THE ACCOUNTANTS MANUAL

May 2010

THE ACCOUNTANTS MANUAL

LANDMARK RULINGS

- Is Keyman Insurance Policy allowable as business expenditure?
- How banks should pass entries in its books of accounts for writing off bad-debts?
- Does treatment at concessional rate amounts to philanthropy under the IT Act?

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Editorial

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Accounting Academics

Total Questions: 5 **Time Allotted: 30 mins**

(1 / 5) An employee, who joined on April 1, 2008, is entitled to Rs. 10,000 as death-cum-retirement gratuity for each completed year of service. As per actuarial estimates at the end of 2008-09, the expected date of vesting is 25 years from current date (31 /03/09) and the appropriate discounting rate based on market yield on Governiiient Bond is 10% p.a. At the end of first half-year of 2009-10, the appropriate annual discounting rate of 9.98% is considered appropriate.

Determine the amount of expense for gratuity the employer should recognise in first half-year of 2009-10.

(2 / 5) An enterprise earned Rs. 60,000 before tax in first quarter of 2009-10. At the end of first quarter, the enterprise estimates annual earning of Rs. 2 lakh before tax. The estimated deduction from gross total income for tax purpose was Rs. 25,000.

The enterprise earned Rs. 80,000 before tax in second quarter of 2009-10. At the end of second quarter, the enterprise estimates annual earning of Rs. 2.20 lakh before tax and expects to have deduction from gross total income for tax purpose Rs. 22,000.

Assume tax rate 30% and compute tax expense to recognise in first and second quarters of 2009-10.

(3 / 5) A mutual fund purchased 10,000 Debentures of C Ltd. on September 1, 2008 @ Rs. 129 per debenture, cum-interest. All of these debentures were sold on June 1, 2009 @ Rs. 127.50 per debenture cum-interest. The debentures pay half-yearly interest on September 30, and March 31. The coupon rate is 12% p.a. Nominal value per debenture was Rs. 100.

Record the transactions in books of the mutual fund.

(4 / 5) A Ltd. acquired four qualifying assets in 2009-10. The acquisitions were financed partly out of own funds and partly out of borrowed funds at different rates of interest. The following particulars are available.

	Plant 1	Plant 2	Plant 3	Plant 4
Cost of acquisition (Rs. lakh)	70	20	60	50

Acquisition of plant 4 was financed by 12% term loan obtained on 01/04/09. Total own fund invested in acquisition of remaining three plants was Rs. 30 lakh. The remaining cost of acquisition viz. Rs. 120 lakh, was financed by 10% term loan Rs. 90 lakh obtained on 01/10/09 and 15% term loan Rs. 30 lakh obtained on 01/12/09. All three plants were acquired on 01/12/09.

Show allocation of borrowing costs, assuming that the full amounts of such costs are eligible for capitalisation.

(5 / 5) Cost of an item of raw materials inventory at the end of 2009-10 is Rs. 35. The current market price of this item is Rs. 25. It is possible to incorporate the item into a finished unit at a cost of Rs. 200 Determine value of inventory if selling price of the finished unit is:

(i) Rs. 240 (ii) Rs. 228 (iii) Rs. 240.

Accounting Academics

Answers **Time Allotted: 30 mins**

Answer: Question (1 / 5)

Present value of gratuity obligation on 31/03/09 = $10,000 / (1.10)^{25}$ = Rs. 923

Current service cost for first half year of 2009-10 = $5,000 / (1.0998)^{24.5}$ = Rs. 486

Interest cost = 4.99% of Rs. 923 = Rs. 46

Present value of gratuity obligation on 30/09/09 = $15,000 / (1.0998)^{24.5}$ = 1,458

Actuarial loss = Rs. 1,458 - (Rs. 923 + Rs. 486 + Rs. 46) = Rs. 3

Total expense to recognise in first half-year of 2009-10 = (Rs. 486 + Rs. 46 + Rs. 3) = Rs. 535

Answer: Question (2 / 5)

Effective tax rate:

	Quarter 1 Rs.	**Quarter 2** Rs.
Estimated profit before tax	2,00,000	2,20,000
Less: Deduction from Gross total income	25,000	22,000
Estimated taxable profit for the year	1,75,000	1,98,000
Tax (30%)	52,500	59,400
Effective tax rate estimated	26.25%	27.00%

Tax Expense:

	Quarter 1 Rs.	**Quarter 2** Rs.
Estimated profit before tax to date	60,000	1,40,000
Effective tax rate	26.25%	27.00%
Estimated tax expense to date	15,750	37,800
Less: Tax expense recognised already	--	15,750
Tax expense for the quarter	15,750	22,050

Answer: Question (3 / 5)

Interest per month = 10,000 x Rs. 100 x 12% x 1/12 = Rs. 10,000

Interest received on September 30, 2008 = Interest from April 1, 2008 to September 30, 2008

= Rs. 10,000 x 6 months = Rs. 60,000

Interest earned = Interest from September 1, 2008 to September 30, 2008

= Rs. 10,000 x 1 months = Rs. 10,000

Accounting Academics

Answers **Time Allotted: 30 mins**

Answer: Question (3 / 5) contd…..

Interest Recoverable (Included in purchase price) = Rs. 60,000 - Rs. 10,000 = Rs. 50,000
(Interest from April 1, 2007 to August 31, 2007)

Cost of investment = Purchase Price - Interest Recoverable

= 10,000 x Rs. 129 - Rs. 50,000 = Rs. 12,40,000

Interest received on March 31, 2009 = Interest from October 1, 2008 to March 31, 2009

= Rs. 10,000 x 6 months = Rs. 60,000 (Interest Earned)

Interest earned upto date of sale (included in sale price) = Interest from April 1, 2009 to May 31, 2009

= Rs. 10,000 x 2 months = Rs. 20,000 (Interest Recoverable)

Net sale price realized = Sale Price - Interest Recoverable

= 10,000 x Rs. 127.50 - Rs. 20,000 = Rs. 12,55,000.

Books of mutual fund

Date		Dr. Rs. 000	Cr. Rs. 000
01/09/07	Investment in Debenture	1,240	
	Interest Recoverable	50	
	To Bank		1,290
	(Purchase of C Ltd. debentures cum-interest)		
30/09/07	Bank	60	
	To Interest		10
	To Interest Recoverable		50
	(Interest received)		
31/03/08	Bank	60	
	To Interest		60
	(Interest received)		
01/06/08	Bank	1,275	
	To Interest Recoverable		20
	To Investment in Debentures		1,240
	To Profit on disposal		15
	(Disposal of Investment in C Ltd. debentures cum-interest)		
31/03/09	Interest Recoverable	20	
	To Interest		20
	(Interest Recoverable recognised as income)		

Accounting Academics

Answers **Time Allotted: 30 mins**

Answer: Question (4 / 5)

Total borrowing cost accruing after commencement of capitalisation (01/12/09) in respect of funds borrowed generally = 10% on Rs. 90 lakh for 4 months + 15% on Rs. Rs. 30 lakh for 4 months = Rs. 4.5 lakh

Total amount of fund borrowed generally = Rs. 120 lakh

Weighted average capitalisation rate = (4.5/120) x 100 = 3.75%

Proportion of borrowed fund:

Total cost of acquisition of plants 1, 2 and 3 = Rs. 150 lakh.
Borrowed fund used = Rs. 120 lakh.
Proportion of borrowed fund used = (120 / 150) x 100 = 80%

Allocation of borrowing costs:

Assets	Acquisition Costs Rs. Lakh	Borrowing Costs Rs. Lakh	
Plant 1	70	2.1	70 x 3.75% x 80%
Plant 2	20	0.6	20 x 3.75% x 80%
Plant 3	60	1.8	60 x 3.75% x 80%
	150	4.5	
Plant 4		6.0	12% x 50
Capitalised		10.5	
Interest on 10% loan for 2 months		1.5	Recognised as expense
		12.0	

Answer: Question (5 / 5)

	Case (i) Rs.	Case (ii) Rs.	Case (iii) Rs.
Selling price of finished unit	240	228	210
Less: Estimated cost of making	200	200	200
Net realizable value of material if sold as part of finished unit	40	28	10
Net realizable value of material, if sold as it is	25	25	25
Net realizable value	40	28	25
Cost of inventory	35	35	35
Value of inventory (Lower of cost and net realizable value)	35	28	25

In the first case, the selling price Rs. 240, exceeds relevant cost of finished product Rs. 225 (Rs. 200 + Rs. 25 = Rs. 225) by Rs. 15. The enterprise decides to incorporate the material in finished product. The value of raw materials inventory has not been written down below cost (Rs. 35) because as part of finished product, the item can recover Rs. 40, which is more than Rs. 35.

In the second case, the selling price Rs. 228, exceeds relevant cost of finished product Rs. 225 (Rs. 200 + Rs. 25 = Rs. 225) by Rs. 3. The enterprise decides to incorporate the material in finished product. The amount recovered for the material as part of finished unit Rs. 28 is more than market price Rs. 25 but less than cost Rs. 35. The value of raw materials inventory is written down to Rs. 28.

In the third case, relevant cost of finished product Rs. 225 exceeds selling price Rs. 210 by Rs. 15. The enterprise decides to sale the material as it is for Rs. 25. The value of raw materials inventory is written down to Rs. 25.

Auditing Fundas

Total Questions: 2 **Time Allotted: 20 mins**

List the important Internal Controls in relation to the following:

(a) Purchase and Creditors.

(b) Sales and Debtors.

Answers **Time Allotted: 20 mins**

Answer: Question (a)

The important controls in relation to Purchase and Creditors are:

- Re-order Level: Re-Order levels for various items of materials should be defined on the basis of factors like lead time, usage rate, ordering costs, EOQ, etc.
- Purchase Requisition: The Storekeeper should prepare a Purchase Requisition at the Re-order Level and forward the same to the Purchase Department. Copies of this requisition should be sent to Production Planning, Inspection, Stores and Cost Control Department.
- Tenders: Tenders should be invited on an objective basis before placing orders. There should be a procedure for evaluation of tender proposals on grounds such as quality, quantity, terms of supply, payment terms, price, duties and taxes, procedural formalities etc.
- Purchase Order: The decision on purchase should be confirmed by formal Purchase Order. These documents should be pre-numbered and serially controlled.
- Gate Pass: Upon passing the main factory gate, a gate pass should be prepared as evidence of inward movement of materials as also for discipline and security reasons.
- Inspection: The Inspection and Receipt Department i.e. goods receiving area should be adequately staffed to inspect, record and store goods received.
- Goods Received Notes: Goods Received Notes should be pre-numbered and serially controlled. All materials received into stores should be properly documented.
- Division of Work: The following duties must be segregated - (a) Preparing GRN's, (b) Recording goods received in Stock Records, (c) Custody and authorising issue of stores, and (d) Verification of Goods Received Notes with invoices.
- Invoice Verification: Invoices should be recorded promptly in an Invoice Register. These invoices should be verified with rates on Purchase Orders and quantities as per Goods Received Notes. The calculations should be checked before posting.
- Debit Notes: There should be a defined procedure for raising and recording Debit Notes due to differences in quantities, rates or any other reason. These should be duly followed up with the Suppliers and confirmations should be obtained.
- Cut Off Transactions: Goods Received Notes unmatched with invoices (i.e. materials received but not yet invoiced by Supplier) should be duly followed up and liabilities for goods received at year-end should be duly recorded.
- Purchases Ledger: Balances in Creditors Ledger should be listed periodically and reconciled with the Control Account as per General Ledger. Statements of Accounts received from Suppliers should be regularly compared with the Ledger accounts and duly reconciled.

Auditing Fundas

Answers **Time Allotted: 20 mins**

Answer: Question (b)

The important controls in relation to Sales & Debtors include the following:

- Form Control: All documents like Invoices, Delivery Challans etc. should be serially numbered and put under the custody of a responsible official. Missing documents should be promptly investigated.
- Credit Appraisal: Decisions on whether to grant credit, extent and period of credit etc should be decided by a responsible official. Credit limits should be checked before customer orders are accepted. There should be a defined procedure for accepting customer orders, issuing production orders and despatch notes.
- Division of work: Despatch, sales and invoicing functions should be segregated. Also, the duties in recording sales ledgers, receipts of cash and issue of receipts should be segregated. Further, duties like recording sales, maintaining customer's accounts and preparing debtors' statement, should be assigned to different persons.
- Delivery Challans (DC): DC's should be verified with customer's purchase order by an authorised person before despatch. It should be serially filed, by a person who has no access to stocks or has no accounting or invoicing duties.
- Acknowledgement for supply: Customers' acknowledgement for goods despatched should be obtained. Adequate records should be maintained for part deliveries.
- Prompt Invoicing: Invoices prepared for all deliveries should be sent to customers within a reasonable time. The invoiced quantity should be matched with the customer's orders and Delivery Challans.
- Cut off procedures: Arrangements should be made to ensure that goods despatched but not invoiced (or vice versa) during an accounting period are properly dealt with in the accounts for the period.
- Intra-group transactions: Wherever necessary there should be suitable control arrangements to deal with stock transfer to branches, divisions, etc. and sale to Companies or Firms within the same business group.
- Pricing: Prices on invoices should be as per the standard price list. Unusual discounts, price reductions or further charges recovered from customers, if any, should be properly authorised.
- Receipts: The record of receipts should be duly verified with the bank pay–in slip and the cashbook. Cash collections/takings should be matched with invoices.
- Sales Returns: There should be proper recording of returned goods. The reasons for rejections, returns etc, should be clearly ascertained for further internal review.
- Credit Notes: Credit Notes shall be duly authorised and verified with related invoices. The reasons for issuing the credit note e.g. quantity / rate / charge difference should be clearly indicated. Care should be taken to prevent errors and irregularities.
- Sales Ledger: Debtors Ledger balances should be listed regularly and balanced with the Control Account in the General Ledger. Reconciliation Statement should be prepared periodically and reviewed by independent persons. There should be segregation of duties between persons recording transactions and extracting balances.
- Follow-up: "Ageing Schedule" should be prepared to follow up old balances. Statements should be regularly sent to parties for confirmation. Customer queries arising out of statements sent to them, should be handled by a responsible official.
- Action on overdue accounts: There should be a defined procedure for sending periodical reminders to customers, initiating legal action when necessary, and proper authorisation for writing off bad debts.

Law Crawl

Total Questions: 4 **Time Allotted: 15 mins**

(1 / 4) The Board of Directors of a Public Company wants to donate out of its profits to charitable purposes which are not directly related to the business of the Company. Advise, whether the Company can do so? Would your answer be different if the said Company is working, at a loss?

(2 / 4) The Board of ABC Ltd. wants to delegate to the Managing Director, the power to borrow money from bank for the purposes of making investment. Advise whether such delegation of powers to MD is possible.

(3 / 4) Advice XYZ Ltd., which desires to authorize the Managing Director to give loan to Firms in which Directors are interested.

(4 / 4) Mr. X is a Director of PQR Ltd. He accepts the offer of employment as "Chief Executive - Technical Operations" of the same company on a monthly remuneration of Rs. 30,000. Can he be an employee at the same time being the Director of the Company? In case his son is appointed at the same post, does it attract any provisions of the Companies Act?

Answers **Time Allotted: 15 mins**

Answer: Question (1 / 4)

Consent of Shareholders is required for making contributions to Charitable and other Funds not directly related to the business of the Company or welfare of the employees of the Company, if the aggregate of contributions made during the Financial Year exceeds the higher of the following:

- Rs.50,000, or
- 5% of the Average Net Profits determined u/s 349 & 350 during the immediately preceding 3 Financial Years.

Board can donate within the limits specified above, without obtaining Shareholder's approval. For donations in excess of the specified limits, Shareholders' approval in a General Meeting is required.

Even if the Company is working at a loss, the Board can donate a maximum of Rs.50,000 without obtaining prior approval of shareholders.

Answer: Question (2 / 4)

U/s 292, the Board of Directors may also delegate to the Managing Directors, the power to borrow money otherwise than on debentures. The following conditions apply:

- The Board must pass a resolution at its meeting authorizing the Managing Director to borrow from bank(s), money required for the Company's business.
- The resolution delegating this power should specify the total amount outstanding at any one time up to which money maybe borrowed by the MD.
- Care should be taken to ensure that while delegating the power to MD, the ceiling limit u/s 293 (1)(d) (i.e. aggregate of Paid Up Capital and Free Reserves requiring consent in General Meeting) is not exceeded, and that the MOA permits borrowing.

Law Crawl

Answers **Time Allotted: 15 mins**

Answer: Question (3 / 4)

A Company cannot directly or indirectly lend money to persons including Firms, in which Directors or their relatives are partners, without obtaining prior approval of the Central Government in that behalf So, the Company must first seek the Central Government's approval u/s 295.

The power to make loans may be delegated u/s 292(1)(e). So, the Board must pass a resolution delegating this power to the MD and specifying the total amount up to which loans may be made by the delegate, the purpose for which loans maybe made and the maximum amount of loans which maybe made for each such purpose in individual cases.

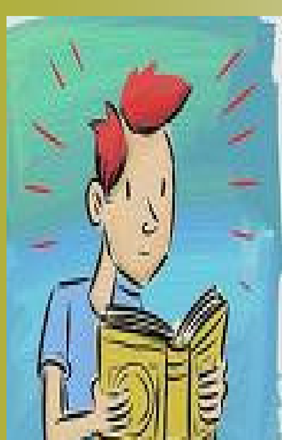
By virtue of Sec. 291(1), the Board must see with reference to the MOA and AOA, whether the Company is authorised to exercise the power.

Answer: Question (4 / 4)

There is nothing in law to prevent a Director from accepting employment under the Company under a special contract, which he may enter into with the Company as held in case of RR Rothandaraman vs CIT. However, such employment constitutes OPP (Office or Place of Profit) u/s 314.

Ajay can be appointed as "Chief Executive – Technical Operations", subject to Shareholders' approval by special resolution, as specified u/s 314(1). In case a Director is appointed to an OPP, there is no monetary minimum limit as to remuneration..

Ajay's son can also be appointed for that post, if the Company accords its consent by a Special Resolution u/s 314(1). However, if monthly remuneration is less than Rs.10,000, Sec.314 provisions do not apply.



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Costing Techniques

Total Questions: 5 **Time Allotted: 30 mins**

(1 / 5) Given below are the details of the monthly overhead expenses relating to a particular machine.

Rent of the department (space occupied by the machine 2/5)	Rs. 800
Lighting of the department	Rs. 700
Insurance, etc.	Rs. 150
Other expenses relating to the machine	Rs. 200
Salary of the supervisor (1/4 of the supervisor's time is occupied by this machine and the remaining equally upon 2 other machines).	Rs. 7,500

The cost of the machine is Rs.10,000 and it has an estimated scrap value of Rs.500. It is known from past experience that the machine:

- will work for 1800 hours per annum.
- will incur expenditure of Rs.1,500 p.a. for repairs and maintenance.
- consumes 10 units of power per hour at a cost of Rs. 2.50 per hour.
- has a working life of 5 years.

Calculate the machine hour rate.

(2 / 5) In a manufacturing concern, the predetermined rate of overhead recovery is Rs. 40/machine hour. During the year, total factory overhead amounted to Rs.88,96,000 and machine hours actually worked were 1,86,500 only.

Actual production and sales during the year were 1,20,000 units and 1,05,000 units respectively. The production shop had 36,000 unfinished units and based on technical estimates these were considered as 50% complete.

Analysis of the data revealed that 37.5% of the unabsorbed overheads were attributable to initial inaccuracies in the planning and the balance was due to rising price levels.

How is unabsorbed overheads treated in cost accounts.

(3 / 5) The Indian Oil Company is a processor of crude oil. For each barrel of crude oil processed in the cracking department, 30 gallons of gasoline, 10 gallons of kerosene and 15 gallons of diesel are obtained. The variable costs of purchasing and processing crude oil totals Rs.30 per barrel. During the current period 30,000 barrels of crude oil were processed. At the end of the current period the inventory consisted of 100,000 gallons of gasoline, 15,000 gallons of kerosene and 50,000 gallons of diesel fuel. Gasoline sells at Rs.0.80 per gallon, kerosene at Rs.0.50 per gallon and diesel fuel at Rs.0.70 per gallon.

- Determine the variable cost of the ending inventories using the units method for allocating joint costs.
- Determine the variable cost of the ending inventories using the net realizable value (NRV) method of allocating the joint costs.

Costing Techniques

Total Questions: 5 **Time Allotted: 30 mins**

(4 / 5) ABC Ltd. is operating at 70 percent capacity and presents the following information:

Break even point	**Rs. 200 crore**
P/V Ratio	**40 percent**
Margin of safety	**Rs.50 crore**

The management has decided to increase production to 95 percent capacity level with the following modifications:

- **The selling price will be reduced by 8 percent.**
- **The variable cost will be reduced by 5 percent on sales.**
- **The fixed cost will increase by Rs. 20 crore, including depreciation on additions, but excluding interest on additional capital.**
- **Additional capital of Rs. 50 crore will be needed for capital expenditure and working capital.**

Compute the sales that will be needed to earn Rs. 10 crore over and above the present profit and also meet 20 percent interest on the additional capital.

What will be the revised Break even point, P/V Ratio and Margin of safety?.

(5 / 5) PQR Enterprises is expecting a profit of Rs. 2,50,000 for the current year. The following further information is available from records:

	Rs.
Selling price per unit	**20**
Variable cost per unit	**10**
Fixed cost of the year	**1,00,000**

The company's production capacity is not fully utilized and market research suggests the following alternative strategies for the forthcoming year:

Strategy 1 : Reduction in selling price by 5%. Expected increase in sales volume 10%.

Strategy 2 : Reduction in selling price by 7%. Expected increase in sales volume 20%.

Strategy 3 : Reduction in selling price by 10%. Expected increase in sales volume 25%.

Evaluate the alternative strategies and state which is the most profitable. Assume the same cost structure as in the current year. Also suggest other factors which must be considered by management before taking a decision.

Costing Techniques

Answers — **Time Allotted: 30 mins**

Answer: Question (1 / 5)

Particulars	Basis of Apportionment	Amount per annum
Fixed charges		
Rent	800 x 2/5	Rs. 320.00
Lighting	700 x 2/5	Rs. 280.00
Insurance		Rs. 150.00
Incidental expenses		Rs. 200.00
Salary of supervisor	7500/4	Rs.1,875.00
Depreciation	(10,000 - 500)/5	Rs.1,900.00
		Rs.4,725.00
Charges per hour	Rs.4725/1800 hours	2.625
Variable charges		
Repairs & Maintenance	1500/1800	0.830
Power	2.50 x 10	25.000
Machine hour rate per hour		Rs.28.455

Answer: Question (2 / 5)

Closing stock of finished goods = Actual production - Sales

= 120000 - 105000 = 15000

Total Equivalent production = Actual production + Equivalent Unfinished units

= 120000 + 18000 (36000 Unfinished units equivalent to 50% complete) = 138000

Unabsorbed Overheads = Overheads incurred - Absorbed Overheads

= 88,96,000 - 74,60,000 (186500 hours @ Rs.40) = 14,36,000

Treatment of unabsorbed overheads in cost accounts:

Particulars	Amount (Rs.)	Treatment
• Due to initial inaccuracies in planning (37.5% of Rs.1436000)	5,38,500	Being abnormal in nature it should be debited to Costing P & L A/c.
• Balance due to rising price levels (Rs.1436000 - Rs.538500)	8,97,500	To be distributed over cost of sales, closing stock of finished goods and closing WIP.
Unabsorbed	14,36,000	

Supplementary rate = Rs.8,97,500 / 1,38,000 units = Rs.6.5036231 per unit

Costing Techniques

Answers **Time Allotted: 30 mins**

Answer: Question (2 / 5) contd…..

Allocation of unabsorbed overhead:

	Rs.
Cost of sales (105000 units x Rs.6.5036231 per unit)	6,82,880
Closing stock of finished goods (15000 units x Rs.6.5036231 per unit)	97,555
Closing WIP (36000 units x 50% i.e. 18000 units x Rs.6.5036231 per unit)	1,17,065
Unabsorbed overhead	8,97,500

Answer: Question (3 / 5)

Production for 30,000 barrels

Gasoline	30,000 x 30	=	900,000 gallons
Kerosene	30,000 x 10	=	300,000 gallons
Diesel	30,000 x 15	=	450,000 gallons

Total variable cost = 30,000 x 30 = Rs.900,000

Using the physical/units method of allocation:

	Output	Ratio	Joint cost apportioned Rs.	Cost per gallon Rs.
Gasoline	9,00,000	0.55	4,95,000	0.55
Kerosene	3,00,000	0.18	1,62,000	0.54
Diesel	4,50,000	0.27	2.43,000	0.54
	16,50,000		9,00,000	

Variable cost of closing inventory

	Gallons	Cost per gallon	Total cost (Rs.)
Gasoline	1,00,000	0.55	55,000
Kerosene	15,000	0.54	8,100
Diesel	50,000	0.54	27,000
			90,100

Using the Net Realizable value method of allocation:

	Output	Sale price	Sales value Rs.	Ratio	Joint cost apportioned Rs.	Cost per gallon Rs.
Gasoline	9,00,000	0.80	7,20,000	0.61	5,49,000	0.61
Kerosene	3,00,000	0.50	1,50,000	0.13	1,17,000	0.39
Diesel	4,50,000	0.70	3,15,000	0.26	2,34,000	0.52
			11,85,000		9,00,000	

Costing Techniques

Answers **Time Allotted: 30 mins**

Answer: Question (3 / 5) contd….

Variable cost of closing inventory

	Gallons	Cost per gallon	Total cost (Rs.)
Gasoline	1,00,000	0.61	61,000
Kerosene	15,000	0.39	5,850
Diesel	50,000	0.52	26,000
			92,850

Answer: Question (4 / 5)

Sales	=	Break even point + Margin of safety		
	=	Rs.200 crore + Rs.50 crore	=	Rs.250 crore at 70% capacity

Sales at 95% capacity	=	(Rs.250 crore/ 0.7) x 0.95	=	Rs.339.285 crore
Sales at reduced price	=	Rs.339.285 crore x 0.92	=	Rs.312.143 crore
Variable cost	=	Rs.312.143 crore x 0.55	=	Rs.171.679 crore
Contribution	=			Rs.140.464 crore
P/V ratio	=	Rs. 140.464 crore/ Rs.312.143 crore	=	45%
Present fixed cost	=	BEP x P/V Ratio = Rs.200 crore x 0.40	=	Rs.80 crore
New fixed cost	=	Rs.80 crore + Rs.20 crore + 0.20 x Rs.50 crore	=	Rs. 110 crore
Present profit	=	0.40 x Rs.250 crore - Rs.80 crore	=	Rs.20 crore
Profit need to earn	=	Rs.20 crore + Rs. 10 crore	=	Rs. 30 crore
Add: New fixed cost	=			Rs.110 crore
Contribution need to earn	=			Rs.140 crore

Therefore,

Sales required	=	Rs.140 crore / 0.45	=	Rs.311.11 crore
Break-even point	=	Fixed cost / Contribution = Rs.110 crore / 0.45	=	Rs.244.44 crore
P/V Ratio	=	45% (Calculated earlier)		
Margin of safety	=	Rs.311.11 crore - Rs.244.44 crore	=	Rs.66.67 crore

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Costing Techniques

Answers **Time Allotted: 30 mins**

Answer: Question (5 / 5)

Current expected contribution:

Fixed cost	Rs. 1,00,000
Profit	Rs.2,50,000
Expected contribution	Rs.3,50,000

Current contribution per unit:

Selling price	Rs.20
Variable cost	(Rs.10)
Contribution per unit	Rs.10

Current expected output = Current expected contribution / Contribution per unit

= Rs.3,50,000 / 10 = 35,000 units.

	Strategy		
	1	2	3
Selling price	(20 - 5% of 20) = 19	(20 - 7% of 20) = 18.60	(20 - 10% of 20) = 18
Variable cost per unit	10	10	10
Unit Contribution	9.00	8.60	8.00
Sales volume	(35,000+10% of 35,000)	(35,000+20% of 35,000)	(35,000+25% of 35,000)
	38,500	42,000	43,750
Total Contribution	3,46,500	3,61200	3,50,000

Strategy 2 is most profitable, giving an incremental contribution of Rs. 11,200 over the present contribution. Strategy 1 would result in reduction in contribution while strategy 3 would not result in any increase or decrease in contribution.

Management should take into account the following important considerations:

- Whether increase in output by 7000 units would result in increase in fixed cost?
- How accurate are the sales forecast? Have they taken into consideration competitor's reaction to price reduction?

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Tax Teasers

Total Questions: 6 **Time Allotted: 20 mins**

State whether the following returns can be revised u/s 139(5) of the IT Act 1961.

(a) Return of loss filed under section 139(3).

(b) Belated Return filed under section 139(4).

(c) A Revised Return filed under section 139(5).

(d) Return filed knowing it to be false.

(e) Return filed u/s 139(1), if notice u/ s 143(2) or 144 has been issued to the assessee.

(f) Return filed for assessment year 2007-08 on 1-4-2009, assessment of which is yet to be completed.

Answers

Time Allotted: 20 mins

Answer: (a) Yes

Once a return of loss is filed under section 139(3), it takes the character of return filed under section 139 (1) in respect of which the assessee can file a revised return claiming higher amount of loss, under section 139(5). Thus, loss return can be revised.

Answer: (b) No

It has been held in Kumar Jagdish Chandra Sinha v CIT that in case a belated return is filed u/s 139(4), revised return under section 139(5) cannot be filed. Revised return are permissible only where original return were filed either under section 139(1) or under section 142(1) and a belated return cannot be deemed to be a return filed under section 139(1).

Answer: (c) Yes

A second revised return can be filed u/s 139(5) correcting omissions or wrong statements made in the first revised return, for, the first revised return replaces the original return and thereby becomes a return under section 139(1). Hence an assessee can revise a return any number of times provided every such revised return is filed within the time limit specified under section 139(5).

Answer: (d) No

Revision under section 139(5) can be made only with a view to rectify any omission or wrong statement in the return. Such omission or wrong statement in the return must be due to a bona fide inadvertence or mistake on the part of the assessee; the same should not be deliberate as held in case of Sunanda Ram Deka v. CIT. Hence, false returns cannot be revised.

Answer: (e) Yes

Where the assessee has filed the original return within the due date and the period of one year from the end of the relevant assessment year has not expired, then the assessee can file a revised return even after the receipt of a notice under section 143 (2) or 144, as issue of notice udder these sections means that the assessment is not yet completed.

Answer: (f) No

Revised return can be filed within one year from the end of the relevant assessment year (i.e. by the 31st March, 2009 for the assessment year 2007-08) or before the completion of assessment, whichever is earlier. Therefore, the return filed for the assessment year 2007-08 cannot be revised as being barred by limitation.

Financial Issues

Total Questions: 2 **Time Allotted: 15 mins**

Write short notes on the following:

(a) Commercial Paper
(b) Certificate of Deposit

Answers **Time Allotted: 15 mins**

Answer: (a) Commercial Paper

Commercial Papers (CPs) are short-term, unsecured promissory notes issued at a discount to face value by well-known companies that are financially strong and carry a high credit rating. They are sold directly by the issuers to investor, or else placed by borrowers through agents like merchant banks and security houses. The flexible maturities at which they can be issued is one of the main attractions for borrowers and investors since issues can be adapted to the needs of both. The CP market has the advantage of giving highly rated corporate borrowers cheaper funds than they could obtain from the banks while still providing institutional investors with higher interest earnings than they could obtain from the banking system. The issue of CP imparts a degree of financial stability to the system as the issuing company

The following are the features of CP:

- They are negotiable by endorsement and delivery like pro-notes and hence are highly flexible instruments.
- They are issued in multiples of Rs.5 lakhs, but the amount should not be less than Rs.25 lakhs by any single investor.
- The maturity varies between 15 days to a year.
- They are purely unsecured as they are backed by the credit of the issuing company.
- They normally have a buy-back facility; the issuers or dealers can buy-back the CPs if needed.
- No prior approval of RBI is needed for CP issues and underwriting of the issue is not mandatory.

Answer: (b) Certificate of Deposit

With a view to further widen the range of money market instruments and to give investors greater flexibility in the deployment of their short-term surplus funds, RBI permitted banks to issue Certificate of Deposits (CDs). CDs are defined as short-term deposits by way of usance promissory notes having a short maturity of not less than 3 months and not more than one year.

They are bank deposit accounts which are transferable from one party to the other. They are different from conventional time deposits due to their free negotiability. Due to this negotiable nature, they are also known as Negotiable Certificates of Deposit (NCDs). Based on the, recommendations of the Vaghul Committee, the RBI formulated a scheme in June, 1989 for the issue of CDs by scheduled banks (excluding RRBs).

The following are the features of CP:

- All scheduled banks, other than Regional Rural Banks and Scheduled Cooperative Banks are eligible to issue CDs.
- CDs can be issued to individuals, corporations, companies, trusts, funds and associations. NRIs can subscribe to CDs but only on a non-repatriation basis.
- They are issued at a discount rate freely determined by the issuing bank and the market.
- They are issued in multiples of Rs.5 lakhs subject to the minimum size of each issue of Rs. 10 lakhs.
- The banks can issue CDs ranging from 3 months to 1 year, whereas financial institutions can issue CDs ranging from 1 year to 3 years.
- CDs are freely transferable by endorsement on delivery but only after 30 days, and it is counted from the date of issue.

Smaller Facts Overlooked

Total Questions: 4 **Time Allotted: 10 mins**

Is premium paid for Keyman Insurance allowable as business expenditure under the IT Act 1961?

Keyman Insurance Policy is to protect the business against a financial set-back which may occur, as a result of a pre mature death, to the business or professional organization. Hence, premium paid by a firm for Keyman Insurance Policy obtained by firm on life of its partner is allowable as business expenditure as held in case of CIT v. B.N. Exports.

For writing off bad debts, is it necessary for banks to pass corresponding entries in individual account of each and every debtor?

For purpose of writing off of bad debts under section 36(1)(vii), it is not necessary for a bank to pass corresponding entries in individual account of each and every debtor and it would be sufficient if debit entries are made in profit and loss account and corresponding credit is made in 'bad debt reserve account'. - Vijaya Bank vs CIT.

Does giving treatment at a concessional rate amounts to philanthropy under section 10(23C) of the Income Tax Act 1961?

Philanthropy is not restricted to give free treatment only to extremely poor, but it would also be philanthropy to give treatment at a concessional rate to those who though not extremely poor but cannot afford to pay full and normal charges, as held in case of Breach Candy Hospital Trust v, Chief CIT.

Is assessee entitled to investment allowance on additional cost of machinery, acquired from a foreign county, due to change in rate of exchange ?

Increase in liability of assessee during previous year on account of change in rate of exchange was part of actual cost of machinery acquired from a foreign country and assessee would be entitled to investment allowance on additional cost due to such liability. CIT v. India Pistons Ltd.

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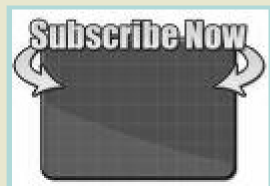

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