (iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

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- (iv) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
 - (v) for the purchase of its own shares or other securities under section 68.

(c) Importance of Audit Working Papers:

- (i) It provides guidance to the audit staff with regard to the manner of checking the schedules.
- (ii) The auditor is able to fix responsibility on the staff member who signs each schedule checked by him.
- (iii) It acts as evidence in the court of law when a charge of negligence is brought against the auditor.
- (iv) It acts as the process of planning for the auditor so that he can estimate the time that may be required for checking the schedules.

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention.

(d) Inherent Limitations of Internal Control System: Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations, such as-

- (i) Management's consideration that cost of an internal control does not exceeds the expected benefits.
- (ii) Most controls do not tend to be directed at unusual transactions.
- (iii) The potential of human error due to carelessness, misjudgment and misunderstanding of instructions.

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- (iv) The possibility that control may be circumvented through collusion with employees or outsiders.
 - (v) The possibility that a person responsible for exercising control may abuse that authority.
 - (vi) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.
 - (vii) Manipulation by management with respect to transactions or estimates and judgements required in the preparation of financial statements.
 - (viii) Inherent limitations of Audit.
- (e) Auditor's Approach for Re-issue of Forfeited Shares:** The auditor should-
- (i) ascertain that the Board of Directors has the authority under the Articles to re-issue forfeited shares;
 - (ii) refer to the resolution of the Board of Directors, re-allotting forfeited shares;
 - (iii) vouch the amounts collected from person to whom the shares have been allotted and verify the entries recorded from re-allotment and see that the total amount received on the share, including that received prior to forfeiture, is not less than the par value;
 - (iv) verify that computation of the amount of surplus resulting on the reissue of shares credited to the Capital Reserve Account; and
 - (v) where partly paid shares are forfeited for non-payment of call, and re-issued as fully paid, the reissue is considered as an allotment at a discount and compliance of the provisions of Section 53 of the Companies Act, 2013 is essential as issuance of shares at discount other than sweat equity share are void.

Test Series: February, 2015

MOCK TEST PAPER – 1
INTERMEDIATE (IPC): GROUP – II
PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC
MANAGEMENT
SECTION – A: INFORMATION TECHNOLOGY
SUGGESTED ANSWERS/HINTS

1. (i) **Decision Table:** A Decision Table is a table which may accompany a flowchart defining the possible contingencies that may be considered within the program and the appropriate course of action for each contingency. A Decision Table is divided into four quadrants: Condition Stub, Condition Entries, Action Stub and Action Entries, with each quadrant having specific significance.
- (ii) **Value Chain:** Value Chain is defined as a chain of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market. Research and development; Design of products, services, or processes; Production; Marketing and sales; Distribution and Customer service are some of the business functions of the value chain.
- (iii) **Computer Bus:** Computer Bus is a communication system that transfers data between components inside a computer, or between

computers that covers all related hardware components (wire, optical fiber, etc.) and software, including communication protocol.

- (iv) **Wi-Fi:** Wi-Fi is a popular wireless networking technology that uses radio waves to provide wireless high-speed Internet and network connections and have limited range. A typical wireless access point might have a range of 32 meters (120 ft.). Wi-Fi networks use radio technologies called 802.11 to provide secure, reliable, fast wireless connectivity. A Wi-Fi network can be used to connect electronic devices to each other, to the Internet, and to wired networks (which use Ethernet technology).
- (v) **Vulnerability:** Vulnerability is an inherent weakness in the design, configuration, or implementation of a network or system that renders it susceptible to a threat. Software Bugs, insecure default configurations, trusting untrustworthy information and negligence at end-users' parts are some of the factors responsible for occurrence of vulnerabilities in the software.
- (vi) **Repeater:** Repeater is a communication processor that boosts or amplifies the signal before passing it to the next section of cable in a network.
- (vii) **Knowledge Management Systems:** Knowledge Management System (KMS) refers to any kind of IT system that stores and retrieves knowledge, improves collaboration, locates knowledge sources, mines repositories for hidden knowledge, captures and uses knowledge, or in some other way enhances the Knowledge Management process.
- (viii) **XBRL:** eXtensible Business Reporting Language (XBRL) is freely available international standards-based business reporting language developed by accountants for financial reporting.
- (ix) **Business Application:** Business Application is defined as a computer program used to fulfill a person's need for regular occupation or commercial activities like keeping track of inventory

levels, checking for bank account balances, checking status of delivery of goods dispatched and all other business activities. Business Applications may be classified on the basis of – Nature of processing, Source of application, Nature of business and Functions covered /nature of application.

(x) **HTTPS:** HyperText Transfer Protocol Secure (HTTPS) is a communications protocol for secure communication over a computer network, with especially wide deployment on the Internet. The security of HTTPS uses long term public and secret keys to exchange a short term session key to encrypt the data flow between client and server.

2. (a) **Cloud Computing:** Cloud Computing architecture refers to the components and subcomponents that typically consist of a front end platform (fat client, thin client, mobile device), back end platform (servers, storage), a cloud based delivery, and a network (Internet, Intranet, Intercloud). Cloud architecture typically involves multiple cloud components communicating with each other over a tight or loose coupling of cloud resources, services, middleware, and software components.

A cloud computing architecture consists of two parts - **Front End** and a **Back End** that connect to each other through a network, usually the Internet. The front end is the side the computer user or client, sees. The back end is the “cloud” section of the system.

- ◆ **Front End:** The Front End of the cloud computing system comprises of the client's devices (or it may be a computer network) and some applications are needed for accessing the cloud computing system. All the cloud computing systems do not give the same interface to users. For example - Web services like electronic mail programs use some existing web browsers such as Firefox, Microsoft's Internet Explorer or

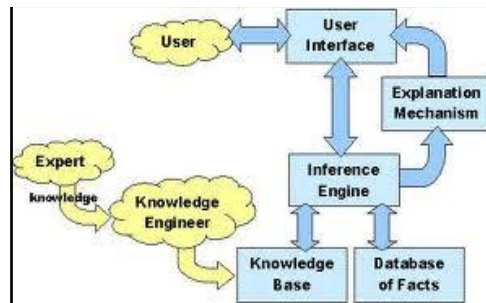
Apple's Safari. Other types of systems have some unique applications which provide network access to its clients.

- ◆ **Back End:** Back End refers to some physical peripherals. In cloud computing, the back end is cloud itself which may encompass various computer machines, data storage systems and servers. Groups of these clouds make a whole cloud computing system. Theoretically, a cloud computing system can include practically any type of web application program such as video games to applications for data processing, software development and entertainment residing on its individual dedicated server for services. There are some set of rules, generally called as **Protocols** which are followed by this server and it uses a special type of software termed as **Middleware** that allow computers that are connected on networks to communicate with each other.

(b) Some of the business uses of the Internet are following:

- ◆ Strategic business alliances
- ◆ Providing customer and vendor support
- ◆ Collaboration among business partners
- ◆ Buying and selling products and services
- ◆ Marketing, sales, and customer service applications
- ◆ Growth of cross-functional business applications
- ◆ Emergence of applications in engineering, manufacturing, human resources and accounting.
- ◆ Enterprise communications and collaboration
- ◆ Attracting new customers with innovative marketing and products.

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- ◆ Retaining present customers with improved customer service and support.
 - ◆ Developing new web-based markets and distribution channels for existing products.
 - ◆ Developing new information-based products accessible on the Web.
 - ◆ Generating revenue through electronic commerce applications is a growing source of business value.
 - ◆ Electronic commerce.
3. (a) **Expert System:** An Expert System (ES) is a computerized information system that allows non-experts to make decisions comparable to those of an expert. The aim of the expert system is to have a team of seasoned specialists holding industry-wide experience who further spread across implementations. Expert system has leveraged its strengths to plan and execute a miscellaneous variety of projects for Defence, Government, Finance, Telecom, and Engineering sectors. The key components of an Expert System take into consideration the knowledge, facts and user interface with the help of knowledge engineer to accomplish the task.
- ◆ **Knowledge Base:** This includes the data, knowledge, relationships, rules of thumb (heuristics), and decision trees used by experts to solve a particular problem. A knowledge base is the computer equivalent of all the knowledge and that encloses both realistic and heuristic knowledge.



- ◆
- ◆ **Inference Engine:** This program contains the logic and reasoning mechanisms that simulate the expert logic process and deliver advice. It uses data obtained from both the knowledge base and the user to make associations and inferences, form its conclusions, and recommend a course of action.
- ◆ **User Interface:** This program allows the user to design, create, update, use and communicate with the expert system.
- ◆ **Explanation facility:** This facility provides the user with an explanation of the logic the ES used to arrive at its conclusion.
- ◆ **Database of Facts:** This holds the user's input about the current problem. Gradually a database of facts is built up which the inference engine will use to come to a decision. The quality and quantity of data gained from the user will influence the reliability of the decision.

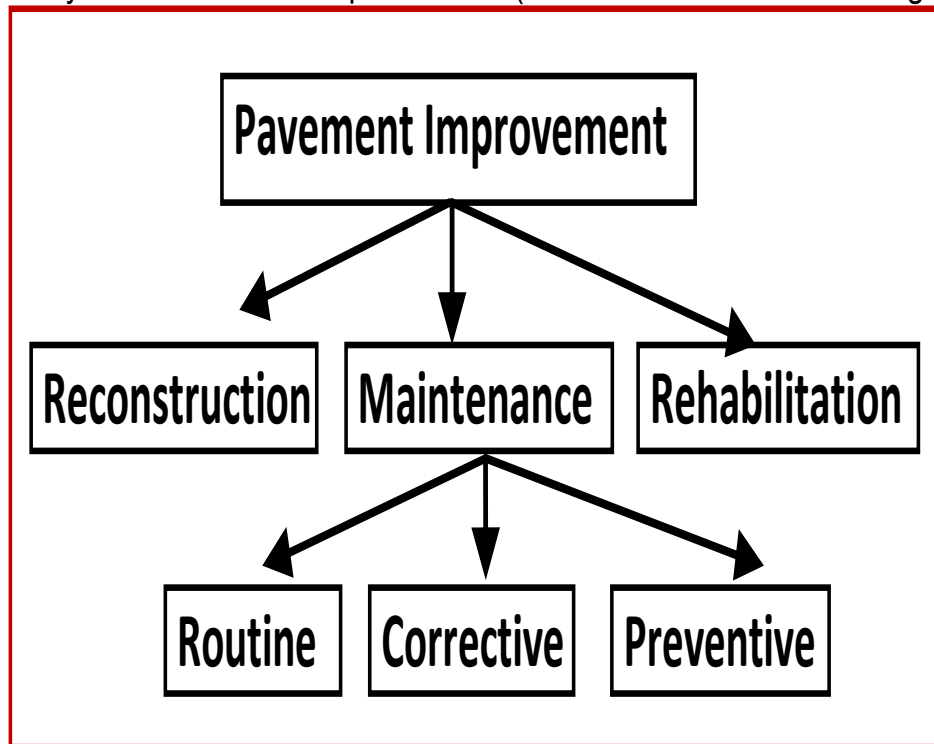
(b) **Smart Cards:** Smart cards have an embedded microchip instead of magnetic strip. The chip contains all the information a magnetic strip contains but offers the possibility of manipulating the data and executing applications on the card. Three types of smart cards are as follows:

- ◆ **Contact Cards** – Smart cards that need to insert into a reader in order to work, such as a smart card reader or automatic teller machines.

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- ◆ **Contactless Cards** – Contactless smart cards don't need to be inserted into a reader. Just waving them near a reader is just sufficient for the card to exchange data. This type of cards is used for opening doors.
 - ◆ **Combi/Hybrid Cards** – Combi cards contain both technologies and allow a wider range of applications.
4. (a) **Network Virtualization:** In IT, Virtualization is the process of creating logical computing resources from available physical resources. Network Virtualization allows a large physical network to be provisioned into multiple smaller logical networks and conversely allows multiple physical LANs to be combined into a larger logical network. This behaviour allows administrators to improve network traffic control, enterprise and security." Major applications of the concepts of the virtualization are given as follows:
- ◆ **Server Consolidation:** Virtual machines are used to consolidate many physical servers into fewer servers, which in turn host virtual machines. Each physical server is reflected as a virtual machine "guest" residing on a virtual machine host system. This is also known as "Physical-to-Virtual" or 'P2V' transformation.
 - ◆ **Disaster Recovery:** Virtual machines can be used as "hot standby" environments for physical production servers. This changes the classical "backup-and-restore" philosophy, by providing backup images that can "boot" into live virtual machines, capable of taking over workload for a production server experiencing an outage.
 - ◆ **Testing and Training:** Hardware virtualization can give root access to a virtual machine. This can be very useful such as in kernel development and operating system courses.

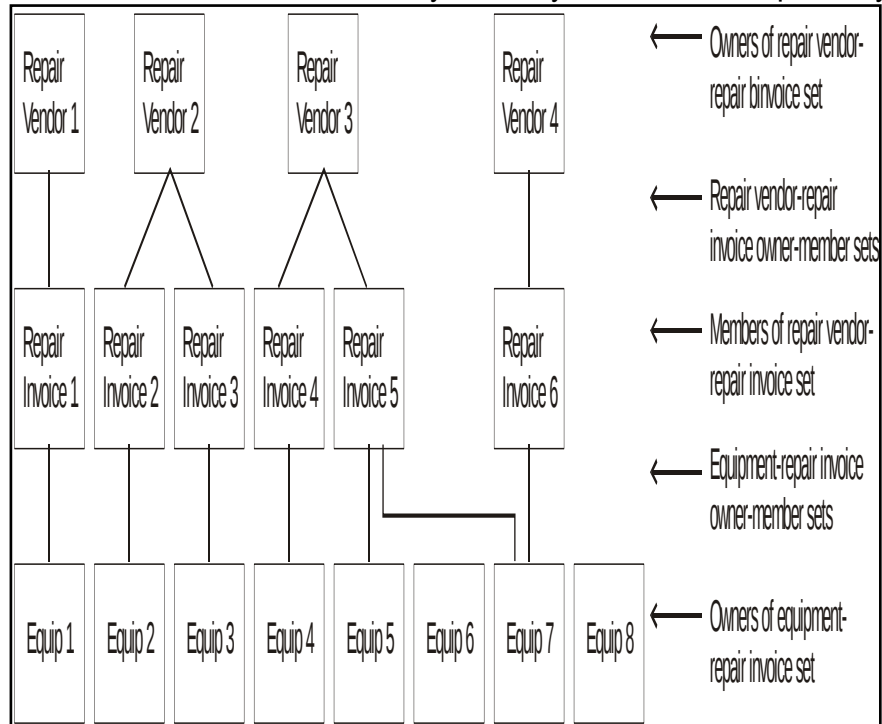
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- ◆ **Portable Applications:** Portable applications are needed when running an application from a removable drive, without installing it on the system's main disk drive. Virtualization can be used to encapsulate the application with a redirection layer that stores temporary files, windows registry entries and other state information in the application's installation directory and not within the system's permanent file system.
 - ◆ **Portable Workspaces:** Recent technologies have used virtualization to create portable workspaces on devices like iPods and USB memory sticks.
- (b) We need Grid Computing because of the following reasons:
- ◆ Civil engineers collaborate to design, execute, & analyze shake table experiments.
 - ◆ An insurance company mines data from partner hospitals for fraud detection.
 - ◆ An application service provider offloads excess load to a compute cycle provider.
 - ◆ An enterprise configures internal & external resources to support e-Business workload.
 - ◆ Large-scale science and engineering are done through the interaction of people, heterogeneous computing resources, information systems and instruments, all of which are geographically and organizationally dispersed.
5. (a) **Hierarchical Database Model:** In a hierarchical database model, records are logically organized into a hierarchy of relationships. A hierarchically structured database is arranged logically in an inverted tree pattern. All records in hierarchy are called nodes. The top parent record in the hierarchy is called the **root record**. Records that “own” other records are called **parent records**. Each node is related to the others in a parent-child relationship. Each

parent record may have one or more child records, but no child record may have more than one parent record. Thus, the hierarchical data structure implements one-to-one and one-to-many relationships. (Refer the fig.)



Network Database Model: The network model is a variation on the hierarchical model such that it is built on the concept of multiple branches (lower-level structures) emanating from one or more nodes (higher-level structures) and that branch may be connected to multiple nodes. The network model is able to represent redundancy in data more efficiently than in the hierarchical model. The network model also permits a record to be a member of more than one set at one time that allows the network model to implement the many-to-

one and the many-to-many relationship types.

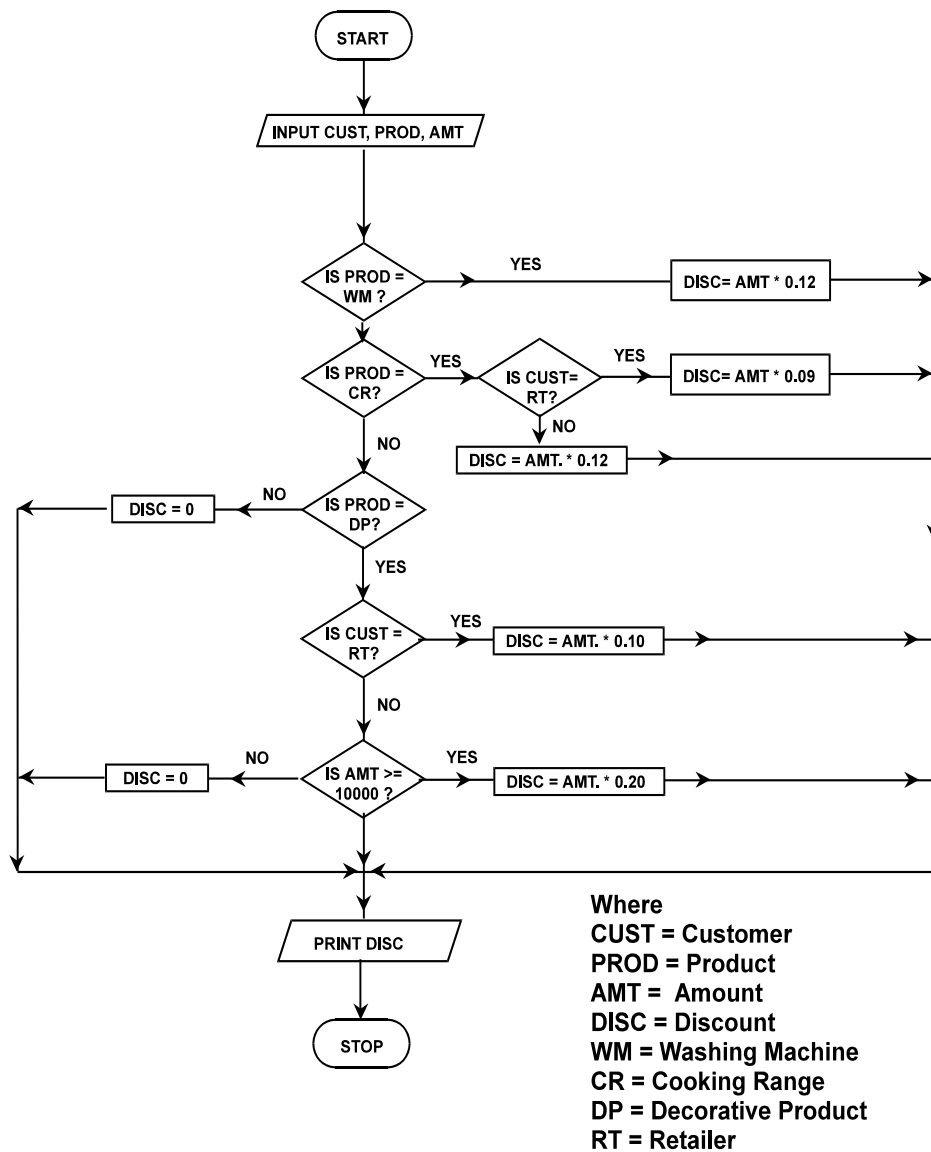


(b) Transport Layer of OSI Model: Transport Layer or Layer 4 ensures reliable and transparent transfer of data between user processes, assembles and disassembles message packets and provides error recovery and flow control. Multiplexing and encryption are undertaken at this layer level. This means that the Transport Layer can keep track of the segments and retransmit those that fail.

Network Layer of OSI Model: The Network Layer or Layer 3 provides the functional and procedural means of transferring variable length data sequences from a source to a destination via one or more networks, while maintaining the quality of service requested by the Transport Layer. The Network Layer makes a choice of the physical route of transmission; creates a virtual circuit for upper layers to make them independent of data transmission and switching;

establishes, maintains, terminates connections between the nodes and ensure proper routing of data.

(a) The required flowchart is given below in Fig.



(b) Some of the advantages of using Decision Tree are as follows:

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- These are simple to understand and interpret. People are able to understand decision tree models after a brief explanation.
 - Possible scenarios can be added in Decision Tree.
 - Worst, best and expected values can be determined for different scenarios.
7. (a) **Bluetooth:** Bluetooth is a wireless technology standard for exchanging data over short distances up to 50 meters (164 feet) from fixed and mobile devices, creating Personal Area Networks (PANs) with high levels of security. Bluetooth is like a very low-power, short-range radio signal and are secure from the moment they're sent. Few devices that utilize Bluetooth technology are - Keyboards and mice; Printers; Cell phones and headsets; Personal Digital Assistants; Desktop and laptop computers; Digital cameras, and Remotes. Through the use of a mobile phone with Bluetooth enabled in them, we can send pictures, videos, exchange business cards and also transfer files to our PC. Both data and voice transmissions can be sent and received through the use of short range networks.
- (b) **Business Process Reengineering (BPR):** BPR aims at major transformation of the business processes to achieve dramatic improvement. 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). BPR is the main method by which organizations become more efficient and modern. It transforms an organization in ways that directly affect its performance. Information Systems are valuable assets that knowledge workers can take advantage of. BPR combines small granular functions conducted by several persons into functional units of larger granularity, and supports

knowledge workers in performing these tasks with dedicated information systems.

- (c) **Mesh Network:** In this structure, there is random connection of nodes using communication links. A mesh network may be fully connected or connected with only partial links. In fully interconnected topology, each node is connected by a dedicated point to point link to every node. The reliability is very high as there are always alternate paths available if direct link between two nodes is down or dysfunctional. In this, the network problems are easier to diagnose. However, fully connected networks are not very common because of the high cost of installation and maintenance.
- (d) **Core Banking Systems:** CORE (Centralized Online Real-time Environment) Banking System (CBS) may be defined as the set of basic software components that manage the services provided by a bank to its customers through its branches (branch network). Core banking systems are the heart of a bank. The various elements of core banking include - Making and servicing loans; Opening new accounts; Processing cash deposits and withdrawals; Processing payments and cheques; Calculating interest; Customer relationship management (CRM) activities; Managing customer accounts; Establishing criteria for minimum balances, interest rates, number of withdrawals allowed and so on; Establishing interest rates; and Maintaining records for all the bank's transactions etc. Examples of major core banking products include Infosys' Finacle, Nucleus FinnOne and Oracle's Flexcube application (from their acquisition of Indian IT vendor i-flex).
- (e) **Application Controls:** Application Controls deal with the application functions that need to be in place to accomplish reliable information processing.

Types of Application Subsystem and their description

Application Subsystem	Description of Subsystem
Boundary	Comprises the components that establish the interface between the user and the system.
Input	Comprises the components that capture, prepare, and enter commands and data into the system.
Communication	Comprises the components that transmit data among subsystems and systems.
Processing	Comprises the components that perform decision making, computation, classification, ordering, and summarization of data in the system.
Database	Comprises the components that define, add, access, modify, and delete data in the system.
Output	Comprises the components that retrieve and present data to users of the system.

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

**PAPER –7: INFORMATION TECHNOLOGY AND STRATEGIC
MANAGEMENT**

SECTION – B: STRATEGIC MANAGEMENT

SUGGESTED ANSWERS / HINTS

1. (a) By virtue of its command over resources and information organisations are also in position to yield power and influence over some of the elements of external environment. The same elements which exercise power over the organization are also subject to the influence and power of the organization in some respects. To the extent that the organization is able to hold power over the environment increases its autonomy and freedom of action. It can dictate terms to the external forces and mould them to its will.
- (b) Market penetration is a growth strategy where the business focuses on selling existing products into existing markets. It is achieved by making more sales to present customers without changing products in any major way. Penetration might require greater spending on advertising or personal selling.
- (c) Concentric diversification amounts to related diversification. In this form of diversification, the new business is linked to the existing businesses through existing systems such as process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. However, concentric diversification differs from vertically integrated diversification in the nature of the linkage the new product has with the existing ones. The new product is only connected in a loop-like manner at one or more points in the firm's existing process/technology/product chain. In concentric diversification there are benefits of synergy with the current operations.
- (d) Identifying an organisation's existing vision, mission, objectives are the starting point for any strategic management process. Determining vision and mission provides long-term direction, delineate what kind of enterprise the company is trying to become and infuse the organisation with a sense of purposeful action.

(e) Education is considered to be a noble profession. An educational institution often functions as a not-for-profit organization managed by trusts and societies. They include schools, colleges and universities. Being inherently non-commercial in nature, educational organisations do not have cut-throat competition as in case of their commercial counterparts. However, as the number of institutions belonging to both public and private sector are increasing, the competition is gradually rising. Through the use of strategic management techniques such institutions are expected to concentrate attention towards:

- Getting better name and recognition.
- Attracting talented students.
- Designing the curriculum in such a way to provide better citizenry and employability.
- Appointing and retaining quality faculty for teaching.
- Preparing students for the future challenges by capacity building.

2. (a) (i) **Incorrect:** It is in the very nature of strategy that it is flexible and pragmatic. Strategy is art of the possible. It does not preclude second-best choices, trade-offs, sudden emergencies, pervasive pressures, failures and frustrations. However, in a sound strategy, allowances are made for possible miscalculations and unanticipated events.

(ii) **Correct:** Strength is an inherent capacity which an organization can use to gain strategic advantage over its competitors. An example of strength is superior research and development skill which can be used for continuous product innovation or for new product development so that the company gains competitive advantage.

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- (b)** Although correlated, strategy implementation is fundamentally different from strategy formulation in the following ways:
- (i) Strategy formulation is positioning forces before the action. Strategy implementation is managing forces during the action.
 - (ii) Strategy formulation focuses on effectiveness whereas strategy implementation focuses on efficiency.
 - (iii) Strategy formulation is primarily an intellectual process whereas implementation of strategy is primarily an operational process.
 - (iv) Strategy formulation requires good intuitive and analytical skills while strategy implementation requires special motivation and leadership skills.
 - (v) Strategy formulation requires coordination among a few individuals while strategy implementation requires organization wide coordination.
3. **(a)** Industry is a consortium of firms whose products or services have homogenous attributes or are close substitutes such that they compete for the same buyer. For example, all paper manufacturers constitute the paper industry.
- (b)** Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the marketplace - the particular strategy elements, product attributes, resources, competencies, competitive capabilities, and business outcomes that spell the difference between profit and loss and, ultimately, between competitive success or failure.
- (c)** Value chain analysis refers to separate activities which are necessary to underpin an organization's strategies and are linked together both within and around the organization. Organizations are much more than a random collection of machines, money and people. Value chain of a manufacturing organization comprises of primary and supportive activities.

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4. The term PESTLE is used to describe a framework for analysis of macro environmental factors. PESTLE analysis involves identifying the political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy. 'PESTLE analysis is an acronym for:
- P - Political factors are how and to what extent a government intervenes in the economy and the activities of corporate. Political factors may also include goods and services which the government wants to provide or be provided and those that the government does not want to be provided.
 - E - Economic factors have major impacts on how businesses operate and take decisions. For example, interest rates, exchange rate affect a firm's costs. The money supply, inflation, credit flow, per capita income, growth rates have a bearing on the business decisions.
 - S - Social factors affect the demand for a company's products and how that company operates.
 - T - Technological factors can determine barriers to entry, minimum efficient production level and influence outsourcing decisions. Furthermore, technological shifts can affect costs, quality, and lead to innovation.
 - L - Legal factors affect how a company operates, its costs, and the demand for its products.
 - E - Environmental factors affect industries such as tourism, farming, and insurance. Growing awareness to climate change is affecting how companies operate and the products they offer – it is both creating new markets and diminishing or destroying existing ones.
5. (a) Strategic planning and implementation have become must for all

organizations for their survival and growth in the present turbulent business environment. Many organizational giants have also followed the path of extinction failing to manage drastic changes in the business environment. The organizations have to build competitive advantage over the competitors in the business warfare in order to win. The major benefits of strategic management are:

- ◆ Strategic management helps organisations to be more proactive instead of reactive in shaping its future. Organisations are able to analyse and take actions instead of being mere spectators. Thereby they are able to control their own destiny in a better manner.
- ◆ Strategic management provides framework for all the major business decisions of an enterprise such as decisions on businesses, products, markets, manufacturing facilities, investments and organisational structure.
- ◆ Strategic management is concerned with ensuring a good future for the firm. It seeks to prepare the corporation to face the future and act as pathfinder to various business opportunities.
- ◆ Strategic management serves as a corporate defence mechanism against mistakes and pitfalls. It helps organisations to avoid costly mistakes in product market choices or investments.

Over a period of time strategic management helps organisation to evolve certain core competencies and competitive advantages that assist in its fight for survival and growth.

- (b)** Mission statements broadly describe an organizations present capabilities, customer focus, activities, and business makeup. Following points are useful while writing mission of a company:

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- ◆ Good mission statements are highly personalized – unique to the organization for which they are developed.
 - ◆ One of the roles of a mission statement is to give the organization its own special identity, business emphasis and path for development.
 - ◆ A company's business is defined by what needs it is trying to satisfy, customer groups it is targeting, technologies and competencies it uses and the activities it performs.
 - ◆ Technology, competencies and activities are important in defining a company's business because they indicate the boundaries on its operation.
 - ◆ The mission should not be to make profit.
6. Rising competition, business cycles and economic volatility have created a climate where no business can take viability for granted. Turnaround strategy is a highly targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level. Turnaround strategy is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is a question. Once turnaround is successful the organization may turn to focus on growth.

Conditions for turnaround strategies: When firms are losing their grips over market, profits due to several internal and external factors, and if they have to survive under the competitive environment they have to identify danger signals as early as possible and undertake rectification steps immediately. These conditions may be, inter alia cash flow problems, lower profit margins, high employee turnover and decline in market share, capacity underutilization, low morale of employees, recessionary conditions, mismanagement, raw material supply problems and so on.

Action plan for turnaround strategy

Stage One – *Assessment of current problems*: The first step is to assess the current problems and get to the root causes and the extent of damage the problem has caused. Once the problems are identified, the resources should be focused toward those areas essential to efficiently work on correcting and repairing any immediate issues.

Stage Two – *Analyze the situation and develop a strategic plan*: Before you make any major changes; determine the chances of the business's survival. Identify appropriate strategies and develop a preliminary action plan. Analyze the strengths and weaknesses in the areas of competitive position.

Stage Three – *Implementing an emergency action plan*: If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive. The plan typically includes human resource, financial, marketing and operations actions to restructure debts, improve working capital, reduce costs, improve budgeting practices, prune product lines and accelerate high potential products. A positive operating cash flow must be established as quickly as possible and enough funds to implement the turnaround strategies must be raised.

Stage Four – *Restructuring the business*: The financial state of the organization's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Prepare cash forecasts, analyze assets and debts, review profits and analyze other key financial functions to position the organization for rapid improvement.

During the turnaround, the "product mix" may be changed, requiring the organization to do some repositioning. Some facilities might be closed; the organization may even withdraw from certain markets to make organization leaner or target its products toward a different niche. The "people mix" is another important ingredient in the organization's competitive effectiveness. Reward and compensation

systems that encourage dedication and creativity encourage employees to think profits and return on investments.

Stage Five – *Returning to normal*: In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added. Emphasis is placed on a number of strategic efforts such as carefully adding new products and improving customer service, creating alliances with other organizations, increasing the market share, etc.

7. The prominent areas where the human resource manager can play strategic role are as follows:
 - a. *Providing purposeful direction*: The human resource management must be able to lead people and the organization towards the desired direction involving people. The management have to ensure harmony between organisational objectives and individual objectives. Objectives are specific aims which must be in the line with the goal of the organization and the all actions of each person must be consistent with them.
 - b. *Creating competitive atmosphere*: In the present business environment, maintaining competitive position or gains is an important objective of any business. Having a highly committed and competent workforce is very important for getting a competitively advantageous position.
 - c. *Facilitation of change*: The human resource manager will be more concerned about furthering the organization not just maintaining it. He has to devote more time to promote acceptance of change rather than maintaining the status quo.
 - d. *Diversification of workforce*: In a modern organization, management of diverse workforce is a great challenge. Workforce diversity can be observed in terms of male and female, young and old, educated and uneducated, unskilled and professional employee and so on.

Maintaining a congenial healthy work environment is a challenge for HR Manager. Motivation, maintaining morale and commitment are some of the key task that a HR manager has to perform.

- e. *Empowerment of human resources:* Empowerment involves giving more power to those who, at present, have little control what they do and little ability to influence the decisions being made around them.
- f. *Building core competency:* The human resource manager has an important role to play in developing core competency by the firm. A core competence is a unique strength of an organization which may not be shared by others. Organization of business around core competence implies leveraging the limited resources of a firm. It needs creative, courageous and dynamic leadership having faith in organization's human resources.
- g. *Development of works ethics and culture:* A vibrant work culture will have to be developed in the organizations to create an atmosphere of trust among people and to encourage creative ideas by the people. Far reaching changes with the help of technical knowledge will be required for this purpose.