PAPER – 1 : ACCOUNTING

*Answer **all** questions.*

Working notes should form part of the answer.

Question 1

From the following balance sheets of Sneha Ltd. as on 31.3.2003 and 31.3.2004 prepare a statement of sources and applications of fund and a schedule of changes in working capital for the year ending 31.3.2004:

Balance Sheets

Liabilities	31.3.2003 Rs.	31.3.2004 Rs.	Assets	31.3.2003 Rs.	31.3.2004 Rs.
Equity share capital	13,00,000	16,90,000	Goodwill	65,000	42,500
Profit and loss account	4,90,100	8,77,500	Building	11,70,000	11,37,500
10% Debentures	16,25,000	13,00,000	Machinery	16,18,500	21,38,500
Creditors	9,00,000	10,00,000	Non-trade investments	5,07,000	3,93,250
Bills payable	42,500	1,70,000	Debtors	4,16,000	11,70,000
Provision for tax	2,60,000	9,75,000	Stock	5,07,000	7,99,500
Dividend payable	–	42,250	Cash	2,60,000	2,92,500
			Prepaid expenses	42,250	52,000
			Debenture discount	31,850	29,000
	46,17,600	60,54,750		46,17,600	60,54,750

The following additional information is given:

(i)

	Building Rs.	Machinery Rs.
Accumulated depreciation 31.3.2003	4,87,500	15,92,500
Accumulated depreciation 31.3.2004	5,20,000	15,66,500
Depreciation for 2003-2004	32,500	1,36,500

(ii) *Profit and loss account for 2003-2004 is as follows:*

	Rs.
Balance as on 31.3.2003	4,90,100
Add: Profit for 2003-2004	4,71,900
	9,62,000
Less: Dividend	84,500
	8,77,500

(iii) During 2003-2004 machinery costing Rs. 2,92,500 was sold for Rs. 97,500.

(iv) Investments which were sold for Rs. 1,17,000 had cost Rs. 97,500.

(v) Provision for Taxation and Dividend are to be taken as Non-current liabilities. (20 marks)

Answer

(a)

Sneha Ltd.
Fund Flow Statement
for the year ended 31st March, 2004

	Amount (Rs.)
Sources of funds	
Share capital (Rs. 16,90,000 – Rs. 13,00,000)	3,90,000
Sale of machinery	97,500
Sale of investments	1,17,000
Funds from operation (W.N. 1)	16,70,500
	22,75,000
Applications of funds	
Debentures redeemed (Rs. 16,25,000 – Rs. 13,00,000)	3,25,000
Machinery purchased (W.N. 4)	7,86,500
Tax paid*	2,60,000
Dividend (Rs. 84,500 – Rs. 42,250)	42,250
Increase in working capital	8,61,250
	22,75,000

Schedule of Changes in Working Capital
for the year ended 31st March, 2004

		Balance as on		*Changes in working capital*	
		1.4.2003	*31.3.2004*	*Increase*	*Decrease*
		Rs.	*Rs.*	*Rs.*	*Rs.*
Current Assets:					
Debtors		4,16,000	11,70,000	7,54,000	–
Stock		5,07,000	7,99,500	2,92,500	–
Cash		2,60,000	2,92,500	32,500	–
Prepaid expenses		42,250	52,000	9,750	–
	A	12,25,250	23,14,000		
Current Liabilities:					
Creditors		9,00,000	10,00,000		1,00,000
Bills payable		42,500	1,70,000		1,27,500
	B	9,42,500	11,70,000	10,88,750	2,27,500
Working capital (A – B)		2,82,750	11,44,000		
Increase in working capital				—	8,61,250
				10,88,750	10,88,750

* The provision for taxation has been treated as a non-current liability as per the requirement of the question. Last year's provision for taxation amounting Rs. 2,60,000 has been assumed to be paid in the current year ended 31st March, 2004.

Working Notes:

1. Statement showing funds generated from operations

				(Rs.)
Increase in profit and loss account during the year (Rs. 8,77,500 – Rs. 4,90,100)				3,87,400
Add: Non-cash expenditures				
(1)	Loss on sale of machinery (W.N. 4)		32,500	
(2)	Investments written off (W.N. 2)		16,250	
(3)	Provision for tax		9,75,000	
(4)	Depreciation			
	on building (Rs. 11,70,000 – Rs. 11,37,500)	32,500		
	on machinery (W.N. 3)	1,36,500	1,69,000	
(5)	Goodwill written off (Rs. 65,000 – Rs. 42,500)		22,500	
(6)	Debenture discount written off (Rs. 31,850 – Rs. 29,000)		2,850	
(7)	Dividend		84,500	13,02,600
				16,90,000
Less: Non-cash incomes				
(1)	Profit on sale of investments (Rs. 1,17,000 – Rs. 97,500)			19,500
Funds from operations				16,70,500

2. Non Trade Investment Account

Dr.		*Rs.*			*Cr.* *Rs.*
To	Balance b/d	5,07,000	By	Bank -Sale	1,17,000
To	Profit on sale (Rs. 1,17,000 – Rs. 97,500)	19,500	By	Profit and loss account – written off (balancing figure)	16,250
			By	Balance c/d	3,93,250
		5,26,500			5,26,500

3. Provision for Depreciation on Machinery Account

Dr.		*Rs.*			*Cr.* *Rs.*
To	Machinery -sale (balancing figure)	1,62,500	By	Balance b/d	15,92,500
			By	Depreciation	1,36,500
To	Balance c/d	15,66,500			
		17,29,000			17,29,000

4. Machinery Account

Dr.			*Rs.*				*Cr.* *Rs.*
To	Balance b/d	16,18,500		By	Bank (sale)		97,500
	Add: Provision			By	Depreciation		1,62,500
	for depreciation	15,92,500	32,11,000	By	Loss on sale		32,500
To	Bank -purchase			By	Balance c/d		
	(balancing figure)		7,86,500		W.D.V.	21,38,500	

		Add: Provision for depreciation	15,66,500	37,05,000
	39,97,500			39,97,500

Question 2

Lucky does not maintain proper books of accounts. However, he maintains a record of his bank transactions and also is able to give the following information from which you are requested to prepare his final accounts for the year 2003:

	1.1.2003	*31.12.2003*
	Rs.	*Rs.*
Debtors	*1,02,500*	*–*
Creditors	*–*	*46,000*
Stock	*50,000*	*62,500*
Bank Balance	*–*	*50,000*
Fixed Assets	*7,500*	*9,000*

Details of his bank transactions were as follows:

	Rs.
Received from debtors	*3,40,000*
Additional capital brought in	*5,000*
Sale of fixed assets (book value Rs. 2,500)	*1,750*
Paid to creditors	*2,80,000*
Expenses paid	*49,250*
Personal drawings	*25,000*
Purchase of fixed assets	*5,000*

No cash transactions took place during the year. Goods are sold at cost plus 25%. Cost of goods sold was Rs. 2,60,000. *(16 marks)*

Answer

Trading and Profit and Loss Account
for the year ended 31st December, 2003

		Amount *Rs.*			*Amount* *Rs.*
To	Opening stock	50,000	By	Sales (Rs. 2,60,000 × 125/100)	3,25,000
To	Purchases (balancing figure)	2,72,500	By	Closing stock	62,500
To	Gross profit c/d (Rs. 2,60,000 × 25/100)	65,000			
		3,87,500			3,87,500

To	Expenses	49,250	By	Gross profit b/d	65,000
To	Loss on sale of fixed assets	750			
To	Depreciation on fixed assets (W.N.1)	1,000			
To	Net profit	14,000			
		65,000			65,000

Balance Sheet as on 31st December, 2003

Liabilities		*Amount Rs.*	*Assets*	*Amount Rs.*
Capital (W.N. 5)	1,69,000		Fixed assets	9,000
Add: Additional capital	5,000		Debtors (W.N. 3)	87,500
Net profit	14,000		Stock	62,500
	1,88,000		Bank balance	50,000
Less: Drawings	25,000	1,63,000		
Creditors		46,000		
		2,09,000		2,09,000

Working Notes:

1. Fixed assets account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Balance b/d	7,500	By	Bank (sale)	1,750
To	Bank	5,000	By	Loss on sale of fixed asset	750
			By	Depreciation (balancing figure)	1,000
			By	Balance c/d	9,000
		12,500			12,500

2. Bank account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Balance b/d (balancing figure)	62,500	By	Creditors	2,80,000
To	Debtors	3,40,000	By	Expenses	49,250
To	Capital	5,000	By	Drawings	25,000
To	Sale of fixed assets	1,750	By	Fixed assets	5,000
			By	Balance c/d	50,000
		4,09,250			4,09,250

3. Debtors account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Balance b/d	1,02,500	By	Bank	3,40,000
To	Sales (Rs. 2,60,000 $\times \frac{125}{100}$)	3,25,000	By	Balance c/d (balancing figure)	87,500
		4,27,500			4,27,500

4. Creditors account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Bank	2,80,000	By	Balance b/d (balancing figure)	53,500
To	Balance c/d	46,000	By	Purchases (from trading account)	2,72,500
		3,26,000			3,26,000

5. Balance Sheet as on 1st January, 2003

Liabilities	*Rs.*	*Assets*	*Rs.*
Creditors (W.N. 4)	53,500	Fixed assets	7,500
Capital (balancing figure)	1,69,000	Debtors	1,02,500
		Stock	50,000
		Bank balance (W.N. 2)	62,500
	2,22,500		2,22,500

Question 3

(a) The Life Insurance Fund of an Insurance Company was on 31.3.2004 Rs. 60 lakhs before providing for dividend of Rs. 20,000 for the year 2003-2004. While ascertaining the above fund figure, the following items were omitted:

(i) Interest received on investments Rs. 63,000 after deduction of tax at source 10%.

(ii) Bonus utilized for reduction of premium Rs. 14,000.

(iii) Death claim intimated, but not yet admitted Rs. 36,000.

(iv) Death claim covered under re-insurance Rs. 12,000.

(v) Consideration for annuities granted Rs. 9,000.

Interim bonus for the valuation period paid was Rs. 80,000.

Net liabilities as per valuation was Rs. 50 lakhs. It is now proposed to carry forward Rs.2,70,000.

The company declared a reversionary bonus of Rs.12 per Rs. 1,000 and gave the policyholders an option to get the bonus in cash for Rs. 5 per Rs. 1,000. Total business of the company is Rs. 15 crores, 40% of the policyholders decided to get bonus in cash.

Prepare:

(i) Valuation Balance Sheet as on 31.3.2004.

(ii) Distribution Statement showing the amount due to the policyholders.

Also give Journal Entries relating to reversionary bonus.

(*b*) *Power Electric Company decides to replace one of its old plant by an improved plant with larger capacity. The cost of the new plant is Rs. 16,00,000.*

Materials and Labour earlier and now are in the ratio of 4 : 6.

Original cost of the old plant is Rs. 3,00,000. Materials cost has gone up by 2½ times and Labour cost by 3 times since then. Old materials worth Rs. 10,000 were used in the construction of the new plant and Rs. 20,000 were realised from the sale of old materials.

Give the necessary Journal Entries for recording the above transactions.

(10 + 6 = 16 marks)

Answer

(a) Valuation Balance Sheet as on 31.3.2004

		Rs.			*Rs.*
To	Net liabilities	50,00,000	By	Life insurance fund (adjusted)	60,34,000
To	Net profit	10,34,000		(W.N. 1)	
		60,34,000			60,34,000

Distribution Statement

	Rs.
Net profit as per Valuation Balance Sheet	10,34,000
Add: Interim bonus paid	80,000
	11,14,000
Less: Dividend provided for 2003-2004	20,000
	10,94,000
Less: Carried forward	2,70,000
True surplus	8,24,000

Policy holders will get 8,24,000 × 95%		7,82,800
Less: Interim bonus paid		80,000
Amount due to policy holders		7,02,800

Journal Entries

Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
Profit and loss account	Dr.	3,00,000	
To Bonus payable in cash			3,00,000
(Being the bonus payable in cash)			

Profit and loss account	Dr.	10,80,000*	
To Life insurance fund			10,80,000
(Being transfer to Life insurance fund for new liability)			

Working Notes:

1. Calculation of Adjusted Life Insurance Fund as on 31.3.2004

			Rs.
Life insurance fund before adjustments			60,00,000
Add: Interest on investment (gross)			
$\frac{63,000 \times 100}{(100-10)}$	70,000		
Less: Tax deducted at source	7,000	63,000	
Consideration for annuities granted		9,000	72,000
			60,72,000
Less: Death claim intimated	36,000		
Less: Death claim covered under re-insurance	12,000	24,000	
Bonus utilized in reduction of premium		14,000	38,000
Adjusted Life Insurance Fund			60,34,000

2. Bonus

Rs. 15 crores × 4/10 × 5/1,000 = Rs. 3,00,000 payable in cash

Rs. 15 crores × 6/10 × 12/1,000 = Rs. 10,80,000 transfer to fund

(b) Journal Entries

Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
Plant account	Dr.	7,70,000	
To Bank account			7,60,000
To Replacement account			10,000
(Being the additional cost incurred and old materials utilized in new plant)			
Replacement account	Dr.	8,40,000	
To Bank account			8,40,000
(Being the current cost of replacement)			

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* **Note:** In the present case, the total of bonus payable in cash amounting Rs. 3,00,000 and the bonus by transfer to life insurance fund amounting 10,80,000 comes to Rs. 13,80,000 which is more than the amount due to policyholders (Rs. 7,02,800).

The above solution has been worked out on the basis that the company has sufficient balance in profit and loss account for declaration of bonus.

Bank account	Dr.	20,000	
To Replacement account			20,000
(Being the old materials sold)			
Revenue account	Dr.	8,10,000	
To Replacement account			8,10,000
(Being the balance of replacement account transferred to revenue account)			

Working Note:

Old cost of the plant Rs. 3,00,000:

Material = $3,00,000 \times \frac{4}{10} = 1,20,000$

Labour = $3,00,000 \times \frac{6}{10} = 1,80,000$

		Rs.
Cost of materials increased by 250% = 1,20,000 × 250%		3,00,000
Cost of labour increased by 300% = 1,80,000 × 300%		5,40,000
Current cost of replacing old plant		8,40,000
Less: Sale of old materials	20,000	
Old materials utilized in new plant	10,000	30,000
Amount to be transferred to Revenue account		8,10,000
Cash cost of the new plant		16,00,000*
Add: Old materials utilized		10,000
		16,10,000
Less: Current cost of replacing old plant		8,40,000
Amount to be capitalized		7,70,000

* The cost of new plant has been given as Rs. 16,00,000 in the question. It has been assumed in the above solution that this cost does not include the cost of old materials used in the construction of new plant worth Rs. 10,000.

Question 4

(a) Liquidation of YZ Ltd. commenced on 2nd April, 2004. Certain creditors could not receive payments out of the realisation of assets and out of the contributions from A list contributories. The following are the details of certain transfers which took place in 2003 and 2004:

Shareholders	*No. of Shares transferred*	*Date of Ceasing to be a member*	*Creditors remaining unpaid and outstanding on the date of such transfer*
A	*2,000*	*1st March, 2003*	*Rs. 5,000*
P	*1,500*	*1st May, 2003*	*Rs. 3,300*
Q	*1,000*	*1st October, 2003*	*Rs. 4,300*

R	*500*	*1st November, 2003*	*Rs. 4,600*
S	*300*	*1st February, 2004*	*Rs. 6,000*

All the shares were of Rs. 10 each, Rs. 8 per share paid up. Show the amount to be realised from the various persons listed above ignoring expenses and remuneration to liquidator etc.

(b) The position of Valueless Ltd. on its liquidation is as under:

Issued and paid up Capital:

3,000 11% preference shares of Rs. 100 each fully paid.

3,000 Equity shares of Rs. 100 each fully paid.

1,000 Equity shares of Rs. 50 each Rs. 30 per share paid.

Calls in Arrears are Rs. 10,000 and Calls received in Advance Rs. 5,000. Preference Dividends are in arrears for one year. Amount left with the liquidator after discharging all liabilities is Rs. 4,13,000. Articles of Association of the company provide for payment of preference dividend arrears in priority to return of equity capital. You are required to prepare the Liquidators final statement of account. (8 + 8 = 16 marks)

Answer

(a) Statement of liabilities of B list contributories

Share-holders	*No. of shares transferred*	*Maximum liability (upto Rs. 2 per share)*	*Division of Liability as on*				
			1.5.2003	*1.10.2003*	*1.11.2003*	*1.2.2004*	*Total*
		Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*
P	1,500	3,000	1,500	–	–	–	1,500
Q	1,000	2,000	1,000	555	–	–	1,555
R	500	1,000	500	278	188	–	966
S	300	600	300	167	112	21	600
	3,300	6,600	3,300	1,000	300	21	4,621

Working Note:

Date	**Cumulative liability**	**Increase in liability**	**Ratio of no. of shares held by the members**
1.5.2003	3,300	–	30 : 20 : 10 : 6
1.10.2003	4,300	1,000	20 : 10 : 6
1.11.2003	4,600	300	10 : 6
1.2.2004	6,000	1,400	Only S

Liability of S has been restricted to the maximum allowable limit of Rs. 600, therefore amount payable by S is restricted to Rs. 21 only, on 1.2.2004.

Notes:

1. A will not be liable to pay to the outstanding creditors since he transferred his shares prior to one year preceding the date of winding up.
2. P will not be responsible for further debts incurred after 1st May, 2003 (from the date when he ceases to be member). Similarly, Q and R will not be responsible for the debts incurred after the date of their transfer of shares.

(b) Liquidators' Final Statement of Account

Receipts	*Rs.*	*Payments*	*Rs.*
Cash	4,13,000	Return to contributors:	
Realisation from:		Preference dividend	33,000
Calls in arrears	10,000	Preference shareholders	3,00,000
Final call of Rs. 5 per		Calls in advance	5,000
equity share of Rs. 50 each		Equity shareholders of	
(Rs. 5 × 1,000)	5,000	Rs. 100 each (3,000 × Rs. 30)	90,000
	4,28,000		4,28,000

Working Note:

		Rs.
Cash account balance		4,13,000
Less: Payment for dividend	33,000	
Preference shareholders	3,00,000	
Calls in advance	5,000	3,38,000
		75,000
Add: Calls in arrears		10,000
		85,000
Add: Amount to be received from equity shareholders of Rs. 50 each (1,000 × 20)		20,000
Amount disposable		1,05,000

Number of equivalent equity shares:

3,000 shares of Rs. 100 each = 6,000 shares of Rs. 50 each

1,000 shares of Rs. 50 each = 1,000 shares of Rs. 50 each

= 7,000 shares of Rs. 50 each

$$\text{Final payment to equity shareholders} = \frac{\text{Amount left for distribution}}{\text{Total number of equivalent equity shares}}$$

= Rs. 1,05,000 / 7,000 shares = Rs. 15 per share to equity shareholders of Rs. 50 each.

Therefore for equity shareholders of Rs. 100 each $\left(\text{Rs.}15 \times \frac{100}{50}\right)$

= Rs. 30 per share to equity shareholders of Rs. 100 each.

Calls in advance must be paid first, so as to pay the shareholders on prorata basis. Equity shareholders of Rs. 50 each have to pay Rs. 20 and receive Rs. 15 each. As a result, they are required to pay net Rs. 5 per share.

Question 5

(a) FGH Ltd. has three departments I.J.K. The following information is provided for the year ended 31.3.2004:

	I	*J*	*K*
	Rs.	*Rs.*	*Rs.*
Opening stock	*5,000*	*8,000*	*19,000*
Opening reserve for unrealised profit	•	*2,000*	*3,000*
Materials consumed	*16,000*	*20,000*	•
Direct labour	*9,000*	*10,000*	•
Closing stock	*5,000*	*20,000*	*5,000*
Sales	•	•	*80,000*
Area occupied (sq. mtr.)	*2,500*	*1,500*	*1,000*
No. of employees	*30*	*20*	*10*

Stocks of each department are valued at costs to the department concerned. Stocks of I are transferred to J at cost plus 20% and stocks of J are transferred to K at a gross profit of 20% on sales. Other common expenses are salaries and staff welfare Rs. 18,000, rent Rs. 6,000.

Prepare Departmental Trading, Profit and Loss Account for the year ending 31.3.2004.

(b) Give Journal Entries in the books of Branch A to rectify or adjust the following:

(i) Head Office expenses Rs. 3,500 allocated to the Branch, but not recorded in the Branch Books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for Rs. 1,500.

(iii) Branch paid Rs. 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries account.

(iv) H.O. collected Rs. 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of Rs. 15,000 sent by the Branch has not yet been received by the Head Office.

(vi) Branch A incurred advertisement expenses of Rs. 3,000 on behalf of Branch B.

(10 + 6 = 16 marks)

Answer

(a)

FGH Ltd.

Departmental Trading and Profit and Loss Account for the year ended 31st March, 2004

		I Rs.	*J* Rs.	*K* Rs.	*Total* Rs.			*I* Rs.	*J* Rs.	*K* Rs.	*Total* Rs.
To	Opening stock	5,000	8,000	19,000	32,000	By	Sales			80,000	80,000
To	Material consumed	16,000	20,000		36,000	By	Inter-departmental transfer	30,000	60,000		90,000
To	Direct labour	9,000	10,000		19,000	By	Closing stock	5,000	20,000	5,000	30,000
To	Inter-departmental transfer		30,000	60,000	90,000						
To	Gross profit	5,000	12,000	6,000	23,000						
		35,000	80,000	85,000	2,00,000			35,000	80,000	85,000	2,00,000
To	Salaries and staff welfare	9,000	6,000	3,000	18,000	By	Gross profit b/d	5,000	12,000	6,000	23,000
To	Rent	3,000	1,800	1,200	6,000	By	Net loss	7,000			7,000
To	Net profit		4,200	1,800	6,000						
		12,000	12,000	6,000	30,000			12,000	12,000	6,000	30,000
To	Net loss (I)				7,000	By	Stock reserve b/d (J + K)				5,000
To	Stock reserve (J+K) (Refer W.N.)				3,000		Net profit (J + K)				6,000
To	Balance transferred to Profit and loss account				1,000	By					
					11,000						11,000

Working Note:

Calculation of unrealized profit on closing stock

	Rs.
Stock reserve of J department	
Cost	30,000
Transfer from I department	30,000
	60,000
Stock of J department	20,000

$$\text{Proportion of stock of I department} = \text{Rs. } 20{,}000 \times \frac{\text{Rs.}30{,}000}{\text{Rs.}60{,}000} = \text{Rs.}10{,}000$$

$$\text{Stock reserve} = \text{Rs.}10{,}000 \times \frac{20}{120} = \text{Rs.}1667 \text{ (approx.)}$$

Stock reserve of K department	*Rs.*
Stock transferred from J department	5,000
Less: Profit (stock reserve) 5,000 × 20%	1,000
Cost to J department	4,000

$$\text{Proportion of stock of I department} = \text{Rs. } 4{,}000 \times \frac{\text{Rs.}30{,}000}{\text{Rs.}60{,}000} = \text{Rs.}2{,}000$$

$$\text{Stock reserve} = \text{Rs.}2{,}000 \times \frac{20}{120} = \text{Rs.}333 \text{ (approx.)}$$

Total stock reserve = Rs.1,000 + Rs.333 = Rs.1,333

(b) **Books of Branch A**
Journal Entries

	Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
(i)	Expenses account	Dr.	3,500	
	To Head office account			3,500
	(Being the allocated expenditure by the head office recorded in branch books)			
(ii)	Depreciation account	Dr.	1,500	
	To Head office account			1,500
	(Being the depreciation provided)			
(iii)	Head office account	Dr.	2,000	
	To Salaries account			2,000
	(Being the rectification of salary paid on behalf of H.O.)			
(iv)	Head office account	Dr.	10,000	
	To Debtors account			10,000
	(Being the adjustment of collection from branch debtors)			
(v)	No entry in branch books			
(vi)	Head Office account	Dr.	3,000	
	To Cash account			3,000
	(Being the expenditure on account of Branch B, recorded in books)			

Question 6

*Attempt any **four** of the following:*

(a) On 20.4.2003 JLC Ltd. obtained a loan from the Bank for Rs. 50 lakhs to be utilised as under:

	Rs.
Construction of a shed	*20 lakhs*
Purchase of machinery	*15 lakhs*
Working capital	*10 lakhs*
Advance for purchase of truck	*5 lakhs*

In March, 2004 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31.3.2004 was Rs. 9 lakhs. Show the treatment of interest under AS 16.

(b) A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2003-2004.

Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2004. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?

(c) Explain the treatment of cost arising from alteration in retirement benefit cost as per AS 15.

(d) From the following information find out the amount of provisions to be shown in the Profit and Loss Account of a Commercial Bank:

Assets	*Rs. (in lakhs)*
Standard	*4,000*
Sub-standard	*2,000*
Doubtful upto one year	*900*
Doubtful upto three years	*400*
Doubtful more than three years	*300*
Loss Assets	*500*

(e) What are the features of farm accounting in India?

(f) Write a short note on Reserve for Unexpired Risks in an Insurance Company.

(4 × 4 = 16 marks)

Answer

(a) As per AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized. A qualifying asset is an asset that necessarily takes a substantial period of time (usually 12 months or more) to get ready for its intended use or sale. If an asset is ready for its intended use or sale at the time of its acquisition then it is not treated as a qualifying asst for the purposes of AS 16.

Treatment of interest as per AS 16

	Particulars	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
(1)	Construction of a shed	Qualifying asset	$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 20 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 3.60 lakhs	
(2)	Purchase of machinery	Not a qualifying asset*		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 15 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 2.70 lakhs.

* On the basis that machinery is ready for its intended use at the time of its acquisition/purchase.

(3)	Working capital	Not qualifying asset		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 10 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 1.80 lakhs
(4)	Advance for purchase of truck	Not a qualifying asset		$\left(\text{Rs. 9 lakhs} \times \frac{\text{Rs. 5 lakhs}}{\text{Rs. 50 lakhs}}\right)$ = Rs. 0.90 lakhs
	Total		Rs.3.60 lakhs	Rs.5.40 lakhs

(b) The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2003-2004. Subsequently in 2004 they revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed.

(c) Alteration in the retirement benefit cost may arise from introduction of a retirement benefit scheme for existing employees or because of making of improvements to an existing scheme. As per AS 15 any alternation in retirement benefit cost arising from changes in the actuarial method used or assumptions adopted should be charged or credited to the statement of profit or loss as they arise in accordance with AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies". Additionally, a change in the actuarial method should be treated as a change in accounting policy and disclosed in accordance with AS 5. The cost of additional benefits provided to retired employees due to amendments in the retirement benefit scheme should also be treated in the same manner (i.e. charged to profit and loss statement of the year).

(d) Computation of provision:

Assets	*Amount (Rs. in lakhs)*	*% of Provision*	*Provision (Rs. in lakhs)*
Standard	4,000	0.25	10
Sub-standard	2,000	10	200
Doubtful upto one year*	900	20	180
Doubtful upto three years*	400	30	120

Doubtful more than three years*	300	50	150
Loss	500	100	500
			1160

* Doubtful assets are taken as fully secured.

(e) The features of farm accounting are as follows:

(i) Agricultural sector in India is unorganized and dominated by small farmers. Most agricultural farms are family oriented and part of the farms produce is consumed by the family members. Level of the education of the average farmers appears to be the principal barrier for adaptation of agricultural accounting system. Farmers are not aware of the technique of using accounting data for the purpose of management decision and usefulness of data base management.

(ii) The family takes part in management and provides labour for the farm. Farmers cannot afford the additional expenses involved in hiring a person to maintain accounts.

(iii) Agriculture is in some cases a seasonal occupation and many farmers have other occupations also. Farming operations are uncertain due to natural calamities.

(iv) There are many divisions in farm accounting. Finished product of one division can become the raw material for another.

(v) Tax authorities do not rigorously insist on maintenance of books of account. Collection of statistics by the government is also not adequate.

(f) In most cases policies are renewed annually except in some cases where policies are issued for a shorter period. Since insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies extend into the following year during which the risk continues. Therefore on the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year and therefore, a provision for unexpired risks is made at normally 50% in case of Fire Insurance and 100% of in case of Marine Insurance. This reserve is based on the net premium income earned by the insurance company during the year

PAPER – 2 : AUDITING

*Answer Questions Nos. **1** and **2** and any **four** questions from the rest.*

Question 1

As an auditor, comment on the following situations/statements:

(a) You are the Auditor of a Manufacturing Company, whose year ends on 31st March. An event occurred after the year ended, but before you complete the audit. The audit report issued by you is dated 20th July. The Sales Ledger balance at 31st March was Rs. 95, 000. By 20th July Rs. 65,000 only had been received against this amount as full and final payment. (4 marks)

(b) AAS Ltd. Is procuring the packing materials from M/s XY and Co., a partnership firm consisting of Mr. X and Mr. Y. Mr. Y is the Managing Director of AAS Ltd. The total value of purchases made from XY and Co. by AAS Ltd. During the year 2003-04 had been Rs. 38 lakhs. (4 marks)

(c) X Ltd. is good in profits, but suffers temporarily in liquidity. It proposes to declare dividend of 10% in annual general meeting, but the Board proposes to defer payment of dividend by two months from the date of annual general meeting by getting a resolution passed in AGM. (4 marks)

(d) A Computerised Machinery was purchased by two companies jointly. The price was shared equally. It was also agreed that they would use the machinery equally and show in their Balance Sheets, 50% of the value of the machinery and charge 50% of the depreciation in their respective books of accounts. (4 marks)

Answer

(a) Consideration of Subsequent Events: AAS-19 "Subsequent Events" requires that the auditors should consider the effect of subsequent events on the financial statements and the auditor's report. Depending upon the nature of subsequent event, i.e., adjusting event or non-adjusting event, the auditor has to examine the impact on financial statements. AS-4 "Contingencies and Events Occurring After the Balance Sheet Date" also classifies an adjusting event which provides further evidence of conditions that existed at the balance sheet date after balance sheet date, the effect of such events have to be seen by the auditor on figures contained in the financial statements. The facts indicated in the question clearly reveal that subsequent realisation has been good. Such consideration helps the auditor in assuring the existence of debtors as also the realisability aspect. The auditor's duties in respect of debtors remaining uncollected at the time of giving audit report involves examination of actual past experience of collections from debtors. Further the auditor has to see that how much provision was assessed in respect of bad and doubtful debts having regard to recovery position, due date, legal cases, cheques dishonoured, etc. as on March 31, 2004. Accordingly, the auditor would have now to see that in respect of outstanding amount of Rs.35,000, whether the amount of provision needs any revision.

(b) Transactions with Related Parties: AAS 23, "Related Parties" establishes standards on auditor's responsibilities and audit procedures regarding related party transactions. In this case, the related party relationship is absolutely clear and accordingly the auditor must examine that the disclosure requirements as laid down in AS 18, "Related Party Disclosures" has been followed, as Managing Director. Further, the auditor has to ensure compliance with the CARO, 2003 requirements, viz., transaction required to be entered into the Register pursuant to section 301 of the Companies Act, 1956 and having regard to the fact whether such prices were reasonable or not. Accordingly, the auditor has to ensure that the AAS Ltd. has made proper disclosures in financial statements and the matter has been examined and reported in terms of CARO, 2003 also.

(c) Declaration of Dividends: As per law, dividend once declared cannot be revoked. However, as per facts of the case, X Ltd. has not declared the dividends so far because Board proposed to recommend declaration of 10% dividend in annual general meeting but in view of liquidity problem it proposes to defer the payment of dividend by two months from the date of annual general meeting by getting a resolution passed in AGM. As per the question it is clear that the Board has only made a proposal and the same has not been passed by the shareholders. Therefore, in such a case, X Ltd. may declare dividends at a subsequent general meeting.

Note: Students may note that in case dividend has actually been declared in terms of section 205 (A)(1), the penal and other provisions shall become applicable.

(d) Joint Assets: AS 10, "Accounting for Fixed Assets", issued by the Institute, prescribes that in case of fixed assets owned jointly by enterprises, the extent of the entity's share in such assets, and the proportion in the original cost, accumulated depreciation and written down value should be stated in the Balance Sheet. Accordingly, the treatment followed by the companies reflecting 50% of the value of the machinery and changing 50% depreciation in their respective books of account is proper. However, such jointly owned assets should be indicated separately in the Fixed Assets Register maintained by the company.

*(**Note:** Alternatively, AS-10 also recommends that the pro-rata cost of such jointly owned assets may be grouped together with similar fully owned assets and appropriate disclosure of the same should be made.)*

Question 2

(a) The auditor of a limited company has given a clean report on the financial statement on the basis of Xerox copies of the books of accounts, Vouchers and other records which were taken away by the Income-tax Department in search under section 132 of the I.T. Act, 1961. (5 marks)

(b) E and S were appointed as Joint Auditors of X and Y Ltd. What will be their professional responsibility in a case where the company has cleverly concealed certain transactions that escaped the notice of both the Auditors. (5 marks)

(c) Aakansha is a member of the Institute of Chartered Accountants of England and Wales. Is she qualified to be appointed as auditor of Indian Companies? (2 marks)

(d) Preksha, a member of the ICAI, does not hold a Certificate of practice. Is her appointment as an auditor valid? (4 marks)

(e) 'B' owes Rs. 1001 to 'C' Ltd., of which he is an auditor. Is his appointment valid? Will it make any difference, if the advance is taken for meeting-out travelling expenses? (4 marks)

Answer

(a) Reliability of Audit Evidence: The degree of reliance which can be placed by the auditor on the documentary audit evidence available in the present case will be considerably increased if the xerox copies of account books and vouchers are certified to be true copies by the Income Tax Department. If the tax authorities refuse to certify the same, the auditor should get the certificate to this effect from the management of the company.

The auditor should use procedure like confirmation of balances from third parties, inspection of tangible assets, etc. and obtain evidence which corroborates the documentary evidence available. In any case, the auditor has to satisfy himself that he has obtained sufficient and appropriate audit evidence to support the figures contained in the financial statements and formulate his opinion accordingly. Under such circumstances, the auditor should have appropriately modified his report and bring this fact to the attention of shareholders. In case he was satisfied, a simple paragraph of information was enough but in case the auditor failed to establish the reliability of evidence available, he would be required to a disclaimer of opinion.

(b) Responsibilities of Joint Auditors: In conducting a joint audit, the auditor(s) should bear in mind the possibility of existence of any fraud or error or any other irregularities in the accounts under audit. The principles laid down in AAS2, AAS4 and AAS12 need to be read together for arriving at any conclusion. The principle of joint audit involves that each auditor is entitled to assume that other joint auditor has carried out his part of work properly. However, in this case, if it can be assumed that the joint auditors E and S have exercised reasonable care and skill in auditing the accounts of X & Y Ltd. and yet the concealment of transaction has taken place, both joint auditors cannot be held responsible for professional negligence. However, if such concealment could have been discovered by the exercise of reasonable care and skill, the auditors would be responsible for professional negligence. Therefore, it has to be seen that while dividing the work, the joint auditors have not left any area unattended and exercised reasonable care and skill while doing their work.

(c) Qualification for Appointment as an Auditor: Aakansha, a member of the Institute of Chartered Accountants in England and Wales is not qualified to be appointed as an auditor of a limited company in India, since she is not a chartered accountant within the meaning of the Chartered Accountants Act, 1949 and hence not a member of the Institute of Chartered Accountants of India. (This is on the presumption that Aakansha has

qualified recently from the ICAEW and in the absence of any reciprocity agreement between the two Institutes, as on date, her name is not borne on the Register maintained by the Institute of Chartered Accountants of India). Because as per the Chartered Accountants Act, 1949, a person must be a member of the Institute and holds certificate of practice. However, as it appears from the facts given in the case, Aakansha is not a member of the Institute of Chartered Accountants of India and, thus, is not qualified to audit companies under the Companies Act, 1956.

(d) Qualifications of an Auditor: A person shall be qualified for appointment as an auditor of a company, only if one is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949. Under the Chartered Accountants Act, 1949, only a chartered accountant holding the certificate of practice can engage in public practice. Preksha does not hold a certificate of practice and hence cannot be appointed as an auditor of a company.

(e) Indebtedness to the Company: As per section 226(3)(d) of the Companies Act, 1956, a person who is indebted to the company for an amount exceeding Rs.1000/- or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding Rs.1000/- then he is not qualified for appointment as an auditor of a company. Accordingly, B's appointment is not valid and he is disqualified as the amount of debt exceeds Rs.1000. Even if the advance was taken for meeting out travelling expenses particularly before commencement of audit work, his appointment is not valid because in such a case also the auditor shall be indebted to the company. The auditor is entitled to recover fees on a progressive basis only.

Question 3

(a) What are the auditor's responsibilities for detection of Frauds and Errors? (8 marks)

(b) Explain the various types of companies under Companies (Auditor's Report) Order, 2003. (CARO). (8 marks)

Answer

(a) Auditor's Responsibilities for Detection of Fraud and Error: The primary objective of an auditor is to express an opinion on the financial statements. However, the auditor while conducting the audit is required to consider the risk of material misstatements in the financial statements resulting from fraud or error. An audit conducted in accordance with the auditing standards generally accepted in India is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The fact that an audit is carried out may act as a deterrent, but the auditor is not and cannot be held responsible for the prevention of fraud and error.

The auditor' s opinion on the financial statements is based on the concept of obtaining reasonable assurance; hence, in an audit, the auditor does not guarantee that material misstatements, whether from fraud or error, will be detected. Therefore, the subsequent

discovery of a material misstatement of the financial statements resulting from fraud or error does not, in and of itself, indicate:

(a) failure to obtain reasonable assurance,

(b) inadequate planning, performance or judgment,

(c) absence of professional competence and due care, or,

(d) failure to comply with auditing standards generally accepted in India.

This is particularly the case for certain kinds of intentional misstatements, since auditing procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion between or among one or more individuals among management, those charged with governance, employees, or third parties, or involves falsified documentation. Whether the auditor has performed an audit in accordance with auditing standards generally accepted in India is determined by the adequacy of the audit procedures performed in the circumstances and the suitability of the auditor' s report based on the result of these procedures.

In planning and performing his examination the auditor should take into consideration the risk of material misstatement of the financial information caused by fraud or error. He should inquire with the management as to any fraud or significant error, which has occurred in the reporting period, and modify his audit procedures, if necessary. If circumstances indicate the possible existence of fraud and error, the auditor should consider the potential effect of the suspected fraud and error on the financial information. If he is unable to obtain evidence to confirm, he should consider the relevant laws and regulations before expressing his opinion. The auditor also has the responsibility to communicate the misstatement to the appropriate level of management on a timely basis and consider the need to report to it then changed with governance. He may also obtain legal advice before reporting on the financial information or before withdrawing from the engagement. The auditor should satisfy himself that the effect of fraud is properly reflected in the financial information or the error is corrected in case the modified procedures performed by the auditor confirm the existence of the fraud.

The auditor should also consider the implications of the frauds and errors, and frame his report appropriately. In case of a significant fraud, the same should be disclosed in the financial statement. If adequate disclosure is not made, there should be a suitable disclosure in his audit report.

(b) Types of Companies under CARO, 2003: CARO, 2003 applies to all companies including a foreign company as defined u/s 591 of the Companies Act, 1956. The Order specifically exempts banking companies, insurance companies and companies which have been licensed to operate u/s 25 of the Act. The Order also exempts from its application a private limited company which fulfils certain conditions. The CARO also contains definition of companies engaged in different kinds of activities, viz., manufacturing, mining, chit fund, etc. For instance, it defines manufacturing company as a company engaged in any manufacturing process as defined in the Factories Act, 1948; finance company as a company engaged in the business of financing, whether by making

loans or advances or otherwise, of any industry, commerce or agriculture and includes any company engaged in the business of hire-purchase, lease financing and financing of housing; investment company as a company engaged in the business of acquisition and holding of, or dealing in, shares, stocks, bonds, debentures, debenture stocks, including securities issued by the Central or any State Government or by any local authority, or in other marketable securities of a like nature, etc.

Question 4

(a) Describe the salient features of Financial Administration of Local Bodies. (8 marks)

(b) What are accounting estimates according to Auditing and Assurance Standards—18 (AAS—18)? Give examples. (8 marks)

Answer

(a) Salient Features of Financial Administration of Local Bodies:

(i) **Budgetary Procedure:** The objective of local bodies budgetary procedure are financial accountability, control of expenditure, and to ensure that funds are raised and moneys are spent by the executive departments in accordance with the rules and regulations and within the limits of sanction and authorisation by the legislature or Council. Different aspects covered in budgeting are determining the level of taxation, fees, rates, and laying down the ceiling on expenditure, under revenue and capital heads.

(ii) **Expenditure Control:** At the State and Central level, there is a clear demarcation between the legislature and executive. In the local body, legislative powers are vested in the Council whereas executive powers are delegated to the officers, e.g., Commissioners. All matters of regular revenue and expenditures are generally delegated to the executive wing. For special situations like, reduction in property taxes, refund of security deposits, etc., sanction from the legislative wing is necessary.

(iii) **Accounting System:** Municipal Accounting System has been conventionally prepared under the cash system. In the recent past however, it is being changed to the accrual system of accounting. The accounting system is characterised by (a) subsidiary and statistical registers for taxes, assets, cheques etc., (b) separate vouchers for each type of transaction, (c) compulsory monthly bank reconciliation, (d) submission of summary reports on periodical basis to different authorities at regional and state level.

(b) According to AAS-18, "Audit of Accounting Estimates" accounting estimate means an approximation of the amount of an item in the absence of a precise means of measurement. Some examples are:

(i) Allowances to reduce inventory and accounts receivable to their estimated realizable value.

(ii) Provisions to allocate the cost of fixed assets over their estimated useful lives.

(iii) Accrued revenue.

(iv) Provision for taxation.

(v) Insurer's liability for outstanding claims.

(vi) Provision for loss from a lawsuit.

(vii) Losses on construction contract in progress.

(viii) Amortisations of certain items like goodwill and deferred revenue expenditure.

(ix) Provision to meet warranty claims.

(x) Provision for retirement benefits in the financial statements of employers.

Question 5

How will you vouch and/or verify the following?

(a) Personal expenses of directors met by the company.

(b) Preliminary expenses.

(c) Patents.

(d) Advances given to suppliers. *(4 × 4 = 16 marks)*

Answer

(a) Personal Expenses of Directors:

(i) Check the articles of association, service contract, minutes of general meeting, etc., to check the authorisation for such payment.

(ii) Enquire to ensure that personal expenses are not camouflaged in any other revenue items as contemplated under section 227(1A) of the Companies Act, 1956.

(iii) Ascertain compliance with disclosure according to requirements of Schedule VI to the Companies Act, 1956.

(iv) Check documentary evidences to examine the payments reimbursed.

(v) Check compliance with requirements of CARO, 2003.

(b) Preliminary Expenses: It is the expenditure incurred incidental to the creation, formation and floating of a company. It consists of stamp duties, registration fees, legal costs, consultants fees, expenses of printing of memorandum and articles, etc. The following should be checked:

(a) Check Board's minutes book containing the resolution approving the expenses claimed by promoters as having been spent in formation of the company.

(b) Examine supporting papers and vouchers, contracts, agreements, etc. to support the promoters' claims. Also check bills and receipts issued by the printer of the

memorandum and articles of association, share certificates, etc.

(c) Check receipt for the registration fee paid for registration of the company.

(d) Verify rates of stamp required to be affixed on the memorandum and articles of association.

(e) Ascertain Boards' minutes book for the decision to write off the preliminary expenses over a period. The quantum thereof which has not yet been written off for these expenses should be carried forward in the balance sheet under the head miscellaneous expenditure (to the extent not written off or adjusted) over a period of years.

(f) Check that no expenses other than those what constitutes preliminary expenses are booked under this head, e.g. underwriting commission and brokerage paid.

(c) Patents:

(i) Obtain the schedule containing particulars of the patents owned by the client as on the balance sheet date. The particulars should contain the dates of registration of the patents with the related authorities and the dates in respect of the last renewal.

(ii) See that the total of the values of the patent rights shown in each list agree with the values shown in the respective ledger accounts.

(iii) Examine the cost of patent rights. In case of outright purchase of patent rights, the purchase consideration, legal fees and registration charges should be included in cost. When they are developed within the organisation, all costs incurred on their development including legal and registration expenses for registration of the patent should constitute the cost. Capitalised value should be amortised over the life of the patent.

(iv) See that the renewal fees in respect of the patent rights have been paid and the same has been treated as a revenue charge.

(v) Examine the valuation of the patent rights. It should be seen that the patent rights have been valued at cost less depreciation attributable to the expired legal life of the patent rights. However, if it is found that the patent rights have already lost substantial part of their commercial value, it would be proper to value it at their residual commercial value, when it is less than the book value for their unexpired legal life. In case the product covered by the patent rights does not have any sale value then patents should be shown at nil valuation notwithstanding any residual life. Reference to compliance with the provisions of AS 26 may also be made.

(d) Advances with the Suppliers:

(i) Obtain schedule of debit balances in creditors' account and pay particular attention to the age of the balances. Also scrutinise the bought ledger.

(ii) Enquiry should be made for long unadjusted outstandings and check as to whether any of them would require provisioning.

(iii) Examine that the advances have not been shown as deposits in balance sheet as per section 227(1A) of the Companies Act, 1956.

(iv) Confirmation of balances should be obtained and reconciliation be done in case of any discrepancies.

Question 6

What are the special steps involved in conducting the audit of an Educational Institution? *(16 marks)*

Answer

The special steps involved in the audit of an educational institution are the following:

(i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

(ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

(iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.

(iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

(v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.

(vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.

(vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.

(viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.

(ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

(x) Verify rental income from landed property with the rent rolls, etc.

(xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

(xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.

(xii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.

(xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

(xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

(xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.

(xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.

(xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.

(xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

(xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.

(xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.

(xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.

(xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

(xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

Question 7

(a) While conducting the audit of the accounts of a manufacturing company, you discover that the rate of Gross Profit on Sales has sharply risen in comparison to the previous year.

State the steps you would take to satisfy yourself. *(12 marks)*

(b) State briefly the qualities of Auditors. *(4 marks)*

Answer

(a) There are several possible causes of the sharp increase in the rate of gross profit on sales as compared with that of the previous year, the most likely causes are as under:

(i) *Increase in Sales Prices:* The selling price of the finished products may have been increased. Enquiries should be made by auditor as to whether there have been general or specific price increase and the reasons for the same. The auditor should obtain copies of the company price lists prevailing at different point of time and make the relevant comparison.

(ii) *Reduction in Cost of Manufacturing:* The cost of manufacturing may have reduced substantially. The auditor should examine the stock and purchases records in respect of large purchases of raw materials, comparing current costs with those in the previous year and detailed information supporting the possibility should be sought from the company.

(iii) *Alteration in Sales-mix:* The mix of sales may have been altered, resulting in the sales of more profitable items. Detailed sales analysis should be made for the period in order to ascertain whether the more profitable lines constituted a large proportion of the total sales.

(iv) *Impact of Automation*: The mechanisation or automation of certain manufacturing processes may have resulted in considerable saving in labour cost and this possibility could be easily verify by comparisons of wages records.

(v) *Adherence to Cut-off Procedures:* The company cut-off procedures as regards closing stock and work-in-progress should be investigated, as any change in the procedure as compared with the previous year would cause a difference in the gross profit ratio. It should also be seen that the procedure laid down has been observed by the concerned personnel and rightly adhered to. The auditor should test relevant transaction and ensure that everything is incorporated in the financial statement.

(vi) *Manipulating Sales*: The possibility of items which have been sent to customers on 'sale or return' basis being included in sales, should be investigated, as this would give effect for increase in the rate of gross profit.

(b) Qualities of Auditors: The auditor should possess specific knowledge of accountancy, auditing, taxation, etc. which are acquired by him during the course of his theoretical education. The auditor should also have sufficient knowledge of general principles of law of contracts, partnership; specific statutes and provisions applicable, e.g. Companies Act, 1956, Co-operative Societies Act, etc.; client's nature of business and its peculiar features. Apart from the knowledge acquired by the auditor in the formal manner, the auditor should also possess certain personal qualities such as, tact; caution; firmness; good temper; judgement; patience; clear headedness and commonsense; reliability and trust, etc. In short, all those personal qualities that go to make a good person contribute

to the making of a good auditor. In addition, he must have the shine of culture for attaining a great height. He must have the highest degree of integrity backed by adequate independence. In fact, AAS-1 mentions integrity, objectivity and independence as one of the basic principles. Auditing is a profession calling for wide variety of knowledge to which no one has yet set a limit the most useful part of the knowledge is probably that which cannot be learnt from books because its acquisition depends on the alertness of the mind in applying to ever varying circumstances, the fruits of his own observation and reflection; only he who is endowed with common sense in adequate measure can achieve it.

Question 8

Write short notes on the following:

(a) Analytical review

(b) Audit enquiry under Section 227(1A)

(c) Disclosure requirements of bank balances of a limited company

(d) Audit trail in a computerized accounting environment *(4×4 = 16 marks)*

Answer

(a) Analytical Review: AAS 5 on Audit Evidence defines analytical review as those tests of details which consists of studying significant ratios and trends and investigating unusual fluctuation and items. Thus, analytical reviews are substantive audit procedure with the help of which auditor can perform tests of details in more efficient and effective manner. Therefore, analytical reviews are nothing best analytical review procedures which have been considered at length in AAS-14 on "Analytical Procedures". According to AAS-14, analytical procedures include the consideration of comparisons of the entity's financial information with, for example, comparable information for prior periods or anticipated results of the entity, such as budgets or forecasts. Consideration of relationships among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages, between financial information and relevant non-financial information, such as payroll costs to number of employees also constitute analytical review procedures.

Analytical review procedures are used for the following purposes:

(a) to assist the auditor in planning the nature, timing and extent of other audit procedures;

(b) as substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions; and

(c) as an overall review of the financial statements in the final review stage of the audit.

The extent of reliance that the auditor places on the results of analytical review procedures depends on materiality of the items involved, assessment of inherent and control risks, etc.

(b) Audit enquiry under Section 227(1A): Auditor is required to make an enquiry and report under section 227(1A) of the Companies Act, 1956, if he is not satisfied in respect of the following matters:

(i) Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company.

(ii) Whether the transactions which are represented by mere book entries are not prejudicial to the interests of the company.

(iii) Where the company is not an investment company within the meaning of section 372, or a banking company, whether so much of the assets as consist of shares and debentures and other securities have been sold at a price less than that at which they were purchased by the company.

(iv) Whether loans and advances have been shown by way of deposits.

(v) Whether the personal expenses have been charged to revenue.

(vi) Where it is stated in the books and papers of the company that any shares have been allotted for cash whether the cash has actually been received and if no cash has been received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

(c) Disclosure Requirements for Bank Balance:

As per Part I of Schedule VI to the Companies Act, 1956, the disclosure requirements for bank balance are as under:

(i) Bank balance with scheduled bank.

(ii) Bank balance with banks other than scheduled banks.

The other particulars are to be stated are as under:

(i) Balances lying with scheduled banks in current accounts, call accounts, deposit accounts.

(ii) Where the balance is with non-scheduled bank, the name of the banker, balances lying with such bankers on current accounts, call accounts and deposit accounts, the maximum amount outstanding with them during the year should be specified.

(d) Audit Trail in a Computerised Accounting Environment: An audit trail refers to a situation where it is possible to relate 'one-to-one' basis, the original input along with the final output. The work of an auditor would be hardly affected if "Audit Trail" is maintained i.e. if it were still possible to relate, on a 'one-to-one' basis, the original input with the final output. A simplified representation of the documentation in a manually created audit trail. The particular credit notes may be located by the auditor at any time he may wish

to examine them, even months after the balance sheet date. He also has the means, should he so wish, of directly verifying the accuracy of the totals and sub-totals that feature in the control listing, by reference to individual credit notes. He can, of course, check all detailed calculations, casts and postings in the accounting records, at any time.

In first and early second-generation computer systems, such a complete and trail was generally available, no doubt, to management's own healthy scepticism of what the new machine could be relied upon to achieve – an attitude obviously shared by the auditor.

In such a system

(i) The output itself is as complete and as detailed as in any manual system.

(ii) The trail, from beginning to end, is complete, so that all documents may be identified by located for purposes of vouching, totalling and cross-referencing.

Any form of audit checking is possible, including depth testing in either direction. In case audit trail is missing, the auditor employs Computer Assisted Techniques (CAATs) to ensure the validity of accounting data.

PAPER – 3 : BUSINESS AND CORPORATE LAWS

*Question Nos. **1** and **7** are compulsory.*

*Candidates are required to attempt **three** questions out of Question Nos. 2,3,4,5 and 6 and **two** questions out of Question Nos. 8,9 and 10.*

Question 1

*Answer any **six** of the following:*

(a) *Mr. Seth an industrialist has been fighting a long drawn litigation with Mr. Raman another industrialist. To support his legal campaign Mr. Seth enlists the services of Mr. X a legal expert stating that an amount of Rs.5 lakhs would be paid, if Mr. X does not take up the brief of Mr. Raman. Mr. X agrees, but at the end of the litigation Mr. Seth refuses to pay. D ecide whether Mr. X can recover the amount promised by Mr. Seth under the provisions of the Indian Contract Act, 1872.*

(b) *With a view to boost the sales Hanuman Automobiles sells a motorcar to Mr. A on trial basis for a period of three days with a condition that if Mr. A is not satisfied with the performance of the car, he can return back the car. However, the car was destroyed in a fire accident at the place of Mr. A before the expiry of three days. Decide whether Mr. A is liable for the loss suffered.*

(c) *Define the term 'Cheque' as given in the Negotiable Instruments Act, 1881 and amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002.*

(d) *Explain the provisions of the Indian Partnership Act, 1932 relating to the creation of Partnership by holding out. Upto what extent such partner will be liable to the Partnership firm.*

(e) *Examine the powers of Government to grant exemption to an establishment from payment of bonus under the Payment of Bonus Act, 1965.*

(f) *Manorama Group of Industries sold its textile unit to Giant Group of Industries. Manorama Group contributed 25% of total contribution in Pension Scheme, which was due before sale under the provisions of Employees Provident Fund and Miscellaneous Provisions Act, 1952. The transferee company (Giant Group of Industries) refused to hear the remaining 75% contribution in the Pension Scheme. Decide, in the light of the Employees Provident Fund and Miscellaneous Provisions Act, 1952, who will be liable to pay for the remaining contribution in case of transfer of establishment and upto what extent?*

(g) *State the restrictions imposed on a registered society under the Cooperative Societies Act, 1912 regarding investment or deposit of its surplus funds.*

(h) State the provisions of law relating to functions of a Federal Cooperative Society under the Multi-state Cooperative Societies Act, 2002. (4 x 6 = 24 marks)

Answer

(a) The problem as asked in the question is based on one of the essentials of a valid contract. Accordingly, one of the essential elements of a valid contract is that the agreement must not be one which the law declares to be either illegal or void. A void agreement is one without any legal effect. Thus any agreement in restraint of trade, marriage, legal proceedings etc., are void agreements. Thus Mr. X cannot recover the amount of Rs. 5 lakhs promised by Mr. Seth because it is an illegal agreement and cannot be enforced by law.

(b) The problem as asked in the question is based on the provisions of the Sale of Goods Act, 1930 as contained in Section 8. Accordingly, the contract becomes void if the goods are destroyed or do not answer to the description in the agreement before the risk passes on to the buyer. In the given case that the subject matter of the contract i.e. Motorcar was destroyed before the transfer of property from the seller to the buyer. Thus the risk passes only when the ownership is transferred to the buyer. Therefore, in the present case Mr. A is not liable for the loss suffered due to the fire accident over which A has no control. Thus M/s. Hanuman Automobiles will have to bear whatever loss that has taken place due to the fire accident.

(c) Definition of Cheque:

According to Section 6 of the Negotiable Instruments Act, 1881 as amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 "A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form".

A cheque in the electronic form means 'a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system, ensuring the minimum safety standards with the use of digital signature (with or without biometrics signatures) and asymmetric crypto system' [Explanation I (a)].

A truncated cheque means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing [Explanation I (b)].

Clearing house means the clearing house managed by the Reserve Bank of India or a cleaning house recognised as such by the Reserve Bank of India [Explanation II].

(d) Partnership by 'Holding Out'

According to Section 28 of the Indian Partnership Act, 1932 "anyone who by words spoken or written or by conduct represents himself, or knowingly permits himself to be represented, to be a partner in a firm, is liable as a partner". The statement includes with its purview representation by all possible means enumerated in this section. Thus the person sought to be charged with liability by holding out must have done something which amounts to a representation that he was a partner in the business. This is known as creation of partnership by 'holding out'.

Extent of liability of a partner by holding out:

(i) A partner by holding out is liable as a partner in the firm to anyone who has on the faith of any such representation gives credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit [section 28(1)].

(ii) Provisions of section 28 are also applicable to a former partner who has retired from the firm without giving proper public notice of his retirement. In such case a person, who, even subsequent to the retirement, gives credit to the firm on behalf that he was a partner, will be entitled to hold him liable.

(iii) Where after a partner's death the business is continued in the old firm name, the continued use of that name or of the deceased partner's name as a part thereof shall not be itself make his legal representative or his estate liable for any act of the firm done after his death [Section 28(2)].

(iv) If a person holds himself out to be the partner of a firm, he becomes personally liable. He does not become partner of the firm and is not entitled to any rights as against those who in fact are partners in the firm. By holding out he does not become an agent of the firm.

(e) According to section 36 of the Payment of Bonus Act, 1965, if the appropriate Government having regard to the financial position and other relevant circumstances of any establishment or class of establishments is of the opinion that it will not be in public interest to apply all or any of the provisions of the Act, it may by notification in the official Gazette, exempt for such period as may be specified therein and subject to such conditions as it may think fit to impose, such establishment or class of establishments from all or any of the provisions of the Act. There are two stages in section 36. Viz

(i) The Government shall consider the financial position and other relevant circumstances of an establishment or class of establishments; and

(ii) The Government should be of the opinion that it would not be in public interest to apply all or any of the provisions of the Act.

The expression 'financial position' includes loss suffered by the establishment during the accounting year. The expression 'other relevant circumstances' will include every

consideration as to whether the workmen had principally contributed to the financial loss of the company during that accounting year. If the bonus liability is negligible compared to the loss suffered, company should not be relieved of liability to pay minimum bonus. If the losses sustained by the employer is not due to any misconduct on the part of the employees, the employer is liable to pay statutory minimum bonus *[J.K. Chemicals Ltd. Vs. Government of Maharasthra (1996) Bombay H.C.]*

(f) Problem relating to liability in case of transfer of establishment

The problem as asked in the question is based on the provisions of section 17(B) of the Employees Provident Funds and Miscellaneous Provisions Act, 1952. Accordingly where an employer in relation to an establishment, transfers that establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall be jointly or severally liable to pay the contribution and other sums due from the employer under the provisions of this Act of the scheme or pension scheme, as the case may be, in respect of the period upto the date of such transfer. It is provided that the liability of the transferee shall be limited to the value of the assets obtained by him by such transfer.

It would be thus evident from the aforesaid provisions that 17-B deals with the liability of transferor and transferee in regard to the money due under (a) the Act or (b) the scheme (c) and pension scheme. In the case of the transfer of the establishment brought in by sale, gift, lease etc. The liability of the transferor and transferee is joint and several, but it is limited to the period upto the date of transfer.

Therefore applying the above provisions in the given case the transferor Manorama Group of Industries, the transferor has paid only 25% of the total liability as contribution in pension scheme before sale of the establishment. With regards to remaining 75% liability both the transferor and transferee companies are jointly and severally liable to contribute. In case, the transferor refuses to contribute, the transferee will be liable.

The liability is limited upto the date of transfer and upto remaining amount. Further, the liability of the transferee i.e. Giant Group of Industries, is limited to the extent of assets obtained by it from the transfer of the establishment.

(g) Section 32 of the Co-operative Societies Act, 1912 provides restrictions on investment of funds by a co-operative society. Accordingly the co-operative society may invest or deposit its funds:

(i) in the Government Savings Bank or

(ii) in any of the securities specified in section 20 of the Indian Trust Act, 1882 or

(iii) in the shares or on the security of any other registered society, or

(iv) with any bank or person carrying on the business of banking approved for the purpose by the Registrar, or

(v) in any other mode permitted by the rules.

(h) Functions of a Federal Co-operative Society

Under Section 24 of the Multi-State Co-operative Societies Act, 2002, a federal co-operative society registered with the aim of self-help and mutual aid is authorised to do the following functions -

(a) ensure compliance of the co-operative principles;

(b) make model bye-laws and policies for consideration of its member co-operative;

(c) provide specialised training, education and data-base information;

(d) undertake research, evaluation and assist in preparation of prospective development plans for its member co-operative;

(e) promote harmonious relations amongst member co-operative;

(f) help member co-operative to settle disputes among themselves;

(g) undertake business services on behalf of its member co-operative, if specifically required by or under the resolution of the general body or the ward, or bye-laws of a member co-operative;

(h) provide management development services to a member co-operative;

(i) evolve code of conduct for observance by a member co-operative;

(j) evolve viability norms for a member co-operative;

(k) provide legal aid and advice to a member co-operative;

(l) assist member co-operative in organizing self-help.

(m) develop market information system, logo brand promotion, quality control and technology up gradation.

Question 2

(a) What is meant by Anticipatory Breach of Contract?

Mr. Dubious textile enters into a contract with Retail Garments Show Room for supply of 1,000 pieces of Cotton Shirts at Rs.300 per shirt to be supplied on or before 31st December, 2004. However, on 1st November, 2004 Dubious Textiles informs the Retail Garments Show Room that he is not willing to supply the goods as the price of Cotton shirts in the meantime has gone upto Rs.350 per shirt. Examine the rights of the Retail Garments Show Room in this regard.

(b) State briefly the essential element of a contract of sale under the Sale of Goods Act, 1930. Examine whether there should be an agreement between the parties in order to constitute a sale under the said Act. (6 + 6 = 12 marks)

Answer

(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 promise 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 poimisor is over.

In the given problem Dubious Textiles has indicated its unwillingness to supply the cotton shirts on 1st November 2004 itself when it has time upto 31st December 2004 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 Dubious Textiles immediately after 1st November, 2004, without waiting upto 31st December 2004. The damages will be calculated at the rate of Rs. 50 per shirt i.e. the difference between Rs. 350/- (the price prevailing on 1st November) and Rs. 300/- the contracted price.

(b) Essentials of Contract of Sale

The following elements must co-exist so as to constitute a contract of sale of goods under the Sale of Goods Act, 1930.

(i) There must be at least two parties

(ii) The subject matter of the contract must necessarily be goods

(iii) A price in money (not in kind) should be paid or promised.

(iv) A transfer of property in goods from seller to the buyer must take place.

(v) A contract of sale must be absolute or conditional [section 4(2)].

(vi) All other essential elements of a valid contract must be present in the contract of sale.

The Supreme Court has held in the case of *"State of Madras Vs. Gannon Dunkerley and Co. AIR (1858) S (500)"* that according to the law in order to constitute a sale, it is necessary that there should be an agreement between the parties for the purpose of transferring title of goods which of course presupposes capacity to contract, that it must be supported by money consideration that as a result of transaction the property in the goods must actually pass etc.

Question 3

(a) Describe the provisions of Indian Partnership Act, 1932 regarding the admission of minor in the partnership firm. State the rights and liabilities of such minor before or after he attains majority.

(b) Distinguish between Contract of Indemnity and Contract of Guarantee.

(6 + 6 = 12 marks)

Answer

(a) Minor's Admission into a Partnership Firm: According to Section 11 of the Indian Contract Act, 1872 an agreement by or with a minor is void *(Mohri Bibi Vs. Dharm Das Ghose).* As such, a minor is incapable of entering into a contract of partnership. But with the consent of all the partners for the time being, a minor may be admitted to the benefits of partnership [Section 30(1)]. This provision is based on the rule that a minor cannot be a promisor, but he can be a promisee or a beneficiary.

Position before and on his attaining the age of majority

Position before attaining majority:

Rights:

1. He has a right to such share of the property and of profits of the firm as may have been agreed upon.
2. He has a right to have access to and inspect and copy any of the accounts of the firm but not books. (Section 30(2).
3. When he is not given his due share of profit, he has a right to file a suit for his share of the property of the firm. But he can do so only if he wants to sever his connection with the firm. [Section 30(4)].

Liabilities:

1. The liability of the minor partner is confined only to the extent of his share in the profits and property of the firm. Over and above this, he is neither personally liable nor is his private estate liable [Section 30(3)].
2. He cannot be declared insolvent, but if the firm is declared insolvent his share in the firm vests in the Official Receiver or Official Assignee.

Position on attaining majority:

On attaining majority such a minor has to decide within 6 months whether he shall continue in the firm or leave it. These six months run from the date of his attaining majority or from the date when he first comes to know that he had been admitted to the benefits of partnership whichever date is later. Within this period he should give a public notice of his choice: (a) to become, or (b) not to become, a partner in the firm.

If he fails to give a public notice, he is deemed to have become a partner in the firm on the expiry of the said six months. [Section 30(5)].

When such a minor elects to become a partner:

1. He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.
2. His share in the property and profits of the firm is the share to which he was entitled as a minor partner [Section 30(7)].

When such a minor elects not to become a partner:

1. His rights and liabilities continue to be those of a minor up to the date of the notice.
2. His share is not liable for any acts of the firm done after the date of the public notice.
3. He is entitled to sue the partners for his share or the property and profits in the firm [Section 30(8)].

(b) Distinction between Contract of Indemnity & Contract of Guarantee

	Contract of Indemnity		**Contract of Guarantee**
1.	There are two parties to the contract viz. indemnifier (promisor) and the Indemnified (promise).	1.	There are three parties to the viz. creditor, principal debtor and the surety.
2.	Liability of the indemnifier to the indemnified is primary and independent.	2.	Liability of the surety to the creditor is collateral or secondary, the primary liability being that of the principal debtor.
3.	There is only one contract in case of a contract of indemnity, i.e., between the indemnifier and the indemnified.	3.	In a contract of guarantee there are three contracts, between principal Debtor and Creditor; between creditor and the surety and between surety and principal debtor.
4.	It is not necessary for the indemnifier to act at the request of the indemnified.	4.	It is necessary that surety should give the guarantee at the request of the debtor.
5.	The liability of the indemnifier arises only on the happening of a contingency.	5.	There is usually an existing debt or duty, the performance of which is guaranteed by the surety.
6.	An indemnifier cannot sue a third party for loss in his own name, because there is no privity of contract. He can do so only if there is an	6.	A surety, on discharging the debt due by the principal debtor, steps into the shoes of the creditor. He can proceed against the principal

assignment in his favour. debtor in his own right.

Question 4

(a) State the privileges of a "Holder in due course" under the Negotiable Instruments Act, 1881.

A induced B by fraud to draw a cheque payable to C or order. A obtained the cheque, forged C's indorsement and collected proceeds to the cheque through his Bankers. B the drawer wants to recover the amount from C's Bankers. Decide in the light of the provisions of Negotiable Instruments Act, 1881-

(i) Whether B the drawer, can recover the amount of the cheque from C's Bankers?

(ii) Whether C is the Fictitious Payee?

(iii) Would your answer be still the same in case C is a fictitious person?

(b) On 1st January, 2002, Aryan Textiles Ltd. agreed with the employees for payment of an annual bonus linked with production or productivity instead of bonus based on profits subject to the limit of 30% of their salary wages during the relevant accounting year. It was also agreed by the employees that they will not claim minimum bonus stated under Section 10 of the Payment of Bonus Act, 1965. As per the agreement the employees of Aryan Textiles Ltd claimed annual bonus linked with production or productivity in the relevant accounting year. On refusal of the company the employees of the company moved to the court for relief.

Decide in reference to the provisions of the payment of Bonus Act, 1965 whether the employees will get the relief? Inspite of the aforesaid agreement whether the employees are still entitled to receive minimum bonus. (6 + 6 = 12 marks)

Answer

(a) Privileges of a "Holder in Due Course": According to the provisions of the Negotiable Instruments Act, 1881, a holder in due course has the following privileges:

(i) A person signing and delivering to another a stamped but otherwise inchoate instrument is debarred from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount (Section 20).

(ii) In case of bill of exchange is drawn payable to drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature. It is not permissible for acceptor to allege as against the holder in due course that such name is fictitious (Section 42).

(iii) In case a bill or note is negotiated to a holder in due course, the other parties to the

bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Section 42 and 47).

(iv) The person liable in a negotiable instrument cannot set up against the holder in due course the defences that the instrument had been lost or obtained from the former by means of an offence or fraud or far an unlawful consideration (Section 58).

(v) No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn (Section 120).

(vi) No maker of a promissory note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the rate of the note or bill, to endorse the same (Section 121).

In brief, it is clear that a holder in due course gets a good title in many respects.

Answer to problem

According to Section 42 of the Negotiable Instruments Act, 1881 an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an instrument by the same hand as the drawer's signature, and purporting to be made by the drawer.

The word 'fictitious payee' means a person who is not in existence or being in existence, was never intended by the drawer to have the payment. Where drawer intends the payee to have the payment, then he is not a fictitious payee and the forgery of his signature will affect the validity of the cheque.

Applying the above, answers to the questions asked can be as under:

I. In this case B, the drawer can recover the amount of the cheque from C's bankers because C's title was derived through forged endorsement.

II. Here C is not a fictitious payee because the drawer intended him to receive payment.

III. The result would be different if C is not a real person or is a fictitious person or was not intended to have the payment.

(b) Problem relating to bonus linked with production or productivity (Section 31A)

As per Section 31(A) of the Payment of Bonus Act, 1965, there may be an agreement or settlement by the employees with their employer for payment of an annual bonus linked with production or productivity in lieu of bonus based on profits, as is payable under the Act. Accordingly, when such an agreement has been entered into the employees are

entitled to receive bonus as per terms of the agreement/settlement, subject to the following restriction imposed by Section 31A:

(a) any such agreement/settlement whereby the employees relinquish their right to receive minimum bonus under Section 10, shall be null and void in so far as it purports to deprive the employees of the right of receiving minimum bonus.

(b) If the bonus payable under such agreement exceed 20% of the salary/wages earned by the employees during the relevant accounting year, such employees are not entitled to the excess over 20% of salary/wages.

In the given case Aryan Textile Ltd. agreed with the employees for payment of an annual bonus linked with production or productivity instead of based on profits subject to the limit of 30% of their salary/ wages during the relevant accounting year. According to Section 31A the maximum bonus under this provision can be given which should not exceed 20% of the salary/wages earned by the employee during the relevant accounting year. Hence, the maximum bonus may be paid upto 20% of the salary/wages. If the company agrees to pay more than 20% then it will be against the provisions of the Payment of Bonus Act, 1965.

The employees of Aryan Textiles also agreed not to claim minimum bonus stated in Section 10 of the Payment of Bonus Act, 1965 such an agreement shall be null and void as it purports to deprive the employees of their right of receiving minimum bonus. Hence, the relief may be given by the court, as regards to the payment of bonus to the employees, based on the production or productivity, if it is agreed, subject to a maximum of 20%. The employees will also be entitled legally to claim bonus which is minimum prescribed under Section 10 of the Act, even though they have relinquished such right as per the agreement.

Question 5

(a) Point out the classes of those establishments upon which the provisions of Employees Provident Fund and Miscellaneous Provisions Act, 1952 does not apply.

(b) M/s Supreme Society Ltd., a Multi-state Cooperative Society, is contemplating to transfer some of its assets and liabilities to another Multi-state Cooperative Society. Advise the management of the society about the steps to be taken in this regard. [6 + 6 = 12 marks]

Answer

(a) Provisions not applicable to certain establishments: Section 16 of the Employees Provident Funds and Miscellaneous Provisions Act, 1952 lays down that the provisions of this Act will not be applicable to the following establishments:

(a) An establishment under the Co-operative Societies Act, 1912 or under any other law relating to Co-operative Societies in any state, employing less than 50 persons and

working without the aid of power; or

(b) Any other establishment belonging to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old age pension in accordance with any scheme or rule framed by the Central Government or the State Government governing such benefits; or

(c) To any other establishment set up under any Central, Provincial, or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any scheme or rule framed under the Act governing pension in accordance with any scheme or rule framed under that Act governing such benefits; or

(d) Section 16(2) further empowers the Central Government to exempt whether prospectively or retrospectively any class of establishments (not an individual establishment unless it constitutes a class within itself) from the operation of the Act, if the Government thinks necessary or expedient after taking into consideration the financial position of the establishment or other circumstances of the case. This exemption can be granted only though notification in the Official Gazette.

(b) Transfer of Assets & Liabilities - Steps to be taken

1. M/s Supreme Society Ltd can transfer its assets and liabilities in whole or in part to any other Multi-State Co-operative Society by passing a resolution by a majority of not less than two-thirds of the members present and voting at a general meeting of the society held for this purpose. The resolution should contain the particulars of the assets and liabilities to be transferred.
2. After passing the resolution, M/s Supreme Society Ltd should give notice thereof in writing to all the members and creditors giving them an option of withdrawing their shares, deposits or loans as the case may be. This option has to be exercised within a period of one month of the date of service of the notice and if any member or creditor who does not exercise his option within one month, shall be deemed to have assented to the proposal contained in the resolution. The resolution passed by the society shall not take effect until the assent thereto of all the members and creditors has been obtained.
3. The society should make arrangements for meeting in full or otherwise satisfy all claims of the members and creditors who exercise the option to exist from the society.
4. On receipt of necessary documents relating to the resolution passed by the society, the Central Registrar on being satisfied that the resolution has become effective will issue an order under Section 21 of the Multi-state Co-operative Societies Act, 2002. This will be a sufficient conveyance to vest the assets and liabilities in the transferee society without any further assurance.

Question 6

(a) A group of people having common interest wish to form and registered a society under the Cooperative Societies Act, 1912. Describe briefly

(i) the eligibility conditions to be fulfilled by the group for registration, and

(ii) the power of Registrar to decide the eligibility conditions.

(b) A draws a bill on B. B accepts the bill without any consideration. The bill is transferred to C without consideration. C transferred it to D for value. Decide-

(i) Whether D can sue the prior parties of the bill, and

(ii) Whether the prior parties other than D have any right of action intense?

Give your answer in reference to the Provisions of Negotiable Instruments Act, 1881.

(6 x 6 = 12 marks)

Answer

(a) The eligibility conditions to be fulfilled by the group for registration of a society under the Co-operative Societies Act, 1912 are as follows:

(a) A society other than a society of which a member is a registered society, shall not be registered under the Act if it does not consist of at least 10 persons above the age of 18 years and where the object of the society is the creation of funds to be lent to its members, unless such person:

(i) reside in the same town or village or in the same group of villages; or

(ii) save where the Registrar otherwise directs, are members of the same tribe, class, caste or occupation.

(b) The word "Limited" shall be the last word in the name of every society with limited liability registered under this Act.

If the society fails to retain 10 members, such a failure may lead to the cancellation of its registration.

Powers of Registrar

Under Section 7 of the Act, the Registrar has the final power to decide:

(a) Whether a person is an agriculturist or a non-agriculturist.

(b) Whether any person is resident in a town or a village or group of villages.

(c) Whether two or more villages will be deemed to have formed a group; or

(d) Whether any person belongs to any tribe, class, caste or occupation.

(b) Problem on Negotiable Instrument made without consideration:

Section 43 of the Negotiable Instruments Act, 1881 provides that a negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

(i) In the problem, as asked in the question, A has drawn a bill on B and B accepted the bill without consideration and transferred it to C without consideration. Later on in the next transfer by C to D is for value. According to provisions of the aforesaid section 43, the bill ultimately has been transferred to D with consideration. Therefore, D can sue any of the parties i.e. A, B or C, as D arrived a good title on it being taken with consideration.

(ii) As regards to the second part of the problem, the prior parties before D i.e., A, B, and C have no right of action inter se because first part of Section 43 has clearly lays down that a negotiable instrument, made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction prior to the parties who receive it on consideration.

Question 7

*Answer any **four** of the following:*

(a) Some of the creditors of M/s Get Rich Quick Ltd. have complained that the company was formed by the promoters only to defraud the creditors and circumvent the compliance of legal provisions of the Companies Act, 1956. In this context they seek your advice as to the meaning of corporate veil and when the promoters can be made personally liable for the debts of the company.

(b) M/s ABC Ltd. a company registered in the State of West Bengal desires to shift its registered office to the State of Maharashtra. Explain briefly the steps to be taken to achieve the purpose.

Would it make a difference, if the Registered Office is transferred from the Jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same State?

(c) M/s Honest Cycles Ltd. has received an application for transfer of 1,000 equity shares of Rs.10 each fully paid up in favour of Mr. Balak. On scrutiny of the application form it was found that the applicant is minor. Advise the company regarding the contractual liability of a minor and whether shares can be allotted to

the Balak by way of transfer.

(d) Explain briefly the distinction between shares and debentures and state whether a company can issue debentures with voting rights.

(e) What is meant by "Abridged prospectus". Under what circumstances a company issuing abridged prospectus need not accompany the prescribed details along with the application form for issue of shares? (5 + 5 + 5 + 5 = 20 marks)

Answer

(a) Corporate Veil

After incorporation the company in the eyes of law is a different person altogether from the shareholders who have formed the company. The company has its own existence and as a result the shareholders cannot be held liable for the acts of the company even though the shareholders control the entire share capital of the company. This is popularly known as Corporate Veil and in certain circumstances the courts are empowered to lift or pierce the corporate veil by ignoring the company and directly examine the promoters and others who have managed the affairs of the company after its incorporation. Thus, when the corporate veil is lifted by the courts, (i.e., the courts have disregarded the company as an entity), the promoters can be made personally liable for the debts of the company. In the following circumstances, corporate veil can be lifted by the courts and promoters can be held personally liable for the debts of the company.

(i) Trading with enemy country.

(ii) Evasion of taxes.

(iii) Forming a subsidiary company to act as its agent.

(iv) The benefit of limited liability is destroyed by reducing the number of members below 7 in the case of public company and 2 in the case of private company for more than six months.

(v) Under law relating to exchange control.

(vi) Device of incorporation is adopted to defraud creditors or to avoid legal obligations.

(b) Transfer of Registered Office of a Company

In order to shift the registered office from the State of West Bengal to the State of Maharashtra, M/s ABC Ltd has to take the following steps:

(i) To pass a special resolution and thereafter file the same with the Registrar of Companies.

(ii) To file a Petition before the Company Law Board (Central Government)* under

Section 17, of the Companies Act, 1956.

(iii) To give an advertisement in two newspapers one in English language and the other in local language indicating the change and any member/creditor having objection can write to the Company Law Board (Central Government)*.

(iv) To give notice to the State Government of West Bengal.

(v) To submit all the required documents along with the fee to Company Law Board (Central Government)*.

The Company Law Board (Central Government)* after hearing the petition passes an order confirming the alteration in the memorandum of association of the company regarding the shifting of the registered office. The Company Law Board's (Central Government)* order should be filed by ABC Ltd with both the Registrars of Companies West Bengal and Maharashtra. After registration of the said order the Registrar of Companies Maharashtra will issue a certificate which is the conclusive proof that all the formalities have been complied with.

Change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State: The procedure and law pertaining to the change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State is contained in Section 17A of the Companies Act, 1956 as amended upto date is as follows:

(i) Company can do so only if the Regional Director permits to it.

(ii) Application for permission has to be made on a prescribed form.

(iii) The Regional Directors are required to confirm the Company's application and inform it accordingly within a period of four weeks.

(iv) After getting the confirmation of the Regional Director, the company must file a copy of the same with the Registrar of Companies within two months from the date of the confirmation together with a copy of the altered memorandum.

(v) The Registrar is required to register the same and inform the company within one month from the date of filing.

(vi) The Registrar's certificate is a conclusive evidence of the fact of alteration and of compliance with the requirements (Section 17-A).

(*Note: Students may kindly note that, all Sections of the Companies (Second Amendment) Act, 2002 have not come into force. Till such time, jurisdiction of Company Law Board will continue to remain unchanged.)

(c) The Companies Act, 1956 does not prescribe any qualification for membership. Membership entails an agreement enforceable in a court of law. Therefore, the

contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration. It was held in the case of *Mohri Bibi Vs. Dharmadas Ghose (1930) 30 Cal. 531 (P.C.)* that since minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member of the company. However, the Punjab High Court held in the case of *Diwan Singh vs. Minerva Films Ltd (AIR 1956 Punjab 106)* that there is no legal bar to a minor becoming a member of a company by acquiring shares by way of transfer provided the shares are fully paid up and no further obligation or liability is attached to these. The same view was upheld by the Company Law Board in the case of *S.L. Bagree Vs. Britannia Industries Ltd (1980).*

In view of the above, M/s Honest Cycles Ltd can give membership to Balak through 1000 shares, received by way of transfer, in favour of Mr. Balak a minor because the shares are fully paid up and no further liability is attached to these.

(d) The distinction between a share and a debenture is as under:

(i) Shares are a part of the capital of a company whereas debentures constitute a loan.

(ii) The shareholders are the owners of the company whereas debenture holders are creditors.

(iii) Shareholders generally enjoy voting right whereas debenture holders do not have any voting right.

(iv) Interest on debentures is payable even if there are no profits. Dividend can be paid to shareholders only out of the profits of the company.

(v) Debentures have generally a charge on the assets of the company but shares do not carry any such charge.

(vi) The rate of interest is fixed in the case of debentures whereas on equity shares the dividend may vary from year to year.

(vii) Debentures get priority over shares in the matter of repayment in the event of liquidation of the company.

Issue of Debentures with voting rights

No company can issue any debentures carrying voting rights at any meeting (i.e., members' general meeting) of the company, whether generally or in respect of any particular class of shares (Section 117). This provision applies to debentures issued after the commencement of the Companies Act (Section 117 of 1956 Act).

(e) Abridged Prospectus: As per Section 2(1) of the Companies (Amendment) Act, 2000 "abridged prospectus means a memorandum containing such salient features of a prospectus as may be prescribed." By the Amendment Act of 1988 the company was

permitted to furnish an abridged form of prospectus along with the application for shares or debentures instead of the full prospectus. The Government has revised the format of abridged prospectus to provide for greater disclosure of information to prospective investors so as to enable them to take an informed decision regarding investment in shares and debentures.

The abridged prospectus (in Form 2A) and the share application form should bear the same printed number. The investor may detach the share application form along the perforated line after he has had an opportunity to study the contents of the abridged prospectus, before submitting the same to the company or its designated bankers.

Circumstances where details are not required in the abridged prospectus:

(1) Where the offer is made in connection with a bona fide invitation to a person to enter into an undertaking agreement with respect to the shares or debentures.

(2) Where the shares or debentures are not offered to the public.

(3) Where the offer is made only to the existing members or debenture holders of the company.

(4) Where the shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognized stock exchange.

(5) Where a prospectus is issued as a newspaper advertisement, it is not necessary to specify the contents of the memorandum, or the names etc., of the signatories to the memorandum or the number of shares subscribed for by them.

Question 8

(a) M/s Low Esteem Infotech Ltd. was incorporated on 1.4.2003. No General Meeting of the company has been held so far. Explain the provisions of the Companies Act, 1956 regarding the time limit for holding the first annual general meeting of the Company and the power of the Registrar to grant extension of time for the First Annual General Meeting.

(b) Whether a Company can buy-back its own shares? Explain in brief the provisions of Companies Act, 1956 relating to the sources of funds and conditions for buy-back its own shares by the company. (5 + 5 = 10 marks)

Answer

(a) According to Section 166 of the Companies Act, 1956, every company shall hold its first annual general meeting within a period of 18 months from the date of incorporation. Since M/s Low Esteem Infotech Ltd was incorporated on 1.4.2003, the first annual general meeting of the company should be held on or before 30th September, 2004. Even though the Registrar of Companies is empowered to grant extension of time for a

period not exceeding 3 months for holding the annual general meeting, such a power is not available to the Registrar in the case of the first annual general meeting. Thus, the company and its directors will be liable for the default if the annual general meeting was held after 30th September, 2004.

(b) Buy-back of its own securities: Section 77A of the Companies (Amendment) Act, 1999, provides that a company can purchase its own shares subject to certain conditions and regulations.

Sources of funds for buy-back: A company may purchase its own shares or other specified securities out of:-

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities.

Provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. Such specified securities include "employees stock option or other securities as notified by Central Government from time to time".

Conditions for buy-back: No company shall purchase its own shares or other specified securities under sub-section (1) unless:-

(a) the buy-back is authorized by articles;

(b) a special resolution has been passed in general meeting of the company authorizing the buy-back.

Provided that nothing contained in this clause shall apply in any case where:-

(i) The buy-back is or less than 10% of the total equity paid-up capital and free reserve of the company; and

(ii) Such buy-back has been authorized by the Board by means of a resolution passed at its meeting. Provided further that no offer of buy-back shall be made within a period of 365 days reckoned from the date of the preceding offer of buy-back, if any;

(c) The buy-back is or less than 25% of the total paid-up capital and free reserves of the company; provided that the buy-back of equity shares in any financial year shall not exceed 25% of its total paid-up equity capital in that financial year.

(d) The ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back. Provided that the Central Government may prescribe a higher ratio of the debt than the specified under this clause for, a class or classes of companies. Here the 'debt' includes all amount of unsecured and

secured debts.

(e) All the shares or other specified securities for buy-back are fully paid-up.

(f) the buy-back of the shares or other specified securities listed on any recognized Stock Exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

(g) The buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

Question 9

(a) Annual General Meeting of a Public Company was scheduled to be held on 15.12.2003. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favour of Mr. 'X' and Mr. 'Y'. The proxy in favour of 'Y' was lodged on 12.12.2003 and the one in favour of Mr. X was lodged on 15.12.2003. The company rejected the proxy in favour of Mr. Y as the proxy in favour of Mr. Y was of dated 12.12.2003 and thus in favour of Mr. X was of dated 13.12.2003. Is the rejection by the company in order?

(b) The Board of Directors of M/s Reckless Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus or filing a statement in lieu of prospectus with the Registrar of Companies, Mumbai. Explain the remedies available to the investors in this regard. (5 + 5 = 10 marks)

Answer

(a) In case more than one proxies have been appointed by a member in respect of the same meeting, one which is later time shall prevail and the earlier one shall be deemed to have been revoked. Thus, in the normal course, the proxy in favour of Mr. X, being later in time, should be upheld as valid.

But, as per Section 176 of the Companies Act, 1956, a proxy should be deposited 48 hours before the time of the meeting. In the given case, the proxies should have, therefore, been deposited on or before 13.12.2003 (the date of the meeting being 15.12.2003). X deposited the proxy on 15.12.2003. Therefore, proxy in favour of Mr. X has become invalid. Thus, rejecting the proxy in favour of Mr. Y is unsustainable. Proxy in favour of Y is valid since it is deposited in time.

(b) According to the provisions of Section 70 and 71 of the Companies Act, 1956, any allotment of shares by a company without filing a prospectus or statement in lieu of prospectus will become irregular allotment. The effect of it is that the allotment made by M/s Reckless Investment Ltd will become voidable at the instance of the allottee i.e., the applicant for the shares within a period of two months from the date of allotment. The allotment is voidable at the option of the investor applicant even if the company is in the course of winding up. Further, the directors liable for the default are also liable to

compensate the company and the allottee respectively for any loss to which the company may have sustained or incurred thereby. There is a time limit of two years for claiming damages for loss etc., by the investors.

Question 10

(a) What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital.

(b) The Board of Directors of M/s Optimistic Company Ltd. propose to pay interim dividend of Rs.2 per equity share of Rs.10 each. Advise the Board regarding:

(i) the time limit for payment of interim dividend to the shareholders, and

(ii) steps to be taken in case any dividend amount remains unpaid in the books of the company. (5 + 5 = 20 marks)

Answer

(a) ***Meaning of Guarantee Company:*** Where it is proposed to register a company with limited liability, the choice is to limit liability by shares or by guarantee. Section 12(2)(b) of the Companies Act, 1956 defines it as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited by a stipulated amount mentioned in the memorandum. The members cannot be called upon to contribute more than the stipulated amount for which they have guaranted in the memorandum of association of that company. The articles of association of such company shall state the number of members with which the company is to be registered.

Similarities and dis-similarities between the Guarantee Company and the Company having share capital: The common features between a "guarantee company" and the "company having share capital" are legal personality and limited liability. In case of the later company, the members' liability is limited by the amount remaining unpaid on the shares, which each member holds. Both of them have to state this fact in their memorandum that the members' liability is limited.

However, the dis-similarities between a 'guarantee company' and 'company having share capital' is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in latter case, they may be called upon to do so at any time, either during the company's life or during its winding up.

Further to note, the Supreme Court in *Narendra Kumar Agarwal vs. Saroj Maloo (1995) 6* SC C 114 has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a

company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

It is also clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where these funds can be had from other sources like endowment, fees, charges, donations etc.

(b) The Board of directors of M/s Optimistic Company Ltd should take the following steps for declaration and payment of interim dividend:

(i) The Board should carefully assess the adequacy of profits since in the event of absence or inadequacy of profits, the distribution would amount to reduction of capital.

(ii) The interim dividend amount should be deposited in a special bank account.

(iii) Depreciation on assets should be provided for the full year.

(iv) If there is a carry forward loss from past years, the same should be adjusted against the estimated profits.

(v) The company should transfer to reserves the prescribed percentage of the estimated profits of the period arrived at after providing for current year's depreciation and arrears of depreciation/loss.

Time Limit:

Interim dividend should be paid within 30 days. If any amount of interim dividend remains unpaid or unclaimed, for more than 30 days, the same should be transferred to a special account in a Scheduled Bank called 'Unpaid Interim Divided Account of M/s Optimistic Company Ltd. Any amount remaining in the said bank account for a period of seven years should be transferred to the Investor Education and Protection Fund established under Section 205C of the Companies Act, 1956.

PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

*Question Nos. **1** and **6** are compulsory.*

*Attempt three questions out of the remaining Question Numbers **2,3,4** and **5** and attempt two questions from the remaining Question Numbers **7,8,9.***

Question 1

(a) *Discuss the limitations of Uniform costing.* *(2 marks)*

(b) *Discuss the three methods of calculating labour turnover* *(3 marks)*

(c) *Pokemon Chocolates manufactures and distributes chocolate products. It purchases Cocoa beans and processes them into two intermediate products:*

- *Chocolate powder liquor base*
- *Milk-chocolate liquor base.*

These two intermediate products become separately identifiable at a single split off point. Every 500 pounds of cocoa beans yields 20 gallons of chocolate - powder liquor base and 30 gallons of milk-chocolate liquor base.

The chocolate powder liquor base is further processed into chocolate powder. Every 20 gallons of chocolate-powder liquor base yields 200 pounds of chocolate powder. The milk-chocolate liquor base is further processed into milk-chocolate. Every 30 gallons of milk-chocolate liquor base yields 340 pounds of milk chocolate.

Production and sales data for October, 2004 are:

- Cocoa beans processed *7,500 pounds*
- *Costs of processing Cocoa beans to split off point (including purchase of beans)* *= Rs. 7,12,500*

	Production	*Sales*	*Selling price*
Chocolate powder	*3,000 pounds*	*3,000 pounds*	*Rs. 190 per pound*
Milk chocolate	*5,100*	*5,100*	*Rs. 237.50 per pound*

The October, 2004 separable costs of processing chocolate-powder liquor into chocolate powder are Rs. 3,02,812.50. The October 2004 separable costs of processing milk-chocolate liquor base into milk-chocolate are Rs. 6,23,437.50.

Pokemon fully processes both of its intermediate products into chocolate powder or milk-chocolate. There is an active market for these intermediate products. In October, 2004, Pokemon could have sold the chocolate powder liquor base for Rs. 997.50 a gallon and the milk-chocolate liquor base for Rs. 1,235 a gallon.

Required:

(i) *Calculate how the joint cost of Rs. 7,12,500 would be allocated between the*

chocolate powder and milk-chocolate liquor bases under the following methods:

(a) Sales value at split off point

(b) Physical measure (gallons)

(c) Estimated net realisable value, (NRV) and

(d) Constant gross-margin percentage NRV.

(ii) What is the gross-margin percentage of the chocolate powder and milk-chocolate liquor bases under each of the methods in requirements (i) ?

(iii) Could Pokemon have increased its operating income by a change in its decision to fully process both of its intermediate products ? Show your computations.

(8+2+3=13 marks)

Answer

(a) Limitations of Uniform Costing

(i) Sometimes it is not possible to adopt uniform standards, methods, and procedures of costing in different firms due to differing circumstances in which they operate.

(ii) Many firms do not wish to share cost information and other data with their competitors.

(iii) Small firms believe that uniform costing is beneficial only in case of large firms.

(iv) It induces monopolistic trend in the business, due to which prices may be increased artificially and supplies withheld.

(b) Methods of Calculating labour turnover

(i) Replacement method $= \dfrac{\text{No of employees replaced} \times 100}{\text{Av no of employees on roll}}$

(ii) Separation method $= \dfrac{\text{No of employees separated during the year} \times 100}{\text{Av no of employees on the roll during the year}}$

(iii) Flex method $= \dfrac{(\text{No of employees separated} + \text{No of employees replaced}) \times 100}{\text{Av no of employees on rolls during the period}}$

(c) (i) Comparison of alternative joint-cost allocation methods

Sales value at split-off point method

	Chocolate powder liquor base	*Milk chocolate liquor base*	*Total*
*Sales value of products at split off	Rs 2,99,250	Rs 5,55,750	Rs 8,55,000
Weights	0.35	0.65	1.00
Joint cost allocated	Rs 7,12,500 × 0.35 = Rs 2,49,375	Rs 7,12,500 × 0.65 = Rs 4,63,125	

* 300 × *997.50 = Rs 2,99,250*
450 × 1235 = Rs 5,55,750

Physical measure method

	Chocolate powder liquor base	*Milk chocolate liquor base*	*Total*
Output	300 gallons	450 gallons	750 gallons
Weight	300/750= 0.40	450/750 = 0.60	1.00
Joint cost allocated	Rs 7,12,500 × 0.40 =Rs 2,85,000	Rs 7,12,500 × 0.60 = Rs 4,27,500	Rs 7,12,500

Net realisable value method

	Chocolate powder liquor base	*Milk chocolate liquor base*	*Total*
Final sales value of production	3,000 lbs × Rs 190 = Rs 5,70,000	5,100 lbs × Rs 237.50 = Rs 12,11,250	Rs 17,81,250
Less separable costs	Rs 3,02,812.50	Rs 6,23,437.50	Rs 9,26,250
Net realisable value at split off point	Rs 2,67,187.50	Rs 5,87,812.50	Rs 8,55,000
Weight	2,67,187.50/8,55,000 = 0.3125	5,87,812.5/8,55,000 = 0.6875	
Joint cost allocated	Rs 7,12,500 × 0.3125 = Rs 2,22,656.25	Rs 7,12,500 × 0.6875 = Rs 4,89,843.75	Rs 7,12,500

Constant + gross margin % NRV method

	Chocolate powder liquor base	*Milk chocolate liquor base*	*Total*
Final sales value of production	Rs 5,70,000 (Choclate Powder)	Rs 12,11,250 (Milk Choclate)	Rs 17,81,250
*Less Gross Margin 8%	Rs 45,600	Rs 96,900	Rs 1,42,500
Cost of goods available for sale	Rs 5,24,400	Rs 11,14,350	Rs 16,38,750
Less Separable costs	Rs 3,02,812.50	Rs 6,23,437.50	Rs 9,26,250
Joint cost allocated	Rs 2,21,587.50	Rs 4,90,912.50	Rs 7,12,500

*Final sales value of total production = Rs 17,81,250

Deduct joint and separable cost = Rs 712500+Rs 926250

= Rs 16,38,750

Gross Margin = Rs 1,42,500

Gross margin % $= \frac{\text{Rs } 1,42,500}{\text{Rs } 17,81,250} = 8\%$

(ii) Chocolate powder liquor base (calculations in Rs)

	Sales value at split off	*Physical Measure*	*Estimated net realisable value*	*Constant gross – margin NRV*
Final sale value of Chocolate powder.	5,70,000	5,70,000	5,70,000	5,70,000
Less: separable costs	3,02,812.50	3,02,812.50	3,02,812.50	3,02,812.50
Less: Joint costs	2,49,375	2,85,000	2,22,656.25	2,21,587.50
Gross Margin	17,812.50	(17,812.50)	44,531.25	45,600
Gross Margin %	3.125%	(3.125%)	7.8125%	8%

Milk chocolate liquor base(calculations in Rs)

	Sales value at split off	*Physical Measure*	*Estimated net realisable value*	*Constant gross – margin NRV*
Final sale value of milk chocolate.	12,11,250	12,11,250	12,11,250	12,11,250
Less: separable costs	6,23,437.50	6,23,437.50	6,23,437.50	6,23,437.50
Less: Joint costs	4,63,125	4,27,500	4,89,843.75	4,90,912
Gross Margin	1,24,687.50	1,60,312.50	97,968.75	96,900.50
Gross Margin %	10.29%	13.23%	8.08%	8%

(iii) Further processing of Chocolate powder liquor base into Chocolate powder (calculations in Rs)

Incremental revenue (5,70,000 – (997.50 × 300))	2,70,750
Incremental costs	3,02,812.50
Incremental operating income	(32,062.50)

Further processing of Milk chocolate liquor base into milk chocolate (calculations in Rs)

Incremental revenue(12,11,250 – 5,55,750)	6,55,500
Incremental cost	6,23,437.50
Incremental operating income	32,062.50

The above computations show that Pokemon Chocolates could increase operating income by Rs 32,062.50 if chocolate liquor base is sold at split off point and milk chocolate liquor base is processed further.

Question 2

(a) Discuss cost classification based on variability and controllability. (4 marks)

(b) Discuss ABC analysis as a system of Inventory control. (4 marks)

(c) RST Limited has received an offer of quantity discount on its order of materials as under:

Price per tone	*Tones number*
Rs. 9,600	*Less than 50*
Rs. 9,360	*50 and less than 100*
Rs. 9,120	*100 and less then 200*
Rs. 8,880	*200 and less than 300*
Rs. 8,640	*300 and above*

The annual requirement for the material is 500 tonnes. The ordering cost per order is Rs. 12,500 and the stock holding cost is estimated at 25% of the material cost per annum.

Required:

(i) Compute the most economical purchase level.

(ii) Compute EOQ if there are no quantity discounts and the price per tonne is Rs. 10,500. (4+2=6 marks)

Answer

(a) Cost classification based on variability

Fixed cost – these are costs, which do not change in total despite changes of a cost driver. A fixed cost is fixed only in relation to a given relevant range of the cost driver and a given time span. Rent, insurance , depreciation of factory building and equipment are examples of fixed costs where the final product produced is the cost object.

Variable costs- these are costs which change in total in proportion to changes of cost driver. Direct material, direct labour are examples of variable costs in cases where the final product produced is the cost object.

Semi-variable costs – These are partly fixed and partly variable in relation to output e.g.

telephone and electricity bill.

Cost classification based on controllability

Controllable costs – are incurred in a particular responsibility center and relate to a defined time span. They can be influenced by the action of the executive heading the responsibility center e.g. direct costs.

Uncontrollable costs – are costs which are not influenced by the action of the responsibility manager e.g. expenditure incurred by the tool room is controllable by the foreman in charge of that section, but the share of tool room expenditure which is apportioned to the machine shop is not controllable by machine shop foreman.

(b) ABC Analysis as a system of inventory control

It exercises discriminating control over different items of stores classified on the basis of investment involved.

'A' category of items consists of only a small %age i.e. approximately 10% of total items handled by stores but requires heavy investment, about 70% of inventory value, because of their high prices or heavy requirement or both.

'B' category of items are relatively less important. They may be approximately 20% of the total items of materials handled by stores. The %age of investment required is approximately 20% of total investment in inventories.

'C' category of items do not require much investment. It may be about 10% of total inventory value but they are nearly 70% of the total items handled by store.

EOQ, re-order level concepts are usually used in case of 'A' category items.

(c) (i)

Order size (Q) (Units)	*No. of orders A/Q (Units)*	*Cost of purchase A x per unit cost*	*Ordering cost* $\frac{A}{Q} \times Rs.12500$	*Carrying cost* $\frac{Q}{2} \times C \times 25\%$	*Total cost (3+4+5)*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
40	12.5	48,00,000	1,56,250	48,000	50,04,250
		(500×9600)		$\left(\frac{40}{2} \times 9600 \times 0.25\right)$	
50	10	46,80,000	1,25,000	58,500	48,63,500
		(500×9360)		$\left(\frac{50}{2} \times 9360 \times .25\right)$	
100	5	45,60,000	62,500	1,14,000	47,36,500
		(500×9120)		$\left(\frac{100}{2} \times 9120 \times .25\right)$	

200	2.5	44,40,000	31,250	2,22,000	46,93,250
		(500×8880)	(2.5×12500)	$\left(\frac{200}{2}\times 8880\times 2.5\right)$	
300	1.67	43,20,000	20,875	3,24,000	46,64,875
		(500×8640)	(1.67×12500)	$\left(\frac{300}{2}\times 8640\times .25\right)$	

The above table shows that the total cost of 500 units including ordering and carrying cost is minimum (Rs. 46,64,875) where the order size is 300 units. Hence the most economical purchase level is 300 units.

(ii) $EOQ = \sqrt{\frac{2AO}{c\times i}} = \sqrt{\frac{2\times 500\times 12500}{10500\times .25}} = 69$ tonnes.

Question 3

(a) Discuss the treatment of overtime premium in Cost accounting. *(3 marks)*

(b) Discuss the Gantt task and bonus system as a system of wage payment and incentives. *(3 marks)*

(c) Popeye Company is a metal and wood cutting manufacturer, selling products to the home construction market. Consider the following data for the month of October, 2004:

	Rs.
Sandpaper	*5,000*
Material-handling costs	*1,75,000*
Lubricants and Coolants	*12,500*
Miscellaneous indirect manufacturing labour	*1,00,000*
Direct manufacturing labour	*7,50,000*
Direct materials, October 1, 2004	*1,00,000*
Direct materials, October 31, 2004	*1,25,000*
Finished goods, October 1, 2004	*2,50,000*
Finished goods, October 31, 2004	*3,75,000*
Work-in-process, October 1, 2004	*25,000*
Work-in-process, October 31, 2004	*35,000*
Plant-leasing costs	*1,35,000*
Depreciation-plant equipment	*90,000*
Property taxes on plant equipment	*10,000*

Fire insurance on plant equipment	*7,500*
Direct materials purchased	*11,50,000*
Sales revenues	*34,00,000*
Marketing promotions	*1,50,000*
Marketing salaries	*2,50,000*
Distribution costs	*1,75,000*
Customer-service costs	*2,50,000*

Required:

(i) Prepare an income statement with a separate supporting schedule of cost of goods manufactured.

(ii) For all manufacturing items, indicate by V or F whether each is basically a variable cost or a fixed cost (where the cost object is a product unit). (6+2=8 marks)

Answer

(a) Treatment of Overtime Premium in Cost Accounting

- If overtime is resorted to at the desire of the customer, then overtime premium may be charged to the job directly.
- If overtime is required to cope with general production programme or for meeting urgent orders, the overtime premium should be treated as overhead cost of the particular department or cost center, which works overtime.
- If overtime is worked in a department, due to the fault of another department, the overtime premium should be charged to the latter department.
- Overtime worked on account of abnormal conditions such as flood, earthquake etc should not be charged to cost but to costing P/L A/C.

(b) Gantt Task and Bonus System

This system is a combination of time and piecework system. According to this system a high standard or task is set and payment is made at time rate to a worker for production below the set standard.

Wages payable to workers under the plan are calculated as under:

Output	**Payment**
(i) Output below standard	Guaranteed time rate
(ii) Output at standard	Time rate plus bonus of 20% (usually) of time rate
(iii) Output over standard	High piece rate on worker's output .(It is so fixed ,so as to include a bonus of 20% of time rate)

(c) (i) Popeye company 'Schedule for cost of goods manufactured' for the month ending Oct 2004

	Rs	*Rs*
Direct materials		
Beginning Inventory	1,00,000	
Purchase of Direct Materials	11,50,000	
Cost of direct materials available for use	12,50,000	
Ending inventory	1,25,000	
Direct materials used		11,25,000(V)
Direct manufacturing labour		7,50,000(V)
Indirect manufacturing costs		
Sand Paper	5,000(V)	
Material –handling cost	1,75,000(V)	
Lubricants and coolants	12,500(V)	
Misc indirect mfg labour	1,00,000(V)	
Plant leasing cost	1,35,000(F)	
Depreciation –plant & equipment	90,000 (F)	
Property tax-plant & equipment	10,000(F)	
Fire insurance –plant & equipment	7,500(F)	5,35,000
Manufacturing cost incurred during the month of October ,2004		24,10,000
Add op work –in–progress		25,000
		24,35,000
Less cl. Work–in-progress		35,000
Cost of goods manufactured (to Income statement)		24,00,000

(ii) Popeye Company : Income Statement for the month ending Oct 31,2004

	Rs	*Rs*
Revenues		34.00,000
Cost of goods sold:		
Beginning finished goods	2,50,000	

Cost of goods manufactured	24,00,000	
Cost of goods available for sale	26,50,000	
Ending finished goods	3,75,000	22,75,000
Gross Margin		11,25,000
Marketing, Distribution and Customer Service Costs :		
Marketing promotions	1,50,000	
Marketing salaries	2,50,000	
Distribution costs	1,75,000	
Customer service cost	2,50,000	8,25,000
Operating Income		3,00,000

Question 4

(a) MNP suits is a ready-to-wear suit manufacturer. It has four customers: two wholesale-channel customers and two retail-channel customers.

MNP suits has developed the following activity-based costing system:

Activity	*Cost driver*	*Rate in 2004*
Order processing	*Number of purchase orders*	*Rs. 1,225 per order*
Sales visits	*Number of customer visits*	*Rs. 7,150 per visit*
Delivery-regular	*Number of regular deliveries*	*Rs. 1,500 per delivery*
Delivery-rushed	*Number of rushed deliveries*	*Rs. 4,250 per delivery*

List selling price per suit is Rs. 1,000 and average cost per suit is Rs. 550. The CEO of MNP suits wants to evaluate the profitability of each of the four customers in 2003 to explore opportunities for increasing profitability of his company in 2004. The following data are available for 2003:

Item	*Wholesale customers*		*Retail customers*	
	W	*H*	*R*	*T*
Total number of orders	*44*	*62*	*212*	*250*
Total number of sales visits	*8*	*12*	*22*	*20*
Regular deliveries	*41*	*48*	*166*	*190*
Rush deliveries	*3*	*14*	*46*	*60*
Average number of suits per order	*400*	*200*	*30*	*25*
Average selling price per suit	*Rs. 700*	*Rs. 800*	*Rs. 850*	*Rs. 900*

Required:

(i) Calculate the customer-level operating income in 2003

(ii) What do you recommend to CEO of MNP suits to do to increase the company's operating `income in 2004?

(iii) Assume MNP suits' distribution channel costs are Rs. 17,50,000 for its wholesale customers and Rs. 10,50,000 for the retail customers. Also, assume that its corporate sustaining costs are Rs. 12,50,000. Prepare Income statement of MNP suits for 2003. (6+2+2=10 marks)

(b) Discuss the step method and reciprocal service method of secondary distribution of overheads. (4 marks)

Answer

(a) (i) Customer Profitability Analysis, Customer cost hierarchy

Item	*W*	*H*	*R*	*T*
Revenues	*Rs*	*Rs*	*Rs*	*Rs*
At list price (Rs)				
44×400 = 17600				
62×200 = 12400				
212×30 = 6360				
250×25 = 6250				
17600×1000,12400×1000,				
6360×1000, 6250×1000				
	1,76,00,000	1,24,00,000	63,60,000	62,50,000
Discount				
1000-700=300				
1000-800=200				
1000-850=150				
1000-900=100				
17600×300,12400×200,				
6360×150,6250×100				
	52,80,000	24,80,000	9,54,000	6,25,000
Revenues at actual prices	1,23,20,000	99,20,000	54,06,000	56,25,000
Cost of Goods Sold				
17600×550				
12400×550				
6360×550				
6250×550				
	96,80,000	68,20,000	34,98,000	34,37,500
Gross Margin	26,40,000	31,00,000	19,08,000	21,87,500

	W	*H*	*R*	*T*
Customer level operating costs:				
Order processing	53,900	75,950	2,59,700	3,06,250
(44,62,212,250) × (Rs 1,225)				
Sales Visits	57,200	85,800	1,57,300	1,43,000
(8,12,22,20)× (Rs 7,150)				
Delivery regular	61,500	72,000	2,49,000	2,85,000
(41,48,166,190) × (Rs 1,500)				
Delivery rushed	12,750	59,500	1,95,500	2,55,000
(3,14,46,60) × (Rs 4,250)				
Total customer level operating cost	1,85,350	2,93,250	8,61,500	9,89,250
Customer level operating income	24,54,650	28,06,750	10,46,500	11,98,250
Customer level operating income as %age on revenues at actual prices	19.92	28.29	19.35	21.30

(ii) Key Challenges facing CEO are—

(i) Reduce level of price discounting, especially by W

(ii) Reduce level of customer –level costs, especially by R & T

The ABC cost system highlights areas where R&T accounts are troublesome

They have

- high number of orders
- high number of customer visits,
- high number of rushed deliveries

The CEO needs to consider whether this high level of activity can be reduced without reducing customer revenues.

(iii) Income Statement of MNP suits for 2003 (in Rs)

	Wholesale Customers	*Retail customers*	*Total*
Customer level operating income	Rs 52,61,400	Rs 22,44,750	Rs 75,06,150
Less: distribution channel cost	17,50,000	10,50,000	28,00,000
Distribution channel level operating income	35,11,400	11,94,750	47,06,150

Less: Corporate sustaining costs	12,50,000
Operating Income	34,56,150

(b) Step method and Reciprocal Service method of secondary distribution of overheads

Step method: This method gives cognisance to the service rendered by service department to another service dep't, thus sequence of apportionments has to be selected. The sequence here begins with the dep't that renders service to the max number of other service dep't. After this, the cost of service dep't serving the next largest number of dep't is apportioned.

Reciprocal service method : This method recognises the fact that where there are two or more service dep't, they may render service to each other and, therefore, these inter dep't services are to be given due weight while re-distributing the expense of service dep't. The methods available for dealing with reciprocal servicing are:

- Simultaneous equation method
- Repeated distribution method
- Trial and error method

Question 5

(a) Distinguish between any three of the following:

(i) Cost control and cost reduction

(ii) Bin card and stores ledger

(iii) Job costing and batch costing

(iv) Cost audit and statutory audit.

(b) Brock Construction Ltd. commenced a contract on November 1, 2003. The total contract was for Rs. 39,37,500. It was decided to estimate the total profit on the contract and to take to the credit of P/L A/c that proportion of estimated profit on cash basis, which work completed bore to the total contract. Actual expenditure for the period November 1, 2003 to October 31, 2004 and estimated expenditure for November 1, 2004 to March 31, 2005 are given below:

	November 1, 2003 to October 31, 2004 (Actuals)	*November 1, 2004 to March 31, 2005 (Estimated)*
	Rs.	*Rs.*
Material issued	*6,75,000*	*12,37,500*

Labour:	*Paid*	*4,50,000*	*5,62,500*
	Prepaid	*25,000*	*-*
	Outstanding	*-*	*2,500*
Plant purchased		*3,75,000*	*-*
Expenses:	*Paid*	*2,00,000*	*3,50,000*
	Outstanding	*50,000*	*25,000*
Plant returns to store		*75,000*	*3,00,000*
(historical cost)		*(on March 31, 2004)*	*(on March 31, 2005)*
Work certified		*20,00,000*	*Full*
Work uncertified		*75,000*	
Cash received		*17,50,000*	
Material at site		*75,000*	*37,500*

The plant is subject to annual depreciation @ 33% on written down value method. The contract is likely to be completed on March 31, 2005.

Required:

(i) Prepare the contract A/c. Determine the profit on the contract for the year November, 2003 to October, 2004 on prudent basis, which has to be credited to P/L A/C.

Answer

(a) (i) Cost control and cost reduction

- Cost control is operated through setting standards of targets and comparing actual performance therewith, with a view to identify deviations from standards or norms and taking corrective action in order to ensure that future performance conforms to standards or norms.
- Cost reduction is a continuous process of critical cost examination, analysis and challenge of standards. Each aspect of business viz. products, persons, procedure, method, organisation, personal etc are critically examined and reviewed with a view of improving the efficiency and effectiveness and reducing the costs.
- Cost control lacks the dynamic approach , which cost reduction demands. In cost reduction plans, standards, which are the basis of control are challenged.

- Budgetary control and Standard costing are essential tools and techniques of cost control. Tools and techniques of cost reduction are value engineering , work study, quality management, operation research , market research etc.

(ii) Bin card and stores ledger

Bin card is quantitative record of stores receipt, issue and balance. Control over stock is more effective, in as much as comparisons of actual quantity in hand at any time with the book balance are possible. Bin cards are kept attached to the bins or quite near thereto , so as to assist in the identification of stock.

Stores ledger is quantitative and value record of stores receipts, issue and balance. It is a subsidiary ledger to the main cost ledger. It is maintained by cost accounting deptt.

(iii) Job costing and Batch costing

According to Job costing, costs are collected and accumulated according to jobs. Each job or unit of production is treated as a separate entity for the purpose of costing. Job costing may be employed when jobs are executed for different customers according to their specifications.

Batch costing is a form of job costing, a lot of similar units which comprises the batch may be used as a cost unit for ascertaining cost. Such a method of costing is used in case of pharmaceutical industry, readymade garments, industries manufacturing parts of TV, radio sets etc.

(iv) Cost audit and statutory audit

Cost audit offers valuable assistance to the management in its decision-making process by examining the reliability of cost accounting data and information. Due to the assistance provided by cost audit, management is in a position to know what price is to be fixed for a product, whether the wastages are avoidable, whether to reorganise sales or inventory system to make work more efficient and effective. Cost audit, apart from all the normal ingredients of audits. i.e. vouching, verification etc has within its domain elements of efficiency audit and proprietary audit.

Statutory audit of accounts is to examine whether P/L a/c and Balance Sheet of a company provides a true and fair view of profits (in the relevant financial period) and financial position on a particular date.

(b) Brock Construction Ltd Contract A/C (November 1, 2003 to Oct 31, 2004)

Dr *Cr*

Particulars		*Amount (Rs)*			*Amount (Rs)*
To Materials issued		6,75,000	By plant returned to		
To Labour paid	4,50,000		store on 31/03/04		
Prepaid	25,000	4,25,000	Cost	75,000	

To Plant purchased		3,75,000	*Less:* Dep (1/3)	10,417	64,583
To Expenses paid	2,00,000		By WIP		
+ Outstanding	50,000	2,50,000	Certified	20,00,000	
To Notional profit c/d		6,89,583	Uncertified	75,000	20,75,000
		24,14,583	By plant at site		
To P/L A/C			31/10/04		
2,34,305 ×			Cost	3,00,000	
(17,50,000 /			*Less:* dep(1/3)	1,00,000	2,00,000
20,00,000)			By materials at site		75,000
× (20,00,000 /					24,14,583
39,37,500)		1,04,136	By Notional profit b/d		6,89,583
To work –in-progress		5,85,447			
(Profit in reserve)		6,89,583			6,89,583

Brock Construction Ltd Contract A/C (1 November, 2003 to March 31, 2005)
(For computing estimated profit)

Dr			*Particulars*		*Cr* *Amount (Rs)*
Particulars		*Amount (Rs)*			
To material issued (6,75,000 + 12,37,500)		19,12,500	By material at site		37,500
To labour (paid and outstanding) (4,25,000 + 5,87,500 + 2500)		10,15,000	By plant returned to stores on 31/3/04		64,583
To plant purchased		3,75,000	By plant returned to stores on 31/3/05		1,72,222
			Cost	3,00,000	
			Less Dep	1,00,000	
			Less 5 month Dep	27,778	
To expenses (2,50,000 + 3,25,000)		5,75,000	By Contractee a/c		39,37,500
To estimated profit		2,34,305			
		42,11,805			42,11,805

Question 6

PQR Ltld. is evaluating a proposal to acquire new equipment. The new equipment would cost Rs. 3.5 million and was expected to generate cash inflows of Rs. 4,70,000 a year for nine years. After that point, the equipment would be obsolete and have no significant salvage value. The company's weighted average cost of capital is 16%.

The management of the PQR Ltd. seemed to be convinced with the merits of the investment but was not sure about the best way to finance it. PQR Ltd. could raise the money by issuing a secured eight-year note at an interest rate of 12%. However, PQR Ltd. had huge tax-loss carry forwards from a disastrous foray into foreign exchange options. As a result, the company was unlikely to be in a position of tax-paying for many years. The CEO of PQR Ltd. thought it better to lease the equipment than to buy it. The proposals for lease have been obtained from MGM Leasing Ltd. and Zeta Leasing Ltd. The terms of the lease are as under:

	MGM Leasing Ltd.	*Zeta Leasing Ltd.*
Lease period offered	*9 years*	*7 years*
Number of lease rental payments with initial lease payment due on entering the lease contract	*10*	*8*
Annual lese rental	*Rs. 5,44,300*	*Rs. 6,19,400*
Lease terms equivalent to borrowing cost (Claim of lessor)	*11.5% p.a.*	*11.41% p.a.*
Leasing terms proposal coverage	*Entire*	*Entire*
	Rs. 3.5 million cost of equipment	*Rs. 3.5 million cost of equipment*
Tax rate	*35%*	*35%*

Both the Leasing companies were in a tax-paying position and write off their investment in new equipment using following rate:

Year	*1*	*2*	*3*	*4*	*5*	*6*
Depreciation rate	*20%*	*32%*	*19.20%*	*11.52%*	*11.52%*	*5.76%*

Required:

(i) Calculate the NPV to PQR Ltd. of the two lease proposals.

(ii) Does the new equipment have a positive NPV with (i) ordinary financing, (ii) lease financing ?

(iii) Calculate the NPVs of the leases from the lessors' view points. Is there a chance that they could offer more attractive terms ?

(iv) Evaluate the terms presented by each of the lessors. (5+3+5+3=16 marks)

Answer

(i) NPV to PQR Ltd of MGM Leasing Ltd lease proposal.

Investment decision :Present value of Operating cash inflows

Present Value at 16% = Rs 4,70,000 × 4.6065 = Rs 21,65,055 (A)

Financing decision : Present value of cash outflows

Present value at 12 % = Rs 5,44,300 + Rs 5,44,300 × 5.3282

= Rs 34,44,439 (B)

Hence Net Present Value = (A) – (B) = (Rs 12,79,384)

NPV to PQR Ltd of Zeta Leasing Ltd lease proposal.

Investment decision :Present value of Operating cash inflows

Present Value at 16% = Rs 4,70,000 × 4.6065 = Rs 21,65,055 (A)

Financing decision : Present value of cash outflows

Present value at 12 % = Rs 6,19,400 + Rs 6,19,400 × 4.5638

= Rs 34,46,218. (B)

Hence Net Present Value = (A) – (B) = (Rs 12,81,163)

(ii) NPV of new equipment with ordinary financing

Investment decision :Present value of Operating cash inflows

Present Value at 16% = Rs 4,70,000 × 4.6065 = Rs 21,65,055 (A)

Financing decision : Present value of cash outflows

Rs 35,00,000 (B)

Hence Net Present Value = (A) – (B) = (Rs 13,34,945)

Conclusion : The company has a negative NPV with ordinary financing as well as lease financing.

(iii) NPV to MGM Leasing Ltd.

(Rs, 000)

Year	*Equipment cost*	*Dep'n*	*Dep'n tax shield*	*After tax lease payment*	*After tax CFs*	*Present value factor at 7.8%*	*After tax CFs(Present Value)*
0	(3,500)	700	245	353.795	(2,901.21)	1	(2,901.21)
1		1,120	392	353.795	745.795	0.928	692.0978
2		672	235.2	353.795	588.995	0.861	507.1247

3	403.2	141.12	353.795	494.915	0.798	394.9422
4	403.2	141.12	353.795	494.915	0.74	366.2371
5	201.6	70.56	353.795	424.355	0.687	291.5319
6			353.795	353.795	0.637	225.3674
7			353.795	353.795	0.591	209.0928
8			353.795	353.795	0.548	193.8797
9			353.795	353.795	0.509	180.0817
Total					7.299	159.1502

Discount rate = 12% x(1-.35) =7.8%

NPV = Rs 159.1502

MGM Lease Ltd's NPV is positive. They could reduce the lease terms by Rs 1,59,150 divided by cumulative PV factor at 7.8% (7.299) divided by (1 – 0.35) i.e. Rs 33,545.16 to make their proposal more attractive.

NPV to Zeta Leasing Ltd.

(Rs 000)

Year	*Equip-ment cost*	*Dep'n*	*Dep'n tax shield*	*After tax lease payment*	*After tax CFs*	*Present value factor at 7.8%*	*After tax CFs (Present Value)*
0	(3,500)	700	245	402.61	(2,852.39)	1	(2852.39)
1		1,120	392	402.61	794.61	0.928	737.3981
2		672	235.2	402.61	637.81	0.861	549.1544
3		403.2	141.12	402.61	543.73	0.798	433.8965
4		403.2	141.12	402.61	543.73	0.74	402.3602
5		201.6	70.56	402.61	473.17	0.687	325.0678
6				402.61	402.61	0.637	256.4626
7				402.61	402.61	0.591	237.9425
						6.242	89.8921

NPV (7.8%) = Rs. Rs 89,892

Zeta Ltd could improve the proposal by reducing the lease terms by Rs 89,892 divided by cumulative PV factor at 7.8% (6.242) divided by (1 – 0.35) i.e. Rs 22,155.62 to make their proposal more attractive.

(iv) From PQR Ltd's point of view the leasing terms offered by MGM Leasing gives the least Net Present Value. PQR Ltd is not getting tax shield on leasing , depreciation and interest because of heavy losses incurred in the earlier years. With proper negotiations , the leasing terms can be reduced marginally.

Question 7

(a) You are analysing the beta for ABC Computers Ltd. and have divided the company into four broad business groups, with market values and betas for each group.

Business group	*Market value of equity*	*Unleveraged beta*
Main frames	*Rs. 100 billion*	*1.10*
Personal Computers	*Rs. 100 billion*	*1.50*
Software	*Rs. 50 billion*	*2.00*
Printers	*Rs. 150 billion*	*1.00*

ABC Computers Ltd. had Rs. 50 billion in debt outstanding.

Required:

(i) Estimate the beta for ABC Computers Ltd. as a Company. Is this beta going to be equal to the beta estimated by regressing past returns on ABC Computers stock against a market index. Why or why not ?

(ii) If the treasury bond rate is 7.5%, estimate the cost of equity for ABC Computers Ltd. Estimate the cost of equity for each division. Which cost of equity would you use to value the printer division ? The average market risk premium is 8.5%.

(2+4 =6 marks)

(b) Explain the 'Ageing Schedule' in the context of monitoring of receivables. (3 marks)

(c) Discuss any three ratios computed for investment analysis. (3 marks)

Answer

(a) (i) Beta of ABC computers

$= 1.10 \times 2/8 + 1.50 \times 2/8 + 2 \times 1/8 + 1 \times 3/8$

$= 1.275$

Beta coefficient is a measure of volatility of securities return relative to the returns of a broad based market portfolio. Hence beta measures volatility of ABC Computers stock return against broad based market portfolio. In this case we are considering four business groups in computer segment and not a broad based market portfolio , therefore beta calculations will not be the same.

(ii) Cost of equity

= rf + av mkt risk premium$\times\beta$

= 7.5% + 1.275×8.5% = 18.34%

Main frame KE = 7.5% + 1.10×8.5% = 16.85%

Personal KE = 7.5% + 1.5×8.5% = 20.25%

Computers

Software KE = 7.5% + 2×8.5% = 24.5%

Printers KE = 7.5% + 1×8.5% = 16%

To value printer division, the use of 16% KE is recommended.

(b) Ageing Schedule

An important means to get an insight into collection pattern of debtors is the preparation of their 'Ageing Schedule'. Receivables are classified according to their age from the date of invoicing e.g. 0 – 30 days,31 – 60 days , 61 – 90 days, 91 – 120 days and more. The ageing schedule can be compared with earlier month's figures or the corresponding month of the earlier year.

This classification helps the firm in its collection efforts and enables management to have a close control over the quality of individual accounts. The aeging schedule can be compared with other firms also.

(c) Three ratios computed for investment analysis are as follows;

(i) Earning per share $= \frac{\text{Profit after tax}}{\text{Number of equity shares outstanding}}$

(ii) Dividend yield ratio $= \frac{\text{Equity dividend per share} \times 100}{\text{Market price per share}}$

(iii) Return on capital employed $= \frac{\text{Net profit before interest and tax} \times 100}{\text{Capital employed}}$

Question 8

(a) The following summarises the percentage changes in operating income, percentage changes in revenues, and betas for four pharmaceutical firms.

Firm	*Change in revenue*	*Change in operating income*	*Beta*
PQR Ltd.	*27%*	*25%*	*1.00*
RST Ltd.	*25%*	*32%*	*1.15*
TUV Ltd.	*23%*	*36%*	*1.30*
WXY Ltd.	*21%*	*40%*	*1.40*

Required:

(i) Calculate the degree of operating leverage for each of these firms. Comment also.

(ii) Use the operating leverage to explain why these firms have different beta.
(3+3 =6 marks)

(b) What is debt Securitisation ? Explain the basic debt securitisation process. (6 marks)

Answer

(a) (i) Degree of operating leverage $= \frac{\%\text{ Change in Operating income}}{\%\text{ Change in Revenues}}$

PQR Ltd .	=	25% / 27%	=	0.9259
RST Ltd.	=	0.32 / 0.25	=	1.28
TUV Ltd.	=	0.36 / 0.23	=	1.5652
WXY Ltd.	=	0.40 / 0.21	=	1.9048

It is level specific.

(ii) High operating leverage leads to high beta. The sources of risk are cyclecality of revenues, operating risk and financial risk.

(b) Debt securitisation

It is a method of recycling of funds. It is especially beneficial to financial intermediaries to support the lending volumes. Assets generating steady cash flows are packaged together and against this asset pool, market securities can be issued, e.g. housing finance, auto loans, and credit card receivables.

Process of Debt Securitisation

(i) The origination function – A borrower seeks a loan from a finance company, bank, HDFC. The credit worthiness of borrower is evaluated and contract is entered into with repayment schedule structured over the life of the loan.

(ii) The pooling function – Similar loans on receivables are clubbed together to create an underlying pool of assets. The pool is transferred in favour of Special purpose Vehicle (SPV), which acts as a trustee for investors.

(iii) The securitisation function – SPV will structure and issue securities on the basis of asset pool. The securities carry a coupon and expected maturity which can be asset-based/mortgage based. These are generally sold to investors through merchant bankers. Investors are – pension funds, mutual funds, insurance funds.

The process of securitisation is without recourse i.e. investor bears the credit risk or risk of default. Credit enhancement facilities like insurance, LOC & guarantees are provided.

Question 9

(a) Consider a firm that has existing assets in which it has capital invested of Rs. 100 crores. The after-tax operating income on assets-in-place is Rs. 15 crore. The return on capital employed of 15% is expected to be sustained to perpetuity, and company has a cost of

capital of 10%. Estimate the present value of economic value added (EVA) of the firm from its assets-in-place. . *(4 marks)*

(b) A firm is considering offering 30-day credit to its customers. The firm likes to charge them an annualized rate of 24%. The firm wants to structure the credit in terms of a cash discount for immediate payment. How much would the discount rate have to be? *(4 marks)*

(c) Discuss the risk-return considerations in financing of current assets. *(4 marks)*

Answer

(a) Capital invested in Assets-in-Place = Rs.100 Cr.

$$\textbf{EVA} = \left[\left\{\frac{\text{NOPAT}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Assets}}\right\} - \text{WACC}\right] \times \text{Assets}$$

$$= \{\text{ROA - WACC}\} \times \text{Assets}$$

$$= \{0.15 - 0.10\} \times \text{Rs.100 Cr.}$$

$$= \text{Rs.5 Cr.}$$

PV of EVA from Assets-in-Place

$$= \frac{\text{Rs.5 Cr.}}{0.10} = \text{Rs.50 Cr.}$$

Alternatively

Capital invested	Rs 100 crores
After tax operating income	Rs 15 crores
Less: cost of capital 10% on 100 crores	Rs 10 crores
Economic value added	Rs 5 crores

The return on capital employed is expected to sustain in perpetuity. Hence Present Value of EVA from assets in place = EVA/Cost of capital% = 5.0/0.10= Rs 50 crores.

(b) Interest @ 24% pa for a period of 30 days (year 365 days) = $0.24 \times \frac{30}{365} = 0.019726$ ie 1.9726 %.

Hence the principal of Re 1 , including the interest after 30 days will become 1.019726.

The present value as on zero date will be $\frac{1}{1.019726} = 0.980656$

Hence discount which can be offered to receivables as on zero date = 1 – 0.980656 = 0.019344 ie 1.93%.

(c) The financing of current assets involves a trade off between risk and return. A firm can choose from short or long term sources of finance. Short term financing is less expensive than long term financing but at the same time, short term financing involves greater risk than long term financing.

Depending on the mix of short term and long term financing, the approach followed by a company may be referred as matching approach, conservative approach and aggressive approach.

In matching approach, long-term finance is used to finance fixed assets and permanent current assets and short term financing to finance temporary or variable current assets. Under the conservative plan, the firm finances its permanent assets and also a part of temporary current assets with long term financing and hence less risk of facing the problem of shortage of funds.

An aggressive policy is said to be followed by the firm when it uses more short term financing than warranted by the matching plan and finances a part of its permanent current assets with short term financing.

PAPER – 6 : INFORMATION TECHNOLOGY

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

Question 1

(a) Convert the following from one number system to another system along with the working notes: (1×5 = 5 marks)

(i) $(765.625)_{10}$ = ( )$_2$

(ii) $(11011010.1101)_2$ = ( )$_{10}$

(iii) $(9876)_{10}$ = ( )$_8$

(iv) $(7654)_8$ = ( )$_{16}$

(v) $(AD5)_{16}$ = ( )$_{10}$

(b) Describe briefly, the following terms with reference to Information Technology: (1×5 = 5 marks)

(i) Access time

(ii) Buffer

(iii) Multiplexer

(iv) HTML

(v) CMOS

(c) Give one or two reasons for each of the following: (1×5 = 5 marks)

(i) Use of Cache memory

(ii) Use of Parallel Port

(iii) Use of gateway in Computer network

(iv) Use of Auto Text feature in MS WORD

(v) Need of Diagnostic Routine in System Software.

(d) Write True or False for each of the following: (1×5 = 5 marks)

(i) The clock speed is the speed at which the processor executes instruction.

(ii) A dumb terminal has an inbuilt processing capability.

(iii) ASCII code provides representation of a maximum 256 individual characters.

(iv) A non-impact printer forms character by chemical or electronic means.

(v) Multitasking refers to the use of two or more CPU to perform coordinated work simultaneously.

Answer

(a) (i) $(765.625)_{10} = (?)_2$

2	765	Remainder
2	382	1
2	191	0
2	95	1
2	47	1
2	23	1
2	11	1
2	5	1
2	2	1
	1	0

0.625 x 2= 1.250
0.250 x 2= 0.50
0. 50 x 2= 1.0

Thus, $(765.625)_{10} = (1011111101.101)_2$

(ii) $(11011010.1101)_2 = (?)_{10}$

$(11011010.1101)_2 = 1x2^7+1x2^6+1x2^4+1x2^3+1x2^1+ 1x2^{-1}+1x2^{-2}+1x2^{-4}$

$= 128+64+16+8+2+0.5+0.25+0.0625$

$= 218+0.8125 = (218.8125)_{10}$

Thus, $(11011010.1101)_2 = (218.8125)_{10}$

(iii) $(9876)_{10} = (?)_8$

8	9876	Remainder
8	1234	4
8	154	2
8	19	2
	2	3

Thus, $(9876)_{10} = (23224)_8$

(iv) $(7654)_8 = (?)_{16}$

(7654) = 111 110 101 100

= 1111 1010 1100

= F A C

Hence, $(7654)_8 = (FAC)_{16}$

(v) $(AD5)_{16} = (?)_{10}$

$(AD5) = AX16^2+DX16^1+5X16^0$

$= 10X256 +13X16+5$

$= 2560+208+5$

$= (2773)_{10}$

Thus, $(AD5)_{16} = (2773)_{10}$

(b) (i) **Access Time** : It refers to the time interval between the instant when a computer or control unit calls for transfer of data to or from a storage device and the instant when its operation is completed. Thus, access time is the sum of the waiting time and transfer time.

(ii) **Buffer**: It refers to a storage device used to compensate for differences in the rates of flow of data or in the times of occurrence of events when transmitting data from one device to another.

(iii) **Multiplexer** : This device enables several devices to share one communicator line. It scans each device to collect and transmit data on a single line to the CPU. It also communicates transmission from the CPU to the appropriate terminal linked to the multiplexer.

(iv) **HTML** (Hypertext markup language): This coding language is used to create Hypertext documents for use on the World Wide Web. It allows the creator of the web page to specify how text will be displayed and how to link it to other web pages, files and Internet services.

(v) **CMOS** (Complementary Metal Oxide Semiconductor) : Personal computer uses the CMOS memory to store the date, time and system setup parameters. These parameters are loaded every time the computer is started. It is powered by lithium ion battery.

(c) (i) **Use of cache memory :** The Cache memory acts as a temporary memory and boosts processing power significantly. The cache that comes with the processor is called level one (L1) cache. This cache runs at the processor's clock speeds, and therefore, is very fast. The L1 cache is divided into two sections-one for data, and other for instructions.

(ii) **Use of Parallel Ports:** Parallel ports are used to connect external input/output devices like scanners or printers. Parallel ports facilitate the parallel transmission of data, usually one byte at a time. Parallel ports use 25 pin RS 232C.

(iii) **Use of Gateway in computer network:** Gateways are usually used to link LANs of different topologies, e.g., Ethernet and Token ring for enabling the exchange of data. They do not possess the management facilities of routers but like routers they

can translate data from one protocol to another.

(iv) Use of Auto Text feature in MS-WORD: It is a unique feature of MS-WORD. It allows storing formatted text even paragraphs and graphics. These can be recalled by pressing some keys. It has dictionary of its own and can be customized.

(v) Need of Diagnostic Routine in System software: These programs are written and provided by computer manufacturers. These assist in tracing the processing of the program being debugged. They are also used to find hardware details. Diagnostic routines are often treated as a category of the utility or service programs.

(d) (i) True

(ii) False

(iii) False

(iv) True

(v) False

Question 2

Distinguish between the following: *(4×5 = 20 Marks)*

(i) Semi-conductor memory and Bubble memory.

(ii) Online system and Real time system.

(iii) Client-server architecture and Peer-to-Peer architecture.

(iv) Ring network and Star network.

(v) Intranet and Extranet.

Answer.

(i) Semi-conductor memory and Bubble memory: It is made up of very thin silicon chip which contains a number of small storage cells that can hold data. Instead of being made up of a series of discrete components, these units are constructed as integrated circuits, meaning that a number of transistors are integrated or combined together on a thin silicon wafer to form a complete set of circuits. The faster and more expensive bipolar semi conductor chips are often used in the ALU and high speed buffer storage sections of the CPU, while the slower and less expensive chips that employ metal-oxide semi-conductor technology are used in the main memory section.

On the other hand, **bubble memory** is composed of small magnetic domains formed on a thin single-crystal film of synthetic garnet. These magnetic bubbles, which are actually magnetically charged cylinders, only a few thousandths of a centimeter in size, can be moved across the garnet film by electric charges. The presence or absence of a bubble can be used to indicate whether a bit is 'on' or 'off'. Since data stored in bubble memory

is retained when power to the memory is turned off, it can be used for auxiliary storage. Bubble memory has high potential because of its low production costs and its direct access capabilities, thus it may become widely employed as main memory technology. Since it is small, lightweight, and does not use very much power, bubble memory is finding a great deal of use as an auxiliary storage in portable computers.

(ii) Online System and Real Time System : Online system refers to processing of individual transactions as they occur from their point of origin as opposed to accumulating them into batches. This is made possible by such direct access devices as magnetic disk and number of terminals connected to, and controlled by a central processor. In this way, various departments in a company can be connected to the processor by cable. If operating companies are a number of miles away from the processor then they are linked by means of telegraph, telephone lines or even through satellite. This type of processing provides multi-access to information files by terminal users and also enables them to update files with transaction data. Some examples where online applications are being used are electricity and gas boards, banking system, tour operators, stock exchanges and for stock control.

On the other hand, the term **real time system** refers to the technique of updating files with transaction data immediately after the event to which it relates occurs. Real time system is basically on-line system with one specialty in inquiry processing. The response of system to the inquiry itself is used to control the activity. Real time systems usually operate in multi programming and multi processing. This increases both availability and reliability of the system. CPU's in real time systems should possess capability of what is known as program interrupts.

Some of the leading areas for real-time applications are sales order processing, transport and travel reservation, manufacturing control system, and airline reservation system.

(iii) Client-Server Architecture and Peer- to -Peer architecture : In **Client-Server architecture**, the network has certain machines and devices called servers that are specially dedicated to provide various services to the other computers called clients. Different types of specialised servers include file, fax, printer, modem, e-mail and database server. The most common type of client server arrangement is a LAN composed of microcomputers connected to a network server, which serves to all the clients (users) of the LAN. A client program running on one of the microcomputers can request specific data from the server. The server program retrieves the requested data from its databases and returns it to the client. This way, a LAN permits all the computers connected to it to share hardware, software and data.

On the other hand, in **Peer-to-Peer architecture,** there are no dedicated services. All computers are equal, and therefore, are termed as peer. Normally, each of these machines functions both as a client and a server. This arrangement is suitable for environments with a limited number of users. Moreover, the users are located in the same area and security is not an important issue while the network is envisaged to have a limited growth. At the same time, users need to freely access data and programs that reside on other computers across the network. The basic advantage of this architecture

is simplicity of design and maintenance. Since there is no server, all nodes on the network are fully employed. Further, the network is not totally reliant on a particular computer and linking computers in a peer-to-peer network is more straightforward.

(iv) Ring network and Star network: In **Ring network**, the network cable passes from one node to another until all nodes are connected in the form of a loop or ring. There is a direct point-to-point link between two neighbouring nodes. These links are unidirectional which ensures that transmission by a node traverses the whole ring and comes back to the node, which made the transmission. Ring networks offer high performance for a small number of workstations or for larger networks where each station has a similar workload. These networks can span longer distances than other types of networks and are easily extendable.

The Star network structure, on the other hand, is very popular for LANs. In this topology, the network is characterised by communication channels emanating from centralised computer system. That is, processing nodes in a star network interconnect directly with a central system. Each terminal, small computer, or large mainframe can communicate only with the central site and not with other nodes in the network. If it is desired to transmit information from one node to another, it can be done only by sending the details to the central node, which in turn sends them to the destination. A star network is particularly appropriate for organisations that require a centralised data base or a centralised processing facility. In a Star network, it is easy to add new nodes and also remove nodes. A node failure does not bring down the entire network. It is easier to diagnose network problem through a central hub.

(v) Intranet and Extranet: Intranet is a type of information system that facilitates communication within the organisation, among widely dispersed departments, divisions and regional locations. Intranets connect people together with Internet technology, using web browsers, web servers and data warehouses in a single view. With an Intranet, access to all information, applications and data can be made available through the same browser. The objective is to organise each individual's desktop with minimal cost, time and effort to be more productive, cost efficient, timely and competitive.

An E**xtranet** is an extension of an Intranet that makes the latter accessible to outside companies or individuals with or without an Intranet. It is also defined as a collaborative Internet connection with other companies and business partners. Parts of an Intranet are made available to customers or business partners for specific applications. The Extranet is thus an extended Intranet, which isolates business communication from the Internet through secure solutions. Extranets provide the privacy and security of an Intranet while retaining the global reach of the Internet. An Extranet extends the Intranet from one location to another across the Internet by securing data flows using cryptography and authorisation procedures, to another Intranet of a business partner.

Question 3

(a) Explain the different steps involved in Image processing. *(5 marks)*

(b) What do you mean by Structured Query Language (SQL)? Explain its utility in database management. (5 marks)

(c) A bicycle shop in a city hires bicycles by the day at different rates for different models as given below: (10 marks)

Model No.	*Hire rate per day*
Model No. 1	*Rs. 10*
Model No. 2	*Rs. 9*
Model No. 3	*Rs. 8*
Model No. 4	*Rs. 7*

In order to attract customers, the shopkeeper gives a discount of 15 percent to all those customers, who hire a bicycle for more than one-week period. Further to attract women customer, he gives additional discount of 10 percent irrespective of hire period. For every bicycle hired a security deposit of Rs. 25 must be paid.

Draw a flow chart to print out the details of each customer such as name of customer, bicycle model number, number of days a bicycle is hired for, hire charges, discount and total charges including deposits.

Answer

(a) There are five distinct steps to Image Processing which are briefly discussed below:

Step 1: Data capture : The most common means of converting paper documents into electronic images is to scan them. The scanning device converts the text and pictures into digitized electronic code. The scanner can range from a simple hand held device to a high end, high speed scanner capable of scanning more than 2500 pages an hour. Hand-held scanners could transform text or graphical images into machine-readable data. Fax modems are also used to receive electronic images of documents.

Step 2: Indexing : Document images must be stored in a manner that facilitates their retrieval. Therefore, important document information, such as purchase order numbers or vendor numbers, is stored in an index. Great care is needed in designing the indexing scheme, as it affects the ease of subsequent retrieval of information.

Step 3: Storage : Because images require a large amount of storage space, they are usually stored on an optical disk. One 5.25 inch optical platter can store 1.4 GB or about 25,000 pages of documents. A 12-inch removable optical disk stores upto 60,000 pages of documents, and upto 100 optical disks can be stored in devices called jukeboxes.

Step 4: Retrieval : Keying in any information stored in an index can retrieve documents. The index tells the system which optical disk to search and the requested information can be quickly retrieved.

Step 5: Output : An exact replica of the original document is easily produced on the computer's monitor or on paper, or is transmitted electronically to another computer.

(b) SQL is a query language - a set of commands for creating, updating and accessing data from database. It allows programmers, managers and other users to ask adhoc questions of the database interactively without the aid of programmers. It is a set of about 30 English like commands such as Select…….From……Where.

SQL has following features:

- Simple English like command;
- Command syntax are easy;
- Can be used by non-programmers;
- Can be used for different type of database management systems;
- Allows user to create, update database;
- Allows retrieving data from data base without having detailed information about structure of the records and without being concerned about the processes the DBMS uses to retrieve the data;
- Has become standard practice for DBMS.

Since SQL is used in many database management systems, managers who understand SQL syntax are able to use the same set of commands regardless of the DBMS software that they may use. Thus learning SQL provides managers with access to data in many database management systems.

(c) The required flowchart is given on the next page.

Question 4

(*a*) *Briefly explain various types of communication services used to transmit data in a network.* *(5 marks)*

(b) Explain the different types of payment systems in E-commerce. *(5 marks)*

(c) Discuss the various components of database environment. *(10 marks)*

Answer

(a) An organisation that wishes to transmit data uses one of the common carrier services to carry the messages from station to station. Some of the common types of communication services used to transmit data in a network are briefly discussed below:

Narrow band Service : It is used where data volume is relatively low; the transmission rates usually range from 45 to 3000 bits per second. Examples of this service are telephone companies, typewriters exchange service (TWX) and telex service.

Voice band Service : Voice band services use ordinary telephone lines to send data messages. Transmission rates vary from 300 to 4,800 bits per second, and higher.

Wide band Service : It provides data transmission rates from several thousands to several million bits per second. These services are limited to high-volume users. Such

services generally use coaxial cable or microwave communication. Space satellites have been deployed to rapidly transmit data from any part of the world to another part of the world.

Communication Services may be either leased or dial up. A leased communication channel, which gives the user exclusive use of channel, is used where there are continuing data transmission needs. The dial up variety requires the person to dial the computer. This alternative is appropriate when there are periodic data to be transmitted.

(b) **Payment Systems in E-Commerce:** There are dozens of electronic payment systems proposed or already in practice for E-commerce. But they can be grouped into three categories, based on what information is being transferred on-line.

The first type uses a trusted third party that maintains all sensitive information (such as bank account and credit card numbers) for its clients, which include both buyers and sellers. When there is a transaction, order information is transmitted along with information about payment confirmation and clearing, all of which do not include sensitive information. In effect, no real financial transaction is done on-line. One example of this type of payment system is First Virtual. In this system, the information need not be encrypted since financial transactions are done off-line.

The second type is an extension of the conventional notational fund transfer. In credit card or cheque transactions, sensitive information is exchanged online, hence the information is encrypted for security. This type is becoming the mainstay of online payment methods because consumers are familiar with this system and current payers have vested interest in extending that system to the Internet. Cyber cash and VISA/MasterCard's SET – based transactions are examples of this type of system.

The third type includes variations of digital cash, electronic money and coins. What distinguishes these systems from the other two is not simply the anonymity they afford, but the fact that what is being transferred is value or money itself. With the second type, some one can commit fraud by lifting the message (e.g. credit card number) by running up the charge on the user's account. With digital currency, intercepting a message is an outright theft of user's property, not just information.

(c) Database environment has following components:

(i) ***The database files:*** These files have data elements stored in database file organization formats. The database is created in such a way so as to balance the data management objectives of speed, multiple access paths, minimum storage, program-data independence, and preservation of data integrity. Different database systems have different ways of representing data physically on disk.

(ii) ***A database management system (DBMS):*** A DBMS is a set of systems software programs that manages the database files. The DBMS accesses the files, updates the records, and retrieves data as requested. The DBMS ensures that only those areas are accessed for which clearance has been granted. The DBMS has the responsibility for data security, which is vital in a database environment since database is accessed by many users.

(iii) ***The users:*** Users consist of both the traditional users and application programmers who are not traditionally considered to be users. Users interact with the DBMS indirectly via application programs or directly via a simple query language. This language enables the user to retrieve data in logical formats on an ad hoc basis.

The users interaction with the DBMS includes the definition of the logical relationships in the database, input and maintenance of data, changing and deletion, and manipulation of data.

(iv) ***A host language interface systems:*** This is the part of the DBMS that communicates with the application programs. The host language interface interprets instruction in high-level language application programs, such as COBOL and BASIC programs that request data from the files so that the data needed can be retrieved. During this period the operating system interacts with the DBMS. Application programs do not contain information about the file thus the programs file is independent of a data base system.

(v) ***The application programs:*** These programs perform almost the same functions that they do in a conventional system, but they are independent of the data files and use standard data definitions. This independence and standardization make rapid special purpose program development easier and faster.

(vi) ***A natural language interface systems:*** The query language permits online update and inquiry by users who are relatively unsophisticated about computer systems. This language is often termed 'English-like' because instructions of this language are usually in the form of a simple command in English, which are used to accomplish an enquiry task. Query languages also permit online programming of simple routines by managers who wish to interact with the data. The natural language interface system may also facilitate managers to generate special reports.

(vii) ***The data dictionary/directory:*** Data dictionary is a centralized depository of information, in a computerized form, about the data in the database. The data dictionary contains the scheme of the database i.e. the name of each item in the database and a description and definition of its attributes along with the names of the programs that use them, and who is responsible for the data; authorization tables that specify users and the data and programs authorized for their use. These descriptions and definitions are referred to as the "data standards". Maintenance of a data dictionary is the responsibility of the database administrator.

Whereas the data dictionary informs users or programmers of what data is available in the database and how it is used, the data directory keeps track of where this data is stored on the disk. Thus, the data directory addresses the physical data description and, where hierarchical or network systems are used, the data directory keeps track of the paths to be followed for access.

(viii) ***Online access and update terminals:*** These may be adjacent to the computer or even thousands of miles away. They may be dumb terminals, smart terminals or microcomputers.

(ix) ***The output system, or report generator:*** This provides routine job reports, documents and special reports. It allows programmers, managers and other users to design output reports without writing an application program in a programming language.

Question 5

(a) Explain the concept of mail merge used in MS WORD. (5 marks)

(b) Briefly describe about the different views of a slide offered by PowerPoint to create a better presentation. (5 marks)

(c) What do you mean by Direct Data Entry (DDE) system? Give a brief description of Optical Character Reader. (5 marks)

(d) Define the following functions used in MS-EXCEL: (1×5 = 5 marks)

(i) SUM

(ii) COUNT

(iii) PMT

(iv) FV

(v) INT

Answer

(a) Mail merge: It is an efficient and less time consuming way of preparing mass mailing for a list of addresses. It is a tool for producing repetitive documents. It gives the flexibility while sending letter and then personalizing each copy of it with information such as names, addresses, dates, etc.

Mail merge is built around two sets of components – main document and the data source. The *main document* is a form letter. It contains merge fields where data would be merged. The field names would be replaced with the field contents coming from the *data source* at the time of merging. The data source is a file that contains information like name, address etc. which is merged with the main document to create a final product. The data source can be very easily picked up from MS-Access database, an Excel spreadsheet, Microsoft Address Book or one created in WORD.

Steps to set-up Mail merge are:

(i) *Setting up the main document*: The process of mail merge always starts with creation of a new main document.

(ii) *Setting up the data source*: This step allows the user to specify the data document that will be used as data source.

(iii) *Editing the data source*: This feature allows the user to fill the contents of the fields.

(iv) *Addition of fields to the main document*: This step allows the user to decide the place on the main document where fields from the data source are going to be merged.

(b) Power point comes with different views to help in creating better presentations. It offers five views:

(i) Normal View (ii) Outline View (iii) Slide View

(iv) Slide sorter View (v) Slide show View.

Each view offers a different way to look at the presentation and modify it. One can easily switch between the various views using the buttons on the left hand corner of the scroll bar.

(i) **Normal View:** Normal view is a tri-pane view which offers the slide view, the outline view and the Notes pane. The user should work in normal view when there is a need to frequently switch between text and objects on slide. This view allows editing text both on the slide and the outline view. The slide is also large enough for inserting objects.

(ii) **Outline View:** It is the most comfortable view for working on text. The standard and formatting toolbars are available for editing text. The user can therefore work on the text just like MS- WORD. One can even check spellings and use Find and Replace features to modify text. In this view, the slide is visible only in miniature form. Notes can also be added.

(iii) **Slide View:** The slide view allows the user to see how the text and objects that have been created will appear on each slide. In this slide view, it is convenient to insert objects and modify them. Sometimes, the text inserted on a slide using outline view, runs into too many lines on the slide and even runs out of the slide. In such cases, it is required to trim the text or use an additional slide. The user can edit the text on each slide in the slide view.

(iv) **Slide Sorter View:** It is possible to view all the slides at one time in the slide sorter view. Though it is not possible to rearrange the text or objects on individual slides in this view but one can move the slides around. Even in outline view the slides can be moved around. But if it is desired to see the visual effect of the rearrangement, then the slide sorter view is most useful.

(v) **Slide show View:** This view displays slides in a sequence, moving from one slide to another, transitioning with special effects that have been set, and moving at a preset timings that can be controlled.

(c) Direct Data Entry (DDE): Direct data entry refers to entry of data directly into the computers through machine-readable source documents. DDE does not require manual transcription of data from original paper documents. These devices can scan source documents magnetically or optically to capture data for direct entry into the computer. Magnetic ink character reader and Optical character reader are examples of such devices.

Optical Character Readers (OCR) employ a set of printing characters with standard font that can be read by both human and machine readers. The machine reading is done by light scanning techniques in which each character is illuminated by a light source and the reflected image of the character is analysed in terms of the light-dark pattern produced. Keyboard devices are used to give the required print quality. OCR has the potential of reading even handwritten documents straightaway. OCRs can read upper and lower case letters, numerals, and certain special characters from handwritten, typed and printed paper documents. The specific characters that can be read and whether the characters must be handwritten, typed or printed depends upon the type of OCR being used. OCR annihilates the time consuming step of transcription. Large volume billing applications (e.g. the bills of utility companies, credit card organizations, and magazine subscriptions etc.) increasingly are being adapted to OCR methods.

(d) (i) **SUM:** It is a mathematical function, which calculates the sum of values in a list.

(ii) **COUNT:** It is a statistical function, which counts the number of arrangement values in the specified list. Empty cells are ignored/not counted.

(iii) **PMT:** It is a financial function that is used to calculate the loan payments based on the rate of interest, term of the loan and the principal amount.

(iv) **FV:** It is a financial function, which calculates the future value for a series of equal investments (also called annuity) earning a fixed periodic rate of interest.

(v) **INT:** It is a mathematical function, which computes the integral part of the value. All fractional values are truncated and only the integral part of the value is retained.

Question 6

(a) What do you mean by generalized audit package? Write down the typical steps in using audit package. (5 marks)

(b) Explain the various matters on which central government can make rules under Section 87 of Information Technology Act. (5 marks)

(c) Describe the salient features of EX. NGN accounting package. (5 marks)

(d) Explain the chief uses of Internet. (5 marks)

Answer

(a) Generalized Audit Packages (GAPs): These are standard packages developed by software companies specifically for the purpose of auditors to audit data stored on computers. These are extensively used by auditors worldwide for audit through the computer. These are most economical and standard packages and are available off the shelf, which can be used by auditors over a wide platform of hardware, operating systems, operating environment and database.

Following steps are used in GAPs to perform audit:

(i) Define the audit objectives.

(ii) Identify the tests that the package will be required to do in order to assist the meeting of the audit objectives.

(iii) Make out the package input forms for these tests.

(iv) Compile the package on the computer, clearing reported edit errors. There should be full edit of the parameter cards to execution (Step vii). Maintain security over the package and the audit tests at all times.

(v) If a programmer was used to add coded routines to the package, to fill out the input forms or to advise generally, his work must be tested.

(vi) Obtain copies of the application files to be tested.

(vii) Attend the execution of the package against the copy files.

(viii) Maintain security of the copy files and output until the tests have been fully checked out.

(ix) Check results of the test and draw audit conclusions.

(x) Interface the test results with whatever subsequent manual audit work has to be done.

(b) Power of Central Government to make Rules

Section 87 of the Act confers on the Central Government the power to make rules by notifying in the Official Gazette and the Electronic Gazette, in respect of certain matters, some of which are:

(i) the manner in which any matter may be authenticated by a digital signature,

(ii) the manner and format in which electronic records shall be filed or issued,

(iii) the type of digital signature, manner and format in which it may be affixed,

(iv) the security procedure for the purpose of creating same electronic record and secure digital signature,

(v) the qualifications, experience and terms and conditions of service of Controller, Deputy Controllers and Assistant Controllers,

(vi) the requirements, manner and form in which application is to be made for a license to issue Digital Signature Certificates,

(vii) the period of validity of the license,

(viii) the qualification, experience of an adjudicating Officer, as well as other officers,

(ix) the salary, allowances and terms and conditions of service of the Presiding officer, etc.

(c) **EX.NGN** is designed to work on Windows NT and 95/98. The product is developed on Visual C++ and all reports are designed on Crystal reports. It has the following salient features:

(i) It is a 32-bit application which is compatible with Windows 95/98 and Windows NT.

(ii) Easy-to-use graphical user interface (GUI) as per the Microsoft GUI guidelines.

(iii) Multi tasking facility allows to perform various functions simultaneously.

(iv) Different security passwords can be set for various activities.

(v) It supports multiple companies to be created and maintained.

(vi) Zooming facility allows to obtain more detailed information at transaction level.

(vii) It provides all the accounting support without demanding to remember various codes for different accounts.

(viii) It provides the facility to customize invoice, receipt bill, payments with some particular information, which may not be part of the pre-defined documents.

(ix) It can prepare 72 different types of reports in accounting, which includes, balance sheet, profit and loss account, trial balance, stock position, financial summary, bank reconciliation etc.

(x) It has a powerful feature, which enables to capture information under various business attributes or parameters for subsequent analysis and printing of analysis reports under those attributes. It allows constructing queries for different kinds of information.

(d) The chief uses of the Internet can be classified into three primary types namely, communication, data retrieval and data publishing.

(i) ***Communication:*** Communication on the Internet can be online or offline. When some users connect to a single server or an on-line service at the same time, they can communicate in an on-line chat. This can be truly many-to-many as in a room full of people talking to each other on peer to peer basis. Alternatively, the users send e-mail to each other which can be read by the receiver at a later time. This is off-line communication but “one-to-one” or “one-to-many”. It is also possible for the users to get together electronically with those sharing common interests in “Usenet” for the groups.

(ii) ***Data retrieval:*** For meaningful data retrieval, availability of data that has been compiled from various sources and put together in a usable form is an essential prerequisite. On the internet, a large number of databases exist. These have been put together by commercially run data providers as well as individuals or groups with special interest in particular areas. To retrieve such data, any user needs to know the addresses of such Internet services. Then depending on the depth of information being sought, different databases have to be searched and required information compiled.

(iii) ***Data publishing:*** Data publishing is a new opportunity that Internet has made possible. Information that needs to be made available to others can be either forwarded to specific addresses, posted in a Usenet site or kept on display in a special site. Internet discourages by social pressure, sending of unsolicited E-mail.

Question 7

Write short notes on the following: *(5×4 = 20 marks)*

(i) Program Library Management system

(ii) Computer Output Microfilm (COM)

(iii) Graphical User Interface (GUI)

(iv) Distributed Database.

Answer

(i) Program Library Management Systems: It provides several functional capabilities to facilitate effective and efficient management of the data center software inventory. The inventory may include system and application software program code, job control statements that identify resources used and processes to be performed and processing parameters which direct processing.

Some of the library management system capabilities are:

- ***Integrity*:** Each source program is assigned a modification number and version number and each source statement is associated with a creation date. Security over program libraries, job control language sets and parameter files is provided through the use of passwords, encryption, data compression facilities and automatic back up creation.
- **Update:** It facilitates the addition, deletion, re-sequencing and editing of library members. For example, by creating an automated back-up copy prior to changes being made and maintaining the audit trail of all library activities.
- **Reporting:** Lists of additions, deletions, modifications, library catalog and library member attributes can be prepared for management and audit review.
- **Interface:** It may interface with the operating system, job scheduling system, access control and online program management.

(ii) Computer Output MicroFilm (COM): It is an output technique that records output from a computer as microscopic images on roll or sheet film. The images stored on COM are the same images, which would be printed on paper. It reduces characters 24, 42,or 48 times smaller than normal size. The information is then recorded on 16 mm, 35 mm or 105 mm Microfilm.

The data to be recorded is displaced on CRT and a camera takes a picture of it and places it on the film. The film is then processed either in the recorder unit or separately. After it is processed, it can be retrieved and viewed by the user. It has the following advantages:

- Data can be recorded at a speed of 30,000 lines/minute.
- Cost of recording is very less compared to printed output.

- Huge size data can be recorded.
- Recording space requirement is less.
- It provides easy access to data, using indexing techniques.

(iii) Graphical User Interface (GUI): Through the 1980s, micro computers operating system was strictly text-based command driven software i.e., the users were required to issue commands to the operating system by entering them on the key board, one character at a time. Further, the text-based operating system commands are syntax sensitive, so the user must follow the terms for constructing the commands, otherwise an error message is displayed on the screen of the system.

The trend now-a-days is away from command-driven interfaces to an user-friendly graphics oriented environment called Graphical User Interface.

GUI provides an alternative to cryptic text commands. With the GUI, the user can interact with the operating system and other software packages by selecting options from menus that are temporarily super-imposed over whatever is currently on the screen by using mouse to position the graphics cursors over the appropriate icons. GUIs have effectively eliminated the need for the users to memorise and enter cumbersome commands. MS-Windows provides an efficient GUI environment for personal computers.

(iv) Distributed databases: Under the distributed data processing system, the processing is distributed, hence, the data to be processed must be located at the processing site. This means that the database or parts of the database, must be distributed. There are basically two ways to distribute a database. The first is to provide duplicates of all data at all sites. This approach is called a *replicated database*. If it is necessary for every location to have frequent access to the same data, replication of the database may be recommended. However, replication of a database is very expensive in terms of computer system resources, and it is difficult to maintain consistency for each data element. Even then, replication provides some measure of security by providing duplicates of database in case of failure at one location.

Another means of distributing the database is to partition it. The database may be divided into segments that are appropriate for certain location and those segments distributed only to those locations. This approach is called a *partitioned database*. The database may be partitioned along functional lines. Partitioning may also be achieved along geographical lines. Many organization with many locations partition the database hierarchically.

Distributed database systems usually reduce costs for an organization because they reduce transfer of data between remote sites and the organization headquarters. Distributed database systems may also provide organizations with faster response times for filling orders, answering customer requests or providing managers with information. However, distributed systems sometimes compound the problem of control over the database, increase problems of security, increase data redundancy resulting in danger to data integrity.

PAPER – 1 : ACCOUNTING

*Answer **all** questions.*

Working notes should form part of the answer.

Question 1

The following figures have been extracted from the Books of X Limited for the year ended on 31.3.2004. You are required to prepare a cash flow statement.

(i) Net profit before taking into account income tax and income from law suits but after taking into account the following items was Rs. 20 lakhs:

- *(a) Depreciation on Fixed Assets Rs. 5 lakhs.*
- *(b) Discount on issue of Debentures written off Rs. 30,000.*
- *(c) Interest on Debentures paid Rs. 3,50,000.*
- *(d) Book value of investments Rs. 3 lakhs (Sale of Investments for Rs. 3,20,000).*
- *(e) Interest received on investments Rs. 60,000.*
- *(f) Compensation received Rs. 90,000 by the company in a suit filed.*

(ii) Income tax paid during the year Rs. 10,50,000.

(iii) 15,000, 10% preference shares of Rs. 100 each were redeemed on 31.3.2004 at a premium of 5%. Further the company issued 50,000 equity shares of Rs. 10 each at a premium of 20% on 2.4.2003. Dividend on preference shares were paid at the time of redemption.

(iv) Dividends paid for the year 2002-2003 Rs. 5 lakhs and interim dividend paid Rs. 3 lakhs for the year 2003-2004.

(v) Land was purchased on 2.4.2003 for Rs. 2,40,000 for which the company issued 20,000 equity shares of Rs. 10 each at a premium of 20% to the land owner as consideration.

(vi) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 31.3.2003	*As on 31.3.2004*
	Rs.	*Rs.*
Stock	*12,00,000*	*13,18,000*
Sundry Debtors	*2,08,000*	*2,13,100*
Cash in hand	*1,96,300*	*35,300*
Bills receivable	*50,000*	*40,000*
Bills payable	*45,000*	*40,000*
Sundry Creditors	*1,66,000*	*1,71,300*
Outstanding expenses	*75,000*	*81,800*

(20 marks)

Answer

X Ltd.

Cash Flow Statement

for the year ended 31st March, 2004

	Rs.	*Rs.*
Cash flow from Operating Activities		
Net profit before income tax and extraordinary items:		20,00,000
Adjustments for:		
Depreciation on fixed assets	5,00,000	
Discount on issue of debentures	30,000	
Interest on debentures paid	3,50,000	
Interest on investments received	(60,000)	
Profit on sale of investments	(20,000)	8,00,000
Operating profit before working capital changes		28,00,000
Adjustments for:		
Increase in stock	(1,18,000)	
Increase in sundry debtors	(5,100)	
Decrease in bills receivable	10,000	
Decrease in bills payable	(5,000)	
Increase in sundry creditors	5,300	
Increase in outstanding expenses	6,800	
		(1,06,000)
Cash generated from operations		26,94,000
Income tax paid		(10,50,000)
		16,44,000
Cash flow from extraordinary items:		
Compensation received in a suit filed		90,000
Net cash flow from operating activities		17,34,000
Cash flow from Investing Activities		
Sale proceeds of investments	3,20,000	
Interest received on investments	60,000	
Net cash flow from investing activities		3,80,000
Cash flow from Financing Activities		
Proceeds by issue of equity shares at 20% premium	6,00,000	

Redemption of preference shares at 5% premium	(15,75,000)	
Preference dividend paid	(1,50,000)	
Interest on debentures paid	(3,50,000)	
Dividend paid (5,00,000 + 3,00,000)	(8,00,000)	
Net cash used in financing activities		(22,75,000)
Net decrease in cash and cash equivalents during the year		(1,61,000)
Add: Cash and cash equivalents as on 31.3.2003		1,96,300
Cash and cash equivalents as on 31.3.2004		35,300

Note: Purchase of land in exchange of equity shares (issued at 20% premium) has not been considered in the cash flow statement as it does not involve any cash transaction.

Question 2

From the following information calculate the amount of Provisions and Contingencies and prepare Profit and Loss Account of Zed Bank Ltd. for the year ended 31.3.2004:

		(Rs. in '000)
Interest and Discount		*8,860*
(Includes interest accrued on investments)		
Other Income		*220*
Interest expended		*2,720*
Operating expenses		*2,830*
Interest accrued on Investments		*10*
Additional Information:		
(a)	*Rebate on bills discounted to be provided for*	*30*
(b)	*Classification of Advances:*	
	(i) Standard assets	*4,000*
	(ii) Sub-standard assets	*2,240*
	(iii) Doubtful assets–(fully unsecured)	*390*
	(iv) Doubtful assets – covered fully by security	
	Less than 1 year	*100*
	More than 1 year, but less than 3 years	*600*
	More than 3 years	*600*
	(v) Loss assets	*376*
(c)	*Provide 35% of the profit towards provision for taxation.*	
(d)	*Transfer 20% of the profit to Statutory Reserve.*	

(16 marks)

Answer

ZED Bank Ltd.
Profit and Loss Account
for the year ended 31st March, 2004

(Rs. in '000)

	Particulars	*Schedule No.*	*Year ended on 31st March, 2004*
I.	Income		
	Interest earned (W.N. 1)	13	8,830
	Other income	14	220
	Total		9,050
II.	Expenditure		
	Interest expended	15	2,720
	Operating expenses	16	2,830
	Provisions and contingencies (W.N. 4)		2,200
	Total		7,750
III.	Profit/Loss		
	Net profit/(loss) for the year		1,300
	Profit/(loss) brought forward		Nil
	Total		1,300
IV.	Appropriations		
	Transfer to statutory reserve @ 20%		260
	Balance carried to balance sheet		1,040
	Total		1,300

Working notes:

1. Schedule 13 – Interest earned

			(Rs.'000s)
(i)	Interest and discount	8,860	
	Less: Rebate on bills discounted	(30)	
	Interest accrued on investments	(10)	8,820
(ii)	Interest accrued on investments		10
			8,830

2. Calculation of Provisions and Contingencies

Assets	*Amount (Rs. in '000)*	*% of Provision*	*Provision (Rs. in '000)*
Standard assets	4,000	0.25	10

Sub-standard assets	2,240	10	224
Doubtful assets (unsecured)	390	100	390
Doubtful assets – covered by security			
Less than 1 year	100	20	20
More than 1 year but less than 3 years	600	30	180
More than 3 years	600	50	300
Loss assets	376	100	376
Total provision	8,306		1,500

3. Calculation of provision on tax = 35% (Total income – Total expenditure)
= 35% of Rs. [(9,050 – (2,720 + 2,830 + 1,500)]
= 35% of Rs. 2,000
= Rs. 700

4. Total provisions and contingencies = Rs. 1,500 + Rs. 700 = Rs. 2,200.

Question 3

ABC Ltd. sells goods on Hire-purchase by adding 50% above cost. From the following particulars, prepare Hire-purchase Trading account to reveal the profit for the year ended 31.3.2005:

		Rs.
1.4.2004	*Instalments due but not collected*	*10,000*
1.4.2004	*Stock at shop (at cost)*	*36,000*
1.4.2004	*Instalment not yet due*	*18,000*
31.3.2005	*Stock at shop*	*40,000*
31.3.2005	*Instalments due but not collected*	*18,000*
Other details:		
Total instalments became due		*1,32,000*
Goods purchased		*1,20,000*
Cash received from customers		*1,21,000*

Goods on which due instalments could not be collected were repossessed and valued at 30% below original cost. The vendor spent Rs. 500 on getting goods overhauled and then sold for Rs. 2,800. *(16 marks)*

Answer

In the Books of ABC Ltd.
Hire Purchase Trading Account
for the year ended 31st March, 2005

Dr.							*Cr.*
			Rs.				*Rs.*
1.1.2004	To	Hire purchase stock	18,000	1.1.2004	By	Stock reserve	
1.1.2004	To	Goods sold on hire				(1/3 of Rs. 18,000)	6,000
to		Purchase	1,74,000	1.1.2004	By	Hire purchase sales	1,32,000
31.3.2005	To	Loss on repossession of goods (W.N. 5)	1,600	to 31.3.2005	By	Goods sold on hire purchase (1/3 of Rs. 1,74,000)	58,000
31.3.2005	To	Stock reserve	20,000		By	Profit on sale of repossessed goods (W.N. 4)	900
	To	Profit and loss account (Transfer of profit)	43,300	31.3.2005	By	Hire purchase stock (W.N. 3)	60,000
			2,56,900				2,56,900

Alternatively, Hire Purchase Trading Account can be prepared in the following manner:

Hire Purchase Trading Account
for the year ended 31st March, 2005

Dr.							*Cr.*
			Rs.				*Rs.*
1.1.2004	To	Hire purchase stock	18,000	1.1.2004	By	Stock reserve (1/3 of Rs.	6,000
1.1.2004	To	Hire purchase debtors	10,000			18,000)	
to	To	Goods sold on hire	1,74,000	1.1.2004	By	Cash (Rs. 1,21,000 + Rs.	
31.3.2005		purchase		to		2,800)	1,23,800
	To	Cash (Overhauling charges)	500	31.3.2005	By	Goods sold on hire purchase	58,000
31.3.2005	To	Stock reserve	20,000			(1/3 of Rs. 1,74,000)	
	To	Profit and loss account		31.3.2005	By	Hire purchase stock	60,000
					By	Hire purchase debtors	18,000
		(Transfer of profit)	43,300				
			2,65,800				2,65,800

Working Notes:

1. Memorandum Instalment due but not collected (hire purchase debtors) account

Dr.						*Cr.*
		Rs.				*Rs.*
To	Balance b/d	10,000	By	Cash		1,21,000
To	Hire purchase sales	1,32,000	By	Repossessed stock (Balancing figure)		3,000
			By	Balance c/d		18,000
		1,42,000				1,42,000

2. Memorandum shop stock account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Balance b/d	36,000	By	Goods sold on hire purchase	1,16,000
To	Purchases	1,20,000		(Balancing figure)	
			By	Balance c/d	40,000
		1,56,000			1,56,000

3. Memorandum Instalment not yet due (hire purchase stock) account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Balance b/d	18,000	By	Hire purchase Sales	1,32,000
To	Goods sold on hire purchase [1,16,000 + (1,16,000 × 50%)]	1,74,000	By	Balance c/d (Balancing figure)	60,000
		1,92,000			1,92,000

4. Goods Repossessed account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Hire purchase debtors	3,000	By	Hire purchase trading account (W.N. 5)	1,600
			By	Balance c/d (W.N. 5)	1,400
		3,000			3,000
To	Balance b/d	1,400	By	Cash account	2,800
To	Cash account (expenses)	500			
To	Profit on sale	900			
		2,800			2,800

5.

	Rs.
Original cost of goods repossessed $\left(\text{Rs.}\,3,000 \times \frac{100}{150}\right)$	2,000
Instalments due but not received	3,000
Valuation of repossessed goods (70% of Rs. 2,000)	1,400
Loss on repossession	1,600

Question 4

Following is the Balance Sheet of Mr. Brown as at 31st March, 2005. He has filed a petition in the court for being declared as insolvent:

Liabilities	*Rs.*	*Assets*		*Rs.*
Capital	*18,000*	*Goodwill*		*5,000*
Bank loan (secured by first		*Machinery*		*20,000*
charge on building)	*80,000*	*Building*		*1,15,000*
Loan from Finance Co.,	*30,000*	*Investment in shares*		*5,000*
(secured by second charge		*Furniture*		*7,000*
on building)		*Stock*		*9,000*
Sundry creditors	*59,000*	*Debtors:*		
Sales tax payable	*8,000*	*Good*	*14,000*	
Loan from wife	*5,000*	*Doubtful*	*8,000*	
		Bad	*2,000*	*24,000*
		Cash and bank		*15,000*
	2,00,000			*2,00,000*

Mr. Brown estimated that except the following, all tangible assets are realisable:

(i) A machinery Rs. 5,000 included in the Balance Sheet has no value.

(ii) Debtors (unrealisable) Rs. 7,600.

(iii) Non-moving stock Rs. 3,000.

(iv) Useless furniture Rs. 4,000.

(v) Investment has no value.

Further Information:

(i) Building expected to realise Rs. 1,20,000.

(ii) Loan was given by his wife from her personal sources.

(iii) A bill discounted for Rs. 10,000 is likely to be dishonoured.

(iv) One creditor forgoes his claim for Rs. 4,000.

(v) Mr. Brown started his business on 1.4.2001. His household expenses upto 31.3.2005 is Rs. 48,000. His private Life Insurance Policy matured for Rs. 30,000 on 31.3.2005.

He made profit of Rs. 40,000 upto 31.3.2003.

He incurred loss of Rs. 50,000 from 1.4.2003 to 31.3.2005.

Also, he suffered speculation loss of Rs. 10,000 in the year ended 31.3.2005.

Based on the above information, prepare Statement of Affairs of Mr. Brown as on 31.3.2005 and Deficiency Account. *(16 marks)*

Answer

Statement of Affairs of Mr. Brown as on 31st March, 2005

Dr.						*Cr.*
Gross Liabilities	*Liabilities (as stated and estimated by debtor)*		*Expected to Rank*	*Assets (as stated and estimated by debtor)*	*Book Value*	*Estimated to produce*
Rs.		*Rs.*	*Rs.*		*Rs.*	*Rs.*
74,000	Unsecured creditors as per List A		70,000	Properties as per List E		
80,000	Creditors fully secured as per List B	80,000		Cash and Bank	15,000	15,000
				Stock	9,000	6,000
	Less: Estimated value of			Machinery	20,000	15,000
	securities	1,20,000		Furniture	7,000	3,000
	Surplus	40,000		Goodwill	5,000	–
	Less: Amount carried to			Investment in shares	5,000	–
	List C	30,000		Book debts as per List F		
	Balance thereof to contra	10,000	–	Good	14,000	14,000
30,000	Creditors partly secured as per List C	30,000		Doubtful	8,000	2,400
	Less: Surplus carried from			Bad	2,000	–
					85,000	55,400
	List B	30,000		Surplus from securities in		
	Balance	–	–	the hands of fully		
8,000	Preferential creditors			secured creditors		
	payable in full as per List D			(as per contra)		10,000
						65,400
	Sales tax payable	8,000		*Less*: Preferential		
	Less: Deducted as per contra	8,000	–	creditors as per contra		8,000
						57,400
				Add: Deficiency as		
				explained in List H		12,600
1,92,000			70,000			70,000

Deficiency Account (List H)

	Rs.		Rs.	Rs.
Excess of assets over liabilities as on 01.04.2001 (Balancing figure)	56,000	Net loss arising from business since 01.04.2003		50,000
		Bad debts as per list F		7,600
Net profit arising from business upto 31.03.2003	40,000	Drawings for household expenses		48,000
		Loss on realisation of :		
Profit on realisation of:		Furniture	4,000	
Building	5,000	Machinery	5,000	
Life policy matured	30,000	Stock	3,000	
Creditors forgone claims	4,000	Goodwill	5,000	
Deficiency as per Statement of Affairs	12,600	Investment	5,000	22,000
		Loss on dishonour of bill		10,000
		Speculation losses		10,000
	1,47,600			1,47,600

Question 5

Exe Limited was wound up on 31.3.2004 and its Balance Sheet as on that date was given below:

Balance Sheet of Exe Limited as on 31.3.2004

Liabilities	*Rs.*	*Assets*			*Rs.*
Share capital:		*Fixed assets*			*9,64,000*
1,20,000 Equity shares of Rs. 10 each	*12,00,000*	*Current assets:*			
		Stock		*7,75,000*	
Reserves and surplus:		*Sundry debtors*	*1,60,000*		
Profit prior to incorporation	*42,000*	*Less: Provision for bad and doubtful debts*	*8,000*	*1,52,000*	
Contingency reserve	*2,70,000*	*Bills receivable*		*30,000*	
Profit and loss A/c	*2,52,000*	*Cash at bank*		*3,29,000*	*12,86,000*
Current liabilities:					
Bills payable	*40,000*				
Sundry creditors	*2,26,000*				
Provisions:					
Provision for income tax	*2,20,000*				
	22,50,000				*22,50,000*

Wye *Limited took over the following assets at values shown as under:*

Fixed assets Rs. 12,80,000, Stock Rs. 7,70,000 and Bills Receivable Rs. 30,000.

Purchase consideration was settled by Wye Limited as under:

Rs. 5,10,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of Rs. 100 each. The balance was settled by issuing equity shares of Rs. 10 each at Rs. 8 per share paid up.

Sundry debtors realised Rs. 1,50,000. Bills payable was settled for Rs. 38,000. Income tax authorities fixed the taxation liability at Rs. 2,22,000.

Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to Rs. 8,000.

You are required to:

(i) Calculate the number of equity shares and preference shares to be allotted by Wye Limited in discharge of purchase consideration.

(ii) Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Wye Limited account in the books of Exe Limited.

(iii) Pass journal entries in the books of Wye Limited. *(16 marks)*

Answer

(i) Purchase consideration

	Rs.
Fixed assets	12,80,000
Stock	7,70,000
Bills receivable	30,000
Purchase consideration	20,80,000

Amount discharged by issue of preference shares = Rs. 5,10,000

No. of preference shares to be allotted $= \frac{\text{Rs. } 5,10,000}{100} = 5,100$ shares

Amount discharged by allotment of equity shares = Rs. 20,80,000 – Rs. 5,10,000

= Rs. 15,70,000

Paid up value of equity share = Rs. 8

Hence, number of equity shares to be issued $= \frac{\text{Rs. } 15,70,000}{8}$

= 1,96,250 shares

(ii)

Realisation Account
In the books of Exe Ltd.

Dr.					*Cr.*
		Rs.			*Rs.*
To	Fixed assets	9,64,000	By	Provision for bad and doubtful debts	8,000
To	Stock	7,75,000	By	Bills payable	40,000
To	Sundry debtors	1,60,000	By	Sundry creditors	2,26,000
To	Bills receivable	30,000	By	Provision for taxation	2,20,000
To	Bank account:		By	Wye Ltd. account	
	Liquidation expenses	8,000		(Purchase consideration)	20,80,000
	Bills payable	38,000	By	Bank account: Sundry debtors	1,50,000
	Tax liability	2,22,000			
	Sundry creditors	2,11,000			
To	Equity shareholders (profit transferred)	3,16,000			
		27,24,000			27,24,000

Cash/Bank Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Balance b/d	3,29,000	By	Realisation account:	
To	Realisation account:			Liquidation expenses	8,000
	Sundry debtors	1,50,000		Bills payable	38,000
				Tax liability	2,22,000
				Sundry creditors (Balancing figure)	2,11,000
		4,79,000			4,79,000

Equity Shareholders Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	10% Preference shares		By	Equity share capital account	12,00,000
	in Wye Ltd.	5,10,000	By	Profit prior to incorporation	42,000
To	Equity shares in Wye Ltd.	15,70,000	By	Contingency reserve	2,70,000
			By	Profit and loss account	2,52,000
			By	Realisation account (Profit)	3,16,000
		20,80,000			20,80,000

Wye Limited Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Realisation account	20,80,000	By	10% Preference shares in Wye Ltd.	5,10,000
			By	Equity shares in Wye Ltd.	15,70,000
		20,80,000			20,80,000

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

Particulars		*Dr. Amount Rs.*	*Cr. Amount Rs.*
Business purchase account	Dr.	20,80,000	
To Liquidator of Exe Ltd. account			20,80,000
(Being the amount of purchase consideration payable to liquidator of Exe Ltd. for assets taken over)			
Fixed assets account	Dr.	12,80,000	
Stock account	Dr.	7,70,000	
Bills receivable account	Dr.	30,000	
To Business purchase account			20,80,000
(Being assets taken over)			
Liquidator of the Exe Ltd. account	Dr.	20,80,000	
To 10% Preference share capital account			5,10,000
To Equity share capital account			15,70,000
(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)			

Question 6

Attempt any four of the following:

(a) A major fire has damaged assets in a factory of X Co. Ltd. on 8.4.2004, 8 days after the year end closing of accounts. The loss is estimated to be Rs. 16 crores (after estimating the recoverable amount of Rs. 24 crores from the Insurance Company).

If the company had no insurance cover, the loss due to fire would be Rs. 40 crores.

Explain, how the loss should be treated in the Final accounts of the year ended 31.3.2004.

(b) A Company had deferred research and development cost of Rs. 150 lakhs. Sales expected in the subsequent years are as under:

Years	*Sales (Rs. in lakhs)*
I	*400*
II	*300*
III	*200*
IV	*100*

You are asked to suggest how should Research and Development cost be charged to

Profit and Loss account.

If at the end of the III year, it is felt that no further benefit will accrue in the IV year, how the unamortised expenditure would be dealt with in the accounts of the Company?

(c) *In April, 2004 a Limited Company issued 1,20,000 equity shares of Rs. 100 each. Rs. 50 per share was called up on that date which was paid by all shareholders. The remaining Rs. 50 was called up on 1.9.2004. All shareholders paid the sum in September, 2004, except one shareholder having 24,000 shares. The net profit for the year ended 31.3.2005 is Rs. 2,64,000 after dividend on preference shares and dividend distribution tax of Rs. 64,000.*

Compute basic EPS for the year ended 31.3.2005 as per Accounting Standard 20.

(d) (i) *Mr. Raj a relative of key Management personnel received remuneration of Rs. 2,50,000 for his services in the company for the period from 1.4.2004 to 30.6.2004. On 1.7.2004 he left the service.*

Should the relative be identified as at the closing date i.e. on 31.3.2005 for the purposes of AS 18?

(ii) *X Ltd. sold goods to its associate Company for the 1st quarter ending 30.6.2004. After that, the related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year has to be disclosed as related party transaction.*

(e) *What are the main principles of allocation between Capital and Revenue accounts on a Capital scheme?*

(f) *On 1.4.2001 ABC Ltd. received Government grant of Rs. 300 lakhs for acquisition of a machinery costing Rs. 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 2004 due to non-fulfillment of certain conditions.*

How you would deal with the refund of grant in the books of ABC Ltd.?

(4 × 4 = 16 marks)

Answer

(a) The present event does not relate to conditions existing at the balance sheet date. Hence, no specific adjustment is required in the financial statements for the year ending on 31.3.2004. But if the event occurring after balance sheet date gives an indication that the enterprise may cease to be a going concern, then the assets and liabilities are required to be adjusted for the financial year ended 31st March, 2004. AS 4 (Revised) requires disclosure in respect of events occurring after the balance sheet date representing unusual changes affecting the existence or substratum of the enterprise after the date of the Balance Sheet. In the present event, the loss of assets in a factory can be considered to be an event affecting the substratum of the enterprise. Hence, an appropriate disclosure should be made in the report of the approving authority.

(b) (i) Based on sales, research and development cost to be allocated as follows:

Year	*Research and Development cost allocation (Rs. in lakhs)*
I	$\frac{400}{1,000} \times 150 = 60$
II	$\frac{300}{1,000} \times 150 = 45$
III	$\frac{200}{1,000} \times 150 = 30$
IV	$\frac{100}{1,000} \times 150 = 15$

(ii) If at the end of the III year, the circumstances do not justify that further benefit will accrue in IV year, then the company has to charge the unamortised amount i.e. remaining Rs. 45 lakhs [150 – (60 + 45)] as an expense immediately.

Note: As per para 41 of AS 26 on Intangible Assets, expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. It has been assumed in the above solution that the entire cost of Rs. 150 lakhs is development cost. Therefore, the expenditure has been deferred to the subsequent years on the basis of presumption that the company can demonstrate all the conditions specified in para 44 of AS 26. An intangible asset should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Hence the remaining unamortised amount of Rs. 45,00,000 has been written off as an expense at the end of third year.

(c) Basic earnings per share (EPS) = $\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$

$= \frac{\text{Rs. } 2,64,000}{88,000 \text{ shares (as calculated in working note)}} = \text{Rs. } 3$

Working Note:

Calculation of weighted average number of equity shares

	Number of shares	*Nominal value of shares*	*Amount paid*
1st April, 2004	1,20,000	100	50
1st September, 2004	96,000	100	100
	24,000	100	50

As per para 19 of AS 20 on Earnings per share, Partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period. Assuming that the partly

paid shares are entitled to participate in the dividends to the extent of amount paid, weighted average number of shares will be calculated as:

		Shares
$1,20,000 \times \frac{1}{2} \times \frac{5}{12}$	=	25,000
$96,000 \times \frac{7}{12}$	=	56,000
$24,000 \times \frac{1}{2} \times \frac{7}{12}$	=	7,000
		88,000 shares

(d) (i) According to para 10 of AS 18 on Related Party Disclosures, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence, Mr. Raj, a relative of key management personnel should be identified as relative as at the closing date i.e. on 31.3.2005.

(ii) As per para 23 of AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.2004 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.

(e) The following are the main principles governing the allocation of expenditure on a capital scheme between capital and revenue accounts:

(i) Capital account should bear all charges for the first construction and equipment of a project as well as charges for intermediate maintenance of the work while not yet opened for service. It would also bear charges for such further additions and improvements as may be sanctioned under rules made by competent authority.

(ii) Subject to (iii) below, revenue account should bear all subsequent changes for maintenance and all working expenses. These embrace all expenditure on the working and upkeep of the project and also on such renewals and replacements and such additions, improvements or extensions as prescribed by Government.

(iii) In the case of works of renewal and replacement which partake both of a capital and revenue nature, the allocation of expenditure should be regulated by the broad principle that revenue should pay or provide a fund for the adequate replacement of all wastage or depreciation of property originally provided out of capital grants and that only the cost of genuine improvements, whether determined by prescribed rules or formulae or under special orders of Government, should be debited to capital account. Where under special orders of Government, a Depreciation or Renewals Reserve Fund is established for renewing assets of any commercial department or undertaking, the distribution of expenditure on renewals, and replacements between

capital account and the fund should be so regulated as to guard against over-capitalisation on the one hand and excessive withdrawals from the fund on the other.

(iv) Expenditure on account of reparation of damage caused by extraordinary calamities such as flood, fire, earthquake, enemy action, should be charged to capital account or to revenue account or divided between them in such a way as may be determined by Government according to the circumstance of each case.

(v) Capital receipts in so far as they relate to expenditure previously debited to capital heads, accruing during the process of construction of a project, should be utilised in reduction of capital expenditure. Thereafter, their treatment in the accounts will depend on circumstances, but except under a special rule or order of Government, they should not be credited to the revenue account of the department or undertaking.

(f) According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. The accounting treatment in both the alternatives can be given as follows:

Alternative 1:

		Rs. (in lakhs)
1st April, 2001	Acquisition cost of machinery (Rs. 1,500 – 300)	1,200.00
31st March, 2002	*Less*: Depreciation @ 20%	240.00
	Book value	960.00
31st March, 2003	*Less*: Depreciation @ 20%	192.00
	Book value	768.00
31st March, 2004	*Less*: Depreciation @ 20%	153.60
1st April, 2004	Book value	614.40
May, 2004	*Add*: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting Rs. 914.40 lakhs is to be provided prospectively over the residual useful life of the asset i.e. years ended 31st March, 2005 and 31st March, 2006.

Alternative 2:

ABC Ltd. can also debit the refund amount of Rs. 300 lakhs in capital reserve of the company.

Suggested Answers : PE-II Examination : May, 2005

PAPER – 2 : AUDITING

Answer Questions Nos. 1 and 2 and any four questions from the rest.

Question 1

As an auditor, comment on the following situations/statements:

(a) Z Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2004:

	Amount Rs. in lacs
Securities Premium Account	*80*
Capital Reserve	*60*
General Reserve	*90*

The company had an accumulated loss of Rs. 40 lacs on the same date, which it has disclosed under the head "Profit and Loss Account" on the assets side of the Balance Sheet. (4 marks)

(b) A Ltd. has its Registered Office at New Delhi. During the current accounting year, it has shifted its Corporate Head Office to Indore though it has retained the Registered Office at New Delhi. The Managing Director of the Company wants to shift its books of account to Indore from New Delhi, as he feels that there is no legal bar in doing so. (4 marks)

(c) The Board of Directors of a company have filed a complaint with the Institute of Chartered Accountants of India against their statutory auditors for their failing to attend the Annual General Meeting of the Shareholders in which audited accounts were considered. (5 marks)

(d) The auditor of a company wanted to see the minutes book of Directors meetings. The Chairman of the company refused for the same on the ground that matters of confidential nature were contained therein. (5 marks)

Answer

(a) Debit Balance of Profit and Loss Account: Part I of Schedule VI to the Companies Act, 1956 requires that the debit balance of Profit and Loss Account shall be shown as deduction from the uncommitted reserves, if any. Hence, the accumulated loss of Rs.40 lakhs should be deducted from the General Reserve of Rs.90 lakhs, and the net amount of Rs.50 lakhs should be shown as General Reserve on the Liabilities side of the Balance Sheet. Securities Premium Account and Capital Reserves are not uncommitted reserves and, thus, these shall also be shown on the liabilities side of the balance sheet under the heading of "Reserves and Surplus". In the present case, the disclosure requirements of

Schedule VI to the Act have not been followed and, accordingly, the auditor should modify his report.

(b) Place of Books of Account: Section 209 of the Companies Act, 1956 states that every company shall keep at its registered office proper books of account with respect to all sums of money received and spent, all sales and purchases of goods, all assets and liabilities of the company, and the required cost records.

However, all or any of such books of account aforesaid may be kept at any other place in India as the Board of Directors may decide, and if so, the company shall within seven days of the decision file with the Registrar a notice in Form 23 AA in writing giving the full address of that other place.

Therefore, for shifting the books from Delhi to Indore, the Board's Resolution has to be passed, and notice is to be given to the Registrar of Companies within the specified time. The auditor may, accordingly, inform the Managing Director that his contention is not in accordance with the legal provisions.

(c) Auditor's Attendance at Annual General Meeting: Section 231 of the Companies Act, 1956 confers right on the auditor to attend the general meeting. The said section provides that all notices and other communications relating to any general meeting of a company which any member of the company is entitled to have are also to be forwarded to the auditor. Further, it has been provided that the auditor shall be entitled to attend any general meeting and to be heard at any general meeting which he attends on any part of the business which concerns him as an auditor. Therefore, the section does not cast any duty on the auditor to attend the annual general meeting. The law only confers right on the auditor to receive notices and also attend the meeting if he so desires. Therefore, the complaint filed by the Board of Directors is based on mis-conception of the law.

(d) Right of Access to Board's Minutes: Under section 227(1) of the Companies Act, 1956, the auditor of a company has the right of access at all times to books and accounts and vouchers of the company whether kept at the head office of the company or elsewhere. Further, he is also entitled to require from the officers of the company such information and explanations which he considers necessary for the proper performance of his duties. Therefore, he has a statutory right to inspect the directors' minutes book. The refusal by Chairman to provide access to Directors' Minutes Book shall constitute limitation of scope as far as the auditor's duties are concerned. The auditor may examine whether by performing alternative procedures, the auditor can substantiate the assertions or else he shall have to either qualify the report or give a disclaimer of opinion.

Question 2

(a) Give your comments on the following:

(i) The Central Government has appointed Mr. Sushil, a retired Finance Director of a reputed company, a non-practising member of ICAI, as a special auditor of MM Ltd., on the ground that the company was not being managed on sound business

principles. Mr. Ajay, MD of MM Ltd. feels, that the appointment of Mr. Sushil is not valid as he does not hold a certificate of practice. (5 marks)

(ii) CC Ltd., a Pharmaceutical Company, while valuing its finished stock at the year end wants to include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses. (5 marks)

(b) What categories of Companies are specifically exempted from the application of Companies (Auditor's Report) Order, 2003? (8 marks)

Answer

(a) (i) Appointment of Special Auditor: Section 233A of the Companies Act, 1956, under the circumstances as specified in the section, empowers the Central Government that it may issue directions to the effect that a special audit of the company's accounts for the specified period shall be conducted. Amongst others, one of the circumstances specified is in case a company is not being managed in accordance with some business principles or prudent commercial practices. Further the said section also provides that for the purpose, it may appoint a chartered accountant, whether or not the chartered accountant is in practice, or the company's auditor itself to conduct such special audit. Therefore, the appointment of Mr. Sushil, a non-practising member of Institute of Chartered Accountants of India is within the provisions of law and, accordingly, the contention of Mr. Ajay M.D. is not correct.

(ii) Cost of Inventories: As per Accounting Standard 2 "Valuation of Inventories", cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. However, it makes clear that interest and other borrowing costs are usually not included in the cost of inventories because generally such costs are not related in bringing the inventories to their present location and condition. Therefore, the proposal of CC Ltd. to include interest on bank overdraft as an element of cost is not acceptable because it does not form part of cost of production.

(b) Application of CARO, 2003: The Companies (Auditor's Report) Order, 2003 is applicable to all types of companies but it provides that it shall not apply to:

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;

(ii) an insurance company as defined in clause (21) of section 2 of the Companies Act, 1956;

(iii) a company licensed to operate under section 25 of the Companies Act, 1956; and

(iv) a private limited company with a paid-up capital and reserves of not more than rupees fifty lakhs and has not accepted any public deposit and does not have outstanding loan exceeding rupees ten lakhs or more from any bank or financial

institution and does not have a turnover exceeding rupees five crores. Thus, a private limited company, in order to be exempted from the applicability of the Order, must satisfy all the conditions cumulatively.

(Note: Students may note that CARO, 2003, has been amended by Companies (Auditor's Report) (Amendment) Order, 2004 effective in respect of audit reports signed on or after November 25, 2004. This question has been answered on the basis of original CARO, 2003 only.)

Question 3

(a) With reference to Government Audit, what do you understand by "Audit of Commercial Accounts"? (8 marks)

(b) What do you understand by:

(i) Auditing around the computer (4 marks)

(ii) Auditing through the computer (4 marks)

Answer

(a) Audit of Commercial Accounts: The government also engages in commercial activities and for the purpose it may incorporate following types of entities:

(i) Departmental enterprises engaged in commercial and trading operations, which are governed by the same regulations as other Government departments such as defence factories, mints, etc.

(ii) Statutory corporations created by specific statues such as LIC, Air India, etc.

(iii) Government companies, set up under the Companies Act, 1956.

All aforesaid entities are required to maintain accounts on commercial basis. The audit of departmental entities is done in the same manner as any Government department, where commercial accounts are kept. Audit of statutory corporations depends on the nature of the statute governing the corporation. In respect of government companies, the relevant provisions of Companies Act, 1956 are applicable. As per section 619 of the Companies Act, 1956 the statutory auditor of a Government company shall be appointed or re-appointed by the CAG. Such an auditor must be a chartered accountant. Further, the Companies Act, 1956, provides that the CAG shall have the powers:

(i) to direct the manner in which the company's accounts shall be audited by the auditor, and to give the auditor instructions in regard to any matter relating to the performance of his functions; and

(ii) to conduct a supplementary or test audit of the company's accounts by such person, as he may authorise in this behalf, and for the purposes of such audit to require information or additional information to be furnished to any person or persons, so authorised on such matters by such person or persons, and in such form as the CAG may direct.

The statutory auditor shall submit a copy of his audit report to the CAG, who shall have the right to comment upon or supplement the audit report in such manner he may think fit.

Any such comments upon or supplement to the audit report shall be placed before the company, at the same time, and in the same manner, as the audit report. Thus, it is seen that there is a two layer audit of a Government company, by the statutory auditors, being qualified chartered accountants, and by the CAG. The general standards, principles, techniques and procedures for audit adopted by the C&AG are a mixture of government audit and commercial audit as known and practiced by professional auditors. The concepts of autonomy and accountability of the institution / bodies / corporations / companies have influenced the nature and scope of audit in applying the conventional audit from the angle of economy, efficiency and effectiveness.

(b) (i) Audit Around the Computer: Audit around the computer involves forming of an audit opinion wherein the existence of computer is not taken into account. Rather the principle of conventional audit like examination of internal controls and substantive testing is done. The auditor views the computer as a black box, as the application system processing is not examined directly. The main advantage of auditing around the computer is its simplicity. Audit around the computer is applicable in the following situations:

(i) The system is simple and uses generalised software that is well tested and widely used.

(ii) Processing mainly consists of sorting the input data and updating the master file in sequence.

(iii) Audit trail is clear. Detailed reports are prepared at key processing points within the system.

(iv) Control over input transactions can be maintained through normal methods, i.e. separation of duties, and management supervision.

Generalised software packages, like payroll and provident fund package, accounts receivable and payable package, etc. are available, developed by software vendors. Though the auditor may decide not to go in details of the processing aspects, if there are well tested widely used packages provided by a reputed vendor. However, he has to ensure that there are adequate controls to prevent unauthorised modifications of the package. However, it may be noted that all such generalised packages do not make the system amenable to audit. Some software packages provide generalised functions, that still must be selected and combined to achieve the required application system. In such a case, instead of simply examining the systems input and output, the auditor must check the system in depth to satisfy himself about such system. The main disadvantages of the system of auditing around the computer are:

(a) It is not beneficial for complex systems of large scale in very large multi unit, multi locational companies, having various inter unit transactions. It can be

used only in case of small organisations having simple operations.

(b) It is difficult for the auditor to assess the degradation in the system in case of change in environment, and whether the system can cope with a changed environment.

(ii) Auditing Through the Computer: This approach involves actual use of computer for processing the information by auditor. The circumstances, where auditing through the computer is done are as follows:

(i) The organisation has developed either in house or through a reputed vendor, a software package suitable to its requirement, because of inability of a generalised package to cater to the complex nature of transactions.

(ii) The system processes very large volumes of output. This makes examination of validity of input and output difficult.

(iii) The major part of the internal control system in the organisation is in the computer system itself, as the majority of the records is processed through the computer. Examples are system in bank, insurance companies, online booking in case of Railway, etc.

(iv) The logic of the system is quite complex, and there is virtually no visible audit trail. The auditor has to use the computer to test the logic and controls existing within the system.

The auditor has to use the computer system itself for verification, for which he has to be sufficiently computer literate, and should have adequate technical knowledge and expertise. The auditor can through the computer, increase his performance, and can rely on the data processing by carrying out the required tests and applying his skill.

Question 4

(a) Explain the term "Auditor's Lien". *(8 marks)*

(b) Discuss the concept of "True and Fair". *(8 marks)*

Answer

(a) Auditor's Lien: Under the general principles of law, if any person has lawful possession of the property of another person, on which he has worked, he may retain such property for non payment of any amount outstanding in respect of work done on the property. Accordingly, the auditor may exercise lien on the client's documents in his possession for non payment of fees for work done for the client. As per AAS 3, "Documentation", the working papers are the property of the auditor. The auditor at his discretion may make extracts from his working papers available to his clients. The auditor should also 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 and legal or professional requirement of record retention. However,

regarding books of account of a company, it may be noted that as per section 209 of the Companies Act, 1956, these must be kept at the registered office of the company. However, all or any of the books of account may be kept at any other place in India pursuant to a Board's Resolution, and notice must be filed with the Registrar. Thus, as per such a resolution, if the Board of a company hands over the books of account to the auditor, the auditor may exercise his lien for non payment of fees. However, reasonable facilities must be provided for inspection of the books of account by the directors, members and other authorised persons. The auditor needs to observe provisions of the Companies Act, 1956. Further, in respect of auditor exercising the lien, the views of the Institute of Chartered Accountants of England and Wales are worth noting:

(i) Documents must belong to the client who owes the money, and these documents must come to the possession of the auditor on the client's authority.

(ii) The auditor can retain such documents, only if he has done work on such documents, on which fees have not been paid.

(b) Concept of "True and Fair": The concept of "true and fair" is a fundamental concept in auditing. The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit. This requires that the auditor should examine the accounts with a view to verifying that all assets and liabilities, incomes and expenses are stated at the amounts which are in accordance with accounting principles and policies, and no material item has been omitted. What constitutes "true and fair" has not been defined in the legislation. However, section 211(1) and (2) of the Companies Act, 1956 states that every balance sheet of a company shall give a true and fair view of the state of affairs of the company at the end of the financial year and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.

However, section 211(5) of the Companies Act, 1956 states that the balance sheet and profit and loss account of a company shall not be treated as not disclosing a true and fair view of the state of affairs of the company if they do not disclose any matters which are not required to be disclosed by virtue of the provisions of Schedule VI to the Companies Act, 1956, or by virtue of any notification or any order. Therefore the auditor must see that the accounts are drawn up as per requirements of the provisions of Schedule VI, and whether they contain all matters required to be disclosed therein. In case of companies governed by special Acts, say, banking, electricity, etc. the auditor should see, whether the relevant disclosure requirements are complied with. Thus, what constitutes a true and fair view is a matter of the auditor's judgement in the particular circumstances of the case. In specific terms to ensure truth and fairness, an auditor has to see:

(i) that the assets are neither undervalued or overvalued;

(ii) no material asset is omitted;

(iii) the charge on assets, if any, is disclosed;

(iv) material liabilities should not be omitted, and liabilities are neither undervalued or overvalued;

(v) accounting policies have been followed consistently;

(vi) all unusual, exceptional, non recurring items have been disclosed separately;

(vii) accounts have been drawn as per requirement of Schedule VI to the Companies Act; and

(viii) the accounts have been drawn in compliance to the relevant accounting standards. In case of deviation from accounting standards, disclosure should be made of the reasons for such deviation and financial effects, if any arising due to such deviation.

Question 5

How will you vouch/verify the following:

(a) Advertisement expenses *(4 marks)*

(b) Goodwill *(4 marks)*

(c) Capital work-in-progress *(4 marks)*

(d) Wages paid to seasonal labourer *(4 marks)*

Answer

(a) Advertisement Expenses: The following steps may be taken by the auditor to vouch/verify the different items:

(i) Ascertaining the value of advertisement expenses to ensure that the said expense has been properly allocated.

(ii) Examining that such expenses relate to the client's business.

(iii) Review and examination of the complete list of media of advertisement indicating the dates, location, timing, etc., along with the amounts paid in respect of each category.

(iv) Examination of the receipts for amounts paid.

(v) Reviewing the contracts with the different agencies and ensuring that the billing conforms to the term and conditions specified therein.

(vi) Ensuring that all such outstanding expenses have been properly accounted for.

(b) Goodwill: Goodwill arises from business connections, trade name or reputation of an enterprise. AS 26, "Intangible Assets", states that internally generated goodwill is not to be recognised as an asset, as it is not an identifiable resource controlled by the enterprise, that can be measured reliably at cost. As per AS 10, "Accounting for Fixed Assets", goodwill should be recorded in the books, only when some consideration in money or money's worth has been paid for it. In light of the above discussions, the following points are to be noted for verification of goodwill:

(i) Examine the vendors' agreement on the basis of which assets of the running business have been acquired by the company as per the books of account or a specific amount has been paid for the goodwill.

(ii) Ensure that whenever business is acquired at a price, payable in cash or otherwise , which is in excess of the value of net assets taken over, such excess amount is the goodwill.

(iii) Ensure that only the amount paid to the vendors not represented by tangible or intangible assets, the value of which can be measured reliably has been debited to goodwill account.

(iv) See that goodwill has not been shown in the company's books by writing up the value of its assets, on revaluation, or by writing back the amount of goodwill earlier written off.

(v) Ensure that the goodwill not yet written off has been properly disclosed under the head "Fixed Assets" as per Schedule VI requirements.

(vi) See that the goodwill is being amortised as per financial prudence over a reasonable period.

(c) Capital Work-in-Progress: Capital Work-in-Progress denotes assets under installation. This could either be plant or machinery under construction, or that construction project for establishment of a new factory is under progress. The auditor should take the following steps to verify the same.

(i) Ensure that the capital project is authorised by the Board. See the relevant Board Minutes for the purpose.

(ii) Obtain the break up in details of the amount shown in the Balance Sheet under this head.

(iii) Check purchase cost of plant machinery or other assets with reference to the contract with, and amount paid to the suppliers.

(iv) Examine the allocation of common costs to the Capital Work-in-Progress in case such items have been constructed internally.

(v) Ensure that the assets already put to commercial use are not included under Capital Work-in-Progress.

(vi) Verify that only expenses incurred up to pre commissioning stage are capitalised under this head.

(vii) Obtain the certificate of the engineering department to ascertain the quantum of the Capital Work-in-Progress, and whether the value is correctly represented in the Balance Sheet, and its transfer to Fixed Assets on completion of the project or installation of the plant.

(viii) See that Capital Work-in-Progress is properly disclosed in the Balance Sheet under the head Fixed Assets.

(d) Wages Paid to Seasonal Labourers:

(i) Ascertain and evaluate the internal control system for recruitment and usage of seasonal labourers.

(ii) Examine that these labourers are hired on proper authority and the rates of pay are authorized at appropriate levels.

(iii) Ensure that the attendance is properly checked by the Time Keeping Department.

(iv) Check that the certificate regarding work done by the labourers has been given by the proper person, in case the labourers have been appointed on a per piece basis.

(v) Check the computation of wages payable to the labourers, after taking into account the deductions.

(vi) Confirm that all the payment to the labourers have been acknowledged.

(vii) See the time and job records, to ensure that the labourers have been paid for time worked. See the treatment of abnormal idle time.

(viii) Reconcile the number of seasonal labourers on payroll as per the Personnel Department's records vis-à-vis the number of labourers to whom the wages have been paid, to ensure that there are no ghost workers. This assumes greater importance, if the seasonal labourers are hired on temporary basis, and not on permanent payroll.

Question 6

(a) What special steps will you take into consideration in auditing the accounts of a hotel. *(10 marks)*

(b) Medical Council of India organised a three-day International Conference of Doctors in Delhi. You are asked to audit the accounts of the conference. Draft the audit programme for audit of receipt of participation fees from delegates to the conference. Mention any six points, peculiar to the situation, which you will like to include in your audit programme. *(6 marks)*

Answer

(a) The business of running a hotel is very much dissimilar to running an industrial unit for manufacturing of products. It is a service-oriented industry. The business is characterized by handling of large amounts of liquid cash, stock of foods providing a variety of services, and keeping watch on customers to ensure that they do not leave hotel without settling the dues. In view of these, the following matters require special attention by the auditor.

(i) *Internal Control* - Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage. The following points should be checked:

(a) Effectiveness of arrangement regarding receipts and disbursements of cash.

(b) Procedure for purchase and stocking of various commodities and provisions.

(c) Procedure regarding billing of the customers in respect of room service, telephone, laundry, etc.

(d) System regarding recording and physical custody of edibles, wines, cigarettes, crockery and cutlery, linen, furniture, carpets, etc.

(e) Ensure that are trading accounts are prepared preferably weekly, for each sales point. A scrutiny of the percentage of profit should be made, and any deviation from the norms is to be investigated.

(ii) *Room Sales and Cash Collections:*

(a) There are various sales points scattered in a hotel and sales are both for cash and credit. The control over cash is very important. The charge for room sales is made from the guest register, and tests are to be carried out to ensure that the correct number of guests are charged for the exact period of stay. Any difference between the rate charged to the guests and standard room rent is to be investigated to see that it is properly authorized.

(b) The total sales reported with the total bills issued at each sales point have to be reconciled.

(c) Special care must be taken in respect of bills issued to customers who are staying in the hotel, because they may not be required to pay the bills immediately in cash but at a future date or by credit cards. Billing is to be done room-wise. It must be ensured that all customers pay their bills on leaving the hotel or within specified dates.

(iii) *Stock:* The stock in a hotel are all saleable item like food and beverages. Therefore, following may be noted in this regard:

(a) All movement and transfer of stocks must be properly documented.

(b) Areas where stocks are kept must be kept locked and the key retained by the departmental manager.

(c) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.

(d) Many hotels use specialized professional valuers to count and value the stocks on a continuous basis throughout the year.

(e) The auditor should ensure that all stocks are valued at the year end and that he should himself be present at the year end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories

(iv) *Fixed Assets:* The fixed assets should be properly depreciated, and the Fixed Assets Register should be updated.

(v) *Casual Labour*: In case the hotel employs a casual labour, the auditor should consider, whether adequate records have been maintained in this respect and there

is no manipulation taking place. The wages payment of the casual labour must also be checked thoroughly.

(vi) The compliance with all statutory provisions, and compliance with the Foreign Exchange Regulations must also be verified by the auditor, especially because hotels offer facility of conversion of foreign exchange to rupees.

(vii) Other special aspects are to be verified as under:

(a) Consumption shown in various physical stock accounts must be traced to the customers' bills to ensure that all issues to the customers have been billed.

(b) All payments to the foreign collaborator, it any, are to be checked.

(c) Expenses and receipts are to be compared with figures of the previous year, having regard to the average occupancy of visitors and changes in rates.

(d) Special receipts on account of letting out of auditorium, banquet hall, spaces for shops, boutiques, and special shows should be verified with the arrangements made.

(e) In depth check should be carried out on the customers' ledgers to verify that all charges have been properly made and recovered.

(f) The occupancy rate should be worked out, and compared with other similar hotels, and with previous year. Material deviations should be investigated.

(g) Expenses for painting, decoration, renovation of building, etc. are to be properly checked.

(h) It is common that hotels get their bookings done through travel agents. The auditor should ensure that the money is recovered from the travel agents as per credit terms allowed. Commission paid to travel agents should be checked by reference to the agreement on that behalf.

(i) Apart from control over stock of edibles, control over issue and physical stock of linen crockery, cutlery, glassware, silver, toilet items, etc. should be verified.

(j) The auditor should verify the restaurant bills with reference to KOT (Kitchen order Ticket).

(k) The auditor should ensure that all taxes have been included in the client's bills.

(l) Computation and payment of salaries and wages vis-a-vis number of employees must be checked.

(b) Audit of Receipts of Participation Fees:

The organization of three-day International Conference of Doctors in Delhi by Medical Council of India is a one-time event. Normally, in view of mega-size of the event, a special cell is made in the organization to handle the entire event. Since few people would be handling the event, the internal controls may not be that strong and, thus, more emphasis is required to be given on substantive procedure. Audit of receipt of participation fees should be under the following areas:

(I) *Internal Control System:*

(i) Examine the organization structure of special cell created for the International Conference, if any, and division of responsibilities amongst persons and control/custody over receipt books.

(ii) Verify the internal control system for restricting the participation of unregistered delegates.

(II) *Rate of Participation Fees:*

(i) Verify with reference to resolution passed by the Organizing Committee/Medical Council of India.

(ii) Also verify the rate from the literature/registration form circulated for promotion of conference.

(III) *Receipts of Participation Fees:*

(i) Verify counter foil of the receipts issued for individual registration.

(ii) Ensure that receipts are issued for all the registration received in cash.

(iii) Trace the receipts in Bank Statement or Cash Book – as the case may be.

(iv) Verify Bank Reconciliation Statement and list out dishonoured cheques.

(v) Verify subsequent recovery in respect of dishonoured cheques.

(IV) *Overall Checking:*

(i) Verify the total receipts of participation fees shown in the financial statements with reference to total number of receipts issued to participants.

(ii) Cross check the total number of delegates with reference to the following:

(a) Kits distributed to participants.

(b) Bill of caterer for providing meals during conference.

(c) Capacity of the Hall.

(d) Participation Certificate if any issued.

(V) *Foreign Delegates:* In case of foreign delegates – if registration fees is higher – ensure that they are registered at higher fees.

(VI) *Special Issues:*

(i) Take out list of absentees and in case of nil absentees, probe the issue further.

(ii) If certain participants are exempted from payment of fees – obtain the list along with proper authorization in this regard.

Question 7

(a) Explain with reference to the relevant Auditing and Assurance Standards:

(i) Inherent Risk *(5 marks)*

(ii) Appropriateness of going concern assumption (5 marks)

(b) State the matters to be considered for acquiring knowledge of the business of the client by the auditor. (6 marks)

Answer

(a) (i) Inherent Risk: As per AAS 6 "Risk Assessments and Internal Control", inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

While developing the overall audit plan, the auditor should assess inherent risk at the level of financial statements. In developing the audit programme, the auditor should relate such assessment to material account balances and classes of transactions to the classes of transaction at the level of assertions made in the financial statements. The auditor may assume the risk to be high, taking into account the various factors. If he assesses the inherent risk not to be high, he must document the reasons for such assessment.

In order to assess inherent risk, the auditor has to use his professional judgment, having regard to his experience of previous audit engagements of the entity, controls established by the management, and any significant changes that might have taken place since his last assessment. Possibilities of inherent risk are due to the following factors:

At the level of Financial Statements:

(i) Integrity of Management

(ii) Experience and knowledge of management, and changes in management during the period.

(iii) Unusual pressure on management

(iv) The nature of the entity's business

(v) Economic and competitive factors affecting the industry, changes in technology, consumer demand, etc.

At the level of Account Balances and class of transactions:

(i) Quality of accounting system, i.e., financial statements susceptibility to misstatements.

(ii) Complexity of transactions requiring the work of an expert.

(iii) The degree of judgment involved in determining account balances.

(iv) Susceptibility of assets to loss or misappropriation.

(v) Transactions not subject to ordinary processing.

(ii) Appropriateness of Going Concern Assumption:

As per AAS 16 "Going Concern" when planning and performing audit procedures and in evaluating results thereof, the auditor should consider the appropriateness of going concern assumption underlying the preparation of financial statements.

Though an auditor's report helps to establish the credibility of financial statements, it is not a guarantee as to the future viability of the entity. An entity's continuance as a going concern for the near future, generally around one year after the balance sheet date is assumed in the preparation of financial statement in the absence of any information to the contrary. However, the auditor should consider the risk that the going concern assumption may no longer be appropriate. Examples of indications of risks that the continuance as a going concern may be questionable are:

Financial Indications:

(a) Negative net worth or negative working capital.

(b) Substantial operating losses, and negative cash flows from operations.

(c) Adverse key financial ratios.

(d) Excess short-term borrowings to finance long-term assets.

(e) Arrears of dividend.

(f) Increase of creditors, and inability to pay them on due dates.

(g) Inability to repay the long-term loans on maturity.

(h) Entering into a scheme of arrangement with creditors for reduction of liability.

Operating Indications

(i) Loss of key management personnel without replacement.

(ii) Shortage of important supplies.

(iii) Loss of major market.

(iv) Industrial unrest.

Other Indications:

(i) Non compliance with statutory requirements.

(ii) Sickness of entity under any statutory definition.

(iii) Changes in laws or any government policy, adversely affecting the working of the entity.

(iv) Pending legal proceedings against the entity, which will adversely affect the entity.

(b) Acquiring knowledge of the business of the client: As per AAS 20 "Knowledge of business", the auditor should have or obtain sufficient knowledge of business to enable the auditor to identify and understand the events transactions and practices, that, in the auditor's judgment may have a significant effect on the financial statements or on the examination of the statements. Such knowledge is used by the auditor in assessing the

audit risks and in determining the nature, timing, and extent of audit procedures. Important matters to be considered in gaining knowledge of business are:

(i) Government policies affecting the entity, tariffs and trade restrictions, fiscal, monetary, taxation, financial incentives.

(ii) Interest rate and availability of finance.

(iii) Market, competition, cyclical or seasonal activity.

(iv) Changes in product technology.

(v) Key ratios and operation statistics both of the organization and the entity for last several years.

(vi) Structure, management and ownership of the entity.

(vii) Capital Structure, organizational structure.

(viii) Management objectives, and strategic plans.

(ix) Board of directors.

(x) Business restructuring - acquisition, mergers, etc.

(xi) Key operating personnel - experience and reputation, turnover, etc.

(xii) Management Information System.

(xiii) Product Range - marketing arrangements -location of production and marketing centers.

(xiv) Effectiveness of internal control and Internal Audit.

(xv) Sources of Funds, and their costs.

(xvi) Research and Development.

(xvii) Past audit reports/qualifications

Question 8

(a) Surprise Check

(b) Independence of Internal Auditor

(c) Cost Audit

(d) Capital Redemption Reserve *(4 × 4 = 16 marks)*

Answer

(a) Surprise Check: Surprise checks are a part of normal audit, and the results of such checks are therefore important to the auditor in deciding the scope of his audit and submission of his report. An element of surprise can significantly improve the audit effectiveness. Wherever practical, an element of surprise should be incorporated in the audit programme. The element of surprise in an audit may be both in regard to the time

of audit, that is selection of date, when the auditor will visit the client's office for audit, and selection of the areas of audit. Surprise checks are mainly intended to ascertain whether the internal control system is working effectively, and whether all accounting and other records are kept up to date and as per the statutory regulations. Such checks and surprise visit can exercise good moral checks on the client's staff. Surprise checks also determines whether errors, or frauds exist, and if they exist, bring the matter promptly to the attention of the management so that corrective action can be taken at the earliest. Surprise checks are very effective in case of organizations having weak internal control system, very large, diversified and well spread out organizations, etc. Frequency and extent of surprise checks would depend on the extent to which the auditor feels necessary, depending upon system of internal control complications of transactions, importance of items like cash, investments, stock, etc. The results of surprise checks should be communicated to the management if internal control weakness, fraud, or error is found. The auditor should satisfy himself that adequate action is taken by the management on the matters communicated by him.

(b) Independence of Internal Auditor: The concept of independence is equally relevant for internal auditor also. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. Internal auditor is part of the management but he evaluates the functioning of the management at different levels. Therefore, to be efficient and effective, the internal auditor must have adequate independence. It may be noted that by its very nature, the internal audit function cannot be expected to have the same degree of independence as is essential when the external auditor expresses his opinion on the financial information. To ensure his independence he is made responsible directly to the Board of Directors through audit committee. Such a channel of communication provides an independent mode whereby an internal auditor can communicate and share his views on the scope of internal audit, findings, etc. If internal auditor is made subordinate to lower level, his independence will be effected which will affect his functioning and effectiveness. An outsider, like a firm of chartered accountants, if acting as internal auditor, is likely to be more independent than an employee of the organization.

(c) Cost Audit: Cost Audit is covered by section 233B of the companies Act, 1956. The Central Government may by order direct that audit of cost accounts of a company shall be conducted in the manner, as may be specified in the order by a cost accountant. The cost auditor shall be appointed by the Board of Directors of the company with the previous approval of the Central Government before the appointment of the cost auditor by the Board, a written certificate shall be obtained by the Board from the auditor proposed to be appointed to the effect that if the appointment is made, it will be as per section 224 (lB). Cost audit shall be in addition to an audit under section 224. A cost auditor shall have the some powers and duties as that of a statutory auditor, The cost auditor shall make his report to the Central Government in the prescribed form and within the prescribed time. A copy of the report shall be forwarded to the company. The company shall within 30 days from the date of receipt of a copy of the report furnish the Central Government with full information and explanations on every reservations and

qualifications contained in such report. The Central Government has issued Cost Audit (Report) Rules specifying the form of the report and additional information to be included therein in the form of annexure. The auditor must further report on the adequacy of cost accounting records mentioned by the company under section 209(1)(d) of the Act to confirm that they give a true and fair view of the cost of production, processing, manufacturing, or mining activities as the case may be.

(d) Capital Redemption Reserve: As per section 80 of the Companies Act, 1956 where preference shares are redeemed otherwise than out of a fresh issue, these shall be out of profits, otherwise available for dividends, be transferred to a reserve fund called Capital Redemption Reserve Account, an amount equal to the nominal value of the shares redeemed. The provisions of the Companies Act, 1956, relating to the reduction of share capital of a company shall apply as if the Capital Redemption Reserve account were paid up share capital of the company. The Capital Redemption Reserve Account may be applied by the company in paying up in issued share of the company to be issued to members of the company as fully paid up bonus shares. Capital Redemption Reserve should be disclosed under the head "Reserves & Surplus" on the Liabilities side of the Balance Sheet as per Part-I of Schedule VI to the Companies Act, 1956.

PAPER – 3 BUSINESS AND CORPORATE LAWS

Question Nos. 1, and 7 are compulsory

*Candidates are required to attempt **three** questions out of Question Nos. 2,3,4,5 and 6 and **two** questions out of Question Nos. 8,9 and 10.*

Question 1

*Answer any **six** of the following:*

(a) Father promised to pay his son a sum of Rs. One lakh if the son passed C.A. examination in the first attempt. The son passed the examination in the first attempt, but father failed to pay the amount as promised. Son files a suit for recovery of the amount. State along with reasons whether son can recover the amount under the Indian Contract Act, 1872.

(b) A hire a carriage of B and agrees to pay Rs.500 as hire charges. The carriage is unsafe, though B is unaware of it. A is injured and claims compensation for injuries suffered by him. B refuses to pay. Discuss the liability of B.

(c) Define an "Establishment in public sector". What are the circumstances when the Payment of Bonus Act, 1965 becomes applicable to such an establishment?

(d) Describe the procedure of registration of firm under the Indian Partnership Act. What is the rule of evidence with regard to entries in the Register of firms?

(e) A cheque payable to bearer is crossed generally and marked "not negotiable". The cheque is lost or stolen and comes into possession of B who takes it in good faith and gives value for it. B deposits the cheque into his own bank and his banker presents it and obtains payment for his customer from the bank upon which it is drawn. The true owner of the cheque claims refund of the amount of the cheque from B.

(f) Discuss the liability of the banker collecting the cheque and the banker paying the cheque and B to the true owner of the cheque referring to the provisions of the Negotiable Instruments Act, 1881.

(g) State the emoluments paid to employees, which do not come within the purview of "basic wages" under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

(g) State the provisions relating to the conduct of audit applicable to a society registered under the Cooperative Societies Act, 1912?

(h) State the restrictions on borrowings on a multi-state cooperative society under the Multi-state Cooperative Societies Act. (6 x 4 = 24 marks)

Answer

(a) Problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 10. According to the provisions there should be an intention to create legal relationship between the parties. Agreements of a social nature

or domestic nature do not contemplate legal relationship and as such are not contracts, which can be enforced. This principle has been laid down in the case of Balfour vs. Balfour (1912 2 KB. 571). Accordingly, applying the above provisions and the case decision, in this case son cannot recover the amount of Rs.1 lakh from father for the reasons explained above.

(b) Problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The section provides that if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed. Accordingly, applying the above provisions in the given case B is responsible to compensate A for the injuries sustained even if he was not aware of the defect in the carriage.

(c) Section 2(16) of the Payment of Bonus Act, 1965 defines 'establishment in public sector' to mean an establishment owned, controlled or managed by:

(a) a Government company as defined in Section 617 of the Companies Act, 1956;

(b) a Corporation in which not less than 40% of its capital is held (whether singly or taken together) by -

(i) the Government; or

(ii) the Reserve Bank of India; or

(iii) a Corporation owned by the Government or the Reserve Bank of India.

The provisions of the Payment of Bonus Act, 1965 do not ordinarily apply to an establishment in public sector. However, if the following two conditions are satisfied by such establishment in any accounting year, the provisions of the Act shall apply to such establishment as they apply to an establishment in the private sector:

(i) If in any accounting year, an establishment in the public sector sells goods produced or manufactured by it or renders any services, in competition with an establishment in private sector; and

(ii) the income from such sale or services is not less than 20% of the gross income of the establishment in public sector in that year. (Section 20)

(d) The Indian Partnership Act, 1932 provides that registration of firms may be effected at any time by filing an application in the form of a statement, giving the necessary information, with the Registrar of Firms of the area. Section 57 of the Act empowers the State Government to appoint Registrar of Firms for the purposes of the Partnership Act and defines the areas within which they shall exercise their powers and perform their duties.

Application for registration of a firm shall be accompanied by the prescribed fee. It shall state:

(a) the name of the firm;

(b) place or principal place of business of the firm;

(c) names of other places where the firm carries on business;

(d) date when each partner joined the firm;

(e) names in full and permanent addresses of the partners;

(f) duration of the firm.

The application shall be signed by all the partners or by their agents specially authorized in this behalf. It shall also be certified by them in the prescribed manner.

When the Registrar is satisfied that the above provisions have been complied, he shall record an entry in the Registrar of Firms and issue a certification of registration. Registration takes effect from the date on which the Registrar makes entries in the Register of Firms.

Any statement, notice or intimation recorded with the Registrar by any person shall be a conclusive proof against him of any fact therein stated. The third parties can, however, challenge the fact of statement and prove that it is false and is based on mis-representation or fraud (Section 68).

(e) The cheque in the given case was crossed generally and marked 'Not Negotiable'. Thereafter, the cheque was lost or stolen and came into the possession of B, who takes it in good faith and gives value for it. Section 130 of the Negotiable Instruments Act, 1881 provides that a person taking a cheque crossed generally or specially, bearing in either case the words 'not negotiable', shall not have, and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had. In view of these provisions, B, even though he was a holder in due course, did not acquire any title to the cheque as against its true owner. The addition of the words 'not negotiable' entirely takes away the main feature of negotiability, which is, that a holder with a defective title can give a good title to a subsequent holder in due course. B did not obtain any better title than his immediate transferor, who had either stolen or found the cheque and was not the true owner of the cheque. Therefore, as regards the true owner, B was in no better position than the transferor. B is also liable to repay the amount of the cheque to the true owner. He can, however, proceed against the person from whom he took the cheque.

In the given case, both the collecting banker and the paying bankers would be exonerated. Since the collecting banker, in good faith and without negligence, had received payment for B, who was its customer of the cheque which was crossed generally, the banker would not be liable, in case the title proved to be defective, to the true owner by reason only of having received the payment of the cheque for his customer (Section 131). Since the paying banker on whom the crossed cheque was drawn, had paid the same in due course, the banker would also not be liable to the true owner. (Section 128).

(f) According to Section 2(b) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 'Basic wages' means all emoluments which are earned by an employee while on duty or on leave in accordance with the terms of contract of

employment which are paid or payable in cash to him but does not include:

(i) Cash value of any food concession.

(ii) Any dearness allowance i.e., Payments paid to an employee on account of rise in cost of living, house rent allowance, bonus, commission or over some allowance and

(iii) Any presents made by the employer.

(g) According to Section 17 of the Co-operative Societies Act, 1912, it is obligatory for the Registrar to audit or cause to be audited by some persons authorized by him by a general or special order in writing the accounts of every registered society at least once in every year. The audit as contemplated by the said section includes an examination of over-due debts, if any, and a valuation of the assets and liabilities of the society. Audit also means such an examination of the books, accounts and vouchers of a business as shall enable the auditor to satisfy himself whether or not the balance sheet is properly drawn up so as to exhibit a true and correct view of the state of affairs of the business according to the best of his information and the explanations given to him. The Registrar or any person authorized by a general or special order in writing in this behalf by the Registrar will have access to all the books, accounts, papers and securities of a society. Every officer of the society should furnish such information in regard to the transactions and working of the society as the person making such inspection may require.

(h) Restriction on borrowing:

(a) A Multi-state Co-operative Society under the Multi-State Co-operative Societies Act, 2002 may receive deposits, raise loans and receive grants from external sources to such extent as may be specified in the bye-laws. This is however, subject to the condition that the total amount of deposits and loans received during any financial year shall not exceed 10 times of the sum of subscribed share capital and accumulative reserves. While calculating the total sum subscribed capital and accumulated reserves, the accumulated losses shall be deducted.

(b) A multi-state Co-operative Society may accept funds or borrow funds for the fulfillment of its objects on such terms and conditions as are mutually contracted upon

(c) A multi-state Co-operative Society may issue non-convertible debentures or other instruments subject to the provisions of any laws in force to raise resources for the fulfillment of its objects to the extent of 25% of its paid up share capital.

(d) However, transactions of such a society with any non-member shall be subject to prohibitions and restrictions as may be specified in bye-laws of the society. (Section 68)

Question 2

(a) M Ltd., contracts with Shanti Traders to make and deliver certain machinery to them by 30.6.2004 for Rs. 11.50 lakhs. Due to labour strike, M Ltd. could not manufacture and

deliver the machinery to Shanti Traders. Later, Shanti Traders procured the machinery from another manufacturer for Rs.12.75 lakhs. Shanti Traders was also prevented from performing a contract which it had made with Zenith Traders at the time of their contract with M Ltd. and were compelled to pay compensation for breach of contract. Advise Shanti Traders the amount of compensation which it can claim from M Ltd., referring to the legal provisions of the Indian Contract Act. *(6 marks)*

(b) When can an unpaid seller of goods exercise his right of lien over the goods under the Sale of Goods Act. Can he exercise his right of lien even if the property in goods has passed to the buyer? When such a right is terminated? Can he exercise his right even after he has obtained a decree for the price of goods from the court? *(6 marks)*

Answer

(a) Section 73 of the Indian Contract Act, 1872 provides for consequences of breach of contract. According to it, when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract, to be likely to result from the breach of it. Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach. It is further provided in the explanation to the section that in estimating the loss or damage from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

Applying the above principle of law to the given case, M Ltd is obliged to compensate for the loss of Rs.1.25 lakhs (i.e. Rs.12.75 minus Rs.11.50 = Rs. 1.25 lakhs) which had naturally arisen due to default in performing the contract by the specified date.

Regarding the amount of compensation which Shanti Traders were compelled to make to Zenith Traders, it depends upon the fact whether M Ltd knew about the contract of Shanti Traders for supply of the contracted machinery to Zenith Traders on the specified date. If so, M Ltd is also obliged to reimburse the compensation which Shanti Traders had to pay to Zenith Traders for breach of contract. Otherwise M Ltd is not liable.

(b) A lien is a right to retain possession of goods until the payment of the price. It is available to the unpaid seller of the goods who is in possession of them where-

(i) the goods have been sold without any stipulation as to credit;

(ii) the goods have been sold on credit, but the term of credit has expired;

(iii) the buyer becomes insolvent.

The unpaid seller can exercise 'his right of lien even if the property in goods has passed on to the buyer. He can exercise his right even if he is in possession of the goods as agent or bailee for the buyer.

Termination of lien: An unpaid seller losses his right of lien thereon-

(i) When he delivers the goods to a carrier or other bailee for the purpose of

transmission to the buyer without reserving the right of disposal of the goods;

(ii) When the buyer or his agent lawfully obtains possession of the goods;

(iii) By waiver thereof.

Exercising the Right of Lien after obtaining a decree:

The unpaid seller of goods having a lien thereon, does not lose his lien by reasons only that he has obtained a decree for the price of the goods.

Question 3

(a) State the circumstances when an agent is personally liable for the contracts entered into by him on behalf of his principal. (6 marks)

(b) Ram & Co., a firm consists of three partners A, B and C having one third share each in the firm. According to A and B, the activities of C are not in the interest of the partnership and thus want to expel C from the firm. Advise A and B whether they can do so quoting the relevant provisions of the Indian Partnership Act. (6 marks)

Answer

(a) An agent is personally liable for the contracts entered into by him on behalf of his principal in the following cases/circumstances:

(i) When an contract expressly provides;

(ii) When an agent acts for a foreign principal.

(iii) When an agent acts for an undisclosed principal.

(iv) Where an agent acts for a principal who cannot be sued.

(v) Where the agent signs the contract in his own name without disclosing that he is acting only as an agent.

(vi) Where an agent acts for a principal not in existence.

(vii) Where an agent acts without any authority from the alleged principal or exceeds his authority.

(viii) Where a trade usage or custom makes him personally liable.

(ix) Where the agency is coupled with interest i.e., when an agent has an interest in the subject matter of the contract entered into by him.

(x) Where he receives or pays money by mistake or fraud.

(b) Normally it is not possible for the majority of partners to expel a partner from the firm without satisfying the conditions as laid down in Section 33 of the Indian Partnership Act, 1932. The essential conditions before expulsion can be done are:

(i) power of expulsion should exist in the partnership deed (contract between the partners.

(ii) power has been exercised by the majority of the partners in good faith.

The test of good faith includes:

(a) that the expulsion must be in the interest of the partnership;

(b) that the partner to be expelled is served with a notice; and

(c) that the partner has been given an opportunity of being heard.

Thus, in the given case A and B the majority partners can expel the partner only if the above conditions are satisfied and procedure as stated above has been followed.

Further the invalid expulsion of a partner does not put an end to the partnership and it will be deemed to continue as before.

Question 4

(a) "……there is no implied warranty or condition as to quality or fitness for any particular purpose of goods supplied under a contract of sale…."Discuss the significance and State exceptions, if any. *(6 marks)*

(b) State the powers of the Central Government to authorize certain employers to maintain provident fund accounts under the Employees Provident Funds and Miscellaneous Provisions Act, 1952. *(6 marks)*

Answer

(a) The statement given in the question is the fundamental principle of law of sale of goods, sometime expressed by the maximum 'Caveat Emptor' meaning thereby 'Let the buyer be aware'. In other words, it is no part of the seller's duty in a contract of sale of goods to give the buyer an article suitable for a particular purpose, or of particular quality, unless the quality or fitness is made an express terms of the contract. The person who buys goods must keep his eyes open, his mind active and should be cautious while buying the goods. If he makes a bad choice, he must suffer the consequences of lack of skill and judgement in the absence of any misrepresentation or guarantee by the seller.

There are, however, certain exceptions to the rule which are stated as under:

(i) Where the buyer expressly or by implication, makes known to the seller the particular purpose for which he needs the goods and depends on the skill and judgement of the seller whose business is to supply goods of that description, there is an implied condition that the goods shall be reasonably fit for that purpose;

(ii) If the buyer purchasing an article for a particular use is suffering from an abnormality and it is made known to the seller at the time of sale, implied condition of fitness will apply.

(iii) If the buyer purchases an article under its patent or other trade name and relies on sellers skills and judgement which he makes known to him, the implied condition that are articles are fit for a particular purpose shall apply.

(iv) If the goods can be used for a number of purposes the buyer must tell the seller the particular purpose for which he required the goods otherwise implied condition of fitness of goods for a particular purpose will not apply.

(v) Where the goods are bought by description from a seller who deals in goods of that description whether he is the manufacturer or producer or not, there is an implied condition that the goods are of merchantable quality.

(vi) An implied condition as to quality or fitness for a particular purpose may be annexed by the usage of trade or custom;

In a sale by sample there is an implied condition that

(a) The bulk shall correspond with the sample in quality;

(b) The buyer shall have reasonable opportunity of comparing the bulk with the sample; and

(c) The goods shall be free from any defect, rendering them unmerchantable;

(viii) In the case of eatables and provisions in addition to the implied condition of merchantability, there is an implied condition that the goods shall be wholesome.

(b) Powers of the Central Government to authorize certain employers to maintain Provident Fund Accounts under the Employees' Provident Funds and Misc. Provisions Act, 1952 (Section 16A):

Under Section 16A of the Employees Provident Fund and Miscellaneous Provisions Act, 1952, the Central Government may, on an application made to it in this behalf by the employer and majority of employees in relation to an establishment employing 100 or more persons, authorize the employer, by an order in writing, to maintain a provident fund account in relation to the establishment subject to such terms and conditions as may be specified in the scheme.

The Central Government shall, however, not make such authorization if the employer of such establishment had committed any default in the payment of provident fund contribution or had committed any other offence under the Act during the three years immediately preceding the date of such authorization.

When an establishment is authorized to maintain a provident fund account, the employer in relation to such establishment shall maintain such account, submit such return, deposit the contribution in such manner, provide for such facilities for inspection, pay such administrative charges and abide by such other terms and conditions, as may be specified in the scheme.

Any authorization so made by the Central Government may be cancelled by an order in writing if the employer fails to comply with any of the terms and conditions of the authorization or where he commits an offence under any of the provisions of the Act. Before canceling the authorization, the Central Government shall give the employer a reasonable opportunity of being heard.

Question 5

(a) *'A' draws a cheque for Rs.50,000. When the cheque ought to be presented to the drawee bank, the drawer has sufficient funds to make payment of the cheque. The bank fails before the cheque is presented. The payee demands payment from the drawer.*

What is the liability of the drawer. *(6 marks)*

(b) Explain the rules of set on and set off of allocable surplus under the Payment of Bonus Act. *(6 marks)*

Answer

(a) Section 84 of the Negotiable Instruments Act, 1881 provides that where a cheque is not presented for payment within a reasonable time of its issue and the drawer or person on whose account it is drawn had the right at the time when presentation ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged from the liability, that is to say, to the extent to which such drawer or person is a creditor of the banker to a larger amount than would have been if such cheque had been paid. In determining what is a reasonable time, regard shall be had to the nature of the instrument, the usage of trade and of banker, and the facts of the particular case.

Applying the above provisions to the given problem since the payee has not presented the cheque to the drawer's bank within a reasonable time when the drawer had funds to pay the cheque, and the drawer has suffered actual damage, the drawer is discharged from the liability.

(b) Where for any accounting year, the allocable surplus exceed the amount of maximum bonus payable to the employees in the establishment under Section 11 of the Payment of Bonus Act, 1965, the excess shall, subject to the limit of 20% of the total salary or wage of the employees employed in the establishment in that accounting year, be carried forward for being set on in the succeeding accounting year and so on up to and inclusive of the 4th accounting year. This excess is to be utilized for the purpose of payment of bonus as illustrated in the 4th Schedule.

There may be a case where there is no allocable surplus or where the allocable surplus falls short of the amount of minimum bonus payable to the employee under section 10 and there is no amount or sufficient amount carried forward and set on under the aforesaid provisions which could be utilized for paying minimum bonus. In such a situation minimum amount or the deficiency as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on up to and inclusive of the 4th accounting year in the manner illustrated in the 4th Schedule.

Where in any accounting year any amount has been carried forward and set on and set off under Section 15, in calculating bonus for the succeeding accounting year, the amount of set on and set off carried from the earliest accounting year shall first be taken into account. [Section 15(4)].

Question 6

(a) State the cases in which a banker is justified or bound to dishonour cheques. *(6 marks)*

(b) PQR Cooperative Society Ltd., a Multi-state Cooperative Society desires to change its bye-laws in respect of the following matters:

(i) To increase the number of members of the board from existing 18 to 24.

(ii) To increase the tenure of the directors from the present limit of 4 years to 6 years.

(iii) To reduce the frequency of the board meetings from existing figure of 6 to 4 meetings in a year.

After completion of the required formalities, the society has made an application to the central registrar for registration of the amendments.

Examine the powers of the registrar to register the amendments in the light of the provisions of the Multi-state Cooperative Societies Act. (6 marks)

Answer

(a) In the following cases in which a banker is bound or justified to dishonour cheques:

(i) A banker is justified to dishonour a cheque in reference to payment of a post-dated cheque presented for payment before its ostensible date;

(ii) The banker is bound to pay a cheque only when it has 'sufficient funds of the drawer in his hands' otherwise not.

(iii) The banker is bound to honour his customer's cheque only when the funds of the customers in his hands are 'properly applicable to the payment of such cheques' otherwise not.

(iv) A banker is justified in refusing to honour a cheque which is irregular, or ambiguous, or drawn in a form of doubtful legality;

(v) A banker is justified in refusing payment of a cheque drawn by a customer having credit with one branch of the bank, where the cheque is drawn upon another branch in which he has no account or in which his account is overdrawn.

(vi) When the customer becomes insolvent, or an order of adjudication has been made against him, all his assets vest in the official assignee, and the banker should thereafter refuse to pay his customer's cheques.

(vii) The duty and authority of a banker to pay a cheque drawn on him by his customer is determined by the customer countermanding payment;

(viii) Notice of death of the customer determines the authority of the banker to dishonour a cheque, but if the banker pays a cheque before he receives notice of his customer's death, payment is valid.

(ix) If garnishee or other legal order from a court attaching or otherwise dealing with money in the hands of the banker, is served on the banker.

(x) If it contains material alterations, irregular signature or irregular endorsement.

(xi) If it is stale, that is if it has not been presented within reasonable period.

(b) According to Section 10 of the Multi-State Co-operative Societies Act, 2002 every society can make its own bye-laws which are consistent which the provisions of the Act and not contrary to the provisions of the Act. Accordingly,

(i) The increase in the number of members of the board from the existing strength of 18 to 24 is not permissible because the maximum limit prescribed under the Act is 21.

(ii) The tenure of the directors from the present limit of 4 to 6 years is not permissible because there is a ceiling of 5 years tenure for the directors and other office bearers including the chairperson of the society.

(iii) There are no restriction on the frequency of the board meetings yet the society can reduce the board meetings from 6 to 4.

Thus, the Central Registrar will not approve in the bye-laws in respect of (i) and (ii) items referred to above. Where the Central Registrar registers the amendment, he shall forward a copy of the registered amendments together with a certificate, within a period of one month from the date of registration thereof which shall be conclusive evidence of such amendment(s).

Question 7

Answer any four of the following:

(a) The management of Ambitious Properties Ltd., has decided to take up the business of food processing activity because of the downward trend in real estate business. There is no provision in the object clauses of the Memorandum of Association to enable the company to carry on such business. State with reasons whether its object clause can be amended. State briefly the procedure to be adopted for change in the object clause.

(b) Several small depositors of Overtrading Company Ltd., have made complaints about non-refund of the deposits after due date. Explain briefly (1) the meaning of small depositor and (2) the duty of the company after the default has taken place in the matter of repayment of the deposits.

(c) Explain briefly the meaning of sweat equity shares and the steps that a company has to take for issue of such shares.

(d) A company is required to pay dividend to its shareholders within 30 days of its declaration. State the circumstances when a company will not be deemed to have committed any offence even if it does not pay within 30 days.

(e) The Articles of Association of a private limited company contain provisions restricting the right to transfer shares and limiting the number of members to fifty. What restrictions are generally incorporated in the articles in restricting the right to transfer shares?

(5 x 4 = 20 marks)

Answer

(a) Section 17(1) of the Companies Act, 1956 permits a company to alter its objects for the under mentioned purposes:

(1) to carry on business more economically;

(2) to attain the main purpose of the company by new and improved means;

(3) to carry on some business which the existing circumstances may conveniently or advantageously the combined with be existing business;

(4) to change and enlarge the local area of operations;

(5) to restrict or abandon any of the existing objects;

(6) to sell or dispose of the whole or any part of the undertaking;

(7) to amalgamate with any other company or body of persons.

The case of the company is covered under point No. 3 above and therefore the company can amend its object clause to take up the business of Food Processing activity.

PROCEDURE

The company should amend the object clause by passing a special resolution in a general meeting.

File with the Registrar of companies, a copy of the special resolution within one month from the date of passing of such resolution together with a printed copy of the memorandum as altered and the Registrar shall register the same and certify the registration under his hand written one month from the date of filing of such documents. The certificate is a conclusive evidence that all the requirements with respect to the alteration have been complied with and the memorandum so altered shall be the Memorandum of Association of the company.

(b) Meaning of Small Depositor: According to Section 58AA of the Companies Act, 1956, a small depositor means a depositor who has deposited in a financial year a sum not exceeding Rs. 20,000/- in a company and includes his successors, nominees and legal representatives.

Duty of company in case of default in repayment of deposits: Every company accepting deposits from small depositors should intimate the Company Law Board/Tribunal within 60 days of the date of default the name and address of each small depositor to whom it had defaulted in repayment of deposit or interest thereon. Thereafter, the company should also give intimation to the Company Law Board/ Tribunal on a monthly basis.

(c) Meaning of Sweat Equity Shares: According to Section 79A of the Companies Act, 1956, Sweat Equity Shares means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions by whatever name called.

Steps for issue of Sweat Equity Shares: The company has to take the following steps for issue of sweat equity shares:

(i) A special resolution is to be passed authorising the issue of sweat equity shares.

(ii) The special resolution should specify the number of shares, current market price, consideration, if any, and the class or classes of directors or employees.

(iii) At least one year should have elapsed since the date on which the company was entitled to commence business.

(iv) In the case of a listed company, the sweat equity shares can be issued in accordance with the regulations made by SEBI in this behalf. In the case of unlisted company, the shares are to be issued in accordance with the guidelines as may be prescribed. (Unlisted companies issue of sweat equity share Rules, 2003).

(d) Section 207 of the Companies Act, 1956 provides for the following cases when failure to pay dividend within 30 days of its declaration is not deemed to be an offence:

(i) Where dividend could not be paid due to operation of any law;

(ii) Where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with;

(iii) Where there is a dispute regarding the right to receive dividend;

(iv) Where the dividend has been lawfully adjusted by the company against any sum due to it (company) from the shareholder; or

(v) Where for any reason, the failure to pay the dividend or to post the dividend warrant within the period of 30 days from the date of declaration was not due to any default on the part of the company.

(e) The right of transfer of shares and limiting the number of members to 50 is generally restricted in the following manner:

(i) By authorising the directors to refuse transfer of shares to persons whom they do not approve or by compelling the shareholder to offer his shareholding to the existing shareholders first. It may be noted that it can only restrict the right of sale to a member. On this consideration, the articles usually provide that before selling or transferring his share by the shareholder, the directors must be communicated in writing of such intention of the shareholder.

(ii) By specifying the method for calculating the price at which the shares may be sold by one member to another. Generally, it is left to be determined either by the auditor of the company or by the company at a general meeting.

(iii) By providing that the shareholders who are employees of the company shall offer the shares to specified persons or class of persons when they leave the company's service or from other sources in case of under-subscribed issues, within 60 days from the date of closure of the issue, the company shall refund forthwith the subscription amount in full without interest and with interest @15% p.a. if not paid within 10 days after expiry of the said 60 days.

Question 8

(a) State briefly the provisions relating to minimum subscription and consequence of non-receipt of minimum subscription as per the Companies Act, 1956 and the provisions as per SEBI guidelines. (5 marks)

(b) Write a note on the powers of the Central Government in regard to conversion of debentures and loans into shares of the company under the following heads:

(i) When terms of issue of such debenture or terms of loan do not include term providing for an option of conversion;

(ii) Matters considered in determining the terms and conditions of such conversion.

(iii) Remedy available to the company if conversion or terms of conversion is not acceptable to it. (5 marks)

Answer

(a) In terms of Section 69(1) of the Companies Act, 1956 every prospectus for shares must contain an indication as to the minimum amount which in the opinion of the Board of directors must be raised. The amount so stated in the prospectus which shall be reckoned exclusively of any amount otherwise than in money is referred to as the 'minimum subscription'. The amount payable on application of each share shall not be less than 5% of the nominal amount of the shares.

If the applications are not received by the company for such quantum of shares for making minimum subscription within 120 days of the issue of prospectus, all moneys received from the applicants for shares shall be repaid without interest. If such money is not repaid within 130 days after the issue of prospectus, money will be repaid with interest @6% p.a. after the expiry of 130 days.

POSITION AS PER SEBI GUIDELINES: As per SEBI guidelines, the minimum subscription in respect of public and rights issue shall be 90% of the issue amount. The requirement of 90% minimum subscription shall not be mandatory in case of offer for sale of securities. In case of non-receipt by the company of 90% of the issued amount from public subscription plus accepted development from underwriters or from other sources in case of under-subscribed issues, within 60 days from the date of closure of the issue, the company shall refund forthwith the subscription amount in full without interest and with interest @15% p.a. if not paid within 10 days after expiry of the said 60 days.

(b) (i) Under Section 81 of the Companies Act, 1956 where any debentures have been issued to or loans have been obtained from the Government by a company, whether such debentures have been issued or loans have obtained before or after the commencement of Companies Amendment Act, 1963 (w.e.f. 1.1.1964), the Central Government may, if in its opinion it is necessary in the public interest so to do, by order direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to that Government to be reasonable in the circumstances of the case, even if the terms of issue of such debentures or the terms of such loans do not include term providing for an option for such conversion.

(ii) In determining the terms and conditions of such conversion, the Central Government shall have due regard to the following circumstances:

(i) The financial position of the company;

(ii) The terms of issue of the debentures or the terms of the loans, as the case may be;

(iii) The rate of interest payable on the debentures or the loans;

(iv) The capital of the company, its loan liability, its reserves, its profits during the preceding five years; and

(v) The current market price of the shares in the company.

A copy of every order proposed to be issued by the Central Government shall be laid in draft before each House of Parliament.

The above powers of the Central Government are exercised notwithstanding anything contained in sub-sections (1), (2) and (3) of Section 81 of the Companies Act, 1956.

(iii) Remedies open to the company

If the terms and conditions of such conversion are not acceptable to the company, the company may, within 30 days from the date of communication of such order or within such further time as may be granted by the Court, prefer an appeal to the court in regard to such terms and conditions and the decision of the Court on such appeal and, subject only to such decision, the order of the Central Government shall be final and conclusive.

Question 9

(a) State the procedure for passing a resolution by Postal Ballot. *(5 marks)*

(b) State what is meant by "Quorum" and when does quorum be considered immaterial under the provisions of the Companies Act, 1956. *(5 marks)*

Answer

(a) A listed public company and in case of resolutions relating to such business as the Central Government may, by notification, declare to be conducted only by postal ballot, shall get any resolution passed by means of a postal ballot, instead of transacting the business in general meeting of the company. The procedure laid down in Section 192A is as under:

(i) Where a company decides to pass any resolution by resorting to postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefore and requesting them to send their assent within a period of 30 days from the date of posting of the letter;

(ii) The notice shall be sent by registered post acknowledgement due or by any other method as may be prescribed by the Central Government in this behalf, and shall be annexed with the notice a postage pre-paid envelope for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period;

(iii) The board of directors shall appoint one scrutinizer, who is not in employment of the

company, may be a retired judge or any person of repute, who, in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner;

(iv) The scrutinizer will be in position for 35 days (excluding holidays) from the date of issue of notice for annual general meeting. He is required to submit his final report on or before the said period.

(v) If a resolution is assented to by a requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been passed at a general meeting convened in that behalf.

For this purpose the scrutinizer willing to be appointed is available at the registered office of the company for ascertaining the requisite majority.

(vi) If a shareholder sends his assent or dissent in writing on a postal ballot and thereafter any person fraudulently defences or destroys the ballot paper or declaration of the identity of shareholder, such person shall be punishable with imprisonment for a term which may extend to six months or with fine or both;

(vii) The scrutinizer shall maintain a register to record the consent received, including electronic media, mentioning the particulars of name, address, folio number, number of shares, nominal value of shares, whether the shares have voting, differential voting or non-rights and the scrutinizer shall also maintain record for postal ballot which are received in defaced or mutilated form. The postal ballot and all other papers relating to postal ballot will be under the safe custody of the scrutinizer till the Chairman considers, approves and signs the minutes of the meeting. Thereafter, the scrutinizer shall return the ballot papers and other related papers/register to the company so as to preserve such ballot papers and other related papers/registers safely till the resolution is given effect to.

(viii) As per the Explanation, 'Postal Ballot' includes voting by electronic mode.

(b) Quorum means the minimum number of members that must be present in order to constitute a meeting and transact business thereat. Thus quorum represents the number of members on whose presence the meeting of a company can commence its deliberations. Under the articles provide for a larger number, 5 members personally present in the case of a public company (other than a public company which became public by virtue of Section 43A, now deleted) and 2 members in case of a private company constitute the quorum for a general meeting as given in Section 174 of the Companies Act, 1956. The words 'personally present' excludes proxies. However, the representative of a body corporate appointed under Section 187 or the representative of the President or Governor of a State appointed under Section 187A is a member personally present for the purpose of counting quorum.

If all the members are present, it is immaterial that the quorum required is more than the total number of members. If for example, the articles of a private company provide that 4 members personally present shall be a quorum and the number of members is reduced to 3, the question of quorum will not arise when all the 3 members attend the meeting.

Question 10

(a) State the provisions of the Companies Act regarding calling and holding an extraordinary general meeting with respect to:

(i) Number of members entitled to requisition a meeting.

(ii) Power of the tribunal to order meeting to be called under Section 186. (5 marks)

(b) The minutes of the meeting must contain fair and correct summary of the proceedings thereat. Can the Chairman direct exclusion of any matter from the minutes? Some of the shareholders insist on inclusion of certain matters which are regarded as defamatory of a Director of the company. The Chairman declines to do so. State how the matter can be resolved. (5 marks)

Answer

(a) (i) Number of members entitled to requisition an extraordinary general meeting:

(a) in the case of a company having a share capital, such number of members who hold at the date of requisition, not less than 1/10th of such of the paid up capital of the company as at that date carries the right of voting in regard to that matter;

(b) in the case of a company not having a share capital, such number of members who have at the date of deposit of requisition not less than 1/10th of the total voting power of all the members having at the said date a right to vote in regard to that matter.

(ii) Power of Tribunal to order meeting to be called under Section 186:

If for any reason it is impractical to call a meeting, other than an annual general meeting, in any manner in which meetings of the company may be called, or hold or conduct the meeting of the company in the manner prescribed by the Act or the articles, the Tribunal may, either on its own motion or on the requisition of:

(a) any director of the company or (b) of any member of the company who would be entitled to vote at the meeting:

(a) Order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and

(b) Give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying, or supplementing in relation to the calling holding and conducting of the meeting, the operations of the provisions of the Companies Act, 1956 and of the company's articles. The Tribunal may give direction that one member present in person or by proxy shall be deemed to constitute a meeting with such order shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.

(b) Under Section 193(5) of the Companies Act, 1956 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 proceedings, or

(iii) is detrimental to the interests of the company,

the Chairman shall exercise an absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified above.

Since the Chairman has absolute discretion on the inclusion or exclusion of any matter in the minutes, the insistence of the shareholders will be of no avail.

PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

Questions Nos. 1 and 6 are compulsory.

*Attempt **three** questions out of the remaining Question Nos. 2,3,4 and 5 and attempt **two** questions from the remaining Question Nos. 7,8,and 9.*

Working notes should form part of the answer.

Question 1

(a) Discuss the essential requisites for the installation of uniform costing system. *(3 marks)*

(b) Discuss the treatment of spoilage and defectives in cost accounting *(3 marks)*

(c) A B C D Co. Ltd. produces and sells four products A, B, C and D. These products are similar and usually produced in production runs of 10 units and sold in a batch of 5 units. The production details of these products are as follows:

Product	*A*	*B*	*C*	*D*
Production (Units)	*100*	*110*	*120*	*150*
Cost per unit:				
Direct material (Rs.)	*30*	*40*	*35*	*45*
Direct labour (Rs.)	*25*	*30*	*30*	*40*
Machine hour (per unit)	*5*	*4*	*3*	*4*

The production overheads during the period are as follows:

	Rs.	
Factory works expenses	*22,500*	
Stores receiving costs	*8,100*	
Machine set up costs	*12,200*	
Cost relating to quality control	*4,600*	
Material handling and dispatch	*9,600*	*Rs. 57,000*

The cost drivers for these overheads are detailed below:

Cost	*Cost drivers*
Factory works expenses	*Machine hours*
Stores receiving costs	*Requisitions raised*
Machine set up costs	*No. of production runs*
Cost relating to quality control	*No. of production runs*
Material handling and dispatch	*No. of orders executed*

The number of requisitions raised on the stores was 25 for each product and number of orders executed was 96, each order was in a batch of 05 units.

Required:

(i) Total cost of each product assuming the absorption of overhead on machine hour basis;

(ii) Total cost of each product assuming the absorption of overhead by using activity base costing; and

(iii) Show the differences between (i) and (ii) and comment. (4+4+4=12 marks)

Answer

(a) The Essential requisites for the installation of a Uniform Costing System are:

(i) The firms in the industry should be willing to share / furnish relevant data / information.

(ii) A spirit of cooperation and mutual trust should prevail among the participating firms.

(iii) Mutual exchange of ideas, methods used, special achievements made, research and know-how etc. should be frequent.

(iv) Bigger firms should take the lead towards sharing their experience and know-how with the smaller firms to enable the latter to improve their performance.

(v) Uniformity must be established with regard to several points before the introduction of uniform costing in an industry. Uniformity should be with regard to the following points:

- Size of various units covered by uniform costing.
- Production methods.
- Accounting methods, principles and procedures used.

(b) Normal spoilage (which is inherent in the operation) costs are included in costs either by charging the loss due to spoilage to the production order or charging it to production overhead so that it is spread over all the products. Any value realized from the sale of spoilage is credited to production order or production overhead accounts, as the case may be. The cost of abnormal spoilage is charged to Costing P/L A/C. When spoiled work is the result of rigid specification, the cost of spoiled work is absorbed by good production while the cost of disposal is charged to production overhead.

Defectives that are considered inherent in the process and are identified as normal can be recovered by using the following method.

- Charged to goods products
- Charged to general overheads
- Charged to departmental overheads

If defectives are abnormal, they are charged to Costing Profit and Loss Account.

(c) (i) Statement showing total cost of each product assuming absorption of overheads on Machine Hour Rate Basis.

Particulars	A	B	C	D	Total
Output (units)	100	110	120	150	480
Direct material (Rs.)	30	40	35	45	150
Direct Labour (Rs.)	25	30	30	40	125
Direct labour- Machine hrs	5	4	3	4	
Overhead @ Rs 30/- per Machine hr	150	120	90	120	480
Total cost per unit (Rs.)	205	190	155	205	755
Total cost (Rs.)	20,500	20,900	18,600	30,750	90,750

$$\text{Overhead Rate} = \frac{\text{Total Overhead Cost}}{\text{Total MHrs.}} = \frac{\text{Rs. } 57{,}000}{1{,}900} = \text{Rs. } 30 \text{ per unit}$$

(ii)

TotalOverheads	Rs		
Factory works expenses	22,500	Factory exp per unit	22,500 / 1,900 = Rs. 11.84
Stores receiving cost	8,100	Stores receiving cost	8100 / 100 = Rs. 81
Machine set up costs	12,200	Machine set-up cost	12,200 / 48 = Rs. 254.1
Costs relating to quality control	4,600	Cost relating to QC	4,600/48 =Rs 95.83
Expense relating to material handling & dispatch	9,600	Material handling & dispatch	9,600 / 96 = Rs. 100/-
Total	57,000/-		

Statement showing total cost of each product assuming activity based costing.

Particulars	*A*	*B*	*C*	*D*	*Total*
Output (Units)	100	110	120	150	480
No. of production runs	10	11	12	15	48
No. of stores requisition	25	25	25	25	100
No. of sales orders	20	22	24	30	96
Unit costs - Direct material (Rs.)	30.00	40.00	35.00	45.00	
Unit costs - Direct labour (Rs.)	25.00	30.00	30.00	40.00	
Unit costs - Factory works expenses (Rs.)	59.20	47.36	35.52	47.36	

Unit costs - Stores receiving cost (Rs.)	20.25	18.41	16.88	13.50
Unit costs - Machine set-up cost (Rs.)	25.42	25.42	25.42	25.42
Unit costs – QC (Rs.)	9.58	9.58	9.58	9.58
Unit costs – Material Handling (Rs.)	20.00	20.00	20.00	20.00
Unit cost (Rs.)	189.45	190.77	172.40	200.86
Total cost (Rs)	18,945	20,984.7	20,688.00	30,129

(iii) Statement showing differences (in Rs)

Particulars	*A*	*B*	*C*	*D*
Unit cost MHR	205	190	155	205
Unit cost ABC	189.45	190.77	172.40	200.86
Unit cost - difference	15.55	-0.77	-17.40	4.14
Total cost MHR	20,500	20,900	18,600	30,750
Total cost ABC	18,945	20,985	20,688	30,128

The difference is that A consumes comparatively more of Machine hours.

The use of activity based costing gives different product costs than what were arrived at by utilising traditional costing. It can be argued that Product costs using ABC are more precise as overheads have been identified with specific activities.

Question 2

(a) Distinguish between:

(i) Explicit and Implicit cost

(ii) Job costing and Contract costing. *(3+2= 5 marks)*

(b) An engine manufacturing company has two production departments: (i) Snow mobile engine and (ii) Boat engine and two service departments: (i) Maintenance and (ii) Factory office. Budgeted cost data and relevant cost drivers are as follows:

Departmental costs:	*Rs.*
Snow mobile engine	*6,00,000*
Boat engine	*17,00,000*
Factory office	*3,00,000*
Maintenance	*2,40,000*
Cost drivers:	
Factory office department:	*No. of employees*
Snow mobile engine department	*1,080 employees*

Boat engine department	*270 employees*
Maintenance department	*150 employees*
	1,500
Maintenance department:	*No. of work orders*
Snow mobile engine department	*570 orders*
Boat engine department	*190 orders*
Factory office department	*40 orders*
	800

Required:

(i) Compute the cost driver allocation percentage and then use these percentage to allocate the service department costs by using direct method.

(ii) Compute the cost driver allocation percentage and then use these percentage to allocate the service department costs by using non-reciprocal method/step method.

(2+3= 5 marks)

(c) SK Enterprise manufactures a special product "ZE". The following particulars were collected for the year 2004:

Annual consumption	*12,000 units (360 days)*
Cost per unit	*Re. 1*
Ordering cost	*Rs. 12 per order*
Inventory carrying cost	*24%*
Normal lead time	*15 days*
Safety stock	*30 days consumption*

Required:

(i) Re-order quantity

(ii) Re-order level

(iii) What should be the inventory level (ideally) immediately before the material order is received? (2+1+1 = 4 marks)

Answer

(a) (i) Explicit costs, which are also known as out of pocket costs, refer to costs involving immediate payment of cash. Salaries, wages, interest on capital, etc. are some of the examples of explicit costs. They can be easily measured.

Implicit costs (also known as economic costs) do not involve any immediate cash payment .

The main points of difference between Explicit and Implicit costs are:

- Implicit costs do not involve immediate cash payment whereas Explicit costs involves immediate outgo of cash.
- Implicit costs are not recorded in the book of account whereas Explicit costs are entered in the books of Accounts.

(ii) Job costing and contract costing: In job costing, job work is carried in the premises. An order, a unit, lot or batch of product may be taken as cost unit. Cost is first allocated to cost centres and then charged to individual jobs. It is a system of costing in which the elements of cost are accumulated separately for each job or work undertaken by an organisation. The prices of the jobs are fixed based on the nature of costs and policy of the firm.

In contract costing, contract work is carried on at site. Each contract is a cost unit. Most of the expenses are of direct nature and are directly charged to respective Contract accounts. Only general overheads and head office expenses are apportioned to individual contracts. The pricing is generally through bidding and external forces have major influence in fixing the offer price.

(b) (i)

Cost Driver Allocation percentage

Factory office dept.	*Number of employees*	*Percent used*
Snowmobile engine	1,080	80%
Boat engine	270	20%
Total	1,350	100%

Maintenance dept	Number of work orders	
Snowmobile engine	570	75%
Boat engine	190	25%
	760	100

Service department allocation:

	Factory office dept.	*Maintenance dept.*	*Snowmobile engine*	*Boat engine*
Departmental Cost	Rs. 3,00,000	Rs. 2,40,000	Rs. 6,00,000	Rs. 17,00,000
Allocated costs (Rs):				
Factory office Dept.	(3,00,000)	-	2,40,000	60,000

Maintenance Dept.	-	(2,40,000)	1,80,000	60,000
Total	0	0	10,20,000	18,20,000

(ii) Cost Driver allocation percentage

Factory office dept	*Number of employees*	Percent used
Snowmobile engine	1,080	72%
Boat engine	270	18%
Maintenance dept	150	10%
	1,500	100%
Maintenance dept	Work order	Percent used
Snowmobile engine	570	75%
Boat engine	190	25%
	760	100%

Service department allocation:

	Factory office Dept.	*Maintenance Dept.*	*Snowmobile engine*	*Boat engine*
Departmental costs	Rs. 3,00,000	Rs. 2,40,000	Rs. 6,00,000	Rs. 17,00,000
Allocated costs (Rs):				
Factory office	(3,00,000)	30,000	2,16,000	54,000
Maintenance dept	-	(2,70,000)	20,2500	67,500
Total cost	0	0	10,18,500	18,21,500

(c) (i) How much should be ordered each time i.e., Economic Order Quantity (EOQ)

$$EOQ = \sqrt{\frac{2AB}{CS}}$$

Where A is the annual consumption

B is the ordering cost per order

CS is the carrying cost per unit per annum

$$= \sqrt{\frac{2\times 12,000\times 12}{1\times (24/100)}} = \sqrt{12,00,000}$$

= 1095.4 units or say 1,100 units.

(ii) When should the order be placed i.e., reordering level

Reordering level = *Safety stock +normal lead time consumption

$$\text{Reordering level} = \left[\frac{12000}{360}\times 30\right]+\left[\frac{12,000}{360}\times 15\right]$$

= 1,000+500 = 1,500 units.

(iii) What should be the inventory level (ideally) immediately before the material ordered is received i.e. the Safety Stock.

$$\text{*Safety Stock} = \left[\frac{12,000}{360}\times 30\right]$$

= 1,000 units.

Question 3

(a) Discuss the area of activity in respect of which cost accounting records are to be maintained. (4 marks)

(b) In order to develop tourism, ABCL airline has been given permit to operate three flights in a week between X and Y cities (both side). The airline operates a single aircraft of 160 seats capacity. The normal occupancy is estimated at 60% through out the year of 52 weeks. The one-way fare is Rs. 7,200. The cost of operation of flights are:

Fuel cost (variable)	*Rs. 96,000 per flight*
Food served on board on non-chargeable basis	*Rs. 125 per passenger*
Commission	*5% of fare applicable for all booking*
Fixed cost:	
Aircraft lease	*Rs. 3,50,000 per flight*
Landing Charges	*Rs. 72,000 per flight*

Required:

(i) Calculate the net operating income per flight.

(ii) The airline expects that its occupancy will increase to 108 passengers per flight if the fare is reduced to Rs. 6,720. Advise whether this proposal should be implemented or not. (3+2=5 marks)

(c) A manufacturing unit has purchased and installed a new machine of Rs. 12,70,000 to its fleet of 7 existing machines. The new machine has an estimated life of 12 years and is expected to realise Rs. 70,000 as scrap at the end of its working life. Other relevant data are as follows:

(i) Budgeted working hours are 2,592 based on 8 hours per day for 324 days. This includes 300 hours for plant maintenance and 92 hours for setting up of plant.

(ii) Estimated cost of maintenance of the machine is Rs. 25,000 (p.a.).

(iii) `The machine requires a special chemical solution, which is replaced at the end of each week (6 days in a week) at a cost of Rs. 400 each time.

(iv) Four operators control operation of 8 machines and the average wages per person amounts to Rs. 420 per week plus 15% fringe benefits.

(v) Electricity used by the machine during the production is 16 units per hour at a cost of Rs. 3 per unit. No current is taken during maintenance and setting up.

(vi) Departmental and general works overhead allocated to the operation during last year was Rs. 50,000. During the current year it is estimated to increase 10% of this amount.

Calculate machine hour rate, if (a) setting up time is unproductive; (b) setting up time is productive. (2+3= 5 marks)

Answer

(a) The areas of activity in respect of which cost accounting records are to be maintained under cost accounting record rules are:

- Raw materials, components, stores and spare parts
- Salaries and wages
- Service department expenses
- Utilities
- Depreciation
- Other overheads
- Conversion cost
- R & D expenses
- Interest
- Joint products and by products
- Work-in-progress and finished goods stocks
- Cost statements
- Record of physical verification
- Packing
- Production records.

(b)

No. of passengers 160×60/100 = 96	*Rs*	*Rs.*
(i) Fare collection 96×7,200		6,91,200
Variable costs:		
Fuel		96,000

	Food 96×125		12,000
	Commission 5%		34,560
	Total variable Costs		1,42,560
	Contribution per flight		5,48,640
	Fixed costs: Lease	3,50,000	
	Crew	72,000	4,22,000
	Net income per flight		1,26,640
(ii)	Fare collection 108×6,720		7,25,760
	Variable costs:		
	Fuel		96,000
	Food 108×125		13,500
	Commission @ 5%		36,288
	Contribution		5,79,972
			There is an increase in contribution by Rs. 31,332. Hence the proposal is acceptable

(c) Computation of Machine hour Rate

	Per year	*Per hour (unproductive)*	*Per hour (productive)*
Standing charges			
Operators wages			
4× 420 × 54	90,720		
Add: Fringe Benefits 15%	13,608		
	1,04,328		
Departmental and general overhead			
(50,000 + 5,000)	55,000		
Total Std. Charging for 8 machines	1,59,328		
Cost per Machine 1,59,328/8	19,916		
Cost per Machine hour 19,916/2,200		9.05	
19,916/2,292			8.69

Machine hours:		
Setting time unproductive (2,592-300-92) = 2200		
Setting time productive (2,592-300) = 2,292		
Machine expenses		
Depreciation (12,70,000 - 70,000)/(12 ×2,200)	45.45	
(12,70,000-70,000)/(12 × 2,292)		43.63
Electricity (16× 3)	48.00	
(16×3×2,200)/2,292)		46.07
Special chemical solution (400 × 54)/2,200 , / 2,292	9.82	9.42
Maintenance (25,000/2,200)	11.36	
(25,000/2,292)		10.91
Machine Hour Rate	123.68	118.72

Question 4

(a) Discuss the treatment of research and development expenditures in cost accounting. *(3 marks)*

(b) Explain the area of cost reduction at product design stage. *(3 marks)*

(c) The following figures have been extracted from the cost records of a manufacturing unit: *(2+2+1+1+2=8 marks)*

	Rs.
Stores: Opening balance	*32,000*
Purchases of material	*1,58,000*
Transfer from work-in-progress	*80,000*
Issues to work-in-progress	*1,60,000*
Issues to repair and maintenance	*20,000*
Deficiencies found in stock taking	*6,000*
Work-in-progress: Opening balance	*60,000*
Direct wages applied	*65,000*

Overheads applied	*2,40,000*
Closing balance of W.I.P.	*45,000*

Finish products: Entire output is sold at a profit of 10% on actual cost from work-in-progress. Wages incurred Rs. 70,000, overhead incurred Rs. 2,50,000.

Items not included in cost records: Income from investment Rs. 10,000, Loss on sale of capital assets Rs. 20,000.

Draw up Store Control account, Work-in-progress Control account, Costing Profit and Loss account, Profit and Loss account and Reconciliation statement. (2+3 = 5 marks)

Answer

(a) If research is conducted in the methods of production, the expenses should be charged to production overhead. If the research relates to administration, the expenses are charged to administration overheads. If it is related to market research, the expenses are charged to S&D overheads. Development costs incurred in connection with a particular product should be charged directly to that product. Such expenses are usually treated as deferred revenue expenditure and recovered as cost per unit of the product when production is fully established. Routine nature research expenses are charged to general overheads.

(b) Products design offers the greatest scope of cost reduction of a permanent nature. The impact of a decision made at the beginning stage on costs can be revealed at every stage of manufacture or processing of the product in the factory. The design function, therefore, offers an extremely important area for cost reduction action.

Before making new designs, a design policy has to be settled by top management. The design policy may be selected towards objectives such as:

(a) Low cost and functional efficiency

(b) Widest possible application

(c) Quality and life and

(d) Appearance.

Any attempt to achieve cost reduction through design economies may come into conflict with the over riding design policy and hence a firm policy concerning design has to be settled by overcoming, as far as possible, conflicts.

Potential areas for cost reduction in the field of design are:

(i) Introduction of new designs

(ii) Improvement in the existing designs and

(iii) Standardisation and simplification.

(c) (A) Costing books

Stores Control Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To balance b/d	32,000	By W.I.P. Control A/c	1,60,000
To general ledger adjustment A/c	1,58,000	"Work overhead control a/c	20,000
To work in progress control A/c	80,000	"Costing Profit and Loss a/c	6,000
		"Balance c/d	84,000
	2,70,000		2,70,000

W.I.P. Control Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To balance b/d	60,000	By stores control A/c	80,000
To stores control A/c	1,60,000	By costing profit and loss A/c	
To direct wages control A/c	65,000	(Cost of sales)	4,00,000
To works overhead control A/c	2,40,000	By balance c/d	45,000
	5,25,000		5,25,000

Works overhead control account

Particulars	*Rs.*	*Particulars*	*Rs.*
To general ledger adjustment A/c	2,50,000	By W.I.P. Control A/c	2,40,000
To store ledger control A/c	20,000	By costing profit & loss A/c (under recovery)	30,000
	2,70,000		2,70,000

Costing Profit & Loss Account

Particulars	*Rs.*	*Particulars*		*Rs.*
To W.I.P. control A/c (Cost of sales)	4,00,000	By general ledger adjustment A/c		
		Cost of sales	4,00,000	

		10% profit	40,000	4,40,000
To works overhead control A/c	30,000			
To stores control A/c (shortage)	6,000			
To profit	4,000			
	4,40,000			4,40,000

(B) Financial Books

Profit & Loss Account

Particulars		*Rs.*	*Particulars*		*Rs.*
To opening stock			By sales		4,40,000
Stores	32,000		By closing stock:		
W.I.P.	60,000	92,000	Stores	84,000	
			W.I.P.	45,000	1,29,000
To purchases		1,58,000	By income from investment		10,000
To wages incurred		70,000	By loss		11,000
To overheads incurred		2,50,000			
To loss on sale of capital assets		20,000			
		5,90,000			5,90,000

Reconciliation statement

			Rs.
Profit as per cost accounts			4,000
Add:			
Income from investment recorded in financial accounts			10,000
			14,000
Less:			
Under absorption of wages in cost accounts		5,000	
Loss on sales of capital asset only included in financial accounts		20,000	25,000
Loss as per financial accounts			11,000

Question 5

(a) Explain:

(i) Single and multiple overhead rate

(ii) Sunk cost. *(2+3 = 5 marks)*

(b) A company produces two joint product X and Y, from the same basic materials. The processing is completed in three departments.

Materials are mixed in department I. At the end of this process X and Y get separated. After separation X is completed in the department II and Y is finished in department III. During a period 2,00,000 kgs of raw material were processed in department I, at a total cost of Rs. 8,75,000, and the resultant 60% becomes X and 30% becomes Y and 10% normally lost in processing.

In department II 1/6 of the quantity received from department I is lost in processing. X is further processed in department II at a cost of Rs. 1,80,000.

In department III further new material added to the material received from department I and weight mixture is doubled, there is no quantity loss in the department and further processing cost (with material cost) is Rs. 1,50,000.

The details of sales during the year:

	Product X	*Product Y*
Quantity sold (kgs)	*90,000*	*1,15,000*
Sales price per kg (Rs.)	*10*	*4*

There were no opening stocks. If these products sold at split-off-point, the selling price of X and Y would be Rs. 8 and Rs. 4 per kg respectively.

Required:

(i) Prepare a statement showing the apportionment of joint cost to X and Y in proportion of sales value at split off point.

(ii) Prepare a statement showing the cost per kg of each product indicating joint cost, processing cost and total cost separately.

(iii) Prepare a statement showing the product wise profit for the year.

(iv) On the basis of profits before and after further processing of product X and Y, give your comment that products should be further processed or not.

(2+3+2+2= 9 marks)

Answer

(a) (i) Single and multiple overhead rate: A single overhead rate, when computed for the entire factory is known as the blanket rate.

Blanket rate = Overhead cost of entire factory / total quantum of the base selected

The blanket rates can be utilised in the following cases;

- Where only one major product is being produced.
- Where several products are produced but: (a) all products pass through all departments and (b) all products require the same length of time in each department.

When the above conditions are not applicable , separate departmental rates should be used.

Multiple rates involve computation of separate rates for each production department, service department, cost-centre, each product or line and each production factor.

(ii) Sunk Cost: These costs are the costs of resources already acquired which will be unaffected by choice between various alternatives. These are historical costs, which are incurred in the past and not relevant to the particular decision making problem, being considered. While considering the replacement of a plant, the depreciated book value of the old asset is irrelevant as the amount is a sunk cost, which is to be written off at the time of replacement. Another example of sunk cost is that of development cost already incurred.

(b) Calculation of quantity produced

	Dept I	*Dept II*	*Dept III*
Input (kg)	2,00,000	1,20,000	60,000
Weight lost or added	(20,000)	(20,000)	60,000
	1,80,000	1,00,000	1,20,000
Production of X	1,20,000	1,00,000	
Production of Y	60,000		1,20,000

(i) Statement of apportionment of joint cost

	(Joint cost Rs. 8,75,000)	
	Product X	Product Y
Out put (kg)	1,20,000	60,000
Selling price per kg (Rs.)	8	4
Sales value (Rs.)	9,60,000	2,40,000
Share in Joint cost (4:1)	7,00,000	1,75,000

(ii) Statement of cost per kg

	Product X	*Product Y*
Share in joint cost (Rs.)	7,00,000	1,75,000
Out put (kg)	1,00,000	1,20,000
Cost per kg (Rs.) (Joint cost)	7.00	1.458
Further processing cost per kg (Rs.)	1.80	1.250
Total cost per kg (Rs.)	8.80	2.708

(iii) Statement of profit

	Product X	*Product Y*
Out put (kg)	1,00,000	1,20,000
Sales (kg)	90,000	1,15,000
Closing stock	10,000	5,000
	Rs.	*Rs.*
Sales @ Rs. 10, 4(for product X and Y)	9,00,000	4,60,000
Add: closing stock (kg) (at full cost)	88,000	13,540
Value of production	9,88,000	4,73,540
Less: Share in joint cost	7,00,000	1,75,000
Further processing	1,80,000	1,50,000
Profit	1,08,000	1,48,540

(iv) Profitability statement, before and after processing

	Product X	*Product X*	*Product Y*	*Product Y*
	Before (Rs.)	*After (Rs.)*	*Before (Rs,)*	*After (Rs)*
Sales Value	9,60,000		2,40,000	
Share in joint costs	7,00,000		1,75,000	
Profit	2,60,000	1,08,000 (as per iii above)	65,000	1,48,540 (as per iii above)

Product X should be sold at split off point and product Y after processing because of higher profitability.

Question 6

(a) XYZ Co. Ltd. is a pipe manufacturing company. Its production cycle indicates that materials are introduced in the beginning of the production cycle; wages and overhead accrue evenly throughout the period of the cycle. Wages are paid in the next month

following the month of accrual. Work in process includes full units of raw materials used in the beginning of the production process and 50% of wages and overheads are supposed to be conversion costs. Details of production process and the components of working capital are as follows:

Production of pipes	*12,00,000 units*
Duration of the production cycle	*One month*
Raw materials inventory held	*One month consumption*
Finished goods inventory held for	*Two months*
Credit allowed by creditors	*One month*
Credit given to debtors	*Two months*
Cost price of raw materials	*Rs. 60 per unit*
Direct wages	*Rs. 10 per unit*
Overheads	*Rs. 20 per unit*
Selling price of finished pipes	*Rs. 100 per unit*

Required to calculate:

(i) The amount of working capital required for the company.

(ii) Its maximum permissible bank finance under all the three methods of lending norms as suggested by the Tondon Committee, assuming the value of core current assets: Rs. 1,00,00,000. *(5+5= 10 marks)*

(b) D Ltd. is foreseeing a growth rate of 12% per annum in the next two years. The growth rate is likely to be 10% for the third and fourth year. After that the growth rate is expected to stabilise at 8% per annum. If the last dividend was Rs. 1.50 per share and the investor's required rate of return is 16%, determine the current value of equity share of the company.

The P.V. factors at 16%

Year	*1*	*2*	*3*	*4*
P.V. Factor	*.862*	*.743*	*.641*	*.552*

(6 marks)

Answer

(a) (i) *Amount in Rs*

A – Current Assets

(i) Raw material inventory –(1 month)- 12,00,000 Uts $\times$ 60 $\times$ $\frac{1}{12}$ 60,00,000

(ii) – Work in Progress – Production cycle 1 month

Raw material (added in the beginning) Rs 60,00,000

Wages	$(12,00,000 \times 10 \times \frac{1}{2}) \times 50\% = 5,00,000$		
Overheads	$20 \times 10,00,000 \times \frac{1}{12} \times 50\% = 10,00,000$		
Total			75,00,000
(iii) Finished goods (inventory held for 2 months)			
Total Cost	Material 60.00		1,80,00,000
	Labour 10.00		
	Overheads 20.00 $= 90 \times 12,00,000 \times \frac{2}{12}$		
(iv) Debtors for 2 months $12,00,000 \times$ Rs $90 \times \frac{2}{12}$			1,80,00,000
Total current assets			4,95,00,000
B – Current liabilities			
(v) Creditors for Raw material – 01 month			
$7,20,00,000 \times \frac{1}{12}$			60,00,000
(vi) Creditors for wages			
$12,00,000 \times 10 \times \frac{1}{12}$			10,00,000
Total current liabilities			70,00,000
Net working capital			4,25,00,000

Computation of Maximum Permissible Bank Finance according to Tandon Committee Norms

1st Method

	Rs
CAs	4,95,00,000
CLs	70,00,000
Working capital gap	4,25,00,000
Less 25% from long term sources	(1,06,25,000)
Max Permissible Bank Finance	3,18,75,000

2nd Method

	Rs
Working capital gap	4,25,00,000
Less: 25% of CAs	(1,23,75,000)
MPBF	3,01,25,000

3rd Method

Total current assets – Core current assets = Rs 4,95,00,000 – 1,00,00,000
= Rs 3,95,00,000

	Rs
Real current assets	3,95,00,000
Less: 25%	98,75,000
	2,96,25,000
Less: Current Liabilities	70,00,000
MPBF	2,26,25,000

(b) The current value of equity share of D Ltd. is sum of the following:

(i) Present value (PV) of dividends payments during 1-4 years; and

(ii) Present value (PV) of expected market price at the end of the fourth year based on constant growth rate of 8 per cent.

PV of dividends – year 1-4

Year	*Dividend*	*PV factor at 16%*	*Total PV (in Rs.)*
1	1.50(1 + 0.12)=1.68	0.862	1.45
2	1.68 (1+0.12)= 1.88	0.743	1.40
3	1.88 (1 + 0.10)=2.07	0.641	1.33
4	2.07 (1 + 0.10)= 2.28	0.552	1.26
	Total		5.44

Present value of the market price (P_4) at the end of the fourth year –

$P_4 = D_5 / (Ke-g)$ = Rs. 2.28 (1.08) / (16% – 8%) = Rs. 30.78

PV of Rs. 30.78 = Rs. 30.78×0.552 = Rs. 16.99

Hence;

Value of equity shares Rs. 5.44 + Rs. 16.99 = Rs. 22.43

Question 7

(a) "Decision tree analysis is helpful in managerial decisions." Explain with an example.

(5 marks)

(b) The R&G Company has following capital structure at 31st March 2004, which is considered to be optimum:

	Rs.
13% debenture	*3,60,000*
11% preference share capital	*1,20,000*
Equity share capital (2,00,000 shares)	*19,20,000*

The company's share has a current market price of Rs. 27.75 per share. The expected dividend per share in next year is 50 percent of the 2004 EPS. The EPS of last 10 years is as follows. The past trends are expected to continue:

Year	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*
EPS (Rs.)	1.00	1.120	1.254	1.405	1.574	1.762	1.974	2.211	2.476	2.773

The company can issue 14 percent new debenture. The company's debenture is currently selling at Rs. 98. The new preference issue can be sold at a net price of Rs. 9.80, paying a dividend of Rs. 1.20 per share. The company's marginal tax rate is 50%.

(i) Calculate the after tax cost (a) of new debts and new preference share capital, (b) of ordinary equity, assuming new equity comes form retained earnings.

(ii) Calculate the marginal cost of capital.

(iii) How much can be spent for capital investment before new ordinary share must be sold ? Assuming that retained earning available for next year's investment are 50% of 2004 earnings.

(iv) What will be marginal cost of capital (cost of fund raised in excess of the amount calculated in part (iii))if the company can sell new ordinary shares to net Rs. 20 per share ? The cost of debt and of preference capital is constant.

(2+1+2+2=7 marks)

Answer

(a) Significance of Decision Tree Analysis: it is generally observed that the present investment decision may have several implications for future investments decisions. Such complex investment decisions involve a sequence of decisions over time. It is also argued that since present choices modify future alternatives, industrial activity can not be reduced to a single decision and must be viewed as a sequence of decisions extending from the present time into the future. These sequential decisions are taken on the bases of decision tree analysis. While constructing and using decision tree, some important steps to be considered are as follows:

(i) Investment proposal should be properly defined.

(ii) Decision alternatives should be clearly clarified.

(iii) The decision tree should be properly graphed indicating the decision points, chances, events and other data.

(iv) The results should be analysed and the best alternative should be selected.

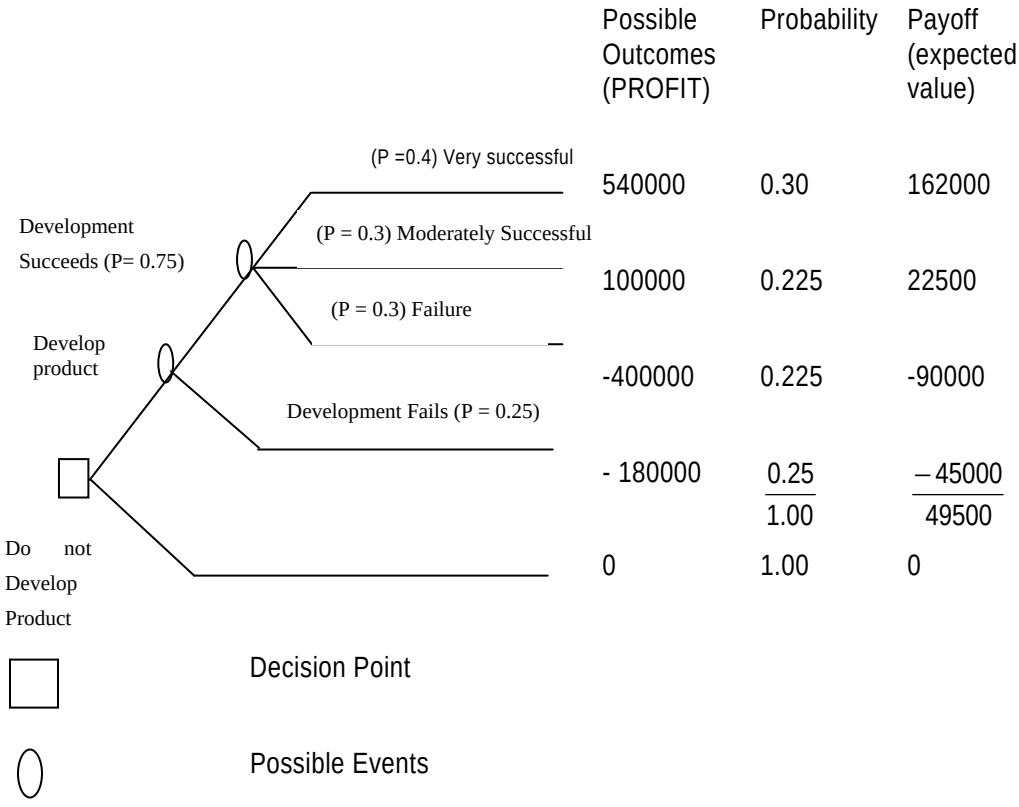
Example – A company is considering whether to develop and market a new product. Development costs are estimated to be Rs. 180,000 and there is a 0.75 probability that the development effort will be successful and balance 0.25 probabilities that it will be unsuccessful. If the development is successful the product will be marketed and it is estimated that –

I. If the product is very successful profits will be Rs. 540000– probability 0.4

II. If the product is moderately successful profits will be Rs. 100000 – probability 0.3

III. If the product is a failure there will be a loss of Rs. 400,000 – probability 0.3

Each of the above profit and loss calculations is after taking the development cost of Rs. 180,000. The diagram is as follows,



(b) The existing capital structure is assumed to be optimum.

Existing Capital Structure Analysis

Type of capital	*Amount (Rs)*	*Proportions*
13% debentures	3,60,000	0.15
11% Preference	1,20,000	0.05
Equity	19,20,000	0.80
	24,00,000	1.00

(i) (a) After tax cost of debt = $K_d = \frac{14}{98} \times (1 - 0.5)$

= 0.07143

After tax cost of preference capital (new)

$Kp = \frac{1.20}{9.80} = 0.122449$

(b) After tax cost of retained earnings

$K_e = \frac{1.3865}{27.75} + g$

(here 'g' is the growth rate)

= 0.05 + 0.12 = 0.17

(ii)

Types of capital	*Proportion*	*Specific cost*	*Product*
(1)	*(2)*	*(3)*	*(2) ×(3)*
Debt	.15	.07143	.0107
Preference	.05	.122449	.0061
Equity	.80	.17	.1360
Marginal cost of capital at existing capital structure			.1528 or 15.28%

(iii) The company can spend the following amount without increasing its MCC and without selling the new shares.

Retained earnings = 1.3865 × 2,00,000 =2,77,300

The ordinary equity (retained earnings in this case) is 80% of the total capital. Thus investment before issuing equity ($\frac{2,77,300}{80} \times 100$) = Rs 3,46,625

(iv) if the company spends more than Rs3, 46,625 , it will have to issue new shares . The cost of new issue of ordinary share is :

$$K_e = \frac{1.3865}{20} + 0.12 = 0.1893$$

The marginal cost of capital of Rs 3,46,625

Types of capital	*Proportion*	*Specific cost*	*Product*
(1)	*(2)*	*(3)*	*(2) ×(3)*
Debt	.15	.07143	.0107
Preference	.05	.122449	.0061
Equity(new)	.80	.1893	0.15144
Marginal cost of capital at existing capital structure			0.16824 or 16.82 %

Question 8

(a) Explain the relevance of time value of money in financial decisions. *(2 marks)*

(b) Discuss the eligibility criteria for issue of commercial paper. *(3 marks)*

(c) The following is the income statement XYZ Company for the year 2004:

		(Rs.)
Sales		*1,62,700*
Add.: Equity In ABC Company's earning		*6,000*
		1,68,700
Expenses	*Rs.*	
Cost of goods sold	*89,300*	
Salaries	*34,400*	
Depreciation	*7,450*	
Insurance	*500*	
Research and development	*1,250*	
Patent amortisation	*900*	
Interest	*10,650*	
Bad debts	*2,050*	
Income tax:		

Current	*6,600*		
Deferred	*1,550*	*8,150*	
Total expenses			*1,54,650*
Net income			*14,050*

Additional informations are:

(i) 70% of gross revenue from sales was on credit.

(ii) Merchandise purchases amounting to Rs. 92,000 were on credit.

(iii) Salaries payable totalled Rs. 1,600 at the end of the year.

(iv) Amortisation of premium on bonds payable was Rs. 1,350.

(v) No dividends were received from the other company.

(vi) XYZ Company declared cash dividend of Rs. 4,000.

(vii) Changes in Current Assets and Current Liabilities were as follows:

	Increase (Decrease) Rs.
Cash	*500*
Marketable securities	*1,600*
Accounts receivable	*(7,150)*
Allowance for bad debt	*(1,900)*
Inventory	*2,700*
Prepaid insurance	*700*
Accounts payable (for merchandise)	*5,650*
Salaries payable	*(2,050)*
Dividends payable	*(3,000)*

Prepare a statement showing the amount of cash flow from operations. (7 marks)

Answer

(a) Time value of money means that worth of a rupee received today is different from the worth of a rupee to be received in future. The preference of money now, as compared to future money is, known as time preference for money.

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

- Risk: There is uncertainly 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.

(b) Eligibility criteria for issuer of commercial paper

The companies satisfying the following conditions are eligible to issue commercial paper.

- The tangible net worth of the company is Rs. 5 crores or more as per audited balance sheet of the company.
- The fund base working capital limit is not less than Rs. 5 crores.
- The company is required to obtain the necessary credit rating from the rating agencies such as CRISIL, ICRA etc.
- The issuers should ensure that the credit rating at the time of applying to RBI should not be more than two moths old.
- The minimum current ratio should be 1.33:1 based on classification of current assets and liabilities.
- For public sector companies there are no listing requirement but for companies other than public sector, the same should be listed on one or more stock exchanges.
- All issue expenses shall be borne by the company issuing commercial paper.

(c) Statement showing cash flow from Operations

	Rs	*Rs*
Cash flow from operations		
Cash sales (30% × 1,62,700)	48,810	
Collection from debtors	1,20,890	
Total cash from operations		1,69,700
Uses of cash from operations		
Payment to suppliers	86,350	
Salaries expense	36,450	
Payment for insurance	1,200	

Research and development	1,250	
Interest payment	12,000	
Income tax payment	6,600	
Total operating cash payment		1,43,850
Net cash flow from operations		25,850

Notes

(1).

Collection from debtors	*Rs*
Credit sales (70% × 1,62,700)	1,13,890
Less : Bad debts (2,050 less 1,900)	150
	1,13,740
Add : decrease in accounts receivables	7,150
Collection from debtors on credit sales	1,20,890

(2) Dividends earned Rs 6,000 on equity of ABC Company has not been considered as it has not been received in cash.

(3) Payment to suppliers

Cost of goods sold	Rs 89,300	
Add: Increase in inventory	2,700	
Purchases	9,200	
Less: increase in accounts payable	5,650	
Payment to suppliers	86,350	

(4) Calculation of salaries payment

Salary expense	Rs 34,400
Add : decrease in salary payable	2,050
Payment of salaries	Rs 36,450

(5) Insurance payments

Insurance	Rs 500	
Add : increase in prepaid insurance	700	
Payment for insurance	Rs 1,200	

(6) Interest payment

Interest expenses	Rs 10,650

	Add : Amortisation of bond premium	1,350
	Interest payments	Rs 12,000
(7)	Income tax payments	
	Income tax expense	Rs 8,150
	Less: deferred tax	1,550
		Rs 6,600
	Changes in current tax payable	Nil
	Income tax payments	Rs 6,600

Question 9

(a) Write notes on:

(i) Venture capital financing

(ii) Seed capital assistance

(b) With the help of the following information complete the Balance Sheet of MNOP Ltd. :

Equity share capital	*Rs. 1,00,000*
The relevant ratios of the company are as follows:	
Current debt to total debt	*.40*
Total debt to owner's equity	*.60*
Fixed assets to owner's equity	*.60*
Total assets turnover	*2 Times*
Inventory turnover	*8 Times*

Answer

(a) (i) *Venture Capital Financing:* The term venture capital refers to capital investment made in a business or industrial enterprise, which carries elements of risks and insecurity and the probability of business hazards. Capital investment may assume the form of either equity or debt or both as a derivative instrument. The risk associated with the enterprise could be so high as to entail total loss or be so insignificant as to lead to high gains.

The European Venture Capital Association describes venture capital as risk finance for entrepreneurial growth oriented companies. It is an investment for the medium or long term seeking to maximise the return.

Venture Capital, thus, implies an investment in the form of equity for high-risk projects with the expectation of higher profits. The investments are made through private placement with the expectation of risk of total loss or huge returns. High technology industry is more attractive to venture capital financing due to the high

profit potential. The main object of investing equity is to get high capital profit at saturation stage.

In broad sense under venture capital financing venture capitalist makes investment to purchase debt or equity from inexperienced entrepreneurs who undertake highly risky ventures with potential of success.

(ii) *Seed Capital Assistance:* The seed capital assistance has been designed by IDBI for professionally or technically qualified entrepreneurs. All the projects eligible for financial assistance from IDBI, directly or indirectly through refinance are eligible under the scheme. The project cost should not exceed Rs. 2 crores and the maximum assistance under the project will be restricted to 50% of the required promoters contribution or Rs 15 lacs whichever is lower.

The seed capital Assistance is interest free but carries a security charge of one percent per annum for the first five years and an increasing rate thereafter.

(b) MNOP Ltd

Balance Sheet

Liabilities	*Rs*	*Assets*	*Rs*
Owner equity	1,00,000	Fixed assets	60,000
Current debt	24,000	Cash	60,000
Long term debt	36,000	Inventory	40,000
	1,60,000		1,60,000

Working Notes

1. Total debt = 0.60 × Owners equity = 0.60 × Rs 1,00,000 = Rs 60,000

   Current debt to total debt = 0.40 , hence current debt = 0.40 × 60,000 = 24,000

2. Fixed assets = 0.60 × Owners equity = 0.60 × Rs 1,00,000 = Rs 60,000

3. Total equity = Total debt + Owners equity = Rs 60,000 + Rs 1,00,000 = Rs 1,60,000

4. Total assets consisting of fixed assets and current assets must be equal to Rs 1,60,000 (Assets = Liabilities + Owners equity). Since Fixed assets are Rs 60,000 , hence , current assets should be Rs 1,00,000

5. Total assets turnover = 2 Times : Inventory turnover = 8 Times

   Hence , Inventory /Total assets = 2/8=1/4, Total assets = 1,60,000

   Therefore Inventory = 1,60,000/4 = 40,000 Balance on Asset side

   Cash = 1,00,000 – 40,000 = 60,000

Suggested Answers- May 2005

Professional Education Course II

PAPER – 6 : INFORMATION TECHNOLOGY

Question No. 1 is compulsory. Answer any four from the rest.

Question 1

(a) Convert the following from one number system to another system along with the working notes:

(i) $(1267.3125)_{10}$ = ( )$_2$

(ii) $(10110.101)_2$ = ( )$_{10}$

(iii) $(1234)_8$ = ( )$_{16}$

(iv) $(B2C)_{16}$ = ( )$_2$

(v) $(10110111.1)_2$ = ( )$_8$ *(1×5= 5 Marks)*

(b) Describe briefly, the following terms with reference to Information Technology:

(i) Asymmetric crypto system

(ii) Subroutine

(iii) Parity bit

(iv) Object oriented Database

(v) FTP. *(1×5 = 5 Marks)*

(c) Give one or two reasons for each of the following:

(i) Use of Serial Interface.

(ii) Use of Spooling Software.

(iii) Use of Fire wall in the system.

(iv) Need of Repeaters in the network.

(v) Need of Reference files. *(1×5 = 5 Marks)*

(d) Write True of False for each of the following

(i) Flash memory chips are one form of static RAM chip.

(ii) A sequential access file can reside only on a magnetic tape.

(iii) A Personnel Computer based on the Intel 80386 chipset has 32 bit processor.

(iv) The speed of Dot matrix printer is measured in terms of CPS.

(v) Outline view of MS-POWER POINT permits frequent switching between text and object on a slide. *(1×5= 5 Marks)*

Answer

(a) (i) $(1267.3125)_{10}$ = ( )$_2$

2	1267	Remainder
2	633	1
2	316	1
2	158	0
2	79	0
2	39	1
2	19	1
2	9	1
2	4	1
2	2	0
2	1	0
	0	1

	0.3125
	×2
0	0.625
	×2
1	0.25
	×2
0	0.50
	×2
1	0

Hence $(1267.3125)_{10}$ = $(10011110011.0101)_2$

(ii) $(10110.101)_2$ = ( )$_{10}$

$(10110.101)_2$ = $1\times2^4+0+1\times2^2+1\times2^1+0+1\times2^{-1}+1\times2^{-3}$

= 16 + 4 + 2 + 0.5 + 0.125 = (22.625)

Hence, $(10110.101)_2$ = $(22.625)_{10}$

(iii) $(1234)_8$ = ( )$_{16}$

$(1234)_8$ = $\overline{001}\ \overline{010}\ \overline{011}\ \overline{100}$

= $\overline{0010}\ \overline{1001}\ \overline{1100}$

= (29C)

Hence, $(1234)_8$ = $(29C)_{16}$

(iv) $(B2C)_{16}$ = ( )$_2$

$(B2C)_{16}$ = $(101100101100)_2$

(v) $(10110111.1)_2$ = ( )$_8$

To convert the given number from binary to octal, we will combine the digit in groups of three adding leading or trailing zeros wherever required.

(10110111.1) = 010 110 111 . 100

= 2 6 7 . 4

Hence, $(10110111.1)_2 = (267.4)_8$

(b) (i) Asymmetric Crypto System*:* It refers to a system of a secure key pair consisting of a private key for creating a digital signature and a public key to verify the digital signature.

(ii) Subroutine – It is a subset of instructions that appears over and again in the program or finds applications in several programs. It is economical to write it once and for all. This saves time for writing and debugging and can be used repeatedly in the same program.

(iii) Parity bit: It is an additional redundant bit that is used to provide a check on the integrity of a data representation. It helps in detecting any errors that may occur while transmitting a binary data.

(iv) Object oriented database or OODB: It provides a repository of reusable objects that only need to be created once. This allows new applications to be put together by appropriately arranging the objects stored in the OODB.

(v) FTP or File Transfer Protocol: It is a very common method of moving files between two Internet sites.

(c) (i) Use of Serial Interface: A serial interface is used to connect a printer to the input device, either a computer or word processor. It allows the printer to accept transmission of data, which is sent serially, or one character at a time.

(ii) Use of spooling software: The purpose of spooling software is to compensate for the speed difference between the computer and its peripheral devices. These programs take the results of computer program and move them from primary memory to disk. The area on the disk where program results are sent is commonly called the output spooling area. Thus, the output device can be left to interact primarily with the disk unit, not the C.P.U. It can be used on the input side also.

(iii) Use of firewall in the system: Firewalls are hardware and software systems that control the flow of traffic between the Internet and organization's Local Area Network and systems. These are set up to enforce specific security policies that are desired. Firewall is an effective means of protecting the internal resources from unwanted intrusion.

(iv) Need of Repeaters in the network – Repeaters are devices that solve the snag of signal degradation which results as data is transmitted along the cables. It boosts the signal before passing it through to the next location.

(v) Need of reference file – These files contain keys of records in other files. In order to retrieve a record from a file, the reference file is first searched to find out in which file a record can be located.

(d) (i) True (ii) False

(iii) True (iv) True

(v) False

Question 2

Distinguish between the following:

(i) Synchronous and Asynchronous data transmission

(ii) RAM and ROM

(iii) Multiprogramming and Multiprocessing

(iv) Third generation and Fourth generation languages

(v) Fixed length field and Variable length field (with reference to database).

(4 X 5 = 20 Marks)

Answer

(i) (a) Synchronous and Asynchronous Transmission

Under Synchronous Transmission, bits are transmitted at fixed rate. The transmitter and receiver both use the same clock signals for synchronization.

- It allows characters to be sent down the line without start-stop bits.
- It allows data to be sent as a multi-word block.
- It uses a group of synchronization bits, which is placed at the beginning and at the end of each block to maintain synchronization.
- Timing is determined by a modem.
- It is a faster way of data transmission and many data words can be transmitted per second. However, the synchronous device is more expensive as it must be smart enough to differentiate between the actual data and the special synchronous characters.

However, in Asynchronous Transmission, each data is accompanied by stop (1) and start (0) bits that identify the beginning and ending of the word. When no information is being transmitted i.e., sender device is idle, the communication line is usually high and there is continuous stream of 1.

- It is a reliable transmission system as the extra start and stop bits ensure that the sender and receiver remain in step with one another.
- It does not require smart device to differentiate between the actual data and start/stop bits.

However, it is inefficient as the transmission speed is slowed down when there is huge volume of information to be transmitted.

(ii) RAM and ROM

RAM or random access memory is the memory system constructed with metal oxide semi conductor storage elements that can be charged . The purpose of RAM is to hold programs and data while they are in use. It is independent of the address of the word. It is fast but can be quite expensive. ROM or Read only Memory is used for micro

programs not available to normal programmers. ROM refers to a storage that cannot be altered by regular program instructions. The information is stored permanently in such memory during manufacture. The information from the memory may be read but fresh information cannot be written into it. ROM BIOS is one such example.

RAM can be further divided according to ways in which the data is stored viz. dynamic RAM and Static RAM. In dynamic RAM, each memory cell quickly loses its charge so it must be refreshed hundred of times each second. Static RAM is larger, faster and more expensive. It is static because it does not require to be continually refreshed. Because of its speed, it is mainly used in cache memory.

ROM on other hand is available in the following three forms:

PROM - Programmable read only Memory

EPROM - Erasable Programmable read only memory

EEPROM – Electrically Erasable Programmable Read Only Memory.

(iii) Multiprogramming and Multiprocessing

Multiprogramming is defined as execution of two or more programs that all reside in primarily storage. Since CPU can execute only one instruction at a time, it cannot simultaneously execute instructions from two or more programs. However, it can execute instruction from one program then from second program and so on. This type of processing is referred to as concurrent execution. It is very useful as most of time CPU remains idle waiting for I / 0 devices to complete their job, as I / 0 devices are very slow. When I/0 devices are working for one program, CPU executes instructions of second program. Thus, multiprogramming is a technique which helps in utilising a computer system more effectively. It is a module, which is available in an operating system.

Multiprocessing, on other hand, refers to the use of two or more central processing units linked together to perform coordinated work simultaneously. Instructions are executed simultaneously because the available CPUs can execute different instructions of the same program or of different programs at any give time. It is also called parallel processing and job can be processed more rapidly than on a single machine. Multiprocessing offers data processing capabilities that are not available when only one CPU is used. Many complex operations can be performed at the same time. Multiprocessing is used for nation's control applications such as rail, road control, airways and traffic control etc.

(iv) Third Generation and Fourth Generation Languages

Third Generation Languages are called procedural languages and they are procedure oriented. They employ plain English like and mathematical expressions. They are intended for professional programmers, and require specification of how to perform task. Programmes written in third generation languages are also difficult to debug and usually translated through compiler. Code is difficult to learn, understand and maintain. These languages were originally developed for batch operations and are typically file oriented. FORTRAN, COBOL etc. are examples of third generation languages.

Fourth Generation Languages(4GLs), on the other hand, can be used by both programmers and non-programmers. 4GL uses English like instructions, has limited mathematical manipulation capability. It offers automatic report formatting, sequencing and record selection by user given criteria. However, 4GLs are less efficient than third generation languages. They require specification of what task to perform and the system determines how to perform that task. 4GL requires fewer instructions, code is easy to maintain and understand. Many features of 4GLs can be learned quickly. 4GLs are more structured and are data base oriented. Generally, these are available in two types (i) Production Oriented and (ii) User Oriented.

(v) Fixed Length Fields and Variable Length Fields

Under Fixed Length Fields scheme, fields are simply placed in sequence one after another. Thus, while designing physical records, it conserves storage space. In this scheme, a trailing blank pad character field and leading zero pad numeric field is used. Hence, under fixed length field scheme we know the exact location within a file for each of the fields of a physical record.

Variable Length Fields scheme makes the location of a particular field and a particular record irregular. That is, depending on which records exist and the precise values for fields, different records and fields will be in different locations. A common way to handle variable length field is to break the relation into a fixed length physical records containing all fixed length fields and one or more variable length physical records. In personal computers, this is how many DBMS handle a memo field which is a variable-length field.

Question 3

(a) Describe briefly, why a file processing system reduces effectiveness of the end user applications ? (5 Marks)

(b) Describe the salient features of Hierarchical database. (5 Marks)

(c) A bank has 500 employees. The salary paid to each employee is sum of his basic pay, Dearness Allowance and House rent allowance. For the purpose of computing house rent allowance bank has classified his employees into three classes A, B and C. The house rent allowance for each class is computed at the rate of 30 percent, 20 percent and 10 percent of the basic pay respectively. The dearness allowance is computed at a flat rate of 60 percent of the basic pay.

Draw a flow chart to determine the percentage of employee falling in the each of the following salary slabs:

(i) Above Rs. 30,000

(ii) Rs. 15,001 to Rs. 30,000

(iii) Rs. 8,001 to Rs. 15,000

(iv) Less than or equal to Rs. 8,000. (10 Marks)

Answer

(a) The file processing system is still being used, but it has several problems that limit its efficiency and effectiveness for end user applications. These are stated below:

1. Data Duplication: Independent data files include a lot of duplicated data; the same data such as customer's name and address is recorded and stored in several files. This data redundancy causes problems when data has to be updated, since separate file maintenance programs have to be developed and coordinated to ensure that each file is properly updated.
2. Lack of Data Integration: Having data in independent files makes it difficult to provide end users with information for ad hoc requests that require accessing data stored in several different files. Special computer programs have to be written to retrieve data from each independent file. This is difficult, time consuming and expensive for the organization.
3. Data Dependence: In file processing system, major components of a system i.e. the organization of files, their physical location on storage, hardware and the application software used to access those files depend on one another in a significant way. Application programs typically contain references to the specific format of data stored in the various files they use. Thus, if changes are made in the format and structure of data and records in a file, changes have to be made in all programs that use this file. This program maintenance effort is a major burden of file processing system.
4. Other Problems: Data elements such as stock numbers and customer address are generally defined differently by different end users and applications. This causes serious inconsistency in the development of programs, which access such data. In addition, integrity of the data is suspected because there is no control over their use and maintenance by authorised end users.

(b) Features of Hierarchical Database

- Hierarchically structured database are less flexible than other database structures because the hierarchy of records must be determined and implemented before a search can be conducted. In other words, the relationships between records are relatively fixed by the structure.
- Ad hoc queries made by managers that require different relationships other than that are already implemented in the database may be difficult or time consuming to accomplish.
- Managerial use of query language to solve the problem may require multiple searches and prove to very time consuming. Thus, analysis and planning activities, which frequently involve ad hoc management queries of the database, may not be supported as effectively by a hierarchical DBMS as they are by other database structures.

- On the plus side, a hierarchical database management system usually processes structured, day-to-day operational data rapidly. In fact, the hierarchy of records is usually specifically organised to maximise the speed with which large batch operations such as payroll or sales invoices are processed.
- Records are logically structured in inverted tree pattern.
- Each record or node in hierarchy is related to other records in a parent-child relationship.
- It implements one-to-one and one-to-many relationship.
- Processing with group records of natural relations can be done faster.
- Child to many parents type logical structure finds difficulty in processing.

(c) The required flowchart is given on the next page.

Question 4

(a) Explain the working principle of Electronic Data Interchange (EDI). *(5 Marks)*

(b) Describe the various services provided by a Data centre. *(5 Marks)*

(c) Discuss the various components of a Local Area Network (LAN). *(10 Marks)*

Answer

(a) Working Principle of EDI – EDI is the electronic exchange of business documents such as invoices, purchase orders, shipping notices etc. It is a three-step process.

In an outgoing scenario

(i) Data from the application is translated into a standard format.

(ii) It is transmitted over communication lines to the trading partner.

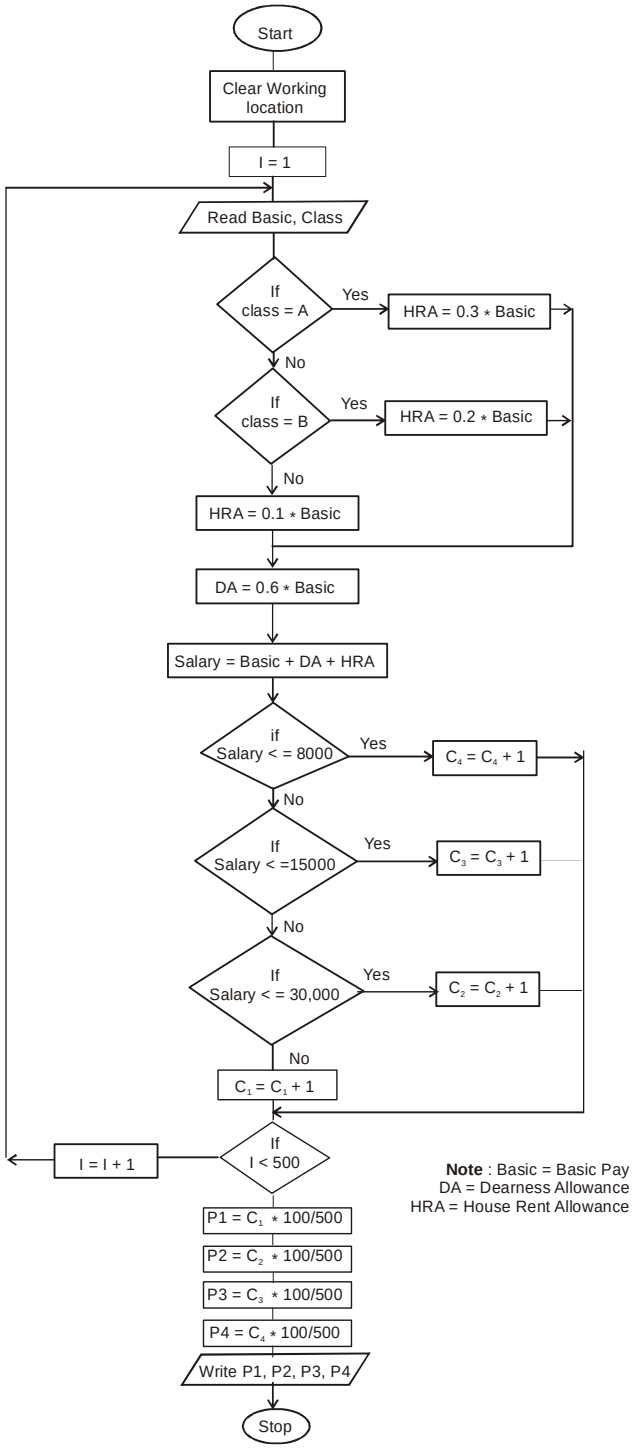
(iii) Finally, it is re-translated by the trading partner's applications.

The process works in reverse when the trading partner wishes to send the EDI transactions.

EDI consists of three components:

(i) Communication - To make EDI work, one needs communication software, translation software and access to standards. Communication software moves data from one point to another, flags the start and end of the document. Translation software helps the user to build a map and shows him how the data fields from his application corresponds to the elements of EDI standards. It also converts data back and forth between the application format and the EDI format.

(ii) Mapping - To build a map, the user first selects the EDI standard for the kind of data he wants to transmit. Usually the trading partner tells about the kind of standards to be used. Next, he edits out parts of the standards, which do not apply, to his application. Next, he imports a file that defines the fields in his application, and finally he makes the map to show where the data required by the EDI standards


Start
Clear Working location
I = 1
Read Basic, Class
If class = A
Yes
HRA = 0.3 * Basic
No
If class = B
Yes
HRA = 0.2 * Basic
No
HRA = 0.1 * Basic
DA = 0.6 * Basic
Salary = Basic + DA + HRA
if Salary < = 8000
Yes
C4 = C4 + 1
No
If Salary < =15000
Yes
C3 = C3 + 1
No
If Salary < = 30,000
Yes
C2 = C2 + 1
No
C1 = C1 + 1
If I < 500
I = I + 1
P1 = C1 * 100/500
P2 = C2 * 100/500
P3 = C3 * 100/500
P4 = C4 * 100/500
Write P1, P2, P3, P4
Stop
Note : Basic = Basic Pay
DA = Dearness Allowance
HRA = House Rent Allowance

is located in his application. Once the map is built, the translator will refer to it during EDI processing every time a transaction of that type is sent or received.

(iii) Profile - The last step is to write a partner profile that tells the system where to send each transaction and how to handle errors or exceptions. Whereas the user needs a unique map for every kind of documents he exchanges with a partner, he should only have to define partner information once.

(b) Services Provided by Data Centre: Some of the value added services that data centres provide are:

(i) Database Monitoring

- This is done via a database agent, which enables the high availability of the database through comprehensive automated management.

(ii) Web Monitoring

- Assess and monitor website performance, availability, response and integrity from a visitor's perspective.
- Report on HTTP, FTP service status, monitor URL availability, verify web content accuracy and changes.

(iii) Backup and restore

- Provide centralized multi-system management capabilities
- Provide comprehensive integral management solution to data storage using backup agent for the operating systems, database and applications.

(iv) Intrusion detection

- Detect malicious activity on the host – based ID systems and, network-based ID systems,
- Provide automated network security assessment and policy compliance evaluation.

(v) Storage on demand

- Provide back-end infrastructure as well as expertise, best practices and process to give a robust and cost-effective storage strategy.
- data storage infrastructure
- Provide security, reliability and availability of data to meet company demands.

(c) Components of a local area network (LAN):

(i) File Server – It is a computer system used for the purpose of managing the file system, servicing the network printers, handling network communication and other functions. It may be dedicated in which case all of its processing power is allocated to network functions or it may be non-dedicated which means that a part of the server functions may be allocated as a workstation.

(ii) Network Operating System – It is loaded into the server's hard disk along with the system management tools and user utilities. When the system is started, Net ware boots and server comes under its control. No processing is done on the server, hence it is called a passive device.

The choice of a dedicated or non-dedicated network server is basically a trade off between the cost and performance and operation of a network.

(iii) Workstations – These are attached to the server through the network interface card and cabling. The dumb terminals are not supported; only intelligent terminals are used on networks. They are active devices and can be disc less also. Workstation processes data after loading programs and data from the server and transfers files back to the server. In short, PC + LAN Card = Workstation.

(iv) Network Interface Card – Every device connected to a LAN needs a network interface card to plug into the LAN. Ethernet card is most widely used.

(v) Network Cabling - Server, workstations and network interface cards are connected together through network cabling. Following types of cables are most popular

(a) Shielded twisted pair

(b) Coaxial cable

(c) Fibre optic cable

Question 5

(a) With reference to word processing, differentiate between the following:

(i) Text Editor and Word Processor

(ii) Type face and Font. *(3+2 = 5 Marks)*

(b) What do you mean by Artificial Intelligence ? Describe any two types of artificial intelligence used in Information Technology. *(5 Marks)*

(c) Describe any five categories with their purposes under which various functions available in MS-EXCEL are classified. *(5 Marks)*

(d) Define the following functions used in MS-EXCEL:

(i) IRR

(ii) LEN

(iii) DMIN

(iv) POWER

(v) MOD (X/Y). *(5 Marks)*

Answer

(a) (i) Text Editor and Word Processor: Text Editors can edit plain text only and offer no formatting features. The user must hit ENTER at the end of each line. They are good for short documents or e-mail text bodies, HTML, web pages and programs.

Word Processors edit text and allow embedded formatting for words, paragraphs and whole documents. They also support word wrap, margins and different typefaces in the same document.

Word processors are specifically designed to prepare such document material as letters and reports whereas text editors are designed to manipulate non-document instructions in computer programs or data. Text editors lack the text formatting and document printing capabilities of word processors.

(ii) A typeface is the set of characters making up an alphabet that all share similar design characteristics (this says nothing about size, weight, style, etc.). A font is typeface of a particular point size, weight, and style. For example, "Times-Roman" is a typeface, but "Times-Roman, 12 point, bold, italic" is a font.

(b) Artificial intelligence (AI) is a software that tries to emulate aspects of human behaviour, such as reasoning, communicating, seeing and hearing. AI software can use its accumulated knowledge to reason and learn from experiences thereby modifies its subsequent reasoning. There are several types of AI including natural language, voice and visual recognition, robotics, neural networks, and expert systems. Natural language and voice & visual recognition both focus on enabling computers to interact more easily and naturally with users. Robotics focuses on teaching machines to replace human labour. Both neural networks and expert systems aim to improve decision-making. Two main types of AI are discussed below:

(i). Natural Language: Perhaps the most attractive means of entering data into the computer is by natural language. Users, who may be unable to remember a command or lost in a hierarchy of menus, desire for a computer, which is able to understand instructions expressed in everyday words.

However, due to the ambiguity of natural language (i.e. sentence structure and meaning), it is difficult for the computer to understand and execute instructions accurately. Although work in this area is currently going on in various parts of the world, the use of natural language in a restricted domain has been quite successful. Natural language understanding, in both speech and written input is the subject of much interest and research, and if successful in future, it may lead to a revolution in the way that data and instructions are input into the computer.

(ii). Voice Synthesizers: Also known as voice-output devices or audio-response units, voice synthesizers convert data in main storage to vocalised sounds understandable to humans. Voice synthesizers can be relatively expensive, but they can connect to almost every computer. Most synthesizer can be plugged into the computer where the printer does, and instead of producing a hardcopy, they speak the output. Speed and pitch can usually be adjusted.

In recent years, there is an increase in the popularity of having voice as one of the ways of output, presenting information in different languages for different users. Multimedia systems, which incorporate multi-media presentation and voice output, are popular amongst consumers. Available in many of today's applications, such as children education software, voice output serves as an excellent and important media for communicating information to those who are blind. From the present trend of development of multi-media systems, it seems that voice output will soon become one of the dominant methods of output.

(c) The functions available in MS-Excel can be categorised under several distinct heads. Five such categories and the purpose for which they can be used are stated below:

S. No.	Category	Purpose
1.	Financial	To calculate interest, depreciation, loan payment, IRR, NPV etc.
2.	Statistical	For common functions such as totals, averages, mean, median, mode etc. and advanced functions.
3.	Maths and Trig	To calculate the absolute values such as pi, logarithms, degrees and angles etc.
4.	Lookup & Reference	To search for and return values from a range, also to create hyperlinks etc.
5.	Data base	To calculate the values in an Excel data base based on conditions specified by the user.

(d) (i) IRR – It is financial function and returns the internal rate of returns for series of cash flows.

(ii) LEN – It is text function and returns the number of characters in a text string.

(iii) DMIN – It is a database function and returns the smallest number in the field of records in the database that matches the condition specified by the user.

(iv) POWER – It is a mathematical function and is used to calculate the value of one number raised to the power of another number (x^y).

(v) MOD (X/Y): It is a mathematical function. It returns modulus or remainder when x is divided by y.

Question 6

(a) Which areas of DBMS should be addressed while maintaining a database ? Explain. *(5 Marks)*

(b) Describe the Integrated Test Facility (ITF) method used in conducting audit through computer. *(5 Marks)*

(c) Describe about the various actions, which warrant penalty under the Section 43 of the IT Act, 2000. (5 Marks)

(d) Briefly explain the various tools available to protect information against intrusions. (5 Marks)

Answer

(a) Following five areas of DBMS managements are be considered when trying to maintain a well-tuned database:

(i) Installation of database

- Correct installation of the DBMS product.
- Ensuring that adequate file space is available.
- Proper allocation of disc space for database.
- Allocation of data files in standard sizes for I/O balancing.

(ii) Memory Usage – One should know about following memory management issues:

- How the DBMS uses main memory ?
- What buffers are being used ?
- What needs the programs in main memory have ?

Knowledge of above issues can help in efficient usage of memory.

(iii) Input / Output (I/O) contention

- Achieving maximum I/O performance is one of the most important aspects of tuning. Understanding how data are accessed by end-users is critical to I/O contention.
- Simultaneous or separate use of input and / or output devices.
- Clock speed of CPU requires more time management of I/O.
- Spooling/Buffering etc. can be used.
- Knowledge of how many and how frequently data are accessed, concurrently used database objects need to be striped across disks to reduce I/O contention.

(iv) CPU Usage

- Multi programming and multi processing improve performance in query processing
- Monitoring CPU load.
- Mixture of online/back ground processing need to be adjusted.
- Mark jobs that can be processed in run off period to unload the machine during peak working hours.

(b) Integrated Test Facility – ITF is a particular form of test data involving the establishment of a dummy entity through which data may be procured. Once the dummy entity is established, the auditor can input transactions and process these using the clients live system alongside the client's live data. It will be necessary to delete the test transactions from the system after the test has been performed. As with all test packs, the output produced is compared with predicted results to determine whether the programmed procedures being tested are operating correctly.

An ITF can be particularly useful in more complex environments, for example, in an on-line, real time banking system. A single terminal can be set up as an "audit bank" (a separate branch which is not consolidated into bank's accounts), which can then be used to perform any of the banking functions for its own dummy customers. In this way extensive testing of the entire system may be carried out without the client's staff being aware that it is taking place.

In order for the ITF technique to be effective the auditor should have a detailed knowledge of the complete system, including the possible effects of the ITF data on all related system files. Knowledge amongst the client's staff of the existence of the Integrated Test Facility should be limited to those who need this knowledge in order to perform their tasks properly.

(c) Penalty Action under Section 43

Section 43 deals with penalty for damage to computer or computer system by any of these methods:

(i) Securing access to the computer, computer system or computer network.

(ii) Downloading or extracting any data, computer database or information from such computer system or those stored in any removable storage medium.

(iii) Introducing any computer contaminant or computer virus into any computer, computer system or network.

(iv) Damaging any computer, computer system or network or any computer data, database or programme.

(v) Disrupting any computer, computer system or network.

(vi) Denying access to any person authorised to access any computer, computer system or network.

(vii) Providing assistance to any person to access any computer, computer system or network in contravention of any provisions of this Act or its Rules.

(viii) Charging the services availed of by one person to the account of another person by tampering with or manipulating any computer, computer system or network.

(d) Several tools are now available to protect information and systems against compromise, intrusion, or misuse:

(i) Firewalls are systems that control the flow of traffic between the Internet and the

firms' internal LANs and Systems. They are usually packaged as turnkey hardware/software packages, and are set up to enforce the specific security policies that are desired. A firewall is a proven, effective means of protecting the firm's internal resources from unwanted intrusion.

(ii) Encryption allows information to transit the Internet while being protected from interception by eavesdroppers. There are two basic approaches to encryption:

(a) Hardware encrypting devices are available at a reasonable cost, and can support high-speed traffic. If the Internet is being used to exchange information among branch offices or development collaborators, for instance, use of such devices can ensure that all traffic between these offices is secure.

(b) Software encryption is typically employed in conjunction with specific application. Certain electronic mail packages for example, provide decryption and encryption for message security.

(iii) Message Authentication makes sure that a message is really from whom it purports to be and it has not been tempered with. Regardless of company's individual needs, clearly defined Internet security policies and procedures should always be part of any corporate Internet security strategy.

(iv) Site Blocking is a software-based approach that prohibits access to certain Web sites that are deemed inappropriate by management. For example, sites that contain explicit objectionable material can be blocked to prevent employees from accessing these sites from company Internet servers. In addition to blocking sites, companies can also log activities and determine the amount of time spent on the Internet and identify the sites visited.

Question 7

Write short notes on the following:

(i) Firmware

(ii) Data dictionary

(iii) Storage area network

(iv) Microsoft windows. *(5×4 = 20 Marks)*

Answer

(i) FIRMWARE: Firmware or micro programs refer to a series of special program instructions. The most basic operations such as addition, multiplication etc, in a computer are carried out by hardwired circuits. These fundamental tasks are then combined in the form of micro programs to produce higher level operations such as move data, make comparison etc. These micro programs are called firmware because they deal with very low level machine operations and thus essentially substitute for additional hardware. Firmware are held in the CPU in a special control storage device.

(ii) Data Dictionary – Data dictionary is a centralized depository of information in a computerised form about the data in the database. The data dictionary contains the scheme of the data base i.e. the name of each item in the data base and a description and definition of its attributes along with the names of the programs that use them and who is responsible for the data; authorisation table that specifies users and the data and programs authorised for their use. These descriptions and definitions are referred to as the data standards. Maintenance of a data dictionary is the responsibility of the data base administrator. It is useful in the following ways:

- If any data fields are to be altered or eliminated, it helps to Identify all programs that might require modifications
- Useful for protecting data integrity of the database data.
- Helps programmer to quickly locate blocks of codes that can be reused in new application.
- (iii) Storage Area Network – SAN is a dedicated centrally managed, secure information infrastructure which enables any to any interconnections of servers and storage system. SAN connectivity is accomplished independently of the LAN. The storage is accessible from the server so users can access any storage device on the SAN regardless of the physical location of the storage or user. A key feature of SANs is their heterogeneous nature, with the ability to concurrently provide storage for servers running differing operating systems. This means that organisations using Solaris, Linux, HP/UX, Windows 2000 and Netware Servers can all access a single SAN.
- It facilitates universal access and sharing of resources
- It improves information protection and disaster tolerance.
- A SAN simplifies and centralises resource management.
- E-Commerce and globalisation has caused the necessity of SAN.
- Zero latency-information can be exchanged immediately.
- Its ability to continually adapt, while immediately accessing and processing information
- It supports distributed computing
- Full integration with different hardware, software from different vendors is possible.

(iv) Microsoft Windows: It is an operating system developed by Microsoft Inc. First time it was launched in 1983 and later on a modified version Windows 3 was introduced in 1990. Subsequently, Microsoft revised and enhanced its operating system almost every year. Windows 95/98 and Windows 2000 operating systems became very popular. Now a day, Windows XP is most commonly used operating system in personal computers. Microsoft Windows operating system has following salient features, which made it very popular

- Friendlier user interface
- Graphic user interface
- 32 bit architecture
- Provides multitasking environment to run multiple tasks concurrently
- Long file name permission
- Easy navigation routes
- Plug and play technology enabling user to connect various peripheral devices or add-ons with minimum of fuss.
- Designed for easy access to network resources
- Facilitates gateways to Internet, Fax
- Backwardly compatible
- Allows a developer to produce software applications to run on Windows without the need to notify Microsoft.

PAPER – 1 : ACCOUNTING

*Answer **all** questions.*

Working notes should form part of the answer.

Question 1

Following is the Balance Sheet as at March 31, 2005:

(Rs. '000)

Liabilities	*Max Ltd.*	*Mini Ltd.*	*Assets*	*Max Ltd.*	*Mini Ltd.*
Share capital:			*Goodwill*	*20*	*–*
Equity shares of Rs. 100 each	*1,500*	*1,000*	*Other fixed assets*	*1,500*	*760*
9% Preference shares of Rs. 100 each	*500*	*400*	*Debtors*	*651*	*440*
			Stock	*393*	*680*
General reserve	*180*	*170*	*Cash at bank*	*26*	*130*
Profit and loss account	*–*	*15*	*Own debentures*		
12% Debentures of Rs. 100 each	*600*	*200*	*(Nominal value Rs. 2,00,000)*	*192*	*–*
Sundry creditors	*415*	*225*	*Discount on issue of debentures*	*2*	*–*
			Profit and loss account	*411*	*–*
	3,195	*2,010*		*3,195*	*2,010*

On 1.4.2005, Max Ltd. adopted the following scheme of reconstruction:

(i) Each equity share shall be sub-divided into 10 equity shares of Rs. 10 each fully paid up. 50% of the equity share capital would be surrendered to the company.

(ii) Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 90% of the dividend claim and accept payment for the balance.

(iii) Own debentures of Rs. 80,000 were sold at Rs. 98 cum-interest and remaining own debentures were cancelled.

(iv) Debentureholders of Rs. 2,80,000 agreed to accept one machinery of book value of Rs. 3,00,000 in full settlement.

(v) Creditors, debtors and stocks were valued at Rs. 3,50,000, Rs. 5,90,000 and Rs. 3,60,000 respectively. The goodwill, discount on issue of debentures and profit and loss (Dr.) are to be written off.

(vi) The Company paid Rs. 15,000 as penalty to avoid capital commitments of Rs. 3,00,000.

On 2.4.2005 a scheme of absorption was adopted. Max Ltd. would take over Mini Ltd. The

purchase consideration was fixed as below:

(a) Equity shareholders of Mini Ltd. will be given 50 equity shares of Rs. 10 each fully paid up, in exchange for every 5 shares held in Mini Ltd.

(b) Issue of 9% preference shares of Rs. 100 each in the ratio of 4 preference shares of Max Ltd. for every 5 preference shares held in Mini Ltd.

(c) Issue of one 12% debenture of Rs. 100 each of Max Ltd. for every 12% debentures in Mini Ltd.

You are required to give Journal entries in the books of Max Ltd. and draw the resultant Balance Sheet as at 2nd April, 2005. *(20 Marks)*

Answer

Journal Entries in the books of Max Ltd.

	Particulars		*Dr. Amount*	*Cr. Amount*
2005			*Rs.*	*Rs.*
April 1	Equity share capital A/c	Dr.	15,00,000	
	To Equity share capital A/c			15,00,000
	(Being sub-division of one share of Rs. 100 each into 10 shares of Rs. 10 each)			
	Equity share capital A/c	Dr.	7,50,000	
	To Capital reduction A/c			7,50,000
	(Being reduction of capital by 50%)			
	Capital reduction A/c	Dr.	13,500	
	To Bank A/c			13,500
	(Being payment in cash of 10% of arrear of preference dividend)			
	Bank A/c	Dr.	78,400	
	To Own debentures A/c			76,800
	To Capital reduction A/c			1,600
	(Being profit on sale of own debentures transferred to capital reduction A/c)			
	12% Debentures A/c	Dr.	1,20,000	
	To Own debentures A/c			1,15,200
	To Capital reduction A/c			4,800
	(Being profit on cancellation of own debentures transferred to capital reduction A/c)			

	12% Debentures A/c	Dr.	2,80,000	
	Capital reduction A/c	Dr.	20,000	
	To Machinery A/c			3,00,000
	(Being machinery taken up by debentureholders for Rs. 2,80,000)			
	Creditors A/c	Dr.	65,000	
	Capital reduction A/c	Dr.	29,000	
	To Debtors A/c			61,000
	To Stock A/c			33,000
	(Being assets and liabilities revalued)			
	Capital reduction A/c	Dr.	4,33,000	
	To Goodwill A/c			20,000
	To Discount on debentures A/c			2,000
	To Profit and Loss A/c			4,11,000
	(Being the balance of capital reduction transferred to capital reserve account)			
	Capital reduction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being penalty paid for avoidance of capital commitments)			
	Capital reduction A/c	Dr.	2,45,900	
	To Capital reserve A/c			2,45,900
	(Being penalty paid for avoidance of capital commitments)			
April 2	Business purchase A/c	Dr.	13,20,000	
	To Liquidators of Mini Ltd.			13,20,000
	(Being the purchase consideration payable to Mini Ltd.)			
	Fixed assets A/c	Dr.	7,60,000	
	Stock A/c	Dr.	6,80,000	
	Debtors A/c	Dr.	4,40,000	
	Cash at bank A/c	Dr.	1,30,000	
	To Sundry creditors A/c			2,25,000

To 12% Debentures A/c of Mini Ltd.			2,00,000
To Profit and loss A/c			15,000
To General reserve A/c Rs. (1,70,000 + 80,000*)			2,50,000
To Business purchase A/c			13,20,000
(Being the take over of all assets and liabilities of Mini Ltd. by Max Ltd.)			
Liquidators of Mini Ltd. A/c	Dr.	13,20,000	
To Equity share capital A/c			10,00,000
To 9% Preference share capital A/c			3,20,000
(Being the purchase consideration discharged)			
12% Debentures of Mini Ltd. A/c	Dr.	2,00,000	
To 12% Debentures A/c			2,00,000
(Being Max Ltd. issued their 12% Debentures in against of every Debentures of Mini Ltd.)			

Balance Sheet of Max Ltd.

as at 2nd April, 2005

Liabilities	*Rs.*	*Assets*	*Rs.*
Equity share capital	17,50,000	Fixed assets	19,60,000
9% Preference share capital	8,20,000	Stock	10,40,000
Profit and loss account	15,000	Debtors	10,30,000
General reserve	4,30,000	Cash at bank	2,05,900
Capital reserve	2,45,900		
12% Debentures	4,00,000		
Sundry creditors	5,75,000		
	42,35,900		42,35,900

* Rs. 80,000 is the balancing figure adjusted to general reserve account as per AS 14 "Accounting for Amalgamation".

Working Notes:

1. *Purchase Consideration:*

	Rs.
Equity share capital $10,000 \times \frac{50}{5} \times$ Rs.10	= 10,00,000
9% Preference share capital $4,000 \times \frac{4}{5} \times$ Rs.100	= 3,20,000
	13,20,000

2. *General Reserve:*

	Rs.
Share capital of Mini Ltd. (Equity + Preference)	14,00,000
Less: Share capital issued by Max Ltd.	13,20,000
General reserve (resulted due to absorption)	80,000
Add: General reserve of Mini Ltd.	1,70,000
General reserve of Max Ltd.	1,80,000
	4,30,000

Question 2

Ram, Rahim and Robert are partners, sharing Profits and Losses in the ratio of 5 : 3 : 2. It was decided that Robert would retire on 31.3.2005 and in his place Richard would be admitted as a partner with new profit sharing ratio between Ram, Rahim and Richard at 3 : 2 : 1.

Balance Sheet of Ram, Rahim and Robert as at 31.3.2005

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		*Cash in Hand*	*20,000*
Ram	*1,00,000*	*Cash at Bank*	*1,00,000*
Rahim	*1,50,000*	*Sundry Debtors*	*5,00,000*
Robert	*2,00,000*	*Stock in Trade*	*2,00,000*
General Reserve	*2,00,000*	*Plant & Machinery*	*3,00,000*
Sundry Creditors	*8,00,000*	*Land & Building*	*5,30,000*
Loan from Richard	*2,00,000*		
	16,50,000		*16,50,000*

Retirement of Robert and admission of Richard is on the following terms:

(a) Plant & Machinery to be depreciated by Rs. 30,000.

(b) Land and Building to be valued at Rs. 6,00,000.

(c) Stock to be valued at 95% of book value.

(d) Provision for doubtful debts @ 10% to be provided on debtors.

(e) General Reserve to be apportioned amongst Ram, Rahim and Robert.

(f) The firm's goodwill to be valued at 2 years purchase of the average profits of the last 3 years.

The relevant figures are:

Year ended 31.3.2002 – Profit Rs. 50,000

Year ended 31.3.2003 – Profit Rs. 60,000

Year ended 31.3.2004 – Profit Rs. 55,000

(g) Out of the amount due to Robert Rs. 2,00,000 would be retained as loan by the firm and the balance will be settled immediately.

(h) Richard's capital should be equal to 50% of the combined capital of Ram and Rahim.

Prepare:

(i) Capital accounts of the partners; and

(ii) Balance Sheet of the reconstituted firm. *(16 Marks)*

Answer

Partners' Capital Accounts

Dr. *Cr.*

		Ram	*Rahim*	*Robert*	*Richard*			*Ram*	*Rahim*	*Robert*	*Richard*
		Rs.	*Rs.*	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*	*Rs.*
To	Revaluation A/c (W.N. 1)	10,000	6,000	4,000	–	By	Balance b/d	1,00,000	1,50,000	2,00,000	–
To	Loan from Robert A/c	–	–	2,00,000	–	By	General reserve	1,00,000	60,000	40,000	–
To	Bank	–	–	58,000	–	By	Goodwill (W.N. 2)	55,000	33,000	22,000	–
To	Balance c/d	2,45,000	2,37,000	–	–						
		2,55,000	2,43,000	2,62,000	–			2,55,000	2,43,000	2,62,000	–
To	Goodwill*	55,000	36,667	–	18,333	By	Balance b/d	2,45,000	2,37,000	–	–
To	Balance c/d	1,90,000	2,00,333	–	1,95,167	By	Loan A/c – transfer	–	–	–	2,00,000
						By	Bank	–	–	–	13,500
		2,45,000	2,37,000	–	2,13,500			2,45,000	2,37,000	–	2,13,500

* As per para 36 of AS 10, 'Accounting for Fixed Assets', goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Therefore, the goodwill raised at the time of retirement of Robert is to be written off in new ratio among remaining partners including new partner – Richard.

Balance Sheet of the reconstituted firm
(after admission of Richard)

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital accounts:		Land and building	6,00,000
Ram	1,90,000	Plant and machinery	2,70,000
Rahim	2,00,333	Stock	1,90,000
Richard	1,95,167	Debtors	4,50,000
Sundry creditors	8,00,000	Cash at bank (W.N. 3)	55,500
Loan from Robert	2,00,000	Cash in hand	20,000
	15,85,500		15,85,500

Working Notes:

1. **Revaluation Account**

		Rs.				*Rs.*
To	Plant and machinery	30,000	By	Land and building		70,000
To	Stock	10,000	By	Partners' capital accounts		
To	Debtors	50,000		Ram	10,000	
				Rahim	6,000	
				Robert	4,000	20,000
		90,000				90,000

2. **Calculation of Goodwill:**

	Rs.
Profit for the year ended 31.3.2002	50,000
Profit for the year ended 31.3.2003	60,000
Profit for the year ended 31.3.2004	55,000
	1,65,000

$$\text{Average profit} = \frac{1,65,000}{3} = \text{Rs. } 55,000$$

Goodwill = Rs. 55,000 × 2 years = Rs. 1,10,000.

3. **Bank Account**

		Rs.			*Rs.*
To	Balance b/d	1,00,000	By	Robert's capital account	58,000
To	Richard's capital A/c	13,500	By	Balance c/d	55,500
		1,13,500			1,13,500

Question 3

M/s Shah & Co. commenced business on 1.4.2004 with Head Office at Mumbai and a Branch at Chennai. Purchases were made exclusively by the Head Office, where the goods were processed before sale. There was no loss or wastage in processing.

Only the processed goods received from Head Office were handled by the Branch. The goods were sent to branch at processed cost plus 10%.

All sales, whether by Head Office or by the Branch, were at uniform gross profit of 25% on their respective cost.

Following is the Trial Balance as on 31.3.2005.

	Head Office		Branch	
	Dr. Rs.	Cr. Rs.	Dr. Rs.	Cr. Rs.
Capital	–	3,10,000	–	–
Drawings	55,000	–	–	–
Purchases	19,69,500	–	–	–
Cost of processing	50,500	–	–	–
Sales	–	12,80,000	–	8,20,000
Goods sent to Branch	–	9,24,000	–	–
Administrative expenses	1,39,000	–	15,000	–
Selling expenses	50,000	–	6,200	–
Debtors	3,09,600	–	1,13,600	–
Branch Current account	3,89,800	–	–	–
Creditors	–	6,01,400	–	10,800
Bank Balance	1,52,000	–	77,500	–
Head Office Current account	–	–	–	2,61,500
Goods received from H.O.	–	–	8,80,000	–
	31,15,400	31,15,400	10,92,300	10,92,300

Following further information is provided:

(i) Goods sent by Head Office to the Branch in March, 2005 of Rs. 44,000 were not received by the Branch till 2.4.2005.

(ii) A remittance of Rs. 84,300 sent by the Branch to Head Office was also similarly not received upto 31.3.2005.

(iii) Stock taking at the Branch disclosed a shortage of Rs. 20,000 (at selling price to the branch).

(iv) Cost of unprocessed goods at Head Office on 31.3.2005 was Rs. 1,00,000.

Prepare Trading and Profit and Loss account in columnar form and Balance Sheet of the business as a whole as at 31.3.2005. *(16 Marks)*

Answer

In the books of Shah & Co.

Trading and Profit and Loss Account for the year ended 31st March, 2005

	Particulars	*H.O.* Rs.	*Branch* Rs.	*Total* Rs.			*H.O.* Rs.	*Branch* Rs.	*Total* Rs.
To	Purchases	19,69,500	–	19,69,500	By	Sales	12,80,000	8,20,000	21,00,000
To	Cost of processing	50,500	–	50,500	By	Goods sent to Branch	9,24,000	–	–
To	Goods received				By	Stock shortage	–	16,000	16,000
	from H.O.	–	8,80,000	–	By	Goods in transit	–	–	44,000
To	Gross profit c/d	3,40,000	1,64,000	5,04,000	By	Closing stock:			
						Processed goods	56,000	2,08,000	2,64,000
						Unprocessed goods	1,00,000	–	1,00,000
		23,60,000	10,44,000	25,24,000			23,60,000	10,44,000	25,24,000
To	Admn. expenses	1,39,000	15,000	1,54,000	By	Gross profit b/d	3,40,000	1,64,000	5,04,000
To	Selling expenses	50,000	6,200	56,200					
To	Stock shortage	–	16,000	16,000					
To	Stock reserve	22,909	–	22,909					
To	Net profit	1,28,091	1,26,800	2,54,891					
		3,40,000	1,64,000	5,04,000			3,40,000	1,64,000	5,04,000

Balance Sheet as at 31st March, 2005

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital	3,10,000		Debtors		
Add: Net profit	2,54,891		H.O.	3,09,600	
	5,64,891		Branch	1,13,600	4,23,200
Less: Drawings	55,000	5,09,891	Closing stock:		
Creditors			Processed goods		
H.O.	6,01,400		H.O.	56,000	
Branch	10,800	6,12,200	Branch	2,08,000	
				2,64,000	
			Less: Stock reserve	18,909	2,45,091
			Unprocessed goods		1,00,000
			Bank Balance		
			H.O.	1,52,000	
			Branch	77,500	2,29,500
			Goods in transit	44,000	
			Less: Stock reserve	4,000	40,000
			Cash in transit		84,300
		11,22,091			11,22,091

Working Notes:

1. **Calculation of closing stocks:**

Stock at Head Office:			*Rs.*
Cost of goods processed Rs. (19,69,500 + 50,500 – 1,00,000)			19,20,000
Less: Cost of goods sent to Branch Rs. $9,24,000 \times \frac{100}{110}$	8,40,000		
Cost of goods sold Rs. $12,80,000 \times \frac{100}{125}$		10,24,000	18,64,000
Stock of processed goods with H.O.			56,000

Stock at Branch:		*Rs.*
Goods received from H.O. (at invoice price)		8,80,000
Less: Invoice value of goods sold Rs. $8,20,000 \times \frac{100}{125}$	6,56,000	
Invoice value of stock shortage Rs. $20,000 \times \frac{100}{125}$	16,000	6,72,000
Stock at Branch at invoice price		2,08,000
Less: Stock Reserve $2,08,000 \times \frac{10}{110}$		18,909
Stock of processed goods with Branch (at cost)		1,89,091

2. Stock reserve

Unrealised profit on Branch stock $\left(Rs.2,08,000 \times \frac{10}{110} \right)$	18,909
Unrealised profit on goods in transit $\left(Rs.44,000 \times \frac{10}{110} \right)$	4,000
	22,909

Question 4

From the following particulars furnished by Shri Ramji, prepare Trading and Profit and Loss account for the year ended 31.3.2005. Also draft his Balance Sheet as at 31.3.2005:

	1.4.2004	*31.3.2005*
	Rs.	*Rs.*
Creditors	*3,15,400*	*2,48,000*
Expenses outstanding	*12,000*	*6,600*
Fixed assets (includes machinery)	*2,32,200*	*2,40,800*
Stock in hand	*1,60,800*	*2,22,400*
Cash in hand	*59,200*	*24,000*
Cash at bank	*80,000*	*1,37,600*
Sundry debtors	*3,30,600*	*?*

Details of the year's transactions are as follows:	
Cash and discount credited to debtors	*12,80,000*
Returns from debtors	*29,000*

Bad debts	*8,400*
Sales (Both cash and credit)	*14,36,200*
Discount allowed by creditors	*14,000*
Returns to creditors	*8,000*
Capital introduced by cheque	*1,70,000*
Collection from debtors (Deposited into bank after receiving cash)	*12,50,000*
Cash purchases	*20,600*
Expenses paid by cash	*1,91,400*
Drawings by cheque	*8,600*
Machinery acquired by cheque	*63,600*
Cash deposited into bank	*1,00,000*
Cash withdrawn from bank	*1,84,800*
Cash sales	*92,000*
Payment to creditors by cheque	*12,05,400*

Note: *Ramji has not sold any Fixed Asset during the year.* *(16 Marks)*

Answer

In the books of Shri Ramji
Trading and Profit and Loss Account
for the year ended 31st March, 2005

Dr.							*Cr.*
		Rs.	*Rs.*			*Rs.*	*Rs.*
To	Opening stock		1,60,800	By	Sales:		
To	Purchases:				Cash	92,000	
	Cash	20,600			Credit	13,44,200	
	Credit (W.N. 3)	11,60,000				14,36,200	
		11,80,600			*Less:* Returns	29,000	14,07,200
	Less: Returns	8,000	11,72,600				
To	Gross Profit c/d		2,96,200	By	Closing stock		2,22,400
			16,29,600				16,29,600
To	Discount allowed		30,000	By	Gross profit b/d		2,96,200
To	Bad debts		8,400	By	Discount		14,000
To	Expenses (W.N. 5)		1,86,000				
To	Depreciation (W.N. 4)		55,000				
To	Net profit		30,800				
			3,10,200				3,10,200

Balance Sheet as at 31st March, 2005

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital (W.N. 1)	5,35,400		Sundry assets	2,32,200	
Add: Additional capital	1,70,000		*Add:* New machinery	63,600	
Net profit	30,800			2,95,800	
	7,36,200		*Less:* Depreciation	55,000	2,40,800
Less: Drawings	8,600	7,27,600	Stock in trade		2,22,400
Sundry creditors		2,48,000	Sundry debtors (W.N. 2)		3,57,400
Outstanding expenses		6,600	Cash in hand		24,000
			Cash at bank		1,37,600
		9,82,200			9,82,200

Working Notes:

(1) Statement of Affairs as at 31st March, 2004

Liabilities	*Rs.*	*Assets*	*Rs.*
Sundry creditors	3,15,400	Sundry assets	2,32,200
Outstanding expenses	12,000	Stock	1,60,800
Ramji's capital		Debtors	3,30,600
(Balancing figure)	5,35,400	Cash in hand	59,200
		Cash at bank	80,000
	8,62,800		8,62,800

(2) Sundry Debtors Account

		Rs.			*Rs.*
To	Balance b/d	3,30,600	By	Cash	12,50,000
To	Sales (14,36,200 – 92,000)	13,44,200	By	Discount	30,000
			By	Returns (sales)	29,000
			By	Bad debts	8,400
			By	Balance c/d (Balancing figure)	3,57,400
		16,74,800			16,74,800

(3) Sundry Creditors Account

		Rs.			*Rs.*
To	Bank – Payments	12,05,400	By	Balance b/d	3,15,400
To	Discount	14,000	By	Purchases (Balancing figure)	11,60,000
To	Returns	8,000			
To	Balance c/d	2,48,000			
		14,75,400			14,75,400

(4)	*Depreciation on Fixed assets*	*Rs.*
	Opening balance	2,32,200
	Add: Additions	63,600
		2,95,800
	Less: Closing balance	2,40,800
	Depreciation for the year 2004 - 2005	55,000
(5)	Expenses to be shown in profit and loss account	
	Expenses (in cash)	1,91,400
	Add: Outstanding of 2005	6,600
		1,98,000
	Less: Outstanding of 2004	12,000
		1,86,000

(6) **Cash and Bank Account**

		Cash	*Bank*			*Cash*	*Bank*
		Rs.	*Rs.*			*Rs.*	*Rs.*
To	Balance b/d	59,200	80,000	By	Purchases	20,600	–
To	Capital	–	1,70,000	By	Expenses	1,91,400	–
To	Debtors	–	12,50,000	By	Plant and machinery	–	63,600
To	Bank	1,84,800	–	By	Drawings	–	8,600
To	Cash	–	1,00,000	By	Creditors	–	12,05,400
To	Sales	92,000	–	By	Cash	–	1,84,800
				By	Bank	1,00,000	–
				By	Balance c/d	24,000	1,37,600
		3,36,000	16,00,000			3,36,000	16,00,000

Question 5

Scorpio Ltd. came out with an issue of 45,00,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share. The promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A & Co; B & Co. and C & Co.
Each underwriter took firm underwriting of 1,00,000 shares each. Subscriptions for 31,00,000 equity shares were received with marked forms for the underwriters as given below:

A & Co.		*7,25,000 shares*
B & Co.		*8,40,000 shares*
C & Co.		*13,10,000 shares*
	Total	*28,75,000 shares*

The underwriters are eligible for a commission of 5% on face value of shares. The entire amount towards shares subscription has to be paid alongwith application. You are required to:

(a) Compute the underwriters liability (number of shares)

(b) Compute the amounts payable or due to underwriters; and

(c) Pass necessary journal entries in the books of Scorpio Ltd. relating to underwriting.

(16 Marks)

Answer

(a) Computation of underwriters' liability of (number of shares):

	A & Co.	*B & Co.*	*C & Co.*
Gross liability	12,00,000	12,00,000	12,00,000
Less: Firm underwriting	1,00,000	1,00,000	1,00,000
	11,00,000	11,00,000	11,00,000
Less: Marked applications	7,25,000	8,40,000	13,10,000
	3,75,000	2,60,000	(2,10,000)
Less: Unmarked applications distributed to A & Co. and B & Co. in equal ratio	1,12,500	1,12,500	Nil
	2,62,500	1,47,500	(2,10,000)
Less: Surplus of C & Co. distributed to A & Co. and B & Co. in equal ratio	1,05,000	1,05,000	2,10,000
Net liability (excluding firm underwriting)	1,57,500	42,500	Nil
Add: Firm underwriting	1,00,000	1,00,000	1,00,000
Total liability (number of shares)	2,57,500	1,42,500	1,00,000

(b) Computation of amounts payable by underwriters:

	Rs.	*Rs.*	*Rs.*
Liability towards shares to be subscribed @ 12 per share	30,90,000	17,10,000	12,00,000
Less: Commission (5% on 12 lakhs shares @ 10 each)	6,00,000	6,00,000	6,00,000
Net amount to be paid by underwriters	24,90,000	11,10,000	6,00,000

(c) Journal Entries in the books of Scorpio Ltd.

		Dr.	*Cr.*
		Rs.	*Rs.*
Underwriting commission A/c	Dr.	18,00,000	
To A & Co. A/c			6,00,000
To B & Co. A/c			6,00,000
To C & Co. A/c			6,00,000
(Being underwriting commission on the shares underwritten)			
A & Co. A/c	Dr.	30,90,000	
B & Co. A/c	Dr.	17,10,000	
C & Co. A/c	Dr.	12,00,000	
To Equity share capital A/c			50,00,000
To Share premium A/c			10,00,000
(Being shares including firm underwritten shares allotted to underwriters)			
Bank A/c	Dr.	42,00,000	
To A & Co. A/c			24,90,000
To B & Co. A/c			11,10,000
To C & Co. A/c			6,00,000
(Being the amount received towards shares allotted to underwriters less underwriting commission due to them)			

Question 6

*Answer any **four** of the following:*

(a) Under what circumstances can an enterprise change its accounting policy?

(b) ABC Ltd. could not recover Rs. 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor.

The debtor became bankrupt in April, 2005 and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of Rs. 10 lakhs in the books of account for the year ended 31st March, 2005?

(c) *X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2004. The wage revision is with retrospective effect from 1.4.2000. The arrear wages upto 31.3.2004 amounts to Rs. 80 lakhs. Arrear wages for the period from 1.4.2004 to 30.06.2004 (being the date of agreement) amounts to Rs. 7 lakhs.*

Decide whether a separate disclosure of arrear wages is required.

(d) *An intangible asset appears in Balance Sheet of A Co. Ltd. at Rs. 16 lakhs as on 31.3.2004. The asset was acquired for Rs. 40 lakhs in April, 1991. The Company has been amortising the asset value on straight line basis. The policy is to amortise for 20 years.*

Do you advise the Company to amortise the entire asset value in the books of the company as on 31.3.2004?

(e) *Ram Co. (P) Ltd. furnishes you the following information for the year ended 31.3.2005:*

Depreciation for the year ended 31.3.2005 (under straight line method)	*Rs. 100 lakhs*
Depreciation for the year ended 31.3.2005 (under written down value method)	*Rs. 200 lakhs*
Excess of depreciation for the earlier years calculated under written down value method over straight line method	*Rs. 500 lakhs*

The Company wants to change its method of claiming depreciation from straight line method to written down value method.

Decide, how the depreciation should be disclosed in the Financial Statement for the year ended 31.3.2005.

(f) *How refund of revenue grant received from the Government is disclosed in the Financial Statements?* *(4 × 4 = 16 Marks)*

Answer

(a) A change in accounting policy is made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. A more appropriate presentation of events or transactions in the financial statements occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise.

(b) As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance

sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of Rs. 10 lakhs according to para 8 of AS 4.

(c) It is given that revision of wages took place in June, 2004 with retrospective effect from 1.4.2000. The arrear wages payable for the period from 1.4.2000 to 30.6.2004 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional liability on account of wages amounting Rs. 87 lakhs (from 1.4.2000 to 30.6.2004) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised), 'Net Profit or Loss for the Period, Prior Period Items and Changes in the Accounting Policies', when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

However, wages payable for the current year (from 1.4.2004 to 30.6.2004) amounting Rs. 7 lakhs is not a prior period item, hence need not be disclosed separately. This may be shown as current year wages.

(d) AS 26 on 'Intangible Assets' came into effect for accounting periods commencing on or after 1.4.2003 and is mandatory in nature.

As per para 63 of the standard, the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of the intangible asset will not exceed ten years from the date when the asset is available for use. Since, in this situation, the amortisation period of ten years determined by applying para 63 has already expired on 31.03.2004, therefore, the carrying amount of Rs. 16 lakhs has to be eliminated with a corresponding adjustment to the balance of revenue reserves of 31.03.2004.

However, if there is persuasive evidence that the useful life of an intangible asset is more than ten years (as per para 67 of the standard), then an intangible asset has to be amortised over the best estimate of its useful life and therefore, assuming that the best estimate of its useful life is 20 years as given in the question, depreciation amounting Rs.2 lakhs $\left(\frac{\text{Rs.40 lakhs - Nil}}{\text{20 years}}\right)$ as per straight line basis should be charged by A Co. Ltd. and no other adjustment is required as on 31.3.2004.

(e) As per para 15 of AS 6 'Depreciation Accounting', when a change in the method of depreciation is made, depreciation should be calculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. The deficiency should be charged to profit and loss account. Similarly, any surplus should be credited in the statement of profit and loss. Such change is a change in the accounting policy, and its effect should be quantified and disclosed.

In the given case, the deficiency of Rs. 500 lakhs would be charged to the profit and loss account of 31.3.2005. In the notes to account, the fact of change in method of depreciation should be elaborated along with the effect of Rs. 500 lakhs. The current depreciation charge of 200 lakhs determined in accordance with the written down value method should be debited to the profit and loss account.

(f) The amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

PAPER – 2 : AUDITING

*Answer Questions Nos. **1** and **2** and any **four** questions from the rest.*

Question 1

As an auditor, comment on the following:

(a) M/s Bonafide Ltd. has taken a Group Gratuity Policy from an Insurance Company. During accounting year 2004-05 it received a communication from the said Insurance Company informing that premium amount for the accounting year 2003-04 was less charged by Rs.75 lacs on account of arithmetical error on the part of Insurance Company. M/s Bonafide Ltd. paid the said sum of Rs. 75 lacs during the accounting year 2004-05 by debiting the same to Prior Period Expenses. (5 Marks)

(b) As on 31.3.2005, there was a claim for damage from one of the customers against the company engaged in selling of accounting software for an alleged failure to provide satisfactory after-sales services in relation to the software purchased from it. Before finalisation of the accounts for the year ended 31.3.2005 (the accounts were finalised on 14th June, 2005), the company won the case and had no liability whatsoever in this regard. The company has made a provision for this contingent liability in its accounts for the year ended 31.3.2005, which, it says, will be reversed in the next year. (5 Marks)

(c) Mr. A was appointed auditor of AAS Ltd. by Board to fill the casual vacancy that arose due to death of the auditor originally appointed in AGM. Subsequently, Mr. A also resigned on health grounds during the tenure of appointment. The Board filled this vacancy by appointing you through duly passed Board resolution. (4 Marks)

(d) SK Ltd. has fully computerised its accounting operations. The stock records are maintained up to date with timely entries passed for all receipts and issues. The company has hired a professional security agency, which monitors and implements a close vigilance over the operations of the company. As such, the company had dispensed with the practice of taking stock of their inventories at the year end as in their opinion the exercise is redundant, time consuming and intrusion to normal functioning of the operations. (4 Marks)

Answer

(a) Prior Period Expenses: Accounting Standard 5 defines the prior period items as income or expenses which arise in the current period as a result of errors or omission in the preparation of the financial statements of one or more prior period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts or oversight. In this case, there has been arithmetical mistake of Rs.75 lacs in computing the amount of premium.

Though in this case there was no error or omission on the part of M/s Bonafide Ltd. and the error was on the part of the Insurance company. But it is the management of the enterprise which is responsible for preparation of financial statements. Thus, the expenditure of Rs.75 lacs pertains to prior period and to be debited to Prior Period

Expenses. Therefore, the accounting treatment accorded by the management is appropriate. The auditor should, however, ensure that the nature of mistake, i.e., insurance premium as well as amount of Rs.75 lacs has been disclosed separately in such a manner that its impact on the current profit or loss can be perceived.

(b) Events Occurring After the Balance Sheet Date: As per facts of the case on 31.3.2005, there was a claim against the company for damages by a customer for not providing after sales service. It is a condition prevailing as on the date of balance sheet. Part I of Schedule VI to the Companies Act, 1956 requires disclosure of claims against company not acknowledged as debt as a footnote under caption contingent liability if the same had not been provided for in the balance sheet. However, as on that date, the company had provided for the contingent liability perhaps in view of expectation that such a claim may crystallize as liability against it. The winning of the case by the company in its favour (before the accounts were approved) after the date of the balance sheet constitutes additional evidence that will be of help in deciding the treatment of the matter in the accounts as per AS 4, "Contingencies and Events Occurring After the Balance Sheet Date". However, no provision would be needed as the case had been won by the company, since confirmed by subsequent event happening after the balance sheet date. The disclosure of facts of the case is, however, necessary with a view to keeping users of financial statements informed about the nature of event as well as the fact that no provision is necessary.

(c) Appointment of Auditor: Section 224(6) of the Companies Act, 1956 provides that the Board of directors "may fill any casual vacancy in the office of an auditor; but while any such vacancy continues, the remaining auditor or auditors, if any, may act". However, where such vacancy is caused by the resignation of an auditor, the vacancy shall only be filled by the company in general meeting. However, in the present case the auditor Mr. A resigned and the vacancy had been filled in by Board. But, the vacancy caused by resignation cannot be filled by Board since it does not amount to casual vacancy. Hence it can be filled only by shareholders in general meeting as per section 224(6).

The fact that the Mr A was appointed by Board originally is a matter irrelevant in this situation. If the cause of vacancy is resignation, then the power of appointment shall vest with the general meeting only. As such, the appointment made by Board is invalid.

(d) Verification of Inventories – Auditors' Duties: The audit procedures to be performed by an auditor to obtain sufficient appropriate audit evidence in relation to inventories have been recommended in the Guidance Note on Audit of Inventories issued by ICAI. On the basis of his evaluation of the effectiveness of the internal controls, the auditor should carry out appropriate substantive procedures in relation to inventories. These substantive procedures include examination of records, attendance at stock-taking, examination of valuation and disclosure of inventories, carrying out analytical procedures, and obtaining confirmations from third parties and representations from the management. CARO 2003 requires specific comment by auditor as to the adequacy and reasonableness of the *physical verification* of inventory It also requires auditor to comment whether discrepancy, if any, observed in such a physical verification had been

duly accounted for.

In view of above, an auditor should insist on the company to do physical verification of inventory. Verification must be done at least yearly, if not more frequently within a year. Dispensing with physical verification altogether is unacceptable. It is not enough that the company had installed good control procedures. It must be tested, for example, in case of inventory, physically verifying the same as to see that no discrepancy exists. Pilferage, misappropriation is not the only cause for discrepancies. Inherent product qualities like shrinkage, evaporation, handling loss, etc. may also account for discrepancies. The auditor should require the management to conduct physical verification by or near the year end. If the management does not accept to the auditor's view the auditor may appropriately make modify in his audit report.

Question 2

(a) Give your comments on the following:

(i) The auditors of ABC Ltd. Issued a qualified opinion about the truth and fairness of the accounts of the company for the year ended 31.3.2005. They typed out the matters of qualifications in a bold font so as to invite the attention of the readers to them. The Board objected to it and required them to be typed out in the same normal font as other paragraphs of the report appear. (5 Marks)

(ii) Auditors of M/s Fortune India (P) Ltd. were changed for the accounting year 2004-05. The closing stock of the company as on 31.3.2004 amounting to Rs. 100 lacs continued as it is and became closing stock as on 31.3.2005. The auditors of the company propose to exclude from their audit programme the audit of closing stock of Rs. 100 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. (5 Marks)

(b) What are the obvious assertions in the following items appearing in the Financial Statements?

(i) Profit and Loss Statement

Travelling Expenditure Rs.50,000 (2 Marks)

(ii) Balance Sheet

Debtors Rs.2,00,000 (2 Marks)

(c) Briefly explain the following:

(i) Control Risk (2 Marks)

(ii) Management Representation (2 Marks)

Answer

(a) (i) Qualified Report: Section 227(3)(e) requires that "the observations or comments of the auditors which have any adverse effect on the functioning of the company" should be given in the auditor's report "in thick type or in italics" so that these are

identified readily and clearly by the readers (including regulatory authorities). According to ICAI, this requirement does not in any way extent the scope of audit. It requires the auditor to evaluate his qualifications and make a judgement regarding which of them deal with matters that may have an adverse effect on the functioning of the company. Since auditor is of the view that such qualifications need to be highlighted in bold in conformity with the provisions of the set, the management has no right to object on the same.

(ii) Verification of Stocks: AAS 22, "Initial Engagements – Opening Balances", requires that for initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

(a) the closing balances of the preceding period have been correctly brought forward to the current period;

(b) the opening balances do not contain misstatements that materially affect the financial statements for the current period; and

(c) appropriate accounting policies are consistently applied.

When the financial statements for the preceding period were audited by the another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the balance sheet date. The contention of the management that the stock has not undergone any change cannot be accepted, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the stock lying as it is might have deteriorated and the same need to be examined. The auditor is advised not to exclude from his audit programme the audit of closing stock.

(b) (i) Travelling Expenditure: Rs.50,000

- Expenditure has been actually incurred for the purpose of travelling.
- Travelling has been undertaken during the year under consideration.
- Total amount of expenditure incurred is Rs.50,000 during the year.
- It has been treated as revenue expenditure and charged to profit and loss account.

(ii) Debtors: Rs.2,00,000

- These include all sales transaction occurred during the year.
- These have been recorded properly and occurred during the year

- These constitute assets of the entity.
- These have been shown at proper value, i.e. after showing the deduction on account of provision for bad and doubtful debts.

(c) (i) Control Risk: AAS-6, "Risk Assessments and Internal Control" defines the Control Risk as under:

"Control Risk" is the risk that a misstatement, that could occur in an account balance or class or transaction and that could be material, either individually or when aggregated with misstatements in other balances or classes, will not be prevented or detected and corrected on a timely basis by the accounting and internal control systems.

(ii) Management Representation: AAS 11, "Representations by Management", establishes standards on the use of management representations as audit evidence, the procedures to be applied in evaluating and documenting management representations, and the action to be taken if management refuses to provide appropriate representations. As per AAS 11, management representation constitutes audit evidence furnished by management to auditor in respect of any transaction entered into by the entity. Management Representation is of great use to the auditor when other sufficient appropriate audit evidence cannot reasonably be expected to exist. In certain instances such as where knowledge of facts is confined to management or where matter is principally of intention, a representation by management may be the only audit evidence which can reasonably be expected to be available for example intention of management to hold a specific investment for long term. However, it cannot be a substitute for other audit evidences expected to be available.

Question 3

(a) Under what circumstances change in accounting policies is permissible?

(b) What are the inherent limitations of audit? *(8+8=16 Marks)*

Answer

(a) Change in Accounting Policies: Normally speaking, same accounting policies are adopted for similar events or transactions in each period so as to enable the user to compare the financial statements of an enterprise over a period of time. However, Accounting Standard 5, "Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies" provides that accounting policies can be changed under the following circumstances:

(1) if the adoption of a different accounting policy is required by statute; or

(2) for compliance with an accounting standard; or

(3) if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

A more appropriate presentation of events or transactions in the financial statements occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise. AS 5 also requires any change in accounting policy consequent upon the adoption of an Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any, contained in that Accounting Standard. However, disclosures required by AS 5 should be made unless the transitional provisions of any other Accounting Standard require alternative disclosures in this regard. For instance, how an enterprise should deal with intangible items appearing in its balance sheet when it applies AS 26, Intangible Assets, for the first time.

(b) Inherent limitations of Audit: The objective of an audit of financial statements, prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements. In forming his opinion on the financial statements, the auditor follows procedures designed to satisfy himself that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The process of auditing, however, is such that it suffers from certain inherent limitations, i.e., the limitation which cannot be overcome irrespective of the nature and extent of audit procedures. Such limitations arise, first of all, on account of exercise of judgment in the auditor's work in deciding the extent of audit procedures and exercising judgement also in assessing the reasonableness of the judgment and estimates made by the management in preparing the financial statements. Secondly, much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. The audit evidence obtained by an auditor is generally persuasive in nature rather than conclusive in nature. Because of these factors, the auditor can only express an opinion. Therefore, absolute certainty in auditing is rarely attainable. There is also likelyhood that some material misstatements of the financial information resulting from fraud or error, if either exists, may not be detected. Another reason which may contribute to inherent limitation is the fact that the entire audit process is generally dependent upon the existence of an effective system of internal control. In such an event, it is clearly evident that there will always be some risk of an internal control system failing to operate as designed. No doubt, internal control system also suffers from certain inherent limitations since any system of internal control is ineffective against fraud involving collusion among employees or fraud committed by management. Certain levels of management may be in a position to override controls; for example, by directing subordinates to record transactions incorrectly or to conceal them, or by suppressing information relating to transactions. Such inherent limitations of internal control system also contribute to inherent limitations of an audit. Therefore, it is quite apparent from above that an audit suffers from certain inherent limitations.

Question 4

How will you verify/vouch the following?

(a) Sales Commission Expenditure

(b) Stock lying with Third Party

(c) Purchase of Motor Car

(d) Sales Return *(4 × 4 = 16 Marks)*

Answer

(a) Sales Commission Expenditure

(1) Ascertain agreement, if any, in respect of sales transaction actually occurred during the year carried out by authorized parties on its behalf. If yes the commission should be in accordance with the terms and conditions as specified.

(2) Check evidence of services rendered by the party to whom commission is paid with reference to correspondence etc.

(3) Ensure that the sales in fact have taken place and the same has been charged to profit and loss account.

(4) Compare the amount incurred in previous years with reference to total turnover.

(b) Stock lying with third party

(1) Obtain confirmations from the third party including the time period and reasons thereof.

(2) Evaluate condition of goods and see whether adequate provision has been made.

(3) Check whether subsequently the goods lying with third party were sold or received back after the expiry of stipulated time period.

(4) Ensure that the goods have been included in the closing stock though lying with third party.

(c) Purchase of Motor Car

(1) Ascertain whether the purchase of car has been properly authenticated.

(2) Check invoice of the car dealer to confirm purchase price.

(3) Examine registration with Transport Authorities to verify the ownership.

(4) Ensure that all expenses relating to purchase of car have been properly capitalized and the same have been disclosed properly in the balance sheet.

(d) Sales Return

(i) Examine the accounting basis for such transactions with reference to corresponding

Debit Note to Debit Note. The relevant correspondence may also be examined.

(ii) Verify by reference to relevant corresponding record in good inward book or the stores records. Further, the figures in these documentary evidences should be compared with the original invoices for rates and other charges and calculation should also be checked.

(iii) Examine in depth to eliminate the possibility of fictitious sales returns for covering bogus sales recorded earlier when such returns outwards are in substantial figure either at the start or end of the accounting year.

(iv) Cross-check with reference to original invoices any rebates in price or allowances if any given by buyers on strength of their Debit Notes.

Question 5

(a) What are the powers of C&AG in relation to the accounts of Government Companies audited by the statutory auditors?

(b) Is there any change in audit approach in the audit of computerised accounts as compared to audit of manual accounts? (8+8=16 Marks)

Answer

(a) Powers of C&AG in Relation to Government Companies: Section 619 of the Companies Act, 1956 contains provisions relating to the audit of government companies. As per section 619(3), the C&AG shall have power:

(a) to direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such ;

(b) to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to person or persons so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may by general or special order, direct.

The auditor aforesaid shall submit a copy of his audit report to the Comptroller and Auditor-General of India who shall have the right to comment upon, or supplement, the audit report in such manner as he may think fit.

The C & AG shall direct the manner in which the company's accounts shall be audited by the statutory auditors and give such auditors instructions in regard to any matter relating to the performance of his functions as such. The directions under section 619(3)(a) broadly covers the system of book-keeping and accounts, internal control etc.

The auditor submits audit report prepared under section 227 to the C&AG who shall have power to comment upon or supplement the report.

(b) Audit Approach in Respect of Computerised Accounts: The principal objective of an audit of financial statements, prepared within a framework of recognised accounting

policies and practices and relevant statutory requirements, if any, is to ensure that the financial statements reflect a true and fair view. The scope of an audit of financial statements is determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the Institute. This would involve assessment of reliability and sufficiency of the information contained in the accounting records and other source data by study and evaluation of accounting system and internal controls in operation. The overall objective and scope of an audit does not change in an EDP environment but the use of a computer changes the processing and storage of financial information and may affect the organisation and procedures employed by the entity to achieve adequate internal control. Accordingly, the procedures followed by the auditor in his study and evaluation of the accounting system and related internal controls and nature, timing and extent of his other audit procedures may be affected by an EDP environment. The computerisation of accounts would also have an impact on the increase in fraud and errors. Unless there is well laid down control with regard to use of programme, access, processing and other operations, the auditor runs the risk of material misstatement appearing in the financial statement. Thus when auditing in an EDP environment, the auditor should have sufficient understanding of computer hardware, software and processing systems to plan the engagement and to understand how EDP affects the study and evaluation of internal control and application of auditing procedures including computer-assisted audit techniques. The auditor should also have sufficient knowledge of EDP to implement the auditing procedures, depending on the particular audit approach adopted. Again, there is lack of audit trail (in a one to one fashion) in a highly computerised environment (e.g. on-line system). In such a case, the auditor has to ensure that data fed are correctly, and reliably processed; no unauthorised data are fed; the output produced to him had not been manipulated. In such a case, the auditor has to audit through the computer.

Thus, it is clear from the above that overall objective and scope of audit does not change irrespective of fact that whether the accounting information is generated manually or through EDP.

Question 6

(a) An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations. (12 Marks)

(b) What special steps will you take into consideration in auditing the receipts from entry fees of an amusement part? Mention any four points specific to the issue. (4 Marks)

Answer

(a) Receipt of Donations

(1) *Internal Control System*: Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.

(2) *Custody of Receipt Books*: Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.

(3) *Receipt of Cheques*: Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.

(4) *Bank Reconciliation*: Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.

(5) *Cash Receipts*: Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.

(6) Foreign Contributions, if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of donations to different NGOs

(1) *Mode of Sending Remittance*: All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.

(2) *Confirming Receipt of Remittance*: All remittances are supported by receipts and acknowledgements.

(3) *Identity:* Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.

(4) *Direct Confirmation Procedure:* Send confirmation letters to entities to whom donations have been paid.

(5) *Donation Utilisation*: Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.

(6) *System of NGOs' Selection*: System for selecting NGO to whom donations have been sent.

(b) Audit of receipts from Entry Fees of an Amusement Park

(1) Evaluate the internal control system regarding entry and collection for entry tickets including rotation of staff.

(2) Ensure that tickets are pre numbered.

(3) Ensure that the deposit of cash collected into the bank account very same next day.

(4) Compute analytical ratios in respect of the receipts pattern i.e. on week ends, holidays, etc. and make comparisons to draw conclusions.

Question 7

(a) State the matters to be specified in Auditor's Report in terms of provisions of Section 227(3) of the Companies Act, 1956. (8 Marks)

(b) What are the reporting requirements in Companies (Auditor's Report) Order, 2003 in respect of money raised by public issues? (8 Marks)

Answer

(a) Matters to be reported by auditor under section 227 (3): Under section 227(3) of the Companies Act, 1956, the report of the auditor shall state -

(i) Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit;

(ii) Whether, in his opinion, proper books of accounts as required by law have been kept by the company so far as appears from his examination of those books; whether proper returns adequate for the purposes of his audit have been received from the branches not audited by him;

(iii) Whether the report on the accounts of the branches audited by branch auditors under section 228 has been forwarded to him and how he had dealt with the same in preparing the auditor's report;

(iv) Whether the company's balance sheet and profit and loss account are in agreement with the books of accounts and returns;

(v) Whether in his opinion the profit and loss account and balance sheet comply with the accounting standards referred to in section 211(3C);

(vi) In thick type or in italics the observations or comments of auditors which have any adverse effect on the functioning of the company;

(vii) Whether any director is disqualified from being appointed as director under section 274(1)(g);

(viii) Whether the cess payable under section 441 A had been paid and if not details of amount of cess not so paid.

(b) Money raised by Public Issues: Companies (Auditor's Report) order, 2003 requires that in case the company has made a public issue of any of its securities like shares, preference shares, debentures and other securities, the auditor is required to report upon the disclosure of end-use of the money by the management in the financial statements. The auditor is also required to state whether he has verified the disclosure made by the management in this regard.

Schedule VI to the Act requires that only unutilized amount of any public issue made by the company should be disclosed in the financial statements of a company. In the absence of any legal requirement of such disclosure, it appears that the clause envisages that the companies should disclose the end use of money raised by the public issue in the financial statements by way of notes and the auditor should verify the same.

Normally, the companies do mention the end-use of the money proposed to be raised through the public issues in the prospectus. An examination of the prospectus would provide the auditor an understanding of the proposed end-use of money raised from public. The auditor should verify that the amount of end-use of money disclosed in the financial statements by the management is not significantly different from the proposed and actual end use. The auditor should obtain a representation from the management as to the completeness of the disclosure with regard to the end-use of money raised by public issues. If the auditor is of the opinion that adequate disclosure with regard to end use of money raised by public issue has not been made in the financial statements, the auditor should state the fact in his audit report. If, for any reason, the auditor is not able to verify the end-use of money raised from public issues, he should state that he is not able to comment upon the disclosure of end-use of money by the company since he could not verify the same. He should also mention the reasons which resulted in the auditor's inability to verify the disclosure.

Question 8

Write short notes on the following:

(a) General Purpose Financial Statements

(b) Permanent Audit File

(c) Going Concern Concept

(d) Vouching *(4 × 4 = 16 Marks)*

Answer

(a) General Purpose Financial Statements: The term "General Purpose Financial Statements" normally includes a balance sheet, a statement of profit and loss (also known as 'income statement'), a cash flow statement and those notes and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with financial information about business and geographical segments, and disclosures about the effects of changing prices. Financial statements do not, however, include such items as reports by directors, statements by the chairman, discussion and analysis by management and similar items that may be included in a financial or annual report. Such financial statements are prepared and presented at least annually and are directed toward the common information needs of a wide range of users. Some of these users may require, and have

the power to obtain, information in addition to that contained in the financial statements. Many users, however, have to rely on the financial statements as their major source of financial information and such financial statements should, therefore, be prepared and presented with their needs in view. Accounting Standards are applicable to all General Purpose Financial Statements.

(b) Permanent Audit File: In the case of recurring audits, some working paper files may be classified as permanent audit files. Normally, auditor may consider classifying such papers as permanent which are required in case of recurring audit assignments This file contains paper of continuing importance to succeeding audits. A permanent audit file normally includes :

- Information concerning the legal and organisational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions.
- Extracts or copies of important legal documents, agreements and minutes relevant to the audit.
- A record of the study and the evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
- Copies of audited financial statements for previous years.
- Analysis of significant ratios and trends.
- Copies of management letters issued by the auditor, if any.
- Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
- Notes regarding significant accounting policies.
- Significant audit observations of earlier years.

(c) Going Concern Concept: AS 1, "Disclosure of Accounting Policies", lays down that the "Going Concern", is one of the fundamental accounting assumption underlying financial statements. This Going Concern concept envisages that the entity will continue for the foreseeable future. Accounts are prepared on this concept unless there are indication that going concern concept is not holding good for a particular entity. On account of this basic concept of going concern, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. If this assumption is unjustified, the entity may not be able to realise its assets at the recorded amounts and there may be changes in the amounts and maturity dates of liabilities. AS 1, "Disclosure of Accounting Policies", also requires that no specific disclosure is required in case the same has been followed in the preparation of financial statements. In case this assumption is not followed, the fact should be disclosed.

AAS 16, "Going Concern", establishes standards on the auditor's responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as a basis for the preparation of the financial statements.

(d) **Vouching:** The act of examining vouchers is referred to as vouching. It is the practice followed in an audit, with the objective of establishing the authenticity of the transaction recorded in the primary books of account. It essentially consists of verifying a transaction recorded in the books of account with the relevant documentary evidence and the authority on the basis of which the entry has been made; also confirming that the amount mentioned in the voucher has been posted to an appropriate account which would disclose the nature of transaction on its inclusion in the final statements of account. After examination, each voucher is marked in a manner to ensure that it may not be presented again in support of another entry. The following points need careful consideration while examining a voucher:

(i) that the date of the voucher falls within the accounting period;

(ii) that the voucher is made out in the client's name;

(iii) that the voucher is duly authorised;

(iv) that the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e., the voucher is complete in all respects; and

(v) that the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

PAPER – 3 : BUSINESS AND CORPORATE LAWS

Question Nos. 1 and 7 are compulsory.

*Candidates are required to attempt **three questions** out of questions **2,3,4,5** and **6** and **two questions** out of questions **8,9 and 10.***

Question 1

Answer any six of the following:

(a) Mr. Ahuja of Delhi engaged Mr. Singh as his agent to buy a house in West Extension area. Mr. Singh bought a house for Rs.20 lakhs in the name of a nominee and then purchased it himself for Rs.24 lakhs. He then sold the same house to Mr. Ahuja for Rs.26 lakhs. Mr. Ahuja later comes to know the mischief of Mr. Singh and tries to recover the excess amount paid to Mr. Singh. Is he entitled to recover any amount from Mr. Singh? If so, how much? Explain. (4 Marks)

(b) Miss X, a film actress agreed to work exclusively for a period of two years, for a film production company. However, during the said period she enters into a contract to work for another film producer. Discuss the rights of the aggrieved film production company under the Indian Contract Act, 1872. (4 Marks)

(c) Explain the meaning of "Accounting year" under the Payment of Bonus Act, 1965. (4 Marks)

(d) State the acts which are considered beyond the implied authority of a partner under the provisions of the Indian Partnership Act, 1932. (4 Marks)

(e) A, a major, and B, a minor, executed a Promissory Note in favour of C. Examine with reference to the provisions of the negotiable Instruments Act, 1881 the validity of the Promissory Note and state whether it is binding on A and B.

(f) State the establishments to which the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, applies. (4 Marks)

(g) Explain the conditions of registration of a society under the Cooperative Societies Act, 1912. (4 Marks)

(h) What are the disqualifications for member of a multi-state cooperative society under the Multi-state Cooperative Societies Act, 2002?

Answer

(a) The problem in this case, is based on the provisions of the Indian Contract Act, 1872 as contained in Section 215 read with Section 216. The two sections provide, that where an agent without the knowledge of the principal, deals in the business of agency on his own account, the principal may:

(1) repudiate the transaction, if the case shows, either that the agent has dishonestly concealed any material fact from him, or that the dealings of the agent have been disadvantageous to him.

(2) claim from the agent any benefit, which may have resulted to him from the transaction.

Therefore, based on the above provisions, Mr. Ahuja is entitled to recover Rs.6 lakhs from Mr. Singh being the amount of profit earned by Mr. Singh out of the transaction.

(b) Where a party comments a breach of negative term of a contract i.e., where he does something which he promised not to do, the aggrieved party can go to court which may be issue an order restraining him from doing what he promised not to do. Such an order of the court is known as injunction. Since Miss X has agreed to work exclusively for the film production company for a period of two years, the aggrieved film production company can go to court and get injunction order restraining Miss X working for another film production company. A similar decision was taken in the case of *Warrior Bros vs. Nelson (1937) 1 K.B. 209*

(c) Section 2(i) of the Payment of Bonus Act, 1965 defines 'accounting year'**.** It means,

(i) in relation to a corporation, the year ending on the day on which the books of Accounts of the Corporation are to be closed and balanced.

(ii) In relation to a company, this term means a period in respect of which any profit or loss account of the company laid before it in an annual general meeting is made up whether that period is a year or not.

(iii) In any other case (a) the year commencing on the first day of April, or (b) if the accounts of an establishment maintained by the company thereof are closed and balanced on any day other than the 31st day of March then at the option of the employer, the year ending on the day on which its Accounts are so closed and balanced.

If, however, the said option is once exercised by the employer, it cannot be exercised once again, except with the permission in writing of the prescribed authority and upon such conditions as that authority may think fit. In other words, the exercise of the said option can only take place on obtaining the previous written permission of the prescribed authority, and the prescribed authority may impose such conditions as it may think fit.

(d) According to Section 19 of the Indian Partnership Act, 1932, unless there is usage or custom of trade to the contrary, the following acts of a partner are considered beyond his implied authority.

(1) Submit a dispute relating to the business of the firm to arbitration.

(2) Open a bank account on behalf of the firm in his own name.

(3) Compromise or relinquish any claim or portion of a claim by the firm against a third party (i.e. an outsider).

(4) Withdraw a suit or proceedings filed on behalf of the firm.

(5) Admit any liability in a suit a proceedings against the firm.

(6) Acquire immovable property on behalf of the firm.

(7) Transfer immovable property belonging to the firm.

(8) Enter into partnership on behalf of the firm.

(e) Minor being a party to Negotiable Instrument: Every person competent to enter into contract has capacity to incur liability by making, drawing, accepting, endorsing, delivering and negotiating a Promissory Note, Bill of Exchange or clearance (Section 26, Para 1, Negotiable Instrument Act, 1881).

As a Minor's agreement is void, he cannot bind himself by becoming a party to a Negotiable Instrument. But he may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself (Section 26, para 2).

In view of the provisions of Section 26 explained above, the promissory note executed by A and B is valid even though a minor is a party to it. B, being a minor is not liable; but his immunity from liability does not absolve the other joint promissory, viz., A from liability *[Sulochona v. Pondiyan Bank Ltd.,].*

(f) Establishments under the EPF & MP Act, 1952: According to Section 13(1) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 applies to the following establishments:

(a) every establishment which is a factory engaged in any industry specified in schedule 1 and in which 20 or more persons are employed; and

(b) any other establishment which employs 20 or more persons or class of such establishments which the Central Government may, by notification in Official Gazette specify in the behalf.

However, the Central Government may, after giving not less than 2 months notice of its intention to do so, apply the provisions of this Act to any establishment with less than 20 persons in the employment.

Further, notwithstanding anything mentioned above or in sub-section (1) of Section 16, where it appears to the Central Provident Fund Commissioner, whether on an application made to him in this behalf or otherwise, that the employer and the majority of employees in relation to any establishment, have agreed that the provisions of this Act should be made applicable to the establishment, he may, by notification in the official, Gazette, apply the provision of this Act to the establishment on and from the date of such agreement or from any subsequent date specified in such agreement.

An establishment to which this Act applies must continue to be governed by this Act, even if the number of persons employed therein falls at any time below 20.

(g) Conditions of Registration of Society (Section 6): The conditions for registration of a society under Section 6 of the Cooperative Society Act, 1912 are as follows:

(1) A society, other than a society of which a member is a registered society, shall not be registered under this Act if it does not consist of at least ten persons above the

age of eighteen years and, where the object of the society is the creation of funds to be lent to its members, unless such persons:

(a) reside in the some town or village or in the same group of villages; or

(b) save where the Registrar otherwise directs, are members of the same tribe, class, caste or occupation.

(2) The word "limited" shall be the last word in the name of every society with limited liability registered under this Act.

If the society fails to retain 10 members, such a failure may lead to the cancellation of its registration (Section 40). But the breach of the conditions referred to in (i) and (ii) above does not lead to cancellation unless the byelaws so provide for.

(h) Disqualifications for member of a Multi-State Co-operative Society: Under Section 29 of the Multi-State Co-operative Societies Act, 1984 as amended by the Amendment Act, 2002, a person shall not be eligible for being a member of a Multi-State Co-operative Society if: -

(1) his business is in conflict or competitive with the business of such Multi-state Co-operative Society; or

(2) he used for two consecutive years the services below the minimum level specified in the bye-laws; or

(3) he has not attended three consecutive general meetings of the Multi-State Co-operative Society and the members in the general meeting have not condoned such absence.

(4) he has made any default in payment of any amount to be paid to the Multi-State Co-operative Society under the byelaws of such society.

Question 2

(a) "An agreement made without consideration is void. "With reference to provisions of the Indian Contract Act, 1872 examine the validity of the statement and explain the cases in which the statement does not apply. (6 Marks)

(b) J, the owner of a Fiat car wants to sell his car. For this purpose he hand over the car to P, a mercantile agent for sale at a price not less than Rs.50,000. The agent sells the car for Rs.40,000 to A, who buys the car in good faith and without notice of any fraud. P misappropriated the money also. J sues A to recover the car. Decide giving reasons whether J would succeed. (6 Marks)

Answer

(a) Validity of an Agreement without consideration: The general rule is that an agreement made without consideration is void (Section 25). In every valid contract consideration is very important. A contract may only be enforceable when an adequate consideration is there. However, the Indian Contract Act, 1872 contains certain

exceptions to this rule. In the following cases, the agreement though made without consideration, will be valid and enforceable.

1. **Natural Love and Affection:** A written and registered agreement based on Natural Love and Affection between the parties standing in near relation (e.g., husband and wife) to each other is enforceable even without consideration. A contract in writing, registered on account of natural love and affection between parties standing near relation to each other are the essential requirements for valid contract though it is without consideration. *(Rajlukhee Devee vs. Bhootnath).*
2. **Compensation for past voluntary services:** A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable under (Section 25(2). In order that a promise to pay for the past voluntary services is binding, the following essential factors must exist:
   (i) the services should have been rendered voluntarily.
   (ii) the services must have been rendered for the promisor.
   (iii) the promisor must be in existence at the time when services were rendered.
   (iv) the Promisor must have intended to compensate to the promisee.
3. **Promise to pay time barred debt:** Where a promise in writing signed by the person making it or by his authorized agent, is made to pay a debt barred by limitation it is valid without consideration [Section 25(3)].
4. **Agency:** According to Section 185 of the Indian Contract Act, 1872 no consideration is necessary to create an agency.
5. **Completed gift:** In case of completed gifts, the rule no consideration no contract does not apply. Explanation (1) to Section 25 of the Act states "Nothing in this section shall affect the validity as between the donor and donee, of any gift actually made." Thus, gifts do not require any consideration.

(b) The problem in this case is based on the provisions of the Sale of Goods Act, 1930 contained in the proviso to Section 27. The proviso provides that a mercantile agent is one who in the customary course of his business, has, as such agent, authority either to sell goods, or to consign goods, for the purpose of sale, or to buy goods, or to raise money on the security of goods [Section 2(9)]. The buyer of goods from a mercantile agent, who has no authority from the principal to sell, gets a good title to the goods if the following conditions are satisfied:

(1) the agent should be in possession of the goods or documents of title to the goods with the consent of the owner.

(2) the agent should sell the goods while acting in the ordinary course of business of a mercantile agent.

(3) the buyer should act in good faith.

(4) the buyer should not have at the time of the contract of sale notice that the agent has no authority to sell.

In the instant case, P, the agent, was in the possession of the car with J's consent for the purpose of sale. A, the buyer, therefore obtained a good title to the car. Hence, J in this case, cannot recover the car from A. A similar decision, in analogous circumstances, was taken in *Folkes v. King*.

Question 3

(a) Examine the validity of a contract when the acceptance from the offeree is obtained under 'Coercion' or under 'Undue influence'. Point out the distinction between 'Coercion' and 'Undue influence'. (6 Marks)

(b) When does dissolution of a partnership firm take place under the provisions of the Indian Partnership Act, 1932? Explain. (6 Marks)

Answer

(a) According to Section 19 of the Indian Contract Act, 1872 when consent to an agreement is given due to coercion or undue influences, such a contract is voidable at the option of the party whose consent was so obtained. The difference between coercion and undue influence is as under:

	Coercion	**Undue Influence**
(a)	It involves the physical force or threat. The aggrieved party is complete to make the contract against its will.	It involves moral or mental pressure. The aggrieved party believes that he or she would make the contract.
(b)	It involves committing or threatening to commit an act forbidden by Indian Penal Code for detaining or threatening to detain property of another person.	No such illegal act is committed or a threat is given.
(c)	It is not necessary that there must be some relationship between the parties.	Some sort of relationship between the parties is absolutely necessary.
(d)	Coercion need not proceed from the promisor nor need it be directed against the promisor.	Undue influence is always essential between the parties to the contract.
(e)	The contract is voidable at the option of the party whose consent has been obtained by the coercion.	Where consent is induced by undue influence, the contract is either voidable or the court may set it sale or enforce it in a modified form.

(f)	In case of coercion where the aggrieved party, as per Section 64, rescinds the contract any benefit received has to be restored back to the other party.	The court has the distinction to direct the aggrieved party to return the benefit in whole or in part or not to give any such directions.

(b) Dissolution of Firm: The Dissolution of Firm means the discontinuation of the jural relation existing between all the partners of the Firm. But when only one of the partners retires or becomes in capacitated from acting as a partner due to death, insolvency or insanity, the partnership, i.e., the relationship between such a partner and other is dissolved, but the rest may decide to continue. In such cases, there is in practice, no dissolution of the firm. The particular partner goes out, but the remaining partners carry on the business of the Firm. In the case of dissolution of the firm, on the other hand, the whole firm is dissolved. The partnership terminates as between each and every partner of the firm.

Dissolution of a Firm may take place (Section 39 - 44)

(a) as a result of any agreement between all the partners (i.e., dissolution by agreement);

(b) by the adjudication of all the partners, or of all the partners but one, as insolvent (i.e., compulsory dissolution);

(c) by the business of the Firm becoming unlawful (i.e., compulsory dissolution);

(d) subject to agreement between the parties, on the happening of certain contingencies, such as: (i) effluence of time; (ii) completion of the venture for which it was entered into; (iii) death of a partner; (iv) insolvency of a partner. In case of death, it is to be noted that the partners may make a contrary agreement only if their number exceeds two. If there are only two partners the only result of either's death will necessarily be the dissolution of the firm. This was made clear by the Supreme Court in *Commissioner of Income-tax vs. G.S. Mills.*

(e) by a partner giving notice of his intention to dissolve the firm, in case of partnership at will and the firm being dissolved as from the date mentioned in the notice, or if no date is mentioned, as from the date of the communication of the notice; and

(f) by intervention of court in case of: (i) a partner becoming the unsound mind; (ii) permanent incapacity of a partner to perform his duties as such; (iii) Misconduct of a partner affecting the business; (iv) willful or persistent branches of agreement by a partner; (v) transfer or sale of the whole interest of a partner; (vi) improbability of the business being carried on save at a loss; (vii) the court being satisfied on other equitable grounds that the firm should be dissolved.

Question 4

(a) "Nemo Dat Quod Non Habet" – "None can give or transfer goods what he does not himself own."

Explain the rule and state the cases in which the rule does not apply under the provisions of the Sale of Goods Act, 1930. *(6 Marks)*

(b) Explain the manner in which the "Executive Committee" under the provisions of the employees' Provident Fund and Miscellaneous Provisions Act, 1952 is constituted. State its composition. *(6 Marks)*

Answer

(a) Exceptions to the Rule Nemo dat Quod Non Habet: The term means, "none can give or transfer goods what he does not himself own". Exceptions to the rule and the cases in which the Rule does not apply under the provisions of the Sale of Goods Act, 1930 are enumerated below:

(1) Effect of Estoppel (Section 27): Where the owner is stopped by the conduct from denying the seller's authority to sell, the transferee will get a good title as against the true owner. But before a good title by estoppel can be made, it must be shown that the true owner had actively suffered or held out the other person in question as the true owner or as a person authorized to sell the goods.

(2) Sale by a Mercantile Agent: A sale made by a mercantile agent of the goods or document of title to goods would pass a good title to the buyer in the following circumstances, namely;

(a) if he was in possession of the goods or documents with the consent of the owner;

(b) if the sale was made by him when acting in the ordinary course of business as a mercantile agent; and

(c) if the buyer had acted in good faith and has at the time of the contract of sale, no notice of the fact that the seller had no authority to sell.(Proviso to Section 27).

(3) Sale by one of the joint owners: If one of the several joint owners of goods has the sole possession of them with the permission of the others the property in the goods may be transferred to any person who buys them from such a joint owner in good faith and does not at the time of the contract of sale have notice that the seller has no authority to sell. [Section 28].

(4) Sale by a person in possession under voidable contract: A buyer would acquire a good title to the goods sold to him by seller who had obtained possession of the goods under a contract voidable on the ground of coercion, fraud, misrepresentation or undue influence provided that the contract had not been rescinded until the time of the sale (Section 29).

(5) Sale by one who has already sold the goods but continues in possession thereof: If a person has sold goods but continues to be in possession of them or of the documents of title to them, he may sell them to a third person, and if such person obtains the delivery thereof in good faith without notice of the previous sale,

he would have good title to them, although the property in the goods had passed to the first buyer earlier. A pledge or other deposition of the goods or documents of title by the seller in possession are equally valid. [Section 30(1)].

(6) Sale by buyer obtaining possession before the property in the goods has vested in him: Where a buyer with the consent of seller obtains possession of the goods before the property in them has passed to him, he may sell, pledge or otherwise dispose of the goods to a third person, and if such person obtains delivery of the goods in good faith and without notice of the lien or other right of the original seller in respect of the goods in good faith and without notice of the lien or other right of the original seller in respect of the goods, he would get a good title to them. [Section 30(2)].

(7) Sale by an unpaid seller: Where on unpaid seller who had exercised his right of lien or stoppage in transit resells the goods, the buyer acquires a good title to the goods as against the original buyer [Section 54(3)].

(8) Sale under the provisions of other Acts:

(i) Sale by an official Receiver or liquidator of the company will give the purchaser a valid title.

(ii) Purchase of goods from a finder of goods will get a valid title under circumstances.

(iii) Sale by a pawnee under default of pawnor will give valid title to the purchaser.

(b) Executive Committee under EPF & MP Act, 1952 – (Section 5A): The Central Government may, by notification in the official Gazette, constitute, with effect from such date as may be specified therein, on Executive Committee to assist the Central Board in the performance of its functions.

The Executive Committee shall consist of the following persons as members, namely:

(a) A chairman appointed by the Central Government from amongst the members of the Central Board;

(b) Two persons appointed by the Central Government from amongst the persons referred to in clause (b) of sub-section (1) of Section 5A.

(c) Three persons appointed by the Central Government from amongst the persons referred to in clause (c) of sub-section (1) of Section 5A.

(d) Three persons representing the employers elected by the Central Board from amongst the persons referred to in clause (d) of sub-section (i) of Section 5A.

(e) Three persons representing the employees elected by the Central Board from amongst the persons referred to in clause (e) of sub-section (i) of Section 5A.

(f) The Central Provident Fund Commissioner, ex-officio.

The terms and conditions subject to which a member of the Central Board may be appointed or elected to the Executive Committee and the time, place and procedure of

the meetings of the Executive Committee shall be such as may be provided for in the scheme.

Question 5

(a) In what way does the Negotiable Instruments Act, 1881 regulate the determination of the 'Date of maturity' of a Bill of Exchange. Ascertain the 'Date of maturity' of a bill payable 120 days after the date. The Bill of exchange was drawn on 1st June, 2005. (6 Marks)

(b) Explain the provisions of the payment of Bonus Act, 1965 relating to the following:

(i) Adjustment of Customary Bonus against bonus payable under the Act.

(ii) What is the time limit within which payment of bonus due to an employee under the Act, be paid? (6 Marks)

Answer

(a) Calculation of maturity of a Bill of Exchange: The maturity of a bill, not payable on demand, at sight or on presentment, is at maturity on the third day after the day on which it is expressed to be payable (Section 22, para 2 of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of a bill payable on demand, at sight, or presentment.

When a bill is made payable as stated number of months after date, the period stated terminates on the day of the month, which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance on protested for Non-acceptance when it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens. (Section 23).

When a bill is made payable a stated number of months after sight and has been accepted for honour, the period terminates which the day of the month which corresponds with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23).

In calculating the date a bill made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or the day of protest for non-accordance, or the day on which the event happens shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable. (Section 22).

When the last day of grace falls on a day, which is public holiday, the instrument is due and payable on the preceding business day (Section 25).

Answer to Problem: In this case the day of presentment for sight is to be excluded i.e. 1st June, 2005. The period of 120 days ends on 21st September, 2005 (June 29 days + July 31 days + August 31 Days + September 29 days = 120 days). Three days of grace are to be added. It falls due on 2nd October, 2005, which happens to be a public holiday. As such it will fall due on 1st October, 2005 i.e., the preceding Business Day.

(b) (i) **Adjustment of customary or Interim Bonus against bonus payable under the Act (Section 17, Payment of Bonus Act, 1965):** If in any accounting year, an employer has paid any puja bonus or other customary bonus to any employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year. The employee shall be entitled to receive only the balance. The employer can do the same thing even in a case where he has paid off the bonus payable under this Act to an employee before the date on which such customary bonus payable becomes payable.

(ii) Time limit for Payment of Bonus (Section 19): The employer is bound to pay his employee bonus within one month from the date on which the award becomes enforceable or the settlement comes into operation, if a dispute regarding payment of bonus is pending before any authority under Section 22. In other cases, however, the payment of the bonus is to be made within a period of 8 months from closing of the accounting year. But this period of 8 months may be extended upto a maximum of 2 years by the appropriate Government or by any authority specified by the appropriate Government. This extension is to be granted on the application of the employer and only for sufficient reasons.

Question 6

(a) Examine when shall a holder of a negotiable instrument be considered as a holder in due course under the provisions of the Negotiable Instruments Act, 1881. (6 Marks)

(b) Discuss the provisions relating to disposal of net profits of a society registered under the Multi-state Cooperative Societies Act, 2002. (6 Marks)

Answer

(a) According to Section 9 of the Negotiable Instruments Act, 1881, a holder of a negotiable instrument will be considered as holder in due course if he fulfills the following conditions.

(i) that for consideration he became the possessor of the negotiable instrument of payable to bearer or the payee or endorsee thereof if payable to order.

(ii) that he became the holder of the instrument before maturity.

(iii) that he became the holder of the instrument in good faith i.e., without sufficient cause to believe that any infinity or defect existed in the title of the person from whom he derived the title.

(b) Disposal of Net Profits (Section 63): Section 63 of the Multi-State Co-operative Societies Act, 2002 provides that out of net profits, a Multi-State Co-operative Society.

(a) transfer at least 25% of the net profits to the Reserve Fund.

(b) one percent of the Net Profits should be credited to the National Co-operative Union of India Limited, New Delhi as contribution to the Education Fund maintained by the union;

(c) transfer on amount not less than 10% to a reserve fund for meeting unforeseen losses.

After transferring the fund to above purposes, the balance of the net profits may be utilized for all or any of the following purposes, namely: -

(a) payment of dividend to the members on their paid-up share capital at a rate not exceeding the prescribed limit;

(b) constitution of, or contribution to, such special funds including education funds, as may be specified in the bye-laws;

(c) purposes connected which the development of Co-operative Movement of charitable purpose as defined in Section 2 of the Charitable Endowments Act, 1890;

(d) payment of ex-gratia amount to employees of the Multi-State Co-operative Society to the extent and in the manner specified in the byelaws.

Question 7

*Answer any **four** of the following:*

(a) Distinguish between 'share warrant' and 'share certificate'. State whether a private company can issue share warrants. (5 Marks)

(b) When is a company required to issue a 'shelf prospectus' under the provisions of the Companies (Amendment) Act, 2000? Explain the provisions of the Act relating to the issue of 'shelf prospectus' and filing it with the Registrar of Companies. (5 Marks)

(c) Dev Limited issued a notice for holding of its Annual General Meeting on 7th November, 2005. The notice was posted to the members on 16.10.2005. Some members of the company allege that the company had not complied with the provisions of the Companies Act, 1956 with regard to the period of notice and as such the meeting was not validly called. Referring to the provisions of the Act, decide:

(i) Whether the meeting has been validly called?

(ii) If there is a short fall in the number of days by which the notice falls short of the statutory requirement, state and explain by how many days does the notice fall short of the statutory requirement?

(iii) Can the short fall, if any, be condoned? (5 Marks)

(d) XYZ Limited realised on 3rd November, 2005 that particulars of charge created on 11th September, 2005 in favour of a bank were not filed with the Registrar of Companies for registration. What procedure should the company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created

on 11th August, 2005 instead of 11th September, 2005? Explain with reference to the relevant provisions of the Companies Act, 1956. *(5 Marks)*

(e) "Every shareholder of a company is also known as a member, while every member may not be known as a shareholder." Examine the validity of the statement and point out the distinction between a 'member' and a 'shareholder'. *(5 Marks)*

Answer

(a) Share certificate and Share Warrant:

(1) A share certificate is a prima facie evidence of document of title, stating that the holder is entitled to specified number of shares. Share warrant is a bearer document stating that the holder is entitled to certain number of shares specified therein.

(2) The holder of a share certificate is a member of the company, but whereas the bearer of a share warrant can be a member only if the articles provide.

(3) A share warrant is a negotiable instrument, where as a share certificate is not so.

(4) A public company can only issue a share warrant, whereas, a share certificate can be issued by a public and private company.

(5) In order to qualify as a director, the person should acquire a share certificate instead of a share warrant.

(6) A share certificate can be issued for a fully paid and partly paid up shares. A share warrant can be issued in respect of only full paid up share.

Private Company issuing Share Warrant:

A Private Company cannot issue share warrant under the provisions of the Company Act, 1956.

(b) Meaning: According to Section 60A as inserted by the Companies (Amendment) Act, 2000 'Shelf Prospectus' means a prospectus issued by any Financial Institutions or bank for one or more issues of the Securities or class of securities specified in that prospectus.

Organization required to issue and file Shelf Prospectus: Any Public Financial Institution, a public sector bank or schedule bank whose main object is financing, shall file a shelf prospectus. 'Financing Means Making loans to or subscribing in the capital of, a private industrial enterprise engaged in infrastructure financing, or such, other company as the Central Government may notify in this behalf.

A company filing a shelf prospectus with the registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus. It shall be required to file an information memorandum on all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within the time prescribed by the Central Government prior to making of a second or subsequent offer of securities under the shelf prospectus.

An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the First offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue securities under that prospectus.

Where an update of information memorandum is filed every time on offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

(c) (i) 21 Days clear notice of an AGM must be given [Section 171, Companies Act, 1956]: In case of notice by post, section 53(2) provides that the notice shall be deemed to have been received on expiry of 48 hours from the time of its posting. Besides, for working out clear 21 days, the day of the notice and the day of the meeting shall be excluded. Accordingly, 21 clear days notice has not been served (only 19 clear days notice is served) and the meeting is, therefore, not validly convened.

(ii) worked as per (i) above, notice falls short by 2 days.

(iii) according to Section 171(2), on AGM called at a notice shorter than 21 clear days shall be valid if consent is accorded thereto by all the members entitled to vote thereat. Thus, if all the members of the company approve the shorter notice, shortfall may be condoned.

(d) Section 125(1) of the Companies Act, 1956 provides that the prescribed particulars of the charge together with the instrument of any, by which the charge is created or evidenced, or a copy thereof, shall be filed with the Registrar within 30 days after the date of the creation of charge. In the given case particulars of charge have not been filed within the prescribed period of 30 days of its creation.

However, the Registrar of Companies is empowered under the proviso to Section 125(1) to extend the period of 30 days by another 30 days on payment of such additional fee not exceeding 10 times the amount of fee specified in Schedule X as the registrar may determine. Taking advantage of this provision, XYZ Limited should immediately file the particulars of charge with the Registrar and satisfy the Registrar that it had sufficient cause for not filing the particulars of charge within 30 days of creation of charge.

If the charge was created on 11th August, 2005, then the company has to apply to the Company Law Board u/s 141 (now Tribunal) and seek extension of time for filing the particulars for registration. The company must satisfy the Company Law Board (now Tribunal).

(a) that the omission was accidental or due to inadvertence or due to some other sufficient cause or was not of the nature of prejudice the position of creditors or shareholders of the company or.

(b) that it is just and equitable to grant relief on other grounds. On such satisfaction, the Company Law Board (now Tribunal) may extend the time for registration of charge on such terms and conditions as it may think expedient. Once the time is

extended and it is made out that the particulars have been filed within the extended time, the Registrar is bound to register the charge.

(e) 'Member' or 'Shareholders' of a company are the persons who collectively constitute the company as a corporate. Entry, the terms 'Member' and 'Shareholder' and 'holder of a share' are used interchangeable. *(Balkrishan Gupta v. Swadeshi Polytex Ltd.)* They are synonymous in the case of a company limited by shares, a company limited by guarantee and having a share capital and on unlimited company whose capital is held in definite shares. But in the case of an unlimited company or a company limited by guarantee, a Member may not be a shareholder, for such a company may not have a share capital.

A shareholder may be distinguished from a Member as follows:

(1) A registered shareholder is a member but a registered member may not be a shareholder because the company may not have a share capital.

(2) A person who owns a bearer share warrant is a shareholder but he is not a member as his name is struck off the register of members. [Section 115(i)]. This means that a person can be a holder of shares without being a member.

(3) A legal Representative of a deceased Member is not a member until he applies for registration. He is, however, a shareholder even though his name does not appear on the register of members.

(4) A person who subscribes to the Memorandum of Association immediately becomes the member, even though no shares are allotted to him. Till shares are allotted to the subscriber, he is a member but not a shareholder of the company.

(5) A person who has transferred his shares ceases to be a holder of those shares from the date of the transfer, but he continues to be a member till such time the transfer is registered in the name of the transfers in the books of the company.

Question 8

(a) M/s India Computers Ltd. was registered as a Public Company on 1st July, 2005 in the State of Maharashtra. Another company by name M/s All India Computers Ltd. was registered in Delhi on 15th July, 2005. The promoters of India Computers Ltd. have failed to persuade the management of All India Computers Ltd. to change the company's name, as it closely resembles with the name of the first registered company.

Advise the Management of India Computers Ltd. about the remedies available to them under the provisions of the Companies Act, 1956. (5 marks)

(b) State the procedure for inspection of Minutes Book of General Meetings of a company, by the members. (5 Marks)

Answer

(a) Since the name of M/s India Computer Ltd., was registered earlier, on 1st July, 2005, the promoters have a right to ask the management of M/s All India Computers Ltd to change its name suitably as the said name closely resembles with that of the first registered

company. Since the management of M/s All India Computers Ltd has not agreed, the promoters of India computers Ltd can approach the Central Government under Section 22 of the Companies Act, 1956 for rectification of the name of the company registered subsequently. The Central Government can direct the second registered company for correction. This direction can be given within 12 months from the date of registration of the latter company and the said company has to comply with the direction within 3 months by changing its name suitably failing which penal provisions will become applicable. The power of the Central Government under Section 22 has been delegated to the Regional Director.

(b) Inspection of Minutes Books of General Meetings: Following are the provisions relating to the procedure for inspection of minutes books of general meetings of a company by the members:

(1) The books containing the Minutes of the proceedings of any general meeting of a company shall-

(a) be kept at the registered office of the company, and

(b) be open, during business hours, to the inspection of any member without charge, subject to such reasonable restrictions as the company may, by its articles or in general meeting impose, so however that not less than two hours in each day are allowed for inspection.

(2) Any member shall be entitled to be furnished, within seven days after he has made a required in that behalf to the company, with a copy of any minutes referred to in sub-section (1), on payment of such sum as may be prescribed for every one hundred words or fractional part thereof required to be copied.

(3) If any inspection required under sub-section (1) is refused, or if any copy required under sub-section (2) is not furnished within the time specified therein, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees in respect of each offence.

(4) In the case of any such refusal or default, the Central Government may, by order, compel on immediate inspection of the Minute books or direct that the copy required shall forthwith be sent to the person requiring it.

Question 9

(a) "Moonstar Ltd" is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'A', a shareholder of the Moonstar Ltd., deposits in advance the remaining amount due on his shares without any calls made by "Moonstar Ltd.".

Referring to the provisions of the Companies Act, 1956, state the rights and liabilities of Mr. A, which will arise on the payment of calls made in advance. (5 Marks)

(b) C, a member of LS & Co. Ltd., holding some shares in his own name on which Final call money has not been paid, is denied by the company voting right at a general meeting on

the ground that the articles of association do not permit a member to vote if he has not paid the calls on the shares held by him.

With reference to the provisions of the Companies Act, 1956, examine the validity of company's denial to C of his voting right. *(5 Marks)*

Answer

(a) Mr.. A, a shareholder of the 'Moon Star Ltd'., deposited in Advance the remaining amount due on his shares without any calls made by 'Moon Star Ltd'. 'Moon Star Ltd' was authorized to accept the unpaid calls by its articles. According to section 92(1) of the Companies Act, 1956, a company may, if so authorized by the articles, accept from any member the whole or a part of the amount remaining unpaid or any shares by him although no part of that amount has been called up. The amount so received or accepted is described as payment in advance of calls. When a company receives payment in advance of calls, the rights and liabilities of the shareholder will be as follows:

(i) The shareholder is not entitled to voting rights in respect of the moneys so paid by him until the same would, but for such payment become presently payable. [Section 92(2)].

(ii) The shareholder's liability to the company in respect of the call for which the amount is paid is distinguished.

(iii) The shareholder is entitled to claim interest on the amount of the call to the extent payable according to the articles of association. If there are no profits, it must be paid out of capital, because shareholder becomes the creditor of the company in respect of this amount.

(iv) The amount received in advance of calls is not refundable.

(v) In the event of winding up the shareholder ranks after the creditors, but must be paid his amount with interest, if any before the other shareholders are paid off.

(vi) The power to receive the payment in advance of calls must be exercised in the general interest and for the benefit of the company.

(b) Section 181 of the Companies Act, 1956 lays down the grounds on which right of a shareholder to vote at the general meeting may be excluded. These are:

(a) Non-payment of calls by a member;

(b) Non-payment of other sums due against a member;

(c) Where company has exercised the right of lien on his shares.

Since the stipulation in the Articles relates to one of the grounds permitted under Section 181, the same is valid C's protest is not valid.

Question 10

(a) In what way does the Companies Act, 1956 regulate the payment of 'underwriting commission'? Explain the provisions of the Act, state the conditions to be complied with before payment of such commission can be made to underwriters of the company.

(5 Marks)

(b) At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favour of the resolution, 5 voted against it and 5 votes were found invalid. The remaining 10 members abstained from voting. The Chairman of the meeting declared the resolution as passed.

With reference to the provisions of the Companies Act, 1956, examine the validity of the Chairman's declaration. (5 Marks)

Answer

(a) Payment of underwriting commission is regulated by the provisions of Companies Act, 1956 stating certain conditions as contained in Section 76. The conditions to be fulfilled are:

(i) The payment of commission should be authorized by the articles.

(ii) The names and addresses of the underwriters and the number of shares or debentures underwriter by each of them should be disclosed in the prospectus.

(iii) The amount of commission should not exceed, in the case of shares, 5% of the price at which the shares have been issued or the amount or rate authorized by the articles, whichever is less and in the case of debentures it should not exceed 2½%.

(iv) The rate should be disclosed in the prospectus, or in the statement in lieu of prospectus (or in a statement in prescribed form signed in the like manner as the statement in the lieu of prospectus) and should be filed with the Registrar along with a copy of the underwriting contract before the payment of the commission.

(v) The number of shares or debentures, which persons have agreed to subscribe absolutely or conditionally for commission, should be disclosed in the manner aforesaid.

(vi) A copy of the contract for the payment of the commission should be delivered to the Registrar along with the prospectus or the statement in lieu of prospectus for registration.

Section 76(4A) clarifies that commission to the underwriter is payable only in respect of those shares or debentures which are offered to the public for subscription. However, where, (i) a person, who for a commission has subscribed (or agreed to subscribe) for shares or debentures of a company and before the issue of the prospectus (or statement in lieu of prospectus) for such shares or debentures, some other person (or persons) has subscribed for any or all of them, and (ii) such a fact together with the aggregate amount of commission payable to the underwriter is disclosed in such prospectus (or statement in

lieu of prospectus), then the company may pay commission to the underwriter in respect of his subscription irrespective of the fact that the shares or debentures have already been subscribed.

(b) Under Section 189(2) of the Companies Act, 1956, for a valid special resolution, the following conditions need to be satisfied:

(i) The intention to propose the resolution, as a special resolution must have been specified in the notice calling the general meeting or other intimation given to the members;

(ii) The notice required under the Companies Act must have been duly given of the general meeting;

(iii) The votes cast in favour of the resolution (whether by show of hands or on poll) by members present in person or by proxy are not less than 3 times the number of votes, if any, cast against the resolution.

Thus, in terms of the requisite majority, votes cast in favour have to be compared with votes cast against the resolution. Abstentions or in valued, if any, are not to be taken into account. Accordingly, in the given problem, the votes cast in favour (20) being more than 3 times of the votes cast against (5), if other conditions of Section 189(2) are satisfied, the decision of the Chairman is in order.

PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

*Question Nos. **1** and **6** are compulsory.*

*Attempt three questions out of the remaining Question Numbers **2, 3, 4** and **5** and attempt two questions from the remaining Question Numbers **7, 8, 9.***

Question 1

(a) *ABC Limited manufactures two radio models, the Nova which has been produced for five years and sells for Rs. 900, and the Royal, a new model introduced in early 2004, which sells for Rs. 1,140. Based on the following Income statement for the year 2004-05, a decision has been made to concentrate ABC Limited's marketing resources on the Royal model and to begin to phase out the Nova model.*

ABC Limited

Income Statement for the year ending March 31, 2005

	Royal Model	Nova Model	Total
	Rs.	Rs.	Rs.
Sales	45,60,000	1,98,00,000	2,43,60,000
Cost of Goods sold	31,92,000	1,25,40,000	1,57,32,000
Gross margin	13,68,000	72,60,000	86,28,000
Selling & Administrative Expenses	9,78,000	58,30,000	68,08,000
Net Income	3,90,000	14,30,000	18,20,000
Unit Produced and sold	4,000	22,000	
Net Income per unit sold	97.50	65	

The standard unit costs for the Royal and Nova models are as follows:

	Royal Model	Nova Model
	Rs.	Rs.
Direct materials	584	208
Direct Labour		
Royal (3.5 hrs x Rs. 12)	42	
Nova (1.5 hrs x Rs. 12)		18
Machine usage		
Royal (4 hrs x Rs. 18)	72	
Nova (8 hrs x Rs. 18)		144
Manufacturing overheads (applied on the basis of machine hours at a pre-determined rate of Rs. 25 per hour)	100	200
Standard Cost	798	570

ABC Ltd.'s Controller is advocating the use of activity-based costing and activity-based cost management and has gathered the following information about the company's manufacturing overheads cost for the year ending March 31, 2005.

Activity centre (Cost driver)	*Traceable Costs Rs.*	*Number of Events*		
		Royal	*Nova*	*Total*
Soldering (Number of solder joints)	*9,42,000*	*3,85,000*	*11,85,000*	*15,70,000*
Shipments (Number of shipments)	*8,60,000*	*3,800*	*16,200*	*20,000*
Quality control (Number of Shipments)	*12,40,000*	*21,300*	*56,200*	*77,500*
Purchase orders (Number of orders)	*9,50,400*	*1,09,980*	*80,100*	*1,90,080*
Machine Power (Machine hours)	*57,600*	*16,000*	*1,76,000*	*1,92,000*
Machine setups (Number of setups)	*7,50,000*	*14,000*	*16,000*	*30,000*
Total Traceable costs	*48,00,000*			

Required:

(i) Prepare a Statement showing allocation of manufacturing overheads using the principles of activity-based costing.

(ii) Prepare a Statement showing product cost profitability using activity-based costing.

(iii) Should ABC Ltd. continue to emphasize the Royal model and phase out the Nova model ? Discuss. (4+4+2 = 10 Marks)

(b) Discuss the essentials of a good Cost Accounting system. (4 Marks)

(c) Discuss ABC analysis as a technique of inventory control. (4 Marks)

Answer

(a) (i) Statement Showing Allocation of Manufacturing Overheads Using Principles of Activity Based Costing.

Activity Center	**Traceable cost Rs.**	**Cost allocation basis**	**Cost Allocation**	
			Royal Rs.	**Nova Rs.**
Soldering	9,42,000	385:1185	2,31,000	7,11,000
Shipments	8,60,000	38:162	1,63,400	6,96,600
Quality control	12,40,000	213:562	3,40,800	8,99,200
Purchase orders	9,50,400	109980:80100	5,49,900	4,00,500

Machine lower	57,600	16:176	4,800	52,800
Machine set ups	7,50,000	14:16	3,50,000	4,00,000
	48,00,000		16,39,900	31,60,100
Units produced and sold			4,000	22,000
Manufacturing Overheads Cost per unit			Rs. 409.98	Rs. 143.64

(ii) Statement Showing Product Cost and Profitability using Activity Based Costing

	Royal	Nova	Total
	Per Unit Cost Rs.	**Per Unit Cost Rs.**	**Rs.**
Standard cost other than manufacturing OHs cost	698	370	
Manufacturing OHs using activity-based costing	409.98	143.64	
Cost	1,107.98	513.64	
Selling Price/unit	1,140	900	
Gross Margin / unit	32.02	386.36	
Gross Margin	1,28,080	84,99,920	86,28,000
Selling & Adm. Expenses	9,78,000	58,30,000	68,08,000
Net Income	**(8,49,920)**	**26,69,920**	**18,20,000**

(iii) Novo Model should continue to be bread and butter product and Royal model should not be over-emphasized; rather it's pricing is required to be corrected.

(b) Essentials of a Good Cost Accounting System

(i) It should be tailor-made, practical, simple and capable of meeting the requirements of a business concern.

(ii) The data to be used by the Cost Accounting System should be accurate; otherwise it may distort the output of the system.

(iii) Necessary cooperation and participation of executives from various departments of the concern is essential for developing a good system of cost accounting.

(iv) The cost of installing and operating the system should justify the results.

(v) A carefully phased program should be prepared by using network analysis for the

introduction of the system.

(vi) Management should have faith in the costing system and should also provide a helping hand for its development and success.

(c) ABC Analysis as a technique of Inventory Control

It is a system of inventory control. It exercises discriminating control over different items of stores classified on the basis of investment involved. Usually they are divided into three categories according to their importance, namely, their value and frequency of replenishment during a period.

'A' category of items consists of only a small % i.e. about 10% of total items handled by the stores but require heavy investment about 70% of inventory value, because of their high prices or heavy requirement or both.

'B' category of items are relatively less important – 20% of the total items of material handled by stores and % of investment required is about 20% of total investment in inventories.

'C' category - 70% of total items handled and 10% of value.

For 'A' category items, stock levels and EOQ are used and effective monitoring is done.

For 'B' Category same tools as in 'A' category are applied.

For 'C' category of items, there is no need of exercising constant control. Orders for items in this group may be placed either after 6 months or once in a year, after ascertaining consumption requirements.

Question 2.

From the following Information for the month ending October, 2005, prepare Process Cost accounts for Process III. Use First-in-fist-out (FIFO) method to value equivalent production.

Direct materials added in Process III (Opening WIP)	*2,000 units at Rs. 25,750*
Transfer from Process II	*53,000 units at Rs. 4,11,500*
Transferred to Process IV	*48,000 units*
Closing stock of Process III	*5,000 units*
Units scrapped	*2,000 units*
Direct material added in Process III	*Rs. 1,97,600*
Direct wages	*Rs. 97,600*
Production Overheads	*Rs. 48,800*

Degree of completion:

	Opening Stock	*Closing Stock*	*Scrap*
Materials	*80%*	*70%*	*100%*
Labour	*60%*	*50%*	*70%*
Overheads	*60%*	*50%*	*70%*

The normal loss in the process was 5% of production and scrap was sold at Rs. 3 per unit. *(14 Marks)*

Answer

(a) Process III Process Cost Sheet (FIFO Method) Period.....

Op. Stock : 2000 units

Introduced : 53000 units

Statement of Equivalent Production

Input		Output		Equivalent production					
Item	**Units**	**Item**	**Units**	**Material A**		**Material B**		**Labour & OHs.**	
Op stock	2,000	Work on op WIP	2,000	-	-	400	20	800	40
Process II transfer	53,000	Introduced & completed during the period (48,000 – 2000)	46,000	46,000	100	46,000	100	46,000	100
			48,000						
		Normal Loss (2000+53000 – 5000) x 5%	2,500	-	-	-	-	-	-
	55,000	Cl WIP	5,000	5,000	100	3,500	70	2,500	50
			55,500	51,000		49,900		49,300	
		Ab. Gain	500	500	100	500	100	500	100
			55,000	50,500		49,400		48,800	

Statement of Cost for each Element

Element of cost	**Cost (Rs.)**	**Equivalent Production.**	**Cost per unit Rs.**
Material A			
Transfer from previous. Process	4,11,500		
Less: Scrap value of Normal Loss 2500 x Rs. 3	7,500		
	4,04,000	50,500	8
Material B	1,97,600	49,400	4
Wages	97,600	48,800	2
Overheads	48,800	48,800	1
	7,48,000		15

Process Cost Sheet (in Rs)

Op WIP (for completion)	Mat B	400×Rs. 4	=	1,600
	Wages	800× Rs. 2	=	1,600
	OHs.	800× Re. 1	=	800
				4,000
Introduced and completely processed during the period		46000× Rs. 15	=	Rs. 6,90,000
Closing WIP	Mat A	5,000×8	=	40,000
	Mat B	3,500×4	=	14,000
	Wages	2,500×2	=	5,000
	OHs	2,500×1	=	2,500
				61,500
Abnormal Gain		500× Rs. 15	=	7,500

Process III A/c

	Units	Amount (Rs.)		Units	Amount (Rs.)
To bal b/d	2,000	25,750	By Normal Loss	2,500	7,500
To Process II A/c	53,000	4,11,500	By process IV A/c (6,90,000 + 4000 + 25,750)	48,000	7,19,750
To Direct Material		1,97,600	By bal C/d	5,000	61,500
To Direct Wages		97,600			
To Prodn. Ohs		48,800			
To Abnormal Gain	500	7,500			
	55,500	7,88,750		55,500	7,88,750

Question 3.

(a) Discuss the circumstances under which a Cost Audit is ordered and the purpose of Cost Audit. *(4 Marks)*

(b) The following is the Trading and Profit & Loss Account of Omega Limited:

Dr.		*Cr.*	
Particulars	*Rs.*	*Particulars*	*Rs.*
To Materials consumed	*23,01,000*	*By Sales*	
To Direct wages	*12,05,750*	*(30,000 units)*	*48,75,000*
To Production Overheads	*6,92,250*	*By Finished goods*	

To Administration Overheads	*3,10,375*	*Stock (1,000 units)*		*1,30,000*
To Selling and Distribution Overheads	*3,68,875*	*By Work-in-progress:*		
To preliminary Expenses written off	*22,750*	*Materials*	*55,250*	
To Goodwill written off	*45,500*	*Wages*	*26,000*	
To Fines	*3,250*	*Production*		
To Interest on Mortgage	*13,000*	*Overheads*	*16,250*	*97,500*
To Loss on Sale of machine	*16,250*	*By Dividends received*		*3,90,000*
To Taxation	*1,95,000*			
To Net Profit for the year	*3,83,500*	*By Interest on bank deposits*		*65,000*
	55,57,500			*55,57,500*

Omega Limited manufactures a standard unit.

The Cost Accounting records of Omega Ltd. Show the following:

(i) Production overheads have been charged to work-in-progress at 20% on Prime cost.

(ii) Administration Overheads have been recovered at Rs. 9.75 per finished Unit.

(iii) Selling & distribution Overheads have been recovered at Rs. 13 per Unit sold.

(iv) The Under- or Over-absorption of Overheads has not been transferred to costing P/L A/c.

Required:

(i) Prepare a proforma Costing Profit & Loss account, indicating net profit.

(ii) Prepare Control accounts for production overheads, administration Overheads and selling & distribution Overheads.

(iii) Prepare a statement reconciling the profit disclosed by the cost records with that shown in Financial accounts. (3+3+4 = 10 Marks)

Answer

(a) Circumstances under which Cost Audit is ordered

(i) Price Fixation – The need for fixation of retention price in case of materials of national importance like steel, cement etc., may cause a necessity for cost audit.

(ii) Cost variation within an industry: Cost audit may be necessary to find reasons for such differences.

(iii) Inefficient Management – Where a factory is run inefficiently and uneconomically,

institution of cost audit may be necessary.

(iv) Tax assessment – Where a duty or tax is levied on products based on cost of production, the levying authorities may ask for cost audit to determine the correct cost of production.

Purposes of Cost Audit

Protective purpose – To examine that there is no undue wastage or losses and the costing system brings out the correct cost of production or processing.

Constructive purpose – Cost Audit provides information to management useful in regulating production, choosing economical methods of operation and reducing operations cost.

(b) (i) Costing Profit & Loss A/c

Materials		Rs. 23,01,000
Wages		12,05,750
	Prime Cost	35,06,750
	Production overheads (20% of Prime Cost)	7,01,350
		42,08,100
Less:	Work in Progress	97,500
	Manufacturing cost incurred during the period	41,10,600
Add:	Admn. Ohs (9.75 x 31000)	3,02,250
	Cost of Production	44,12,850
Less	Cl. Finished goods stock($4412850 \times \frac{1000}{31000}$)	1,42,350
	COGS	42,70,500
Add	Selling & distribution OHs (30,000× Rs. 13)	3,90,000
	Cost of Sales	46,60,500
	Profit	2,14,500
	Sales	48,75,000

(ii) Production OH A/c

	Rs		*Rs*
To Gen ledger Adj. A/c	6,92,250	By WIP A/c	7,01,350
To Bal. C/d	9,100		
	7,01,350		7,01,350

Admn. OH A/c

	Rs		*Rs*
To Gen Ledger Adj. A/c	3,10,375	By Finished goods A/c	3,02,250
		By bal c/d	8,125
	3,10,375		3,10,375

Selling & Distribution OHs A/c

	Rs		*Rs*
To Gen. Ledger Adj A/c	3,68,875	By Cost of Sales A/c	3,90,000
To bal C/d	21,125		
	3,90,000		3,90,000

(iii) Reconciliation Statement

			Rs
	Profits as per cost accounts		2,14,500
Add:	Prodn. OHs over absorbed	9,100	
	Selling & distribution OHs (Over absorbed)	21,125	
	Dividend received	3,90,000	
	Interest on bank deposits	65,000	4,85,225
			6,99,725
Less:	Admn Ohs under-absorbed	8,125	
	Preliminary exp. w/off	22,750	
	Goodwill w/off	45,500	
	Fines	3,250	
	Interest on Mortgage	13,000	
	Loss on sale of machinery	16,250	
	Taxation	1,95,000	
	Write-down of Finished stock	12,350	3,16,225
	(1,42,350 – 130,000)		
	Profit as per Financial Accounts		3,83,500

Question 4.

(a) A re-roller produced 400 metric tons of M.S. bars spending Rs. 36,00,000 towards materials and Rs. 6,20,000 towards rolling charges. Ten percent of the output was found to be defective, which had to be sold at 10% less than the price for good production. If the sales realization should give the firm an Overall profit of 12.5% on cost, find the selling price per metric ton of both the categories of bars. The scrap arising during the

rolling process fetched a realization of Rs. 60,000. *(6 Marks)*

(b) The existing Incentive system of Alpha Limited is as under:

Normal working week	*5 days of 8 hours each plus 3 late shifts of 3 hours each*
Rate of Payment	*Day work: Rs. 160 per hour*
	Late shift: Rs. 225 per hour
Average output per operator for 49-hours week i.e. including 3 late shifts	*120 articles*

In order to increase output and eliminate overtime, it was decided to switch on to a system of payment by results. The following Information is obtained:

Time-rate (as usual)	:	*Rs. 160 per hour*
Basic time allowed for 15 articles	:	*5 hours*
Piece-work rate	:	*Add 20% to basic piece-rate*
Premium Bonus	:	*Add 50% to time.*

Required:

(i) Prepare a Statement showing hours worked, weekly earnings, number of articles produced and labour cost per article for one operator under the following systems:

(a) Existing time-rate

(b) Straight piece-work

(c) Rowan system

(d) Halsey premium system

Assume that 135 articles are produced in a 40-hour week under straight piece work, Rowan Premium system, and Halsey premium system above and worker earns half the time saved under Halsey premium system. *(2×4 = 8 Marks)*

Answer

(a) Computation of Selling Price

	Rs.		
Cost of Materials	36,00,000		
Less: Scrap	60,000	Rs.	35,40,000
Rolling charges			6,20,000
Total cost			41,60,000
Add Profit (12.5% on cost)			5,20,000
Sales value		Rs.	46,80,000

Output (effective)

$$360 \text{ tons} + \frac{9}{10} \times 40 \text{ tons} = 396 \text{ tons}$$

Selling price per MT of good output

= Rs. 46,80,000/396

= Rs. 11,818.18

Selling price of defective per MT

= 0.9× Rs. 11,818.18 = Rs. 10,636.36

(b) Table showing Labour Cost per Article

Method of Payment	Hours worked	Weekly earnings	Number of articles produced	labour cost per article
Existing time rate	49	Rs. 8,425	120	Rs. 70.21
Straight piece rate system	40	Rs. 8,640	135	Rs. 64
Rowan Premium System	40	Rs. 9,007.41	135	Rs. 66.72
Halsey Premium System	40	Rs. 8,600	135	Rs. 63.70

Working Notes:

Existing time rate

Weekly wages	40 hrs @ Rs160/hr	= Rs6,400
	9 hrs @ Rs225/hr	= Rs2,025
		Rs8,425

Piece Rate System

Basic time:	5 hour for 15 articles.	
	Cost of 15 articles at hourly rate of Rs160/hr	= Rs800
	Add 20%	= Rs160
		Rs960

∴ Rate per article = Rs960 / 15

= Rs64

Earnings for the week

= 135 articles x Rs64

= Rs.8,640.

Rowan Premium System

Basic Time	:	5 hours for 15 articles
Add	:	50% to time
		7.5 hours for 15 articles
	Or	30 minutes per article

∴ Time allowed for 135 articles = 67.5 hours

Actual time taken for 135 articles = 40 hours

$$\text{Earnings} = (HW \times RH) + \left[\frac{TA - HW}{TA} \times HW \times RH\right]$$

$$= (40 \text{ hrs} \times \text{Rs}160) + \left(\frac{67.5 - 40}{67.5} \times 40 \times \text{Rs}.160\right)$$

= Rs9007.41

Halsey Premium System

$$\text{Earnings} = HW \times RH + \frac{50}{100}(TA - HW) \times RH$$

$$= 40 \times \text{Rs}160 + \frac{1}{2}(67.5 - 40) \times \text{Rs}160$$

= Rs8,600.

Question 5.

From the details furnished below you are required to compute a comprehensive machine-hour rate:

Original purchase price of the machine (subject to depreciation at 10% per annum on original cost)		*Rs. 3,24,000*
Normal working hours for the month		*200 hours*
(The machine works to only 75% of capacity)		
Wages of Machineman	*Rs. 125 per day (of 8 hours)*	
Wages for Helper (machine attendant)	*Rs. 75 per day (of 8 hours)*	
Power cost for the month for the time worked		*Rs. 15,000*
Supervision charges apportioned for the machine centre for the month		*Rs. 3,000*
Electricity & Lighting for the month		*Rs. 7,500*

Repairs & maintenance (machine) including Consumable stores per month	*Rs. 17,500*
Insurance of Plant & Building (apportioned) for the year	*Rs. 16,250*
Other general expense per annum	*Rs. 27,500*

The workers are paid a fixed Dearness allowance of Rs. 1,575 per month. Production bonus payable to workers in terms of an award is equal to 33.33% of basic wages and dearness allowance. Add 10% of the basic wage and dearness allowance against leave wages and holidays with pay to arrive at a comprehensive labour-wage for debit to production.

(14 Marks)

Answer

Computation of Comprehensive Machine Hour Rate

	Per month(Rs)	Per hour(Rs)
Fixed cost		
Supervision charges	3,000	
Electricity and lighting	7,500	
Insurance of Plant and building (16,250×1/12)	1,354.17	
Other General Expenses (27,500×1/12)	2,291.67	
Depreciation (32,400×1/12)	2,700	
	16,845.84	112.31
Variable Cost		
Repairs and maintenance	17,500	116.67
Power	15,000	100.00
Wages of machine man		44.91
Wages of Helper		32.97
Machine Hour rate (Comprehensive)		Rs406.86

Effective machine working hour's p.m.

200 hrs. × 75% = 150 hrs.

Wages per machine hour

	Machine man	Helper
Wages for 200 hours (Rs. 125× 25)	Rs. 3,125	

(Rs. 75× 25)		Rs. 1,875
D.A.	Rs. 1,575	Rs. 1,575
	Rs. 4,700	Rs. 3,450
Production bonus (1/3 of above)	1,567	1,150
	6,267	4,600
Leave wages (10%)	470	345
	6,737	4,945
Effective wage rate per machine hour (150 hrs in all)	Rs. 44.91	Rs. 32.97

Question 6

The following are the Balance Sheets of Gama Limited for the year ending March 31, 2004 and March 31, 2005:

Balance Sheet

As on March, 31

	2004	*2005*
	Rs.	*Rs.*
Capital and Liabilities		
Share Capital	*6,75,000*	*7,87,500*
General Reserves	*2,25,000*	*2,81,250*
Capital Reserve (Profit on Sale of investment)	*-*	*11,250*
Profit & Loss Account	*1,12,500*	*2,25,000*
15% Debentures	*3,37,500*	*2,25,000*
Accrued Expenses	*11,250*	*13,500*
Creditors	*1,80,000*	*2,81,250*
Provision for Dividends	*33,750*	*38,250*
Provision for Taxation	*78,750*	*85,500*
Total	*16,53,750*	*19,48,500*
Assets		
Fixed Assets	*11,25,000*	*13,50,000*
Less: Accumulated depreciation	*2,25,000*	*2,81,250*
Net Fixed Assets	*9,00,000*	*10,68,750*
Long-term Investments (at cost)	*2,02,500*	*2,02,500*
Stock (at cost)	*2,25,000*	*3,03,750*
Debtors (net of provision for doubtful debts of Rs.	*2,53,125*	*2,75,625*

45,000 and Rs. 56,250 respectively for 2004 and 2005 respectively)		
Bills receivables	*45,000*	*73,125*
Prepaid Expenses	*11,250*	*13,500*
Miscellaneous Expenditure	*16,875*	*11,250*
	16,53,750	*19,48,500*

Additional Information:

(i) During the year 2004-05, fixed assets with a net book value of Rs. 11,250 (accumulated depreciation, Rs. 33,750) was sold for Rs. 9,000.

(ii) During the year 2004-05, Investments costing Rs. 90,000 were sold, and also Investments costing Rs. 90,000 were purchased.

(iii) Debentures were retired at a Premium of 10%.

(iv) Tax of Rs. 61,875 was paid for 2003-04.

(v) During the year 2004-05, bad debts of Rs. 15,750 were written off against the provision for Doubtful Debt account.

(vi) The proposed dividend for 2003-04 was paid in 2004-05.

Required:

Prepare a Funds Flow Statement (Statement of changes in Financial Position on working capital basis) for the year ended March 31, 2005. (16 Marks)

Answer

Computation of Funds from Operation

Profit and loss balance on March 31, 2005	Rs. 2,25,000
Add: Depreciation	90,000
Loss on Sale of Asset	2,250
Misc. Expenditure written off	5,625
Transfer to Reserves	56,250
Premium on Redemption of debentures	11,250
Provision for Dividend	38,250
Provision for Taxation	68,625
	4,97,250
Less: P/L balance on March 31, 2004	1,12,500
Funds from operations	3,84,750

Accumulated Depreciation A/c

To Fixed Asset A/c	33,750	By Bal. b/d	2,25,000
		By P/L A/c	90,000
To Bal. c/d	2,81,250	(Prov. for dep.) (Bal. fig.)	
	3,15,000		3,15,000

Fixed Assets A/c

To Bal. b/d	11,25,000	By Accumulated Depreciation A/c	33,750
		By Cash	9,000
To Bank (Purchase of Fixed Asset) (Bal. fig.)	2,70,000	By P/L (Loss on sale)	2,250
		By Bal. c/d	13,50,000
	13,95,000		13,95,000

Provision for Tax A/c

To Cash (tax paid)	61,875	By Bal. b/d	78,750
		By P/L A/c (Prov.)	
To Bal. c/d	85,500	(Bal. fig.)	68,625
	1,47,375		1,47,375

Statement of Changes in Working Capital

	March 31, 2004	*March 31, 2005*	*Change in W/C*	
			+	-
Current Assets				
Stock	2,25,000	3,03,750	78,750	
Debtors	2,53,125	2,75,625	22,500	
Bills Receivables	45,000	73,125	28,125	
Prepaid Expenses	11,250	13,500	2,250	
	5,34,375	6,66,000	1,31,625	-
Less: Current liabilities				
Accrued Expenses	11,250	13,500	-	2,250
Creditors	1,80,000	2,81,250	-	1,01,250
	1,91,250	2,94,750	1,31,625	1,03,500
Working Capital	3,43,125	3,71,250	-	-
Increase in Working Capital				28,125
			1,31,625	1,31,625

Funds Flow Statement for the year ended March 31, 2005

Sources of Funds	*Rs.*
Working Capital from Operations	3,84,750
Sale of Fixed Assets	9,000
Sale of Investments	1,01,250
Share Capital Issued	1,12,500
Total Funds Provided (A)	Rs. 6,07,500
Application of Funds	*Rs.*
Purchase of Fixed Assets	2,70,000
Purchase of Investments	90,000
Payment of Debentures (at a premium of 10%)	1,23,750
Payment of Dividends	33,750
Payment of Taxes	61,875
Total Funds Applied (B)	5,79,375
Increase in Working Capital (A-B)	Rs. 28,125

Question 7

Using the following data, complete the Balance Sheet given below:

Gross Profits	*Rs. 54,000*
Shareholders' Funds	*Rs. 6,00,000*
Gross Profit margin	*20%*
Credit sales to Total sales	*80%*
Total Assets turnover	*0.3 times*
Inventory turnover	*4 times*
Average collection period (a 360 days year)	*20 days*
Current ratio	*1.8*
Long-term Debt to Equity	*40%*

Balance Sheet

Creditors	……	*Cash*	……
Long-term debt	……	*Debtors*	……
Shareholders' funds	……	*Inventory*	……
		Fixed assets	……

(12 Marks)

Answer

Gross Profits Rs. 54,000

Gross Profit Margin 20%

$$\therefore \quad \text{Sales} = \frac{\text{Gross Profits}}{\text{Gross Profit Margin}}$$

$$= \text{Rs. } 54{,}000 / 0.20$$

$$= \text{Rs. } 2{,}70{,}000$$

Credit Sales to Total Sales = 80%

$$\therefore \quad \text{Credit Sales} = \text{Rs. } 2{,}70{,}000 \times 0.80$$

$$= \text{Rs. } 2{,}16{,}000$$

Total Assets Turnover = 0.3 times

$$\therefore \quad \text{Total Assets} = \frac{\text{Sales}}{\text{Total Assets Turnover}}$$

$$= \frac{\text{Rs. } 2{,}70{,}000}{0.3}$$

$$= \text{Rs. } 9{,}00{,}000$$

Sales – Gross Profits = COGS

$$\therefore \quad \text{COGS} = \text{Rs. } 2,\ 70{,}000 - 54{,}000$$

$$= \text{Rs. } 2,\ 16{,}000$$

Inventory turnover = 4 times

$$\text{Inventory} = \frac{\text{COGS}}{\text{Inventory turnover}} = \frac{2{,}16{,}000}{4}$$

$$= \text{Rs. } 54{,}000$$

Average Collection Period = 20 days

$$\therefore \quad \text{Debtors turnover} = \frac{360}{\text{Average Collection Period}}$$

$$= 360/20 = 18$$

$$\therefore \quad \text{Debtors} = \frac{\text{Credit Sales}}{\text{Debtors turnover}}$$

$$= \frac{\text{Rs. } 2{,}16{,}000}{18}$$

$$= \text{Rs. } 12{,}000$$

Current ratio = 1.8

$$1.8 = \frac{\text{Debtors} + \text{Inventory} + \text{Cash}}{\text{Creditors}}$$

1.8 Creditors = (Rs. 12,000 + Rs. 54,000 + Cash)

1.8 Creditors = Rs. 66,000 + Cash

Long-term Debt to Equity = 40%

Shareholders Funds = Rs. 6, 00,000

∴ Long-term Debt = Rs. 6, 00,000×40%

= Rs. 2, 40,000

Creditors (Balance figure)= 9, 00,000 – (6, 00,000 + 2, 40,000)

= Rs. 60,000

∴ Cash = (60,000×1.8) – 66,000

= Rs. 42,000

Balance Sheet

Creditors (Bal. Fig)	60,000	Cash	42,000
		Debtors	12,000
Long- term debt	2,40,000	Inventory	54,000
Shareholders' funds	6,00,000	Fixed Assets (Bal fig.)	7,92,000
	9,00,000		9,00,000

Question 8

MNP Limited is thinking of replacing its existing machine by a new machine which would cost Rs. 60 lakhs. The company's current production is Rs. 80,000 units, and is expected to increase to 1,00,000 units, if the new machine is bought. The selling price of the product would remain unchanged at Rs. 200 per unit. The following is the cost of producing one unit of product using both the existing and new machine:

			Unit cost (Rs.)
	Existing Machine (80,000 units)	*New Machine (1,00,000 units)*	*Difference*
Materials	*75.0*	*63.75*	*(11.25)*
Wages & Salaries	*51.25*	*37.50*	*(13.75)*
Supervision	*20.0*	*25.0*	*5.0*
Repairs and Maintenance	*11.25*	*7.50*	*(3.75)*
Power and Fuel	*15.50*	*14.25*	*(1.25)*
Depreciation	*0.25*	*5.0*	*4.75*

Allocated Corporate Overheads	*10.0*	*12.50*	*2.50*
	183.25	*165.50*	*(17.75)*

The existing machine has an accounting book value of Rs.1,00,000, and it has been fully depreciated for tax purpose. It is estimated that machine will be useful for 5 years. The supplier of the new machine has offered to accept the old machine for Rs.2,50,000. However, the market price of old machine today is Rs.1,50,000 and it is expected to be Rs.35,000 after 5 years. The new machine has a life of 5 years and a salvage value of Rs.2,50,000 at the end of its economic life. Assume corporate Income tax rate at 40%, and depreciation is charged on straight line basis for Income-tax purposes. Further assume that book profit is treated as ordinary income for tax purpose. The opportunity cost of capital of the Company is 15%.

Required:

(i) Estimate net present value of the replacement decision.

(ii) Estimate the internal rate of return of the replacement decision.

(iii) Should Company go ahead with the replacement decision? Suggest.

Year (t)	*1*	*2*	*3*	*4*	*5*
$PVIF_{0.15,t}$	*0.8696*	*0.7561*	*0.6575*	*0.5718*	*0.4972*
$PVIF_{0.20,t}$	*0.8333*	*0.6944*	*0.5787*	*0.4823*	*0.4019*
$PVIF_{0.25,t}$	*0.80*	*0.64*	*0.512*	*0.4096*	*0.3277*
$PVIF_{0.30,t}$	*0.7692*	*0.5917*	*0.4552*	*0.3501*	*0.2693*
$PVIF_{0.35,t}$	*0.7407*	*0.5487*	*0.4064*	*0.3011*	*0.2230*

(8+3+1=12 Marks)

Answer

(i) Net Cash Outlay of New Machine

Purchase Price	Rs. 60,00,000
Less: Exchange value of old machine	
[2, 50,000- 0.4(2,50,000-0)]	1,50,000
	Rs. 58,50,000

Market Value of Old Machine: The old machine could be sold for Rs. 1,50,000 in the market. Since the exchange value is more than the market value, this option is not attractive. This opportunity will be lost whether the old machine is retained or replaced. Thus, on incremental basis, it has no impact.

Depreciation base: Old machine has been fully depreciated for tax purpose.

Thus the depreciation base of the new machine will be its original cost i.e. Rs. 60,00,000.

Net Cash Flows: Unit cost includes depreciation and allocated overheads. Allocated overheads are allocations from corporate office therefore they are irrelevant. The depreciation tax shield may be computed separately. Excluding depreciation and allocated overheads, unit costs can be calculated. The company will obtain additional revenue from additional 20,000 units sold.

Thus, after-tax saving, excluding depreciation, tax shield, would be

= {100,000(200 – 148) – 80,000(200 – 173)} ×(1 – 0.40)

= {52,00,000 – 21,60,000}×0.60

= Rs. 18,24,000

After adjusting depreciation tax shield and salvage value, net cash flows and net present value is estimated.

Calculation of Cash flows and Project Profitability

Rs. ('000)

		0	*1*	*2*	*3*	*4*	*5*
1	After-tax savings	-	1824	1824	1824	1824	1824
2	Depreciation (Rs. 60,00,000 – 2,50,000)/5	-	1150	1150	1150	1150	1150
3	Tax shield on depreciation (Depreciation × Tax rate)	-	460	460	460	460	460
4	Net cash flows from operations (1+3)	-	2284	2284	2284	2284	2284
5	Initial cost	(5850)					
6	Net Salvage Value (2,50,000 – 35,000)	-	-	-	-	-	215
7	Net Cash Flows (4+5+6)	(5850)	2284	2284	2284	2284	2499
8	PVF at 15%	1.00	0.8696	0.7561	0.6575	0.5718	0.4972
9	PV	(5850)	1986.166	1726.932	1501.73	1305.99	1242.50
10	NPV	Rs.1913.32					

(ii) *Rs. ('000)*

	0	*1*	*2*	*3*	*4*	*5*
NCF	(5850)	2284	2284	2284	2284	2499
PVF at 20%	1.00	0.8333	0.6944	0.5787	0.4823	0.4019
PV	(5850)	1903.257	1586.01	1321.751	1101.57	1004.35
PV of benefits	6916.94					
PVF at 30%	1.00	0.7692	0.5917	0.4550	0.3501	0.2693
PV	(5850)	1756.85	1351.44	1039.22	799.63	672.98
PV of benefits	5620.12					

$$\text{IRR} = 20\% + 10\% \times \frac{1066.94}{1296.82}$$

$$= 28.23\%$$

(iii) *Advise:* The company should go ahead with replacement project, since it is positive NPV decision.

Question 9

(a) A Company needs Rs. 31,25,000 for the construction of new plant. The following three plans are feasible:

I The Company may issue 3,12,500 equity shares at Rs. 10 per share.

II The Company may issue 1,56,250 ordinary equity shares at Rs. 10 per share and 15,625 debentures of Rs,. 100 denomination bearing a 8% rate of interest.

III The Company may issue 1,56,250 equity shares at Rs. 10 per share and 15,625 preference shares at Rs. 100 per share bearing a 8% rate of dividend.

(i) If the Company's earnings before interest and taxes are Rs. 62,500, Rs. 1,25,000, Rs. 2,50,000, Rs. 3,75,000 and Rs. 6,25,000, what are the earnings per share under each of three financial plans ? Assume a Corporate Income tax rate of 40%.

(ii) Which alternative would you recommend and why?

(iii) Determine the EBIT-EPS indifference points by formulae between Financing Plan I and Plan II and Plan I and Plan III.

(6+1+3=10 Marks)

(b) Discuss Miller-Orr Cash Management model. (2 Marks)

Answer

(a) (i) Computation of EPS under three-financial plans.

Plan I: Equity Financing

EBIT	Rs. 62,500	Rs. 1,25,000	Rs. 2,50,000	Rs. 3,75,000	Rs. 6,25,000
Interest	0	0	0	0	0
EBT	Rs. 62,500	Rs. 1,25,000	Rs. 2,50,000	Rs. 3,75,000	Rs. 6,25,000
Less: Taxes 40%	25,000	50,000	1,00,000	1,50,000	2,50,000
PAT	Rs. 37,500	Rs. 75,000	Rs. 1,50,000	Rs. 2,25,000	Rs. 3,75,000
No. of equity shares	3,12,500	3,12,500	3,12,500	3,12,500	3,12,500
EPS	0.12	0.24	0.48	0.72	1.20

Plan II: Debt – Equity Mix

EBIT	Rs. 62,500	Rs. 1,25,000	Rs. 2,50,000	Rs. 3,75,000	Rs. 6,25,000
Less: Interest	1,25,000	1,25,000	1,25,000	1,25,000	1,25,000
EBT	(62,500)	0	1,25,000	2,50,000	5,00,000
Less: Taxes 40%	25,000*	0	50,000	1,00,000	2,00,000
PAT	(37,500)	0	75,000	1,50,000	3,00,000
No. of equity shares	1,56,250	1,56,250	1,56,250	1,56,250	1,56,250
EPS	(0.24)	0	0.48	0.96	1.92

* The Company will be able to set off losses against other profits. If the Company has no profits from operations, losses will be carried forward.

Plan III : Preference Shares – Equity Mix

EBIT	Rs. 62,500	Rs 1,25,000	Rs. 2,50,000	Rs. 3,75,000	Rs. 6,25,000
Less: Interest	0	0	0	0	0
EBT	62,500	1,25,000	2,50,000	3,75,000	6,25,000
Less: Taxes (40%)	25,000	50,000	1,00,000	1,50,000	2,50,000
PAT	37,500	75,000	1,50,000	2,25,000	3,75,000
Less: Pref. dividend	1,25,000	1,25,000	1,25,000	1,25,000	1,25,000
PAT for ordinary shareholders	(87,500)	(50,000)	25,000	1,00,000	2,50,000
No. of Equity shares	1,56,250	1,56,250	1,56,250	1,56,250	1,56,250
EPS	(0.56)	(0.32)	0.16	0.64	1.60

(ii) The choice of the financing plan will depend on the state of economic conditions. If

the company's sales are increasing, the EPS will be maximum under Plan II: Debt – Equity Mix. Under favourable economic conditions, debt financing gives more benefit due to tax shield availability than equity or preference financing.

(iii) EBIT – EPS Indifference Point : Plan I and Plan II

$$\frac{(EBIT^*)\times(1-T_C)}{N_1}=\frac{(EBIT^*-Interest)\times(1-T_C)}{N_2}$$

$$\frac{EBIT^*(1-0.40)}{3,12,500}=\frac{(EBIT^*-1,25,000)\times(1-0.40)}{1,56,250}$$

$$EBIT^* = \frac{3,12,500}{3,12,500-1,56,250}\times 1,25,000$$

= Rs. 2,50,000

EBIT – EPS Indifference Point: Plan I and Plan III

$$\frac{EBIT^*(1-T_c)}{N_1}=\frac{EBIT^*(1-T_c)-\text{Pref. Div.}}{N_2}$$

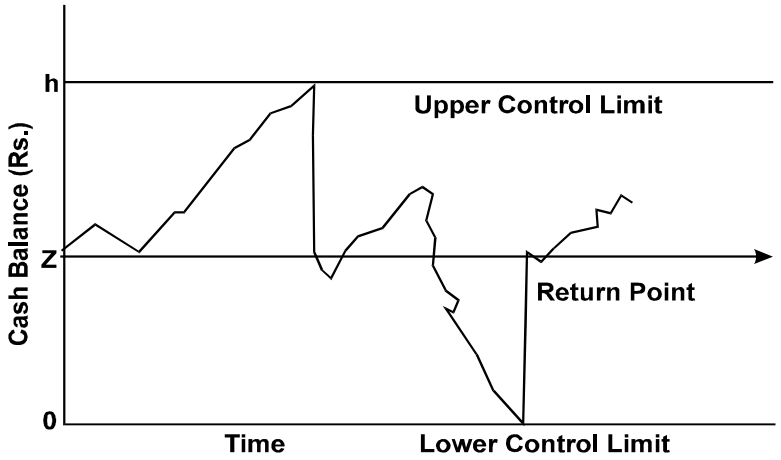
$$EBIT^* = \frac{N_1}{N_1-N_2}\times\frac{\text{Pref. Div.}}{1-T_C}$$

$$= \frac{3,12,500}{3,12,500-1,56,250}\times\frac{1,25,000}{1-0.4}$$

= Rs. 4,16,666.67

(b) Miller – Orr Cash Management Model

According to this model the net cash flow is completely stochastic. When changes in cash balance occur randomly, the application of control theory serves a useful purpose. The Miller – Orr model is one of such control limit models. This model is designed to determine the time and size of transfers between an investment account and cash account. In this model control limits are set for cash balances. These limits may consist of 'h' as upper limit, 'z' as the return point and zero as the lower limit.



MILLER-ORR CASH MANAGEMENT MODEL

When the cash balance reaches the upper limit, the transfer of cash equal to 'h – z' is invested in marketable securities account. When it touches the lower limit, a transfer from marketable securities account to cash account is made. During the period when cash balance stays between (h, z) and (z, 0) i.e. high and low limits, no transactions between cash and marketable securities account is made. The high and low limits of cash balance are set up on the basis of fixed cost associated with the securities transaction, the opportunities cost of holding cash and degree of likely fluctuations in cash balances. These limits satisfy the demands for cash at the lowest possible total costs. The formula for calculation of the spread between the control limits is:

$$\text{Spread} = 3\left(\frac{3/4 \times \text{Transaction Cost} \times \text{Variance of Cashflows}}{\text{Interest rate}}\right)^{1/3}$$

And, the return point can be calculated using the formula:

$$\text{Return point} = \text{Lower limit} + \frac{\text{Spread}}{3}$$

PAPER – 6 : INFORMATION TECHNOLOGY

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

Question 1

(a) *Convert the following from one number system to another system alongwith the working notes:*

(i) $(11011101)_2$ = ($)_{10}$

(ii) $(423.25)_{10}$ = ($)_2$

(iii) $(6437)_8$ = ($)_{16}$

(iv) $(CDEF)_{16}$ = ($)_2$

(v) $(11011.11101)_2$ = ($)_{16}$ *(1×5 = 5 Marks)*

(b) Describe briefly, the following terms with reference to Information Technology:

(i) Digitization

(ii) Compiler

(iii) PCI slots

(iv) Debug

(v) Cursor *(1×5 = 5 Marks)*

(c) Give one or two reasons for each of the following:

(i) Use of Modem

(ii) Use of Graph Plotter

(iii) Use of Subroutine

(iv) Use of Operating System

(v) Need of Protocol Converters. *(1×5 = 5 Marks)*

(d) Write True or False for each of the following:

(i) Digital computer process data input in a continuous form

(ii) Each side of DVD can hold upto 4.7 GB data.

(iii) Speed of Non-Impact Printers is measured in LPM.

(iv) Microcomputers are based on RISC architecture.

(v) E.X.NGN offers 72 basic reports in accounting. *(1×5 = 5 Marks)*

Answer

(a) (i) $(11011101)_2$ = ($)_{10}$

$(11011101)_2 = 1\times2^7+1\times2^6+0\times2^5+1\times2^4+1\times2^3+1\times2^2+0\times2^1+1\times2^0$

$= 128+64+16+8+4+1$

$= (221)$

Hence, $(11011101)_2 = (221)_{10}$

(ii) $(423.25)_{10} = (\quad)_2$

2	423	Remainder	▲	.25
2	211	1		×2
2	105	1		0.50
2	52	1		×2
2	26	0		1.00
2	13	0		
2	6	1		
2	3	0		
2	1	1		
	0	1		

Hence, $(423.25)_{10} = (110100111.01)_2$

(iii) $(6437)_8 = (\quad)_{16}$

To convert the given number from octal to hexadecimal, we will represent each digit of the number by three bit binary number. These binary bits will then be combined in group of four bits adding leading zeros, if required.

$(6437)_8 = (110 \quad 100 \quad 011 \quad 111)$

$= (1101 \quad 0001 \quad 1111)$

$= (D \quad 1 \quad F)$

Hence, $(6437)_8 = (D1F)_{16}$

(iv) $(CDEF)_{16} = (\quad)_2$

To convert the given hexadecimal number to binary, each digit will be represented by a group of four binary bits.

$(CDEF) = (1100 \quad 1101 \quad 1110 \quad 1111)$

Hence, $(CDEF)_{16} = (1100110111101111)_2$

(v) $(11011.11101)_2 = (\quad)_{16}$

To convert the given number from binary to hexadecimal, we will combine the digits

in groups of four, adding leading or trailing zeros wherever required.

$(11011.11101)_2$ = (0001 1011. 1110 1000)

= (1B · E8)

Hence, $(11011.11101)_2$ = $(1B \cdot E8)_{16}$

(b) (i) Digitization: The process of converting the graphical information such as lines, pictures and graphs etc. to digital form with the help of Image Scanner is called digitizing.

(ii) Compiler: It is a software which converts source programs written in a high level language into machine level language. It is an important part of systems software for most computers.

(iii) PCI slots: The PCI (Peripheral Component Interface) slots are used for connecting PCI based devices like sound cards, internal modems and graphics accelerator cards.

(iv) Debug: Error in a programme is called a bug and the process of finding and correcting the errors in a source programme is called debug.

(v) Cursor: A symbol that marks the current position of the mouse on the screen or the point of entry of data is referred to as cursor.

(c) (i) Use of Modem: Modem stands for modulator/demodulator. It is a device that converts a digital computer signal into analog telephone signal or vice-versa. Modems are required to communicate computer data with (using) ordinary telephone lines because computer data is in digital form but telephone lines are analog.

(ii) Use of Plotters: It is an output device which is used to print graphs, designs, drawings and maps on the paper. It is used particularly in applications like computer-aided design (CAD).

(iii) Use of subroutine: It is a small independent program which is included in the main program to perform a specific function again and again with different values of data.

(iv) Use of operating system: It is a system software which acts as an interface between the user and the computer system. It is used to managed the system resources like memory, processor, I/O devices and data.

(v) Need of Protocol Converters: Protocols are the standard set of rules which govern the flow of data on a communication network. To enable diverse system components to communicate with one another and to operate as functional unit, protocol conversion is needed. It can be accomplished via hardware, software, or a combination of hardware and software.

(d) (i) False

(ii) True

(iii) False

(iv) False

(v) True

Question 2

Distinguish between the following:

(i) DDL and DML

(ii) Dumb Terminal and Intelligent Terminal

(iii) LAN and WAN

(iv) Computer Aided Design (CAD)/Computer Aided Manufacturing (CAM)

(v) Sequential File Organisation and Random File Organisation. *(4×5 = 20 Marks)*

Answer

(i) DDL and DML

Data Definition Language (DDL) is used to create a link between logical and physical structure of database file. Logical refers to the way the user views the data and physical refers to the way the data is stored on the storage media. Overall logical view of the data is called Schema and particular application view is called Subschema.

Functions performed by DDL include the following:

(a) Describes the Schema and Subschema.

(b) Describes the field name and data type of each field.

(c) Indicates the keys of record i.e. defines Primary, Secondary and Foreign key.

(d) Defines for data security restrictions i.e. defines the passwords and access rights of various users.

(e) Provides for logical and Physical data independence.

(f) Provides means for associating the related records of different files.

On the other hand, **Data Manipulation Language (DML)** provides the techniques for processing the data stored in database files.

Functions performed by DML include the following:

(a) Provides the techniques for data manipulation such as insertion, deletion and updation of records.

(b) Enables the user and application programmes to process the data on logical basis rather than physical location basis.

(c) Provides for programming languages independence. A DML must support various high level programming languages like COBOL, PL/1, C++ etc.

(d) Allows the user and application programmers to be independent of physical data

structure and physical data structure maintenance.

(e) Provides for use of record relationship which is defined using DDL.

(ii) Dumb Terminal and Intelligent Terminal

Dumb Terminal consists of I/O devices for data entry and obtaining the results but has no processing capability. This terminal cannot process the data at its own level, processing is done by central host computer. In other words, in these types of terminals, entire workload is on the main computer. Thus, if the processing speed of main computer is less, the waiting time of the users working on different terminals will be increased. Further, failure of main computer will result in breakdown of the entire network. Such terminals are generally used in centralised processing.

Intelligent Terminal, on the other hand, consists of a small microprocessor in addition to I/O devices. This microprocessor can process the data upto a certain level. It means that these terminals have processing capabilities in addition to performing Input and Output operations. Using these terminals, workload on the central computer is reduced, hence response to the users is fast. Intelligent terminals can be used in a stand-alone basis, or can be part of a network of terminals.

(iii) LAN and WAN

LAN	WAN
It stands for Local Area Network.	It stands for Wide Area Network.
It is the collection of computers and associated devices within restricted geographical area of 1 kilometer.	It is the collection of computers and associated devices within thousands of Kilometers e.g. within state/Country/World.
Computers are physically connected with each other using special network cabling like Co-axial cable/UTP cable/Fiber optic cable.	Computers are connected with telephone lines/satellite link.
Communication channel is privately owned.	Communication channel is public owned.
Data is transferred in digital form.	Data is transferred in analog form.
Modem is not required for connectivity.	Modem is always required for connectivity.
It is relatively cheap to establish.	It is expensive to establish.
Data transfer cost is less.	Data transfer cost is high.
Less expensive communication interface device like Network Interface Card (NIC) is required.	Expensive communication interface devices like Modem/VSA T (Very Small aperture terminal) etc. are required.

Data transmission is less error prone.	Data transmission is more error prone.
Data transfer speed through Co-axial cable is less than the data transfer through satellite link used in WAN.	Data transfer speed (baud rate) is highest through satellite.
Computer networks established within College/University campus, Bank Branch or within an orqanisation are examples of LAN.	Bank network in the whole country and Railway/Airlines Reservation Systems are examples of WAN.

(iv) Computer Aided Design (CAD)/Computer Aided Manufacturing (CAM)

Computer-Aided Design (CAD) refers to the use of a wide range of computer-based tools that assist engineers, architects and other design professionals in their design activities. It involves both software and sometime special-purpose hardware. CAD is sometimes translated as "computer-assisted" or "computer-aided drafting". First commercial applications of CAD were in large companies in automotive and aerospace industry, as well as in electronics. As computers became more affordable, the application area gradually expanded.

When the field was initially established it was typically limited to producing drawings similar to hand-drafted drawings. Advances in computer technology have allowed more skillful application of computers in design activities. Today CAD is not limited to drafting, it ventures into more "intellectual" areas of designer's expertise.

On the other hand, CAM stands for **computer-aided manufacturing.** CAM with computer-aided design systems produces quicker and more efficient manufacturing processes. This methodology is applied in different manufacturing areas. CAM can be used for following applications:

- Verification of the data
- Panelization of the design to fit the raw material.
- Ability to edit
- Ability to add manufacturing information

CAM has great usage in mechanical engineering. In electronic design automation, CAM tools prepare printed circuit board (PCB) and integrated circuit design data for manufacturing.

(v) Sequential File Organisation and Random File Organisation

In Sequential File organization, all records are in ascending or descending order by a record key. To locate an individual record, a sequential search from the first record on the file must be performed. Each individual record must be examined until the required record is located. Such a search can be time consuming. Therefore, sequential organisation is impractical for an application that requires immediate access to individual

records. On the other hand, sequential organisation would be good for payroll system that is run on a batch basis and every record on the master file being accessed.

Under **Random File Organisation,** transactions can be processed in any order and written at any location through the stored file. To access a record, prior records need not be scanned. The CPU can go directly to the desired record using randomizing procedure without searching all the previous records in the file. Randomizing procedure is characterized by the fact that records are stored in such a way that there does not exist any simple relationship between the keys of the adjacent records. The technique provides for converting the record key number to a physical location represented by a disk address through a computational procedure. This type of file organization is used for those applications where file activity is low or high amount of file interrogation is involved.

Question 3

(a) Define an Expert System. Explain its benefits. *(5 Marks)*

(b) What are the constituents of a Data Centre ? *(5 Marks)*

(c) A water distribution company has two categories of consumers (Domestic and Commercial).

The charges of water per unit consumed by these consumers are Rs. 5.00 and Rs. 8.00 respectively. The computer database of the company has the following information:

- *Consumer's name*
- *Category*
- *Units consumed*
- *Bill's date*
- *Date of payment.*

The company processes bills according to the following criterion:

If the consumer is domestic and pays his bill within 10 days of the bill date, 7% discount is given. If he pays the bill within 15 days, no discount is given. If he makes the payment after 15 days of the bill date, 10% surcharge is levied. For commercial consumers, corresponding percentage be 15%, 0% and 15% respectively.

Draw a Flow chart to calculate the bill amount, discount, surcharge and net amount of the bill for each type of consumer and print it. *(10 Marks)*

Answer

(a) Expert System: It is a computerized information system that allows non-experts to make decisions comparable to those of an expert. Expert systems are used for complex or ill-structured tasks that require experience and specialized knowledge in newer and specific subject areas. Expert systems can be example-based, rule-based or frame-based.

Expert systems contain the following components:

(i) Knowledge base which includes data, knowledge, relationships, rules of thumb and decision rules etc.

(ii) Inference engine which contains the logic and reasoning mechanism that simulate the expert logic process and deliver advice.

(iii) User interface, a program which allows the user to design, create, update, use and communicate with the expert system.

(iv) Explanation facility, which provides the user with an explanation of the logic.

(v) Knowledge acquisition facility.

Benefits offered by expert systems are:

- They provide a cost effective alternative to human experts.
- They are faster and more consistent and do not get distracted, overworked or stressed out.
- They produce better quality and more consistent decisions. Expert systems assist users in identifying potential decision making problems, which increase the probability that sound decisions will be made.
- They can increase productivity.
- They preserve the expertise of an expert leaving the organisation.
- They can outperform a single expert because their knowledge is representative of numerous experts.

(b) Constituents of a Data Centre: To keep equipments running reliably, even under the worst circumstances, the data centre is built with following carefully engineered support infrastructure:

(i) Network connectivity with various levels of physical connectivity using Fibre Optic and copper communication link and service provider redundancy.

(ii) Dual DG sets and Dual UPS,

(iii) Heating, ventilation and Air Conditioning (HVAC) systems for temperature control.

(iv) Fire extinguishers.

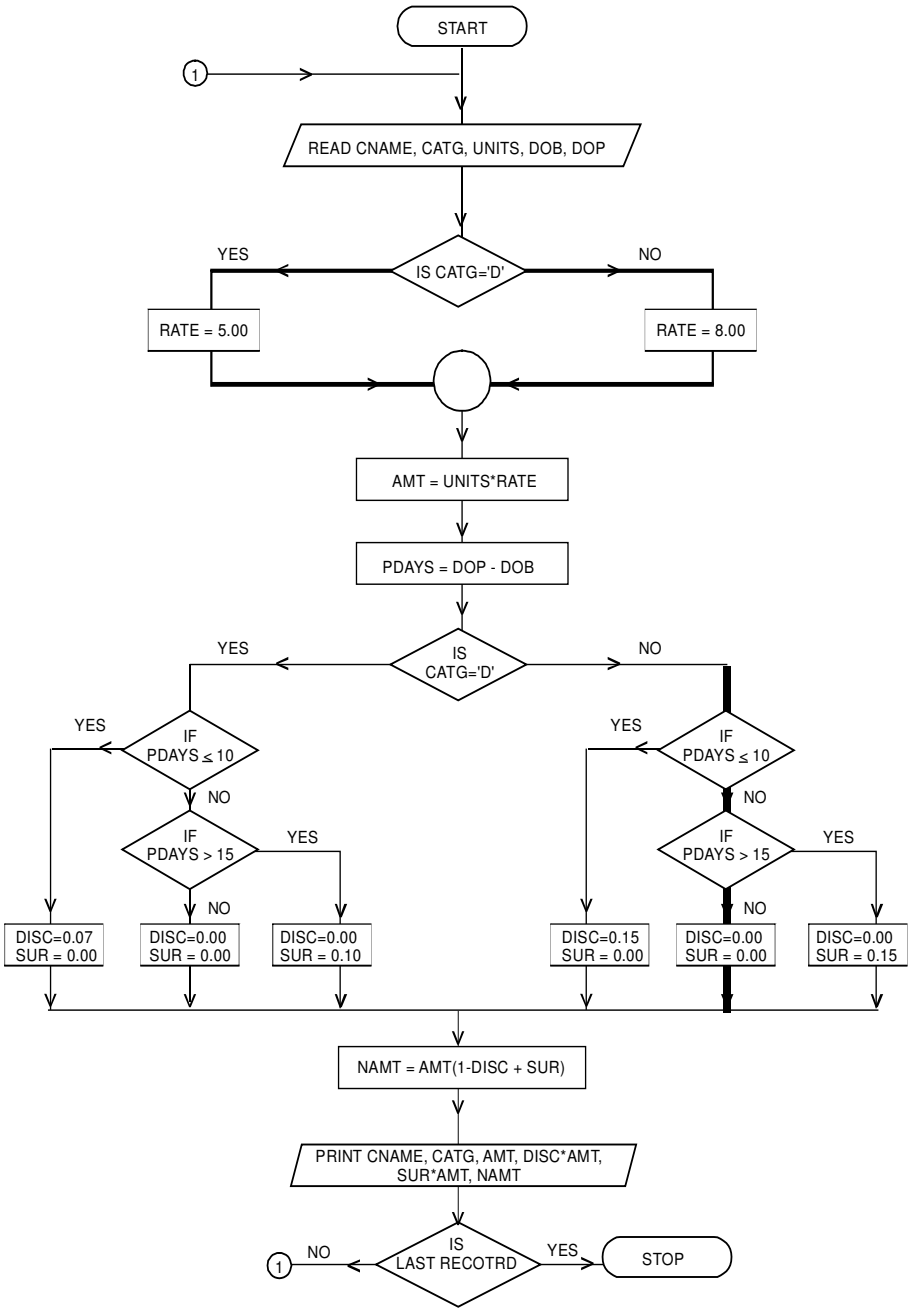
(v) Physical security systems like Security guards, Biometric devices, Smart Card, CCTV etc.

(vi) Raised flooring to avoid flood and water logging.

(vii) Network equipments, Network Management software,

(viii) Network security by segregating the public and private network using Intrusion detection system (IDS) and firewalls.

(c) The required flowchart is given below.



Question 4

(a) Explain the various functions of communications software. *(5 Marks)*

(b) Explain any five communication interface devices. *(5 Marks)*

(c) Discuss the several integrity controls that DBMS has to support. *(10 Marks)*

Answer

(a) Communications software manages the flow of data across a network. It performs the following functions:

(i) **Access control:** Linking and disconnecting the different devices, automatically dialing and answering telephones; restricting access to authorized users; and establishing parameters such as speed, mode and direction of transmission.

(ii) **Network management:** Polling devices to see whether they are ready to send or receive data; queuing input and output; determining system priorities; routing messages, and logging network activity, use and errors etc.

(iii) **Data and file transmission:** Controlling the transfer of data, files and messages *among* the various devices.

(iv) **Error detection and control:** Ensuring that the data sent was indeed the data received.

(v) **Data security:** Protecting data during transmission from unauthorized access.

(b) Five commonly used communication interface devices are briefly discussed below:

(i) **Network Interface Card (NIC):** It is an electronic card which is installed in server as well as in all the nodes for interconnection of nodes with server. Network Interface card provides a connector on its back for connection of nodes and server using network cable. NIC has buffer for storing incoming and outgoing packets, thus improving the network throughput. NIC uses Linear bus topology, according to which only one node can access the data from the server at a time. NIC is installed in one of the available PCI/ISA slot on the motherboard.

(ii) **Modem (Modulator/Demodulator):** It is an electronic device which is used to convert digital signals to analog telephone signals (modulation) and analog signals to digital data (demodulation) in a data communication system. Modem allows the communication *among* computers through telephone lines. Motorola, GVC, O-Link, AOCOM are some of the manufacturers of Modems. Modems can be categorized on the basis of speed, price and other features. But, most commonly people classify them as internal or external. Internal modem looks like the sound cards and video cards that fit inside the computer. External modem connects to the serial port of the computer. Speed of modem can be 28.8Kbps (Kilo bits per second) or 56.6 Kbps.

Modem installed in Laptop computers is similar to credit card size, known as PCMCIA (Personal Computer Memory Card International Association) modem.

(iii) **Multiplexer (MUX):** It is an electronic device which allows number of devices to share a single communication line. Multiplexer continuously scans the nodes and server to find out whether any of them wants to send data to other nodes or not. This process of continuously scanning by multiplexer is called Polling. Multiplexer may perform Time division multiplexing (TOM) or Frequency division multiplexing (FOM).

(iv) **Front-end communication processor:** In case of high volume data transfer, a separate computer, known as front-end communication processor is used for sending and receiving data, code conversions, editing and verification of data, terminal recognition and control of transmission lines thus relieving the main computer for data processing tasks rather than data transmission.

(v) **Protocol Converter:** Protocols are the standard sets of rules which govern the flow of data on a communication network. Dissimilar devices, which follow different protocols, can not communicate with each other without protocol conversion. For example, one computer representing data in ASCII code can not communicate with another computer using EBCDIC code for data representation without protocol conversion. Protocol converter is an electronic device which is used for protocol conversion. However, protocol conversion can also take place through software.

(c) Data Integrity Controls can be built into the physical structure of the fields. In order to have the correct data base, DBMS needs to have certain controls on the data fields. Security controls that DBMS may impose on the data fields are as follows:

(i) **Data Type:** It enforces one form of data integrity control since it defines the type of data to be entered in the field. It may be number, character, alphanumeric data etc.

(ii) **Length of the data field:** It defines the maximum number of characters or digits to be entered.

(iii) **Default value:** A default value is the value a field will assume unless a user enters an explicit value for an instance of that field. Assigning a default value to a field can reduce data entry time since entry of a value can be skipped and it can also help to reduce data entry errors for the most common value.

(iv) **Range control:** A range control limits the set of permissible values a field may assume. The range may be a numeric lower to upper bound or a set of specific values. Range controls must be used with caution since the limits of the range may change over time. A combination of range controls and coding led to the Year 2000 problem faced by many organizations, in which a field for year was represented by only the numbers 00 to 99. It is better to implement any range controls through a DBMS since range controls in programs may be inconsistently enforced and it is more difficult to find and change them.

(v) **Null value control:** A null value is an empty value. Each primary key must have an integrity control that prohibits a null value. Any other required field may also have a null value control placed on. For example, a university may prohibit adding a course to its database unless that course has a title as well as a value of the primary key,

Course_ID. Many fields legitimately may have a null value, so this control should be used only when truly required by business rules.

(vi) **Referential integrity:** Referential integrity on a field is a form of range control in which the value of that field must exist as the value in some field in another row of the same or different table. That is, the range of legitimate values comes from the dynamic contents of a field in a database table, not from some pre-specified set of values. It may be noted that referential integrity guarantees that only some existing cross-referencing value is used, not that it is the correct one.

Question 5

(a) Explain "Decision table". Explain in brief four parts of a decision table. (5 Marks)

(b) Describe any five formatting features available in MS-WORD. (5 Marks)

(c) Define the following functions with respect to MS-EXCEL:

(i) STDEV

(ii) TRANC

(iii) SQRT

(iv) LN

(v) PV. (1×5 = 5 Marks)

(d) Explain any five features offered by e-mail software. (5 Marks)

Answer

(a) 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. Decision tables are necessitated by the fact that branches of the flowchart multiply at each diamond (comparison symbol) and may easily run into scores and even hundreds. If, therefore, the programmer attempts to draw a flowchart directly, he is liable to miss some of the branches.

A decision table is divided into four parts:

(i) **Condition stub:** It contains statements i.e., the factors to be considered in making a decision.

(ii) **Action stub:** It introduces one or more actions i.e., steps to be taken when a certain combination of conditions exists.

(iii) **Condition entries:** It lists in its various columns the possible permutations of answers to the questions in the condition stub.

(iv) **Action entries:** It lists in its columns corresponding to the condition entries, the actions contingent upon the set of answers to the questions in that column.

(b) Five formatting features available in MS-Word are discussed below:

1. **Modify Fonts:** Font refers to the print type, style and size of characters used in printing. The use of different fonts changes the look of the text. Word 2000 offers a number of different font types to choose from, e.g., Times New Roman, Arial, Courier etc. The default font in any word document is Times New Roman. Besides the regular style, it can be made either bold, italic or bold italic. Underlining the text can further enhance the style. Word 2000 also offers eleven different effects that can be applied to the text. Text can be shadowed, outlined, embossed, engraved etc.

2. **Paragraph alignment, Indenting & line spacing:** Alignment of lines for the written text is the most common convention followed. Each line of written matter on a page maintains a constant horizontal distance from the left edge of the page. Word makes alignment effortless even while offering four types of alignment to text. They are Left, Right, Centre and Justify.

   Indenting of paragraph means we specify the distance of the text from the margin. By using indenting, the selected paragraphs stand out from the other text in the document. Various types of paragraph indent options are available in Word 2000. Line spacing determines the amount of vertical space between lines of text. By increasing the line spacing, the readability of document increases.

3. **Drop Cap**: Word 2000 allows the first character of the word at the beginning of a chapter or article to be enlarged. This feature is called drop cap. The number of lines that the capital letter can be dropped ranges between one to ten lines below.

4. **Tab**: In order to align text in a columnar manner, Word offers tab feature which is similar to the tab function key available in the manual or electronic typewriters. Word 2000 allows to change the tab setting to suit user requirements. It is further possible to specify suitable alignment for text in each tab.

5. **Numbers and Bullets:** While writing certain kind of communication e.g. business or legal communication, it is convenient to state the ideas point by point. This usually happens in letters where user is trying to put across his views and wishes to give reasons. Word offers numbers and bullets options to highlight each new point in the list. It is also possible to have multi-level bullets and numbering.

(c) Functions in MS-Excel

(i) **STDEV:** This statistical function is used to calculate the standard deviation of items in the range of cells.

(ii) **TRANC:** This mathematical function is used to truncate a number to an integer by removing the decimal or fractional part of the number.

(iii) **SQRT:** This mathematical function is used to calculate the square root of a number.

(iv) **LN(x):** This mathematical function is used to calculate natural logarithm of a number to the base.

(v) **PV:** This financial function is used to calculate the present value of payments made in each period and not changed during the life of annuity at the given rate of interest and for a particular time period.

(d) Five features offered by e-mail software: Electronic mail (e-mail) on the Internet provides quick and cost effective transfer of messages to other e-mail users worldwide. The e-mail software comprises of many important and useful features. Five of them are briefly discussed below:

(i) **Composing messages:** With the help of an Internet Browser, it is possible to compose messages in an attractive way using various fonts. It is also possible to spell-check the message before finalizing it.

(ii) **Replying to the mails received:** It is possible to reply to any mail received by merely using the “Reply" facility available on the Internet Browser. This facility also allows one to send the same reply to all the recipients of the original message. This helps in saving lot of time in terms of remembering addresses, typing the subject matter etc.

(iii) **Address book:** This is an electronic form of address book wherein the following information can be saved: Name, full address, e-mail address, organization and designation of a person etc. It is also possible to store addresses on the basis of categories. Letters or circulars can be sent to individual address or all members of a particular category.

(iv) **Printing of messages:** It is possible to print messages received as well as messages sent. As a result, hard copy of any message can also be kept.

(v) **Offline Editing/Composing/Reading:** One does not have to be connected to the Internet all the time to be able to read/edit/compose messages. Ideally, one should log on to the Internet, download all the messages on to one's own hard disk and then get disconnected from the Internet. Once the user is offline, he should read all the messages that have been received. Even composing of messages can be done offline. This saves Internet time as well as helps in keeping the telephone line free.

In addition to above mentioned features, e-mail software also allows forwarding of messages, transfer of data files and sending e-greeting cards on various occasions.

Question 6

(a) Explain white box approach for Auditing. *(5 Marks)*

(b) Explain in brief the advantages of Optical Character Reader. *(5 Marks)*

(c) Explain the various matters on which power of controller can make rules under Section 89 of Information Technology Act. *(5 Marks)*

(d) What are the different OLE automation support provided by E.X.NGN software ? *(5 Marks)*

Answer

(a) White box approach for auditing: Computerisation has progressed to a point where entire processing cycle occurs within the computer systems. Thus, traditional audit trail has disappeared. No corresponding manual documents are available. It is thus necessary to examine the internal working of the computer system. The auditor can verify the programs himself and technically satisfy himself that systems, checks, controls, error detection and data security procedures are satisfactory. The auditor can use test-checks to test the system in operation and ask for special print outs by making use of programming facilities available within the installation. By acquiring the necessary skills, the auditor can use the computer itself as an audit tool to improve the quality of his own audit and reduce time spent on detailed verification of transactions. This is called White-box approach for audit.

Auditor's primary concern under this approach includes the system of controls, examination and testing of computer-implemented controls. Practically the computer itself could be used to perform such examination and testing functions. In some cases, sheer volume and complexity of transactions require use of corresponding powerful tools for the audit. This leads to the need for using Computer Assisted Audit Techniques (CAAT).

(b) Advantages of Optical Character Reader (OCR)

(i). It employs a set of printing characters with standard font that can be read by both human and machine readers.

(ii) OCR eliminates the human effort of transcription. It has the potential of reading even handwritten documents straightway.

(iii) Paper work explosion can be handled because OCR is economical for a high rate of input.

(iv) Since documents have only to be typed or handwritten, not very skilled staff is required.

(v) These input preparation devices are much cheaper than the keypunch or the key-to-tape devices.

(c) The Controller has been given powers under Section 89 to make regulations consistent with the Information Technology Act and the related rules so as to carry out the purposes of this Act. However, he may do so after consultation with the Cyber Regulations Advisory Committee and with the previous approval of the Central Government. These regulations shall be notified in the Official Gazette. These regulations shall be related to the following matters:

(i) the particulars relating to maintenance of data base containing the disclosure record of every Certifying Authority,

(ii) the conditions and restrictions subject to which the Controller may recognise any foreign Certifying Authority,

(iii) the terms and conditions subject to which a licence may be granted,

(iv) other standards to be observed by a Certifying Authority,

(v) the manner in which the Certifying Authority may make the disclosure under Section 34,

(vi) the particulars of statement to be submitted along with an application for the issue of a Digital Signature Certificate,

(vii) the manner in which the subscriber should communicate the compromise of private key to the Certifying Authority.

(d) Different OLE automation support provided by E.X.NGN software: Automation allows the user to program on E.X.NGN. The automation objects can be called using VBA scripts for getting data from E.X.NGN or data into E.X.NGN. Various functions of E.X. are provided as automation objects. The properties and a methods of these objects can be set from outside E.X Some of the important E.X automation objects are create accounts, maintain accounts and balances, maintain items and narration and enter vouchers through OLE controllers. OLE automation offers the unique opportunity of integrating another application say payroll software, personal management, portfolio management etc. along with E.X NGN so as umbrella of applications can be integrated with EX.NGN.

Question 7

Write short notes on the following:

(i) Parallel Processing

(ii) IT Act, 2000

(iii) Extranet

(iv) Video Conferencing. *(5×4 = 20 Marks)*

Answer

(a) Parallel Processing: It is also called Multiprocessing. It requires use of two or more CPUs, linked together to perform coordinated work simultaneously. Instructions are executed simultaneously because the available CPUs can execute different instructions of the same program or of different programs at any given time.

In case of parallel processing, there may be multiprogramming or there may not be multiprogramming. If there is no multiprogramming, then different CPU execute different programs, thereby reducing the overall execution time. Parallel processing systems provide those data processing capabilities, which are not found in those systems that have single processor. Many complex operations can be performed at the same time. CPUs can function on complementary units to provide data and control for one another. Parallel processing is used in Air Traffic control systems, and Traffic lights control system etc. Super Computers, which have multiple CPU's, perform parallel processing.

(b) IT Act 2000: Computers are being used to create, transmit and store the information in electronic form instead of paper documents but the main hurdle in e-Governance is the requirement of writing and signature for legal recognition. At present, many legal provisions require the evidence in the form of paper documents having signatures.. The law of evidence is based on paper-based records; hence for success of *e-Governance e-*Commerce, legal changes were required.

Therefore, Govt. of India introduced a new law for giving legal recognition to electronic records. This gave birth to Information Technology bill, 1999 which was passed by both the houses of Parliament in May 2000 and the President gave his assent in August 2000. This Information Technology bill is called Information Technology Act, 2000 which also contains cyber laws.

Objectives of the Information Technology Act 2000 are:

(a) To grant legal recognition to transactions carried out by means of EDI and E-Commerce in place of paper based methods of communication.

(b) To give legal recognition to digital signatures for authentication of any information.

(c) To facilitate electronic filing of documents with Govt. departments.

(d) To facilitate electronic storage of data.

(e) To facilitate and give legal recognition to electronic fund transfers between bank and financial institutions.

(f) To give legal recognition for keeping books of accounts in electronic form by bankers.

(g) To amend the Indian penal code, the Indian Evidence Act, the Banker's Book Evidence Act and Reserve bank of India Act.

The Act consists of 94 Sections spread over thirteen chapters and four schedules to the Act. The schedules of Act contain related amendments in other acts namely the Indian Penal Code, the India Evidence Act, 1972, the Banker's Book Evidence Act, 1891 and the Reserve Bank of India, 1934.

(c) Extranet: An extranet is an extension of an Intranet that makes the latter accessible to outside companies or individuals with or without an intranet. It is also defined as a collaborative Internet connection with other companies and business partners. Parts of an intranet are made available to customers or business partners for specific applications. The extranet is thus an extended intranet, which isolates business communication from the Internet through secure solutions. Extranet provides the privacy and security of an Internet while retaining the global reach of the Internet. The key characteristic of an Extranet is that it extends the Intranet from one location to another across the Internet by securing data flows using cryptography and authorization procedures, to another Intranet of a business partner. This way, Intranets of business partners, material suppliers, financial services, distributors, customers, etc. are connected to the Extranets by an agreement between the collaborating parties. The emphasis is on allowing access to authorised groups through strictly controlled

mechanisms. This has led to the true proliferation of e-commerce.

(d) Video conferencing: Video Conferencing is the use of television equipment to link geographically dispersed conference participants. The equipment provides both sound and picture. Like audio conferencing, video conferencing does not require a computer.

In video conferencing participants can see and hear each other, generally, participants gather in relatively expensive, specially equipped rooms that can handle the complexities of simultaneous video and audio transmission.

There are three possible video conferencing configurations:

One way Video and Audio: Video and Audio signals are sent from a single transmitting site to one or more receiving sites.

One way Video and two way Audio: People at the receiving sites can talk to people at the transmitting site, while every one views the same video images.

Two way Video and Audio: The Video and Audio communications between all sites are two-way. This is the most effective of the electronically aided conferencing approaches.

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PAPER – 1 : ACCOUNTING

Answer all questions.

Working notes should form part of the answer.

Question 1

Mr. X runs a retail business. Suddenly he finds on 31.3.2006 that his Cash and Bank balances have reduced considerably. He provides you the following information:

(i) Balances	31.3.2005	31.3.2006
	Rs.	Rs.
Sundry Debtors	35,400	58,800
Sundry Creditors	84,400	22,400
Cash at Bank	1,08,400	2,500
Cash in Hand	10,400	500
Rent (Outstanding for one month)	2,400	3,000
Stock	11,400	20,000
Electricity and Telephone bills-outstanding	--	6,400

(ii) Bank Pass-book reveals the following	Rs.
Total Deposits	10,34,000
Withdrawals:	
Creditors	8,90,000
Professional charges	34,000
Furnitures and Fixtures (acquired on 1.10.05)	54,000
Proprietor's drawings	1,61,900

(iii) Rent has been increased from January, 2006.

(iv) Mr. X deposited all cash sales and collections from debtors after meeting wages, shop expenses, rent, electricity and telephone charges.

(v) Mr. X made all purchases on credit.

(vi) His credit sales during the year amounts to Rs.9,00,000.

(vii) He incurred Rs.6,500 per month towards wages.

(viii) He incurred following expenses:

(a) Electricity and telephone charges Rs.24,000 (paid)

(b) Shop expenses Rs.18,000 (paid).

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(ix) Charge depreciation on furniture and fixtures @10% p.a.

Finalise the accounts of Mr. X and compute his profit for the year ended 31.3.2006. Prepare his statement of affairs and reconcile the profit and capital balance.

(20 Marks)

Answer

Trading and profit and Loss Account of Mr. X

For the year ended 31st March, 2006

	Rs.		*Rs.*	*Rs.*
To Opening Stock	11,400	By Sales:		
To Purchases	8,28,000	Cash	2,97,500	
To Gross Profit	3,78,100	Credit	9,00,000	11,97,500
		By Closing Stock		20,000
	12,17,500			12,17,500
To Wages	78,000	By Gross Profit		3,78,100
To Rent*	30,600			
To Electricity & Telephone**	30,400			
To Professional charges	34,000			
To Shop Expenses	18,000			
To Depreciation ($Rs.54,000 \times \frac{10}{100} \times \frac{1}{2}$)	2,700			
To Net Profit	1,84,400			
	3,78,100			3,78,100

	Rs.
*Rent Paid	30,000
Less: Outstanding on 1.4.2005	(2,400)
	27,600
Add: Outstanding on 31.3.2006	3,000
	30,600

	Rs.
**Electricity & Telephone charges paid	24,000
Add: Outstanding on 31.3.2006	6,400
	30,400

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Statement of Affairs of Mr. X as on 31-03-2005 & 31-03-2006

Liabilities	*31-3-2005*	*31-3-2006*	*Assets*	*31-3-2005*	*31-3-2006*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Capital Account			Furniture	-	51,300
(Balancing Figure)	78,800	1,01,300			
Sundry Creditors	84,400	22,400	Stock	11,400	20,000
Outstanding Expenses:			Sundry Debtors	35,400	58,800
Rent	2,400	3,000	Bank	1,08,400	2,500
Electricity & Telephone		6,400	Cash	10,400	500
	1,65,600	1,33,100		1,65,600	1,33,100

Reconciliation of Profit

	Rs.
Capital on 31.03.2006	1,01,300
Add: Drawings	1,61,900
	2,63,200
Less: Opening Capital on 1.4.2005	(78,800)
Profit for the year	1,84,400

Working Notes

1. Total Debtors Account

	Rs.		*Rs.*
To Balance b/d	35,400	By Cash (Balancing Figure)	8,76,600
To Credit Sales	9,00,000	By Balance c/d	58,800
	9,35,400		9,35,400

2. Total Creditors Account

	Rs.		*Rs.*
To Bank	8,90,000	By Balance b/d	84,400
To Balance c/d	22,400	By Credit Purchases	8,28,000
	9,12,400		9,12,400

3. Cash Account

	Cash (Rs.)	*Bank (Rs.)*		*Cash (Rs.)*	*Bank (Rs.)*
To Balance b/d	10,400	1,08,400	By Bank	10,34,000	-
To Sundry Debtors	8,76,600	-	By Wages	78,000	-
To Cash Sales (Balancing figure)	2,97,500	-	By Rent	30,000	-

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To Cash A/c (Contra)	-	10,34,000	By Electricity & Telephone	24,000	-
			By Shop Expenses	18,000	-
			By Professional charges	-	34,000
			By Sundry Creditors A/c	-	8,90,000
			By Furniture	-	54,000
			By Drawings A/c	-	1,61,900
			By Balance c/d	500	2,500
	11,84,500	11,42,400		11,84,500	11,42,400

Question 2

(a) *From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial bank:*

	Assets	*Rs. in lakhs*
(i)	*Standard (Value of security Rs.6,000 lakhs)*	*7,000*
(ii)	*Sub-standard*	*3,000*
(iii)	*Doubtful*	
	(a) Doubtful for less than one year (Realisable value of security Rs.500 lakhs)	*1,000*
	(b) Doubtful for more than one year, but less than 3 years (Realisable value of security Rs.300 lakhs)	*500*
	(c) Doubtful for more than 3 years (No security)	*300*

(b) *From the following details, prepare bills for collection (Asset) Account and Bills for collection (Liability) Account:*

	Rs.
On 1.4.2005, Bills for Collection were	*51,00,000*
During the year 2005-06 Bills received for Collection amounted to	*75,00,000*
Bill collected during the year 2005-06	*98,47,000*
Bill dishonoured and returned during the year	*27,10,000*

(c) *X Fire Insurance Co. Ltd. commenced its business on 1.4.2005. It submits you the following information for the year ended 31.3.2006:*

	Rs.
Premiums received	*15,00,000*
Re-insurance premiums paid	*1,00,000*
Claims paid	*7,00,000*
Expenses of Management	*3,00,000*

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Commission paid *50,000*

Claims outstanding on 31.3.2006 *1,00,000*

Create reserve for unexpired risk @40%

Prepare Revenue account for the year ended 31.3.2006.

(8+4+4= 16 Marks)

Answer

(a)

Asset	*Amount Rs. in lakhs*	*% of provision*	*Provision Rs. in lakhs*
Standard	7,000	0.25*	17.50
Sub-standard	3,000	10	300
Doubtful (less than one year)			
On secured portion	500	20	100
On unsecured portion	500	100	500
Doubtful (more than one year but less than three years)			
On secured portion	300	30	90
On unsecured portion	200	100	200
Doubtful Unsecured (more than three years)	300	100	300
Total provision			1,507.50

*The rate of provision has been raised from 0.25% to 0.40% vide RBI's Circular No. DBOD. No. BP.BC.40/21.04.048/2005-06, dated November 4, 2005.

(b)

Bills for collection (Asset) Account

		Rs.			*Rs.*
1.4.2005	To Balance b/d	51,00,000	2005-06	By Bills for collection (Liability) A/c	98,47,000
2005-06	To Bills for collection	75,00,000		By Bills for collection (Liability) A/c	27,10,000
			31.3.2006	By Balance c/d	43,000
		1,26,00,000			1,26,00,000
1.4.2006	To Balance b/d	43,000			

Bills for collection (Liability) Account

2005- 06	To Bills for collection (Asset) A/c	98,47,000	1.4.2005	By Balance b/d	51,00,000
	To Bills for collection (Asset) A/c	27,10,000	2005-06	By Bills for collection (Asset) A/c	75,00,000

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31.3.2006	To Balance c/d	43,000		
		1,26,00,000		1,26,00,000
			1.4.2006 By Balance b/d	43,000

(c) Form B – RA (Prescribed by IRDA)

Name of the Insurer: X Fire Insurance Co. Ltd.

Registration No. and Date of registration with the IRDA: ……..

Revenue Account for the year ended 31st March, 2006

	Particulars	*Schedule*	*Current year ended on 31st March, 2006*
			Rs.
1.	Premiums earned (Net)	1	14,00,000
2.	Change in provision for unexpired risk (NIL – 5,60,000)	2	(5,60,000)
	Total (A)		8,40,000
1.	Claims incurred (Net)	3	8,00,000
2.	Commission		50,000
3.	Operating Expenses	4	3,00,000
	Total (B)		11,50,000
	Operating Profit/(Loss) from Fire Insurance Business C =(A - B)		(3,10,000)

Schedule 1

Premiums earned (Net)

	Rs.
Premium received	15,00,000
Less: Premium on re-insurance paid	1,00,000
	14,00,000

Schedule 2

Reserve for unexpired risk @ 40% on net premium

$\text{Rs.}14,00,000 \times \frac{40}{100} = \text{Rs.}5,60,000$

Schedule 3

Claims

	Rs.
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2006	1,00,000
	8,00,000

Schedule 4

Operating expenses

	Rs.
Expenses of Management	3,00,000

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Question 3

Concept & Co., with its Head Office at Mumbai has a branch at Nagpur. Goods are invoiced to the Branch at cost plus 33 1/3%. The following information is given in respect of the branch for the year ended 31st March, 2006:

	Rs.
Goods sent to Branch (Invoice price)	*4,80,000*
Stock at Branch on 1.4.2005 (Invoice price)	*24,000*
Cash sales	*1,80,000*
Return of goods by customers to the Branch	*6,000*
Branch expenses (paid in cash)	*53,500*
Branch debtors balance on 1.4.2005	*30,000*
Discount allowed	*1,000*
Bad debts	*1,500*
Collection from Debtors	*2,70,000*
Branch debtors cheques returned dishonoured	*5,000*
Stock at Branch on 31.3.2006 (Invoice price)	*48,000*
Branch debtors balance on 31.3.2006	*36,500*

Prepare, under the Stock and Debtors system, the following Ledger Accounts in the books of the Head Office:

(i) Nagpur Branch Stock Account

(ii) Nagpur Branch Debtors Account

(iii) Nagpur Branch Adjustment Account.

Also compute shortage of Stock at Branch, if any. *(16 Marks)*

Answer

In the books of head office

Nagpur Branch Stock Account

		Rs.			Rs.
1.4.2005	To Balance b/d	24,000	31.3.06	By Bank A/c (Cash Sales)	1,80,000
31.3.2006	To Goods sent to Branch A/c	4,80,000		By Branch Debtors (Credit Sales)	2,80,000
	To Branch Debtors	6,000		By Stock shortage:	
				Branch P&L A/c 1,500*	
				Branch Adjustment A/c (Loading) 500	2,000
				By Balance c/d	48,000
		5,10,000			5,10,000

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Nagpur Branch Debtors Account

1.4.2005	To Balance b/d	30,000	31.3.2006	By Bank A/c (Collection)	2,70,000
31.3.2006	To Bank A/c (dishonour of cheques)	5,000		By Branch Stock A/c	6,000
	To Branch Stock A/c	2,80,000*		By Bad debts	1,500
				By Discount allowed	1,000
				By Balance c/d	36,500
		3,15,000			3,15,000

Nagpur Branch Adjustment Account

To Branch Stock A/c (loading of loss)	500*	By Stock Reserve A/c	6,000
To Stock Reserve	12,000	By Goods sent to Branch A/c	1,20,000
To Gross Profit c/d	1,13,500		
	1,26,000		1,26,000
To Branch Stock A/c (Cost of loss)	1,500	By Gross Profit b/d	1,13,500
To Branch Expenses	56,000		
To Net Profit (Transferred to General P & L A/c)	56,000		
	1,13,500		1,13,500

*Balancing figure.

Working Notes:

1. Credit Sales have not been given in the problem. So, the balancing figure of Branch Debtors Account is taken as credit sales
2. Loading is 33 $\frac{1}{3}$ % of Cost; i.e. 25% of invoice value

   Loading on opening stock = 24,000 $\times$ 25% = 6,000
3. Loading on goods sent = 4,80,000 $\times$ 25% = Rs.1,20,000
4. Loading on Closing Stock = Rs.48,000 $\times$ 25% = Rs.12,000
5. Total Branch Expenses = Cash expenses + Bad debt + Discount allowed

   = Rs.53,500 + Rs.1,500 + Rs.1,000 = Rs.56,000

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6. Gross Profit

Total sales (at invoice price)- Goods returned by customers (at invoice price) x $\frac{33.33}{100+33.33}$

{(Rs. 1,80,000+ Rs. 2,80,000)- Rs. 6,000} x $\frac{33.33}{133.33}$ = Rs. 1,13,500

Question 4

(a) Raj Ltd. gives you the following information for the year ended 31st March, 2006:

(i) Sales for the year Rs.48,00,000. The Company sold goods for cash only.

(ii) Cost of goods sold was 75% of sales.

(iii) Closing inventory was higher than opening inventory by Rs.50,000.

(iv) Trade creditors on 31.3.2006 exceed the outstanding on 31.3.2005 by Rs.1,00,000.

(v) Tax paid during the year amounts to Rs.1,50,000.

(vi) Amounts paid to Trade creditors during the year Rs.35,50,000.

(vii) Administrative and Selling expenses paid Rs.3,60,000.

(viii) One new machinery was acquired in December, 2005 for Rs.6,00,000.

(ix) Dividend paid during the year Rs.1,20,000.

(x) Cash in hand and at Bank on 31.3.2006 Rs.70,000.

(xi) Cash in hand and at Bank on 1.4.2005 Rs.50,000.

Prepare Cash Flow Statement for the year ended 31.3.2006 as per the prescribed Accounting standard.

(b) What all are the differences between Cash Flow statement and Fund Flow statement?

(12+4= 16 Marks)

Answer

(a)

Cash flow statement of Raj Limited
for the year ended 31.3.2006

Direct Method

	Rs.	*Rs.*
Cash flow from operating activities:		
Cash receipt from customers (sales)	48,00,000	
Cash paid to suppliers and expenses (Rs.35,50,000 + Rs.3,60,000)	39,10,000	
Cash flow from operation	8,90,000	

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Less: Tax paid	1,50,000	
Net cash from operating activities		7,40,000
Cash flow from investing activities:		
Purchase of fixed assets	(6,00,000)	
Net cash used in investing activities		(6,00,000)
Cash flow from financing activities:		
Dividend Paid	(1,20,000)	
Net cash from financing activities		(1,20,000)
		20,000
Add: Opening balance of Cash in Hand and at Bank		50,000
Cash in Hand and at Bank on 31.3.2006		70,000

(b) Differences between cash flow statement and fund flow statement

(i) Cash flow statement deals with the change in cash position between two points of time. Fund flow statement deals with the changes in working capital position.

(ii) Cash flow statement contains opening as well as closing balances of cash and cash equivalents. The fund flow statement does not contain any such opening and closing balance.

(iii) Cash flow statement records only inflow and outflow of cash. Fund flow statement records sources and application of funds.

(iv) Fund flow statement can be prepared from the cash flow statement under indirect method. However, a cash flow statement cannot be prepared from fund flow statement.

(v) A statement of changes in working capital is usually prepared alongwith fund flow statement. No such statement is prepared along with the cash flow statement.

Question 5

Firm X & Co. consists of partners A and B sharing Profits and Losses in the ratio of 3 : 2. The firm Y & Co. consists of partners B and C sharing Profits and Losses in the ratio of 5 : 3.

On 31st March, 2006 it was decided to amalgamate both the firms and form a new firm XY & Co., wherein A, B and C would be partners sharing Profits and Losses in the ratio of 4:5:1.

Balance Sheet as at 31.3.2006

Liabilities	*X & Co.,*	*Y & Co.*	*Assets*	*X & Co.*	*Y & Co.*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Capital:			*Cash in hand/bank*	*40,000*	*30,000*
A	*1,50,000*	*---*	*Debtors*	*60,000*	*80,000*
B	*1,00,000*	*75,000*	*Stock*	*50,000*	*20,000*

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C	---	*50,000*	*Vehicles*	---	*90,000*
Reserve	*50,000*	*40,000*	*Machinery*	*1,20,000*	---
Creditors	*1,20,000*	*55,000*	*Building*	*1,50,000*	---
	4,20,000	*2,20,000*		*4,20,000*	*2,20,000*

The following were the terms of amalgamation:

(i) Goodwill of X & Co., was valued at Rs.75,000. Goodwill of Y & Co. was valued at Rs.40,000. Goodwill account not to be opened in the books of the new firm but adjusted through the Capital accounts of the partners.

(ii) Building, Machinery and Vehicles are to be taken over at Rs.2,00,000, Rs.1,00,000 and Rs.74,000 respectively.

(iii) Provision for doubtful debts at Rs.5,000 in respect of X & Co. and Rs.4,000 in respect of Y & Co. are to be provided.

You are required to:

(i) Show, how the Goodwill value is adjusted amongst the partners.

(ii) Prepare the Balance Sheet of XY & Co. as at 31.3.2006 by keeping partners capital in their profit sharing ratio by taking capital of 'B' as the basis. The excess or deficiency to be kept in the respective Partners' Current account. *(16 Marks)*

Answer

(i) Adjustment for raising and writing off of goodwill

	Raised in old profit sharing ratio		*Total*	*Written off in new ratio*	*Difference*
	X & Co.	*Y & Co.*			
	3:2	*5:3*			
	Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*
A.	45,000	---	45,000 Cr.	46,000 Dr.	1,000 Dr.
B.	30,000	25,000	55,000 Cr.	57,500 Dr.	2,500 Dr.
C	---	15,000	15,000 Cr.	11,500 Dr.	3,500 Cr.
	75,000	40,000	1,15,000	1,15,000	Nil

(ii) Balance Sheet of X Y & Co.(New firm) as on 31.3.2006

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		Vehicle	74,000
A	1,72,000	Machinery	1,00,000
B	2,15,000	Building	2,00,000
C	43,000	Stock	70,000

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Current Accounts:		Debtors	1,31,000
A	22,000	Cash & Bank	70,000
C	18,000		
Creditors	1,75,000		
	6,45,000		6,45,000

Working Notes:

1. Balance of Capital Accounts at the time of amalgamation of firms

X & Co. Profit and loss sharing ratio 3:2	*A's Capital*	*B's Capital*
	Rs..	*Rs.*
Balance as per Balance Sheet	1,50,000	1,00,000
Add: Reserves	30,000	20,000
Revaluation profit (Building)	30,000	20,000
Less: Revaluation loss (Machinery)	(12,000)	(8,000)
Provision for doubtful debt.	(3,000)	(2,000)
	1,95,000	1,30,000
Y & Co. Profit and loss sharing ratio 5:3	*B's Capital*	*C's Capital*
	Rs.	*Rs.*
Balance as per Balance sheet	75,000	50,000
Add: Reserves	25,000	15,000
Less: Revaluation (vehicle)	(10,000)	(6,000)
Provision for doubtful debts	(2,500)	(1,500)
	87,500	57,500

2. Balance of Capital Accounts in the balance sheet of the new firm as on 31.3.2006

		A	*B*	*C*
		Rs.	*Rs.*	*Rs.*
Balance b/d:	X & Co.	1,95,000	1,30,000	--
	Y & Co.	--	87,500	57,500
		1,95,000	2,17,500	57,500
Adjustment for goodwill		(1,000)	(2,500)	3,500
		1,94,000	2,15,000	61,000

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Total capital Rs. 4,30,000 (B's capital* i.e. Rs.2,15,000 x 2) to be contributed in 4:5:1 ratio.	1,72,000	2,15,000	43,000
Transfer to Current Account	22,000	---	18,000

Question 6

Answer any four of the following:

(a) *X Co. Limited purchased goods at the cost of Rs.40 lakhs in October, 2005. Till March, 2006, 75% of the stocks were sold. The company wants to disclose closing stock at Rs.10 lakhs. The expected sale value is Rs.11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.2006.*

(b) *Explain the 'Accounting of Revaluation of Assets' with reference to AS 10.*

(c) *Explain the uses of Accounting information in agriculture farm.*

(d) *Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is, payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2006, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at Rs.9 lakhs. Decide whether the income by way of interest from dealers is eligible for recognition as per AS 9.*

(e) *AB Ltd. launched a project for producing product X in October, 2004. The Company incurred Rs.20 lakhs towards Research and Development expenses upto 31st March, 2006. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.*

Advise the Company as per the applicable Accounting Standard.

(f) *List the preferential creditors, who are eligible for preferential payment upon insolvency of an individual.* *(4x4=16 Marks)*

Answer

(a) As per Para 5 of AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost and net realizable value.

In this case, the cost of inventory is Rs.10 lakhs. The net realizable value is 11,00,000 × 90% = Rs.9,90,000. So, the stock should be valued at Rs.9,90,000.

(b) As per Para 30 of AS 10 "Accounting for Fixed Assets", an increase in net book value arising on revaluation of fixed assets should be credited to owner's interests under the head of 'revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed assets is charged directly to

* B's Capital Rs.21,500 being one-half of the total capital of the firm.

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profit and loss statement except that to the extent such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilized , it may be charged directly to that account.

(c) Uses of Accounting information in agricultural farm

A suitably designed accounting system can be used for extracting the following information:

(i) Crop-wise performance and overall performance of the agricultural enterprise.

(ii) Comprehensive information regarding yields, revenue, input and cost of the enterprise.

(iii) Financial state of affairs at a particular point of time.

(iv) Profit or loss of the firm during the year.

(v) Data base for management decisions such as replacement of farm equipments, crop mix etc.

(vi) Furnishing information to banks and financial institutions.

(vii) Reliable source document for farm management survey.

(viii) Reliable source document for assessment of agricultural income tax.

(d) As per AS 9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

In this case, the company never realized interest for the delayed payments make by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized.

(e) As per Para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting Rs. 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2006.

(f) Preferential creditors get preference over other unsecured creditors. Hence, they are known as preferential creditors. By law, the following are the preferential creditors:

(i) all debts due to Government or any local authority.

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(ii) Salary and wages to staff in respect of the services rendered to the insolvent during 4 months preceding the date of presentation of insolvency petition, subject to the following limits:

(a) Under the Presidency Towns Insolvency Act – Rs.300 for such clerk and Rs.100 each for each such servant or labourer.

(b) Under the Provincial Insolvency Act Rs.20 for each such clerk, servant or labourer.

(iii) One month's rent due to the landlord is preferential under the Presidency Towns Insolvency Act. Rent is not at all preferential as per the provincial Insolvency Act .

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PAPER – 2 : AUDITING

Answer Questions Nos. 1 and 2 and any four questions from the rest.

Question 1

As an auditor, comment on the following situations/statements:

(a) *Travelling expenses of Rs. 2.25 lakhs shown in Profit and Loss Account of X Ltd., including a sum of Rs. 1.10 lakhs spent by a Director on his foreign travel for company's business accompanied by his mother for her medical treatment (5 Marks)*

(b) *X Ltd., to whom Companies (Auditor's Report) Order, 2003 is applicable, has issued 9% Debenture of Rs. 5 crores, redeemable after 5 years and used the proceeds of issue for payment of Sundry Creditors and other Current Liabilities of Rs. 2.80 crores. (5 Marks)*

(c) *The surplus arising from sale of investment was set-off against a non-recurring loss and was not disclosed separately. (5 Marks)*

(d) *The register of members of AP Ltd. Has not been written up-to-date and as a result, the balances in the register do not agree with the amount of issued Share Capital. (5 Marks)*

Answer

(a) Personal Expenses Charged to Revenue Account: As per the provisions of Section 227(1A) of the Companies Act, 1956, the auditor shall enquire whether personal expenses have been charged to revenue account and make a report to the members in case he is not satisfied with the answer.

In this case, the auditor should examine documentary evidence in support of the travelling expenses of Rs.1.10 lakhs incurred by the director and ascertain the personal component thereof. Then he should enquire as to whether such personal expenses incurred by the company are covered by contractual obligations or by any accepted business practices. In case, the answer is negative, the auditor should make a report thereon and qualify his audit report.

(b) Application of Long-Term Funds: The Companies (Auditor's Report) Order, 2003 required the auditor to report whether funds raised on short-term basis have been used by the company for long-term investment and long-term funds have been used to finance short-term assets.

In this case, 'X' Ltd., issued 9% debentures of Rs.5 crores and out of the proceeds, it used Rs. 2.80 crores for payment of sundry creditors and other current liabilities. The auditor will enquire about the object of issue of debentures and end use of Rs.5 crores. Further, the auditor should refer to Board's resolution authorizing the utilization of the fund for payment of current liabilities. He will refer to the Cash Flow Statement and would obtain the requisite information and explanations from the management and if he is satisfied that long-term funds have been used for payment of short-term liabilities, he will state in audit report accordingly.

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(Note: The aforesaid answer is based on the earlier CARO, 2003 which required the auditor to look into application of long-term funds into short-term application as well. However, as per the amended CARO, 2003 as revised by the Companies Auditors' Report (Amendment) Order, 2004, the auditor is not required to look into application of long-term funds.

(c) Disclosure of Surplus on Sale of Investments: AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changing in Accounting Policies" prescribes the classification and disclosure of items in the statement on profit and loss account. AS 5 requires separate disclosure of prior period item, extraordinary items, etc. distinctly so as to reflect the financial position of enterprise for better understanding of users of financial statements. In the instant case, the setting-off of surplus arising from sale of investments against a non-recurring item is not proper because such an adjustment fails to disclose the performance of enterprise. Though, sale of investments (even if such investments are long-term) is an ordinary activity of the enterprise, the AS 5 requires that, "When items of income and expenses within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately". Accordingly the auditor should modify his report bringing out the impact of adjusting surplus on investments against loss on non-recurring items.

(d) Maintenance of Statutory Register: Register of members is a statutory book, which should be maintained by every company. The auditor should ascertain whether the company updates the register and then examine whether it is in agreement with the amount of issued capital. Because in the audit of share capital, it constitutes one of the internal documentary evidence. The auditor may also consider applying alternative audit procedures because If the company fails to update the register and the auditor fails to obtain sufficient appropriate audit evidence, the auditor may qualify his report.

Question 2

Give your comments on the following:

(a) Mr. X, a Director of M/s KP Private Ltd., is also a Director of another company viz., M/s GP Private Ltd., which has not filed the annual accounts and annual return for last three years 2002-03 to 2004-05. Mr. X is of the opinion that he is not disqualified u/s 274(1)(g) of the Companies Act, 1956, and auditor should not mention disqualification remark in his audit report. (5 Marks)

(b) Mr. Aditya, a practising chartered accountant is appointed as a "Tax Consultant" of ABC Ltd., in which his father Mr. Singhvi is the Managing Director. (4 Marks)

(c) You have been appointed the sole auditor of a company where you were one of the joint auditors for the immediately preceding year and the said joint auditors is not re-appointed. (4 Marks)

(d) No Annual General Meeting (AGM) was held for the year ended 31st March, 2005, in XYZ Ltd., Ninu is the auditor for the previous year, whether she is continuing to hold office for

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current year or not. *(3 Marks)*

Answer

(a) Disqualification of a Director u/s 274(1)(g) of the Companies Act, 1956: Section 227(3)(f) of the Companies Act, 1956 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as director u/s 274(1)(g) of the Companies Act, 1956. As per provisions of Section 274(1)(g), if a director is already holding a directorship of a "public company" which has not filed the annual accounts and annual returns for any continuous three financial years shall not be eligible to be appointed as a director of any other public company.

In this case since Mr X is a director of Private Ltd. Company, hence the provisions of section 274(1)(g) are not applicable to him and as such he is not disqualified from directorship of both the companies. Therefore, the auditor shall not report about the disqualification u/s 227(3)(f) of the Companies Act, 1956.

(b) Appointment of a Practising CA as 'Tax Consultant': A chartered accountant appointed as an auditor of a company, should disclose his interest while making the audit report. If this disclosure is not made, it would amount to "misconduct" under the Chartered Accountants Act, 1949.

In this case, Mr Aditya is a "Tax Consultant" and not a "Statutory Auditor" of ABC Ltd., hence he is not liable to disclose his relationship with Managing Director of the company except as required by section 349 of the Companies Act, 1956.

(c) Appointment of Sole Auditor: When one of the joint auditors of the previous year is appointed as the sole auditor for the next year, it is similar to non re-appointment of one of the retiring joint auditors. Accordingly, provisions of the Companies Act, 1956 to be complied with are as under:

1. Ascertain that special notice u/s 225(1) of the Companies Act, 1957 was received by the company from a member at least 14 days before the AGM date.
2. Check whether the said notice has been sent to all the members at least 7 days before the date of the AGM as per section 190(2) of the Companies Act, 1956.
3. Verify the notice contains an express intention of a member for proposing the resolution for appointing a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment.
4. The notice is also sent to the retiring auditor as per section 225(2) of the Companies Act, 1956.
5. Verify whether any representation, received from the retiring auditor was sent to the members of the company.
6. Verify from the minutes book whether the representation received from the retiring joint auditor was considered at the AGM.

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(d) Tenure of Appointment: Section 224(1) provides that an auditor is appointed for a particular period, i.e., from conclusion of one annual general meeting until conclusion of the next annual general meeting. In case the annual general meeting is not held within the period prescribed, the auditor will continue in office till the annual general meeting is actually held and concluded. Therefore, Ninu shall continue to hold office till the conclusion of the annual general meeting.

Question 3

(a) Why are Computer Aided Audit Techniques (CAAT) required in EDP audit? What are the advantages of CAATs? (10 Marks)

(b) State the different types of Analytical Review carried out in verification of inventories. (6 Marks)

Answer

(a) Computer Aided Audit Techniques (CAATs): The use of computers may result in the design of systems that provide less visible evidence than those using manual procedures. CAATs are such techniques applied through the computer which are used in the verifying the data being processed by it. System characteristics resulting from the nature of EDP processing that demand the use of Computer Aided Audit Techniques (CAAT) are:

(i) *Absence of input documents*: Data may be entered directly into the computer systems without supporting documents. In on-line transaction systems, written evidence of individual data entry authorization, e.g., credit limit approval may not be available.

(ii) *Lack of visible transaction trail*: Certain data may be maintained on computer files only. In a manual system, it is normally possible to follow a transaction through the system by examining source documents, books of account, records, files and reports. In an EDP environment, however, the transaction trail may be partly in machine-readable form, and it may exist only for a limited period of time.

(iii) *Lack of visible output*: In a manual system, it is normally possible to examine visually the results of processing. In EDP systems, the results of processing may not be printed or only a summary data may be printed. Thus, the lack of visible output may result in the need to access data retained on machine readable files.

(iv) *Ease of Access to data and computer programmes*: Data and computer programmes may be altered at the computer or through the use of computer equipment at remote locations. Therefore, in the absence of appropriate controls, there is an increased potential for unauthorized access to, and allocation of, data and programmes by persons inside or outside the entity.

Advantages of CAAT

(i) *Audit effectiveness*: The effectiveness and efficiency of auditing procedures will be improved through the use of CAAT in obtaining and evaluating audit evidence, for

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example –

(a) Some transactions may be tested more effectively for a similar level of cost by using the computer.

(b) In applying analytical review procedures, transactions or balance details of unusual items may be reviewed and reports got printed more efficiently by using the computer.

(ii) *Savings in time*: The auditor can save time by reviewing the EDP controls using CAAT than through other audit procedures.

(iii) *Effective test checking and examination in depth*: CAAT permits effective examination in depth of selected transactions since the auditor constructs the lost audit trail.

(b) Analytical Procedures for Verification of Inventories: The auditor can adopt the following analytical procedures to verify the stock of inventories:

(i) Quantitative reconciliation of opening stocks, purchases, production, sales and closing stocks;

(ii) Comparison of closing stock quantities and amounts with those of the previous year.

(iii) Comparison of the stock turnover ratios for the current year with that of the previous year and with industry standards if available.

(iv) Comparison of the closing stock (Raw materials, closing work-in-progress and finished goods are percentage of total stocks) with the corresponding figures of the previous year.

(v) Comparison of current year gross profit ratio of the previous year.

(vi) Comparison of actual stock, purchase and sales figures with the budgeted figures if available.

(vii) Comparison of raw-material yield/wastage with previous year figures.

Question 4

How will you verify/vouch the following?

(a) Purchase of quoted investment *(4 Marks)*

(b) Discounted bill receivable dishonoured *(4 Marks)*

(c) Amount due to subsidiary companies *(4 Marks)*

(d) Purchase return *(4 Marks)*

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Answer

(a) Purchase of Quoted Investment:

(i) Ascertain the date of purchase, rate of purchase, nature of investments purchased and nature of transaction, i.e., error cum-dividend/interest/right/bonus.

(ii) Compare the rate of purchase with quotation available. Obtain suitable explanations in case of significant variations.

(iii) Verify the amount paid towards purchase of investments.

(iv) Trace the amount in the cheque book counterfoils and bank statements.

(v) Obtain a schedule of investment from Management for physical verification at the year end.

(vi) Verify the investment certificate to confirm title.

(vii) Confirm compliance with statutory provisions such as 227(1A) and CARO, 2003 under section 227(4A) of the Companies Act, 1956.

(viii) Verify whether investments are duly disclosed in financial statements in accordance with recognized accounting policies and practices and relevant statutory requirements.

(b) Discontinued Bill Receivable Dishonoured:

(i) to client's account.

(iv) Verify entries for dishonour passed in the parties account.

(v) Confirm whether bank charges, noting charges, etc. have been debited to party.

(vi) Verify whether B/R has been returned along with banker's advice.

(vii) Obtain a schedule of Bills discounted / dishonoured and examine the same.

(ii) Trace the credit entry and subsequent dishonour entry in the bank statement.

(iii) Confirm that no debit is raised by the banker for dishonour, without first adding the amount Ensure that the dishonour has been properly noted on the B/R.

(viii) Examine correspondence with lawyer and other subsequent events, which may provide other evidence of the debt becoming band or doubtful, etc.

(c) Amounts due to Subsidiary Companies:

(i) Examine whether the subsidiary company is authorized by its Memorandum of Association to advance the loan to the holding company.

(ii) Verify the interest rate at which the loan has been obtained and particulars of the security that has been furnished for confirming the amount of interest and disclosure of the charge in the Balance Sheet.

(iii) Inspect the documents executed by the holding company which constitute the basis of the loan and the provision in the Memorandum under which the loan has been raised.

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(iv) Verify by reference to the Balance Sheet of the subsidiary company that the loan is duly reflected in the Balance Sheet as a loan due from the holding company.

(v) Amounts due to subsidiary companies may be on account of credit purchases at goods or services which should be verified with the relevant documentary evidences.

(vi) Confirm whether the provisions of section 301 of the Companies Act, 1956, where applicable have been complied.

(d) Purchase Returns

(i) Examine debit note issued to the supplier which in turn may be confirmed by corresponding credit note issued by the supplier acknowledging the same. The relevant correspondence may also be examined.

(ii) Verify by reference to relevant corresponding record in good outward book or the stores records. Further, the figures in these documentary evidence should be compared with the supplier's original invoices for rates and other charges and calculation should also be checked.

(iii) Examine in depth to eliminate the possibility of fictitious purchase returns for covering bogus purchases recorded earlier when such returns outwards are in substantial figure either at the beginning or end of the accounting year.

(iv) Cross-check with reference to original invoices any rebates in price or allowances if any given by suppliers on strength of their Credit Notes.

Question 5

(a) What are the special considerations in an audit of a Limited Company? *(8 Marks)*

(b) Explain propriety audit in the context of Government Audit. *(8 Marks)*

Answer

(a) Special Consideration in and Audit of Limited Company:

1. *Initial Verification*

(a) Examine basic documents, viz., Memorandum of Association and Articles of Association of the company, prospectus issued, etc.

(b) Check the certificate of incorporation and certificate of commencement of business.

(c) Examine transactions entered into by the company with reference to the date of these certificates.

(d) Verify the contracts entered into with vendors or other persons for purchase of property, payment of commission, etc.

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2. *Board's Duties*

   (a) Ensure that Board of Directors act well within their powers and no *ultra vires* act is ratified.

   (b) Also check that the Board has not exercised the powers that are to be exercised by the members in their General Meeting.

   (c) Verify that only acts that can be delegated are in fact delegated to others and that the Board takes decisions only by resolutions at properly constituted meetings.

   (d) Inspect minutes of meetings of Board of Directors.

   (e) Verify whether the Board has obtained sanction of the Central Government, wherever applicable, e.g., increase in remuneration to Directors in excess of specified amounts.

3. Compliance with relevant provisions of the Companies Act, 1956 relating to share capital; provision relating to Board provisions relating to accounts and audit, etc.

4. Compliance with provisions relating to section 224 to 233.

(b) Propriety Audit: Under 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. However, some general principles have been laid down in the Audit Code, which have for long been recognized as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

1. The expenditure should not be *prima facie* more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.

2. No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.

3. Public moneys should not be utilised for the benefit of a particular person or section of the community unless:

   (i) the amount of expenditure involved is insignificant; or

   (ii) a claim for the amount could be enforced in a Court of law; or

   (iii) the expenditure is in pursuance of a recognised policy or custom; and

   (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

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Question 6

(a) What are the special steps involved in framing a system of Internal Check? *(8 Marks)*

(b) How the audit is advantageous to Sole Trader? *(8 Marks)*

Answer

(a) General Considerations in Framing a System of Internal Check: The term "internal check" is defined as the "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". The following aspects should be considered in framing a system of internal check:

(1) No single person should have an independent control over any important aspect of the business. The work done by one person should automatically be checked by another person in routine course.

(2) The duties/work of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.

(3) Every member of the staff should be encouraged to go on leave at least once in a year so that frauds successfully concealed by such a person can be detected in his absence.

(4) Persons having physical custody of assets must not be permitted to have access to the books of account.

(5) There should be an accounting control in respect of each important class of assets, in addition, these should be periodically inspected so as to establish their physical condition.

(6) The system of Budgetary Control should be introduced.

(7) For stock-taking, at the close of the year, trading activities should, if possible, be suspended. The task of stock-taking, and evaluation should be done by staff belonging to other than stock section.

(8) The financial and administrative powers should be sub divided very judicially and the effect of such division should be reviewed periodically.

(9) Finally, the system must be capable of being expanded or contracted to correspond to the size of the concern.

(b) Advantages of Audit to a Sole Trader:

(i) Although sole traders are not required by any law (except u/s 44AD, 44AE, 44AF, 44AB and other provisions of the Income-tax Act, 1961) to have their accounts audited, yet it has become customary for many of them who derive their large incomes from numerous sources and whose expenditure is vast and varied to get

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their accounts audited. Also, sole traders, get their financial statements audited due to regulatory requirements, such as stock brokers or on a specific instructions of the bank for approval of loans, etc. The sole trader can determine the scope of the audit as well as the conditions under which it will be carried out. For example, he can stipulate that only a partial audit shall be carried out or certain parts of the accounts shall not be checked. It will also be decided that the audit will be carried out continuously or at the end of the year. Thus, the duties and the nature of auditor's work will depend upon the agreement that he has entered into with the sole trader. But he must obtain clear instructions from his clients in writing as to what he is expected to do. The following are some of the advantages that can be derived from an audit of this nature:

(i) The individual is assured of having his accounts properly maintained and his expenditure vouched.

(ii) He is also assured of not being defrauded by the accountant and his agents. Even if they have done some defalcations, etc. these may be discovered by the auditors.

(iii) The audited accounts are reliable and are generally accepted by the Income-tax Department and hence, individuals do not feel any difficulty for taxation assessments, etc.

(iv) The audited accounts of a deceased are very helpful for executors and administrators.

Question 7

(a) What are the meaning and purposes of Sampling? Explain in the light of AAS-15, Audit Sampling. *(8 Marks)*

(b) State briefly Audit Procedures and Audit Techniques *(8 Marks)*

Answer

(a) Meaning of Audit Sampling: "Audit Sampling" means the application of audit procedures to less than 100% of the items within an account balance or class of transaction to enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning he population. There are two major methods in which the size of the sample and the selection of individual items of the sample are determined. These methods are : (1) judgmental sampling; and (2) statistical sampling.

Under Judgmental Sampling the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor. The judgmental sampling is criticised on the grounds that it is neither objective nor scientific. The expected degree of objective cannot be assured in judgmental sampling because the risk of personal bias in selection of sample items cannot be eliminated. The closeness of the qualities projected by the sample results with that of the whole population cannot be measured be-

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cause the sample has not been selected in accordance with the mathematically based statistical techniques. However, it may be stated that the auditor with his experience and knowledge of the client's business can evaluate accurately enough the sample findings to make audit decision and the mathematical proof of accuracy in some cases may be a luxury which the auditor cannot afford. In judgmental sampling the auditor's opinion determines the sample size but it cannot be measured how far the sample size would fulfill the audit objective. In statistical sampling, the sample results are measurable as to the adequacy and reliability of the audit objectives.

Statistical sampling is a method of audit testing which is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, debtors' confirmation, payroll checking, vouching of invoices and petty cash vouchers.

Whatever may be the method, judgmental or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

(b) As per AAS 1 on Basic Principles Governing an Audit states, "the auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information. Therefore, audit procedures are broadly classified in two categories, viz., compliance procedures and substantive procedures.

Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. In obtaining audit evidence from compliance procedures, the auditor is concerned with assertions that the control exists, the control is operating effectively and the control has so operated throughout the period of intended reliance. So the auditor is concerned with the existence, effectiveness and continuity of the control system.

Substantive procedures are tests designed to obtain evidence as to the completeness, accuracy and validity of the data produced by accounting system. They are of two types :

(1) tests of details of transactions and balances.

(2) analysis of significant ratios and trends including the resulting investigation of unusual fluctuations and items.

Audit techniques on the other hand refers to collection and accumulation of audit evidence. Some of the techniques commonly adopted by the auditors are the following:

- Posting checking
- Casting checking

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- Physical examination and count
- Confirmation
- Inquiry
- Year-end scrutiny
- Re-computation
- Tracing in subsequent period
- Bank Reconciliation

The two terms, procedure and techniques, are often used interchangeably; in fact, however, a distinction does exist. Procedure may comprise a number of techniques and represents the broad frame of the manner of handling the audit work; techniques stand for the methods employed for carrying out the procedure. For example, procedure requires an examination of the documentary evidence. This job is performed by the procedure known as vouching which would involve techniques of inspection and checking computation of documentary evidence.

Question 8

Write short notes on the following:

(a) Statutory Report of a Public Company under section 165(4)

(b) Scrutiny of General Ledger

(c) Initial Engagements

(d) General Principles of Verification of Assets *(4×4 = 16 Marks)*

Answer

(a) Audit of Statutory Report of a Public Company: Under section 165 of the Companies Act, 1956 every public company limited by shares, or limited by guarantee and having a share capital, has to hold a statutory meeting of its members within a period of not less than one month and nor more than six months from the date at which the company is entitled to commence business. It sets out the following matters:

(i) The total number of shares allotted, distinguishing shares allotted (as fully or partly paid up) otherwise than in cash, and stating in the case of shares partly paid up, the extent to which they are so paid up, and in either case, the consideration for which they have been allotted;

(ii) the total amount of cash received by the company in respect of all the shares allotted, distinguished as aforesaid;

(iii) An abstract of the receipts of the company and the payments made thereout, up to date within seven days of the date of the report, exhibiting under distinctive headings the receipts of the company from shares and debentures and other sources, the payments made thereout, the particulars concerning the balance

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remaining in hand, and an account or estimate of the preliminary expenses of the company, showing separately any commission or discount paid or to be paid on the issue or sale of shares or debentures;

(iv) the names, addresses and occupations of the directors, auditors and also, manager and secretary, if any, and the changes, if any, which have occurred in such names, addresses and occupations since the date of the incorporation of the company;

(v) the particulars of any contract which, or the modification or the proposed modification of which, is to be submitted to the meeting for its approval together in the latter case with the particulars of the modification or proposed modification;

(vi) the extent, if any, to which each underwriting contract, if any, has not been carried out, and the reasons therefore;

(vii) the arrears, if any, due on calls from every director and the manager; and

(viii) the particulars of any commission or brokerage paid or to be paid for issue or sale of shares or debentures to any director or the manager.

The statutory report is to be certified as correct by at least two directors of the company, one of whom should be a managing director, where there is one. The auditors of the company should also certify that part of the report which relates to the shares allotted by the company, the cash received in respect of such shares, and the receipts and payments of the company.

(b) Scrutiny of General Ledger:

(i) The General Ledger contains all the balances which are ultimately included in the Profit and Loss Account and the Balance Sheet. Its examination, therefore is undertaken last of all.

(ii) The scrutiny of General Ledger should be carried out with due care in as much as it is the final review of balances which, on inclusion in Final Accounts, cumulatively reflect the financial position of the concern.

(iii) Entries in the General Ledger usually are posted in a summary form from the books of original entries such as Cash Book, Journal, Sales Book, Purchase Book and other subsidiary books. Therefore, it should be confirmed that all the postings on various accounts have been verified, totals, etc. checked.

(iv) It should also be ascertained that balances in all the income and expense accounts have been adjusted: (a) according to standard accounting practices (i.e., all unpaid, prepaid expenses have been adjusted and accrued Income and prerecorded income is properly adjusted; and (b) on a consideration of the legal provisions which are applicable to the concern.

(v) The balances in the General Ledger should be traced to the trial balance and from the trial balance to the final accounts.

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(c) Initial Engagement: As per AAS 22, "Initial Engagements – Opening Balances", initial audit engagements mean:

(i) When the auditor is engaged to carry out the audit of Financial Statements of an entity for the first time; or

(ii) When the financial statements of the entity for the preceding period were audited by another auditor.

The situation mentioned in (i) above arises when the auditor is appointed to take up the audit for the first-time or no audit was carried out of the financial statements of the entity for the immediately preceding period. The situation mentioned in (ii) above arises whenever there is a change of auditor. For initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

(a) the closing balances of the preceding period have been correctly brought forward to the current period; and

(b) appropriate accounting policies are consistently applied.

(d) General Principles of Verification of Assets: Verification of assets is an important audit process. Primarily verification of assets is the responsibility of the management since the management is expected to have a greater intimate knowledge of the assets of the business as regards location, use, conditions, etc. than what an outsider might be able to acquire on their inspection. The auditor, however, should follow the general principles in verification and valuation of fixed assets and other assets as stated below:

(i) To confirm that the assets were in existence on the date of the Balance Sheet. The existence of fixed assets can be verified by physical verification and/or by comparing the particulars of assets as are entered in the schedule attached to the Balance Sheet with the Plant or Property Register and reconciling their total value with the General Ledger balances. As per the CARO, 2003, the auditor has to report on the physical verification of the fixed assets by the management, and the treatment of the discrepancies, if any.

The existence of other assets such as cash, etc. can be physically verified at the last day of the balance sheet, where assets, e.g., government securities, share certificates, debentures, bonds, etc. are in the custody of the bank or third party, such assets, should, preferably, be either physically inspected or certificate should be obtained.

(ii) To ascertain that the assets had been acquired for the purposes of the business and they are under proper authority.

(iii) To confirm that the rights of ownership of the assets vested in or belonged to the client in respect of assets appearing in the balance sheet. In case they are jointly held with someone sales, then this fact must be disclosed.

(iv) To confirm that the assets were free from any lien or charge not disclosed in the balance sheet, and if the assets are given under lien or charge is created in favour of creditors, it is to be ascertained that no unauthorized charge has been created

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against any asset and all charges are duly registered and disclosed. Where shares or securities on fixed deposits, receipts, etc. are lodged with a bank to secure loan or an overdraft, a certificate should be obtained fro the bank showing the nature of charge, if any.

(v) To ascertain the original amount at which the asset was acquired so as to satisfy that the assets are shown in the accounts at 'historical cost'. All other expenses, which were incurred to bring the asset to their present working condition, have been capitalized.

(vi) To ensure that the assets have been correctly valued having regard to their physical conditions, recoverability, etc. The assets should normally be valued according to generally accepted accounting principles on a consistent basis.

(viii) To ascertain that the assets have been properly disclosed in the balance sheet with regard to statutory requirements in accordance with the nature of business and relevant accounting standards in a consistent manner, e.g., AS 1, AS 2, AS 10, AS 16, AS 26, etc.

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PAPER – 3 : BUSINESS AND CORPORATE LAWS

Question Nos. 1 & 7 are compulsory.

Candidates are required to attempt four questions out of questions 2, 3, 4, 5 and 6 and two questions out of questions 8, 9 and 10.

Question 1

Answer any four of the following:

(a) *Ramaswami proposed to sell his house to Ramanathan. Ramanathan sent his acceptance by post. Next day, Ramanathan sends a telegram withdrawing his acceptance. Examine the validity of the acceptance in the light of the following:*

(i) *The telegram of revocation of acceptance was received by Ramaswami before the letter of acceptance.*

(ii) *The telegram of revocation and letter of acceptance both reached together.*

(b) *Suraj sold his car to Sohan for Rs. 75,000. After inspection and satisfaction, Sohan paid Rs. 25,000 and took possession of the car and promised to pay the remaining amount within a month. Later on Sohan refuses to give the remaining amount on the ground that the car was not in a good condition. Advise Suraj as to what remedy is available to him against Sohan.*

(c) *Prakash Chandra is working as a salesman in a company on salary basis. The following payments were made to him by the company during the previous financial year –*

(i) *overtime allowance,*

(ii) *dearness allowance*

(iii) *commission on sales*

(iv) *employer's contribution towards pension fund*

(v) *value of food.*

Examine as to which of the above payments form part of "salary" of Prakash Chandra under the provisions of the payment of Bonus Act, 1965.

(d) *Ram, Mohan and Gopal were partners in a firm. During the course of partnership, the firm ordered Sunrise Ltd. to supply a machine to the firm. Before the machine was delivered, Ram expired. The machine, however, was later delivered to the firm. Thereafter, the remaining partners became insolvent and the firm failed to pay the price of machine to Sunrise Ltd.*

Explain with reasons:

(i) *Whether Ram's private estate is liable for the price of the machine purchased by the firm?*

(ii) *Against whom can the creditor obtain a decree for the recovery of the price?*

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(e) Point out the differences between "transfer by negotiation" and "transfer by assignment" under the provisions of the Negotiable Instruments Act, 1881.

(f) Explain the Law relating to extent of contribution by an employee to his Provident Fund under the Employees Provident Fund and Miscellaneous Provisions Act, 1952. Can the amount of contribution be increased by the employee? (4 × 5= 20 Marks)

Answer

(a) The problem is related with the communication and time of acceptance and its revocation. As per Section 4 of the Indian Contract Act, 1872, the communication of an acceptance is a complete as against the acceptor when it comes to the knowledge of the proposer.

An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

Referring to the above provisions

(i) Yes, the revocation of acceptance by Ramanathan (the acceptor) is valid.

(ii) If Ramaswami opens the telegram first (and this would be normally so in case of a rational person) and reads it, the acceptance stands revoked. If he opens the letter first and reads it, revocation of acceptance is not possible as the contract has already been concluded.

Alternate Answer

(a) Section 5 had stand that revocation of acceptance must reach the offeror 'before the communication of the acceptance is complete as against the acceptor, but not after wards'.

The section does not clearly answer the question raised above about both the acceptance and the withdrawal reaching simultaneously. However, the illustration attached to Section 5 of the Act stated that the acceptor may revoke his acceptance at any time before or at the moment when the letter communicating the acceptance reaches the offeror but not afterwards. So, the two communications reaching simultaneously will neutralize each other and the agreement would not be formed.

There is a case also to support this view. In Countess of Dunmore vs. Alexander, the court stated that 'the admission (by offeror) that the two letters were received together puts and end to the case'.

(b) As per the section 55 of the Sale of Goods Act, 1930 an unpaid seller has a right to institute a suit for price against the buyer personally. The said Section lays down that

(i) Where under a contract of sale the property in the goods has passed to buyer and the buyer wrongfully neglects or refuses to pay for the goods, the seller may sue him for the price of the goods [Section 55(1)].

(ii) Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price. It makes no difference even if the property in the goods

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has not passed and the goods have not been appropriated to the contract [Section 55(2)].

This problem is based on above provisions. Hence, Suraj will succeed against Sohan for recovery of the remaining amount. Apart from this Suraj is also entitled to:-

(1) Interest on the remaining amount

(2) Interest during the pendency of the suit.

(3) Costs of the proceedings.

(c) Computation of Salary / Wages: According to Section 2(21) of the Payment of Bonus Act, 1965 salary and wages means all remuneration other than remuneration in respect of overtime work, capable of being expressed in terms of money, which would if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment, or of work done in such employment. It includes dearness allowance, i.e. all cash payment by whatever name called, paid to an employee on account of a rise in the cost of living. But the term excludes:

(i) Any other allowance which the employee is for the time being entitled to;

(ii) The value of any house accommodation or of supply of light, water, medical attendance or other amenities of any service or of any concessional supply of food grains or other articles;

(iii) Any traveling concession;

(iv) Any contribution paid or payable by the employer to any pension fund or for benefit of the employee under any law for the time being in force.

(v) Any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex-gratia payment made to him; and

(vi) Any commission payable to the employee.

It may be noted that where an employee is given, in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such food allowance or the value of such food shall be deemed to form part of the salary or wage for such employee.

In view of the provisions of Section 2(21) explained above, the payment of dearness allowance and value of free food by the employer forms part of salary of Prakash Chandra while remaining three payments i.e. payment for overtime, commission on sales and employer's contribution towards pension funds does not form part of his salary.

(d) Partnership Liability: The problem in question is based on the provisions of the Indian Partnership Act, 1932 contained in Section 35. The Section provides that where under a contract between the partners the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any act of the firm done after his death. Therefore, considering the above provisions, the problem may be answered as follows:

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(i) Ram's estate in this case will not be liable for the price of the Machinery purchased. *[Bagel Vs. Willer]*

(ii) The creditors in this case can have only a personal decree against the surviving partners and decree against the partnership assets in the hands of those partners. However, since the surviving partners are already insolvent, no suit for recovery of the debt would lie against them. A suit for goods sold and delivered would not lie against the representative of the deceased partner. This is because there was not debt due in respect of the goods in Ram's life time. *[Bagel vs. Willer].*

(e) Negotiation and Assignment: The essential distinction between transfer by negotiation and transfer by agreement are as under as provisions of the Negotiable Instrument Act, 1881.

(i) In the latter case the assignee does not acquire the right of a holder in due course but has only the right, title and interest of his assignor; on the other hand in the former case he acquires all the rights of a holder in due course i.e., right from equities *(Mohammad Khuerail vs. Ranga Rao, 24 M. 654).*

(ii) In the case of negotiable instrument, notice of transfer is not necessary while in the case of assignment of chose in action, notice or assignment must be served by the assignee on his debtor.

(iii) Again, in the case of transfer of negotiable instrument, consideration is presumed, but in the case of transfer by assignment, consideration must be proved as in the case of any other contract.

(iv) Negotiation requires either delivery only in the case of "bearer" instrument, or endorsement and delivery only in the case of " order instrument". But in the case of an assignment, Section 130 of the Transfer of Property Act requires a document to be reduced into writing and signed by the transferor.

(v) Endorsement does not require payment of stamp duty whereas negotiation requires payment of stamps duty.

(f) Contribution to Provident Fund: Section 6 of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 states that the employee contribution to the fund shall be 10% of the basic wage, dearness allowance and retaining allowance (if any). An employee can at his will contribute beyond 10% if the scheme makes provision therefore subject to the conditions that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this Section. This rule will prevail irrespective whether the employer employs the person directly or through contractor.

According to the first proviso to the said section the Central government may, however, raise the aforesaid percentage of contribution from 10% to 12% in respect of any establishments. It may do so after making such enquiries as it deems fit.

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According to the second proviso if the amount of any contribution involves fraction of a rupee, the scheme may provide for rounding off such fraction to the nearest rupee, half of a rupee or a quarter of rupee.

It may be noted that the dearness allowance mentioned above shall be deemed to include also the cash value of any food concession, allowed to the employees; also that "retaining allowance" means an allowance payable for the time being to an employee of any factory or other establishment during any period in which the, establishment is not working for retaining his service.

Question 2

(a) Explain the circumstances whereunder a party to a contract may be exempted from the performance of contract on the ground of 'Supervening impossibility' under the Indian Contract Act, 1872. *(5 Marks)*

(b) State the grounds on the basis of which a member of a Society registered under the cooperative Societies Act, 1912 can be expelled? *(5 Marks)*

Answer

(a) Supervening impossibility: When performance of a promise becomes impossible or illegal by occurrence of an unexpected, event or a change of circumstances beyond the contemplation of parties, is called supervening impossibility. In case of supervening impossibility the contract becomes void.

Circumstances: A party to a contract may be excused from the performance of his promise on the ground of 'supervening impossibility' under the Indian Contract Act, 1872 in the following circumstances.

(a) Accidental destruction of the subject matter of the contract: If the subject matter of the contract is destroyed by an accident both the parties are excused from the performance of the contract.

(b) Non-existence or non occurrence of a particular state of things: Non-existence or non occurrence of a particular state of things of the contract exempts the parties from the performance of the contract.

(c) Incapacity to perform a contract of personal services: In case of contract of personal service, disability or incapacity to perform, caused by the act of God e.g. illness, constitutes lawful excuse for non-performance of the contract.

(d) Change in law: Performance of a contract may also become impossible due to a subsequent change in the law. The law passed after the contract may prohibit performance of some act, which may be very basis of the contract. As such the contract is discharged due to subsequent impossibility and the parties become free from their mutual obligations.

(e) Outbreak of war: Contracts may be affected by war in a variety of ways, viz., (i) by emergency legislation controlling prices or otherwise relating to restriction of trade; (ii) by prohibiting or restraining transaction with alien enemy.

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(b) Expulsion of a member: Section 43(2)(ii) of the Co-operative Societies Act, 1912 provides the grounds of expulsion of a member. As per provisions of the Act a member may be expelled if:

(i) he fails to fulfill his obligations in the matter of dues (the number of months' arrears being specified);

(ii) he becomes a member of another similar society and refuses to withdraw (because each member has the right to inspect the books of the society and may pass information to a rival society of which he is a member);

(iii) he is to be proceeded against for debts;

(iv) he becomes insolvent;

(v) he engages in such activities as might be contrary to the principle of the society;

(vi) he becomes insane;

(vii) he is convicted by Criminal Court, especially of bribery, forget, theft or fraud; and

(viii) he has committed an act which is considered dishonourable by the Managing Committee.

If a member of society with unlimited liability joins another society and so pledges his liability twice over, he should be expelled.

Question 3

(a) Ravi becomes guarantor for Ashok for the amount which may be given to him by Nalin within six months. The maximum limit of the said amount is Rs. 1 lakh. After two moths Ravi withdraws his guarantee. Upto the time of reconviction of guarantee, Nalim had given to Ashok Rs. 20,000.

(i) Whether Ravi is discharged from his liabilities to Nalin for any subsequent loan.

(ii) Whether Ravi is liable if Ashok fails to pay the amount of Rs. 20,000 to Nalin ?

(5 Marks)

(b) When is the registration of a Partnership firm deemed to be complete under the Indian Partnership Act, 1932? What are the consequences when a partnership firm is not registered? (5 Marks)

Answer

(a) Discharge of Surety by Revocation (Problem): As per section 130 of the India Contract Act, 1872 a specific guarantee cannot be revoked by the surety if the liability has already accrued. A continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

As per the above provisions (i) Yes, Ravi is discharged from all the subsequent loan because it's a case of continuing guarantee. (ii) Ravi is liable for payment of Rs. 20,000 Nalin because the transaction has already completed.

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(b) Registration of firm: Registration of a partnership firm is affected by delivering to the Registrar of Firms, a statement in the prescribed form accompanied by the prescribed fee (Section 58 of the Indian Partnership Act). The act of the party by way of presentation of Statement under Section 58 makes registration effective; whereas the Act of the Registrar in recording an entry of the statement in the Registrar of the Firms is only a clerical act *(Jayalakshmi R&O M vs. Income Tax commissioner).*

The effects of non-registration of a firm as contained in section 69 are as follows:

1. Suits between Partners & Firm [Section 69 (1)] A partner of an unregistered firm cannot sue the firm or any partner of the firm to enforce a right arising from a contract or conferred by the Partnership Act. He can do so if (i) the firm is registered and (ii) the person suing is or has been shown in the Registrar of Firms as a partner in the firm.
2. Suits between Firm and third parties [Section 69(2)] An unregistered firm cannot sue a third party to enforce a right arising from a contract.
3. Claim of set-off [Section 69(3)]: An unregistered firm or any partner thereof cannot claim a set-off in a proceeding instituted against the firm by a third party to enforce a right arising from a contract until the registration of the firm is effected. This right of set-off, however, is not affected if the claim of set-off is less than Rs. 100 in value [Section 69(4)(b)].

Question 4

(a) Point out the differences between the transactions of "Sale" and "hire-purchase" in the light of the provisions of the Sale of goods Act, 1930. (5 Marks)

(b) Explain the salient features of the "Employees Pension Scheme" as provided under the Employees Provident Fund and Miscellaneous Provisions Act, 1952. (5 Marks)

Answer

(a) Sale and Hire Purchase: Following are the differences between sale and hire purchase:

Sale	Hire Purchase Agreement
1. Ownership is transferred from the seller to the buyer as soon as the contract is entered into.	1. Ownership is transferred from the seller to the hire-purchaser only when a certain agreed number of installments are paid.
2. The position of the buyer is that of the owner	2. The position of the hire-purchaser is that of the bailee.
3. The buyer cannot terminate the contract and as such is bound to pay the price of the goods.	3. The hire-purchaser has an option to terminate the contract at any stage, and cannot be forced to pay the further installments.

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4. If the payment is made by the buyer in installments, the amount payable by the buyer to the seller is reduced, for the payment made by the buyer is towards the price of the goods.	4. The installments paid by the hire-purchaser are regarded as hire charges and not as payment towards the price of the goods till option to purchase the goods is exercised.
5. The Sale agreements are governed by the Sales of good Act, 1930.	5. The hire-purchase agreements are governed by the Hire-Purchase Act, 1972.

(b) Employees' Pension Scheme: The scheme called the Employees' Pension Scheme in accordance with the provisions of Section 6A of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 provides for:

(a) Superannuation pension, retiring pension or permanent total disablement pension to the employees of any establishment or class of establishments to which the Act applies; and

(b) Widow or widower's pension, children pension or orphan pension payable to the beneficiaries of such employees.

The Act further provides that notwithstanding anything contained in Section 6 of the Act, there shall be established, as soon as may be after framing of the Pension Scheme, a Pension Fund into which there shall be paid, from time to time, in respect of every employee who is a member of the pension scheme:

(a) Such sums from the employers' contribution under Section 6 not exceeding 8 1/3% of the basic wages, dearness allowance and retaining allowance, if any, of the concerned employees, as may be specified in the pension scheme;

(b) Such sums as are payable by the employers of exempted establishments under sub-section (6) of Section 17.

(c) The net assets of the Employees' Family Pension Fund as on the date of the establishment of the Pension Fund;

(d) Such sums as the Central Government may, after due appropriation by Parliament by law in this behalf, specify.

Further, the pension scheme may provide for all or any of the matters specified in Schedule III.

Question 5

(a) When is an alteration in a negotiable instrument is deemed to be a "material alternation" under the Negotiable Instruments Act, 1881? What are the consequences of material alternation in a negotiable instrument? *(5 Marks)*

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(b) The executive of a Cooperative Society is willing to convert the Society into a Multi-State Cooperative Society. Advise as to what steps are required to be taken for the said conversion under the Multi-State cooperative Societies Act, 2002. (5 Marks)

Answer

(a) Material alternation and its effect: As per the negotiable Instrument Act, 1881, an alteration is material which

(a) alters the character or identity of the instrument or which shakes the very foundation of the instrument.

(b) changes the rights and, liabilities of the parties or any of the parties to the instrument or

(c) alters the operation of the instrument.

Any change in an instrument which causes it to speak a difference language in effect from that which it originally spoke, or which changes the legal identity or character of the instrument either in its terms or the relation of the parties to it is a material alteration. It makes no difference whether the alteration is beneficial or prejudicial.

Instances of material alteration. The following alterations are material i.e. the alteration of the date, the sum payable, the time of payment, the place of payment, additional of place of payment, and the rate of interest.

These alterations vitiate the instrument.

Effect of material alteration – As per Section 87 of the Negotiable Instrument Act, 1881, a material alteration of a negotiable instrument renders the same void against persons who were parties thereto before such alteration unless they have consented to the alteration.

But if an alteration is made in order to carry out the common intention of the original parties, it does not render the instrument void. Any material alteration if made by an indorsee, discharges his indorser from all liability to him in 'respect of the consideration thereof.

(b) Conversion of Society: As per the Multi-State Co-operative Societies Act, 2002 (Section 22) steps for conversion of co-operative society into multi-state cooperative society are as follows:

1. A co-operative society by amending its bye-laws may extend its jurisdiction and convert itself into multi-state cooperative society.
2. Such amended by-laws in order to be valid must be registered with the Central Registrar.
3. The Central Registrar after consulting Registrars of Co-operative Societies of the State concerned may register the amendment within a period of six months from the date of receipt by him, if he is satisfied that the amendment fulfills the requirement

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of members being from more than one state and is in accordance with section 11(4) of the Act.

4. A co-operative society shall be deemed to have been converted into a multi-state cooperative society unless it is registered as Multi-State Co-operative Society.

5. The Registrar shall thereafter forward a copy to the Co-operative Society, a copy of the registered amendment with the certificate which shall be a conclusive evidence that the amendment has been registered.

6. If the central Registrar refuses to register amendment of the bye-laws of the Co-operative Society, the reasons of refusal shall be communicated within seven days from the date of refusal.

Question 6

(a) Explain the procedure relating to computation of "working days' for the purpose of payment of bonus under the Payment of Bonus Act, 1965. Can there be a deduction in the amount of bonus on the ground that the employee has not worked for all working days in an accounting year? (5 Marks)

(b) What qualifications and disqualifications have been laid down for appointment of a person on the post of auditor of a Multi-State Cooperative Society under the Multi-State Cooperative Societies Act, 2002? (5 Marks)

Answer

(a) Computation of working days: Section 14 of the Payment of Bonus Act, 1956 provides for computation of number of working days for the purposes of Section 13. Section 13 in turn prescribes a scale whereby bonus can be proportionately reduced in certain cases. Under Section 14, following days shall be deemed to be the working days of an employee and shall be counted while calculating the total working days on which he has been on work for the purpose of bonus:

(i) day when he has been laid off under and agreement or by a standing order under Industrial Employment (Standing orders) Act, 1946 or Industrial Dispute Act, 1947 or any other law,

(ii) he has been on leave with salary or wage,

(iii) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment and

(iv) the employee has been on maternity leave with salary or wages during the accounting year.

As per Section 13, where an employee has not worked for all the working days in an accounting year, the minimum bonus of Rs. 100 or, as the case may be or Rs. 60, if such bonus is higher than 8.33% of his salary or wage for the days he has worked in that accounting year shall be proportionately reduced.

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Both Section 13 and 14 do not cover a case where an employee was prevented from working by reason of an illegal order of termination. If an employee by himself and on his volition has not worked on all the working days in an accounting year, then the formula prescribed in Section 13 read with section 14 has to be applied. But where an employee was ready and willing to work, but for reasons beyond his control was unable to work gets the eligibility for bonus under Section 8 of the Act, it cannot be said that section 14 is bar for such a claim.

(b) Qualification and disqualifications of auditors: As per section 72 of the Multi-State Co-operative Society Act, 2002 the qualification and disqualifications of an auditor are as under:

Qualification: A person shall not be qualified for appointment as an auditor of a Multi State Co-operative Society unless he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.

Disqualifications: None of the following persons shall be qualified for appointment as an auditor of a Multi-State Co-operative society:

(a) A body corporate

(b) An officer or employee of the multi state co-operative society.

(c) A person who is a member, or who is in the employment of an officer or employee, of the Multi-State Co-operative Society.

(d) A person who is indebted to Multi-State Co-operative Society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State Co-operative Society for an amount exceeding one thousand rupees.

A person shall also not be qualified for appointment as an auditor of a Multi-State Co-operative Society if he is, by virtue of sub-section (2), disqualified for appointment as an auditor of any other body corporate or Multi-State Co-operative Society or Co-operative Society.

If an auditor becomes subject, after his appointment, to any of the disqualification specified above, he shall be deemed to have vacated his office as such.

Question 7

Answer any four of the following:

(a) Mars India Ltd. owed to Sunil Rs. 1,000. On becoming this debt payable, the company offered Sunil 10 shares of Rs. 100 each in full settlement of the debt. The said shares were fully paid and were allotted to Sunil.

Examine the validity of thisss allotment in the light of the provisions of the Companies Act, 1956.

(b) What is the meaning of "Certificate of Incorporation" under the provisions of the Companies Act, 1956?

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(c) *What are the provisions relating to "Information Memorandum" contained in Section 60B of the Companies Act, 1956 [inserted by the Companies (Amendment) Act, 2000]?*

(d) *The Directors of "Sunrise Computers Ltd." desire to change the Company's name to "Royal Computers Ltd." and seek your advice. Explain the procedure to be followed, for the said purpose, under the Companies Act, 1956.*

(e) *Explain the meaning of "transmission of Shares" under the Companies Act, 1956. In what ways is "transmission of shares" different from "Transfer of Shares"?*

(4 × 5=20 Marks)

Answer

(a) Allotment of Shares: As per the Section 75 of the Companies Act, 1956 when shares are allowed to a person by a company, payment may be made – (i) in cash, or (ii) in kind (with the consent of the company).

'Cash' here does not necessarily mean the current coin of the country. It means "such transaction as would in an action at law for calls, support a plea of payment."

On the basis of the above provision and decision of the related case *Coregam Gold Mining Co. of India V. Roper, (1892), A.C. 125*, the allotment of fully paid up shares in full satisfaction of Sunil's debt is valid.

(b) Certificate of incorporation: Upon the registration of the documents required for registration of a proposed company and filed by such company along with the necessary fee, the Registrar of Companies issues a certificate that the company is incorporated and in the case of a limited company, that it is limited (Section 34 of the Companies Act, 1956).

Section 35 provides that the certificate of incorporation given by the Registrar in respect of all the requirements of this Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorized to be registered and duly registered under this Act. A certificate of incorporation is conclusive as to all administrative acts relating to incorporation and as to the date of incorporation *(Jubilee Cotton Mills vs. Leuris)*

Commencement of Business: A private company can commence its business as soon as it gets certificate of incorporation. But a company having a share capital which has issued a prospectus inviting the public to subscribe for its shares cannot commence any business or exercise borrowing power unless:

(a) The minimum number of shares which have to be paid for in cash has been subscribed and allotted.

(b) Every director has paid, in respect of share for which he is bound to pay an amount equal to what is payable on shares offered to the public on application and allotment.

(c) No money is or may become liable to be paid to application of any shares or debentures offered for public subscription by reason of any failure to apply for or to

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obtain permission for the shares or debentures to be dealt in any recognised stock exchange; and

(d) A statutory declaration by the secretary or one of the directors that the aforesaid requirements have been complied with is filed with the Registrar.

If, however, a company having a share capital has not issued a prospectus inviting the public to subscribe for its shares, it cannot commence any business or exercise borrowing powers unless it has issued a statement in lieu of prospectus and the conditions contained in paragraph (b) and (d) aforesaid have been complied with.

The Registrar of Companies shall examine them and if satisfied, shall issue to the company a certificate to commence business.

(c) Information Memorandum: Section 60B of the Companies Act, 1956 (inserted by the Companies Amendment Act, 2000) provides the following regarding information memorandum:

1. A public company making an issue of securities may circulate information memorandum to the public prior to filing of a prospectus.
2. A company inviting subscription by an information memorandum shall be bound to file a prospectus prior to the opening of the subscription lists and the offer as a red-herring prospectus, at least three days before the opening of the offer.
3. The information memorandum and red-herring prospectus shall carry same obligations as are applicable in the case of a prospectus.
4. Any variation between the information memorandum and the red-herring prospectus shall be highlighted as variations by the issuing company.

   Explanation – For the purposes of Sub-sections (2), (3) and (4), "red-herring prospectus' means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered.
5. Every variation as made and highlighted in accordance with sub-section (4) above shall be individually intimated to the persons invited to subscribe to the issue of securities.
6. In the event of the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription moneys or post-dated cheques or stock invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of subscription paid.
7. The applicant or proposed subscriber shall exercise his right to withdraw from the application on any intimation of variation within seven days from the date of such

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intimation and shall indicate such withdrawal in writing to the company and the underwriters.

8. Any application for subscription which is acted upon by the company or underwriters or bankers to the issue without having given enough information of any variations, or the particulars of withdrawing of offer or opportunity for cancelling the post-dated cheques or stock invest or stop payments for such payments shall be void and the applicants shall be entitled to receive a refund, or return of its post-dated cheques or stock-invest or subscription monies or cancellation of its application, as if the said application had never been made and the applicants are entitled to receive back their original application and interest at the rate of fifteen per cent from the date of encashment till payment of realisation.

9. Upon the closing of the offer of securities, a final prospectus stating therein the total capital raised whether by way, of debt or share capital and the closing price of the securities and any other details as were not complete in the red-herring prospectus shall be filed in a case of a listed public company with the Securities and Exchange Board and Registrar, and in any other case with the Registrar only.

(d) Change of name of the company: 'Sunrise Computers Ltd.' may change its name to 'Royal Computers Ltd.' as per section 21 of the Companies Act, 1956.

A company may by special resolution, and with the approval of the Central Government, signified in writing, change its name [Section 21]. Power under Section 21 has been delegated to the Registrar of Companies vide notification GSR 507(E) dated 24-6-85]. The application for change of name is required to pay a fee of Rs. 500/- to ascertain whether the proposed name is available and thereafter pass the required special resolution and thereafter submit the necessary documents to the Registrar. If the Registrar is satisfied that the relevant procedures have been complied with by the Company, in this regard, the Registrar shall issue fresh certificate with the change embodied therein. The change in name shall not affect any of the company's rights or obligations of the company or render any legal proceedings by / or against it. Any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by its new name [Section 23].

(e) Transmission and transfer of shares: Under Section 109B of the Companies Act, 1956, transmission of shares takes place when shares are transferred under the operation of law, either on the death of the registered shareholder or on his being adjudged as insolvent. It also takes place where the holder is a company if it goes into liquidation. Upon the death, the shares of the deceased vest in his executors or administrators and the estate becomes liable for calls if the shares are not fully paid up. In the like manner the official assignee or the receiver, as the case may be, is also entitled to be registered as a member in the place of shareholder who has been adjudged as insolvent *[R. W. Key and Sons (1902) IC, 467]*. However, the executors or administrators may decline to be registered as members for various reasons. In that event the legal representatives, by virtue of Section 109, shall be entitled to transfer the shares of the deceased irrespective of whether they are partly paid or fully paid.

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Similarly, the official assignee has the statutory power to transfer the shares under Section 58(1) of the Presidency Towns Insolvency Act.

Distinction between transfer and transmission of shares

	Transfer of shares		Transmission of shares
1.	It is affected by a voluntary/deliberate act of the parties.	1.	It takes place by operation of law e.g. due to death, insolvency or lunacy of a member.
2.	It takes place for consideration.	2.	No consideration is involved.
3.	The transferor has to execute a valid instrument of transfer.	3.	There is no prescribed instrument of transfer.
4.	As soon as the transfer is complete, the liability of the transferor ceases.	4.	Shares continue to be subject to the original liabilities.

Question 8

(a) The Registrar of Companies on examining the statutory report filed with him by M/s Jyothi Company Ltd., finds that the report has been certified as correct, by all the directors of the Company, except the Managing Director. The Registrar refuses to register the said document on the ground that it was not signed by the Managing Director of the Company.

Answer the following in the light of the Companies Act, 1956:

(i) Whether the Registrar of Companies can hold the officers of the Company liable?

(ii) What provisions of the Companies Act have not been complied with by the company and its officers?

(iii) To what penalties are the Company and its officers liable? (5 Marks)

(b) To remove the Managing Director, 40% members of Global Ltd. submitted requisition for holding extra-ordinary general meeting. The company failed to call the said meeting and hence the requisitionists held the meeting. Since the Managing Director did not allow the holding of meeting at the registered office of the Company, the said meeting was held at some other place and a resolution for removal of the Managing Director was passed.

Examine the validity of the said meeting and resolution passed therein in the light of the companies Act, 1956. *(5 Marks)*

Answer

(a) FILING REPORT WITHOUT SIGNATURE:

(i) Yes, the Registrar can hold the officers of the company liable.

(ii) Section 165(4) of the Companies Act, 1956 requires the statutory report to be certified as correct by at least two directors of the company one of whom must be a

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managing director, where there is one. Thus, the aforesaid provision of Section 165(4) has not been complied with.

(iii) Sub –Section (9) of Section 165 provides for penalties for non-compliance of Sub-section (4). It makes every director or other officer of the Company who is in default punishable with fine upto Rs. 5,000/-.

(b) Extraordinary meeting: Every shareholder of a company has a right to requisition for an extraordinary general meeting. He is not bound to disclose the reasons for the resolution to be proposed at the meeting *[Life Insurance Corporation of India vs. Escorts Ltd., (1986) 59 Comp. Cas. 548]*.

Section 169 of the companies Act contains provisions regarding holding of extraordinary general meetings. It provides that if directors fail to call a properly requisitioned meeting, the requisitionists or such of the requisitionists as represent not less than 1/10th of the total voting rights of all the members (or a majority of them) may call a meeting to be held on a date fixed within 3 months of the date of the requisition.

Where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in R. Chettiar v. M. Chettiar that the meeting may be held any where else.

Further, resolutions properly passed at such a meeting, are binding on the company.

Thus, in the given case, since all the above mentioned provisions are duly complied with. Hence the meeting with the resolution removing the managing director shall be valid.

Question 9

(a) What do you understand by "Charge" under the Companies Act, 1956? Distinguish between "fixed Charge" and "Floating charge". (5 Marks)

(b) The Articles of Association of X Ltd. require the personal presence of 7 members to constitute quorum of General Meetings. The following persons were present in the extra-ordinary meeting to consider the appointment of Managing Director:

(i) A, the representative of Governor of Madhya Pradesh.

(ii) B and C, shareholders of preference shares,

(iii) D, representing Y Ltd. and Z Ltd.

(iv) E, F, G and H as proxies of shareholders.

Can it be said that the quorum was present in the meeting? (5 Marks)

Answer

(a) Charge: The term 'charge' has not been adequately defined in the Companies Act, 1956 except that section 124 provides that the expression charge shall include a mortgage. However, it can be understood that where in transaction for value, both parties evidence the intention that property existing or future shall be made available as security for the

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payment of a debt and that the creditor/mortgage shall have a pleasant right to have it made available, there is a charge.

Distinction between fixed charge and floating charge:

	Fixed charge		Floating charge
1.	It is a legal charge.	1.	It is an equitable charge.
2.	It is a charge on specific, ascertained and existing asset.	2.	It is a charge on present and future assets. No specific assets.
3.	Company cannot deal with the assets except with the consent of the charge holder.	3.	Company is free to use or deal with the assets the way it likes until the charge becomes fixed.
4.	Registration of fixed charge on movable assets is not compulsory.	4.	Registration of all floating charge on all kinds of assets is compulsory by law.
5.	Fixed charge has always priority over floating charge.	5.	Ambulatory and shifting in character.

(b) Quorum: In this case the quorum for a general meeting is 7 members to be personally present. For the purpose of quorum, only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting.

Again, only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum.

If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of a latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum (Section 187)

Where two or more companies which are members of another company, appoint a single person as their representative then each such company will be counted as quorum at a meeting of the latter company.

Again Section 187A of the Companies Act, 1956 provides that the President of India or Governor of a State, if he is a member of a company, may appoint such a person as he thinks fit, to act as its representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and thus considered as member personally present.

In view of the above there are only three members personally present.

'A' will be included for the purpose of quorum. B & C have to be excluded for the purpose of quorum because they represent the preference shares and since the agenda being the appointment of Managing Director, their rights cannot be said to be directly affected and therefore, they shall not have voting rights. D will have two votes for the purpose of quorum as he represents two companies ' Y Ltd.' and 'Z Ltd.' E, F, G and H are not to be included as they are not members but representing as proxies for the members.

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Thus it can be said that the requirements of quorum being 7, 3 members personally present shall not constitute a valid quorum for the meeting.

Question 10

(a) A Company served a notice of General Meeting upon its members. The notice stated that a resolution to increase the share capital of the Company would be considered at such meeting. A shareholder complaints that the amount of the proposed increase was not specified in the notice. Is the notice valid? (5 Marks)

(b) Answer the following in relation to the provisions of the Companies Act, 1956:

(i) Can the declaration of Board of Directors of interim dividend be revoked?

(ii) Who is empowered to declare final dividend ? (5 Marks)

Answer

(a) Notice of Meeting: Section 173 of the Companies Act, 1956 requires a company to annex an explanatory statement to every notice for a meeting of company, at which some 'special business' is to be transacted. This explanatory statement is to bring to the notice of members all material facts relating to each item of special business. Section 173 further specifies that all business in case of any meeting other than the annual general meeting is regarded as special business. Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 173 of the Companies Act, 1956.

(b) Dividend

(i) The Articles of a company may empower the directors to declare interim dividends, i.e., dividends in between its two annual general meetings. The Board may from time to time pay to the members such interim dividends as appear to it to be justified by the profits of the Company. (Article 86 of Table A)

An interim dividend is not a debt. It is a settled law that in case of an interim dividend which the directors have resolved to pay, they have an option at any time before payment to review their decision and resolve not to pay.

Hence, interim dividend declared by Board of Directors may be revoked.

(ii) The dividend is declared by a company by a resolution passed at the annual general meeting. The Board of directors determines the rate of dividend to be declared and recommends it to the meeting of shareholders. The rate determined by the Board is to be sanctioned by the members of the company in general meeting. The members may reduce the rate recommended by the Board but they cannot increase it. Technically, therefore, a final dividend can only be declared by the members of a company *[Kantilal Manital v. Commr. Of Income Tax (1956) 26 Comp. Cas 357 (Bom.)]*.

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Alternative Answer

(b) (i) Till the passing of the Companies (Amendment) Act, 2000, there was no provision in the Companies Act (except reg. 86 of Table A) relating to interim dividend. The Companies (Amendment) Act, 2000 has introduced sub-section (14A) in section 2 whereby 'interim dividend' is now part of 'dividend' and accordingly all provisions of the Companies Act relating to 'dividends' have become applicable to 'interim dividend' also.

To put things beyond doubt, section 205 ha also been amended to provide for the following:

- The Board of Directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend.
- The amount of dividend including interim dividend so deposited above shall be used for payment of interim dividend.
- The provisions contained in sections 205, 205A, 205C, 206, 206A and 207, as far as may be, also apply to any interim dividend.

Another view is there that the decision on interim dividend can be revoked only before transfer of the amount to the separate bank account pursuant to section 205(1A) of the Act. Further, according to Secretarial Standard 3 of the ICSI, interim dividend once declared cannot be revoked. A judicial decision in this regard can only remove the confusion.

Accordingly, it seems that the interim dividend, like final dividend, should be considered as a debt due and thus cannot be revoked.

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PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

Question Nos. 1 and 6 are compulsory.

Attempt three questions out of the remaining Question Numbers 2, 3, 4 and 5 and attempt two questions from the remaining Question Nos. 7, 8 and 9.

Working notes should form part of the answer.

Question 1

(a) *ABC Bank is examining the profitability of its Premier Account, a combined Savings and Cheque account. Depositors receive a 7% annual interest on their average deposit. ABC Bank earns an interest rate spread of 3% (the difference between the rate at which it lends money and rate it pays to depositors) by lending money for home loan purpose at 10%.*

The Premier Account allows depositors unlimited use of services such as deposits, withdrawals, cheque facility, and foreign currency drafts. Depositors with Premier Account balances of Rs. 50,000 or more receive unlimited free use of services. Depositors with minimum balance of less than Rs. 50,000 pay Rs. 1,000-a-month service fee for their Premier Account.

ABC Bank recently conducted an activity-based costing study of its services. The use of these services in 2005-06 by three customers is as follows:

	Activity-Based Cost Per Transaction	Account Usage		
		Customer X	Customer Y	Customer Z
Deposits/withdrawal with teller	Rs. 125	40	50	5
Deposits/withdrawal with automatic teller machine (ATM)	Rs. 40	10	20	16
Deposits/withdrawal on pre-arranged monthly basis	Rs. 25	0	12	60
Bank Cheques written	Rs. 400	9	3	2
Foreign Currency drafts	Rs. 600	4	1	6
Inquiries about Account balance	Rs. 75	10	18	9
Average Premier Account balance for 2005-06		Rs. 55,000	Rs. 40,000	Rs. 12,50,000

Assume Customer X and Z always maintains a balance above Rs. 50,000, whereas Customer Y always has a balance below Rs. 50,000.

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Required:

(i) Compute the 2005-06 profitability of the customers X, Y and Z Premier Account at ABC Bank.

(ii) What evidence is there of cross-subsidisation among the three Premier Accounts? Why might ABC Bank worry about this Cross-subsidisation, if the Premier Account product offering is Profitable as a whole?

(iii) What changes would you recommend for ABC Bank's Premier Account?

(b) Discuss the treatment of Idle time and Overtime premium in Cost Accounting.

(c) Discuss the essential requisites for the installation of Uniform costing system.

(11 + 4 + 3 = 18 Marks)

Answer

(a) (i) Customer Profitability Analysis

ABC Bank – Premier Account

Activity	Activity based cost	Customers		
		X	Y	Z
	Rs.	Rs.	Rs.	Rs.
Deposits/withdrawal with teller	125	5,000 *(40 × 125)*	6,250 *(40 × 125)*	625 *(5 × 125)*
Deposits/withdrawal with ATM	40	400 *(10 × 40)*	800 *(20 × 40)*	640 *(16 × 40)*
Deposits/withdrawal on prearranged monthly basis	25	0 *(0 × 25)*	300 *(12 × 25)*	1,500 *(60 × 25)*
Bank cheques written	400	3,600 *(9 × 400)*	1,200 *(3 × 400)*	800 *(2 × 400)*
Foreign currency drafts	600	2,400 *(4 × 600)*	600 *(1 × 600)*	3,600 *(6 × 600)*
Inquiries about Account balance	75	750 *(10 × 75)*	1,350 *(18 × 75)*	675 (9 × 75)

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Customer cost (A)		12,150	10,500	7,840
Spread on Average balance maintained	3%	1,650 *(3% × 55,000)*	1,200 (3% × 40,000)	37,500 *(3% × 12,50,000)*
Service fee	Rs. 1,000 p.m.		12,000	
Customer benefit		1,650	13,200	37,500

	Customers		
	X	Y	Z
Customer Profitability (Benefits – Costs)	Rs. (10,500)	Rs. 2,700	Rs. 29,660

(ii) Customer Z is most profitable and is cross-subsidising the most demanding customer X. Customer Y is paying for the services used, because of not being able to maintain minimum balance. No doubt, 'Premier Account' product offering is profitable as a whole, but the worry is of not finding customers like customer Z who will maintain a balance higher than the stipulated minimum. It appears, the minimum balance stipulated is inadequate considering the services availed by depositors in 'Premium Account'.

(iii) The changes suggested to ABC Bank's 'Premier Account' are as follows:

- Increase the requirement of minimum balance from Rs. 50,000 to Rs. 1,00,000.
- Charge for value added services like Foreign Currency Drafts.
- Do not allow deposits/withdrawal below Rs. 10,000 at the teller. Only ATM machine withdrawal be allowed.
- Inquiries about account balance to be entertained only through Phone Banking/ATM.

(b) Treatment of Idle time and Overtime Premium in Cost Accounting

- Normal idle time is treated as a part of the cost of production. Thus, in the case of direct workers, an allowance for normal idle time is built into labour cost rates. In case of indirect workers, normal idle time is spread over all the products or jobs through the process of absorption of factory overheads.

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- Abnormal idle time cost is not included as a part of production cost and is shown as a separate item in costing Profit and Loss Account.
- Management should aim at eliminating controllable idle time and on a long-term basis reduce even the normal idle time.
- If overtime is resorted to at the desire of the customer , then overtime premium may b charged to the job directly.
- If overtime is required to cope with general production programme or for meeting urgent orders, the overtime premium should be treated as overhead cost of the particular department/cost centre.

(c) Essential requisites for the Installation of Uniform Costing System

- The firm in the industry should be willing to share/furnish relevant data/information.
- A spirit of cooperation and mutual trust should prevail among the participating firms.
- Mutual exchange of ideas, methods used, and special achievements made, research and know-how should be frequent.
- Uniformity must be established with regard to following points:
  1. Size of the various units covered by uniform costing.
  2. Production methods.
  3. Accounting methods, principles and procedures used.

Question 2

(a) PQR Limited produces a product which has a monthly demand of 52,000 units. The product requires a component X which is purchased at Rs. 15 per unit. For every finished product, 2 units of Component X are required. The Ordering cost is Rs. 350 per order and the Carrying cost is 12% p.a.

Required:

(i) Calculate the economic order quantity for Component X.

(ii) If the minimum lot size to be supplied is 52,000 units, what is the extra cost, the company has to incur?

(iii) What is the minimum carrying cost, the Company has to incur?

(b) Discuss the treatment of Under-absorbed and Over-absorbed overheads in Cost Accounting. *(8 + 6 = 14 Marks)*

Answer

(a) (i) $EOQ = \sqrt{\frac{2AO}{c \times i}}$

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$$= \sqrt{\frac{2 \times (52,000 \times 12) \times 350}{15 \times 0.12}}$$

= 15,578 units of components.

(ii) Extra cost incurred by the company

Total cost (when order size is 52,000 units) = Total ordering cost + Total carrying cost

$$= \frac{A}{Q} \times O + \frac{Q}{2} \times C \times i$$

$$= \left(\frac{52,000 \times 12}{52,000} \times Rs.350 \right) + \frac{52,000}{2} \times 15 \times 12\%$$

= Rs 4,200 + Rs 46,800

= Rs 51,000

Total cost when order size is 15,578 units

$$= \left(\frac{52,000 \times 12}{15,578} \times Rs.350 \right) + \frac{15,578}{2} \times 15 \times 12\%$$

= 14,020 + 14,020 = 28,040

Extra cost incurred = 51,000 – 28,040 = Rs 22,960

(iii) Minimum carrying cost, the company has to incur

$$= \frac{Q}{2} \times C \times i$$

$$= \frac{15,578}{2} \times Rs.15 \times 12\%$$

= Rs 14,020

Alternative solution

(a) Assuming the annual demand of 'x' is 1,04,000 units (2 × 52,000 units) as per instruction that for every finished product , 2 units of component 'x' are required , the calculation of 2(a)(i),(ii) and (iii) will be as follows:

(i) $EOQ = \sqrt{\frac{2AO}{c \times i}}$

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$$= \sqrt{\frac{2 \times (2 \times 52,000 \times 12) \times 350}{15 \times 0.12}}$$

= 22,030 units of component 'x'

(ii) Extra cost incurred by the company

Total cost (when order size is 52,000 units) = Total ordering cost + Total carrying cost

$$= \frac{A}{Q} \times O + \frac{Q}{2} \times C \times i$$

$$= \left(\frac{2 \times 52,000 \times 12}{52,000} \times Rs. 350 \right) + \frac{52,000}{2} \times 15 \times 12\%$$

= Rs. 55,200

Total cost (when order size is 20,030 units)

$$= \left(\frac{2 \times 52,000 \times 12}{22,030} \times Rs. 350 \right) + \frac{22,030}{2} \times 15 \times 12\%$$

Total cost incurred = 19,828 + 19,827 = 39,655.

Extra cost incurred = 55,200 – Rs. 39,655 = Rs. 15,545.

(iii) Minimum carrying cost, the company has to incur

$$= \frac{Q}{2} \times C \times i$$

$$= \frac{22,030}{2} \times Rs. 15 \times 12\%$$

= Rs. 19,827.

(b) Treatment of under-absorbed and over-absorbed overheads in Cost Accounting

Overhead expenses are usually applied to production on the basis of pre-determined rates

$$\text{Pre determined overhead rate} = \frac{\text{Estimated / normal overheads for the period}}{\text{Budgeted number of units during the period}}$$

The under/over absorption may take place due to variation in actual overhead rate due to any of the following:

(i) The actual level of production may be different from budgeted level during the period.

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(ii) The actual overheads incurred during the period may be different from the budgeted ones.

(iii) Both the overheads and level of activity may be different from budgeted levels during the period.

If the amount of overheads under/over absorption is insignificant/small, it may be transferred to Costing Profit and Loss Account.

Where the difference is large due to wrong estimation, it would be desirable to adjust the cost of products manufactured as otherwise the cost figures would convey a misleading impression.

However, over or under recovery of overheads due to abnormal reasons, such as abnormal over or under capacity utilisation should be transferred to Costing Profit and Loss Account.

Question 3

(a) *RST Construction Limited commenced a contract on April 1, 2005. The total contract was for Rs. 49,21,875. It was decided to estimate the total Profit on the contract and to take to the Credit of Profit and Loss Account that proportion of estimated profit on cash basis, which work completed bore to total Contract. Actual expenditure for the period April 1, 2005 to March 31, 2006 and estimated expenditure for April 1, 2006 to September 30, 2006 are given below:*

	April 1, 2005 to March 31, 2006	*April 1, 2006 to September 30, 2006*
	(Actuals)	*(Estimated)*
	Rs.	*Rs.*
Materials Issued	*7,76,250*	*12,99,375*
Labour: Paid	*5,17,500*	*6,18,750*
: Prepaid	*37,500*	*—*
: Outstanding	*12,500*	*5,750*
Plant Purchased	*4,00,000*	*—*
Expenses: Paid	*2,25,000*	*3,75,000*
: Outstanding	*25,000*	*10,000*
: Prepaid	*15,000*	*—*
Plant returns to Store (historical cost)	*1,00,000*	*3,00,000*
	(On September 30, 2005)	*(On September 30, 2006)*
Work certified	*22,50,000*	*Full*

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Work uncertified	*25,000*	*—*
Cash received	*18,75,000*	*—*
Materials at site	*82,500*	*42,500*

The plant is subject to annual depreciation @ 25% on written down value method. The contract is likely to be completed on September 30, 2006.

Required:

(i) Prepare the contract A/c. Determine the profit on the contract for the year 2005-06 on prudent basis, which has to be credited to Profit and Loss Account.

(b) Distinguish between any two of the following:

(i) Profit Centres and Investment Centres.

(ii) Product Cost and Period Cost.

(iii) Job Costing and Batch Costing. *(10 + 4 = 14 Marks)*

Answer

(a) Contract Account for the year ending March 31, 2006

			Rs.				*Rs.*
To	Materials issued		7,76,250	By	Work-in-progress		
To	Labour	5,17,500			Certified	22,50,000	
	Add: Outstanding	12,500			Uncertified	25,000	22,75,000
	Less: Prepaid	37,500	4,92,500	By	Plant returned to store		
To	Plant		4,00,000		on 30.09.2005		
To	Expenses	2,25,000			(1,00,000 – 25% × ½)		87,500
	Add: Outstanding	25,000		By	Plant at site		
	Less: Prepaid	15,000	2,35,000		(3,00,000 – 25%)		2,25,000
				By	Materials at site		82,500
To	Notional Profit c/d		7,66,250				
			26,70,000				26,70,000
To	Profit and Loss A/c			By	Notional Profit b/d		7,66,250
	$10,21,125 \times \frac{22,50,000}{49,21,875} \times \frac{18,75,000}{22,50,000}$		3,89,000				
To	WIP (Reserve)		3,77,250				
			7,66,250				7,66,250

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Contract Account (for entire life period April 1, 2005 to September 30, 2006)

		Rs.				Rs.
To	Materials issued		By	Contractee A/c		49,21,875
	(7,76,250 + 12,99,375)	20,75,625	By	Materials at site		42,500
To	Labour (5,17,500 – 37,500 + 12,500 + 6,18,750 + 37,500 – 12,500 + 5,750)	11,42,000	By	Plant returned on September 30, 2005 (1,00,000 – 12,500)		87,500
To	Plant	4,00,000	By	Plant returned on		
To	Expenses	6,10,000		September 30, 2006	3,00,000	
	(2,25,000 + 25,000 – 15,000 + 3,75,000 – 25,000 + 15,000 + 10,000)			Depreciation for 2005-2006 @ 25%	75,000	
					2,25,000	
To	Estimated profit on contract	10,21,125		Depreciation 2006-2007(1/2)	28,125	1,96,875
		52,48,750				52,48,750

(b) (i) Profit Centres and investment centres

A profit centre is a centre where the manager has the responsibility of generating and maximising profits. In such centres, the manager is responsible for revenue and cost.

Investment centres are those centres which are concerned with earning an adequate ROI. In such centres, the manager is responsible for investment, revenue and cost.

(ii) Product costs and period costs

Product costs are costs which are associated with purchase and sale of goods. These are costs are used for inventory valuation and incurred up to factory stage.

Period costs are costs, which are not assigned to the products but are charged as expenses against revenues of the period in which they are incurred e.g. Selling, General Administrative and Distribution overheads.

(iii) Job Costing and Batch costing

In case of Job costing, the cost of each job is ascertained separately. Such a method is suitable in case of printing press, motor workshop, etc.

Batch costing is the extension of Job costing. A batch may represent a number of small orders passed through the factory in batches. Each batch is treated as a unit of cost and thus separately costed. Here cost per unit is determined by dividing the cost of batch by the number of units produced in the batch.

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Question 4

(a) Discuss the reconciliation of Profit as per Cost Accounts and Financial Accounts.

(b) XYZ Auto Ltd. is in the business of selling cars. It also sells insurance and finance as part of its overall business strategy. The following information is available for the company.

	Physical Units	*Sales Value*
Sales of Cars	*10,000 Cars*	*Rs. 30,000 lacs*
Sales of Insurance	*6,000 Policies*	*Rs. 1,500 lacs*
Sales of Finance	*8,000 Loans*	*Rs. 19,200 lacs*

The Revenue earnings from each line of business before expenses are as follows:

Sale of Cars	*3% of Sales value*
Sale of Insurance	*20% of Sales value*
Sale of Finance	*2% of Sales value*

The expenses of the company are as follows:

Salesman salaries	*Rs. 200 lacs*
Rent	*Rs. 100 lacs*
Electricity	*Rs. 100 lacs*
Advertising	*Rs. 200 lacs*
Documentation cost per insurance policy	*Rs. 100*
Documentation cost for each loan	*Rs. 200*
Direct sales expenses per car	*Rs. 5,000*

Indirect costs have to be allocated in the ratio of physical units sold.

Required:

(i) Make a cost sheet for each product allocating the direct and indirect costs and also showing the product wise profit and total profit.

(ii) Calculate the percentage of profit to revenue earned from each line of business.

(6 + 8 = 14 Marks)

Answer

(a) Reconciliation of Profits as per Cost Accounts and Financial Accounts

When cost accounts and financial accounts are kept separately, it is imperative that these should be reconciled.

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Items included in the financial accounts but not in Cost Accounts

- Income tax
- Profit and loss appropriations
- Dividend paid
- Amounts written off – goodwill, preliminary expenses

Matters of Pure Finance

- Interest received on bank deposits
- Dividends received
- Profits/loss made on sale of fixed assets
- Expenses of the Company's Share transfer office

Items included in Cost Accounts only

- Opportunity cost of faculties used
- Under/Over absorbed overheads
- Difference due to different basis of inventory valuation.

(b) Product Cost Sheet

	Total	Cars	Insurance	Finance
Sales units		10,000	6,000	8,000
Sales value (Rs in lakhs)		30,000	1,500	19,200
Revenue earnings		3%	20%	2%
Revenue earned (Rs in lakhs)	1584	900	300	384
Direct costs (Rs in lakhs)	522	500 *(5000 × 10000)*	6 *(100 × 6000)*	16 *(200 × 8000)*
Indirect costs (allocated in the ratio of physical units sold) 0.4167:0.25:0.3333				
Salesman salaries (Rs in lakhs)	200			
Rent (Rs in lakhs)	100			
Electricity (Rs in lakhs)	100			
Advertising (Rs in lakhs)	200			

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	600	250	150	200
Total costs	1122	750	156	216
Profits (Revenue – Total cost)	462	150	144	168
% of Profits to revenue earned	29.17%	16.67%	48%	43.75%

Question 5

(a) *A Company produces a component, which passes through two processes. During the month of April, 2006, materials for 40,000 components were put into Process I of which 30,000 were completed and transferred to Process II. Those not transferred to Process II were 100% complete as to materials cost and 50% complete as to labour and overheads cost. The Process I costs incurred were as follows:*

Direct Materials	*Rs.15,000*
Direct Wages	*Rs.18,000*
Factory Overheads	*Rs.12,000*

Of those transferred to Process II, 28,000 units were completed and transferred to finished goods stores. There was a normal loss with no salvage value of 200 units in Process II. There were 1,800 units, remained unfinished in the process with 100% complete as to materials and 25% complete as regard to wages and overheads.

No further process material costs occur after introduction at the first process until the end of the second process, when protective packing is applied to the completed components. The process and packing costs incurred at the end of the Process II were:

Packing Materials	*Rs.4,000*
Direct Wages	*Rs.3,500*
Factory Overheads	*Rs.4,500*

Required:

(i) Prepare Statement of Equivalent Production, Cost per unit and Process I A/c.

(ii) Prepare statement of Equivalent Production, Cost per unit and Process II A/c.

(b) *Discuss the accounting of Selling and Distribution overheads.* *(10 + 4 = 14 Marks)*

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Answer

(a) Process I

Statement of Equivalent Production and Cost

	Material	Labour and Overheads	Total
Units completed	30,000	30,000	
Closing Inventory	10,000	5,000	
Equivalent Production	40,000	35,000	
	Rs	*Rs*	*Rs*
Current Process cost	15,000	30,000	45,000
Cost/unit	0.375	0.8571	
Closing inventory cost	3,750	4,286	8,036
Material transferred to Process II			36,964

Process I Account

	Units	Rs.		Units	Rs.
Direct material	40,000	15,000	Process II A/c	30,000	36,964
Direct wages		18,000	Work-in-progress inventory	10,000	8,036
Factory overheads		12,000			
	40,000	45,000		40,000	45,000

Process II

Statement of Equivalent Production and Cost

	Material	Labour and Overheads	Total
Units completed	28,000	28,000	
Closing Inventory	1,800	450	
Equivalent Production	29,800	28,450	
Process cost	36,964	8,000	44,964
Cost/unit	1.24	0.2812	
Closing inventory	2,232	127	2,359
			42,605
Packing material cost			4,000
			Rs. 46,605

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Process II Account

		Units	Rs.			Units	Rs.
To	Material transferred from Process I	30,000	36,964	By	Finished goods stores A/c	28,000	46,605
To	Packing Material		4,000	By	WIP stock	1,800	2,359
To	Direct wages		3,500	By	Normal loss	200	–
To	Factory overheads		4,500				
		30,000	48,964			30,000	48,964

(b) Accounting of Selling and Distribution Overheads

It is difficult to determine an entirely satisfactory basis for computing the overhead rate for absorbing selling and distribution overheads. The basis usually adopted is:

- Sales value of goods
- Cost of goods sold
- Gross profit on sales
- Number of orders or units sold

Expenses	Basis for allocation
Salaries in Sales Department.	Estimated time devoted to the sale of various products.
Advertisements	Actual amount incurred for each product
Show room expenses	Average space occupied by each product
Rent of finished goods, go downs and expenses on own delivery vans.	Average quantities delivered during a period

Question 6

(a) A company is considering a proposal of installing a drying equipment. The equipment would involve a cash outlay of Rs. 6,00,000 and net working capital of Rs. 80,000. The expected life of the project is 5 years without any salvage value. Assume that the company is allowed to charge depreciation on straight-line basis for Income-tax purpose. The estimated before-tax cash inflows are given below:

	Before-tax Cash inflows (Rs. '000)				
Year	*1*	*2*	*3*	*4*	*5*
	240	*275*	*210*	*180*	*160*

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The applicable Income-tax rate to the company is 35%. If the company's opportunity cost of capital is 12%, calculate the equipment's discounted payback period, payback period, net present value and internal rate of return.

The PV factors at 12%, 14% and 15% are:

Year	*1*	*2*	*3*	*4*	*5*
PV factor at 12%	*0.8929*	*0.7972*	*0.7118*	*0.6355*	*0.5674*
PV factor at 14%	*0.8772*	*0.7695*	*0.6750*	*0.5921*	*0.5194*
PV factor at 15%	*0.8696*	*0.7561*	*0.6575*	*0.5718*	*0.4972*

(b) Discuss the changing scenario of Financial Management in India. (10 + 6 = 16 Marks)

Answer

(a) (i) Equipment's initial cost = Rs. 6,00,000 + 80,000 = Rs. 6,80,000

(ii) Annual straight line depreciation = Rs. 6,00,000/5 = Rs. 1,20,000

(iii) Net cash flows can be calculated as follows:

= Before tax Cash Flows × (1 – Tc) + Tc × Depreciation

(Rs. '000)

		Cash flows				
Year	*0*	*1*	*2*	*3*	*4*	*5*
Initial cost	(680)					
Before tax cash flows		240	275	210	180	160
Tax @ 35%		84	96.25	73.5	63	56
After tax cash flows		156	178.75	136.5	117	104
Depreciation tax shield (Depreciation × Tc)		42	42	42	42	42
Working capital released		–	–	–	–	80
Net Cash Flow		198	220.75	178.5	159	226
PVF at 12%	1.00	0. 8929	0.7972	0.7118	0.6355	0.5674
PV	(680)	176.79	175.98	127.06	101.04	128.24
NPV	29.12					

	0	*1*	*2*	*3*	*4*	*5*
PVF at 15%	1	0.8696	0.7561	0.6575	0.5718	0.4972
PV	(680)	172.18	166.91	117.36	90.92	112.37
NPV	(20.26)					

Internal Rate of Return

$$IRR = 12\% + \frac{29.12}{49.38} \times 3\%$$

= 13.77%

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Discounted Payback Period

Discounted Cash flows at K = 12% considered

$$= 176.79 + 175.98 + 127.06 + 101.04 + 12 \times \frac{99.13}{128.24}$$

= 4 years and 9.28 months

Payback Period (Net Cash flows are considered)

$$= 198 + 220.75 + 178.5 + 12 \times \frac{82.75}{159}$$

= 3 years and 6.25 months

(b) Changing Scenario of Financial Management in India

Modern Financial Management has come a long way from the traditional corporate finance. As the economy is opening up and global resources are being tapped, the opportunities available to finance managers virtually have no limits. The finance manager is now responsible for shaping the fortunes of the enterprise, and is involved in the most vital decision of the allocation of capital.

Due to the changes in the global environment the finance manager needs to have a broader and far-sighted outlook, and must realize that his actions would have far-reaching consequences for the firm because they influence the size, profitability, growth, risk and survival of the firm, and as a consequence, affect the overall value of the firm.

Some of the important changes in the environment are:

- Interest rates have been freed from regulation.
- The rupee has become fully convertible on current account.
- Optimum debt-equity mix is possible. The firms have to take advantage of financial leverage to increase shareholders' wealth.
- Free pricing and book building for IPOs, seasoned equity offerings.
- Share buybacks and reverse book building.
- Raising resources globally through ADRs/GDRs.
- Treasury management.
- Risk Management due to introduction of options and futures trading.

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Question 7

JKL Limited has the following Balance Sheets as on March 31, 2006 and March 31, 2005:

Balance Sheet

	Rs. in lakhs	
	March 31, 2006	*March 31, 2005*
Sources of Funds		
Shareholders Funds	*2,377*	*1,472*
Loan Funds	*3,570*	*3,083*
	5,947	*4,555*
Applications of Funds		
Fixed Assets	*3,466*	*2,900*
Cash and bank	*489*	*470*
Debtors	*1,495*	*1,168*
Stock	*2,867*	*2,407*
Other Current Assets	*1,567*	*1,404*
Less: Current Liabilities	*(3,937)*	*(3,794)*
	5,947	*4,555*

The Income Statement of the JKL Ltd. for the year ended is as follows:

	Rs. in lakhs	
	March 31, 2006	*March 31, 2005*
Sales	*22,165*	*13,882*
Less: Cost of Goods Sold	*20,860*	*12,544*
Gross Profit	*1,305*	*1,338*
Less: Selling, General and Administrative Expenses	*1,135*	*752*
Earnings before Interest and Tax (EBIT)	*170*	*586*
Interest Expense	*113*	*105*
Profit before Tax	*57*	*481*
Tax	*23*	*192*
Profit after Tax (PAT)	*34*	*289*

Required:

(i) Calculate for the year 2005-06:

(a) Inventory turnover ratio

(b) Financial Leverage

(c) Return on Investment (ROI)

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(d) Return on Equity (ROE)

(e) Average Collection period.

(ii) Give a brief comment on the Financial Position of JKL Limited. *(12 Marks)*

Answer

Ratios for the year 2005-2006

(i) (a) Inventory turnover ratio

$$= \frac{\text{COGS}}{\text{Average Inventory}}$$

$$= \frac{20{,}860}{\frac{(2{,}867 + 2{,}407)}{2}}$$

= 7.91

(b) Financial leverage

	2005-06	*2004-05*
$= \frac{\text{EBIT}}{\text{EBIT} - \text{I}}$	$= \frac{170}{57}$	$= \frac{586}{481}$
	= 2.98	= 1.22

(c) ROI

$$= \frac{\text{NOPAT}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Average Capital employed}}$$

$$= \frac{57 \times (1 - .4)}{22{,}165} \times \frac{22{,}165}{\frac{(5{,}947 + 4{,}555)}{2}}$$

$$= \frac{34.2}{22{,}165} \times \frac{22{,}165}{5{,}251}$$

= 0.65%

(d) ROE

$$= \frac{\text{PAT}}{\text{Average shareholders' funds}}$$

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$$= \frac{34}{\frac{(2,377+1,472)}{2}}$$

$$= \frac{34}{1,924.5}$$

= 1.77%

(e) Average Collection Period

$$\text{Average Sales per day} = \frac{22,165}{365} = \text{Rs. } 60.73 \text{ lakhs}$$

$$\text{Average collection period} = \frac{\text{Average Debtors}}{\text{Average sales per day}}$$

$$= \frac{\frac{(1,495+1,168)}{2}}{60.73}$$

$$= \frac{1,331.5}{60.73}$$

= 22 days

(ii) Brief Comment on the financial position of JKL Ltd.

The profitability of operations of the company are showing sharp decline due to increase in operating expenses. The financial and operating leverages are becoming adverse. The liquidity of the company is under great stress.

Question 8

(a) Discuss the major considerations in Capital Structure Planning.

(b) A Company issues Rs. 10,00,000 12% debentures of Rs. 100 each. The debentures are redeemable after the expiry of fixed period of 7 years. The Company is in 35% tax bracket.

Required:

(i) Calculate the cost of debt after tax, if debentures are issued at

(a) Par

(b) 10% Discount

(c) 10% Premium.

(ii) If brokerage is paid at 2%, what will be the cost of debentures, if issue is at par?

(6 + 6 = 12 Marks)

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Answer

(a) Major Considerations in Capital Structure Planning

There are three major considerations, i.e. risk, cost of capital and control, which help the finance manager in determining the proportion in which he can raise funds from various sources.

Although, 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. Structuring capital is a shrewd financial management decision and is something which makes or mars the fortunes of the company.

As discussed earlier, there are three major considerations i.e. risk, cost of capital and control, which 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.

The other considerations which the finance manager has to keep in mind while planning for capital structure are corporate taxation, trading on equity, Government policies on interest rates and lending priority sectors, legal requirements, marketability, maneuverability, flexibility, timing, dilution in EPS, BVPS and control, size of company, purpose of financing, period of finance, nature of enterprise, requirement of investors and provision for future.

(b) $$K_d = \frac{I(1-T_c) + \frac{(RV - NP)}{N}}{\left(\frac{RV + NP}{2}\right)}$$

Where,

I = Annual Interest Payment

NP = Net proceeds of debentures

RV = Redemption value of debentures

T_c = Income tax rate

N = Life of debentures

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(i) (a) Cost of debentures issued at par

$$= \frac{1,20,000 \times (1-0.35) + \frac{(10,00,000 - 10,00,000)}{7}}{\left(\frac{10,00,000 + 10,00,000}{2}\right)}$$

$$= \frac{78,000}{10,00,000} = 7.8\%$$

(b) Cost of debentures issued at 10% discount

$$= \frac{1,20,000 \times (1-0.35) + \frac{(10,00,000 - 9,00,000)}{7}}{\left(\frac{10,00,000 + 9,00,000}{2}\right)}$$

$$= \frac{78,000 + 14,286}{9,50,000} = 9.71\%$$

(c) Cost of debentures issued at 10% premium

$$K_d = \frac{1,20,000 \times (1-0.35) + \frac{(10,00,000 - 11,00,000)}{7}}{\left(\frac{10,00,000 + 11,00,000}{2}\right)}$$

$$= \frac{78,000 - 14,286}{10,50,000} = 6.07\%$$

(ii) Cost of debentures, if brokerage is paid at 2% and debentures are issued at par

$$K_d = \frac{1,20,000 \times (1-0.35) + \frac{(10,00,000 - 9,80,000)}{7}}{\left(\frac{(10,00,000 - 20,000) + 10,00,000}{2}\right)}$$

$$= \frac{80,857}{9,90,000} = 8.17\%$$

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Question 9

(a) A company has sales of Rs. 25,00,000. Average collection period is 50 days, bad debt losses are 5% of sales and collection expenses are Rs. 25,000. The cost of funds is 15%. The company has two alternative collection programmes:

	Programme I	*Programme II*
Average Collection Period reduced to	*40 days*	*30 days*
Bad debt losses reduced to	*4% of sales*	*3% of sales*
Collection Expenses	*Rs. 50,000*	*Rs. 80,000*

Evaluate which Programme is viable.

(b) Write short notes on any two of the following:

(i) Debt Securitisation

(ii) American Depository Receipts

(iii) Bridge Finance. *(6 + 6 = 12 Marks)*

Answer

(a) Evaluation of Alternative Collection Programmes

	Present Programme	*1st Programme*	*2nd Programme*
	Rs.	*Rs.*	*Rs.*
Sales revenues	25,00,000	25,00,000	25,00,000
Average collection period (days)	50	40	30
Receivables (Rs.)	3,42,466 $\left(25,00,000 \times \frac{50}{365}\right)$	2,73,973	2,05,479
Reduction in receivables from present level (Rs.)	–	68,493	1,36,987
Savings in interest @ 15% p.a. (A)	–	10,274	20,548
% of Bad debt loss	5%	4%	3%
Amount (Rs.)	1,25,000	1,00,000	75,000
Reduction in bad debts from present level (B)	–	25,000	50,000
Incremental benefits from present level (C) = (A) + (B)	–	35,274	70,548
Collection expenses (Rs.)	25,000	50,000	80,000

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Incremental collection expenses from present level (D)	–	25,000	55,000
Increment net benefit (C – D)	–	10,274	15,548

Conclusion: From the analysis it is apparent that Programme I has a benefit of Rs. 10,274 and Programme II has a benefit of Rs. 15,548 over present level. Whereas Programme II has a benefit of Rs. 5,274 more than Programme I. Thus, benefits accrue at a diminishing rate and hence Programme II is more viable.

(b) (i) Debt Securitisation

It is a method of recycling of funds. It is especially beneficial to financial intermediaries to support the lending volumes. Assets generating steady cash flows are packaged together and against this asset pool market securities can be issued.

The basic debt securitization process can be classified in the following three functions:

- The origination function
- The pooling function
- The securitisation function

The process of securitization is generally without recourse i.e. investors bear the credit risk and issuer is under an obligation to pay to investors only if the cash flows are received by him from the collateral. The benefits to the originator are that assets are shifted off the balance sheet, thus giving the originator recourse to off-balance sheet funding.

(ii) American Depository Receipts

Depository Receipts issued by Indian company in the USA are known as American Depository Receipts (ADRs). Such receipts have to be issued in accordance with the provisions stipulated by the Securities and Exchange Commission (SEC), USA, which are very stringent.

These are securities offered by non-US companies who want to list on any of the US exchange. Each ADR represents a certain number of a company's regular shares. ADRs allow US investors to buy shares of these companies without the costs of investing directly in a foreign stock exchange. ADRs are issued by an approved New York bank or trust company against the deposit of the original shares. These are deposited in a custodial account in the US. Such receipts have to be issued in accordance with the provisions stipulated by the SEC, USA which are very stringent.

ADRs can be traded either by trading existing ADRs or purchasing the shares in the issuer's home market and having new ADRs created, based upon availability and market conditions. When trading in existing ADRs, the trade is executed on the secondary market on the New York Stock Exchange (NYSE) through Depository

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Trust Company (DTC) without involvement from foreign brokers or custodians. The process of buying new, issued ADRs goes through US brokers, Helsinki Exchanges and DTC as well as Deutsche Bank. When transactions are made, the ADRs change hands, not the certificates. This eliminates the actual transfer of stock certificates between the US and foreign countries.

(iii) Bridge Finance

Bridge finance refers to loans taken by a company normally from commercial banks for a short period, pending disbursement of loans sanctioned by financial institutions. Normally, it takes time for financial institutions to disburse loans to companies. However, once the loans are approved by the term lending institutions, companies, in order not to lose further time in starting their projects, arrange short term loans from commercial banks. Bridge loans are also provided by financial institutions pending the signing of regular term loan agreement, which may be delayed due to non-compliance of conditions stipulated by the institutions while sanctioning the loan. The bridge loans are repaid/ adjusted out of the term loans as and when disbursed by the concerned institutions. Bridge loans are normally secured by hypothecating movable assets, personal guarantees and demand promissory notes. Generally, the rate of interest on bridge finance is higher as compared to term loans.

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PAPER – 6 : INFORMATION TECHNOLOGY

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

Question 1

(a) Convert the following from one system to another system along with the Working Notes:

(i) $(101101.1101)_2$ = ( )$_{10}$

(ii) $(56.57)_8$ = ( )$_{16}$

(iii) $(36.125)_{10}$ = ( )$_2$

(iv) $(11001.10)_2$ = ( )$_8$

(v) $(426.40)_8$ = ( )$_{10}$ *(1× 5 = 5 Marks)*

(b) Describe briefly, the following terms with reference to Information Technology:

(i) Structured Query Language (SQL)

(ii) Drag

(iii) Bidirectional Printing

(iv) Formatting

(v) Internet Service Provider (ISP) *(1× 5 = 5 Marks)*

(c) Give one or two uses for each of the following:

(i) Use of Dynamic Processing

(ii) Use of cache memory in a processor

(iii) Use of RS-232C port

(iv) Use of Bridges in the Network

(v) Use of drivers *(1× 5 = 5 Marks)*

(d) Write True or False for each of the following:

(i) MS-Windows is a multi tasking operating system.

(ii) Magnetic tape supports random file organisation.

(iii) The default number of worksheets in an MS-EXCEL workbook is three.

(iv) In MS-WORD, Drop cap can be selected from Tool Menu.

(v) Flash memory uses solid-state chips to store data and the data stays recorded only when the power supply is turned on. *(1× 5 = 5 Marks)*

Answer

(a) (i) $(101101.1101)_2$ = ( )$_{10}$

$(101101.1101) = 1\times 2^5 + 1\times 2^3 + 1\times 2^2 + 1\times 2^0 + 1\times 2^{-1} + 1\times 2^{-2} + 1\times 2^{-4}$

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$= 32 + 8 + 4 + 1 + \frac{1}{2} + \frac{1}{4} + \frac{1}{16}$

$= 45 + 0.5 + 0.25 + 0.0625$

$= (45.8125)$

Hence, $(101101.1101)_2 = (45.8125)_{10}$

(ii) $(56.57)_8 = (\quad)_{16}$

$(56.57)_8 = 101 \quad 110 \;.\; 101 \quad 111$

$= 0010 \quad 1110 \;.\; 1011 \quad 1100$

$= \quad 2 \quad E \quad . \quad B \quad C$

Hence, $(56.57)_8 = (2E \;.\; BC)_{16}$

(iii) $(36.125)_{10} = (\quad)_2$

2	36	Remainder
2	18	0
2	9	0
2	4	1
2	2	0
2	1	0
	0	1

.125
× 2
0.250
× 2
0.500
× 2
1.000

Hence $(36.125)_{10} = (100100.001)_2$

(iv) $(11001.10)_2 = (\quad)_8$

$(11001.10)_2 = 011 \quad 001 \;.\; 100$

$= 3 \quad 1 \quad . \quad 4$

Hence, $(11001.10)_2 = (31.4)_8$

(v) $(426.40)_8 = (\quad)_{10}$

8	426	Remainder
8	53	2
8	6	5
	0	6

0.40
× 8
5.00

Hence, $(426.40)_8 = (652.5)_{10}$

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(b) (i) Structured Query Language (SQL): It refers to a set of commands for creating, updating and accessing data from a data base. It also aids the manager to make ad hoc queries from the database.

(ii) Drag: It refers to the activity of moving something around the computer monitor with the help of the mouse. Dragging involves holding down one of the mouse buttons while the user moves it.

(iii) Bi-directional Printing: Under bi-directional printing, a printer types the first line from left to right and the second line from right to left and so on through out the page. This speeds up the printing sequences.

(iv) Formatting: The process of creating tracks and sectors on the storage media is called formatting. By this process, each location of the storage media is assigned a physical address for reading/writing the data.

(v) Internet Service Provider (ISP): An institution that provides access to the Internet subscriber on a charge basis is referred to as Internet Service Provider. For example, in India VSNL (Videsh Sanchar Nigam Ltmited) is one of the Internet Service Providers.

(c) (i) Use of Dynamic Processing: This technique is used for swapping jobs in and out of computer memory according to their priorities and the number of time slices allocated to each task. It helps in increasing the processing speed of various tasks.

(ii) Use of cache memory in a processor: Processors incorporate their own internal memory called cache. The cache acts as a temporary memory and boosts the processing power significantly. The cache that comes with the processor is called L1 cache. It runs at the processor's clock speed, and therefore is very fast.

(iii) Use of RS-232C port: It is a parallel port that is used to connect external input/output devices like scanner or printer. It facilitates the parallel transmission of data.

(iv) Use of Bridges in the Network: The main task of a bridge computer is to receive and pass data from one LAN to another. In order to transmit this data successfully, the bridge magnifies the data transmission signals. It can act as a repeater as well as a link.

(v) Use of drivers: Drivers are small programs that translate the program's generic instructions into instructions for a specific piece of hardware. When a new hardware is introduced, the programmer of an operating system just writes a driver for it. Operating system has a library of device drivers, one for each specific hardware item.

(d) (i) True

(ii) False

(iii) True

(iv) False

(v) False

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Question 2

Distinguish between the following. Answer any four:

(i) Key to disk and Key-to-diskette.

(ii) Serial transmission and Parallel transmission.

(iii) Ring Network and Mesh Network.

(iv) Centralised processing and Distributed processing.

(v) Hardware and Software. *(5× 4 = 20 Marks)*

Answer

(i) Key to disk and Key-to-diskette

Key to-disk system consists of a mini processor, number of keying stations, supervisor console and a magnetic disk. Keying station consists of a keyboard and VDU. Supervisor's console is used to monitor the functioning of different operators working on different keying stations, usage of magnetic disk and status of Input data.

Each keying station is connected to the mini processor and for each keying station, fixed area of main memory in the mini processor is allocated. When the data is entered from a keying station, it is stored in its allocated area. When the allocated area in the mini processor is filled with data, then the data from that area is shifted on the magnetic disk as a record. Key-to-disk system provides accuracy of input, security and monitoring of progress. However, since all the keying stations are connected with a single mini processor and in case mini processor fails, then all keying stations stop working.

Key-to-diskette stand-alone computers are provided to the different operators for data entry. Data entered by them is stored on the floppy disks. The data recorded on the floppy disks are later transferred to magnetic tapes with the help of data converter. The data converter can handle upto 20 diskettes at a time.

Since all the computers used are stand-alone computers, therefore, if one computer fails, it will not stop the working of others. In addition to this, stand-alone computers can be installed close to the source of data. Key-to-diskette system allows decentralized recording of data and centralized conversion on magnetic tape for processing by a mainframe computer.

(ii) Serial transmission and Parallel transmission

Under Serial transmission, one bit of data is transferred at a time. A serial port which facilitates serial transmission data is used for the installation of Mouse/Modem. It is a cheap mode of data transfer. Data can be transferred to long distances. However, in serial transmission, data transfer is slow.

Under parallel transmission, a complete byte of data is transferred at a time. Centronic and IEEE are examples of Parallel ports used to connect Printer/Scanner. In parallel transmission data transfer is fast. However, it is an expensive mode of data transfer. Also, data cannot be transferred to long distances.

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(iii) Ring network and mesh network

In a ring network, the network cable passes from one node to another until all nodes are connected in the form of a loop or ring. There is a direct point-to-point link between two neighboring nodes. These links are unidirectional which ensures that transmission by a node traverses the whole ring and comes back to the node, which made the transmission.

Mesh network is a random connection of nodes using communication links. Network lines are expensive to install and maintain. The links are planned to minimize cost and maintain reliable and efficient traffic movement. A mesh network may be fully connected or connected with only partial links. Each node is connected with 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.

(iv) Centralised Processing and Distributed Processing

Centralized Processing	Distributed Processing
Complete data is processed by central host computer.	Data is processed locally at the user workstation but stored in the central host computer for sharing of data among various users.
All the database files are stored on the central host computer, hence security of data is of major consideration which requires regular backup.	Database files are physically distributed among various users as Partitioned database or Replicated database. Backup of data is taken by individual user.
Dumb Terminals/Intelligent Terminals are used.	Intelligent Terminals are used.
Central host computer is required to be of high speed, usually mini or mainframe computer, as entire workload is on the main CPU.	Central host computer known as Server can be even a microcomputer since data is processed by user workstations.
Waiting time of a user can be high, as main CPU may be busy in processing the data of other users.	Data is processed immediately; hence waiting time of users is less.
Terminals are connected with central host computer using high-speed communication link, which communicate with host computer frequently to access/process the data. Hence, communication expenditure is more.	Communication expenditure is less, as terminals called nodes communicate with server occasionally for data access.
Failure of Central host computer will paralyze the entire network.	Failure of server will not completely breakdown the entire network.

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(v) Hardware and Software

Hardware	Software
Physical components of a computer system are called hardware.	Collection of programs designed for specific needs is called software.
Input devices, processing unit, output devices and auxiliary storage devices are different categories of hardware.	Software can be divided into three types- application software, system software and general-purpose software.
Keyboard, mouse, printer, CPU, RAM are example of hardware	Financial Accounting software, operating system, MS-WORD etc. are examples of software.
Hardware is manufactured/assembled by hardware manufacturing companies/ hardware vendors.	Software is developed by software development firms.
Hardware is independent of software.	Software cannot be developed/used without hardware i.e. software is dependent on hardware.
Hardware repair requires hardware engineer.	Software development/modification requires software professionals like application programmer and system programmer.
It is bulky and requires more storage space.	Software can be copied on CD/DVD, which is lightweight and transportable.
Hardware is supported by uninterrupted power supply (UPS).	Software operation requires requisite hardware.
Hardware can be assembled, Indian branded or of MNC brand.	Software can be licensed or pirated.

Question 3

(a) What is Decision Support System (DSS)? Explain its various components. (5 Marks)

(b) Explain briefly various Disaster Recovery (DR) plans for eliminating Down time. (5 Marks)

(c) Draw a flow chart to compute and print Income-tax, Surcharge and Education cess on the income of a person, where income is to be read from terminal and tax is to be calculated as per the following rates:

	Slab (Rs.)	*Rate*
(i)	*1 to 1,00,000*	*No tax*
(ii)	*1,00,001 to 1,50,000*	*@ 10% of amount above 1,00,000*

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(iii)	*1,50,001 to 2,50,000*	*Rs. 5,000 + 20% of amount above 1,50,000*
(iv)	*2,50,001 onwards*	*Rs. 25,000 + 30% of amount above 2,50,000*
	Surcharge	*@ 10% on the amount of total tax, if the income of a person exceeds Rs. 10,00,000*
	Education cess	*2% on the total tax*

(10 Marks)

Answer

(a) Decision Support Systems: These are information processing systems which help the managers in decision making process. Advancement in hardware technology, interactive computing design graphics capabilities and programming languages has helped in the development of decision supports systems. These systems support management decision making process by solving relatively unstructured problems. A friendly computer interface eases the communication between the user and the decision support system.

A decision support system has following four basic components:

1. The Users: The user of a decision support system is usually a manager with the unstructured or semi-structured problem to solve. The manager may be at any level of authority in the organization (either top management or operating management). Typically, users do not need a computer background to use a decision support system for problem solving. The most important knowledge is a thorough understanding of the problem and the factors to be considered in finding a solution.

2. Databases: Decision support system includes one or more databases. These databases contain both routine and non-routine data from both internal and external sources. The data from external sources include data about the operating environment surrounding an organization–for example, data about economic conditions, market demand for the organization's goods or services and industry competition.

   Some of the data may come from internal resources, for example, data from the financial and managerial accounting systems such as account, transaction and planning data. The database may also capture data from other subsystems such as marketing, production and personnel. External database may also take into consideration assumptions about such variables as interest rates, market price, vacancy rates and level of competition.

3. Planning languages: Two types of planning languages that are commonly used in decision support systems are:

   (i) General purpose planning languages, and

   (ii) Special purpose planning languages.

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General-purpose planning languages allow users to perform many routine tasks like retrieving various data from a database or performing statistical analyses. The languages in most electronic spreadsheets are good examples of general–purpose planning languages. These enable users to tackle a broad range of budgeting, forecasting and other worksheet-oriented problems. Special purpose planning languages are more limited in what they can do, but they usually do certain jobs better than general purpose planning languages. Some statistical languages, such as SAS, SPSS and Minitab are examples of special purpose planning languages.

4. Model Base: The planning language in a decision support system allows the user to maintain a dialogue with the model base. The model base is the brain of the decision support system because it performs data manipulations and computations with the data provided to it by the user and the database. There are many types of model bases, but most of them are custom-developed models that do some types of mathematical functions like cross tabulation, regression analysis, time series analysis, linear programming and financial computations. The analysis provided by the routines in the model base is the key to supporting the user's decision. Even where quantitative analysis is simple, a system that requires users to concentrate on certain kinds of data can improve the effectiveness of decision making.

(b) Data centers must have proper disaster recovery systems that minimize downtime for its customers. Downtime can be eliminated by proper disaster recovery plans for mission-critical data. The different types of Disaster recovery plans (DRP) are:

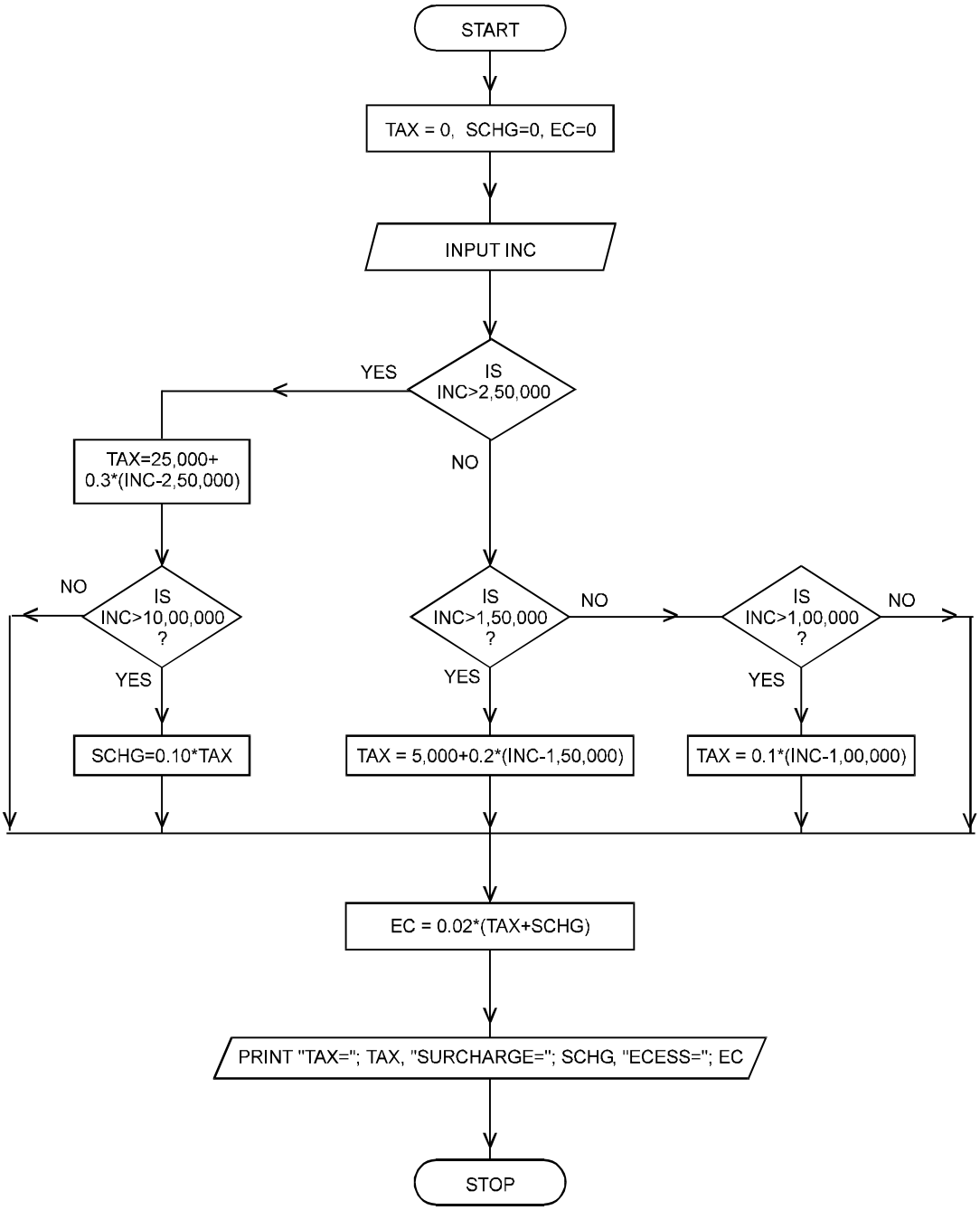
(i) Cold Site: It is an alternative facility that is devoid of any resources or equipments, except air conditioning and raised flooring. In this DRP, equivalent hardware is installed at Disaster site immediately but lost data can not be restored.

(ii) Warm site: It is an alternative processing site that is only partially equipped. In this DRP, organization data is copied on another site in periodic intervals so that in case of disaster, data can be restored from another site but the changes made in the data by the organization between the last backup time and current time is lost. Therefore, after the restoration of data, updation is required in the data to make it live data.

(iii) Hot site: It is an alternative facility that has the equipments and resources to recover business functions that are affected by a disaster. In this DRP, mirror image of data is stored simultaneously at the alternate site with the storage of data at current location. Therefore, data can be restored immediately in case of any disaster and downtime is avoided.

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(c) The required flowchart is given below:



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Question 4

(a) Briefly discuss features of data centres. *(5 Marks)*

(b) Describe various functions performed by a Database Administrator. *(5 Marks)*

(c) Define Database. Explain in brief different types of databases. *(10 Marks)*

Answer

(a) Features of Data Centers

(i) Size: Data Centers are characterized by the size of their operations. It can have hundred to several thousand servers. It would require a minimum area of approx. 5000 to 30000 Sq. Meters. It must have high quality construction to withstand the weight of servers to be installed inside.

(ii) Data Security: Data Centers have maximum data security and 100 per cent availability. They are protected from intruders with the help of firewalls and password/access rights. These are able to withstand the natural calamities like fire, flood and power failures. Security of data is also maintained by use of anti-virus software and proper backup/recovery procedures. The recovery site is well maintained and everything in data centre is replicated for failure recovery.

(iii) Availability of data: The goal of the data center is to maximize the availability of data and to minimize downtime. Therefore, redundancy is built into all mission critical infrastructure of the data centre such as connectivity, electrical supply and air conditioning, surveillance and fire suppression.

(iv) Electrical and Power systems: Data Centers have highest power availability using Uninterrupted Power supply (UPS).

(v) Security: Physical security and Data security are critical to operations. Physical security of data is maintained with the help of security guards, Biometric devices, Smart card and Closed circuits TV. Data security is addressed at multiple levels through firewalls, IDS, anti-virus, and access control mechanism.

(b) Functions performed by a Data Base Administrator (DBA)

(i) Designs the physical structure of database including decisions regarding database structure, file organization and hardware requirements.

(ii) Responsible for database performance tuning so that different users may access the data in least possible time.

(iii) Maintenance of the data dictionary is a responsibility of the DBA.

(iv) Maintains the security procedures like protection of data from unauthorized access, recovery of data in case of system failure etc.

(v) Preparation of documentation, which includes recording the procedures and data descriptions.

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(vi) Monitors database environment to ensure accuracy, integrity and security of data and maintenance of database performance standards.

(vii) Responsible for adding new utility programs and implementing latest database management software versions in the organization.

(viii) Maintains the edit control over database by way of providing different access rights to different users.

(ix) Maintains configuration control of database so that no user can insert/delete/modify a field of any database files at his own level.

(x) Ensures that the operating staff performs its data base processing related responsibilities which include loading the database, following maintenance and security procedures, taking backups and following restart and recovery procedures after some hardware and software failures.

(c) Data base: A data base is a repository for related collection of data. It is a computer file system that uses a particular file organization to facilitate rapid updating of individual records, simultaneous updating of related records, easy access of information by all applications programs and rapid access to all stored data which must be brought together for a particular routine report or inquiry or a special purpose report or enquiry.

The main types of databases are discussed below:

(i) Operational data bases: These data bases store detailed data needed to support the operations of the entire organization. These are also called subject area data bases, transaction data bases and production data bases.

(ii) Management data bases: These data bases store data and information extracted from selected operational and external data base. They consist of summarized information mostly needed by the top management and other end users as part of their decision support systems and executive information systems to support managerial decision-making.

(iii) Information warehouse data bases: It stores data from current and previous years. It contains data that has been extracted from the various operational and management databases of an organization. It is a central source of data that has been standardized and integrated so that it can be used by different levels of management in an organization.

(Iv) Distributed data bases: These are data bases of local work groups and departments at regional offices, branch offices, manufacturing plants and other work sites.

(v) End user data bases: These data bases consist of data files developed by end users at their workstations. For example, users may have their own electronic copies of documents they have generated with word processing package or received by electronic mail.

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(vi) External data bases: Access to external, privately owned online data bases or data banks is available for a fee, to the end users and organizations from commercial information services.

(vii) Text data bases: Text data bases are natural outgrowth of the use of computers to create and store documents electronically. Thus, online data base services store bibliographic information such as publications in larger text data bases. They are also available on CD-ROM or optical disks.

(viii) Image data Base: A wide variety of images can also be stored electronically in image data bases. For example, electronic encyclopedia is available on CD-ROM. It can be used in document image processing. Thousands of pages of business documents can be optically scanned and stored as document images on a single optical disk. Workers can view and modify documents at their own workstations and electronically transfer them to the workstations of other end users in the organization.

Question 5

(a) Describe briefly various benefits provided by online systems. *(5 Marks)*

(b) Explain various benefits offered by Electronic Data Interchange (EDI). *(5 Marks)*

(c) Define the following functions used in MS-EXCEL:

(i) ABS

(ii) NPER

(iii) AVERAGE

(iv) ROUND

(v) PROPER *(1× 5 = 5 Marks)*

(d) Explain briefly, the enhanced features of power point. *(5 Marks)*

Answer

(a) Benefits provided by Online Systems – Online systems provide a number of benefits all of which assist in improving administrative efficiency which is essential in today's competitive business environment. Some of the benefits are out-lined below:

1. *Integration of clerical staff with the computer*: Online systems assist in harnessing activities of clerical staff to the computer by the use of terminals. They can have access to information which is required for the efficient performance of their jobs in dealing with customer inquires and order processing.

2. *Elimination of tedious tasks:* Routine clerical tasks are replaced by terminal operations providing a greater degree of job interest, operating efficiency and job satisfaction.

3. *Reduction in paper work:* Volume of paper work generated by normal clerical system and batch processing system is relatively high. Online systems reduce the

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volume of print-out required for management reports since the information can be displayed on terminal screen on demand.

4. *Improved accuracy:* As terminal messages are checked for accuracy before being transmitted to the computer by data validation programs, the quality of information in a system increases as the input errors are reduced. Hence, information is more reliable.

5. *File updating improved:* Master files are more easily updated by terminal key board with regard to transaction data, since special runs are not required to be set up as is the case with batch processing applications.

6. *Management information more readily available:* Management information becomes more readily available by direct access facilities which enables managers to obtain a greater degree of control to the operations for which they are responsible.

7. *Improved customer services:* Improvements in the level of customers service can be expected in those systems which are concerned with appliances sales, booking systems and account inquiries.

8. *Reduced data preparation cost:* On-line systems dispense with the need to convert human sensible data into machine sensible data thereby eliminating punching and verifying operations. This saves time and the cost associated with such operations.

(b) Benefits of Electronic Data Interchange (EDI)

(*i*) *Issue and receive orders faster:* Since most purchasing transactions are routine, they can be handled automatically, utilising the staff for more demanding and less routine tasks.

(*ii*) *Make sales more easily:* Quotes, estimates, order entry and invoicing will proceed more smoothly and efficiently. Orders received electronically ensure that information is available immediately, so that an organisation can respond faster and be more competitive.

(*iii*) *Get paid sooner:* Invoices received electronically can be reconciled automatically, which means they are earmarked for payment in one's trading partner's accounting department sooner. And, in turn, the purchasing department is in a position to negotiate for better terms including faster payment.

(*iv*) *Minimise capital tied up in inventory:* For manufacturing organisations with a just-in-time strategy, the right balance is crucial but every organisation stands to benefit from reduced order lead times.

(*v*) *Reduced letters and memos:* Letters and memos do not follow rigid rules for formatting. They can be handled by an electronic mail system.

(*vi*) *Decrease enquiries:* Customers or suppliers can make direct on-line enquiries on product availability, expected date of delivery, discount policy etc. or other non-sensitive information instead of consuming the staff's precious time.

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(*vii*) *Make bulk updates of catalogues and parts listings:* Information regarding introduction of new products, revision of sales price which are incorporated by the supplier in its catalogue can be immediately communicated to the related parties with the help of electronic communication.

(c) (i) ABS(X): It is a mathematical function used to calculate the absolute value of x where x is any number. For example., if x = -3 then ABS (x) = 3

(ii) NPER: It is a financial function which returns the number of periods for an investment based on periodic constant payment and a constant interest rate.

(iii) AVERAGE: It is a statistical function which calculates the average of the values in the list of its arguments.

(iv) ROUND (x, n): It is a mathematical function used to round off the number x to n number of decimal places e.g. if x = 2.1752 and n=2 then ROUND (x, n) will return 2.18

(v) PROPER (text string): This is a text function which capitalizes the first letter in each word of a text string and converts all other letters to lowercase letters, e.g. if the text string is 'eXAMination', then this function will return 'Examination'.

(d) The enhanced features of Power Point are briefly discussed below:

(i) Modifying the impact of slides: We can add message by adding effective text to the slides to enhance the presentation. Power point offers many different design options to suit various presentation needs. One can add objects, graphical bullets and animation. Sound and video to play in the slides can also be added. The user can modify visual impact for a presentation by using transitions.

(ii) Adding objects: Objects like clip art, Word Art, tables and charts can be inserted on all slides or to selected slides. Logos of companies can be displayed using slide master. Text, clipart, table, video clip, a sound clip, or other objects can also be added to slides in the slide view or normal view. Certain objects can be selected from the clip art gallery. Picture tools bar can be used to modify these pictures.

(iii) Creating graph bullets: Bullets are used frequently for placing text on slides and to determine the levels of various lines of text on a slide. Various types of bullets can be used and they enhance the look and clarity of the presentation. From the bullets and numbers dialogue box, characters button can be pressed to view more bullets apart from the regular bullets that are available. Bullets can be created using any picture file also.

(iv) Adding transitions and animations: Power point offers special effects and features that can enhance the work of an online presentation. One can use things such as slide transitions, timings, movies and animations etc.

By using transition, the presenter can set the way each slide appears on the screen. Speed of the transitions can also be set. Slide transitions can be accompanied by special sound effects to enhance the presentation. One can even animate pictures and charts to produce dramatic effects during presentation.

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Question 6

(a) Explain the importance of "Data Volume" and "Usage Analysis" in the design of a database. *(5 Marks)*

(b) Define the following terms with reference to Section 2 of Information Technology Act, 2000:

(i) Key Pair

(ii) Originator

(iii) Digital Signature

(iv) Secure System

(v) Computer Network. *(1× 5 = 5 Marks)*

(c) Explain the advantages of decision tables. *(5 Marks)*

(d) Explain major steps involved in using the CAATs. *(5 Marks)*

Answer

(a) Data Volume and Usage Analysis: Data-volume and usage analysis i.e. frequency-of-use statistics are critical inputs to the physical database design process. The volume and frequency statistics are generated during the systems analysis phase of the systems development process when systems analysts are studying current and proposed data processing and business activities. The data-volume statistics represent the size of the business, and should be calculated assuming business growth over at least a several-year period. The access frequencies are estimated from the timing of events, transaction volumes, and reporting and querying activities. Since many databases support ad hoc accesses, and such accesses may change significantly over time, the access frequencies tend to be less certain than the volume statistics. Fortunately, precise numbers are not necessary. What is crucial is the relative size of the numbers, which will suggest where the greatest attention needs to be given in order to achieve the best possible performance. Data volume and usage analysis helps in taking decisions regarding the following:

- Hardware configuration including Processor speed and Hard disk capacity
- File organization and Indexing field
- Selection of a database structure like Hierarchical, Network or Relational database structure
- Selection of DBMS/RDBMS like Foxpro, MS-Access, Oracle or SOL.

(b) (i) Key pair: In an asymmetric crypto system, comprising of a private key and its related public key. These keys are so related that the public key can be used to verify a digital signature created by the private key.

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(ii) Originator: It refers to a person who sends, generates, stores or transmits any electronic message or causes any electronic message to be sent, generated, stored or transmitted to any other person but does not include an intermediary.

(iii) Digital signature: It refers to authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provision of section 3.

(iv) Secure system: It means computer hardware, software and procedures which are reasonably secure from the unauthorized access and misuse, provide a reasonable level of reliability and correct operation and adhere to generally accepted security procedures.

(v) Computer network: It refers to the interconnection of two or more computers through the use of special cabling like UTP/Fiber optic cable, telephone lines, microwave or satellite link or other communication media; and terminals or a complex consisting of two or more interconnected computers whether or not the interconnection is continuously maintained.

(c) Advantages of Decision tables

(i) A decision table provides a framework for a complete and accurate statement of processing or decision logic. It forces a discipline on the programmer to think through all possible conditions.

(ii) A decision table may be easier to construct than a flow chart.

(iii) A decision table is compact and easily understood making it very effective for communication between analysts or programmers and non-technical users. Better documentation is provided by it.

(iv) Direct conversion of decision table into computer program is possible.

(v) It is possible to check that all test combinations have been considered.

(vi) Alternatives are shown side by side to facilitate analysis of combinations.

(vii) The tables show cause and effect relationships.

(viii) They use standardized format.

(ix) Complex tables can easily be split into simpler tables.

(x) Table users are not required to possess computer knowledge.

(d) The major steps to be undertaken by the auditor in using the CAATs are to:

- Set the objectives of the CAAT application.
- Determine the content and accessibility of the entity's files.
- Define the transaction types to be tested.
- Define the procedures to be performed on the data.
- Define the output requirements.

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- Identify the audit and computer personnel who may participate in the design and application of CAAT.
- Refine the estimates of costs and benefits.
- Ensure that the use of the CAAT is properly controlled and documented.
- Arrange the administrative activities, including the necessary skills and computer facilities.
- Execute the CAAT application.
- Evaluate the results.

Question 7

Write short notes on the following:

(i) Smart Card Systems

(ii) Language Translators

(iii) Network Attached Storage (NAS)

(iv) Program (Parallel) Simulation. *(5 × 4 = 20 Marks)*

Answer

(i) Smart Card Systems: Smart cards are similar to credit card in size and shape but have small microprocessor chip and memory to store the details of the card holder.

So far, smart cards are used mostly for E-commerce and EFT (Electronic fund transfer). However, these days smart cards are being used to store the complete details of the card holder such as holders particulars, identity, address, insurance data, relatives' details, medical background and even finger prints of the holders. These cards can help the doctors to provide immediate treatment in case the cardholder is disabled by an accident or illness. It can serve as an identity card at various security checkpoints, the stored fingerprints could be compared to fingerprints of people who are authorized to enter a secured area.

Data from Smart cards is read with the help of a device known as Smart Card Reader. Smart cards are going to replace the need of multiple documents to be retained by a person like Ration card, Driving license, Passport, Identity card, Voter card etc.

(ii) Language Translators: It is a general term used for any assembler, compiler or other routines that accept statements in one language and produce equivalent statements in another language.

There are three types of translators:

(a) Compiler: It is system software, which is used to translate source codes to object codes. It scans the complete source program to find the syntax errors of the program and declares all those errors at the end of the compilation run. Once the user corrects all the errors, it then generates executable codes.

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(b) Interpreter: It is a system software, which is also used to translate source codes to object codes. It scans the lines of source program one by one. If there is an error in a line of source program, then it declares that error before proceeding to the next line. Therefore, it becomes necessary for the user to correct that error before finding errors in the remaining program, if any.

(c) Assembler: It is a system software which is used to translate assembly language program to object code.

(iii) Network-Attached Storage (NAS): It is a dedicated shared storage solution connected to a network, allowing the file and data sharing among different clients of the network. It is platform and operating system independent. It can be attached with the network without switching off the network and requires no changes to the existing file servers.

A NAS device is a stand-alone, single-purpose and high performance system. It is used to satisfy the storage requirement of different users with its own operating system, integrated hardware and software. NAS devices are suitable for heterogeneous networks. NAS is a totally integrated network system with SCSI hard disk drives and is basically a modular file server. It runs independently and provides excellent services to all the users. It functions even if the network server is down.

Benefits

(a) High performance and fast connectivity.

(b) Simpler and less expensive due to consolidation and centralization.

(c) Additional cost savings due to simplified installation process and ease of administration.

(d) Common storage from various platforms.

(e) Platform independence.

(f) Scalability due to modular design.

(g) Remote connectivity to storage.

Considerations

(a) Dependent on network bandwidth.

(b) Single point of failure i.e. NAS system failure will result in halting the working of all the clients.

(iv) Program (Parallel) Simulation: The auditor also may adopt this concept through parallel Simulation. This consists of a separate computer application that performs the same functions as those used by the installed program. It uses the same data and files and the results must be the same as those produced by the installed program. Conceptually this is the same as auditing around the computer. Parallel simulations may be done in any programming language. General -purpose audit software makes it possible for non-technical persons to create the parallel programs with little effort. Speed of execution is

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not a criterion, as the parallel simulation will be done only on a one-off basis and not as a regular basis.

This application uses computer audit programs designed to perform the same procedures as client programs. The computer audit program is applied to the client data files and the results obtained are compared with the results of processing done by the client's program on the same file. Program simulation is analogous to the clerical performance of an accounting routine. It confirms that the program procedures have operated correctly. It may also verify that the resulting balances are derived correctly from the input data.

The list of instructions to the audit staff should include an instruction to check whether there is a procedure of reprocessing some important or sensitive applications and comparing the results with those obtained earlier.

PAPER – 1 : ACCOUNTING

Answer all questions.

Working notes should form part of the answer.

Question 1

The following is the Balance Sheet of A Ltd. as at 31st March, 2006:

Liabilities	*Rs.*	*Assets*	*Rs.*
8,000 equity shares of Rs.100 each	*8,00,000*	*Building*	*3,40,000*
10% debentures	*4,00,000*	*Machinery*	*6,40,000*
Loan from A	*1,60,000*	*Stock*	*2,20,000*
Creditors	*3,20,000*	*Debtors*	*2,60,000*
General Reserve	*80,000*	*Bank*	*1,36,000*
		Goodwill	*1,30,000*
		Misc. Expenses	*34,000*
	17,60,000		*17,60,000*

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

(1) B Ltd. would take over all Assets, except bank balance at their book values less 10%. Goodwill is to be valued at 4 year's purchase of superprofits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) B Ltd. is to take over creditors at book value.

(3) The purchase consideration is to be paid in cash to the extent of Rs.6,00,000 and the balance in fully paid equity shares of Rs.100 each at Rs.125 per share.

The average profit is Rs.1,24,400. The liquidation expenses amounted to Rs.16,000. B Ltd. sold prior to 31st March, 2006 goods costing Rs.1,20,000 to A Ltd. for Rs.1,60,000. Rs.1,00,000 worth of goods are still in stock of A Ltd. on 31st March, 2006. Creditors of A Ltd. include Rs.40,000 still due to B Ltd.

Show the necessary Ledger Accounts to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 2006 after the takeover. (20 Marks)

Answer

Books of A Limited
Realisation Account

		Rs.			Rs.
To	Building	3,40,000	By	Creditors	3,20,000
To	Machinery	6,40,000	By	B Ltd.	12,10,000

To	Stock	2,20,000	By	Equity Shareholders (Loss)		76,000
To	Debtors	2,60,000				
To	Goodwill	1,30,000				
To	Bank (Exp.)	16,000				
		16,06,000				16,06,000

Bank Account

To	Balance b/d	1,36,000	By	Realisation (Exp.)	16,000
To	B Ltd.	6,00,000	By	10% debentures	4,00,000
			By	Loan from A	1,60,000
			By	Equity shareholders	1,60,000
		7,36,000			7,36,000

10% Debentures Account

To	Bank	4,00,000	By	Balance b/d	4,00,000
		4,00,000			4,00,000

Loan from A Account

To	Bank	1,60,000	By	Balance b/d	1,60,000
		1,60,000			1,60,000

Misc. Expenses Account

To	Balance b/d	34,000	By	Equity shareholders	34,000
		34,000			34,000

General Reserve Account

To	Equity shareholders	80,000	By	Balance b/d	80,000
		80,000			80,000

B Ltd. Account

To	Realisation A/c	12,10,000	By	Bank	6,00,000
			By	Equity share in B Ltd.(4,880 shares at Rs.125 each)	6,10,000
		12,10,000			12,10,000

Equity Shares in B Ltd. Account

To	B Ltd.	6,10,000	By	Equity shareholders	6,10,000
		6,10,000			6,10,000

Equity Share Holders Account

To	Realisation	76,000	By	Equity share capital	8,00,000

To	Misc. Expenses	34,000	By	General reserve	80,000
To	Equity shares in B Ltd.	6,10,000			
To	Bank	1,60,000			
		8,80,000			8,80,000

B Ltd

Balance Sheet as on 1st April, 2006 (An extract)*

Liabilities	*Rs.*	*Assets*	*Rs.*
4880 Equity shares of Rs.100 each	4,88,000	Goodwill	2,16,000
(Shares have been issued for consideration other than cash)		Building	3,06,000
Securities Premium	1,22,000	Machine	5,76,000
Profit and Loss A/c			
Less: unrealized profit 15,000	.....		
Creditors (3,20,000 - 40,000)	2,80,000	Stock (1,98,000 -15,000)	1,83,000
Bank Overdraft	6,00,000	Debtors (2,60,000 – 40,000) 2,20,000	
		Less: Provision for bad debts 26,000	1,94,000

Working Notes:

1. Valuation of Goodwill	*Rs.*
Average profit	1,24,400
Less: 8% of Rs.8,80,000	70,400
Super profit	54,000
Value of Goodwill = 54000 x 4	2,16,000

2. Net Assets for purchase consideration		
Goodwill as valued in W.N.1		2,16,000
Building		3,06,000
Machinery		5,76,000
Stock		1,98,000
Debtors		2,60,000
Total Assets		15,56,000
Less: Creditors	3,20,000	
Provision for bad debts	26,000	3,46,000
Net Assets		12,10,000

* In the absence of the particulars of assets and liabilities (other than those of A Ltd.), the complete Balance Sheet of B Ltd. after takeover cannot be prepared.

Out of this Rs.6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000) Rs. 6,10,000 in shares of Rs.125/-. Thus, the number of shares to be allotted 6,10,000/125 = 4,880 shares.

3. Unrealised Profit on Stock	Rs.
The stock of A Ltd. includes goods worth Rs.1,00,000 which was sold by B Ltd. on profit. Unrealized profit on this stock will be $\frac{40,000}{1,60,000} \times 1,00,000$	25,000
As B Ltd purchased assets of A Ltd. at a price 10% less than the book value, 10% need to be adjusted from the stock i.e., 10% of Rs.1,00,000.	(-10,000)
Amount of unrealized profit	15,000

Question 2

'X' and 'Y' carrying on business in partnership sharing Profit and Losses equally, wished to dissolve the firm and sell the business to 'X' Limited Company on 31-3-2006, when the firm's position was as follows:

Liabilities	*Rs.*	*Assets*	*Rs.*
X's Capital	*1,50,000*	*Land and Building*	*1,00,000*
Y's Capital	*1,00,000*	*Furniture*	*40,000*
Sundry Creditors	*60,000*	*Stock*	*1,00,000*
		Debtors	*66,000*
		Cash	*4,000*
	3,10,000		*3,10,000*

The arrangement with X Limited Company was as follows:

(i) Land and Building was purchased at 20% more than the book value.

(ii) Furniture and stock were purchased at book values less 15%.

(iii) The goodwill of the firm was valued at Rs.40,000.

(iv) The firm's debtors, cash and creditors were not to be taken over, but the company agreed to collect the book debts of the firm and discharge the creditors of the firm as an agent, for which services, the company was to be paid 5% on all collections from the firm's debtors and 3% on cash paid to firm's creditors.

(v) The purchase price was to be discharged by the company in fully paid equity shares of Rs.10 each at a premium of Rs.2 per share.

The company collected all the amounts from debtors. The creditors were paid off less by Rs.1,000 allowed by them as discount. The company paid the balance due to the vendors in cash.

Prepare the Realisation account, the Capital accounts of the partners and the Cash account in the books of partnership firm. *(16 Marks)*

Answer

Realisation Account

		Rs.				*Rs.*
To	Land & Building	1,00,000	By	Sundry Creditors		60,000
To	Furniture	40,000	By	X Ltd. Co. - Purchase consideration – (W.N.1)		2,79,000
To	Stock	1,00,000	By	X Ltd. Company – Sundry Debtors	66,000	
To	Debtors	66,000		*Less*: Commission 5% on 66,000	3,300	62,700
To	X Ltd. Co. - Sundry Creditors	59,000				
To	X Ltd. Co. – Commission 3% on 59,000	1,770				
To	Profits transferred to A's Capital A/c	17,465				
	B's Capital A/c	17,465				
		34,930				
		4,01,700				4,01,700

Capital Accounts

		A	*B*			*A*	*B*
		Rs.	*Rs.*			*Rs.*	*Rs.*
To	Shares in X Ltd. Co.–(W.N.2)	1,63,980	1,15,020	By	Balance b/d	1,50,000	1,00,000
To	Cash – Final Payment	3,485	2,445	By	Realisation a/c - Profit	17,465	17,465
		1,67,465	1,17,465			1,67,465	1,17,465

Cash Account

		Rs.			*Rs.*
To	Balance b/d	4,000	By	A's Capital A/c- Final payment	3,485
To	X Ltd. Co. (Amount realized from Debtors less amount paid to creditors) –(W.N.3)	1,930	By	B's Capital A/c- Final Payment	2,445
		5,930			5,930

Working Notes:

1 Calculation of Purchase consideration:

	Rs.
Land & Building	1,20,000
Furniture	34,000
Stock	85,000
Goodwill	40,000
	2,79,000

2. The shares received from the company have been distributed between the two partners A & B in the ratio of their final claims i.e., 1,67,465: 1,17,465*.

No. of shares received from the company = $\frac{2,79,000}{12} = 23,250$

A gets $\frac{23,250 \times 1,67,465}{2,84,930} = 13,665$ shares valued at 13,665 x 12 = Rs.1,63,980. B gets the remaining 9,585 shares, valued at Rs.1,15,020 (9,585 × 12)

3. Calculation of net amount received from X Ltd on account of amount realized from debtors less amount paid to creditors.

		Rs.
	Amount realized from Debtors	66,000
Less:	Commission for realization from debtors (5% on 66,000)	3,300
		62,700
Less:	Amount paid to creditors	59,000
		3,700
Less:	Commission for cash paid to creditors (3% on 59,000)	1,770
Net amount received		1,930

* In the above situation, shares received from X Ltd. Company have been distributed between two partners A and B in the ratio of their final claims. Alternatively, shares received from X Ltd. can be distributed among the partners in their profit sharing ratio i.e. Rs. 2,79,000 x ½ =Rs. 1,39,500 each. In that case, firm will pay cash amounting Rs. 27,965 to A and will receive cash Rs.22,035 from B.

Question 3

The following are the summarized Balance Sheets of 'X' Ltd. as on March 31, 2005 and 2006:

Liabilities	*As on 31.3.2005 (Rs.)*	*As on 31.3.2006 (Rs,.)*
Equity share capital	*10,00,000*	*12,50,000*
Capital Reserve	*---*	*10,000*
General Reserve	*2,50,000*	*3,00,000*
Profit and Loss A/c	*1,50,000*	*1,80,000*
Long-term loan from the Bank	*5,00,000*	*4,00,000*
Sundry Creditors	*5,00,000*	*4,00,000*
Provision for Taxation	*50,000*	*60,000*
Proposed Dividends	*1,00,000*	*1,25,000*
	25,50,000	*27,25,000*

Assets	*Year 2005 (Rs.)*	*Year 2006 (Rs.)*
Land and Building	*5,00,000*	*4,80,000*
Machinery	*7,50,000*	*9,20,000*
Investment	*1,00,000*	*50,000*
Stock	*3,00,000*	*2,80,000*
Sundry Debtors	*4,00,000*	*4,20,000*
Cash in Hand	*2,00,000*	*1,65,000*
Cash at Bank	*3,00,000*	*4,10,000*
	25,50,000	*27,25,000*

Additional Information:

(i) Dividend of Rs.1,00,000 was paid during the year ended March 31, 2006.

(ii) Machinery during the year purchased for Rs.1,25,000.

(iii) Machinery of another company was purchased for a consideration of Rs.1,00,000 payable in equity shares.

(iv) Income-tax provided during the year Rs.55,000.

(v) Company sold some investment at a profit of Rs.10,000, which was credited to Capital reserve.

(vi) There was no sale of machinery during the year.

(vii) Depreciation written off on Land and Building Rs.20,000.

From the above particulars, prepare a cash flow statement for the year ended March, 2006 as per AS 3 (Indirect method). *(16 Marks)*

Answer

Cash Flow Statement for the year ending on March 31, 2006

		Rs.	*Rs.*
I.	Cash flows from Operating Activities		
	Net profit made during the year (W.N.1)	2,60,000	
	Adjustment for depreciation on Machinery (W.N.2)	55,000	
	Adjustment for depreciation on Land & Building	20,000	
	Operating profit before change in Working Capital	3,35,000	
	Decrease in Stock	20,000	
	Increase in Sundry Debtors	(20,000)	
	Decrease in Sundry Creditors	(1,00,000)	
	Income-tax paid	(45,000)	
	Net cash from operating activities		1,90,000
II.	Cash flows from Investing Activities		
	Purchase on Machinery	(1,25,000)	
	Sale of Investments	60,000	(65,000)
III.	Cash flows from Financing Activities		
	Issue of equity shares (2,50,000-1,00,000)	1,50,000	
	Repayment of Long term loan	(1,00,000)	
	Dividend paid	(1,00,000)	(50,000)
Net increase in cash and cash equivalent			75,000
Cash and cash equivalents at the beginning of the period			5,00,000
Cash and cash equivalents at the end of the period			5,75,000

Working Notes:

(i) Net Profit made during the year ended 31.3.2006

Increase in P & L (Cr.) Balance		30,000
Add:	Transfer to general reserve	50,000
Add:	Provision for taxation made during the year	55,000
Add:	Provided for proposed dividend during the year	1,25,000
		2,60,000

(ii) Machinery Account

		Rs.			Rs.
To	Balance b/d	7,50,000	By	Depreciation (Bal. Fig.)	55,000
To	Bank	1,25,000	By	Balance c/d	9,20,000
To	Equity share capital	1,00,000			
		9,75,000			9,75,000

(iii) Provision for Taxation Account

		Rs.			*Rs.*
To	Cash (Bal. Fig.)	45,000	By	Balance b/d	50,000
To	Balance c/d	60,000	By	P & L A/c	55,000
		1,05,000			1,05,000

(iv) Proposed Dividend Account

		Rs.			Rs.
To	Bank	1,00,000	By	Balance b/d	1,00,000
To	Balance c/d	1,25,000	By	P & L A/c (Bal. Fig.)	1,25,000
		2,25,000			2,25,000

(v) Investment Account

		Rs.			*Rs.*
To	Balance b/d	1,00,000	By	Bank A/c	60,000
To	Capital Reserve A/c (Profit on sale of investment)	10,000		(Balancing figure for investment sold)	
			By	Balance c/d	50,000
		1,10,000			1,10,000

Question 4

(a) The life fund of Well-Life Assurance Co. was Rs.90,00,000 as on 31st December, 2005. The interim bonus paid during the valuation period was Rs.1,50,000. The periodical actuarial valuation determined the net liability at Rs.75,00,000. Surplus brought forward from the previous valuation was Rs.9,00,000. The directors of the company proposed to carry forward Rs.10,00,000 and to divide the balance between the shareholders and the policy holders. You are required to show:

(i) The valuation Balance Sheet.

(ii) The Net Profit for the valuation period.

(iii) The distribution of the surplus.

(b) The following is an extract from the Trial Balance of Dream Bank Ltd. as at 31st March, 2006:

Rebate on bills discounted as on 1-4-2005	*68,259 (Cr.)*
Discount received	*1,70,156 (Cr.)*

Analysis of the bills discounted reveals as follows:

Amount (Rs.)	*Due date*
2,80,000	*June 1, 2006*
8,72,000	*June 8, 2006*
5,64,000	*June 21, 2006*
8,12,000	*July 1, 2006*
6,00,000	*July 5, 2006*

You are required to find out the amount of discount to be credited to Profit and Loss account for the year ending 31st March, 2006 and pass Journal Entries. The rate of discount may be taken at 10% per annum. (8+8= 16 Marks)

Answer

(a)

Well Life Assurance Co. Ltd.
Valuation Balance Sheet as on Dec. 31, 2005

Liabilities	*Amount*	*Assets*	*Amount*
	Rs.		*Rs.*
To Net liability as per actuarial valuation	75,00,000	By Life Fund as per Balance Sheet	90,00,000
To Surplus (Bal. Fig.)	15,00,000		
	90,00,000		90,00,000

Net Profit for the valuation period:	*Rs.*
Surplus as per valuation balance sheet	15,00,000
Add: Interim Bonus distributed	1,50,000
	16,50,000
Less: Surplus at the beginning	9,00,000
Net profit for the valuation period	7,50,000

Distribution of Surplus	
Total Surplus	16,50,000
Less: Surplus to be carried forward	10,00,000
	6,50,000

Shareholders (5% of Rs. 6,50,000)		32,500
Policy holders (95% of Rs. 6,50,000)	6,17,500	
Less: Interim bonus already distributed	1,50,000	4,67,500
		5,00,000

(b) The amount of rebate on bills discounted as on 31st March, 2006 for the period which has not been expired upto that day will be calculated as follows:

Discount on Rs.2,80,000 for 62 days @ 10%	4,756
Discount on Rs.8,72,000 for 69 days @ 10%	16,484
Discount on Rs.5,64,000 for 82 days @ 10%	12,671
Discount on Rs.8,12,000 for 92 days @ 10%	20,467
Discount on Rs.6,00,000 for 96 days @ 10%	15,781
Total	70,159

The amount of discount to be credited to the profit and loss account will be:

	Rs.
Transfer from rebate on bills discounted as on 31.03.2005	68,259
Add: Discount received during the year	1,70,156
	2,38,415
Less: Rebate on bills discounted as on 31.03.2006 (as above)	70,159
	1,68,256

Journal Entries

		Rs.	*Rs.*
Rebate on bills discounted A/c	Dr.	68,259	
To Discount on bills A/c			68,259
(Transfer of unexpired discount on 31.03.2005)			
Discount on bills A/c	Dr.	70,159	
To Rebate on bills discounted			70,159
(Unexpired discount on 31.03.2006 taken into account)			
Discount on Bills A/c	Dr.	1,68,256	
To P & L A/c			1,68,526
(Discount earned in the year, transferred to P&L A/c)			

Question 5

Mr. Ashok keeps his books in Single Entry system. From the following information, prepare Trading and Profit & Loss Account for the year ended 31st March, 2006 and the Balance Sheet as on that date:

Assets and Liabilities	*31.3.2005*	*31.3.2006*
	(Rs.)	*(Rs.)*
Sundry Creditors	*30,000*	*25,000*
Outstanding expenses	*1,000*	*500*
Fixed Assets	*23,000*	*22,000*
Stock	*16,000*	*22,500*
Cash in Hand and at Bank	*14,000*	*16,000*
Sundry Debtors	*?*	*36,000*

Following further details are available for the Current year:

	Rs.		*Rs.*
*Total receipts from debtors**	*1,30,000*	*Cash purchases*	*2,000*
Returns inward	*3,000*	*Fixed Assets purchased and paid by cheque*	*1,000*
Bad Debts	*1,000*	*Drawings by cheques*	*6,500*
Total Sales	*1,50,000*	*Deposited into the bank*	*10,000*
Discount received	*1,500*	*Withdrawn from bank*	*18,500*
Return outwards	*1,000*	*Cash in hand at the end*	*2,500*
Capital introduced		*Paid to creditors by cheques*	*1,20,000*
(paid into Bank)	*15,000*	*Expenses paid*	*20,000*
Cheques received from Debtors	*1,25,000*		

(16 Marks)

Answer

Trading and Profit and Loss Account
for the year ended on 31st March, 2006

	Particulars	*Amount*		*Particulars*	*Amount*
		Rs.			*Rs.*
To	Opening Stock	16,000	By	Sales:	
To	Purchases:			Cash	

*The words given as "Cash receivable from debtors" in the question paper have been replaced by "Total receipts from debtors" to draw the final accounts.

					(W.N.1)	6,500	
	Cash	2,000			Credit	1,43,500	
	Credit (W.N.3)	1,17,500				1,50,000	
		1,19,500			*Less*:Returns	3,000	1,47,000
	Less: Returns	1,000	1,18,500	By	Stock		22,500
To	Gross Profit c/d		35,000				
			1,69,500				1,69,500
To	Expenses	20,000					
	Add: O/s at the end	500		By	Gross profit b/d		35,000
		20,500		By	Discount received		1,500
	Less: O/s at the beginning	1,000	19,500				
To	Bad debts		1,000				
To	Depreciation		2,000				
To	Net Profit		14,000				
			36,500				36,500

Balance Sheet
as on 31st March, 2006

Liabilities		*Amount*	*Assets*		*Amount*
		Rs.			*Rs.*
Capital (W.N.5)	48,500		Fixed Assets	23,000	
*Add:*Additional Capital	15,000		*Add:* Purchased during the year	1,000	
Add: Net Profit	14,000		*Less:* Depreciation	2,000	22,000
Less: Drawings	6,500	71,000	Stock		22,500
Creditors		25,000	Cash		2,500
Outstanding Exp.		500	Bank		13,500
			Debtors		36,000
		96,500			96,500

Working Notes:

1. Cash Account

	Particulars	*Amount*		*Particulars*	*Amount*
		Rs.			*Rs.*
To	Balance b/d	4,500	By	Purchases	2,000
To	Sales (Bal. Fig.)	6,500	By	Bank (contra)	10,000
To	Debtors	5,000	By	Expenses	20,000

To	Bank (contra)	18,500	By	Balance c/d	2,500
		34,500			34,500

2. Bank Account

	Particulars	*Amount*		*Particulars*	*Amount*
		Rs.			*Rs.*
To	Balance b/d (Bal. Fig.)	9,500	By	Fixed Assets	1,000
To	Capital	15,000	By	Drawings	6,500
To	Cash (contra)	10,000	By	Cash (contra)	18,500
To	Debtors	1,25,000	By	Creditors	1,20,000
		———	By	Balance c/d	13,500
		1,59,500			1,59,500

3. Creditors Account

	Particulars	*Amount*		*Particulars*	*Amount*
		Rs.			*Rs.*
To	Bank	1,20,000	By	Balance b/d	30,000
To	Returns	1,000	By	Purchase (Bal. Fig.)	1,17,500
To	Discount received	1,500			
To	Balance c/d	25,000			———
		1,47,500			1,47,500

4. Debtors Account

	Particulars	*Amount*		*Particulars*	*Amount*
		Rs.			*Rs.*
To	Balance b/d (Bal. Fig.)	26,500	By	Cash	5,000
To	Sales	1,43,500	By	Bank	1,25,000
			By	Bad Debts	1,000
			By	Returns	3,000
		———	By	Balance c/d	36,000
		1,70,000			1,70,000

5. Opening Balance Sheet as on 31.3.2005

Liabilities	*Amount*	*Assets*	*Amount*
	Rs.		*Rs.*
Creditors	30,000	Fixed Assets	23,000

O/s Expenses	1,000	Stock	16,000
Capital (Bal. Fig.)	48,500	Cash	4,500
		Bank (W.N.2)	9,500
	———	Debtors (W.N.4)	26,500
	79,500		79,500

Question 6

Answer any four of the following:

(a) What are the costs that are to be included in Research and Development costs as per AS 8.

(b) The Company reviewed an actuarial valuation for the first time for its Pension Scheme, which revalued a surplus of Rs.12 lacs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs.4 lacs instead of Rs.10 lacs. The average remaining life of the employees, if estimated to be 6 years, you are required to advise the Company considering the accounting standards 5 and 15.

(c) X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at Rs.10 lacs to another company for Rs.15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4.

(d) What are the conditions that are to be satisfied for 'Amalgamation in the nature of Merger'?

(e) Write short note on "Appropriation Act" with reference to Government Accounts.

(f) Define related party transaction under AS 18. *(4x4=16 Marks)*

Answer

(a) According to paras 41 and 43 of AS 26*, **"**No intangible asset arising from research (or from the research phase of an internal project) should be recognized in the research phase. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.

Examples of research costs are:

- Costs of activities aimed at obtaining new knowledge;
- Costs of the search for, evaluation and final selection of, applications of research findings or other knowledge;
- Costs of the search for alternatives for materials, devices, products, processes, systems or services; and

* AS 8 stands withdrawn w.e.f. 1st April, 2003 i.e. the date from which AS 26 'Intangible Assets' becomes mandatory. Therefore the above answer has been given as per AS 26.

- Costs of the activities involved in formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes systems or services."

According to paras 45 and 46 of AS 26, "In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

Examples of development activities/costs are:

- Costs of the design, construction and testing of pre-production or pre-use prototypes and models;
- Costs of the design of tools, jigs, moulds and dies involving new technology;
- Costs of the design, construction ad operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- Costs of the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services."

(b) According to para 92 of AS 15 (Revised 2005) on "Employee Benefits", any actuarial gains and losses should be recognized immediately in the statement of profit and loss account as income or expense.

In the given case, the amount of surplus from pension scheme of Rs. 12 lacs is an actuarial gain, which should be recognized as income in the profit and loss account of the current year and not to be adjusted from the amount of annual contribution.

The surplus arising due to review of actuarial valuation of pension scheme by a company should be treated as a change in accounting policy and disclosed in accordance with AS 5(Revised).

(c) According to para 13 of AS 4 "Contingences and Events occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In this case the sale of immovable property was carried out before the closure of the books of Accounts. This is clearly an event occurring after the balance sheet date. Agreement to sell was effected before the balance sheet date and the registration was done after the balance sheet date. So the adjustment for the sale of immovable property is necessary in the books of account for the year ended 31st March, 2006.

(d) As per AS 14 "Accounting for Amalgamations", amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their

nominees) become equity shareholders of the transferee company by virtue of amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

(e) Appropriation Act: After the demand is passed by the legislature, appropriation bill is introduced to provide for the appropriation out of the Consolidated Fund of India or the State or the Union Territory having separate legislature for all moneys required to meet (a) the grants made by the legislature; (b) the expenditure charged on consolidated fund but not exceeding in any case the amount shown in the statement previously laid before the legislature. No money can be withdrawn from the consolidated fund until the appropriation bill is passed. The sum is authorized in the Appropriation Act or intended to cover all the changes including the liability of past years to be paid during a financial year or to be adjusted in accounts of the year. Any unspent balance lapses and is not available for utilisation in the following year.

(f) According to AS 18, "Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions."

A related party transaction involves a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

Following are the examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

- Purchases or sales of goods (finished or unfinished);
- Purchases or sales of fixed assets;
- Rendering or receiving of services;
- Agency arrangements;
- Leasing or hire purchase arrangements;
- Transfer of research and development;
- Licence agreements;
- Finance (including loans and equity contributions in cash or in kind);
- Guarantees and collateral etc.
- Management contracts including for deputation of employees.

PAPER – 2 : AUDITING

Answer Question Nos. 1 and 2 and any four questions from the rest.

Question 1

As an Auditor, comment on the following situations/statements:

(a) SMT Enterprises entered into a contract for sale of its goods worth Rs. 24 lacs with ST Ltd. The goods were inspected, approved and finalised by the inspection team of ST Ltd. ST Ltd. made the whole payment of Rs. 24 lacs. However, it requested SMT Enterprises to dispatch the goods in six equal monthly instalments from October, 2005 to March, 2006. In the month of January,2006, due to natural calamity, ST Ltd. informed SMT Enterprises to stop dispatches of the remaining three instalments until further notice. At the time of finalising its accounts for the financial year 2005-06, SMT Enterprises booked sales amounting to Rs. 12 lacs and showed remaining Rs. 12 lacs as Advance Against Sales. (5 Marks)

(b) X Ltd. had a major break down in its plant in the month of February, 2006. In the month of March, 2006 it entered into an agreement with an engineering firm for the purpose of repairing its plant for a consideration of Rs. 180 lacs. The engineering firm started the repairing work in the month of April, 2006 and completed it in the same month. X Ltd. made the provision for said expenditure on repairs in its books of account for the financial year 2005-06 on the plea that the event of break down leading to repair expenditure had taken place in the financial year 2005-06, binding contract for repairs was entered into during the financial year 2005-06 and repair work was also completed before the financial statements were approved by the Board of Directors of the company.

(5 Marks)

(c) The management tells you that WIP is not valued since it is difficult to know the same in view of multiple processes involved and in any case opening and closing WIP would be more or less the same. (4 Marks)

(d) JKT Ltd. having Rs. 40 lacs paid up capital, Rs. 9.50 lacs reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being Rs. 4.90 crores, Rs. 4.50 crores and Rs. 6 crores, but does not have any internal audit system. In view of the management, internal audit system is not mandatory.

(4 Marks)

Answer

(a) Revenue Recognition (AS-9): Revenue from sales can be recognised only if the following conditions are fulfilled:

(i) The seller of goods has transferred to the buyer, the property in the goods for a price and all significant risks and rewards of ownership have been transferred to a degree usually associated with ownership and

(ii) There is no significant uncertainty exists regarding the amount of consideration that will be derived from the sale of the goods.

In the light of above two conditions in the given case SMT Enterprise had transferred the property in the goods at an agreed price and all significant risks and rewards. Thus sale is fully completed. Mere postponement of delivery until further notice as requested by ST LTD., does not alter the status of sale.

As the sale is completed, entire amount of Rs. 24 lakhs should be recognized lacs in the F.Y. 2005-2006 only. SMT Enterprise recognising only 12 lacs sales in F. Y. 2005-2006 is not correct.

(b) Provision for Expenditure on Repairs (AS 29): As per AS-29 on provisions, contingent liabilities and contingent assets, a liability is defined as a present obligation of the enterprise, arising from past events the settlement of which is expected to result in an outflow of resources embodying economic benefits. A provision is a liability which can be measured only by using a substantial degree of estimation. Provision for liability can be made which is existing as on the date of balance sheet.

In the instant case, though the event of break down and binding contract for repairs was entered into F. Y. 2005-06, but as the Engineering firm has not started performing the work of repair until the date of balance sheet, liability can not be said to have been arisen as on the date of balance sheet.

In view of the above, provision made by X Ltd. for expenditure on repairs in its books of account of F.Y. 2005-06, for repair work to be done in the next F.Y. 2006-07 is absolutely wrong, as there was no obligation. The auditor should bring this wrong provision to the notice of the authorities of X Ltd. and report accordingly.

(c) Valuation Of WIP : AS-2, prescribes the valuation of inventories. The word inventories includes any item held in the process of production. Production process is going on but final product has not came out before the end of accounting year. This is known as WIP, and company will have to find out the stage of completion of products. It has to decide and find out the process at which the said stock is lying at the end of the year and value the same. In certain cases, due to nature of the product and the manufacturing process involved, physical verification of WIP may be impracticable. But in such cases, if necessary, the advice of an expert can be taken in the matter. The value of such WIP is normally done by taking the basic raw material cost and adding thereto the proportionate factory overhead cost incurred up to the stage of completion.

WIP is an item of Manufacturing, Trading & Profit & Loss A/c and also forming part of current assets, is relevant and can not be ignored. Omitting WIP will result in under or over statement of profit and current assets.

Part II of Schedule VI to the Companies Act also prescribes that the figures of opening and closing balances of stock and WIP be disclosed in the profit & loss account. Part I of the same schedule requires that the mode of valuation of stock be shown in the Balance Sheet.

The argument of the management that the opening and closing WIP would be more or less the same is not justified because the cost incurred for raw materials and overheads would be different and would give different value of opening and closing WIP.

Taking into consideration all the above aspects, management is wrong and if WIP is not valued or taken into consideration, he should qualify his report.

(d) Internal Audit System in Case of Company : As per CARO-2003, para 4(vii), statutory auditor is required to comment whether the auditee company has an internal audit system commensurate with the size and nature of company's business.

Internal audit system is mandatory where:-

(i) The company has a paid up capital and reserve exceeds 50 lakhs as at the commencement of the financial year or

(ii) The company has an average annual turnover of rupees 5 crores or more for a period of 3 consecutive financial year preceding the current financial year.

Applying the above conditions in the given case, the second condition is fulfilled and the company is required to maintain and internal audit system commensurate with its size and the nature of its business.

Hence the management view that internal audit system in their case is not mandatory is wrong.

The auditor will have to mention the fact of not having such internal audit system in his report.

Question 2

(a) Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director. (4 Marks)

(b) PBS & Associates, a firm of Chartered Accountants, has three partners P, B and S. The firm is already having audit of 60 companies, which includes 2 branch audits of a company. The firm is offered 3 company audits, out of which one is a private company, other is a foreign company and the third one is a public company. Decide and advise whether PBS & Associates will exceed the ceiling prescribed under Section 224(1B) by accepting the above audit assignments? (4 Marks)

(c) RT Ltd. Received Rs. 50 lacs as grant from the State Government towards the part cost of a specific machinery. The company credited the above sum of Rs. 50 lacs as income in its Profit and Loss Account for the year. What are your views on the accounting treatment of the above receipt of Rs. 50 lacs? (4 Marks)

(d) Audit of expenditure is one of the major components of Government Audit. In this context, write in brief what do you understand by:

(i) Audit against Rules and Orders

(ii) Audit of Sanctions

(iii) Propriety Audit *(6 Marks)*

Answer

(a) Appointment of First Auditor of Company : As per Section 224(5) of the Companies Act, 1956 the first auditor of a company can be appointed by the Board of Directors within one month of the date of registration of the company. If the Board fails to appoint the first auditor or auditors, the company, in general meeting, is empowered to make such appointment. This authority is not available to the Managing Director of the company himself. Such appointment should be made through Board of Directors or by shareholders in the general meeting.

In view of the above provision, Managing Director is advised not to appoint first auditors himself and let the Board to take decision in this regard. It will be considered as violation of section 224(5) of the Companies Act, 1956.

(b) Ceiling Limit for accepting Audit of Companies : As per Section 224(1B) of Companies Act, 1956, a Chartered Accountant cannot hold more than the specified number of company audit. It further says that in case of Chartered Accountant firms, the specified number is 20 companies per such partner who is not in whole time employment elsewhere. While counting 20 companies, not more than 10 companies may have a paid up share capital of Rs.25 lacs or more. Besides, while counting 20 companies ceiling limit, the following companies should not be considered as these companies are outside the scope of section 224.

(i) Branch audit

(ii) Special audit

(iii) Audit of foreign companies and

(iv) Audit of private companies.

In the given case if Mr. P, B and S do not hold any audits in their personal capacity or as partners of other firms, the total number of companies audit that can be accepted by M/s. PBS & Associates is 60.

Total Audit at present	60
Less: Branch Audit	2
Balance	58
Add: New Audit offered	01
(private co. audit and audit of foreign co. excluded)	
Total Audit of companies	59

Thus PBS Associates can accept additional audit of all above three companies as given

in the question which will be considered well within the limit specified by section 224(1B) of the Companies Act, 1956.

(c) Accounting for Government Grants (AS-12): Grants or subsidy related to specific fixed assets are Govt. grants whose primary condition is that an organisation qualifying for such grant, should either purchase, construct or otherwise acquire such assets.

Besides Govt. may specify the type or location of the assets or the periods during which they are to be acquired or held.

For accounting treatment, following basis should be taken into consideration:

(i) Grant to be shown as a deduction from gross value of assets concerned in arriving at its book value. Depreciation is charged on reduced value of fixed assets

Or

(ii) Grant related to depreciable asset is treated as deferred income which is recognised as revenue in the Profit & Loss account on a systematic and rational basis over the useful life of asset and

(iii) In case of grants related to non-depreciable assets, the same shall be credited to Capital Reserve Account.

Taking into consideration the above view, accounting treatment given of the grants received by the organisation is not correct.

As an auditor, it will be advised to correct the wrong treatment given (the whole amount of grants Rs.50 lacs credited to Profit & Loss Account), otherwise, it is the duty of the auditor to qualify his report.

(d) (i) Audit against Rules and Orders: Audit against rules and orders aims to ensure that expenditure conforms the relevant provisions of the constitution and of the laws and rules made there under. It also seeks to satisfy the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. It includes :

(1) Rules and orders regulating the powers to incur and sanction expenditure

(2) Rules and orders dealing with the mode of presentation of claims against Government and in general the financial rules prescribing the detailed procedure to be followed by Govt. servants in dealing with Government transactions and

(3) Rules and orders regulating the conditions of services, pay and allowances, and pensions of Govt. servants.

(ii) Audit of Sanctions: The auditor has to ensure that each item of expenditure is covered by sanction, either general or special from the competent authority. The audit of sanction is directed both in respect of ensuring that:

(1) The expenditure is properly covered by a sanction and

(2) to satisfy that the authority sanctioning it, is competent for the purpose by virtue of powers vested by constitution.

(iii) Propriety Audit: It means to bring out cases of improper, avoidable or infractious expenditure, even though the expenditure has been incurred in conformity with the existing rules and regulations. A transaction may satisfy all the requirements of regularity audit in so far as the various formalities regarding rules and regulations are concerned, but may still be highly wasteful. Audit against propriety which are as under:

(1) The expenditure should not be prima-facie more than the occasion demands.

(2) No authority should exercise its powers of sanctioning expenditure to pass an order which will directly or indirectly to its own advantage.

(3) Public money should not be utilised for the benefit of particular person or section of the community.

Question 3

(a) What are the basic principles governing an audit as laid down in AAS 1 ? Explain in brief. (10 Marks)

(b) What is meant by external confirmation? Mention four situations where external confirmation may be useful for auditors. (6 Marks)

Answer

(a) Basic Principles Governing an Audit: Auditing and Assurance Standard-1 on "Basic Principles Governing an Audit" issued by the ICAI describes the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit of financial information of any entity is carried out. The basic principles as stated are as under:

(i) Integrity, Objectivity and Independence: The auditor should be honest, straightforward and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity .

(ii) Confidentiality: The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

(iii) Skills and Competence: The audit should be performed and the report should be prepared with due professional care by persons who have adequate training, experience and competence in auditing.

(iv) Work Performed by Others : When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will be entitled to rely on work performed by others provided he exercise adequate skill and care and is not aware

of any reasons to believe that he should not have so relied. The auditor should carefully direct supervise and review work delegated to assistants and obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose since he will continue to be responsible for forming and expressing his opinion on the financial information.

(v) Documentation : The auditor should document matters which are important in providing evidence that the audit was carried in accordance with the basic principles.

(vi) Planning: Planning enables the auditor to conduct an effective audit in an efficient and timely manner. Primarily, planning should be based on the knowledge of the client's business. Plans should be further developed and revised as necessary during the course of the audit.

(vii) Audit Evidence: The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

(viii) Accounting System and Internal Control: The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded and internal controls normally contribute to such assurance.

(ix) Audit Conclusion and Reporting : The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:

(1) the financial information has been prepared using acceptable accounting policies which have been consistently applied,

(2) the financial information complies with relevant regulations and statutory requirements,

(3) there is an adequate disclosure of all material matter relevance to the proper presentation of the financial information, subject to statutory requirements, where applicable.

(b) External Confirmation: The purpose of Auditing and Assurance Standard 30 is to establish standards on the auditor's use of external confirmations as a means of obtaining audit evidence.

External confirmation is the process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by management in the financial statements. The auditor should employ external confirmation procedure in consultation with management.

AAS 5 "Audit Evidence" states that in general, audit evidence from external sources is more reliable than audit evidence generated internally. Audit evidence in the form of written responses to confirmation requests received directly by the auditor from third parties who are not related to the entity being audited, when considered individually or cumulatively with audit evidence from other procedures, may assist in reducing audit risk for the related financial statement assertions to an acceptably low level.

Following are the examples of situations where external confirmation may be useful.

(i) Bank balance & other information from bankers

(ii) Account receivable balances

(iii) Stock held by third parties

(iv) Property Title Deed held by third parties

(v) Investments purchased but delivery not taken

(vi) Loan from lenders

(vii) Account payable balances

(viii) Long outstanding share application money

Question 4

How will you vouch and/or verify the following ?

(a) Goods sent on Consignment *(4 Marks)*

(b) Expenditure on Foreign Travelling. *(4 Marks)*

(c) Re-issue of Forfeited Shares *(4 Marks)*

(d) Premium paid for insurance of a Motor car. *(4 Marks)*

Answer

(a) Goods sent on consignment: Such transaction should be vouched and verified as under-

(i) Proforma invoice sent with goods.

(ii) Freight evidences given by the transporter like Challan, Bill, Receipt for freight charged.

(iii) Insurance charge to be verified from cover note and premium paid receipt issued by Insurance Company.

(iv) Account sale sent by consignee, referring to sale price of the goods sold, expenses incurred by him and stock remained unsold.

(v) Unsold goods should have been taken in the closing stock valued properly inclusive of expenses (Proportionate) incurred by consignee.

(vi) Journal entries relating to such transaction be verified from the books of the Company.

(b) Expenditure on foreign traveling: Such expenditure should be vouched on the basis of actual expenditure incurred for which the following matters should be taken into consideration.

(i) The counterfoil of the air ticket to inspect.

(ii) Visa entry on passport to be verified.

(iii) Foreign currency drawn from authorised dealers for expenses abroad to verify.

(iv) Sanctions by the Board of Directors be verified.

(v) If any advances taken against such traveling, adjustments thereof by verifying entries in the books.

(vi) To see that all vouchers for traveling expenses should be authorised by some responsible official.

(vii) Such expenditures are incurred in the interest of the business.

(c) Re- issue of forfeited shares:

(i) The auditor should ascertain that Board of Directors has the authority under the Articles to Re-issue forfeited shares. Check relevant resolution of the Board of Directors.

(ii) The auditor should 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 shares including that received prior to forfeiture, is not less than the par value.

(iii) The auditor should verify the amount of surplus resulting on the re-issue of shares rightly credited to Capital Reserve Account.

(iv) Where partly paid shares are forfeited for non-payment of calls, and are re-issued as fully paid, the re-issue is treated as an allotment at a discount. In such case, the provisions of Sec. 79 of the Companies Act would require compliance.

(d) Premium paid on Insurance of a Motor Car:

(i) Check insurance cover note issued by Insurance Company. Verify car no., period of Insurance etc.

(ii) See that "No claim Bonus" is given, where entitled, by the Insurance Company.

(iii) Ensure that proper adjustment is made for pre-paid insurance premium.

Question 5

(a) What special steps are involved in audit of a Cinema Hall? *(10 Marks)*

(b) What do you understand by Internal checks? *(6 Marks)*

Answer

(a) Special steps involved in audit of a Cinema Hall:

(i) Verify

(a) that entrance to the cinema hall is only through printed tickets;

(b) tickets are serially numbered and bound into books;

(c) that the number of tickets issues for each show and class are different;

(d) that for advance booking a separate series of tickets is issued and

(e) stock of tickets is kept in proper custody.

(ii) If tickets are issued through computer- audit the system to ensure its reliability and authenticity of data generated by it.

(iii) System should provide that at the end of each show a proper statement should be prepared and cash collected be tallied.

(iv) Cash collected is deposited in banks partly on the same day and rest on the next day – depending upon the banking facility available.

(v) Verify that proper record is kept for free passes issued and the same are issued under proper authority.

(vi) Cross check the entertainment tax deposited.

(vii) Verify the income from advertisements and slides showed before the show.

(viii) Vouch the expenditure incurred on publicity of picture, maintenance of hall, electricity expenses etc.

(ix) Vouch recoveries of advertisement expenses etc from film distributors.

(x) Vouch payment of film hire with reference to agreement with distributor or producer.

(xi) Verify the basis of other incomes earned like restaurant, car and scooter parking and display windows etc.

(xii) Confirm that depreciation on machinery and furniture has been charged at an appropriate rate which are higher, as compared to those admissible in the case of other businesses, in respect of similar assets.

(b) Internal Check: It means checks on day to day transaction which operate continuously as part of the routine system whereby the work of one person is proved independently or is complimentary to the work of another. The object of internal check is mainly prevention or early detection of fraud or error-intentional or unintentional. By employing a good system, the chances of occurrence of errors or fraud or their remaining undetected are greatly reduced. Internal check is a part of the overall internal control system and operates as a built-in-devices as far as the staff organisation and job allocation aspects of the control system are concerned. The system in accounting implies organization of system of bookkeeping and arrangement of staff in such a manner that no one person

can completely carry through a transaction and record every aspect thereof.

Therefore it is increasingly being recognised that for an audit to be effective, especially when the size of a concern is large, the existence of a system of internal check is essential. The auditor can rely on sound system of internal check and on that consideration, reduce the extent of detailed checking to be carried out by him. Scope of audit can be reduced by both the time and cost factors.

Question 6

(a) Explain the scope paragraph of auditors Report. *(8 Marks)*

(b) How the work of an expert should be evaluated before accepting the same as an Audit evidence? *(8 Marks)*

Answer

(a) Scope Paragraph Of Auditors Report (AAS 2): The auditor's report should prescribe the scope of the audit by stating that the audit was conducted in accordance with auditing standards generally accepted in India. The Auditing and Assurance Standards issued by ICAI establish the auditing standards generally accepted in India. The reader needs this is as an assurance that the audit has been carried out in accordance with such established standards. Scope means auditor's ability to perform audit procedures deemed necessary in the circumstances.

As per AAS 2 the scope of an audit of financial statement will be determined by the auditor having regard to the terms of the engagement, the requirement of relevant legislation and the pronouncements of the Institute. The terms of engagement cannot however restrict the scope of an audit in relation to matters which are prescribed by legislation or by pronouncements of the Institute.

(b) Evaluation of work of an expert: AAS-9 discusses the auditors responsibility in relation to and the procedure the auditor should consider in using the work of an expert as audit evidence. When the auditor delegates work or uses work performed by experts, he will continue to be responsible for forming and expressing his opinion on the financial information. In such cases, the auditor should obtain reasonable assurance that work performed by experts is adequate for his purpose. When the auditor intends to use the work of an expert, he should examine:-

(i) Evidence to gain knowledge regarding the terms of the expert's engagement. There should not have been placed any restriction affecting his work (under influence).

(ii) Expert's relationship with the client.

(iii) The sources of data used by him are sufficient and appropriate in the circumstances.

(iv) The assumptions and methods used and, if appropriate, their consistency with the prior period.

(v) The result of the expert's work in the light of the auditor's overall knowledge of the business and of the results of his audit procedures.

(vi) The auditor should also satisfy himself that the substance of the expert's findings is properly reflected in the financial information.

Question 7

(a) While conducting the audit of accounts of a manufacturing company, you discover that the rate of Gross Profit on Sales has sharply decreased in comparison to the previous year. State the steps you would take to satisfy yourself. (12 Marks)

(b) Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term? (4 Marks)

Answer

(a) Rate of Gross Profit on Sales: When rate of Gross Profit on Sales of a manufacturing company has sharply decreased in comparison to the previous year, the auditor should satisfy the reasons for the same. Following factors should be considered which might cause decrease in the Gross Profit of the manufacturing company:

(i) Undervaluation of closing stock or overvaluation of opening stock either due to wrong valuation of stock or mistake in stock taking .

(ii) Change in the basis of stock valuation. For example, opening stock was valued at market price above cost when closing stock valued at cost which is below the market price .

(iii) Inclusion in the current year, the amount of goods purchased in the previous year, that were received and taken in the same year.

(iv) Reversal of fictitious sale entries recorded in the previous year to boost up profit.

(v) Sales return entry passed two times or entry for purchase return has not been passed whenever goods are returned to suppliers .

(vi) Excess provision for wages or direct expenses have been made .

(vii) Goods sent out for sale on approval or on a consignment basis not included in closing stock.

(viii) Value of unusual stock of consumable stores (fuel and packing materials) are not shown as stock or not adjusted from corresponding expenses .

(ix) Expenses which should be charged in the in Profit and Loss Account but wrongly charged to the Trading Account.

(x) Insurance claim received in respect of goods lost in transit or destroyed by fire, not credited in Trading Account.

(xi) Goods sold or given as samples or destroyed, not accounted for.

(b) Removal of an auditor: Removal of an auditor before the expiry of his term requires prior approval of the Central Govt. [Section 224(7)]. This is a very stringent provision to ensure that any auditor who is inconvenient to the management cannot be removed so easily. Such a provision goes a long way to ensure independence of auditor.

Therefore law has provided this safeguard so that Central Govt. can know the real reason of auditor's removal before expiry of his term and if not satisfied with the reason, may not accord approval.

On the other hand, if the auditor has completed his term, i.e. has submitted his report and thereafter he is not re-appointed, then the matter is not serious enough for Central Govt. to call for its intervention.

In view of the above, Central Govt. permission is required when auditors are removed before expiry of their term and the same is not required when they are not re-appointed after the expiry of their term.

Question 8

Write short notes on the following :

(a) Audit Programme *(4 Marks)*

(b) Current Investments *(4 Marks)*

(c) First in First out (FIFO) method *(4 Marks)*

(d) Accounting Estimates. *(4 Marks)*

Answer

(a) Audit Programme : Audit programme is a written documents setting forth, in details, the various aspects of the proposed audit. Such programme is prepared before commencing the audit and it is updated with the progress of the audit.

Without a written and pre-determined programme, work is necessarily, to be carried out on the basis of some, 'mental' plan. In such a situation, there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, the danger insignificantly less and the audit can proceed systematically.

It serves as a guide to be carried out in the succeeding year. A properly drawn up audit programme serve as evidence in the event of any charge of negligence being brought against auditor.

Audit programme normally provide for the following:

(i) Audit procedure to be applied

(ii) Extent of check

(iii) Timing of check

(iv) Allocation of work amongst the audit team members.

(v) Special instructions based on past experience of the auditee.

Audit programme provides sufficient details to serves as a set of instruction to the team and also help to control the proper execution of work.

(b) Current Investment : It means an Investment that is by nature readily saleable & realisable and is intended to be held for not more than one year, from the date on which such investment is made.

As per AS 13, the valuation of current investment at lower of cost and fair value provides a prudent method of determining the carrying amount to be stated in the balance sheet.

Any reduction to fair value and any reversal of such reduction are to be included in the Profit & Loss Account. It is essential to disclose in financial statement the accounting policies for determination of carrying amount of investment and income therefrom. Disclosure of profit/loss on disposal of current investment and changes in carrying amount of investment is also necessary.

(c) First-In-First-Out (FIFO) Method: It is a cost formula used in assigning the cost to inventories which are ordinarily interchangeable. The FIFO formula assumes that the items of inventories which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those which have been most recently purchased or produced. This method of valuation of inventory is not applied where items of inventory are not ordinarily interchangeable.

(d) Accounting Estimates : It means an approximation of the amount of an item in absence of a precise means of measurement.

Management is responsible for making accounting estimates included in financial statements. These estimate are often made in conditions of uncertainty regarding the outcome of events that have occurred or likely to occur and involved the use of judgement. As a result, the risk of material misstatement is greater when accounting estimates are involved.

Examples:

(I) accrued revenue

(ii) provision for taxation

(iii) provision for a loss from a lawsuit

(iv) provision to allocate the cost of fixed assets over their estimated useful lives

(v) Insurer's liability for outstanding claims

(vi) provision for retirement benefits in the financial statements of employers

(vii) amortisation of certain items like goodwill and deferred revenue expenditure

PAPER – 3 : BUSINESS AND CORPORATE LAWS

Question 1

Answer any four of the following:

(a) *X, a minor was studying in M.Com. in a college. On 1st July, 2005 he took a loan of Rs. 10,000 from B for payment of his college fees and to purchase books and agreed to repay by 31st December, 2005. X possesses assets worth Rs. 2 lakhs. On due date X fails to pay back the loan to B. B now wants to recover the loan from X out of his (X's) assets. Referring to the provisions of Indian Contract Act, 1872 decide whether B would succeed.* *(5 Marks)*

(b) *A contracts to sell B, by showing sample, certain quantity of rape-seed oil described as 'foreign refined rape-seed-oil'. The oil when delivered matches with the sample, but is not foreign refined rape-seed oil. Referring to the provisions of Sale of Goods Act, 1930 advise the remedy, if any, available to B.* *(5 Marks)*

(c) *Referring the provisions of the Payment of Bonus Act, 1965, state whether the following persons are entitled to bonus under the Act:*

  (i) *An apprentice;*

  (ii) *An employee dismissed on the ground of misconduct;*

  (iii) *A temporary workman;*

  (iv) *A piece-rated worker.* *(5 Marks)*

(d) *A, B and C are partners in a firm. A introduces D to X as a partner in business. D, infact, was not a partner in the firm's business. D did not deny this statement. X advanced a loan of Rs. 20 lakhs to the firm. On firm's failure to repay the loan X wants to hold D responsible for the repayment of the above loan. Referring to the provisions of the Indian Partnership Act, 1932 decide whether X would succeed in recovering the loan from D.* *(5 Marks)*

(e) *J. a shareholder of a Company purchased for his personal use certain goods from a Mall (Departmental Store) on credit. He sent a cheque drawn on the Company's account to the Mall (Departmental Store) towards the full payment of the bills. The cheque was dishonoured by the Company's Bank. J, the shareholder of the company was neither a Director nor a person in-charge of the company. Examining the provisions of the Negotiable Instruments Act, 1881 state whether J has committed an offence under Section 138 of the Act and decide whether he (J) can be held liable for the payment, for the goods purchased from the Mall (Departmental Store).* *(5 Marks)*

(f) *Explain the provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 relating to the liability of an employer in case of transfer of the establishment to another person.* *(5 Marks)*

Answer

(a) Yes, B can proceed against the assets of X. According to section 68 of Indian Contract Act 1872 "If a person, incapable of entering into a contract, or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person." Since the loan given to X is for the necessaries suited to the conditions in life of the minor, his assets can be sued to reimburse B.

(b) B has a remedy to repudiate the contract. According to section 15 of the Sale of Goods Act, 1930, when the goods are sold by sample as well as by description, there shall be an implied condition that the goods shall correspond to the sample as well as description. In this case, A supplied refined rape oil which did correspond with the sample but was not correspond to the description of foreign refined rape-oil. Hence the B has the right to repudiate the contract.

(c) (i) An Apprentice is not entitled to bonus *[Wheel RIM Co. Vs. Govt. of Tamil Nadu (1971)]*

(ii) An employee dismissed on the ground of misconduct is disqualified for any bonus. *[Pandian Roadways Corporation Ltd. Vs. Presiding Officer (1996)]*

(iii) A temporary workman is entitled to bonus on the basis of the total number of days worked by him.

(iv) A piece-rated worker is entitled to bonus. *[Mathurads Kani Vs. L.A. Tribunal (1958)]*

(d) Yes, X can hold D responsible for the repayment of loan as he is the partner by Estopple or by holding out. Section 28(1) Indian Partnership Act, 1932 lays down this principle as follows: "Anyone who by words spoken or written or by conduct represents himself, or knowingly permits himself to be represented, to be a partner in a firm, is liable as a partner in that firm to anyone who has on the faith of any such representation given credit to the firm, whether the person represented to be a partner does or does not know that representation has reached the person so giving credit." Hence D becomes a partner by holding out as he did not deny the statement given by A. Hence D is liable to make repayment of loan.

(e) The facts of the problem are identical with the facts of a case know as *H.N.D. Mulla Feroze Vs. C.Y. Somaya julu, J(2004) 55 SCL (AP)* wherein the Andhra Pradesh High Court held that although the petitioner has an legal liability to refund the amount to the appellant, petitioner is not the drawer of the cheque, which was dishonoured and the cheque was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Hence, it was held that the petitioner J could not be said to have committed the offence under Section 138 of the Negotiable Instrument Act, 1881. Therefore X also is not liable for the cheque but legally liable for the payments for the goods.

(f) According to Section 17B of the Employee's Provident Fund and Miscellaneous Provisions Act 1952, where an employer in relation to an establishment, transfer that

establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall jointly or severely be liable to pay the contribution and other sum due from the employer under any provision of this Act of the Scheme or the pension scheme, as the case may be, in respect of the period up to the date of such transfer. The liabilities of the transferee shall be limited to the value of the assets obtained by him by such transfer. The liability of transferor and transferee in relating to all the money due under the Act or the Scheme or pension scheme in case of the transfer of the establishment.

Question 2

(a) "The relationship of principal and agent (i.e. Agency) may be constituted by subsequent ratification by the principal." Examine the validity of the statement and state the requisites of a valid ratification in the light of the provisions of the Indian Contract Act, 1872. (5 Marks)

(b) A society; registered under the Multi-state Cooperative Societies Act, 2002 intends to issue non-convertible debentures to the general public. Referring to the provisions of the Multi-state Cooperative Societies Act, 2002 state whether a society registered under the Act is empowered to do so. (5 Marks)

Answer

(a) Where an agent does an act for his principal without his knowledge or authority or where he exceeds the given authority, the principal is not held bound by the transaction so made. However, Section 196 of the Indian Contract Act, 1872, permits the principal to ratify the act of the agent. According to this section "Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratify them, the same effects will follow as if they had been performed by his authority. "Agency in such a case is said to be constituted by ratification.

To be valid, a ratification must fulfill the following conditions:

(i) The agent must purport to act an agent.

(ii) The principal must have been in existence at the time the agent originally acted.

(iii) Ratification may be expressed or implied (Section 197).

(iv) No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective (Section 198).

(v) Ratification must be of the entire transaction. A contract cannot be ratified partially (Section 199).

(vi) Ratification of unauthorized act must not injure third person. (Section 200)

(vii) An illegal act cannot be ratified.

(viii) The person ratifying the act must have contractual capacity.

(b) According to the Section 67 of the Multi-State Co-operative Societies Act, 2002, a Multi State Co-operative Society may issue non-convertible debentures to the extent of 25% of its paid up share capital for the fulfillment of its objects on such terms and conditions as are mutually contracted upon. However, the total amount of deposits and loans received during any financial year shall not exceed ten times or the sum of subscribed share capital and accumulated reserves.

Question 3

(a) Explaining the provisions of the Indian Contract Act, 1872, answer the following:

(i) A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability ?

(ii) C, the holder of an over due bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability ?

(5 Marks)

(b) "Sharing of profits is only a prima facie, not a conclusive evidence of the existence of partnership." Examine the validity of the statement in the light of the provisions of the Indian Partnership Act, 1932 and state as to how would you determine whether a group of persons does or does not constitute partnership. (5 Marks)

Answer

(a) (i) According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission for the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case the B omits to supply the timber. Hence C is discharged from his liability.

(ii) According to Section 136 of the Indian Contract Act, 1872, where a contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor, the surety is not discharged. In the given question the contract to give time to the principal debtor is made by the creditor with X who is a third person. X is not the principal debtor. Hence A is not discharged.

(b) It is true that sharing of profits of business is an essential element to constitute a partnership. But it is only a prima facie evidence but not a conclusive evidence of the existence of partnership. It is also true that the partners agree to share the profits of a business which is carried on by all or by one of them acting for all. However, the sharing of profits would not by itself make such person partner with the persons carrying on a business. Sharing of profits by the following person will not make them partners in the partnership firm:

(i) by a lender of money to persons engaged or about to engage in any business;

(ii) by a servant or agent as remuneration.

(iii) by widow or child or a deceased partner as annuity, or

(iv) by a previous owner or part owner of the business as consideration for the sale of goodwill or share thereof.

To determine whether a group of persons running a business does or does not constitute partnership, Section 6 of the India Partnership Act, 1932 has to be referred. According to Section 6 "In determining whether a group of persons is or is not firm, regard shall be had to the real relation between the parties as shown by all relevant facts taken together. It is very clear from this that in determining relationship between parties and ascertaining the existence of partnership all relevant facts such as follows are to be considered –

(i) There must be an agreement between two or more persons

(ii) There must be a business of partnership

(iii) The partners must have agreed to share the profits of business

(iv) The business must be carried on by all or any one of them acting for all. In other words there must be mutual agency between the partners. Existence of mutual agency which is the cardinal principle of partnership law, is very much helpful in reaching a conclusion in this regard. In this situation each partner is the principal as well as agent of the other partners.

Hence, in order to determine whether the relation of partnership exists between two or more persons or not, one should examine all the facts and circumstances as cited above.

Question 4

(a) Distinguish between a 'Condition' and a 'Warranty' in a contract of sale. When shall a 'breach of condition' be treated as 'breach of warranty' under the provisions of the Sale of Goods Act, 1930 ? Explain. (5 Marks)

(b) Explain the provisions of the Employees Provident fund and Miscellaneous Provisions Act, 1952 relating to the following and state:

(i) Whether the balance to the credit of Provident Fund Account of an employee is attachable by the decree of a Court ?

(ii) Whether the payment of contribution to provident fund of an employee, to be made by his employer, who has become insolvent, a preferential payment ? (5 Marks)

Answer

(a) Difference between Condition and Warranty

(i) A condition is a stipulation essential to the main purpose of the contract whereas a warranty is a stipulation collateral to the main purpose of the contract.

(ii) Breach of condition gives rise to a right to treat the contract as repudiated whereas in case of breach of warranty, the aggrieved party can claim damage only.

(iii) Breach of condition may be treated as breach of warranty whereas a breach of warranty cannot be treated as breach of condition.

According to Section 13 of the Sale of Goods Act, 1930 a breach of condition may be treated as breach of warranty in following circumstances:

(i) Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition,

(ii) Where the buyer elects to treat the breach of condition as breach of a warranty.

(iii) Where the contract of sale is non-severable and the buyer has accepted the whole goods or any part thereof.

(iv) Where the fulfillment of any condition or warranty is excused by law by reason of impossibility or otherwise.

(b) (i) According to Section 10 of Employee's Provident Fund and Miscellaneous Provisions Act 1952, the amount standing to the credit of any member in the fund or credit of any exempted employee in provident fund shall not in any way capable or, being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member on the exempted employee.

The amount standing to the credit of the aforesaid categories of persons at the time of their death and payable to their nominees under the scheme or the rules vests in nominees. And the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or the exempted employee and shall also not be liable to attachment under any decree or order of any court.

(ii) According to Section 11 of the Employee's Provident Fund and Miscellaneous Provisions Act 1952, if the employer is adjudged as insolvent or if the employer is a company and an order for winding thereof has been made, the amount due from the employer whether in respect of the employee's contribution or employer's contribution must be included among the debts which are to be paid in priority to all other debts in the distribution of the property of the insolvent or the assets of the company. In other words, this payment will be a preferential payment provided the liability thereof has accrued before this order of adjudication or winding up is made.

Question 5.

(a) B obtains A's acceptance to a bill of exchange by fraud. B endorses it to C who is a holder in due course. C endorses the bill to D who knows of the fraud. Referring to the provisions of the Negotiable Instruments Act, 1882, decide whether D can recover the money from A in the given case. (5 Marks)

(b) Explain the powers of the Board of Directors of a multi-state Cooperative Society, as conferred upon the Board under Multi-state Cooperative Societies Act, 2002. (5 Marks)

Answer

(a) Section 53 of the Negotiable Instrument Act, 1881 provides that a holder of negotiable instrument who derives title from a holder in due course has the right thereon of that holder in due course. Such holder of the bill who is not himself a party to any fraud or illegality affecting it, has all the rights of that holder in due course as regards to the acceptor and all parties to the bill prior to that holder. In this case, it is clear that though D was aware of the fraud, he was himself not a party to it. He obtained the instrument from C who was a holder in due course. So D gets a good title and can recover from A.

(b) According to Section 49(2) of the Multi-State Co-operative Societies Act, 2002, the Board of Directors may exercise the following powers:

(i) to admit member;

(ii) to interpret the organizational objectives and set up specific goals to be achieved towards these objectives;

(iii) to make periodic appraisal of operations;

(iv) to appoint and remove a Chief Executive and such other employees of the society as are not required to be appointed by the Chief Executive;

(v) to make provisions for regulating the appointment of employees of the Multi-State Co-operative Society and the scales of pay, allowances and other conditions of service of, including disciplinary action against, such employees;

(vi) to place the annual report, annual financial statements, annual plan and budget for the approval of the general body;

(vii) to consider audit and compliance report and place the same before the general body;

(viii) to acquire or dispose of immovable property;

(ix) to review membership in other co-operatives;

(x) to approve annual and supplementary budget;

(xi) to raise funds;

(xii) to sanction loans to the members; and

(xiii) to take such other measures or to do such other acts as may be prescribed or required under this Act or the by-laws or as may be delegated by the general body.

Question 6

(a) Explain the provisions of the Payment of Bonus Act, 1965 relating to 'Minimum' and 'Maximum' amount of bonus payment to an employee, for an accounting year. (5 Marks)

(b) In what ways does the Cooperative Societies Act, 1912 restricts the powers of a society registered under the Act, to make loans to its members and to borrow money the reform? can such borrowings be made by a Society from non-members also ? Explain. (5 Marks)

Answer

(a) According to the Section 10 of the Payment of Bonus Act, 1965, subject to the other provisions of the Act, every employer shall be bound to pay to every employee in respect of every accounting year, minimum bonus which shall be 8.33% of the salary or wage earned by the employee during the accounting year or Rs. 100 whichever is higher, whether or not the employer has any allocable surplus in the accounting year.

In case of an employee who has not completed 15 years of age at the beginning of accounting year, he will be entitled to a minimum bonus which shall be 8.33% of the salary or wage during the accounting year or Rs. 60/- whichever is higher.

Even if the employer suffers losses during the accounting year he is bound to pay minimum bonus as prescribed by Section 10 *[State V. Sardar Dalip Singh Majilhia (1979)]*

The maximum bonus payable to an employee in an accounting year is 20% of his salary/wages as defined under the Act.

(b) According to Section 29 of the Co-operative Societies Act, 1912, a registered society can make loan only to members, and with the general or special sanction of the Registrar, to another registered society.

A society with unlimited liability is prohibited from lending money on the security of movable property without the sanction of the Registrar. Lending of money on mortgage of immovable property by any registered society may be prohibited or restricted by the State Government.

According to Section 30 of the Act, savings of members must be accepted in preference to deposits from non-members, the section provides that deposits and loans from non-members shall be received only to such extent and under such conditions as may be prescribed by the rules or by-laws.

Question 7

Answer any four of the following:

(a) The principal business of XYZ Company Ltd. was the acquisition of vacant plots of land and to erect the houses. In the course of transacting the business, the Chairman of the Company acquired the knowledge of arranging finance for the development of land. The XYZ Company introduced a financier to another company ABC Ltd. and received an agreed fee of Rs. 2 lakhs for arranging the finance. The Memorandum of Association of the company aurhorises the company to carry on any other trade or business which can in the opinion of the board of directors, be advantageously carried on by the company in connection with the company's general business. Referring to the provisions of the Companies Act, 1956 examine the validity of the contract carried out by XYZ Company Ltd. with ABC Ltd. (5 Marks)

(b) Explain the Provisions of Companies Act, 1956 relating to the establishment of Investor Education and Protection Fund. (5 Marks)

(c) XY Ltd. has its registered office at Mumbai in the State of Maharashtra. For better administrative conveniences the company wants to shift its registered office from Mumbai to Pune (State of Maharashtra). What formalities the company has to comply with under the provisions of the Companies Act, 1956 for shifting its registered office as stated above ? Explain. (5 Marks)

(d) With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. X received copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply. X sold these shares at a heavy loss. Mr. X claims damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement. Referring to the provisions of the Companies Act, 1956 examine whether X's claim for damages is justified. (5 Marks)

(e) Explain the provisions of the Companies Act, 1956 relating to 'Resolutions requiring Special Notice'. State the resolutions that require 'Special Notice' under the Act.

(5 Marks)

Answer

(a) Under the provision of Companies Act, 1956 as contained in Section 17(1) a company is permitted to alter the objects to carry on some business which come under the existing circumstances may conveniently advantageously be combined with the existing law of the company.

In the light of the clause in the Memorandum of Association of the company which authorizes the company to carry on any other trade or business which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with the general business. Since the directors honestly believes that the transaction could be advantageously carried on an ancillary to the company's main objects, therefore, it was not ultra vires. *(Bell Houses ltd. Vs. City Wall Properties Ltd.)*

(b) Investor Education and Protection Fund (Section 205C)

Companies Act, 1956 vide Section 205C provides for the establishment of Investor Education and Protection Fund. There shall be credited to the fund the following accounts:

(i) Amounts in the unpaid dividend of the company's unclaimed for 7 years.

(ii) The application money received by companies for allotment of any securities and due forefund.

(iii) Matured deposits with companies.

(iv) Matured debentures with companies.

(v) Interest accrued on the amount stated in (i) to (iv) above.

(vi) Grants and donations given to the fund by the Central Government / State Government, companies or any other institutions for the purposes of the fund; and

(vii) Interest or other income received out of the investments made from the Fund (Section 205C(2)). The fund shall be utilized for promotion of investor awareness and protection of interest of investor in accordance with the rules as may be prescribed.

(c) According to Section 17A read with Section 146 of the Companies Act, 1956, the following procedure is to be followed by the company for shifting of the registered office of the company:

(i) A special resolution is required to be passed at a general meeting of the share holders.

(ii) Confirmation of Regional Director is to be obtained and for this company has to apply in the prescribed form.

(iii) The Regional Director shall convey his confirmation within four weeks from the date of receipt of the application.

(iv) Copy of the special resolution within 30 days and certified copy of the confirmation along with a printed copy of the altered memorandum of association must be filed with the Registrar of Companies within 2 months from the date of confirmation.

(v) Within one month of the filing, the Registrar of Companies shall certify registration, which shall be the conclusive evidence that all requirements with respect to alteration and conformation have been complied with.

(d) According to Section 62 of the Companies Act, 1956, every director, promoter and every person who is responsible for the issue of the prospectus containing false or untrue information are liable to compensate all those persons who subscribe to the shares on the faith of prospectus. It was held in the case of *Peek Vs. Gurney* that the above-mentioned remedy by way or damage will not be available to a person if he has not purchased the shares on the basis of prospectus. Since X purchased shares through the stock exchange open market which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. X will not succeed.

(e) Special Notice (Section 190)

Section 190 of the Companies Act, 1956 deals with resolutions requiring special notice. Accordingly the section provides that where under any provision contained the Company Act or in the Acts, special notice is required to be given of any resolution, notice of intention to move the resolution should be given to the company, not less than 14 days clear days before the meeting at which it is to be moved.

Special notice is required to move, besides the resolution mentioned in the Articles, the following resolutions:

(i) a resolution appointing an auditor other than the retiring one. (Section 225)

(ii) a resolution providing expressly that the retiring auditor shall not be reappointed. (Section 225)

(iii) a resolution purporting to remove a director before the expiry of his period of office. (Section 284).

(iv) a resolution to appoint another director in place of the removed director. (Section 284)

Question 8.

(a) Distinguish between 'Reduction of Share Capital' and Diminution of Share Capital'.

(5 Marks)

(b) X had applied for the allotment of 1,000 shares in a company. No allotment of shares was made to him by the company. Later on, without any further application from X, the company transferred 1,000 partly-paid shares to him and placed his name in the Register of Members. X, knowing that his name was placed in the Register of Members, took no steps to get his name removed from the Register of members. The company later on made final call. X refuses to pay for this call. Referring to the provisions of the Companies Act, 1956, examine whether his (X's) refusal to pay for the call is tenable and whether he can escape himself from the liability as a member of the company. (5 Marks)

Answer

(a) (i) Reduction of capital may be a reduction in nominal capital, subscribed capital or paid up capital whereas diminution denotes a cancellation of that portion of the issued capital which has not been subscribed [Section 94(1) (e)]

(ii) Both require authorization by Articles but reduction of capital can be effected only by a special resolution whereas diminution can be effected by an ordinary resolution.

(iii) Reduction of capital needs confirmation by the court [Section 101] whereas diminution needs no such confirmation [Section 94(2)]

(iv) In case of reduction, Court (now Tribunal) may order the company to add the words 'and reduce' after its name [Section 102(3)] but no such order can be passed in case of diminution [Section 94]

(v) In case of diminution notice is to be given to the Registrar within 30 days from the date of cancellation, whereas in the case of reduction more detailed procedure regarding notice to the Registrar has been prescribed by section 103, though there is no such time limit as aforesaid.

(b) According to Section 164 of the Companies Act, 1956, the register of member is a prima facie evidence of the truth of its contents. The contents of the register of members are of decisive importance in determining as to who were the shareholders of the company at a crucial time. Accordingly, if a person's name, to his knowledge, is there in the register, he shall be deemed to be a member. In the given case X knows that his name is included in the register of shareholders and stands by and allows his name to remain, he is holding out to the public that he is shareholder and thereby he will be liable as shareholder.

Question 9.

(a) DJA Company Ltd. has only 50 preference shareholders. A meeting of the preference shareholders was called by the company for amending the terms of these shares. Mr. A, was the only preference shareholder who attended the meeting. He, however, held proxies from all other shareholders. He took the Chair, conducted the meeting and passed a resolution for amending the terms of the issue of these shares. Referring to the provisions of the Companies Act, 1956, examine the validity of the meeting and the resolution passed thereat. (5 Marks)

(b) Who are entitled to get notice for the general meeting called by a Public Limited Company registered under the Companies Act, 1956 ? Does the non-receipt of a notice of the meeting by any one entitled to such notice invalidate the meeting and the resolution passed thereat ? What would be your answer in case the omission to give notice to a member is only accidental omission ? (5 Marks)

Answer

(a) This question was decided in *Sharp Vs., Dawes* case which provides that "The word meeting prima facie means coming together of more than one person." In this given case, only one shareholder present. This was not a meeting within the meaning of the Companies Act, 1956. According to Section 174 another requirement of valid meeting is the presence of a required quorum. Moreover, the section also says that "the members actually present shall be the quorum." The presence of one member may not be enough. This was not a valid meeting.

In *East Vs. Bennet Brothers Ltd. (1911)* it has been held that in case of a class meeting of all the shares of a particular class are held by one person, one person shall form the quorum. In the given case, since all the shares are not held by one person, no quorum is therefore present. The meeting and the resolution passed there shall not be valid.

(b) Notice of meeting shall be given -

(i) to every member of the company;

(ii) to the persons entitled to a share in consequence of the death or insolvency of a member;

(iii) to a auditor or auditors [Section 172(2)] and,

The company cannot take notice of the beneficial owners of shares who are, therefore, not entitled to notice, where, however, anyone is legally entitled to represent the members, such representative is entitled to receive the notice.

The private company, which is not, a subsidiary of a public company may prescribe, by its articles, persons to whom the notice should be given.

The non-receipt of notice or accidental omission go given notice to any member shall not invalidate the proceedings in the meeting [Section 172(3)]. However, omission to serve notice of meeting on a member on the mistaken ground that he is not a shareholder cannot be said to be an accidental omission. Accidental omission means that the

omission must be not only designed but also not deliberate. *[Maharaja Export Vs. Apparels Exports Promotion Council (1986)].*

Question 10.

(a) When is an expert not liable for untrue statements in the prospectus issued by a company ? (5 Marks)

(b) Referring to the provisions of the Companies Act, 1956 state the mattes relating to 'Ordinary Business' which may be transacted at the Annual General Meeting of a Company. What kinds of resolutions need to be passed to transact the 'ordinary Business' and the 'Special Business' at the Annual General Meeting of the Company ? Explain. (5 Marks)

Answer

(a) According to Section 62(3) of the Companies Act, 1956, an expert who would be liable by reason of having given his consent under Section 58 to the issue of the prospectus containing a statement made by him wouldn't be liable if he can prove:

(i) that having given his consent to the issue of the prospectus, withdrew it in writing before the delivery of a copy of the prospectus for registration, or

(ii) that after the delivery of a copy of the prospectus for registration but before allotment, he on becoming aware of the untrue statement withdrew his consent in writing and gave reasonable public notice thereof and the reasons therefore; or

(iii) that he was competent to make the statement and he had reasonable ground to believe, and did up to the time of allotment of the shares and debentures believe that the statement was true.

(b) Ordinary Business (Section 173)

In accordance with the provision of Companies Act, 1956 as contained in Section 172, the business to be transacted at an annual general meeting may comprise of:

(i) Ordinary Business: which relate to the following matters:

(a) Consideration of accounts, balance sheet and the report of the Board of Directors and auditors.

(b) Declaration of dividend.

(c) Appointment of Directors in place of those retiring; and

(d) Appointment of auditors and fixation of their remuneration.

(ii) Special Business: Any other business scheduled to be transacted at the meeting shall be deemed to be special business.

Ordinary business can be passed by an ordinary resolution. However, special business may be transacted either by passing ordinary resolution or special resolution, depending upon the requirements of Companies Act, 1956.

PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

Question No. 1 and 6 are compulsory.

Answer any three questions from the rest.

Working notes should form part of the answer wherever appropriate, suitable assumptions should be made.

Question 1

(a) *ABC Ltd. Manufactures two types of machinery equipments Y and Z and applies/absorbs overheads on the basis of direct-labour hours. The budgeted overheads and direct-labour hours for the month of December, 2006 are Rs. 12,42,500 and 20,000 hours respectively. The information about Company's products is as follows:*

	Equipment Y	*Equipment Z*
Budgeted Production volume	*2,500 units*	*3,125 units*
Direct material cost	*Rs. 300 per unit*	*Rs. 450 per unit*
Direct labour cost		
Y : 3 hours @ Rs. 150 per hour		
X : 4 hours @ Rs. 150 per hour	*Rs. 450*	*Rs. 600*

ABC Ltd.'s overheads of Rs. 12,42,500 can be identified with three major activities:

Order Processing (Rs. 2,10,000), machine processing (Rs. 8,75,000), and product inspection (Rs. 1,57,500). These activities are driven by number of orders processed, machine hours worked, and inspection hours, respectively. The data relevant to these activities is as follows:

	Orders processed	*Machine hours worked*	*Inspection hours*
Y	*350*	*23,000*	*4,000*
Z	*250*	*27,000*	*11,000*
Total	*600*	*50,000*	*15,000*

Required:

(i) *Assuming use of direct-labour hours to absorb/apply overheads to production, compute the unit manufacturing cost of the equipments Y and Z, if the budgeted manufacturing volume is attained.*

(ii) *Assuming use of activity-based costing, compute the unit manufacturing costs of the equipments Y and Z, if the budgeted manufacturing volume is achieved.*

(iii) *ABC Ltd.'s selling prices are based heavily on cost. By using direct-labour hours as an application base, calculate the amount of cost distortion (under-costed or over-costed) for each equipment.*

(iv) Discuss, how an activity-based costing might benefit ABC Ltd.

(b) Discuss the use of perpetual inventory records and continuous stock verification, and its advantages.

(c) Discuss the various reports provided by Cost Accounting Department.

(10 + 4 + 4 = 18 Marks)

Answer

(a) (i) Overheads application base: Direct labour hours

	Equipment Y	*Equipment Z*
	Rs.	*Rs.*
Direct material cost	300	450
Direct labour cost	450	600
Overheads*	186.38	248.50
	936.38	1,298.50

$$\text{*Pre-determined rate} = \frac{\text{Budgeted overheads}}{\text{Budgeted direct labour hours}}$$

$$= \frac{\text{Rs.}\,12,42,500}{20,000\ \text{hours}} = \text{Rs.}\,62.125$$

(ii) Estimation of Cost-Driver rate

Activity	*Overhead cost*	*Cost-driver level*	*Cost driver rate*
	Rs.		*Rs.*
Order processing	2,10,000	600 Orders processed	350
Machine processing	8,75,000	50,000 Machine hours	17.50
Inspection	1,57,500	15,000 Inspection hours	10.50

	Equipment Y	*Equipment Z*
	Rs.	*Rs.*
Direct material cost	300	450
Direct labour cost	450	600
Prime cost	750	1,050

Overhead cost		
Order processing 350 : 250	1,22,500	87,500
Machine processing 23,000 : 27,000	4,02,500	4,72,500
Inspection 4,000 : 11,000	42,000	1,15,500
Total overhead cost	5,67,000	6,75,500
Per unit cost		
= 5,67,000/2,500	226.80	Rs. 216.16
= 6,75,500/3,125		
Unit manufacturing cost	Rs. 976.80	Rs. 1,266.16

(iii)

	Equipment Y	*Equipment Z*
	Rs.	*Rs.*
Unit manufacturing cost–using direct labour hours as an application base	936.38	Rs. 1,298.50
Unit manufacturing cost–using activity based costing	976.80	Rs. 1,266.16
Cost distortion	(–)40.42	(+)32.34

Low volume product Y is under-costed and high volume product Z is over-costed using direct labour hours as a basis for overheads absorption. It is due to the limitation of traditional costing system.

(iv) Activity-based costing system is suitable in case of ABC Ltd because it is a multi-product company and overheads costs are substantial portion of total cost. The use of activity based costing will avoid cost distortion as ABC Ltd has a large proportion of non-unit-level activities such as orders processed and inspection hours.

(b) Use of perpetual inventory records and continuous stock verification: Perpetual inventory represents a system of records maintained by the stores department. These are Bin cards and Stores ledger.

Bin Card is a quantitative record of receipt, issue and closing balance of each item of stores. Separate bin cards are maintained for each item. Each card is filled up with physical movement of goods i.e. on receipt and issue.

Stores Ledger is quantitative and value record of receipt, issue and closing balance of each item of stores. It is filled with the help of goods received note and material issue requisitions.

A perpetual inventory is usually checked by a programme of continuous stock taking. Continuous stock taking means physical checking of those records with actual stock.

Advantages of perpetual inventory

(1) Physical stocks can be counted and book balances adjusted as and when desired without waiting for entire stock taking to be done.

(2) Quick compilation of Profit and Loss Account due to prompt availability of stock figures.

(3) Discrepancies are easily located and thus corrective action can be promptly taken.

(4) A systematic review of the perpetual inventory reveals the existence of surplus, dormant, obsolete and slow moving materials, so that remedial measures may be taken in time.

(5) Fixation of various stock levels and checking of actual balance in hand.

(c) Various reports provided by Cost Accounting Department

(i) Cost sheet setting out the total cost, analysed into various elements.

(ii) Consumption of material statements.

(iii) Labour utilization statements.

(iv) Overheads incurred compared with the budget and overheads actually charged to production.

(v) Sales effected compared with budgets.

(vi) Reconciliation of actual profits earned with budgeted profits.

(vii) The total cost of abnormally spoiled work in factory and abnormal losses.

(viii) Labour turnover, cost of recruitment and training new employees.

(ix) Expenses incurred on R & D as compared with those budgeted.

Question 2

A Chemical Company carries on production operation in two processes. The material first pass through Process I, where Product 'A' is produced.

Following data are given for the month just ended:

Material input quantity	*2,00,000 kgs.*
Opening work-in-progress quantity (Material 100% and conversion 50% complete)	*40,000 kgs.*
Work completed quantity	*1,60,000 kgs.*
Closing work-in-progress quantity (Material 100% and conversion two-third complete)	*30,000 kgs.*
Material input cost	*Rs. 75,000*
Processing cost	*Rs. 1,02,000*

Opening work-in-progress cost

Material cost	*Rs. 20,000*
Processing cost	*Rs. 12,000*

Normal process loss in quantity may be assumed to be 20% of material input. It has no realisable value.

Any quantity of Product 'A' can be sold for Rs. 1.60 per kg.

Alternatively, it can be transferred to Process II for further processing and then sold as Product 'AX' for Rs. 2 per kg. Further materials are added in Process II, which yield two kgs. of product 'AX' for every kg. of Product 'A' of Process I.

Of the 1,60,000 kgs. per month of work completed in Process I, 40,000 kgs are sold as Product 'A' and 1,20,000 kgs. are passed through Process II for sale as Product 'AX'. Process II has facilities to handle upto 1,60,000 kgs. of Product 'A' per month, if required.

The monthly costs incurred in Process II (other than the cost of Product 'A') are:

	1,20,000 kgs. of Product 'A' input	*1,60,000 kgs. of Product 'A' input*
	Rs.	*Rs.*
Materials Cost	*1,32,000*	*1,76,000*
Processing Costs	*1,20,000*	*1,40,000*

Required:

(i) Determine, using the weighted average cost method, the cost per kg. of Product 'A' in Process I and value of both work completed and closing work-in-progress for the month just ended.

(ii) Is it worthwhile processing 1,20,000 kgs. of Product 'A' further?

(iii) Calculate the minimum acceptable selling price per kg., if a potential buyer could be found for additional output of Product 'AX' that could be produced with the remaining Product 'A' quantity. *(6 + 4 + 4 = 14 Marks)*

Answer

(i)

Process I

Statement of equivalent production

Inputs		Output		Equivalent output			
Particulars	Units	Particulars	Units	Material		Conversion	
	Kg.		*Kg.*	*%*	*Unit kg.*	*%*	*Units kg.*
Opening W.I.P.	40,000	Normal loss	40,000	–	–	–	–
New material introduced	2,00,000	Units introduced & completed	1,60,000	100%	1,60,000	100%	1,60,000
		Abnormal loss	10,000	100%	10,000	100%	10,000
		Closing WIP	30,000	100%	30,000	2/3rd	20,000
	2,40,000		2,40,000		2,00,000		1,90,000

Process I
Statement of cost for each element

Elements of cost	Costs of opening WIP	Costs in process	Total cost	Equivalent units	Cost/Unit (Kg.)
	Rs.	*Rs.*	*Rs.*	*Kg.*	*Rs.*
Material	20,000	75,000	95,000	2,00,000	0.475
Conversion cost	12,000	1,02,000	1,14,000	1,90,000	0.600
	32,000	1,77,000	2,09,000		1.075

Statement of apportionment of cost

Units completed	Elements	Equivalent units	Cost/unit	Cost	Total cost
			Rs.	*Rs.*	*Rs.*
Work completed	Material	1,60,000	.475	76,000	
	Conversion	1,60,000	.600	96,000	1,72,000
Closing WIP	Material	30,000	.475	14,250	
	Conversion	20,000	.600	12,000	26,250

(ii) Statement showing comparative data to decide whether 1,20,000 kg. of product 'A' should be processed further into 'AX'.

Alternative I – To sell product 'A' after Process – I		*Rs.*
Sales 1,20,000 × 1.60		1,92,000
Less: Cost from Process I 1,20,000 × 1.075		1,29,000
Gain		63,000
Alternative II – Process further into 'AX'		
Sales 2,40,000 × 2.00		4,80,000
Less:Cost from Process I 1,20,000 × 1.075 =	Rs. 1,29,000	
Material in Process II	= Rs. 1,32,000	
Processing cost in Process II	= Rs. 1,20,000	3,81,000
Gain		99,000
Hence company should process further		
It will increase profit by 99,000 – 63,000 =	Rs. 36,000	

(iii) Calculation of minimum selling price/kg:

Cost of processing remaining 40,000 kg. further	*Rs.*
Material 1,76,000 − 1,32,000	44,000
Processing cost 1,40,000 – 1,20,000	20,000
Cost from process I relating to 40,000 kg. 'A' (40,000 × 1.075)	43,000
Benefit foregone if 40,000 kg. 'A' are further processed	
40,000 (1.60 – 1.075)	21,000
Total cost	1,28,000
Additional quantity of product 'AX' (40,000 × 2)	80,000
∴ Minimum selling price $\left(\frac{1,28,000}{80,000}\right)$ =	Rs. 1.60

Question 3

(a) A Manufacturing Company has an installed capacity of 1,50,000 units per annum. Its cost structure is given below:

		Rs.
(i)	*Variable cost per unit*	
	Materials	*10*
	Labour (subject to a minimum of Rs. 1,00,000 per month)	*10*
	Overheads	*4*
(ii)	*Fixed overheads per annum*	*1,92,300*
(iii)	*Semi-variable overheads per annum at 75% capacity (It will increase by Rs. 4,000 per annum for increase of every 5% of the capacity utilisation or any part thereof)*	*60,000*

The capacity utilisation for the next year is budgeted at 75% for first three months, 80% for the next six months and 90% for the remaining three months.

Required:

If the company is planning to have a profit of 20% on the selling price, calculate the selling price per unit for the next year.

(b) Discuss briefly the principles to be followed while taking credit for profits on incomplete contracts. *(10 + 4 = 14 Marks)*

Answer

(a) Working Notes:

(i) Installed capacity per month $\frac{1,50,000}{12}$ =12,500 units

(ii)

Capacity utilisation	75%	80%	90%
Production per month (units)	9,375	10,000	11,250
Total production (units)	3×9,375 = 28,125	10,000 ×6 = 60,000	11,250 ×3 = 33,750
Total	1,21,875 units		

(iii) Calculation of labour cost:

Capacity	75%	80%	90%
Production per month (units)	9,375	10,000	11,250
Labour @ 10 (subject to minimum 1,00,000)	93,750 i.e. minimum 1,00,000	1,00,000	1,12,500
Total labour cost	3×1,00,000 = 3,00,000	6 ×1,00,000 = 6,00,000	3 ×1,12,500 = 3,37,500
Total	Rs 12,37,500		

(iv) Calculation of semi variable overheads:

	75%	80%	90%
Semi variable Overhead per month	$\frac{60,000}{12}$ = 5,000	$\frac{60,000+4,000}{12}$ = 5333.66	$\frac{60,000+12,000}{12}$ = 6,000
Total Semi-variable Overhead	3×5,000 = 15,000	6 ×5333.66 = 32,000	3 ×6,000 = 18,000

Total Rs. 65,000

Calculation of selling price per unit:

	Rs.
Material costs 1,21,875 @ 10	12,18,750
Labour cost	12,37,500
Overheads 1,21,875 @ 4	4,87,500

Semi-variable Overheads	65,000
Fixed Overheads	1,92,300
Total cost	32,01,050
Profit 20% on selling price i.e., 25% on cost	8,00,262.50
Sales	40,01,312.50
Selling price/unit = $\frac{40,01,312.50}{1,21,875}$	Rs. 32.83

(b) The following are the principles to be followed in taking credit for profit on incomplete contracts:

(i) If the contract is less than one-fourth complete, no profit to be taken to Profit and Loss Account of the year. The notional profit, if any, arising in the contract will be treated as Reserve.

(ii) If the contract is more than one-fourth complete but not more than half complete, the profit to be carried to the Profit and Loss Account of the year is computed as under:

$$\frac{1}{3} \times \text{Notional profit} \times \frac{\text{Cash received}}{\text{Work certified}}$$

The balance to be carried to Reserve.

(iii) If the contract is more than half complete but not almost complete, the profit to be carried to the Profit and Loss Account of the year is computed as under:

$$\frac{2}{3} \times \text{Notional profit} \times \frac{\text{Cash received}}{\text{Work certified}}$$

The balance to be treated as Reserve.

(iv) If the contract is almost compete, say 90% and above, the profit on completion is estimated as under:

Cost of work certified	XXX
Cost of work not certified	XXX
Estimated costs to complete the contract	XXX
Total	A
Contract Price	B
Estimated profit on completion =	A – B

The profit to be taken to Profit and Loss Account is

$$\text{Estimated profit on completion} \times \frac{\text{Work certified}}{\text{Contract price}} \times \frac{\text{Cash received}}{\text{Work certified}}$$

(v) If there is a loss in any year, it is to be written off to Profit and Loss Account of the year.

Question 4

(a) Distinguish between any two of the following:

(i) Cost control and Cost reduction.

(ii) Controllable costs and Uncontrollable costs.

(iii) Absolute ton-kms and Commercial ton-kms.

(b) PQR Ltd., manufactures a special product, which requires 'ZED'. The following particulars were collected for the year 2005-06:

(i)	*Monthly demand of Zed*	*:*	*7,500 units*
(ii)	*Cost of placing an order*	*:*	*Rs. 500*
(iii)	*Re-order period*	*:*	*5 to 8 weeks*
(iv)	*Cost per unit*	*:*	*Rs. 60*
(v)	*Carrying cost % p.a.*	*:*	*10%*
(vi)	*Normal usage*	*:*	*500 units per week*
(vii)	*Minimum usage*	*:*	*250 units per week*
(viii)	*Maximum usage*	*:*	*750 units per week*

Required:

(i) Re-order quantity.

(ii) Re-order level.

(iii) Minimum stock level.

(iv) Maximum stock level.

(v) Average stock level. *(4 + 10 = 14 Marks)*

Answer

(a) (i) Cost control involves pre-determination of targeted costs, measuring the actual costs, investigating into the causes of variations between the two and instituting the corrective action, whereas cost reduction is achievement of real and permanent reduction in the unit cost of goods manufactured or services rendered without impairing their suitability or diminution in the quality of product. Cost reduction involves saving in unit cost; such saving is of permanent nature and the utility and quality of the goods and services remain un-affected.

(ii) Controllable costs are the costs which can be influenced by the action of a specified member of an undertaking. Controllable cots incurred in a particular Responsibility centre can be influenced by the action of the executive heading that Responsibility centre.

Uncontrollable costs are those costs which cannot be influenced by the action of a specified member of an undertaking. The distinction between controllable and uncontrollable cots is not very sharp and is sometimes left to individual judgement. In fact, no cost is controllable; it is only in relation to a particular individual that we may specify a particular cost to be either controllable or non-controllable.

(iii) Absolute tones-kms are the sum total of tones-kms arrived at by multiplying various distances by respective load quantities carried.

Commercial tones-kms are arrived at by multiplying total distance kms by average load quantity.

(b) (i) $\text{Re - order quantity} = \sqrt{\frac{2AO}{C \times i}}$

$$= \sqrt{\frac{2 \times 7,500 \times 12 \times 500}{60 \times 10}}$$

= 3,873 units

(ii) Re-order level

= Maximum re-order period × Maximum usage

$= 8 \text{ weeks} \times 750 \text{ units per week}$

= 6,000 units

(iii) Minimum stock level

= Re-order level – {Normal usage × Average reorder period}

= 6,000 – (500 × 6.5)

= 2,750 units

(iv) Maximum stock level

= Re-order level + Re-order quantity – (Minimum usage × Minimum re-order period)

= 6,000 + 3,873 – (5 × 250)

= 8,623 units

(v) Average stock level

= ½ (Minimum stock level + Maximum stock level)

= ½ (2,750 + 8,623)

= 5,687 units

Question 5

(a) RST Ltd. has two production departments: Machining and Finishing. There are three service departments: Human Resource (HR), Maintenance and Design. The budgeted

costs in these service departments are as follows:

	HR	*Maintenance*	*Design*
	Rs.	*Rs.*	*Rs.*
Variable	*1,00,000*	*1,60,000*	*1,00,000*
Fixed	*4,00,000*	*3,00,000*	*6,00,000*
	5,00,000	*4,60,000*	*7,00,000*

The usage of these Service Departments' output during the year just completed is as follows:

Provision of Service Output (in hours of service)

	Providers of Service		
Users of Service	*HR*	*Maintenance*	*Design*
HR	–	–	–
Maintenance	*500*	–	–
Design	*500*	*500*	–
Machining	*4,000*	*3,500*	*4,500*
Finishing	*5,000*	*4,000*	*1,500*
Total	*10,000*	*8,000*	*6,000*

Required:

(i) Use the direct method to re-apportion RST Ltd.'s service department cost to its production departments.

(ii) Determine the proper sequence to use in re-apportioning the firm's service department cost by step-down method.

(iii) Use the step-down method to reapportion the firm's service department cost.

(b) What are the essential pre-requisites of integrated accounting system? Discuss.

(c) What are the advantages of inter-firm comparison system? Discuss.

(7 + 3 + 4 = 14 Marks)

Answer

(a) (i) Apportionment of Service Department Overheads amongst production departments using Direct Method:

	Production Deptts.		Service Deptts.		
	Machining	*Finishing*	*HR*	*Maintenance*	*Design*
	Rs.	Rs.	Rs.	Rs.	Rs.
Overhead as per primary distribution			5,00,000	4,60,000	7,00,000

Apportionment design 4,500 : 1,500	5,25,000	1,75,000
Maintenance 3,500 : 4,000	2,14,667	2,45,333
HR 4,000 : 5,000	2,22,222	2,77,778
	9,61,889	6,98,111

(ii) The proper sequence for apportionment of service department overheads is

First	HR
Second	Maintenance
Third	Design

The sequence has been laid down based on service provided.

(iii) Apportionment of Service Department overheads amongst production departments using step-down method.

	Production Department		Service Department		
	Machining	*Finishing*	*HR*	*Maintenance*	*Design*
	Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*
Overhead as per primary distribution	–	–	5,00,000	4,60,000	7,00,000
Apportionment HRD 4 : 5 : – : 0.5 : 0.5	2,00,000	2,50,000	(–)5,00,000	25,000	25,000
Maintenance 7 : 8: –: 1	2,12,188	2,42,500	–	(–)4,85,000	30,312
Design 3 : 1	5,66,484	1,88,828	–	–	(–)7,55,312
	9,78,672	6,81,328			

(b) Estimated Pre-requisites for integrated accounts:

(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.

(c) Advantages of inter-firm comparison:

(i) Such a comparison gives an overall view of the industry as a whole to its members

– the present position of industry, progress made during the past and future of the industry.

(ii) It helps a concern in knowing its strengths or weaknesses in relation to others so that remedial measures may be taken.

(iii) It ensures an unbiased specialized reporting on particular problems of the concern.

(iv) It develops cost consciousness among members of industry.

(v) It helps Government in effecting price regulation.

(vi) It helps to improve the quality of products manufactured and to reduce the cost of production. It is thus, advantageous to the industry as well as to the society.

Question 6

(a) A proforma cost sheet of a Company provides the following particulars:

	Amount per unit (Rs.)
Raw materials cost	*100*
Direct labour cost	*37.50*
Overheads cost	*75*
Total cost	*212.50*
Profit	*37.50*
Selling Price	*250*

The Company keeps raw material in stock, on an average for one month; work-in-progress, on an average for one week; and finished goods in stock, on an average for two weeks.

The credit allowed by suppliers is three weeks and company allows four weeks credit to its debtors. The lag in payment of wages is one week and lag in payment of overhead expenses is two weeks.

The Company sells one-fifth of the output against cash and maintains cash-in-hand and at bank put together at Rs.37,500.

Required:

Prepare a statement showing estimate of Working Capital needed to finance an activity level of 1,30,000 units of production. Assume that production is carried on evenly throughout the year, and wages and overheads accrue similarly. Work-in-progress stock is 80% complete in all respects.

(b) Discuss the conflicts in Profit versus Wealth maximization principle of the Firm.

(12 + 4 = 16 marks)

Answer

(a) Activity level: 1,30,000 units

Statement showing Estimate of Working Capital Needs

A.	Investment in Inventory:		
	Raw material inventory: 1 month $\left(1,30,000 \times \frac{4}{52} \times \text{Rs.}100\right)^{*}$		10,00,000
	WIP Inventory : 1 week $\left(1,30,000 \times \frac{1}{52} \times 0.80 \times 212.50\right)$		4,25,000
	Finished goods inventory: 2 weeks $\left(1,30,000 \times \frac{2}{52} \times 212.50\right)$		10,62,500
B.	Investment in Debtors: 4 weeks at cost $\left(1,30,000 \times \frac{4}{5} \times \frac{4}{52} \times 212.50\right)$		17,00,000
C.	Cash balance		37,500
D.	Investment in Current Assets (A + B + C)		42,25,000
E.	Current Liabilities:		
	Creditors : 3 weeks $\left(1,30,000 \times \frac{3}{52} \times 100\right)$	7,50,000	
	Deferred wages : 1 week $\left(1,30,000 \times \frac{1}{52} \times 37.50\right)$	93,750	
	Deferred overheads : 2 weeks $\left(1,30,000 \times \frac{2}{52} \times 75\right)$	3,75,000	12,18,750
	Net Working Capital Needs		30,06,250

** For calculation purposes, 4 weeks has been considered as equivalent to a month.*

(b) The company may pursue profit maximisation goal but that may not result into creation of shareholder value. The profits will be maximized if company grows through diversification and expansion. But all growth may not be profitable. Only that growth is profitable where

ROA > WACC or ROE > K_E or Firms invest in positive NPV profits.

However, profit maximisation cannot be the sole objective of a company. It is at best a limited objective. If profit is given undue importance, a number of problems can arise like the term profit is vague, profit maximisation has to be attempted with a realisation of risks involved, it does not take into account the time pattern of returns and as an objective it is too narrow.

Whereas, on the other hand, wealth maximisation, as an objective, means that the company is using its resources in a good manner. If the share value is to stay high, the company has to reduce its costs and use the resources properly. If the company follows the goal of wealth maximisation, it means that the company will promote only those policies that will lead to an efficient allocation of resources.

Question 7

(a) A Company had the following Balance Sheet as on March 31, 2006:

Liabilities and Equity	*Rs. (in crores)*	*Assets*	*Rs. (in crores)*
Equity Share Capital		*Fixed Assets (Net)*	*25*
(one crore shares of Rs. 10 each)	*10*	*Current Assets*	*15*
Reserves and Surplus	*2*		
15% Debentures	*20*		
Current Liabilities	*8*		
	40		*40*

The additional information given is as under:

Fixed Costs per annum (excluding interest)	*Rs. 8 crores*
Variable operating costs ratio	*65%*
Total Assets turnover ratio	*2.5*
Income-tax rate	*40%*

Required:

Calculate the following and comment:

(i) Earnings per share

(ii) Operating Leverage

(iii) Financial Leverage

(iv) Combined Leverage.

(b) Discuss the need for social cost benefit analysis. *(8 + 4 =12 Marks)*

Answer

(a) Total Assets = Rs. 40 crores

Total Asset Turnover Ratio = 2.5

Hence, Total Sales = 40 × 2.5 = Rs. 100 crores

Computation of Profits after Tax (PAT)

	(Rs. in crores)
Sales	100
Less: Variable operating cost @ 65%	65
Contribution	35
Less: Fixed cost (other than Interest)	8
EBIT	27
Less: Interest on debentures (15% × 20)	3
PBT	24
Less: Tax 40%	9.6
PAT	14.4

(i) Earnings per share

$$\therefore \text{EPS} = \frac{\text{Rs. } 14.4 \text{ crores}}{1 \text{ crore equity shares}} = \text{Rs. } 14.40$$

(ii) Operating Leverage

$$\text{Operating leverage} = \frac{\text{Contribution}}{\text{EBIT}} = \frac{35}{27} = 1.296$$

It indicates the choice of technology and fixed cost in cost structure. It is level specific. When firm operates beyond operating break-even level, then operating leverage is low. It indicates sensitivity of earnings before interest and tax (EBIT) to change in sales at a particular level.

(iii) Financial Leverage

$$\text{Financial Leverage} = \frac{\text{EBIT}}{\text{PBT}} = \frac{27}{24} = 1.125$$

The financial leverage is very comfortable since the debt service obligation is small vis-à-vis EBIT.

(iv) Combined Leverage

$$\text{Combined Leverage} = \frac{\text{Contribution}}{\text{EBIT}} \times \frac{\text{EBIT}}{\text{PBT}}$$

$$= 1.296 \times 1.125$$

$$= 1.458$$

The combined leverage studies the choice of fixed cost in cost structure and choice of debt in capital structure. It studies how sensitive the change in EPS is vis-à-vis change in sales.

The leverages – operating, financial and combined are measures of risk.

(b) Need for Social Cost Benefit Analysis (SCBA)

Several hundred crores of rupees are committed every year to various public projects. Analysis of such projects has to be done with reference to social costs and benefits, since they cannot be expected to yield an adequate commercial return on the funds employed, at least during the short run.

Social cost benefit analysis is important for the private corporations also who have a moral responsibility to undertake socially desirable projects.

The need for social cost benefit analysis arises due to the following:

(i) Market prices are used to measure costs and benefits in project analysis; they do not represent social values due to imperfections in the market.

(ii) Monetary cost benefit analysis fails to consider the external effects of the project. The external effects can be positive like development of infrastructure or negative like pollution and imbalance in environment.

(iii) Taxes and subsidies are transfer payments and hence ignored in social benefit cost analysis.

(iv) The SCBA is essential for measuring the redistribution effect of benefits of project, as benefits going to poorer section are more important than going to sections which are economically better off.

(v) Projects manufacturing tobacco products are not distinguished from those generating power or producing necessities of life. Thus merit wants are important appraisal criterion for SCBA.

Question 8

(a) Discuss the financial ratios for evaluating company performance on operating efficiency and liquidity position aspects.

(b) Company UVW has to make a choice between two identical machines, in terms of Capacity, 'A' and 'B'. They have been designed differently, but do exactly the same job.

Machine 'A' costs Rs. 7,50,000 and will last for three years. It costs Rs. 2,00,000 per year to run.

Machine 'B' is an economy model costing only Rs. 5,00,000, but will last for only two years. It costs Rs. 3,00,000 per year to run.

The cash flows of Machine 'A' and 'B' are real cash flows. The costs are forecasted in rupees of constant purchasing power. Ignore taxes. The opportunity cost of capital is 9%.

Required:

Which machine the company UVW should buy?

The present value (PV) factors at 9% are:

Year	t_1	t_2	t_3
$PVIF_{0.09.t}$	*0.9174*	*0.8417*	*0.7722*

(4 + 8 = 12 Marks)

Answer

(a) Financial ratios for evaluating performance on operational efficiency and liquidity position aspects are discussed as:

Operating Efficiency: Ratio analysis throws light on the degree of efficiency in the management and utilization of its assets. The various activity ratios (such as turnover ratios) measure this kind of operational efficiency. These ratios are employed to evaluate the efficiency with which the firm manages and utilises its assets. These ratios usually indicate the frequency of sales with respect to its assets. These assets may be capital assets or working capital or average inventory. In fact, the solvency of a firm is, in the ultimate analysis, dependent upon the sales revenues generated by use of its assets – total as well as its components.

Liquidity Position: With the help of ratio analysis, one can draw conclusions regarding liquidity position of a firm. The liquidity position of a firm would be satisfactory, if it is able to meet its current obligations when they become due. Inability to pay-off short-term liabilities affects its credibility as well as its credit rating. Continuous default on the part of the business leads to commercial bankruptcy. Eventually such commercial bankruptcy may lead to its sickness and dissolution. Liquidity ratios are current ratio, liquid ratio and cash to current liability ratio. These ratios are particularly useful in credit analysis by banks and other suppliers of short-term loans.

(b) Statement Showing the Evaluation of Two Machines

	Machines	*A*	*B*
(i)	Purchase Cost	Rs. 7,50,000	Rs. 5,00,000
(ii)	Life of Machine	3 years	2 years
(iii)	Running Cost of Machine per year	Rs. 2,00,000	Rs. 3,00,000
(iv)	PVIFA 0.09,3	2.5313	
	PVIFA 0.09, 2		1.7591
(v)	PV of Running Cost of Machine	Rs. 5,06,260	Rs. 5,27,730
(vi)	Cash outflows of Machine {(i) + (v)}	Rs. 12,56,260	Rs. 10,27,730
(vii)	Equivalent PV of Annual Cash outflow (vi/iv)	Rs. 4,96,290	Rs. 5,84,236

Recommendation: Company UVW should buy Machine 'A' since equivalent annual cash outflow is less than that of Machine B.

Question 9

(a) Discuss the dividend-price approach, and earnings price approach to estimate cost of equity capital.

(b) From the information contained in Income Statement and Balance Sheet of 'A' Ltd., prepare Cash Flow Statement:

Income Statement for the year ended March 31, 2006

		Rs.
Net Sales	(A)	2,52,00,000
Less:		
Cash Cost of Sales		1,98,00,000
Depreciation		6,00,000
Salaries and Wages		24,00,000
Operating Expenses		8,00,000
Provision for Taxation		8,80,000
	(B)	2,44,80,000
Net Operating Profit (A – B)		7,20,000
Non-recurring Income – Profits on sale of equipment		1,20,000
		8,40,000
Retained earnings and profits brought forward		15,18,000
		23,58,000
Dividends declared and paid during the year		7,20,000
Profit and Loss Account balance as on March 31, 2006		16,38,000

Balance Sheet as on

Assets	March 31, 2005 (Rs.)	March 31, 2006 (Rs.)
Fixed Assets:		
Land	4,80,000	9,60,000
Buildings and Equipment	36,00,000	57,60,000
Current Assets:		
Cash	6,00,000	7,20,000
Debtors	16,80,000	18,60,000
Stock	26,40,000	9,60,000
Advances	78,000	90,000
	90,78,000	1,03,50,000

Balance Sheet as on

Liabilities and Equity	*March 31, 2005*	*March 31, 2006*
	(Rs.)	*(Rs.)*
Share Capital	*36,00,000*	*44,40,000*
Surplus in Profit and Loss Account	*15,18,000*	*16,38,000*
Sundry Creditors	*24,00,000*	*23,40,000*
Outstanding Expenses	*2,40,000*	*4,80,000*
Income-tax payable	*1,20,000*	*1,32,000*
Accumulated Depreciation		
on Buildings and Equipment	*12,00,000*	*13,20,000*
	90,78,000	*1,03,50,000*

The original cost of equipment sold during the year 2005-06 was Rs. 7,20,000.

(2 + 10 = 12 Marks)

Answer

(a) In dividend price approach, cost of equity capital is computed by dividing the current dividend by average market price per share. This ratio expresses the cost of equity capital in relation to what yield the company should pay to attract investors. It is computed as:

$$K_e = \frac{D_1}{P_o}$$

Where,

D_1 = Dividend per share in period 1

P_0 = Market price per share today

Whereas, on the other hand, the advocates of earnings price approach co-relate the earnings of the company with the market price of its share. Accordingly, the cost of ordinary share capital would be based upon the expected rate of earnings of a company. This approach is similar to dividend price approach, only it seeks to nullify the effect of changes in dividend policy.

(b) Cash Flow Statement of Company A Ltd.
for the year ending March 31, 2006

Cash flows from Operating Activities

	Rs.
Net Profits before Tax and Extra-ordinary Item	16,00,000
Add: Depreciation	6,00,000

Operating Profits before Working Capital Changes	22,00,000
Increase in Debtors	(1,80,000)
Decrease in Stock	16,80,000
Increase in Advances	(12,000)
Decrease in Sundry Creditors	(60,000)
Increase in Outstanding Expenses	2,40,000
Cash Generated from Operations	38,68,000
Income tax Paid	8,68,000
Net Cash from Operations	30,00,000

Cash flows from Investment Activities

	Rs.
Purchase of Land	(4,80,000)
Purchase of Buildings and Equipment	(28,80,000)
Sale of Equipment	3,60,000
Net Cash used in Investment Activities	(30,00,000)

Cash flows from Financing Activities

		Rs.
Issue of Share Capital	8,40,000	
Dividends Paid	(7,20,000)	
Net Cash from Financing Activities		1,20,000
Net increase in Cash and Cash Equivalents		1,20,000
Cash and Cash Equivalents at the beginning		6,00,000
Cash and Cash Equivalents at the end		7,20,000

Buildings and Equipment Account

	Rs.		*Rs.*
Balance b/d	36,00,000	Sale of Asset	7,20,000
Cash/Bank (purchase) (Balancing figure)	28,80,000	Balance c/d	57,60,000
	64,80,000		64,80,000

Accumulated Depreciation on Buildings and Equipment Account

	Rs.		*Rs.*
Sale of Asset		Balance b/d	12,00,000
(Accumulated depreciation)	4,80,000	Profit and Loss (Provisional)	6,00,000
Balance c/d	13,20,000		
	18,00,000		18,00,000

Sale of Asset Account

	Rs.
Original Cost	7,20,000
Less: Accumulated Depreciation	4,80,000
Net Cost	2,40,000
Profit on Sale of Asset	1,20,000
Sale Proceeds from Asset Sales	3,60,000

PAPER – 6 : INFORMATION TECHNOLOGY

Question No. 1 is compulsory.

Answer any four questions from remaining six questions.

Question 1

(a) Convert the following from one system to another system alongwith the Working Notes:

(i) $(1357)_{10}$ = ( )$_2$

(ii) $(1463)_{10}$ = ( )$_8$

(iii) $(101101110)_2$ = ( )$_{16}$

(iv) $(573)_8$ = ( )$_{16}$

(v) $(1100100110)_2$ = ( )$_8$ *(1 × 5 = 5 Marks)*

(b) Describe briefly, the following terms with reference to Information Technology:

(i) Interpreter

(ii) Stored Program Concept

(iii) Toggle

(iv) Object Program

(v) Router. *(1 × 5 = 5 Marks)*

(c) Give one or two uses for each of the following:

(i) Use of MACROS

(ii) Use of BIOS

(iii) Use of Parallel Ports

(iv) Use of Web Browser

(v) Use of Repeaters. *(1 × 5 = 5 Marks)*

(d) Write True or False for each of the following:

(i) Compiler is one of the hardware devices in a computer.

(ii) The Address BUS is a set of wires that connects the CPU and RAM and carries the memory address.

(iii) The F2 key is used to edit the formula cell in a spreadsheet.

(iv) A spooling software is used to compensate the speed difference between the computer and its peripheral devices.

(v) DML describes the data type and name of each field. *(1 × 5 = 5 Marks)*

Answer

(a) (i) $(1357)_{10} = (\quad)_2$

2	1357	Remainder
2	678	1
2	339	0
2	169	1
2	84	1
2	42	0
2	21	0
2	10	1
2	5	0
2	2	1
2	1	0
	0	1

Hence $(1357)_{10} = (10101001101)_2$

(ii) $(1463)_{10} = (\quad)_8$

8	1463	Remainder
8	182	7
8	22	6
8	2	6
2	0	2

Hence, $(1463)_{10} = (2667)_8$

(iii) $(101101110)_2 = (\quad)_{16}$

To convert the given number from binary to hexadecimal number, we will combine the digits in groups of four, adding leading zeros if required.

(*101101110*) = 0001 0110 1110

= 1 6 E

Hence, $(101101110)_2 = (16E)_{16}$

(iv) $(573)_8$ = ($)_{16}$

(573) = 101 111 011

= 0001 0111 1011

1 7 B

Hence, $(573)_8$ = $(17B)_{16}$

(v) $(1100100110)_2$ = ($)_8$

To convert the given number from binary to octal, we will combine the digits in groups of three, adding leading zeros if required.

(1100100110) = 001 100 100 110

= 1 4 4 6

Hence, $(1100100110)_2 = (1446)_8$

(b) (i) Interpreter: It refers to a language translator that converts source program written in high level language to machine code and executes it immediately statement by statement.

(ii) Stored program concept: Computers can perform variety of mathematical calculations without error. They can sort data, merge lists, search files, make logical decisions and comparisons. However, computer is devoid of any original thinking. It is provided with a set of instructions. These instructions are stored in primary memory and executed under the command of the control unit of CPU. This is known as stored program concept.

(iii) Toggle: It is a switch or control code that turns an event on or off by repeated action or use. It also means to turn something on or off by repeating the same action.

(iv) Object program: It refers to a program expressed in a machine language, which can be directly executed by a particular computer. A compiler takes source program as an input and produces the object code/program.

(v) Router: It is a special purpose computer along with software that handles the connection between two or more networks. Routers spend all their time looking at the destination addresses of the packets passing through them and deciding which route to send them on.

(c) (i) Use of Macro: Macro is a small program used for carrying out a pre-recorded series of steps by giving few keyboard shortcuts. It automates the tasks, and carries out those pre-defined steps automatically once it is triggered.

(ii) Use of BIOS: BIOS stands for Basic Input Output System. It is a small chip on the motherboard that loads the hardware settings required to load various devices like keyboard, monitor or disk drives. Most new PCs come with flash BIOS – these BIOS can be software upgraded to support new devices.

(iii) Use of parallel ports: These are used to connect external input/output devices like scanners or printers. Parallel ports facilitate the parallel transmission of bits of data, usually one byte at a time. Parallel ports use 25 pins RS 232 C connector.

(iv) Use of Web Browser: It is a client program (software) that is used to look at various kinds of Internet resources. Mosaic, Netscape Navigator and Internet Explorer are some of the commonly used web Browsers.

(v) Use of Repeaters: These are devices that solve the snag of signal degradation as data is transmitted along various cables. Repeater boosts or amplifies the signal before passing it through to the next section of cable.

(d) (i) False

(ii) True

(iii) True

(iv) True

(v) False.

Question 2

Distinguish between the following. Answer any four:

(i) Cache memory and ROM

(ii) On line system and Batch processing

(iii) Ring Network and Star Network

(iv) Analog computer and Digital computer

(v) Network-attached storage and Direct-attached storage. *(5 × 4 = 20 Marks)*

Answer

(i) Cache Memory and ROM: Cache memory refers to internal memory on the processor. It is a temporary memory and is used to boosts the processing power of the computer significantly. On the other hand, ROM or Read-only memory is used for Micro programs not available to normal users. The term read-only means that the storage cannot be altered by regular program instructions. The information is stored permanently in such memory at the time of manufacturing. One set of instructions found in ROM is called ROM – BIOS which stands for Read-only Memory Basic Input Output system. It is used for performing the basic control and supervisory operations of the computer.

There are two types of cache memory. The cache that comes with the processor is called Level One (L1) cache. This cache runs at the processor's clock speed, and therefore is very fast. The cache is divided into 2 sections – one for data, the other for instructions. Generally, more the L1 cache, faster the processor. Additionally, PCs also include a much slower secondary, or Level Two (L2) cache. This cache resides on the motherboard and delivers slower performance when compared with the L1 cache.

On the other hand, there are various types of ROM available. PROM or Programmable Read Only Memory is a non-volatile memory, which allows the user to program the chip with a PROM writer. The chip can be programmed once, thereafter, it cannot be altered.

EPROM or Erasable Programmable Read Only Memory can be electrically programmed. Unlike ROM and PROM chips, EPROM chips can be erased and reprogrammed. Exposing the chip to Ultra-violet light performs erasure.

In EEPROM or Electricity Erasable Programmable Read Only Memory, data can be erased by applying electrical charges.

(ii) On-line systems and Batch processing: *Online systems* refer to processing of individual transactions as they occur from their point of origin as opposed to accumulating them into batches. Aside from transaction processing and file updating, inquiries can also be handled by the online processing systems.

On-line Systems are in use in various organizations for applications such as Electricity and Gas Boards, Banking industry, Tour operators and Stock exchanges.

On-line systems offer following benefits:

(a) Integration of clerical staff with the computer.

(b) Elimination of tedious tasks.

(c) Reduction in paper work.

(d) Improved accuracy.

(e) Improved file updating.

(f) Management information more readily available.

(g) Improved customer services.

(h) Reduced data preparation cost.

Batch Processing, on the other hand is used in those business applications that consist of high volume of input transactions. In this, batches of transactions are accumulated in a file sorted by the key field and processed against the master file to update the latter and produce the desired results. This job is done periodically and scheduled at a non-peak time depending upon the workload. Under batch processing, the files can be stored on sequential media also.

(iii) Ring Network and Star Network: In *Ring Network* topology, the network cable passes from one node to another until all nodes are connected in the form of a loop or ring. There is a direct point-to-point link between two neighboring nodes. These links are unidirectional which ensures that transmission by a node traverses the whole ring and comes back to the node, which made the transmission. In *Star Network* topology, the network is characterized by communication channels emanating from centralized computer system. That is, processing nodes in a star network interconnect directly with a central system. Each terminal, small computer, or larger main-frame can communicate only with the central site and not with other nodes in the network. If it is desired to

transmit information from one node to another, it can be done only by sending the details to the central node, which in turn sends them to the destination.

Ring networks offer high performance for a small number of workstations or for larger networks where each station has a similar workload. These networks can span longer distances than star networks and are easily extendable. A star network is particularly appropriate for organizations that require a centralized database or a centralized processing facility. In a star network, it is easy to add new nodes and also remove nodes. A node failure does not bring down the entire network. It is easier to diagnose network problem through a central hub.

(iv) Analog computer and Digital computer: *Analog computers* process data input in a continuous form. Data such as voltage, resistance or temperature and pressure etc. are represented in a computer as a continuous, unbroken flow of information. In engineering and scientific applications where quantities to be processed exist in wave forms or continually rising and falling voltages, pressure and so on, analog computers are very useful.

Digital computers, on the other hand, count and accept letters or numbers through various input devices that convert the data into electric pulses, and perform arithmetic operations on numbers in discrete form. In addition to performing arithmetic operations, they are also capable of storing data for processing, performing logical operations, editing or deleting the input data and printing out the result of its processed routine at high speed.

(v) Network-attached storage and direct-attached storage: *Network-attached storage (NAS)* is a dedicated shared storage solution that attaches to a network topology, becoming immediately and transparently available as a network resource for all clients. NAS is platform and operating system independent. It can be attached without powering down the network, and requires no changes to the existing file servers. A NAS device is typically a stand alone, high performance, single-purpose system or component. It serves specific storage needs with its own operating system and integrated hardware and software. NAS devices are well suited to serve heterogeneous networks. They enable file and data sharing among different types of clients.

Direct attached storage (DAS), on the other hand, is a storage device that connects directly to a single server. Network workstations access the server to connect to this storage. Because the server may be handling distributed applications such as e-mail or databases, the performance of DAS is typically not as high as that of networked storage. DAS uses the security features of the server's network operating system.

Question 3

(a) Describe various factors which determine the best file organization for an application.

(b) Describe the various types of data communication modes.

(c) An electric supply company charges the following rates for its domestic consumers:

No. of units consumed	*Charges/unit (Rs.)*
For the first 200 units	*1.60*
For the next 300 units	*2.10*
Over 500 units	*3.90*

Surcharge @ 20% of the bill is to be added to the charges.

Draw a Flow chart for the above, which will read the consumer number and the number of units consumed and print out the total charges with the consumer number and the units consumed. *(5 + 5 + 10 = 20 Marks)*

Answer

(a) Best file organization: There are several factors that must be considered for determining the best file organization for a particular application. These are described below:

File volatility: It refers to the number of additions and deletions to the file in a given period of time. The payroll file for a construction company where the employee roster is constantly changing is a highly volatile file. An ISAM file would not be a good choice in this situation, since additions would have to be placed in the overflow area and constant reorganization of the file would have to occur. Other direct access methods would be better. Perhaps even sequential file organization would be appropriate if there were no interrogation requirements.

File activity: It is the proportion of master file records that are actually used or accessed in a given processing run. At one extreme is the real-time file where each transaction is processed immediately and hence at a time, only one master record is accessed. This situation obviously requires a direct access method. On the other extreme, in payroll application, each record is accessed when payroll is processed. Therefore, sequential master file would be more efficient.

File interrogation: It refers to the retrieval of information from a file. If the retrieval of individual records must be fast to support a real-time operation such as airline reservation then some kind of direct organization is required.

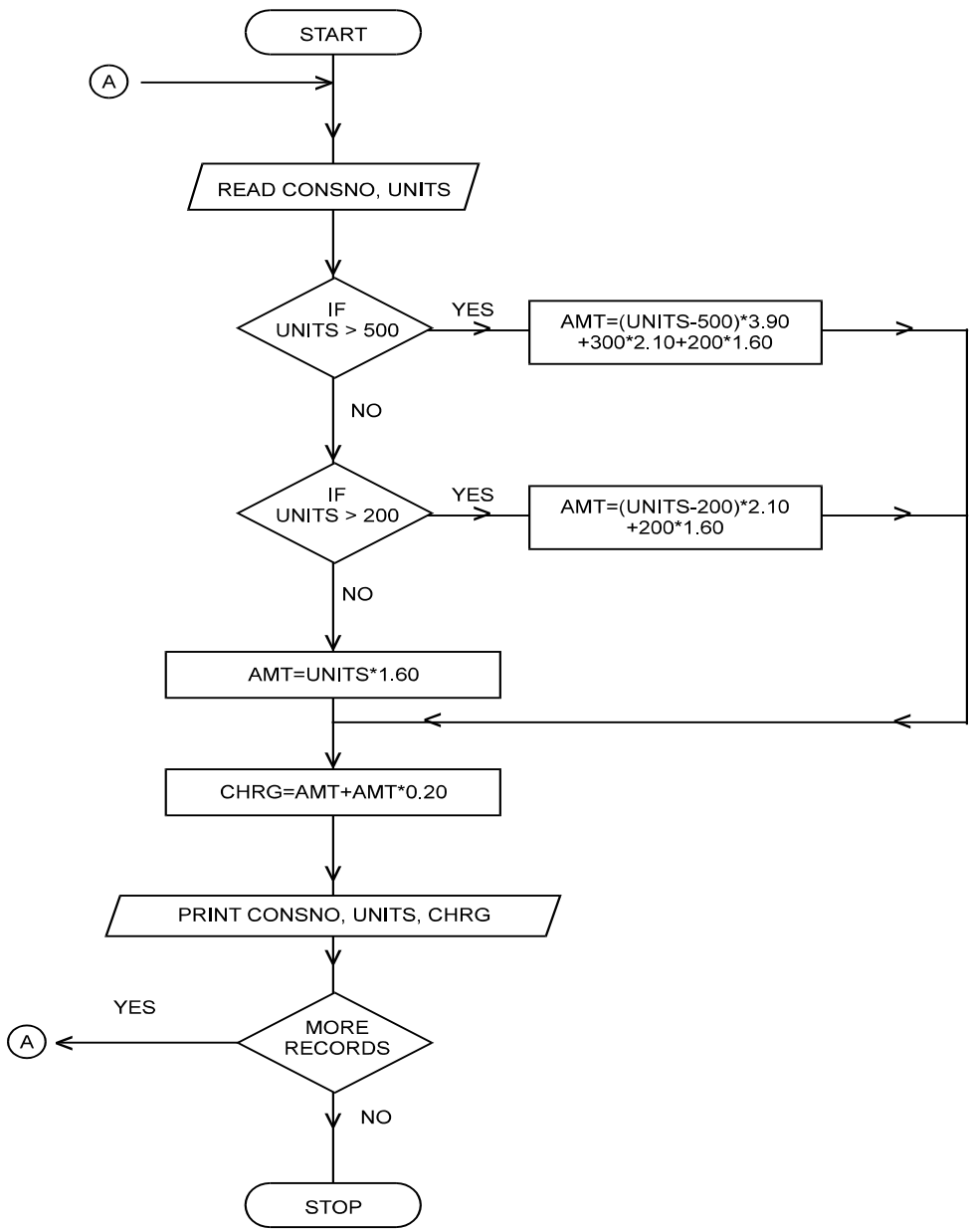
(b) There are three different types of data communication modes:

Simplex: A simplex communication mode permits data to flow in only one direction. A terminal connected to such a line is either a send-only or a receive – only device. Simplex mode is seldom used because a return path is generally needed to send acknowledgements, control or error signals.

Half duplex: In this mode, data can be transmitted back and fourth between two stations, but data can only go in one of the two directions at any given point of time.

Full duplex: A full duplex connection can simultaneously transmit and receive data between two stations. It is most commonly used communication mode. A full duplex line is faster, since it avoids the delay that occur in a half-duplex mode each time the direction of transmission is changed.

(c) The required flow chart is given below:



Question 4

(a) What are the important decisions which influence the physical design of a Database? Explain.

(b) Describe briefly the various features of Data centres.

(c) Explain the benefits offered by electronic commerce application and implementation.

(5 + 5 + 10 = 20 Marks)

Answer

(a) Important decisions that influence the physical data base design are discussed below:

(i) Choosing the storage format called data-type for each attribute from the logical data model. The format is chosen to minimize storage space and to maximize data integrity.

(ii) Grouping attributes from the logical data model into physical records.

(iii) Arranging similarly structured records in secondary memory (primary hard disks) so that individual and groups of records (called file organizations) can be stored, retrieved and updated rapidly. Consideration may also be given to protect data and recovering data after errors are found.

(iv) Selecting structures (called indexes and database architectures) for storing and connecting files to make retrieval of related data more efficient.

(v) Preparing strategies for handling queries against the database that will optimize performance and take advantage of the file organizations and indexes that the users have specified. Efficient database structures will be of benefit only if queries and the database management systems that handle those queries are tuned intelligently to use those structures.

(b) Features of data centers:

(i) *Size:* Data centres are characterized foremost by the size of their operations. A financially viable data center could contain from a hundred to several thousand servers. This would require a minimum area of around 5,000 to 30,000 square meters. Apart from this, the physical structure containing a data center should be able to withstand the sheer weight of the servers to be installed inside. Thus, there is a need for high quality construction.

(ii) *Data security:* Another issue critical for data centres is the need to ensure maximum data security and 100 per cent availability of the facilities. Data centres have to be protected against intruders by controlling access to the facility and by video surveillance. They should be able to withstand natural disasters and calamities, like fire and power failures. Recovery sites must be well maintained as it is here that everything in the data center is replicated for failure recovery.

(iii) *Availability of Data*: The goal of a data center is to maximize the availability of data and to minimize potential downtime. To do this, redundancy has to be built into all the mission critical infrastructure of the data center.

(iv) *Electrical and power systems:* A data centre should provide the highest power availability with uninterrupted power systems.

(v) *Security:* Physical security and systems security are critical to operations. Thus, it should provide both types of security measures to ensure the security of equipments and data placed at the data center.

(c) Benefits of Electronic Commerce applications:

(1) Reduced costs to buyers from increased competition in procurement as more suppliers are able to compete in an electronically open marketplace.

(2) Reduced errors, time, and overhead costs in information processing by eliminating requirements for re-entering data.

(3) Reduced costs to suppliers by electronically accessing on-line databases of bid opportunities, on-line abilities to submit bids, and on-line review of rewards.

(4) Reduced time to complete business transactions, particularly from delivery to payment.

(5) Creation of new markets through the ability to easily and cheaply reach potential customers.

(6) Easier entry intro new markets, especially geographically remote markets, for companies of all sizes and locations.

(7) Better quality of goods as specifications are standardized and competition is increased, and improved variety of goods through expanded markets and the ability to produce customized goods.

(8) Faster time to market as business processes are linked, enabling seamless processing and eliminating time delays.

(9) Optimization of resource selection as businesses form cooperative teams to increase the chances of economic successes, and to provide the customer products and capabilities more exactly meeting his or her requirements.

(10) Reduced inventories and reduction of risk of obsolete inventories as the demand for goods and services is electronically linked through just-in-time inventory and integrated manufacturing techniques.

(11) Ability to undertake major global programs in which the cost and personnel needed to manage a non-automated system would be unreasonable and prohibitive.

(12) Reduced overhead costs through uniformity, automation and large scale integration of management processes.

(13) Reduced use of ecologically damaging materials through electronic coordination of activities and the movement of information rather than physical objects.

(14) Reduced advertising costs.

(15) Reduced delivery cost, notably for goods that can also be delivered electronically.

(16) Reduced design and manufacturing cost.

(17) Improved market intelligence and strategic planning.

(18) More opportunity for niche marketing.

(19) Equal access to markets.

Question 5

(a) Explain the concept of mail merge used in MS-WORD.

(b) Explain the various types of decision tables.

(c) Explain briefly the various tools offered by MS-WORD for efficient writing.

(d) Define the following functions used in MS-EXCEL:

(i) DMAX

(ii) VAR

(iii) SUM

(iv) INT

(v) FV *(5 + 5 + 5 + 5 = 20 Marks)*

Answer

(a) Mail Merge: Mail Merge is one of the most important tools of MS-Word. It is efficient and less time consuming way of preparing mass mailing for a list of addresses. It is a tool for producing repetitive document, and gives the flexibility, in personalizing each copy of it with information such as names, addresses, dates etc.

Components of Mail Merge: Mail merge is built around two sets of components – main document and data source. The main document is a form letter. It contains merge fields (or field names) where data would be merged. The field names would be replaced with the field contents coming from the data source at the time of merging. The data source is a file that contains information like name, address etc., which is merged with the main document to create a final product. The data source can be very easily picked up from Access database, an Excel spreadsheet, Microsoft Address Book or one created in MS-Word.

(b) There are three types of decision tables as discussed below:

(i) *Limited Entry Tables*: In this type of decision table, the condition and action statements are complete. The condition and action entries merely define whether or not a condition exists or an action should be taken. The symbols used in the condition entries are:

Y : Yes, the condition exists.

N : No, the condition does not exist.

– : Irrelevant, the condition does not apply, or it makes no difference whether the condition exists or not.

The symbols used in the action entries are:

X : Execute the action specified by the action statement.

– : Do not execute the action specified by the action statement.

(ii) *Extended Entry Table*: The condition and action statements in an extended entry table are not complete, but are completed by the condition and action entries.

(iii) *Mixed Entry Table*: It combines both the limited and extended entry forms. While the limited and extended entry forms can be mixed within a table, only one form may be used within a condition statement/entry or an action statement/entry.

(c) MS-Word offers several useful tools for efficient writing and to increase efficiency. These are:

- Auto Correct: Auto Correct has a dictionary of its own which contains a list of commonly mistyped words. The user can customize this dictionary by making additions to it of the words one mistypes. The user may also provide the correct spelling of the word with which Word should replace the mistyped one. Once the entry is in the Auto Correct dictionary, Word automatically makes correction of such words.
- Auto Text: Auto Text is a unique feature of Word. It allows the user to store formatted text, even paragraphs and graphics. These can be recalled by pressing some keys. Auto Text is like Auto Correct in that it also has dictionary of its own and can be customized. However, AutoText has to be explicitly called to allow it to work. AutoText has an AutoComplete tip that will complete the text without the user having to type the entire word.
- Spelling and Grammar: As English is not a very phonetic language; the spelling of some words can be learnt only by memorizing. As an example, a word 'achieve' has to be spelt 'achieve' or 'acheive'. One of the first tools that the word processors came equipped with to beat the electronic typewriter was the spell check. The spell checking function checks each word in the document against the dictionary and underlines it with a red curly line if a word with wrong spelling appears or is not found in the dictionary. There are numbers of options available, which the user can set in the software.
- Thesaurus: The thesaurus is a useful writing tool that comes along with the word processor. If the user is unhappy with the choice of a word, he can easily look up the thesaurus to find a more precise word.
- Find and Replace Test: 'Find' helps to locate specific text in a document while 'Replace' helps to substitute it with new text. The user has the option of replacing all words with one keystroke if he is sure that all the entries of that word need to be replaced. However,

if one wants to replace only some of the entries of the word then MS-Word will take one through the document, entry after entry.

(d) (i) *DMAX*: It is a database function. It returns the largest number in the field(column) of records in the database that matches the conditions specified.

(ii) *VAR*: It is a Statistical function, which is used to estimate the variance based on a sample.

(iii) *SUM*: It is a statistical function, which adds all the numbers in a range of cells.

(iv) *INT*: It is a mathematical function that computes the integral part of the value. All fractional values are truncated and only the integral part of the value is retained.

(v) *FV*: It is a financial function which calculates the future value for a series of equal investments (also called annuity) earning at fixed periodic rate of interest.

Question 6

(a) Explain the duties of Certifying Authorities under Section 30 of Information Technology Act.

(b) Write down the typical steps in using audit package.

(c) Describe the salient features of EX.NGN accounting package.

(d) What do you mean by object-oriented programming? Explain its advantages.

(5 + 5 + 5 + 5 = 20 Marks)

Answer

(a) Duties of Certifying Authorities under Section 30 of Information Technology Act are stated below:

(1) (a) Make use of hardware, software and procedures that are secure from intrusion and misuse;

(b) Provide a reasonable level of reliability in the services, which suit to the performance of intended functions.

(c) Adhere to security procedures to ensure that the secrecy and privacy of the digital signatures are assured.

(d) Observe such other standards as may be specified by regulations.

(2) Every certifying Authority shall also ensure that every person employed by him complies with the provisions of the Act, or rules, regulations or orders made there under.

(3) A certifying Authority must display its license at a conspicuous place of the premises in which it carries on its business. A certifying Authority whose licence is suspended or revoked shall immediately surrender the licence to the controller.

(4) Certifying Authority shall disclose its digital signature certificate, which contains the public key corresponding to the private key used by that authority and other relevant facts.

(b) Typical steps in using audit package are enumerated below:

(i) Define the audit objectives.

(ii) Identify the tests that the package will be required to do in order to assist the meeting of the audit objectives.

(iii) Make out the package input forms for these tests.

(iv) Compile the package on the computer, clearing reported edit errors. There should be full edit of the parameter cards to execution (step 7). Maintain security over the package and the audit tests at all times.

(v) If a program was used to add coded routines to the package, to fill out the input forms or to advise generally, his work must be tested.

(vi) Obtain copies of the application files to be tested.

(vii) Attend the execution of the package against the copy files.

(viii) Maintain security of the copy files and output until the tests have been fully checked out.

(ix) Check results of the test and draw audit conclusions.

(x) Interface the test results with whatever subsequent manual audit work has to be done.

(c) The accounting package EX.NGN is compatible to the Windows Operating System and developed in Visual Studio VC++. It has the following salient features:

(i) It is 32-bit application, compatible to Windows OS.

(ii) It has multitasking facility, which allows performing various functions simultaneously.

(iii) It is completely GUI based.

(iv) Different security passwords can be set for various activities.

(v) It has zooming facility to obtain more detailed information at transaction level.

(vi) It provides all the accounting support without demanding to remember various codes for different accounts.

(vii) It provides the facility to customize invoice, receipt bill, payments with some particular information, which may not be part of the pre-defined documents.

(viii) It supports multiple companies' information to be created and maintained.

(ix) It can prepare 72 different types of reports in accounting, which include balance sheet, profit and loss account, trial balance, stock position, financial summary, and bank reconciliation etc.

(x) It has a powerful feature, which enables to capture information for subsequent analysis. It also allows constructing queries for different kinds of information.

(d) With traditional programming approaches, developing a new program means writing entirely new code. In case of a complex program, developing it from scratch and achieving a reasonable quality level becomes a formidable task. The solution of these problems is a new way of developing programs using an object oriented programming (OOP). An object is a predefined set of program codes that, after having been written and tested, will always behave the same way so that it can be used for other applications. All programs consist of specific tasks such as saving or retrieving data and calculations. In OOP, an object is written for each specific task and saved in the library so that anyone can use it. Objects can be modified, reused, copied or created.

In OOP, objects are selected by pointing to a representative icon, small amount of code necessary for finishing the program is written and then linking these objects together creates a new program. OOP offers following advantages:

- It is easy to use.
- It allows graphical user interface.
- It enables faster development of programs.
- Programs produced are more reliable.
- When an object is updated, all programs using that object are updated automatically.

Question 7

Write short notes on the following. Answer any four:

(i) WORM Disks

(ii) Bar Code Reader

(iii) Web Casting

(iv) World Wide Web

(v) Digital Signature. *(5 × 4 = 20 Marks)*

Answer

(i) WORM Disks: It stands for write once, read many optical laser disks, or WORM disks. These are used by end user companies to store their own proprietary information. Once the data have been written to the medium, they only can be read, not updated or changed. The PC version of a WORM disks cartridge, which looks like a 5¼ inch version of the 3½ inch diskette, has a capacity of 200 MB. Access times for CD-ROM and WORM drives tend to be quite slow by hard disk drive standards, ranging from 100 to 300 milliseconds. The WORM disks cartridge is a feasible alternative to magnetic tape for archival storage; for example, a company might wish to keep a permanent record of all financial transactions during the last year. Another popular application of WORM disks is an information system that requires the merging of text and images which do not change for a period of time.

(ii) Bar Code Reader: It is an input device, most commonly found in supermarkets and departmental stores. It converts the bar code, which is a pattern of printed bars on products, into a product code by emitting a laser beam to reflect off the bar code image. A light sensitive detector identifies the bar code image by recognizing special bars at both ends of the image. Once the detector has identified the bar code, it converts the individual bar patterns into numeric digits and feeds that number to the computer, just as though the number had been typed on a key board. The special bars at each end of the image are different, so the reader can tell whether the bar code has been read right side up or upside down. After the bar code reader converts a bar code image into a number it feeds that number to the computer, as if the number had been typed on a keyboard.

It provides following advantages:

- Improves accuracy of data entry
- Better customer service
- Faster check out at the point of sale
- Greater control and reliability of inventory records
- Most widely used input device after the keyboard and mouse.

(iii) Webcasting or push technology is web-based technology. This allows users to passively receive broadcast information rather than actively search the Web for information. Push technology allows users to choose from a menu of sources, specifying what kind of information they want to receive. Once selected, the information is automatically forwarded to the user. Internet news services, which deliver the day's activities to the user's desktop, are an example of push technology.

Users can also download software, select the frequency with which they will receive services, and subscribe to a variety of information sources. There is very little cost involved to the user for push services because information is delivered with advertising, and users view their custom-tailored news off-line. Webcasting eliminates the frustration of the user which he/she faces while surfing the Internet to get right kind of information.

(iv) World Wide Web : The *World Wide Web* (WWW) or the Web is a component of the Internet that provides access to large amounts of information located on many different servers. The Web also provides access to many of the services available on the Internet.

The fundamental unit of the Web is the Web page. The Web page is a text document that contains links to other Web pages, graphic and audio files, and other Internet services such as file transfer protocol (FTP) and E-mail. Tens of thousands of Web servers are connected to the Internet running special software in the servers allowing the users to access Web pages. A user can access directly any Web page on one of these servers and follow the links to other pages. This process creates a Web of links around the world and so the name World Wide Web.

To view a Web page, the user must use a special client software package called a Web browser. There are number of browsers in the market, like Mosaic, Netscape Nevigator and Internet Explorer etc.

(v) Digital Signature: Digital Signature means authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provision of section 3 of Information Technology Act, 2000.

Digital signature is created in two steps. First, the electronic record is converted into a message digest by using a mathematical "hash function" which digitally freezes the electronic record thus ensuring the integrity of the content of the intended communication contained in the electronic record. Any tempering with the contents of the electronic record will immediately invalidate the digital signature. Secondly, the identity of the person affixing the digital signature is authenticated through the use of a private key which attaches itself to the message digest and which can be verified by anybody who has the public key corresponding to such private key. This will enable anybody to verify whether the electronic record is retained intact or has been tampered with since it was so fixed with the digital signature. It will also enable a person who has a public key to identify the originator of the message.

Section 35 of the Act lays down the procedure for issuance of a digital signature certificate.

PAPER – 1 : ACCOUNTING

Answer all questions.

Working notes should form part of the answer.

Question 1

A, B and C carried on business in partnership, sharing Profits and Losses in the ratio of 1:2:3. They decided to form a private limited company, AB (P) Ltd. and C is not interested to take over the shares in AB (P) Ltd. The authorized share capital of the company is Rs.12,00,000 divided into 12,000 ordinary shares of Rs.100 each.

The company was incorporated and took over goodwill as valued and certain assets of the partnership firm on 31.3.2006. The Balance Sheet of the partnership firm on that date was as follows:

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital Accounts:			*Fixed Assets:*	
A		*1,00,000*	*Machinery*	*1,20,000*
B		*2,00,000*	*Land*	*1,74,000*
C		*3,00,000*	*Motorcycles*	*30,000*
Current Accounts:			*Furniture & fittings*	*11,000*
A		*39,420*	*Current Assets:*	
B		*60,580*	*Stock*	*2,35,000*
A's Loan A/c	*28,000*		*Debtors*	*43,000*
(+) Interest accrued	*2,000*	*30,000*	*Cash in hand*	*87,000*
Current Liability:			*C's overdrawn*	*1,00,000*
Creditors		*70,000*		
		8,00,000		*8,00,000*

C, who retired was presented by the other partners (A and B) with one motorcycle valued in the books of the firm Rs.9,000. The remaining motorcycles were sold in the open market for Rs.13,000. C also received certain furniture for which he was charged Rs.2,000. The debtors which were all considered good, were taken over by C for Rs.40,000. A and B were charged in their profit sharing ratio for the book value of Motorcycle presented by them to C.

It was agreed that C who is not willing to take the shares in AB (P) Ltd. was discharged first by providing necessary cash. A and B should bring cash, if necessary.

AB (P) Ltd. took over the remaining furniture and fittings at a price of Rs.13,000, the machinery for Rs.1,25,000, the stock at an agreed value of Rs.2,00,000 and the land at its book value. The value of the goodwill of the partnership firm was agreed at Rs.88,000. The creditors of the firm were settled by the firm for Rs.70,000. A's loan account together with interest accrued was transferred to his capital account.

The purchase consideration was discharged by the company by the issue of equal number of fully paid up equity shares at par to A and B.

Prepare Realisation A/c, Capital A/cs of the partners and Cash A/c. Also draw the Balance Sheet of AB (P) Ltd. *(20 Marks)*

Answer

Realization Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Machinery	1,20,000	By	Creditors	70,000
To	Land	1,74,000	By	AB (P) Ltd. – Purchase consideration (Refer Working Note)	6,00,000
To	Motor Cycles	30,000	By	A's Capital A/c	3,000
To	Furniture & Fittings	11,000	By	B's Capital A/c	6,000
To	Stock	2,35,000	By	C's Capital A/c (2,000 + 40,000)	42,000
To	Debtors	43,000	By	Cash A/c (Sale of Motor Cycle)	13,000
To	Cash (payment to creditors)	70,000			
To	Profit transferred to				
	A's Capital A/c	8,500			
	B's Capital A/c	17,000			
	C's Capital A/c	25,500			
		7,34,000			7,34,000

Partners' Capital Accounts

Dr									*Cr.*
		A	*B*	*C*			*A*	*B*	*C*
		Rs.	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*
To	Current A/c	-	-	1,00,000	By	Balance b/d	1,00,000	2,00,000	3,00,000
To	Realisation A/c (Assets taken over)	3,000	6,000	42,000	By	Current A/c	39,420	60,580	-
To	Equity shares in AB (P) Ltd.	3,00,000	3,00,000	-	By	A's Loan A/c	30,000	-	-
To	Cash A/c	-	-	1,83,500	By	Realization A/c (Profit)	8,500	17,000	25,500
					By	Cash A/c	1,25,080	28,420	
		3,03,000	3,06,000	3,25,500			3,03,000	3,06,000	3,25,500

Cash Account

Dr.					Cr.
		Rs.			Rs.
To	Balance b/d	87,000	By	Realisation A/c	70,000
To	Realisation A/c	13,000	By	C's Capital A/c	1,83,500
To	A's Capital A/c	1,25,080			
To	B's Capital A/c	28,420			
		2,53,500			2,53,500

Balance Sheet of AB (P) Ltd.

Liabilities	*Rs.*	*Assets*	*Rs.*
Authorised Share Capital:		*Fixed Assets:*	
12,000 Equity Shares of Rs.100 each	12,00,000	Goodwill	88,000
		Land	1,74,000
Issued, Subscribed & Paid up:		Machinery	1,25,000
6,000 equity shares of Rs.100 each fully paid up (shares were issued for consideration otherwise than for cash)	6,00,000	Furniture & Fittings	13,000
		Current Assets:	
		Stock	2,00,000
	6,00,000		6,00,000

Working Note:

Calculation of Purchase Consideration

Assets taken over by AB (P) Ltd.	*Rs.*
Machinery	1,25,000
Furniture & Fittings	13,000
Land	1,74,000
Stock	2,00,000
Goodwill	88,000
Purchase Consideration	6,00,000

Purchase consideration is discharged by the issue of equal number of equity shares of Rs.100 each (3,000 shares) at par to A & B.

Question 2

The following is the Balance sheet of Weak Ltd. as on 31.3.2006:

Liabilities	*Rs.*	*Assets*	*Rs.*
Equity shares of Rs.100 each	*1,00,00,000*	*Fixed assets*	*1,25,00,000*
12% cumulative preference shares of Rs.100 each	*50,00,000*	*Investments (Market value Rs.9,50,000)*	*10,00,000*
10% debentures of Rs.100 each	*40,00,000*	*Current assets*	*1,00,00,000*
Sundry creditors	*50,00,000*	*P & L A/c*	*4,00,000*
Provision for taxation	*1,00,000*	*Preliminary expenses*	*2,00,000*
	2,41,00,000		*2,41,00,000*

The following scheme of reorganization is sanctioned:

(i) All the existing equity shares are reduced to Rs.40 each.

(ii) All preference shares are reduced to Rs.60 each.

(iii) The rate of interest on debentures is increased to 12%. The debentureholders surrender their existing debentures of Rs.100 each and exchange the same for fresh debentures of Rs.70 each for every debenture held by them.

(iv) One of the creditors of the company to whom the company owes Rs.20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of Rs.40 each in full satisfaction of his claim.

(v) Fixed assets are to be written down by 30%.

(vi) Current assets are to be revalued at Rs.45,00,000.

(vii) The taxation liability of the company is settled at Rs.1,50,000.

(viiii) Investments to be brought to their market value.

(ix) It is decided to write off the fictitious assets.

Pass Journal entries and show the Balance sheet of the company after giving effect to the above. *(16 Marks)*

Answer

Journal Entries in the books of Weak Ltd.

			Rs.	*Rs.*
(i)	Equity share capital (Rs.100) A/c	Dr.	1,00,00,000	
	To Equity Share Capital (Rs.40) A/c			40,00,000
	To Capital Reduction A/c			60,00,000
	(Being conversion of equity share capital of Rs.100 each into Rs.40 each as per reconstruction scheme)			

(ii)	12% Cumulative Preference Share capital (Rs.100) A/c	Dr.	50,00,000	
	To 12% Cumulative Preference Share Capital (Rs.60) A/c			30,00,000
	To Capital Reduction A/c			20,00,000
	(Being conversion of 12% cumulative preference share capital of Rs.100 each into Rs.60 each as per reconstruction scheme)			
(iii)	10% Debentures A/c	Dr.	40,00,000	
	To 12% Debentures A/c			28,00,000
	To Capital Reduction A/c			12,00,000
	(Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)			
(iv)	Sundry Creditors A/c	Dr.	20,00,000	
	To Equity Share Capital A/c			12,00,000
	To Capital Reduction A/c			8,00,000
	(Being a creditor of Rs.20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of Rs.40 each in full settlement of his dues as per reconstruction scheme)			
(v)	Provision for Taxation A/c	Dr.	1,00,000	
	Capital Reduction A/c	Dr.	50,000	
	To Liability for Taxation A/c			1,50,000
	(Being conversion of the provision for taxation into liability for taxation for settlement of the amount due)			
(vi)	Capital Reduction A/c	Dr.	99,50,000	
	To P & L A/c			4,00,000
	To Preliminary Expenses A/c			2,00,000
	To Fixed Assets A/c			37,50,000
	To Current Assets A/c			55,00,000
	To Investments A/c			50,000
	To Capital Reserve A/c			50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Preliminary Expenses, Fixed Assets, Current Assets, Investments and the Balance transferred to Capital Reserve)			

(vii)	Liability for Taxation A/c	Dr.	1,50,000	
	To Current Assets (Bank A/c)			1,50,000
	(Being the payment of tax liability)			

Balance Sheet of Weak Ltd. (and reduced) as on 31.3.2006

Liabilities	*Rs.*	*Assets*	*Rs.*
Issued, subscribed and paid up capital: 1,30,000 equity shares of Rs.40 each	52,00,000	Fixed Assets (1,25,00,000 – 37,50,000)	87,50,000
12% Cumulative Preference Shares of Rs. 60 each	30,00,000	Investments (10,00,000 – 50,000)	9,50,000
Reserves & Surplus: Capital Reserve	50,000	Current Assets (45,00,000 – 1,50,000)	43,50,000
Secured Loan: 12% Debentures	28,00,000		
Current Liabilities and Provisions:			
Sundry Creditors: (50,00,000 – 20,00,000)	30,00,000		
	1,40,50,000		1,40,50,000

Working Note:

Capital Reduction Account

	Rs.		*Rs.*
To Liability for taxation A/c	50,000	By Equity share capital	60,00,000
To P & L A/c	4,00,000	By 12% Cumulative preference share capital	20,00,000
To Preliminary expenses	2,00,000	By 10% Debentures	12,00,000
To Fixed assets	37,50,000	By Sundry creditors	8,00,000
To Current assets	55,00,000		
To Investment	50,000		
To Capital Reserve (balancing figure)	50,000		
	1,00,00,000		1,00,00,000

Question 3

Red and Co. of Mumbai started a branch at Bangalore on 1.4.2006 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money remitted to H.O. The branch does not maintain

double entry books of account and necessary accounts relating to branch are maintained in H.O. Following further details are given for the year ending on 31.3.2007:

	Rs.
Cost of goods sent to branch	*1,00,000*
Goods received by branch till 31.3.2007 at Invoice price	*1,08,000*
Credit sales for the year	*1,16,000*
Closing debtors on 31.3.2007	*41,600*
Bad debts written off during the year	*400*
Cash remitted to H.O.	*86,000*
Closing cash on hand at branch on 31.3.2007	*4,000*
Cash remitted by H.O. to branch during the year	*6,000*
Closing stock in hand at branch at invoice price	*12,000*
Expenses incurred at branch	*24,000*

Draw up the necessary Ledger Accounts like Branch Debtors Account, Branch Stock Account, Goods sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment A/c for ascertaining gross profit and Branch Profit and Loss A/c for ascertaining Branch profit. *(16 Marks)*

Answer

Branch Debtors A/c

Dr.					*Cr.*
		Rs.			*Rs.*
To	Branch Stock A/c	1,16,000	By	Branch Cash A/c (balancing figure)	74,000
			By	Bad Debts (written off)	400
			By	Balance c/d	41,600
		1,16,000			1,16,000

Goods Sent to Branch A/c

To	Branch Adjustment A/c	20,000	By	Branch Stock A/c	1,20,000
	$1,00,000 \times \frac{20}{100}$				
To	Purchases/ Trading A/c	1,00,000			
		1,20,000			1,20,000

Branch Cash A/c

To	Branch Debtors A/c	74,000	By	Branch Expenses A/c	24,000
To	H.O. A/c (cash remittance)	6,000	By	H.O. (cash remittance)	86,000
To	Branch Stock A/c		By	Balance c/d	4,000
	- Cash Sales (balancing figure)	34,000			
		1,14,000			1,14,000

Branch Stock A/c

To	Goods sent to Branch A/c	1,20,000	By	Branch Debtors A/c	1,16,000
To	Branch Adjustment A/c	54,000	By	Branch Cash A/c (Sales)	34,000
	(Excess profit over normal loading - balancing figure)		By	Goods in Transit (1,20,000-1,08,000)	12,000
			By	Balance c/d	12,000
		1,74,000			1,74,000

Branch Expenses A/c

To	Branch Cash A/c	24,000	By	Branch P&L A/c	24,000

Branch Adjustment A/c

To	Stock Reserve A/c	2,000	By	Goods sent to Branch A/c	20,000
To	Goods in transit Reserve A/c	2,000	By	Branch Stock A/c	54,000
To	Branch P&L A/c (Balancing figure)	70,000			
		74,000			74,000

Branch P & L A/c

To	Branch Expenses A/c	24,000	By	Branch Adjustment A/c	70,000
To	Bad Debts	400			
To	Net Profit (transferred to General P&L A/c)	45,600			
		70,000			70,000

Working Notes:

1. Loading is 20% of cost i.e. 16.67% (1/6th) of invoice value.

   Loading on closing stock = Rs. 1/6th of Rs.12,000 =Rs. 2,000.

2. Loading on goods sent to branch = 1/6th of Rs.1,20,000 = Rs. 20,000.

3. Loading on goods in transit = 1/6th of Rs. 12,000 = Rs. 2,000.

Question 4

(a) From the following information of details of advances of X Bank Limited calculate the amount of provisions to be made in profit and loss account for the year ended 31.3.2007:

Asset classification	*Rs. in lakhs*
Standard	*6,000*
Sub-standard	*4,400*
Doubtful:	
For one year	*1,800*
For two years	*1,200*
For three years	*800*
For more than three years	*600*
Loss assets	*1,600*

(b) X Electricity Company Limited decides to replace one of its old plants with a modern one in April, 2006. The plant when installed in the year 2000, costed the company Rs.26 lakhs, the components of materials and labour being in the ratio of 7:3. It is ascertained that the cost of labour and materials have risen by 30% and 25% respectively. The cost of new plant is Rs.66 lakhs and in addition old materials worth Rs.92,000 are reused. Old materials worth Rs.1,68,000 are sold. Under double account system compute the following:

(i) The amount to be written off to Revenue A/c.

(ii) The amount to be capitalized.

(iii) Draw up the necessary Journal entries.

(iv) Draw up the Replacement Account. *(6 + 10 Marks)*

Answer

(a) Statement showing provisions on various performing and non-performing assets

Asset Classification	*Amount*	*Provision*	*Amount of Provision*
	Rs. in Lakhs	*%*	*Rs. in lakhs*
Standard	6,000	0.40	24
Sub-standard**	4,400	10	440
Doubtful**			
One year	1,800	20	360
2 years	1,200	30	360

** Sub standard and doubtful assets have been treated as fully secured.

3 years	800	30	240
More than 3 years	600	100*	600
Loss assets	1,600	100	1,600
			3,624

(b) (i) Statement showing amount to be written off to Revenue Account

			Rs.
Cost of old plant			26,00,000
Add:.	Increase in cost of material	26,00,000x $\frac{7}{10}\times\frac{25}{100}$	4,55,000
	Increase in cost of Labour	26,00,000 x $\frac{3}{10}\times\frac{30}{100}$	2,34,000
	Current cost of old plant		32,89,000
Less:	Cost of Material used	92,000	
	Cost of Material sold	1,68,000	(-) 2,60,000
Amount to be written off to Revenue A/c			30,29,000

(ii) Statement showing amount to be capitalised

Cost of new plant excluding the value of old materials used		66,00,000
Less:	Current cost of old plant	32,89,000
Current cost to be capitalized		33,11,000
Add:	Value of old material used	92,000
Total amount to be capitalized		34,03,000

(iii) Journal Entries in the Books of X Electricity Company Ltd.

			Rs.	*Rs.*
(a)	Replacement Account	Dr.	32,89,000	
	To Bank Account			32,89,000
	(Being the replacement of old plant by a new plant; the current cost of replacement Rs.32,89,000)			
(b)	Plant Account	Dr.	34,03,000	
	To Replacement Account			92,000
	To Bank Account			33,11,000

* w.e.f. 31st March 2007

(Being additional cost of new plant capitalized and also old materials used in construction of new plant)

(c)	Bank Account	Dr.	1,68,000	
	To Replacement A/c			1,68,000
	(Being the sale of old materials for Rs.1,68,000)			

(d)	Revenue A/c	Dr.	30,29,000	
	To Replacement Account			30,29,000
	(Being the balance of replacement account transferred to revenue account)			

(iv) Replacement Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Bank A/c	32,89,000	By	New Plant A/c	92,000
			By	Bank A/c	1,68,000
			By	Revenue A/c (Balancing figure)	30,29,000
		32,89,000			32,89,000

Question 5

Mr. A is insolvent. He supplies to you the following information as on 31.3.2006:

	Rs.
Cash in hand	*10,000*
Creditors for goods	*10,00,000*
Taxes due to Government	*35,000*
Bank loan secured by lien on stock	*1,50,000*
Furniture (expected to realize Rs 50,000)	*75,000*
Stock (expected to realize 50%)	*6,00,000*
Book debts (good)	*4,50,000*
Book debts (doubtful) expected to realize 40%	*5,50,000*
Bills discounted (Rs.40,000 bad)	*1,40,000*
Loan from Nathan secured by second charge on stock	*2,00,000*

Bills receivable (Rs.40,000 bad) *1,00,000*

Mr. A started business four years ago with a capital of Rs.4,50,000. He drew Rs.75,000 each year for private purposes, but did not maintain proper books of accounts. Mrs. A gave up her jewellery valued Rs.1,00,000 to the receiver.

Prepare Statement of Affairs of Mr. A as on 31.3.2006 and Deficiency Account as on that date.

(16 Marks)

Answer

Statement of Affairs of Mr. 'A' as on 31.3.2006

Gross Liabilities	*Liabilities*		*Expected to Rank*	*Property & Assets*	*Book Value*	*Expected to produce*
Rs.		*Rs.*			*Rs.*	*Rs.*
11,40,000	Unsecured creditors as per list A		10,40,000	Properties as per list E :		
1,50,000	Fully Secured Creditors			Cash in Hand	10,000	10,000
	as per List B (Bank Loan)	1,50,000		Furniture	75,000	50,000
	Less: Estimated value of stock	3,00,000		Jewellery from wife	-	1,00,000
		1,50,000		Book debts as per		
	Surplus transferred to List C	1,50,000	-	List F:		
2,00,000	Partly secured creditors as per List C (Loan from Nathan)	2,00,000		Good	4,50,000	4,50,000
	Surplus transferred from List B	1,50,000	50,000	Doubtful	5,50,000	2,20,000
35,000	Preferential creditors as per list D (Taxes due to Government)	35,000		Bills Receivable as per List G	1,00,000	60,000
	Deducted as per contra	35,000	-		11,85,000	8,90,000
				Less: Preferential creditors as per contra		35,000
						8,55,000
				Deficiency as explained in List H		2,35,000
15,25,000			10,90,000			10,90,000

Deficiency Account (List H)

	Rs.		*Rs.*	*Rs.*
Excess of Assets over Liabilities	4,50,000	Bad debts as per List F		3,30,000
Accumulated Profit up to 31st March, 2006 (Refer Working Note 2)	2,50,000	Drawings (75,000x4)		3,00,000
		Other Losses:		
Profit from other sources: Jewellery from wife	1,00,000	Loss on realization of Furniture	25,000	
Deficiency as per Statement of Affairs	2,35,000	Stock	3,00,000	
		Bills receivable	40,000	3,65,000
		Loss on Bills Discounted		40,000
	10,35,000			10,35,000

Working Notes:

1. Calculation of unsecured creditors as per List A

	Gross	*Expected to Rank*
	Rs.	*Rs.*
Creditors for Goods	10,00,000	10,00,000
Liabilities for Bills Discounted	1,40,000	40,000
	11,40,000	10,40,000

2. Calculation of Accumulated Profit/Loss

Trial Balance

Debit	*Rs.*	*Credit*	*Rs.*
Cash	10,000	Creditors	10,00,000
Furniture	75,000	Taxes due to Government	35,000
Stock	6,00,000	Bank Loan	1,50,000
Debtors (4,50,000 + 5,50,000)	10,00,000	Loan from Nathan	2,00,000
Bills Receivable	1,00,000	Capital	4,50,000
Drawings (75,000 x 4)	3,00,000	Accumulated Profit (b/f)	2,50,000
	20,85,000		20,85,000

Question 6

Answer any four of the following:

(a) What are the disclosure requirements of AS-7 (Revised)?

(b) How would you treat the Government grant received relating to a depreciable asset under the following cases as per AS-12?

Case i: Gross value of asset Rs.2 crores and Grant received Rs.20 lakhs only.

Case ii: Gross value of asset Rs.2 crores and Grant received Rs.2 crores.

(c) Explain the concept of actuarial valuation.

(d) What are the information that are extracted from the well designed accounting system in Agricultural Farm?

(e) Write a short note on 'B' List contributories under Liquidation of a company.

(d) What are the information that are to be disclosed in the financial statements as per AS-10? (4x4= 16 Marks)

Answer

(a) According to paragraphs 38, 39 and 41 of AS 7, an enterprise should disclose:

(a) the amount of contract revenue recognized as revenue in the period;

(b) the methods used to determine the contract revenue recognized in the period; and

(c) the methods used to determine the stage of completion of contracts in progress.

In case of contract still in progress the following disclosures are required at the reporting date:

(a) the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;

(b) the amount of advances received; and

(c) the amount of retentions.

An enterprise should also present:

(a) the gross amount due from customers for contract work as an asset; and

(b) the gross amount due to customers for contract work as a liability.

(b) In accordance with AS 12, government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value.

Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged.

Case i

Grant received amounting Rs.20 lakhs is required to be deducted from Rs.2 crores. The balance of Rs.1.80 crores to be shown as an assest in the Balance Sheet and

depreciation should also be charged on Rs.1.80 crores.

Case ii

As the grant is received for the entire cost of the asset, the asset shall be recorded at a nominal value of Rs.100 in the Balance sheet so that the existence of the amount is reflected. No depreciation is to be charged in this case.

Note: Alternatively, in both the cases government grant may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(c) Actuarial valuation is the process used by an actuary* to estimate the present value of benefits to be paid under a retirement scheme and the present values of the scheme assets and, sometimes, of future contributions. In the case of defined benefit scheme the cost of retirement benefits, to be charged to Profit and Loss Account on year to year basis, is determined on actuarial basis. According to paragraph 65 of AS 15 (revised 2005), an enterprise should use the Projected Unit Credit** method to determine the present value of its defined benefit obligations and the related current service cost and, wherever applicable, past service cost.

(d) A well designed accounting system can be used for extracting the following information:

1. Crop-wise performance and overall performance of the agricultural enterprise.
2. Comprehensive information regarding yield, revenue, input and cost of the enterprise.
3. Financial state of affairs i.e. assets and liabilities of the farm at a particular point of time.
4. Profit/Loss of the farm during a year.
5. Data base for other decisions, namely (a) acquire assets or hire services for ploughing, irrigation, weeding, threshing etc.; (b) replacement of draught animal, machinery and farming technique; (c) selection of crop-mix; (d) choosing farm size; (e) farm diversification, for example adding crop and non-farming activities like processing of agricultural products; (f) divestment decisions whether to discontinue agricultural operations.
6. Supporting data to the lenders including banks and co-operative societies to assess farm's financial requirements as well as debt servicing ability.
7. Reliable data for farm management survey.
8. Reliable data for assessment of agricultural income tax.

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* Actuary is an expert person who can calculate the liability where the factors affecting the calculation of liability are uncertain and cannot be determined in ordinary course.

** Projected Unit Credit method (sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method) considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build the final obligation.

(e) The shareholders who transferred partly paid shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors as existed on the date of transfer of shares. Such shareholders are called B List Contributories. Their liability will crystallize only (i) when the existing assets available with the liquidator are not sufficient to cover the liabilities; (ii) when the existing shareholders fail to pay the amount due on the shares to the liquidator.

(f) As per AS 10, the following information should be disclosed in the financial statements :

(i) gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements ;

(ii) expenditure incurred on account of fixed assets in the course of construction or acquisition ; and

(iii) revalued amount substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

PAPER – 2 : AUDITING

Answer Question Nos. 1 and 2 and any four questions from the rest.

Question 1

As an auditor, comment on the following :

(a) *You are a Principal Auditor of Sri Company Limited which has three branches the accounts of which are subject to audit by qualified branch auditors. One of the branch auditors qualified his report for non-provision of doubtful debts which he considered to be material for the company as a whole. Subsequent to their reporting, but before you could sign the audit report on the accounts of the company as a whole, the management informed you that the debt under the subject-matter of qualification in Branch Auditor's report had been fully recovered.* *(5 Marks)*

(b) *A Ltd. is a holding company of B Ltd. B Ltd. is going to start a new project estimated to cost Rs. 20 crores. For this A Ltd. made an investment of Rs. 10 crores in the shares of B Ltd. by borrowing the same from financial institution @10% p.a. As on 31st March, 2005 the project was not completed. The Directors of A Ltd. want to capitalize the interest upto 31st March, 2005 on borrowings amounting to Rs. 1 crore and add it to the cost of investments.* *(5 Marks)*

(c) *A contractor entered into a contract for building roads for Rs. 2 crores. After completing 60% of the contract he came to know that the cost of completing the contract would be Rs. 2.40 crores. The accountant transferred Rs 0.24 crores i.e., 60% of total loss of Rs. 0.40 crores to Profit and Loss account in the current year.* *(5 Marks)*

(d) *Finished goods costing worth Rs. 10 lacs were damaged due to floods in July, 2004. These goods were included in the closing stock as on March 31, 2005 at an estimated realisable value of Rs. 4 lacs. These goods, ultimately, could be sold for Rs. 3 lacs only in the accounting year 2005-06. The difference of Rs. 1 lac was debited to prior period expenditure in the accounting year 2005-06.* *(5 Marks)*

Answer

(a) Qualification in branch auditor's report-subsequent events: The Branch auditor had qualified on non-provision of a major debt. After his report but before the issue of report by Principal auditor an event happened which has thrown new light on the facts that existed as on the date of balance sheet date. This is a subsequent event within the meaning of AAS 19 i.e. event that had taken place between the date of balance sheet date and the date of signing the audit report. In relation to the cases where the component (i.e. branch) is audited by another auditor, the subsequent event would include events that had taken place between the date of audit report of the component and the date of signing the audit report of the entity as a whole by the principal auditor. On becoming aware of the subsequent events, the auditor should consider whether the accounts had been drawn so as to give effect to the facts of subsequent events. Accordingly, the auditor should omit qualification as the debt is no more doubtful in view of its recovery in full. However, the auditor may check that it has in fact been received by a substantial

vouching of the subsequent events which had been considered by him to make himself fully satisfied about his report in the matter.

(b) Capitalisation of interest on borrowing cost : AS-16 states that borrowing cost that are directly attributable to the acquisition, construction or production of a qualifying asset, should be capitalized as a part of the cost of that asset. Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale, e.g. manufacturing plants, power generation facilities etc. that require a substantial period of time to bring them to a saleable condition.

In the given case interest of Rs. 1 crore should not be capitalized because as per AS-16

(a) Investment of Rs. 10 crores in the shares of B Ltd. By A Ltd. is not a qualifying asset.

(b) Only borrowing cost incurred upto acquisition is allowed to be capitalized which would be nil in the case of investments.

Therefore the intention of company is wrong. As an auditor it should be brought to the knowledge of management and interest of Rs. 1 crore should be shown as an expenditure in profit & Loss a/c.

(c) Recognition of Contract Revenue & Expenditure : As per AS-7 when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately irrespective of the stage of completion.

In the given case the revenue that can be recognized for the contract i.e. Rs. 2 crore and the expected expense on the contract is Rs. 2.4 cores. 60% of the contract has been completed. Therefore as per AS-7 whole amount of expected loss i.e. Rs.0.40 crores should be recognized as an expense immediately irrespective of the stage of completion of the contract.

Therefore the action of accountant of transferring only Rs. 0.24 crores to the profit & loss a/c is wrong. He must transfer whole Rs. 0.40 crore to profit & loss a/c as an expense.

Auditor must advice the accountant to rectify the same and if he fails to do so he should qualify his report.

(d) Prior Period Items: As per AS 5 "Prior Period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods."

Prior Period items should be distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information become known or the transaction is finally settled.

In the instant case there is no error or omission in prior periods. It is a case of accounting estimates which have changed when the damaged goods have been finally sold.

Thus the difference of Rs. 1 Lac, debited to prior period expenditure in the accounting year 2005-06 is a wrong accounting treatment.

Question 2

(a) Give your comments on the following:

(i) M/s A & Co., Chartered Accountants, were appointed first auditors of KLM Ltd. By its Board of Directors. The shareholders of the company removed M/s A & Co. before the expiry of their term, by an ordinary resolution in an Extraordinary General Meeting and appointed another auditors in their place. M/s A & Co. have objected that without prior approval of Central Government their removal is illegal. (4 Marks)

(ii) The Articles of Association of ABC Ltd. do not authorise the company to buy back its own shares. However, a special resolution has been passed in general meeting of the company authorising the buy-back. The Directors of the company are of the opinion that even without authority in the Articles of Association the buy-back is possible due to special resolution passed in the general meeting authorizing the buy-back. (4 Marks)

(b) W Ltd. approached SB & Co. a leading firm of Chartered Accountants having two partners S & B to conduct the audit for the year ended on 31st March, 2006. Mr. B is holding 500 equity shares @ Rs. 50 each in W Ltd. Can SB & Co. accept audit of W Ltd.?

(4 Marks)

(c) In a medium size trading organisation the accountant was given additional responsibility *of making recoveries from the debtors. On one occasion, when an insurance claim of Rs. 25,000 was received, he credited the same to the account of a debtor and misappropriated the cash which he had recovered from the said debtor. Pinpoint weaknesses in the internal control system which led to this situation. (4 Marks)*

Answer

(a) (i) Removal of first auditor

As per sub- section (7) of section 224, an auditor may be removed from office before the expiry of his term, by the company in a general meeting , obtaining the prior approval of the Central Govt. in that behalf except that such approval is not required for the removal of the first auditor appointed by the directors under the proviso to sub-section (5) of section 224 of the Companies Act,1956.

Thus the first auditor appointed by the Board of Directors may be removed by shareholders merely passing an ordinary resolution, without obtaining approval of Central Govt.

In view of the above provision of law, the objection of M/s A & Co., Chartered Accountants is not correct as while removing the first auditors of the company before expiry of their term, prior approval prior approval of Central Govt. is not required.Hence the removal of the first auditors by shareholders is valid.

(ii) Buy–back of shares: Section 77A of the companies Act, 1956 provides for various conditions subject to which only the buy-back can be made. The conditions, inter-alia, provide that the buy-back is authorized by its articles. Another condition is that

a special resolution is passed in general meeting of the company authorizing the buy-back.

However, such special resolution alone will not do in the absence of authority in articles.

Therefore, the Directors are wrong in their opinion. The action of the company will be illegal in view of the specific provision under section 77A of the Companies Act, 1956.

(b) Disqualification for Appointment as an auditor: Under section 226(3) of the Companies Act, 1956 a person is not qualified for appointment as auditor of a company if he/she is holding any security of that company.Securities means an instrument which carries voting rights.

A firm would also be disqualified to be appointed asa n auditor even if one partner is disqualified under this clause.

The provision relating to disqualifications aims to prohibit certain financial relationship so as to ensure that an auditor appears to be independent to the world at large.

In the given case Mr. B a partner of Chartered accountancy firm is having 500 equity shares in W Ltd. Holding 500 shares means he is having voting right., Therefore SB & Co. cannot accept audit of W Ltd. If they accept they are violating the provisions of section 226(3) (e).

(c) Following two essential features of internal control are relevant here :

(i) Breaking the chain of the work in a manner so that no single person can handle a transaction from the beginning to the end and

(ii) Segregation of accounting and custodial functions.

Weakness in internal control system in the instant case:

(a) The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries.

(b) It also appears that system for issuing receipts for amount received - whether cash or cheque- is also lacking.

(c) In a small and to some extent medium size organization, the supervision of the owner offsets the deficiencies in internal control system. But in this case, it appears, that supervision and personal control is also lacking.

Thus, in the given case, the main weakness of the system is that it is ignoring the basic requirements of a good internal control system.

Question 3

(a) Explain audit risk by reference to its components. *(8 Marks)*

(b) In case of government companies, Comptroller and Auditor General of India has a right to issue directions to auditor and do supplementary audit. Explain. *(8 Marks)*

Answer

(a) Audit Risk: Audit Risk has been discussed in AAS-6. "Audit risk" means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated.

Components of Audit Risk : As per AAS-6 three components of audit risk are:

1. Inherent Risk - It is the susceptibility of an account balance or class of transactions to misstatement that could be material, individually or when aggregated with misstatements in other balances or classes assuming that there were no related internal controls e.g. accounts involving a high degree of management judgement or highly movable assets like jewellery will involve more inherent risk than other accounts.
2. Control Risk - It is the risk that misstatement that could occur in an account balance or class of transaction and that could be material, individually or when aggregate with misstatements in other balances or classes will not be prevented or detected and corrected on a timely basis by the accounting and internal control system. To assess control risk, the auditor should consider the adequacy of control design, as well as test adherence to control procedures. In absence of such assessment, the auditor should assume that control risk is high.
3. Detection Risk - It is the risk that an auditor's substantive procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material, either individually or when aggregated with misstatements in other balances or classes. The level of detection risk relates directly to the auditor's procedures. Some detection risk would always be present even if an auditor were to examine 100 percent of the account balances.

Inherent and control risk differ from detection risk in that they exist independently of an audit of financial information. Inherent and control risk 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 risk to an acceptable low level.

(b) Power of C & AG: The audits of government companies are carried out by auditors who are appointed by C&AG. The audit is done by qualified Chartered Accountants and the audit is done on similar lines with the audits of limited companies.In addition to report under section 227, the auditors have to give report on the specific matters as contained in the directives of the C&AG.

As per section 619(3) the C&AG shall have power

a. To direct the manner in which the company's accounts shall be audited by the statutory auditor and give instruction in regard to any matter relating to the performance of his functions as such. The direction under section 619(3)(a) broadly covers the system of book keeping and accounts, internal control etc.
b. To conduct a supplementary audit or test audit by such person as he may authorize in this behalf and require the information or additional information to be provided to

any person or persons so authorized, on such matters by such person or persons and in such form as C & AG may by general or special order, direct .

Thus, in case of Govt. Companies, audit is conducted by professional auditors, appointed on the advice of C & AG and the latter is authorized u/s 619(4) of the Companies Act, 1956 to conduct supplementary audit or test audit.The C&AG shall direct the manner in which the company's accounts shall be audited by the statuary auditors and give such auditors necessary instructions in regard to any matter relating to the performance of their functions as such.

The statuary auditor shall submit a copy of their audit report to C & AG who shall have right to comment upon or supplement the audit report submitted by the statuary auditors in such a manner as he may think fit.

Question 4

How will you verify/vouch the following?

(a) Loss of stock by theft. *(4 Marks)*

(b) Stock lying with subcontractor for fabrication. *(4 Marks)*

(c) Sale of empties. *(4 Marks)*

(d) Expenditure for advertisement in newspaper. *(4 Marks)*

Answer

(a) Loss of Stock by Theft

(i) The most important evidence for verification will be the First Information Report (FIR) filed with the Police for this theft.

(ii) The contents of the FIR will be cross checked with the financial books and stock records.

(iii) If no FIR is lodged, then deeper analysis will be required including satisfaction of the reasons for not filing FIR.

(iv) The quantity and value of the stolen stock is not included in the closing stock will be ensured.

(v) Verify whether such stock was insured and whether theft claim was lodged with the insurance company.

(b) Stock lying with sub-contractors for fabrication

(i) The stock lying with the sub contractor for processing should be confirmed by the confirmation letter obtained from the sub contractors.

(ii) The necessity of holding stock by them should be vouched. If the stock is lying with them for long, the reason for the same should be ascertained. The condition of the stock should be confirmed by the management.

(iii) The stock should be valued at cost or net realizable value whichever is less. The processing charges incurred should be added to the cost. The provision for the liability towards unpaid processing charges should be created.

(iv) The stock should be disclosed under the head current assets under the sub head inventory.

(v) Adjustment in accounts should be made for any discrepancies between stock confirmed and stock sent out as per memorandum records.

(c) Sale of Empties : When the empties or containers in which goods necessarily have to be supplied are costly, the manufacturer normally agrees to purchase them back at a reduced price as compared to the one charged for them. Therefore check whether

(i) Separate account of issue and receipt of empties has been prepared.

(ii) In separate maintained a/c check how many empties lies in warehouse and how many are with customers.

(iii) Check how many empties customers may return after the close of the year.

(iv) Check whether proper provision has been made against the contingency of the containers being returned by customers and that for the wear and tear.

(v) Check the amount of sale with entry in cash book.

(vi) See the sold empties are reduced from the stock.

(vii) If the empties are sold on credit, ask for direct confirmation from purchasing party and confirm the sale.

(d) Expenditure for Advertisement in News paper

(i) Vouch the copy of the newspaper sent by the newspaper/ advertisement agency to ensure that advertisement actually appeared in the newspaper.

(ii) See the date of advertisement which appeared in the newspaper should fall in the current accounting year.

(iii) Contents of advertisement should be verified to ascertain that the advertisement was of the entity and was for the business and not of personal nature.

(iv) Ensure the rate charged with the offer received for rates from newspaper and ensure that the size and placement i.e. page is in accordance with the rate charged.

(v) Ensure deduction of TDS and service tax wherever applicable.

(vi) Ensure that it is printed in all issues of the newspaper for which newspaper has charged.

Question 5

(a) Give four examples of accounting estimates. *(4 Marks)*

(b) State any four important elements of input control in processing of data in a computerised accounting system. *(4 Marks)*

(c) What are the disadvantages of the use of an audit programme? (4 Marks)

(d) Mention any four financial indications which may indicate the risk that continuance as a going concern may be questionable. (4 Marks)

Answer

(a) Examples of Accounting Estimates (any four)

(i) Allowances to reduce inventory and account receivables to their estimated realizable value.

(ii) Provisions to allocate the cost of fixed assets and their estimated useful lives.

(iii) Accrued Revenue.

(iv) Provision for taxation

(v) Provision for a loss from a law suit.

(vi) Insurer's liability for outstanding claims.

(vii) Losses on construction contracts in progress.

(viii) Amortisation of certain items like goodwill and deferred revenue expenditure.

(ix) Provision to meet warranty claims.

(x) Provision for retirement benefits like gratuity etc.

(b) Control over input in a computerized data system (any four)

(i) The input fed into the computer should be authorized. The authorization levels should be checked. The authorization is effected by levels of access to the entry for the computer system. The access control is operated through use of password and logging procedures.

(ii) The system should devise controls to check that data input are accurate.

(iii) The input document should be reviewed and verified by another person after preparation.

(iv) Transaction should be accurately converted into machine readable language and recorded in a computer data file.

(v) The transactions are not lost, duplicated, or changed without authorization.

(vi) There should be validity and cross reference checks inbuilt in the system to throw light on errors which appear in the process of feeding input.

(vii) Incorrect transactions are thrown out by a list which must be corrected, resubmitted before the process could run on the inputs.

(viii) The check digit total of financial information contained in the document or hash total may be used to act as a control tool.

(ix) The serial control may be used in inputting data that are to follow serial sequence. Any deviation in serial sequence will have to be automatically signaled out.

(c) Disadvantages of the use of an Audit Programme

(i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.

(ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on.

(iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.

(iv) A hard and fast programme may kill the initiative and innovation of efficient and enterprising assistants.

(d) Financial Indications which may indicate the risk that continuance as a going concern may be questionable (any four):

Indications of risk that continuance as a going concern may be questionable could come from the financial statements or from other sources. Financial indications which may indicate the risk that continuance as a going concern may be questionable are as under:

(i) Negative net worth or negative working capital .

(ii) Fixed term borrowings approaching maturity without realistic prospects of renewal or repayment or excessive reliance on short-term borrowings to finance long-term assets.

(iiii) Adverse key financial ratios.

(iv) Substantial operating losses.

(v) Substantial negative cash flows from operations.

(vi) Arrears or discontinuance of dividends.

(vii) Inability to pay creditors on due dates.

(viii) Difficulty in complying with the terms of loan agreements.

(ix) Change from credit to cash-on-delivery transactions with suppliers.

(x) Inability to obtain financing for essential new product development or other essential investments.

(xi) Entering into a scheme of arrangement with creditors for reduction of liability.

Question 6

Define a comprehensive Audit Progamme for auditing the receipt of fees from the students of a school run by a Charitable Trust. *(16 Marks)*

Answer

Audit Programme for Auditing Receipts of Fees in a School run by Charitable Trust

1. Check names entered in the Students Fee Register for each month or terms with the respective Attendance Register of the class and ensure that fees is collected from all students attending the classes.
2. Verify that there operates a system of internal check which ensures that demands against the students are properly raised.
3. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collection in the Fee Register to confirm that revenue from this source has been duly accounted for.
4. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance or in arrears is accounted for accordingly.
5. Check admission fees with admission slips signed by the head of the instruction and confirm that admission fees is credited to capital Fund.
6. Verify free studentships and concessions and ensure that a proper system and authorization exists for such cases.
7. Confirm that fines for late payment or absence etc. have been either collected or remitted under proper authority.
8. Audit the old and heavy arrears of fees and ensure such fees are not collected by staff without accounting the receipt.
9. Ensure that caution money is shown as liability.
10. Verify the cases of refund of fees.
11. Verify the cases of very old caution money refunds.
12. If fees are increased during the year ensure such increase is properly collected and accounted for.
13. Compare broadly the trend of fees receipts of last three years with reference to number of students of respective years.
14. Scrutinise Bank Reconciliation Statement to find out cheques received for fees are not dishonoured.
15. See that the investment representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested alongwith the corpus.
16. Verify any Government or local authority grant with the memo of grant.

Question 7

(a) (i) What is a qualified audit report? *(3 Marks)*

(ii) Under what circumstances a qualified audit report is issued? *(5 Marks)*

(b) On what companies the Companies (Auditor's Report) Order, 2003 is applicable and what companies are not covered by it? (8 Marks)

Answer

(a) (i) Qualified Audit Report: Qualified reports is issued by an auditor when the auditor is not satisfied as to the truth and fairness of the accounts in certain respects which are reserved and so indicated in his report. Such reservations or exceptions are called qualifications. The auditors reports that the accounts do exhibit true and fair view of the affairs and financial status subject to or except the matters of reservations. Such type of reporting is called qualified report.In majority of cases, items which are the subject matter of qualification, are not so material as to affect the truth and fairness of the whole of the accounts but merely create uncertainty about a particular item.

According to 'Statement on Qualifications in Auditor's Report' issued by the ICAI, all qualifications should be contained in the auditor's report. The words 'subject to' are essential to state any qualification on the financial statements in clear and unambiguous manner.The auditors should state all qualifications independently in their report in an adequate manner so that a reader can assess the significance of these qualifications.

(ii) Qualified audit report is issued when-

1. The auditor is not satisfied in material respects about the truth and fairness of the accounts, proper disclosure, compliance with the Companies Act in areas concerning with financial data.
2. His non-satisfaction is due to circumstances such as limitation on scope of his work, disagreement with management or uncertainty over financial information .
3. The effect of limitation, disagreement, or uncertainty is not so material as to warrant issue of an adverse opinion so as to render the accounts as wholly untrue or unfair or a disclaimer wherein no opinion could be framed.
4. Examples are - (a) non-provision of depreciation, (b) non-provision of doubtful debts (c) disagreement as to timing of accrual of certain income (d) uncertainty as to income recognition but which had been accounted (e) the uncertainty as to recoverability of carried down values of certain assets etc.

(b) Companies covered by the CARO, 2003 : The Order applies to all companies except certain categories of companies specifically exempted from the application of the Order.The Order also applies to foreign companies as defined in section 591 of the Act. According to sub-section (1) of the aforesaid section, companies falling under the following two classes are construed as foreign companies:

(a) companies incorporated outside India which, after the commencement of the Act, establish a place of business within India; and

(b) companies incorporated outside India which have, before the commencement of the Act, established a place of business within India and continue to have an established place of business within India at the commencement of the Act.

In respect of foreign companies, an established place of business in India would include a liaison office. The Order is also applicable to the audits of branch(es) of a company under the Act since sub section 3(a) of Section 228 of the Act clearly specifies that a branch auditor has the same duties in respect of audit as the company's auditor.

Companies Not covered by the order : CARO does not apply to following companies:

(i) A banking company as defined in Clause (c) of section 5 of Banking Regulation Act, 1949;

(ii) An insurance company as defined in clause (21) of Section 2 of the Companies Act, 1956;

(iii) A company licensed to operate under section 25 of the Companies Act, 1956 and

(iv) A private limited company with a paid-up capital and reserves not more than Rs. 50 lakh and which does not have outstanding loan exceeding rupees 25 lakhs from any bank or financial institution and does not have a turnover exceeding rupees 5 crores at any point of time during the financial year.

A private limited company must satisfy all the above condition cumulatively otherwise company auditor has to report on the matters specified in CARO 2003.

Question 8

Write short notes on the following:

(a) Fundamental Accounting Assumptions *(4 Marks)*

(b) Provisions versus Specific Reserves *(4 Marks)*

(c) Sufficient Appropriate Audit Evidence *(4 Marks)*

(d) Auditor's Independence *(4 Marks)*

Answer

(a) Fundamental Accounting Assumptions : AS-1 states that certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed. The following have been generally accepted as fundamental accounting assumptions:

(i) Going Concern: The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

(ii) *Consistency*: It is assumed that accounting policies are consistent from one period to another.

(iii) *Accrual*: Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

(b) Provisions versus specific Reserves : Provisions are amounts charged against revenue to provide for depreciation, renewal or diminution in the value of assets or a known liability the amount of which cannot be determined with substantial accuracy or a claim which is disputed.

Amounts contributed or transferred from profits to make good the diminution in assets values due to the fact that some of them have been lost or destroyed, as a result of some natural calamity or debts have proved to be irrecoverable are also described as provisions. Provisions are normally charged to the Profit and Loss Account before arriving at the amount of profit.

On the other hand, a specific reserve is created for some definite purpose out of the profits of the company. The purpose may be anything connected with the business which the Article of Association, or the directors want to be provided for, such as dividend equalization, replacement of fixed assets, expansion of the organization, Income-tax liability for future foreign exchange fluctuation etc. Though the concerned amounts are carried under the earmarked heads, these are available for distribution as dividend on the recommendation of directors but subject to the approval of shareholders, since these are created by appropriation of profits. To create any specific reserve, existence of profit is essential. Some of the specific reserves may be required under the contractual obligations or legal compulsion, for example: (i) funds for redemption of debentures and (ii) development rebate reserve.

Thus provisions are amounts set apart to meet specific liabilities. These must be provided for regardless of the fact whether or not any profit has been earned by the concern. While to create any specific reserve, existence of profit is essential.

(c) Sufficient Appropriate Audit Evidence : AAS 1 on basic principles governing an audit states "the auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedure, to enable him to draw a reasonable conclusion therefrom on which to base his opinion on the financial information".Sufficiency and appropriateness are interrelated and apply to evidence obtained from both compliance and substantive procedures. Sufficiency refers to the quantum of audit evidence obtained; appropriateness relates to its relevance and reliability. The auditor should evaluate whether he has obtained sufficient appropriate audit evidence before he draws his conclusions therefrom. The evidence should, in total, enable the auditor to form an opinion on the financial information.

(d) Auditor's Independence : Independence is the keystone upon which the respect and dignity of a profession is based. Independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged

him or to his own self interest. The independence is a condition of mind and personal character and should not be confused with the superficial and visible standards of independence which are sometime imposed by law. In the context of auditors, his independence is necessary so as to enable him to express unbiased opinion on financial statements. The user of the financial statement will rely on the opinion of the auditor only when he is convinced about his independence. Independence of the auditor has not only to exist in fact, but should also appear to so exist to all reasonable persons.

The chartered accountant is not known personally to the third parties who rely on professional opinion and accept his opinion and accept his opinion principally on a larger faith on the entire accounting profession.

The Companies Act, 1956, has therefore enacted specific provisions to give concrete shape to this vital concept:

(i) The provisions disqualifying certain types of persons from undertaking audit of limited companies.

(ii) Provisions relating to ceiling on the number of audits that can be undertaken by a chartered accountant.

(iii) Provisions requiring special resolution for appointing auditors in certain cases.

(iv) Other provisions on appointment, re-appointment and removal of auditors, are designed with sufficient independence to carry out the audit in the larger interest of shareholders and other users.

(v) Power to qualify his report is yet another weapon in the armory of the auditor to protect his independence.

PAPER – 3 : BUSINESS AND CORPORATE LAWS

Question Nos. 1 & 7 are compulsory. Candidates are required to attempt four questions out of questions 2, 3, 4, 5 and 6 and two questions out of questions 8, 9 and 10.

Question 1

Answer any four of the following:

(a) Y holds agricultural land in Gujarat on a lease granted by X, the owner. The land revenue payable by X to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue law, the consequence of such sale will be termination of Y's lease. Y, in order to prevent the sale and the consequent termination of his own lease, pays the Government, the sum due from X. Referring to the provisions of the Indian Contract Act, 1872 decide whether X is liable to make good to Y, the amount so paid ?

(b) A, an agent of a buyer, had obtained goods from the Railway organization and loaded the goods on his truck. In the meantime, the Railway organization received a notice from B, a seller, for stopping goods in transit as the buyer had become insolvent. Referring to the provisions of the Sale of Goods Act, 1930 decide whether the Railway organization can stop the goods in transit, as instructed by the seller ?

(c) A and B entered into an agreement to carry on a business of manufacturing and selling toys. Each one of them contributed Rs. 35 lacs as their capital with a condition that A and B will share the profits equally, but the loss, if any is to be borne by A alone. Referring to the provisions of the Indian Partnership Act, 1922 decide whether three exists a partnership between A and B.

(d) A owns a certain sum of money to B. A does not know the exact amount and hence he makes out a blank cheque in favour of B, signs and delivers it to B with a request to fill up the amount due payable by him. B fills up fraudulently the amount larger than the amount due, payable by A and endorses the cheque to C in full payment of dues of B. Cheque of A is dishonoured. Referring to the provisions of the Negotiable Instruments Act, 1881, discuss the rights of B and C.

(e) Examine whether the Payment of Bonus Act, 1965 be applicable to the following cases:

(i) J, who is working in a social welfare organization.

(ii) D, an employee employed by an establishment engaged in an industry carried on by a department of the Central Government.

(f) While an employee may increase his contribution to Provident Fund, is an employer also liable to proportionately increase his contribution to the above under the Employees Provident Funds and Miscellaneous Provisions Act, 1952 ? Explain. (4×5 =20 Marks)

Answer

(a) Yes, X is bound to make good to Y the amount so paid. Section 69 of the Indian Contract Act, 1872, provides that "A person who is interested in the payment of money

which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other. In the given case Y has made the payment of lawful dues of X in which Y had an interest. Therefore, Y is entitled to get the reimbursement from X.

(b) The right of stoppage of goods in transit can be exercised only so long as the goods are in the course of transit. In the given case the transit was at an end as soon as the agent of the buyer obtained goods from the Railway Organisation. Therefore Railway Organisation cannot act as instructed by the seller, who has lost the light of stoppage of the goods in transit as provided in (Section 30 Sale of Goods Act, 1930)

(c) Yes, it is a case of partnership between A and B as sharing losses is not an essential condition to create a partnership. Section 13(b) of the Indian Partnership act 1932 provides Subject to the contract between the partners, the partners are entitled to share equally in the profits earned, and shall contribute equally to the losses sustained by the firm." In the given case the partners make a contract contrary to this provision where A agrees to bear all the losses of the business.

(d) Section 44 of the Negotiable Instruments Act 1881 is applicable in this case. According to Section 44 of this Act, B who is a party in immediate relation with the drawer of the cheque is entitled to recover from A only the exact amount due from A and not the amount entered in the cheque. However the right of C, who is a holder for value, is not adversely affected and he can claim the full amount of the cheque from B.

(e) (i) As per the provisions contained in Section 32 (v) (c) of the Payment of Bonus Act, 1965, 'J' is not entitled to any bonus as the said Act is not applicable to social welfare organization.

(ii) Similarly the said Act is not applicable to the employees engaged by a Department of the Central Government vide Section 32 (iv).

(f) Section 6 of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 provides that an employee can at his will contribute beyond 10% if the scheme makes provision therefor subject to the condition that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this section.

Question 2

(a) Examine whether the following constitute a contract of 'Bailment' under the provisions of the Indian Contract Act, 1872:

(i) V parks his car at a parking lot, locks it, and keeps the keys with himself.

(ii) Seizure of goods by customs authorities. (5 Marks)

(b) State the circumstances under which the Registrar of Societies may cancel the registration of a society registered under the Cooperative Societies Act, 1912. What is the effect of such cancellation ? Explain. (5 Marks)

Answer

(a) (i) No. Mere custody of goods does not mean possession. For a bailment to exist the bailor must give possession of the bailed property and the bailee must accept it (Section 148, Indian Contract Act, 1872 is not applicable).

(ii) Yes, the possession of the goods is transferred to them custom authorities (section 148) is applicable.

(b) The Registrar may cancel the registration of a society under the Co-operative Societies Act, 1912 in the following circumstances:

(i) If the Registrar, after an inquiry has been held by him under Section 35 of the Act, into the constitution, working and financial condition of a registered society, or after a inspection of the books of a society, or after inspection of the books of a society has been made under Section 36, or on receipt of an application made by three-fourths of the members of the members of a society, is of opinion that the society ought to be dissolved. The cancellation take effect after the expiry of two months from the date of the order of cancellation, if no appeal is preferred against the order by any member within that period. If, however, an appeal is presented within that period, the cancellation takes effect only when it is confirmed by the appellate authority i.e., the State Government (Section 39)

(ii) Where it is a condition of the registration of a society that it should consist of at least ten members, and it is proved to the satisfaction of the Registrar that the number of the members has been reduced to less than ten. In this case, the cancellation takes effect from the date of the order (Section 40 and 41).

The effect of such cancellation is that the society ceases to exist as a corporate body from the date the cancellation take effect (Section 41) and the Registrar may appoint a competent person to be liquidator of the society (Section 42)

Question 3

(a) A contracted with B to supply him (B) 500 tons of iron-steel @ Rs. 5,000 per ton, to be delivered at a specified time. Thereafter, A contracts with C for the purchase of 500 tons of iron-steel @ Rs. 4,800 per ton, and at the same time told 'C' that he did so for the purpose of performing his contract entered into with B. C failed to perform his contract in due course. Consequently, A could not procure any iron-steel and B rescinded the contract. What would be the amount of damages which A could claim from C in the circumstances ? Explain with reference to the provisions of the Indian Contract, 1872.

(5 Marks)

(b) A, B and C are partners in a firm called ABC Firm. A, with the intention of deceiving D, a supplier of office stationery, busy certain stationery on behalf of the ABC Firm. The stationery is of use in the ordinary course of the firm's business. A does not give the stationery to the firm, instead brings it to his own use. The supplier D, who is unaware of the private use of stationery by A, claims the price from the firm. The firm refuses to pay

for the price, on the ground that the stationery was never received by it (firm). Referring to the provisions of the Indian Partnership Act, 1932 decide:

(i) Whether the Firm's contention shall be tenable ?

(ii) What would be your answer if a part of the stationery so purchased by A was delivered to the firm by him, and the rest of the stationery was used by him for private use, about which neither the firm nor the supplier D was aware? (5 Marks)

Answer

(a) The problem in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 73. Section 73 provides that when a contract has been broken the party who suffers by such breach is entitled to receive from the party who has broken the contract compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract to be likely to result from the breach of it. The leading case in this point is *Hadley v Baxendale.*

In a leading case of *"Hadley vs. Baxendale"* it was decided that if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.

In the instant case 'A' had intimated to 'C' that he was procuring iron steel from him for the purpose of performing his contract whit 'B' Thus, C had the knowledge of the special circumstance. Therefore, is entitled to claim from 'C' Rs. 1,00,000 (difference between the procuring price of iron steel and contracted selling price to 'B') being the amount of profit 'A' would have made by the performance of his contract with 'B'. If A had not told C of B's contract then the amount of damages would have been the difference between the contract price and the market price on the day of default

If 'A' had not told 'c' of B's contract then the amount of damages would have been the difference between the contract price and the market price on the day of default.

(b) The problem in the question is based on the 'Implied Authority' of a partner provided in Section 19 of the Indian Partnership Act 1932. The section provides that subject to the Indian Partnership Act, 1932, the section provides that subject to the provisions of Section 22 of the Act, the act, the act of a partner, which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm. The authority of a partner to bind the firm conferred by this section is called his 'Implied Authority' [Sub-Section (i) of section 19]. Further more, every partner is in contemplation of law the general and accredited agent of the partnership and may consequently bind all the other partners by his acts in all matters which are within the scope and object of the partnership Hence, if the partnership is of a general commercial nature, he may buy goods on account of the partnership.

Considering the above provisions and explanation, the questions as asked in the problem may be answered as under:

(i) The firm's contention is not tenable, for the reason that the partner, in the usual course of the business on behalf of the firm has on implied authority to bind the firm. The firm is, therefore, liable for the price of the goods,

(ii) In the second case also the answer would be the same as above, i.e. the implied authority of the partner binds the firm.

In both the cases, however, the firm ABC can take action against A, the partner but it has to pay the price of stationery to the supplier D,

Question 4

(a) Mr. S agreed to purchase 100 bales of cotton from T, out of his large stock and sent his men to take delivery of the goods. They could pack only 60 bales. Later on, there was an accidental fire and the entire stock was destroyed including 60 bales that were already packed. Referring to the provisions of the Sale of Goods Act, 1930 explain as to who will bear the loss and to what extent? (5 Marks)

(b) Explain the meaning of the term 'Basic Wages' under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. (5 Marks)

Answer

(a) Section 26 of the Sale of Goods Act, 1930 provides that unless otherwise agreed, the goods remain at the seller's risk until the property there in is transferred to the buyer, the goods are at buyer's risk whether delivery has been made or not. Further Section 18 read with Section 23 of the Act provide that in a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer, unless and until the goods are ascertained where there is contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be express or implied. Applying the aforesaid law to the facts of the case in hand, it is clear that Mr. S has the right to select the good out of the bulk and he has sent his men for same purpose.

Hence the problem can be answered based on the following two assumptions and the answer will vary accordingly.

Where the bales have been selected with the consent of the buyer's representatives:

(i) In this case the property in the 60 bales has been transferred to the buyer and gods have been appropriated to the contract. Thus loss arising due to fire in case of 60 bales would be borne by Mr. S. As regards 40 bales, the loss would be borne by Mr. V, since the goods have not been identified and appropriated.

(ii) Where the bales have not been selected with the consent of buyer's representatives:

In this case the property in the goods has not been transferred at all and hence the loss of 100 bales would be borne by Mr. V completely.

(b) Basic wages" means all emoluments which are earned by an employee while on duty or on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include:

(i) the cash value of any food concessions;

(ii) any dearness allowance (that is to say all cash payment, by whatever name called, paid to an employee on account of rise in the cost of living), house rent allowance, overtime allowance, bonus, commission or pay and other similar allowance payable to the employee in respect of his employment or of work done in such employment; or

(iii) any presents made by the employer. (Section 2(h), EPF & MP Act, 1952.

Question 5

(a) Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following:

(i) A bill of Exchange originally drawn by M for a sum of Rs. 10,000, but accepted by R only for Rs. 7,000.

(ii) A cheque marked 'Not Negotiable' is not transferable. (5 Marks)

(b) Explain the provisions of the Multi-State Cooperative Societies Act, 2002 relating to the appointment and removal of auditors of a society registered under the Act. (5 Marks)

Answer

(a) (i) As per the provisions of the Negotiable Instruments Act 1881, acceptance may be either genial or qualified. It is qualified when the drawee does not accept the bill according to the apparent tenor of the bill but all aches same condition or qualification which have the effect of either reducing his (acceptor's) liability or acceptance of this liability is subject to certain condition, the holder of the bill is entitled to require an absolute and unconditional acceptance, otherwise he will treat it as dishonoured however, he may agree to qualified acceptance nut he does so at his own peril, since he discharge all parties prior to himself, unless he has obtained their consent.

Thus in this given case in accordance with the Explanation to Section 86 of the Act, when the drawee undertakes the payment of part only of the same ordered to be paid. it is a qualified acceptance and the drawer may treat it as dishonoured to unless agreed by him. If the Drawer (M) agrees to acceptance, the drawee (R) is responsible for a sum of Rs. 7000 only.

(ii) It is wrong statement. A cheque marked "not negotiable" is a transferable instrument. The inclusion of the words 'not negotiable' however makes a significant difference in the transferability of the cheques. The holder of such a cheque cannot acquire title better than that of the transferor.

(b) Provision relating to appointment and removal of auditors: (Section 71, Multi-State Co-operative Societies Act, 2002)

(1) A special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.

(2) On receipt of notice of such a resolution, the multi-state co-operative society shall forth with send a copy there of to the retiring auditor.

(3) Where such notice is given and the retiring auditor makes representations in writing to the society (not exceeding a reasonable length) and requests their notification to members, the society shall, (unless the representation are received by it too late):

(a) state the fact of the representations having been made, in any notice of the resolution given to members, and

(b) send a copy of the representation to every member of the multi-state co-operative society to whom notice of the meeting is sent.

(4) If a copy of the representation is not sent to the members because they were received too late or because of the society's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

Question 6

(a) During the accounting year 2005-06, XYZ Limited to which the Payment of Bonus Act, 1965 applies, suffered heavy losses. The Board of Directors of the company decided not to pay any body us to its employees. The employees moved the Court for relief. Referring to the provisions of the Act, decide whether the employees of the company would be given any relief by the Court? (5 Marks)

(b) State the grounds on which a member of a society registered under the Multi-State cooperative Societies Act, 2002 may be expelled from the membership of the Society. (5 Marks)

Answer

(a) Yes, They will succeed. Even if the employer suffers losses during the accounting year he is bound to pay minimum bonus as prescribed by section 10 of the payment of Bonus Act, 1965. i.e.8.33% of the basic wages *(State Vs Sardar Dalip Singh Majilhia, 1979)*

(b) The bye-laws of a co-operative society registered under the Multi State Co-operative Society Act, 2002 may provide that a member may be expelled if:

1. he fails to fulfil his obligations in the matter of dues (the number of months' arrears being specified).
2. he becomes a member of another similar society and refuses to withdraw (because according to the policy of publicity, each member has the right to inspect the books of the society and may pass information to a rival society of which he is a member).
3. he is to be proceeded against for debts.
4. he becomes insolvent.
5. he engages in such activities as might be contrary to the principles of the society.
6. he becomes insane.
7. he is convicted by as criminal court, especially of bribery, forgery, theft or fraud; and
8. he has committed an act, which is considered dishonourable by the Managing Committee.

Further, if a member of a society with unlimited liability joins another society and so pledges his liability join another society and so pledges his liability twice over, he should be expelled.

Question 7

Answer any four of the following:

(a) *The object clause of the Memorandum of Association of LSR Private Ltd, Lucknow authorized to do trading in fruits and vegetables. The company, however, entered into a Partnership with Mr. J and traded in steel and incurred liabilities to Mr. J. The Company, subsequently, refused to admit the liability to J on the ground that the deal was 'Ultra Vires' the company. Examine the validity of the company's refusal to admit the liability to J. Give reasons in support of your answer.* *(5 Marks)*

(b) *VRS Company Ltd. Is holding 45% of total equity shares in SV Company Ltd. The Board of Directors of SV Company Ltd. (incorporated on January 1, 2004) decided to raise the share capital by issuing further Equity shares. The Board of Directors resolved not to offer any shares to VRS Company Ltd, on the ground that it was already holding a high percentage of the total number of shares already issued, in SV Company Ltd. The Articles of Association of SV Company Ltd. provide that the new shares be offered to the existing shareholders of the company. On March 1, 2007 new shares were offered to all the shareholders except VRC Company Ltd. Referring to the provisions of the Companies Act, 1956 examine the validity of the decision of the Board of Directors of SV Company Limited of not offering any further shares to VRS Company Limited. (5 Marks)*

(c) *X, a registered shareholder of Y limited left his share certificates with his broker. A forged the transfer deed in favour of Z, accompanied by these share certificates lodged the transfer deed alongwith the share certificates with the company for registration. The Company Secretary who had certain doubts, wrote to X informing him of the proposed transfer and in the abse of a reply from him (X) within the stipulated time, registered the*

transfer of shares in the name of Z. Subsequently, Z sold the shares to J and J's name was placed in the register of shareholders. Later on, X discovered that forgery has taken place.

Referring to the provisions of the Companies Act, 1956, state the remedy available to X and Z in the given case. Explain. *(5 Marks)*

(d) The paid-up Share Capital of AVS Private Limited is Rs. 1 crore, consisting of 8 lacs Equity Shares of Rs. 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of Rs. 10 each, fully paid-up. XYZ Private Limited and BCL Private Limited are holding 3 lacs Equity Shares and 1,50,000 Equity Shares respectively in AVS Private Limited.

XYZ Private Limited and BCL Private Limited are the subsidiaries of TSR Private Limited.

With reference to the provisions of the Companies Act, 1956, examines whether AVS Private Limited is a subsidiary of TSR Private Limited ? Would your answer be different if TSR Private Limited has 8 out of total 10 directors on the Board of Directors of AVS Private Limited ? *(5 Marks)*

(e) State the purposes for which the object clause of the Memorandum of Association of a public limited company, registered under the Companies Act, 1956, can be altered. *(5 Marks)*

Answer

(a) In terms of Companies Act, 1956, the powers of the company are limited to:

(i) Powers expressly given by the Memorandum (which is popularly known as 'express' power or conferred by the companies Act 1956, or other statue and (ii)

(ii) powers reasonably incidental or necessary to the company's main purpose (termed as "Implied' powers). The Act further provides that the acts beyond the powers of a company are ultra virus and void and cannot be ratified even though every member of the company may give his concert *[Ashbury Railway Carriage Company Vs Richee]*

The object clause enable shareholders, creditors or others to know what its powers are and what is the range of its activities and enterprises, the objects clause in therefore is of fundamental importance to the share holder, creditors and other.

M/s LSR Pvt. Ltd is authorised to trade directly on fruits and vegetables. It has no power to enter into a partnership for Iron and steel with Mr. J, Such act can never be treated as 'express' or 'implied' powers to the company. Mr J who entered into partnership is deemed to be aware of the lack of powers of M/s LSR (Pvt) Ltd. In the light of the above, Mr, J cannot enforce the agreement or liability against M/s LSR Pvt. Ltd Rr. J should be advised accordingly. This conclusion is supported by the decision reported in the case of '*The Ganga Mata Refinery Company (Pvt) Ltd CIT*.

(b) The problem as asked in the question is based on the application of the precisions of the Companies Act, 1956 as contained in Section 81 and the ruling given in *Gas Meter Co. Ltd. Vs Diaphragm & General leather co. Ltd.*

According to Sec 81 if, at any time after the expiry of two years from the formation of the company of after the expiry of One year from the first allotment of shares, whichever is earlier, it is proposed to raise subscribed capital by allotment of further shares, it should be offered to the existing equity share holder of the company in proportion to the capital paid upon those shares. Further in case of Gas Meter Ltd. Vs Diaphragm, & General; leather Co. Ltd where the facts of the case were similar to those given in the problems asked in the question, the articles of Diaphagm Co. provided that the new shares should first be offered to the exciting share holders. The company offered new shares to all shareholders excepting Gas Co., which held its controlling shares. It was held that D company could be sustained from doing this.

In the given case applying the provisions and the ruling in the above case, SV Ltd.'s decision not to offer any further shares to VRS Co. ltd on the ground that VRS Co. Ltd already hold a high percentage of shareholding in SV Co. Ltd. is not valid for the reason that it is violative of the provisions of Section 81 and against the ruling in the above case.

Secondly, the offer for issue of the shares was made on 1st March 2007, i.e. after two years of the formation of the company. Therefore Board of Directors of SV Ltd cannot take a decision not to allot shares to VRS Company, unless the same is approved by the Co. in general meeting by means of special resolution as required under Section 81 (A).

(c) In the given case, there is a forged transfer of shares. The company in such a case should first inquire into the validity of the instrument of transfer. It should also send a notice to the transfer or of his address and inform him that such a transfer has been lodged and if no objection is made before this specified date, it would be registered.

Remedies available to X:

Since a forged transfer is nullity, it does not pass any legal title to the transferee. The true owner can have his name restored on the register of member. A forged document can never have any legal effect.

(1) Can also claim any dividend, which may not have been paid to him during the intervention period. *(Barton V North Staffordshire)*

Remedy to Z:

(2) If by forgery a person obtain a certificate of transfer of shares from a company and transfers the shares to a purchaser for value acting in good faith i.e. without the knowledge of forgery, such purchaser does not get good title to the shares so transferred because a forged transfer is a nullity and cannot be a source of a valid transfer of title. But the company shall be liable to compensate the purchaser in so far as the company had issued a certificate to transfer and was therefore, estopped from denying the liability accruing from his own ach therefore, if Z has suffered any loss, he can claim it from the company in this case.

(d) Holding, subsidiary relationship: For the purpose of determining whether a company is subsidiary of another company, only equity shares issued by the first mentioned company are to be taken into account [Section 4 (1) (b) (ii), Companies Act, 1956].

Again, share held by a subsidiary company shall be treated as held by its holding company [Section 4 (3) (b) (ii)] If a company by itself or along with its subsidiaries holds more than half in nominal value of the equity shares capital of another company, it will be considered as the holding company of the other company [Section 4(3) (b) (ii)]

In this case, the equity share capital of AVS Pvt. Ltd. is Rs. 80,00,000 consisting of 8,00,000 equity shares of Rs 10 each fully paid up XYZ and BCL Pvt. Ltd. are holding 4,50,000 (3,00,000+1,50,000) equity shares in AVS Pvt Ltd., tsr Prt, Ltd will be treated as holding more than half in nominal value of the equity share capital of AVS Pvt Ltd.

If TSR Pvt. Ltd. controls the composition of the board of Directors of AVS Pvt. Ltd; it will also be treated as holding company by virtue of Section 4 (1) (a). Hence the answer will not be different.

(e) The members of a company may rightly expect that their money would be employed only for the objects for which the company has been established. Accordingly, the Act permits alternation of the object, only so far as is considered necessary for specified purposes. Section 17 (1) permits a company to alter its objects for the under mentioned purposes:

(a) to carry on business mire economically:

(b) to attain the main purpose of the company by new or improved means:

(c) To carry on some business which under the existing circumstance may conveniently or advantageously be combined with the existing business.

(d) To change and enlarge the local area of operations;

(e) To restrict or abandon any of the existing objects;

(f) To sell or dispose of the whole or any part of the undertaking;

(g) To amalgamate with any other objects or body or person.

Question 8

(a) Explain the provisions of the Companies Act, 1956 relating to the 'Service of Documents' on a company and the members of the company. When is service of document deemed to be effective in case the document is sent by post ?Explain. (5 Marks)

(b) State any six charges which are required to be registered under the provisions of the Companies Act, 1956. What is the effect of non-registration of a charge required to be registered under the Act ? Explain. (5 Marks)

Answer

(a) Accordingly to Section 53 of the Companies Act, 1956, a company may serve a document on its member either personally or by sending it by post to him, to his registered address, or if he residing abroad in India (who may be residing abroad) to the address (if any) with in India supplied by him to the company for giving notices to him [Section 53 (1)] if a person residing abroad has not supplied to the company on address within in India for the purpose of giving notice to him, then a document advertised in a

newspaper circulating in the neighborhood of the registered office of the company shall be deemed to be duly served on him on the day on which the advertisement appears. [Section 53 (3)] In the case of joint holders of a share, notice may be served on the joint holder name first [Section 53(4)] When a share holder dies, it becomes the duty of the legal representative to furnish their address for a notice to be sent and if they fail to send the intimation to the company, the company is entitled to serve at the address which is recorded with it. The same rule applies in the case of insolvent member, when the assignees have not furnished their address [Section 53 (5)].

Where a document is sent by post, it is enough if the letter containing the document is properly addressed and sent by ordinary post. But at the request of a any member, notice may be served by registered post or under certificate of posting, provided the member has deposited adequate money to meet the express {Section 53 (2) (a)].

Where a document is served by post, service shall be deemed to have been effected:

(1) In the case of notice of a meeting at the expiration of 48 hours after the letter containing the same is posted, and

(2) In any other case at the time at which the letter would be delivered on the ordinary course of post.

(b) The following are the charges required to be registered with the registrar of companies within 30 days after the date of its creation: As per Section 125, Companies Act, 1956

(i) a charge for the purpose of securing any issue of debentures;

(ii) a charge on uncalled share capital of the companies.

(iii) a charge on any immovable property, wherever, situated, or any interest therein,

(iv) a charge on any book debt of the company.

(v) a charge not being a pledge, on any movable property of the company;

(vi) a floating charge on the undertaking or any property of the company including stock-in-trade;

(vii) a charge on calls made but not paid,

(viii) a charge on a ship or any share in ship;

(ix) a charge on goodwill on a patent or licence under a patent, on a trademark or on a copyright or a license under a copy right.

Effect of non registration of charge: -

If any of the charges is not registered, it shall be void against the liquidators and any creditor of the company [Section 125 (1)] *(Monalithic Building Co.)*

When the charge becomes void, the money secured thereby shall immediately become payable (Section 125 (3). The company and every officer of the company may be subjected to a penalty up to Rs. 5000 for every day during which the default continues. In the event of the charge being void for non registration no right of lien can be claimed

on the documents of title, as they are only ancillary to the charged and were delivered pursuant to the charge (In re Mottar Ltd,) Though the charge becomes void for non-registration, but the debt is good as a simple debt is good as a simple debt *(e. Padam ji Co. V Moose)*

Question 9

(a) Though six out of seven signatures to the Memorandum of Association of a company were forged, the company was registered and the Certificate of Incorporation issued. Can the registration of the company be challenged subsequently on the ground of forged signatures ? (5 Marks)

(b) Who are the persons entitled to receive notice of a general meeting of a company, registered under the Companies Act, 1956 ? Shall the non-receipt of notice of the general meeting by any member invalidate the proceedings of the meeting ? Explain. (5 Marks)

Answer

(a) No. Registration cannot be challenged. Section 35 of the Companies Act 1956 declares that certificate of incorporation given by the Registrar in respect of any company shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is company authorized to be registered and duly registered under the Act. *(Peel's Case)*

(b) Persons entitled to notice: Notice of the meeting shall be given:

(a) To every member of the company;

(b) To the persons entitled to a share in consequence of the death or insolvency of a member;

(c) To a auditor or auditors [Section 172 (a); and

The company cannot take notice of the beneficial owner of shares who are, therefore, not entitled to receive notice. Where, however, anyone is legally entitled to represent the member, such representative is entitled to receive the notice.

A private company, which is not, a subsidiary or a public company may prescribe, by its Articles, persons to whom the notice should be given. It does not always follow that all the members of a company are entitled to receive notice of meetings of the company; the Articles frequently provide that preference shareholders shall not be entitled to receive notice of and vote at general meeting of the company, except in certain circumstances. There is a statutory obligation to send notice to preference shareholders when their dividend is in arrears for more that a certain period [section 87(2) (b)]. This obligation arises from the fact that preference shareholders whose dividends are in arrears are entitled to attend and vote at the meeting.

The non-receipt of notice or accidental omission to given notice to any member shall not

invalidate the proceeding in the meeting [Section 172 (3)]. However, omission to serve notice of meeting on a member on the mistaken ground that he is not shareholder cannot be said to be an accidental omission *[Musselwhite Vs. C.H. Musselwhite* & sons Ltd. (1962) 32 Comp. Cas 804] 'Accidental omission' means that the omission must be not only designed but also not deliberate *[Maharaja Export Vs. Apparels Exports Promotion Council (1986) 60 Comp. Cas 353.].*

Question 10

(a) ABC Limited served a notice of a general meeting upon its members. The notice stated that a resolution to increase the Share Capital of the company would be considered at the meeting. A member complains to the company that the amount of the proposed increase was not specified in the notice. In the light of the provisions of the Companies Act, 1956, examine the validity of the notice. (5 Marks)

(b) XYZ Limited held its Annual General Meeting on September 15, 2006. The meeting was presided over by Mr. V, the Chairman of the Company's Board of Directors. On September 17, 2006, Mr. V, the Chairman, without signing the minutes of the meeting, left India to look after his father who fell sick in London. Referring to the provisions of the Companies Act, 1956, state the manner in which the minutes of the above meeting are to be signed in the absence of Mr. V and by whom. (5 Marks)

Answer

(a) Section 173 of the Companies Act, 1956 requires a company to annex an explanatory statement to every notice for a meeting of company, at which some 'special business' is to be transacted. This explanatory statement is to bring to the notice of members all material facts relating to each item of special business. Section 173 further specifies that all business in case of any meeting is regarded as special business. Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 173.

(b) By virtue of Section 193 (1A) (b) of the Companies Act, 1956, minutes of proceeding of general meeting can be signed and dated within a period of 30 days, by a director duly authorized by the board for the purpose. In the circumstances contemplated by the question, therefore, a Board meeting has to be convened and one of the directors present there at be authorized to sign and date the minutes of the annual general meeting.

SUMMARY OF EXAMINERS' COMMENTS ON THE PERFORMANCE OF CANDIDATES

PAPER – 1 : ACCOUNTING

General Comments

The performance of the candidates has not been satisfactory. The answers of the candidates showed lack of knowledge and understanding of the subject, specially the accounting standards. It is also observed that the candidates neglect the theoretical aspects of the subject, they are advised to go through the study material carefully. The solutions to practical problems must be given in suitable formats along with sufficient working notes. It is suggested that the question paper should be gone through carefully before writing the answers. A thorough practice and lots of reading of the subject is required to maintain the level of knowledge expected from the students of PE II Level.

Specific Comments

Question 1. Partnership Accounts: The performance of the candidates was not up to the mark. Most of them failed to ascertain the amount of cash brought in by partners, A and B. Few among them could not show the correct treatment for the asset gifted by A and B to C and consequently, they were not able to prepare realization account, cash account and partners' capital accounts.

Question 2. Internal Reconstruction of a Company: The performance of the candidates was not satisfactory in this part of the question. Many candidates could not give the required journal entry for the settlement of tax liability. Few candidates could not derive the correct amount of balancing figure (transferred to capital reserve) of capital reduction account.

Question 3. Branch Accounts: Most of the candidates performed fairly well in this question. However, some of them could not prepare the branch stock and branch adjustment account properly , as a result of which the correct profit could not be ascertained.

Question 4. (a) Computation of Provision required in the Profit and Loss Account of a Bank: This question was satisfactorily answered by most of the candidates. Most of them did not apply the correct percentages of provisioning, and therefore they were not able to compute the correct amount of provision required in the Profit and Loss Account of Bank.

(b) Accounts of Electricity Supply Company: The candidates have performed badly in this question. Most of the candidates could not prepare the statement showing value of the asset to be capitalized and the amount to be written off to revenue account. They were not able to draw the required journal entries.

Question 5.Insolvency Accounts of Non-Corporate Entities: The overall performance was poor in this question. Except few, all of the candidates failed to attempt the question correctly. Many candidates did not calculate the correct amounts of List A creditors and properties according to List E. Some of them failed to compute the accumulated profit correctly and therefore, could not prepare the deficiency account correctly.

Question 6. Theory Question

(a) AS 7: The performance of the candidates in this part of the question was unsatisfactory. Only few candidates could give the disclosure requirements of AS 7 in the required manner.

(b) Accounting for Govt. Grants: This question was satisfactorily answered by majority of the candidates. However, some candidates could not write about the depreciation provision.

(c) Actuarial Valuation: The overall performance was poor in this part of question. Some of the candidates confused actuarial valuation with accrual basis of accounting and wrote irrelevant answer.

(d) Uses of Accounting Information in Agriculture Farm: Average performance was observed in this part of the question. Some of the candidates described the problems of the farmers rather than the information that can be extracted from the well designed accounting system.

(e) B list Contributories: This question was satisfactorily answered by majority of the candidates.

(f) AS 10: Most of the candidates performed fairly well in this part of the question.

PAPER – 2 : AUDITING

General Comments

1. Answers of the candidates showed lack of knowledge and understanding of the subject especially accounting standards, AAS and Companies Act.
2. Instructions given for writing answers were not followed strictly by most of the candidates.
3. In many cases, answers to sub-questions were not in proper sequences and were scattered throughout the paper.
4. Handwriting of many candidates appeared illegible.
5. Language used for writing answers in general was poor.
6. It was observed that candidates have written unnecessary and irrelevant texts to enlarge the length of answers or just to show off the questions have been attempted.

Specific Comments

Question 1. (a) The answers were not at all satisfactory. Only a few could correlate the answer with AAS-19. Some of the candidates found fault with the branch auditor who qualified the report on non-provision of a major debt.

(b) Most of the candidates mentioned that interest should be capitalized and added with cost of investments. Many candidates were not aware of the provisions of AS-16 on borrowing cost. Only few candidates mentioned that the investment of Rs. 10 crores in shares of B Ltd by A Ltd cannot be considered as qualifying asset and hence interest of Rs. 1 crore should not be

capitalized and should be shown as expenditure in the profit & loss account. Some candidates were confused by referring AS-13 on investment accounting.

(c) Only few candidates answered in conformity with requirement of AS-7 on construction contract by mentioning that whole loss of Rs. 0.40 crores should be transferred to profit & loss account as an expense. Many candidates were not aware that when it is probable that total contract costs will exceed total contract revenue the expected loss should be recognized as expenses immediately irrespective of the stage of completion.

(d) The distinction between prior period expenses and change in accounting estimates was not clearly understood by some candidates. Only selected candidates correctly stated that the instant case cannot be considered as prior period expense as there is no error or omission in the earlier period with reference to AS-5.

Question 2. (a) (i) Though many of the answers were correct a few students mentioned that removal of first auditors by share holders without the approval of Central Govt. is invalid.

(a) (ii) Many of the candidates were unaware of the provision of section 77A of the Companies Act, 1956 regarding buy back of shares. Some agreed with the act of the directors of ABC Ltd in buying back of shares with just a special resolution.

Question 2. (b) Though many of the answers were correct, a few students were not aware of clause (e) to subsection 3 of section 226 of the Companies Act, 1956 which substituted the erstwhile clauses by an amendment in 2000.

(c) Some of the answers were general. Some candidates wasted their time in rewriting the question. Only selected candidates pinpointed the weakness of the internal control system in the instant case and measures to overcome the same.

Question 3. (a) Most candidates identified the types of risk but failed to explain properly.

(b) Most candidates explained at length the various rights of C & AG which is not intended by the question. They failed to concentrate on specific right of issuing directions to auditor and doing supplementary audit.

Question 4 (a), (b), (c), & (d) Answers to these questions were general in nature. Many candidates failed to provide exact vouching/Verification requirements. Only a few candidates mentioned the requirement of verifying the FIR in connection with the loss of stock by theft.

Question 5.(a) Some candidates wrote irrelevant answers without mentioning the examples for Accounting estimates as per AAS-18.

(b) Instead of mentioning elements of input control some candidates wrote General EDP controls.

(c) The answers were in general satisfactory.

(d) Only selected candidates mentioned the financial indicators indicating the risk that continuance as going concern may be questionable with reference to AAS-16.

Question 6. The question is specifically on Audit programme on receipt of school fees. Some candidates have written generally on Audit of school run by a charitable Trust. Candidates

wrote lengthy answers to topic not relevant like constitution, trust deed, minute book, fixed assets, taxation, expenditure of the school etc., resulting in less weightage given to topic on audit programme on receipt of school fees.

Question 7. (a) Many candidates answered the meaning of qualified Audit Report satisfactorily. However circumstances in which a qualified audit report is issued have been mentioned only by selected candidates with reference to AAS-28.

(b) The answers were in general satisfactory. Some candidates failed to mention the applicability of CARO 2003 to foreign companies as defined in Sec 591 of the Companies Act. Some candidates have not mentioned correctly the conditions stipulated to private company for which CARO-2003 is not applicable.

Question 8. (a) The answers were in general satisfactory. Some candidates were not able to identify all the three fundamental accounting assumptions.

(b) The answers were in general satisfactory. Some candidates failed to give examples.

(c) Many candidates wrote elaborately on audit Evidence. Some candidates failed to mention the meaning of sufficiency and appropriateness of audit evidence as defined in AAS-5.

(d) Though the answers were in general satisfactory only few candidates highlighted the provisions of the Companies Act securing the Independence of Auditors.

PAPER – 3 : BUSINESS AND CORPORATE LAWS

General Comments

The performance in general was 'average'. Candidates lacked in

- writing skills
- knowledge of English
- presentation of answers in accordance with the relevant provisions of various laws.

Specific Comments

Question 1. The overall performance was satisfactory except to the sub-question (a) and (d). Candidates should give reasons to their answers and support it with reference to sections.

Question 2. Majority of the candidates were not familiar with the concept of bailment and its practical application. The circumstances under which the Registrar of Societies may cancel registration of a society under the Cooperative Societies Act, 1912 could not be listed correctly by many candidates.

Question 3. The answer to question on claim of damages under the Indian Contract Act, 1872 was sketchy and most of the candidates did not cite the relevant case law. i.e. Hadley v Baxendale. Very few understood and solved the problem on the Implied Authority of Partners based on the Indian Partnership Act, 1932.

Question 4. The performance to both parts of the question was satisfactory.

Question 5. The performance was unsatisfactory. Candidates lacked knowledge of the provisions relating to Negotiable Instruments Act, 1881 and the Multi-State Co-operative Soceities Act, 2002.

Question 6. Most of the candidates solved the problem based on the Payment of Bonus Act, 1965 and answer relating to the question on the grounds on which a member of a society registered under the Multi State Cooperative Societies Act, 2002 may be expelled from the membership of the Society was more sketchy.

Question 7. The problem based on ultra vires transaction was attempted by many candidates but did not refer to the case law i.e Ashbury Railway Carriage Company vs. Richee. The performance to other parts of the questions on company law was average.

Question 8. The question on Service of Documents under the Companies Act, 1956 was attempted by a very few.

Question 9. The problem based on Section 35 of the Companies Act, 1956 was solved by a very few. ie, the validity of the Certificate of Registration which was given based on the document on which the signatures to the Memorandum of Association were forged.

Question 10. Most of the candidates failed to bring out the relevance of section 173 of the Companies Act, 1956 in relation to annexing an Explanatory Statement to every notice for a meeting of the company at which some special business is to be transacted. Signing of minutes and the period within which it is to be signed by a Director was not known to majority of the candidates.

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4	A. : Business Communication (Nov. 2002 to Nov. 2004)	25		40	
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2.	Auditing (May, 2000 to November 2006)	40		40	
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PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

Question No. 1 and 6 are compulsory.

Answer any three questions from the rest.

Working notes should form part of the answer.

Question 1

(a) Following details are related to the work done in Process 'A' of XYZ Company during the month of March, 2007:

Opening work-in-progress (2,000 units)	*Rs.*
Materials	*80,000*
Labour	*15,000*
Overheads	*45,000*
Materials introduced in Process 'A' (38,000 units)	*14,80,000*
Direct labour	*3,59,000*
Overheads	*10,77,000*
Units scrapped: 3,000 units	
Degree of completion:	
Materials	*100%*
Labour and overheads	*80%*
Closing work-in-progress : 2,000 units	
Degree of Completion:	
Materials	*100%*
Labour and overheads	*80%*
Units finished and transferred to Process 'B' : 35,000	
Normal Loss:	
5% of total input including opening work-in-progress	
Scrapped units fetch Rs. 20 per piece.	

You are required to prepare:

(i) Statement of equivalent production;

(ii) Statement of cost;

(iii) Statement of distribution cost; and

(iv) Process 'A' Account, Normal and Abnormal Loss Accounts.

(b) Explain briefly each of the following categories in Activity based Costing by giving at least two examples:

(i) Unit level activities

(ii) Batch level activities

(iii) Product level activities

(iv) Facility level activities. *(10 + 8 = 18 Marks)*

Answer

(a) Statement of Equivalent Production

Input	*Units*	*Output*	*Units*	*Equivalent production*			
				Material		*Labour & Overheads*	
				%	*Units*	*%*	*Units*
Opening WIP	2,000	Completed and transfer to Process 'B'	35,000	100	35,000	100	35,000
Units introduced	38,000	Normal loss (5% of 40,000)	2,000		–		–
		Abnormal loss	1,000	100	1,000	80	800
		Closing WIP	2,000	100	2,000	80	1,600
	40,000		40,000		38,000		37,400

(ii) Statement of Cost

Details	*Cost at the beginning of process*	*Cost added*	*Total cost*	*Equivalent Units*	*Cost per unit*
	Rs.	*Rs.*	*Rs.*	*Rs.*	*Rs.*
Material	80,000	14,80,000	15,60,000		
Less: Value of normal loss			(20 × 2,000 = 40,000)	38,000	40
			15,20,000		
Labour	15,000	3,59,000	3,74,000	37,400	10
Overheads	45,000	10,77,000	11,22,000	37,400	30
					80

(iii) Statement of distribution of cost:

(a) Completed and transferred to process 'B' = 35,000 units @Rs. 80 = Rs. 28,00,000.

(b) Abnormal loss : 1,000 units:

Materials 1,000 units @ 40 = Rs. 40,000

Labour and Overheads 800 units @ 40 = Rs. 32,000

Rs. 72,000

(c) Closing WIP : 2,000 units

Materials 2,000 units @ 40 = Rs. 80,000

Labour and Overheads 1,600 units @ 40 = Rs. 64,000

Rs. 1,44,000

(iv) Process 'A' Account

Dr.							*Cr.*
	Particulars	*Units*	*Amount*		*Particulars*	*Units*	*Amount*
To	Opening WIP	2,000	1,40,000*	By	Normal Loss	2,000	40,000
	Material introduced	38,000	14,80,000	By	Abnormal loss	1,000	72,000
	Direct labour		3,59,000	By	Process 'B' A/c transfer to next process	35,000	28,00,000
	Overheads		10,77,000				
				By	Closing WIP	2,000	1,44,000
		40,000	30,56,000			40,000	30,56,000

*Materials + Labour + Overheads = Rs. (80,000 + 15,000 + 45,000) = Rs.1,40,000.

Normal Loss Account

Dr.							*Cr.*
To	Process 'A' A/c	2,000	40,000	By	By Cost Ledger Control A/c	2,000	40,000
		2,000	40,000			2,000	40,000

Abnormal Loss Account

Dr.							*Cr.*
To	Process 'A' A/c	1,000	72,000	By	By Cost Ledger Control A/c	1,000	20,000
				By	Costing Profit and Loss A/c		52,000
		1,000	72,000			1,000	72,000

(b) (i) Unit level activities – The cost of some activities (mainly primary activities) are strongly co-related to the number of units produced. These activities are known as unit level activities. Examples are:

(a) The use of indirect materials.

(b) Inspection or testing of every item produced or say every 100th item produced.

(c) Indirect consumables.

(ii) Batch level activities – The cost of some activities (mainly manufacturing support activities) are driven by the number of batches of units produced. These activities are known as Batch level activities. Examples are:

(a) Material ordering.

(b) Machine set up cost.

(c) Inspection of products - like first item of every batch.

(iii) Product level activities – The cost of some activities are driven by the creation of a new product line and its maintenance. These activities are known as Product level activities. Examples are:

(a) Designing the product.

(b) Producing parts to a certain specified limit.

(c) Advertising cost, if advertisement is for individual products.

(iv) Facility level activities – The cost of some activities cannot be related to a particular product line, instead they are related to maintaining the building and facilities. These activities are known as Facility level activities. Examples are:

(a) Maintenance of buildings.

(b) Plant security.

(c) Production manager's salary.

(d) Advertising campaigns promoting the company.

Question 2

(a) What is 'Integrated Accounting System'? State its advantages.

(b) A Club runs a library for its members. As part of club policy, an annual subsidy of upto Rs. 5 per member including cost of books may be given from the general funds of the club. The management of the club has provided the following figures for its library department.

Number of Club members	*5,000*
Number of Library members	*1,000*
Library fee per member per month	*Rs. 100*
Fine for late return of books	*Re. 1 per book per day*
Average No. of books returned late per month	*500*
Average No. of days each book is returned late	*5 days*
Number of available old books	*50,000 books*
Cost of new books	*Rs. 300 per book*
Number of books purchased per year	*1,200 books*
Cost of maintenance per old book per year	*Rs. 10*

Staff details	*No.*	*Per Employee Salary per month (Rs.)*
Librarian	*01*	*10,000*
Assistant Librarian	*03*	*7,000*
Clerk	*01*	*4,000*

You are required to calculate:

(i) the cost of maintaining the library per year excluding the cost of new books;

(ii) the cost incurred per member per month on the library excluding cost of new books; and

(iii) the net income from the library per year.

If the club follows a policy that all new books must be purchased out of library revenue (a) What is the maximum number of books that can be purchased per year and (b) How many excess books are being purchased by the library per year?

Also, comment on the subsidy policy of the club. *(4 + 10 = 14 Marks)*

Answer

(a) Integrated Accounting System:

It is such a system of accounting whereby cost and financial accounts are kept in the same set of books. Obviously, then there will be no separate set of books for costing and financial records. Integrated accounts provide or meets out fully the information requirements for costing as well as financial accounts.

Advantages of Integrated Accounting System:

(i) The question of reconciling of costing and financial profits does not arise, as there is one figure of profit only.

(ii) Due to use of one set of books, there is significant extent of saving in efforts made.

(iii) No delay is caused in obtaining information as it is provided from books of original entry.

(iv) It is economical as it is based on the concept of centralisation of Accounting function.

(b) Computation of total revenue

No. of library members	No	1,000
Library fees per month	Rs.	1,00,000
Late fees per month (500 × 5 × 1)	Rs.	2,500
Total Revenue per month	Rs.	1,02,500
Total Revenue per annum (1,02,500 × 12)	Rs.	12,30,000

Computation of total cost

Staff details	*No.*	*Salary per month*	*Total cost*
		Rs.	*Rs.*
Librarian	1	10,000	10,000
Assistant Librarian	3	7,000	21,000
Clerk	1	4,000	4,000
Total Staff cost per month			35,000
Total Staff cost per year (35,000 × 12)			4,20,000
	No.	Cost per book	
Books maintenance cost	50,000	Rs. 10	5,00,000
Total maintenance cost per annum excluding cost of new books (4,20,000 + 5,00,000)			9,20,000

Cost incurred per library member per annum (Rs. 9,20,000/1,000)	Rs.	920
Cost incurred per member per month on the library excluding cost of new books (920/12)	Rs.	76.67
Cost incurred per club member per annum (9,20,000/5,000)	Rs.	184
Cost incurred per club member per month (184/12)	Rs.	15.33
Net income from the library per annum (12,30,000 – 9,20,000)	Rs.	3,10,000
Cost per new book	Rs.	300
Maximum number of new books per annum (3,10,000/300)	No.	1033.333
Present number of books purchased	No.	1200
Excess books purchased (1200 – 1033.333)	No.	166.6667
Subsidy being given per annum	Rs.	50,000
Subsidy per library member per annum (50,000/1,000)	Rs.	50
Subsidy per club member per annum (50,000/5,000)	Rs.	10

Comment:

The club is exceeding its subsidy target to members by Rs. 45 (Rs. 50 – 5) per library member and Rs. 5 (Rs. 10 – 5) per club member.

Question 3

(a) Raw materials 'AXE' costing Rs. 150 per kg. and 'BXE' costing Rs. 90 per kg. are mixed in equal proportions for making product 'A'. The loss of material in processing works out to 25% of the product. The production expenses are allocated at 40% of direct material cost. The end product is priced with a margin of 20% over the total cost.

Material 'BXE' is not easily available and substitute raw material 'CXE' has been found for 'BXE' costing Rs. 75 per kg. It is required to keep the proportion of this substitute material in the mixture as low as possible and at the same time maintain the selling price of the end product at existing level and ensure the same quantum of profit as at present.

You are required to compute the ratio of the mix of the raw materials 'AXE' and 'CXE.

(b) Answer any three of the following:

(i) Explicit and Implicit Costs

(ii) Period Costs and Discretionary Costs

(iii) Efficiency Audit and Proprietary Audit

(iv) Bin Cards and Stock Control Cards. *(8 + 6 = 14 Marks)*

Answer

(a) Working Notes:

(i) Computation of material mix ratio:

Let 1 kg. of product A requires 1.25 kg. of input of materials A X E and B X E

Raw materials are mixed in equal proportions.

Then raw material A X E = $\frac{1.25}{2} = .625$ kg.

Then raw material B X E = $\frac{1.25}{2} = .625$ kg.

(ii) Computation of selling price / kg. of product A

		Rs.
Raw material A X E .625 kg. × 150 = Rs. 93.75		
Raw material B X E .625 kg. × 90 =	Rs. 56.25	150.00
Production expenses (40% of material cost)		60.00
Total cost		210.00

Add: profit 20% of total cost	42.00
Selling price	252.00

Computation of proportions of materials A X E and C X E in 'A'

Let material C X E required in product A be m kg.

Then for producing 1 kg of product 'A', material A X E requirement = (1.25 − m) kg.

To maintain same level of profit and selling price as per Working note (ii), it is required that the total cost of material in 1 kg. of product A should not exceed Rs. 150,

i.e., m kg. × Rs. 75 + (1.25 −m) kg. × 150 = Rs. 150

or 75 m + 187.5 – 150 m = 150

or 75 m = 37.5

or m = 0.5 kg.

Raw material A X E requirement in product A = 1.25 – .5 = .75 kg.

So, proportion of material A X E and C X E

= .75 : .50

i.e. 3 : 2.

(b) (i) Explicit and Implicit cost:

Explicit costs, which are also known as out of pocket costs, refer to costs involving immediate payment of cash. Salaries, wages, interest on loan etc. are examples of explicit costs. They can be easily measured.

The main points of difference between explicit and implicit costs are:

- Implicit costs do not involve immediate cash payment.
- They are not recorded in the books of account.
- They are also known as economic costs.

(ii) Period and Discretionary costs

There are the costs, which are not assigned to the products but are charged as expenses against the revenue of the period in which they are incurred. All non-manufacturing costs such as general and administrative expenses, selling and distribution expenses are period costs.

Such costs are not tied to a clear cause and effect relationship between inputs and outputs. They arise from periodic decisions regarding the maximum outlay to be incurred. Examples are – advertising, public relations, training etc.

(iii) Efficiency audit and Propriety audit:

Efficiency audit is directed towards the measurement of whether corporate plans have been effectively executed. It is concerned with the utilisation of resources in economic and most remunerative manner to achieve the objectives of the concern e.g. the effective utilisation of capital in an organisation can be gauged by determining return on capital employed.

Propriety audit is concerned with executive actions and plans bearing on the finances and expenditure of the company. The auditor has to judge whether the planned expenditure is designed to give optimum results.

(iv) Bin Cards and Stores control cards:

Bin Cards are quantitative records of the stores receipt, issue and balance. It is kept for each and every item of stores by the store keeper. Here, the balance is taken out after each receipt or issue transaction

Stock control cards are also similar to Bin Cards. Stock control cards contain further informations as regards stock on order. These cards are kept in cabinets or trays or loose binders.

Question 4

(a) *A company runs a holiday home. For this purpose, it has hired a building at a rent of Rs. 10,000 per month alongwith 5% of total taking. It has three types of suites for its customers, viz., single room, double rooms and triple rooms.*

Following information is given:

Type of suite	*Number*	*Occupancy percentage*
Single room	*100*	*100%*
Double rooms	*50*	*80%*
Triple rooms	*30*	*60%*

The rent of double rooms suite is to be fixed at 2.5 times of the single room suite and that of triple rooms suite as twice of the double rooms suite.

The other expenses for the year 2006 are as follows:

	Rs.
Staff salaries	*14,25,000*
Room attendants' wages	*4,50,000*
Lighting, heating and power	*2,15,000*
Repairs and renovation	*1,23,500*
Laundry charges	*80,500*
Interior decoration	*74,000*
Sundries	*1,53,000*

Provide profit @ 20% on total taking and assume 360 days in a year.

You are required to calculate the rent to be charged for each type of suite.

(b) 'Under the Rowan Premium Bonus system, a less efficient worker can obtain same bonus as a highly efficient worker.' Discuss with suitable examples. (10 + 4 = 14 Marks)

Answer

(a) (i) Total equivalent single room suites

Nature of suite	Occupancy	Equivalent single room suites
Single room suites	100 × 360 × 100% = 36,000	36,000 × 1 = 36,000
Double rooms suites	50 × 360 × 80% = 14,400	14,400 × 2.5 = 36,000
Triple rooms suites	30 × 360 × 60% = 6,480	6,480 × 5 = 32,400
		Total 1,04,400

(ii) Statement of total cost:

	Rs.
Staff salaries	14,25,000
Room attendant's wages	4,50,000
Lighting, heating and power	2,15,000
Repairs and renovation	1,23,500
Laundry charges	80,500
Interior decoration	74,000
Sundries	1,53,000
	25,21,000
Building rent 10,000 × 12 + 5% on total taking	1,20,000
	+ 5% on takings
Total cost	26,41,000 + 5% on total takings

Profit is 20% of total takings

∴ Total takings = Rs. 26,41,000 + 25% of total takings

Let x be rent for single room suite

Then 1,04,400 x = 26,41,000 + 25% of (1,04,400 x)

or 1,04,400 x = 26,41,000 + 26,100 x

or 78,300 x = 26,41,000

or x = 33.73

(ii) Rent to be charged for single room suite = Rs. 33.73

Rent for double rooms suites Rs. 33.73 × 2.5 = Rs. 84.325

Rent for triple rooms suites Rs. 33.73 × 5 = Rs. 168.65

(b) Bonus under Rowan system = $\frac{\text{Time taken}}{\text{Time allowed}} \times \text{time saved} \times \text{rate per hour}$

For example let time allowed for a job = 4 hours and Labour rate = Rs. 5 per hour.

Case I : Less efficient worker

If time taken = 3 hours

Then time saved = 4 – 3 = 1 hour

Bonus = $\frac{3\,\text{hours}}{4\,\text{hours}} \times 1\,\text{hour} \times \text{Rs.}\,5 = \text{Rs.}\,3.75$

Case II : Highly efficient worker

If time taken = 1 hour

Then time saved = 4 – 1 = 3 hours

Bonus = $\frac{1\,\text{hour}}{4\,\text{hours}} \times 3\,\text{hours} \times \text{Rs.}\,5 = \text{Rs.}\,3.75$

So, it can be concluded that under Rowan System, the less efficient worker and highly efficient worker can get the same bonus.

Question 5

(a) ABC Ltd. has furnished the following information from the financial books for the year ended 31st March, 2007:

Profit & Loss Account

		Rs.			Rs.
To	*Opening stock*		*By*	*Sales (10,250 units)*	*28,70,000*
	(500 units at Rs. 140 each)	*70,000*	*By*	*Closing stock*	
	Material consumed	*10,40,000*		*(250 units at Rs. 200 each)*	*50,000*
	Wages	*6,00,000*			
	Gross profit c/d	*12,10,000*			
		29,20,000			*29,20,000*

To	*Factory overheads*	*3,79,000*	*By*	*Gross profit b/d*	*12,10,000*
	Administration overheads	*4,24,000*		*Interest*	*1,000*
	Selling expenses	*2,20,000*		*Rent received*	*40,000*
	Bad debts	*16,000*			
	Preliminary expenses	*20,000*			
	Net profit	*1,92,000*			
		12,51,000			*12,51,000*

The cost sheet shows the cost of materials at Rs. 104 per unit and the labour cost at Rs. 60 per unit. The factory overheads are absorbed at 60% of labour cost and administration overheads at 20% of factory cost. Selling expenses are charged at Rs. 24 per unit. The opening stock of finished goods is valued at Rs. 180 per unit.

You are required to prepare:

(i) A statement showing profit as per Cost accounts for the year ended 31st March, 2007; and

(ii) A statement showing the reconciliation of profit as disclosed in Cost accounts with the profit shown in Financial accounts.

(b) Explain any two of the following:

(i) Notional profit in Contract costing

(ii) Retention money in Contract costing

(iii) Economic Batch Quantity in Batch Costing. *(10 + 4 = 14 Marks)*

Answer

(a) (i) Statement of profit as per cost accounts

	Units	*Rs.*
Opening stock @ Rs. 180 per unit	500	90,000
Cost of production @ Rs. 240 per unit		
(Refer Working Note 1)	10,000	24,00,000
Total	10,500	24,90,000
Less: Closing stock @ Rs. 240 per unit	−250	−60,000
	10,250	24,30,000
Selling expenses @ Rs. 24 per unit		2,46,000
Cost of sales		26,76,000
Profit		1,94,000
Sales	10,250	28,70,000

Working Notes:

(i) Statement of Cost (10,000 units)

	Total cost	*Cost per unit*
	Rs.	*Rs.*
Materials	10,40,000	104.00
Wages	6,00,000	60.00
Factory Overhead 60% of wages	3,60,000	36.00
Factory cost	20,00,000	200.00
Administrative overhead 20% of factory cost	4,00,000	40.00
Total cost	24,00,000	240.00

(ii) Statement of differences between the two set of accounts:

	Financial A/c	Cost A/c	Difference	Remarks
	Rs.	*Rs.*	*Rs.*	
Factory overhead	3,79,000	3,60,000	19,000	Under recovery
Administrative overhead	4,24,000	4,00,000	24,000	Under recovery
Selling expenses	2,20,000	2,46,000	26,000	Over recovery
Opening stock	70,000	90,000	20,000	Over recovery
Closing stock	50,000	60,000	10,000	Over recovery

(ii) Reconciliation Statement

		Rs.
Profit as per cost accounts		1,94,000
Less: Under recovery of Overhead in Cost A/c		
Factory Overhead	19,000	
Administrative Overhead	24,000	−43,000
Add: Over-recovery of selling overhead in Cost A/c		+26,000
Add: Over-valuation of opening stock in Cost A/c		+20,000
Less: Over-valuation of closing stock in Cost A/c		−10,000
Add: Income excluded from Cost A/c		
Interest	1,000	
Rent	40,000	+41,000

Less: Expenses excluded from Cost A/c		
Bad debts	16,000	
Preliminary expenses	20,000	−36,000
Profit as per financial account		1,92,000

(b) (i) Notional profit in Contract costing:

It represents the difference between the value of work certified and cost of work certified.

Notional Profit = Value of work certified – (Cost of works to date – Cost of work not yet certified)

(ii) Retention Money in Contract Costing:

A contractor does not receive the full payment of the work certified by the surveyor. Contractee retains some amount to be paid after some time, when it is ensured that there is no default in the work done by the contractor. If any deficiency or defect is noticed, it is to be rectified by the contractor before the release of the retention money. Thus, the retention money provides a safeguard against the default risk in the contracts.

(iii) Economic Batch Quantity in Batch Costing

There are two types of costs involved in Batch Costing(i) set up costs(ii) carrying costs.

If the batch size is increased, set up cost per unit will come down and the carrying cost will increase. If the batch size is reduced, set up cost per unit will increase and the carry\ng cost will come down.

Economic Batch quantity will balance both these opponent costs. It is calculated as follows:

$$EBQ = \sqrt{\frac{2DS}{c}}$$

Where,

D = Annual Demand in units

S = Set up cost per batch

C = Carrying cost per unit per annum.

Question 6

(a) The following accounting information and financial ratios of PQR Ltd. relate to the year ended 31st December, 2006:

		2006
I	*Accounting Information:*	
	Gross Profit	*15% of Sales*
	Net profit	*8% of sales*
	Raw materials consumed	*20% of works cost*
	Direct wages	*10% of works cost*
	Stock of raw materials	*3 months' usage*
	Stock of finished goods	*6% of works cost*
	Debt collection period	*60 days*
	All sales are on credit	
II	*Financial Ratios:*	
	Fixed assets to sales	*1 : 3*
	Fixed assets to Current assets	*13 : 11*
	Current ratio	*2 : 1*
	Long-term loans to Current liabilities	*2 : 1*
	Capital to Reserves and Surplus	*1 : 4*

If value of fixed assets as on 31st December, 2005 amounted to Rs. 26 lakhs, prepare a summarised Profit and Loss Account of the company for the year ended 31st December, 2006 and also the Balance Sheet as on 31st December, 2006.

(b) What is Debt securitisation? State the basic debt securitisation process.

(12 + 4 = 16 Marks)

Answer

(a) Working Notes:

(i) *Calculation of Sales*

$$\frac{\text{Fixed Assets}}{\text{Sales}} = \frac{1}{3}$$

$$\therefore \frac{26,00,000}{\text{Sales}} = \frac{1}{3} \Rightarrow \text{Sales} = \text{Rs.}78,00,000$$

(ii) Calculation of Current Assets

$$\frac{\text{Fixed Assets}}{\text{Current Assets}} = \frac{13}{11}$$

$$\therefore \frac{26,00,000}{\text{Current Assets}} = \frac{13}{11} \Rightarrow \text{Current Assets} = \text{Rs. } 22,00,000$$

(iii) *Calculation of Raw Material Consumption and Direct Wages*

		Rs.
Sales		78,00,000
Less: Gross Profit		11,70,000
Works Cost		66,30,000
Raw Material Consumption (20% of Works Cost)	Rs. 13,26,000	
Direct Wages (10% of Works Cost)	Rs. 6,63,000	

(iv) *Calculation of Stock of Raw Materials (= 3 months usage)*

$$= 13,26,000 \times \frac{3}{12} = \text{Rs. } 3,31,500$$

(v) *Calculation of Stock of Finished Goods (= 6% of Works Cost)*

$$= 66,30,000 \times \frac{6}{100} = \text{Rs. } 3,97,800$$

(vi) *Calculation of Current Liabilities*

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = 2$$

$$\frac{22,00,000}{\text{Current Liabilities}} = 2 \Rightarrow \text{Current Liabilities} = \text{Rs. } 11,00,000$$

(vii) *Calculation of Debtors*

$$\text{Average collection period} = \frac{\text{Debtors}}{\text{Credit Sales}} \times 365$$

$$\frac{\text{Debtors}}{78,00,000} \times 365 = 60 \Rightarrow \text{Debtors} = \text{Rs. } 12,82,191.78 \text{ or Rs. } 12,82,192$$

(viii) *Calculation of Long term Loan*

$$\frac{\text{Long term Loan}}{\text{Current Liabilities}} = \frac{2}{1}$$

$$\frac{\text{Long term loan}}{11,00,000} = \frac{2}{1} \Rightarrow \text{Long term loan} = \text{Rs. } 22,00,000.$$

(ix) *Calculation of Cash Balance*

		Rs.
Current assets		22,00,000
Less: Debtors	12,82,192	
Raw materials stock	3,31,500	
Finished goods stock	3,97,800	20,11,492
Cash balance		1,88,508

(x) *Calculation of Net worth*

Fixed Assets		26,00,000
Current Assets		22,00,000
Total Assets		48,00,000
Less: Long term Loan	22,00,000	
Current Liabilities	11,00,000	33,00,000
Net worth		15,00,000

Net worth = Share capital + Reserves = 15,00,000

$$\frac{\text{Capital}}{\text{Reserves and Surplus}} = \frac{1}{4} \Rightarrow \text{Share Capital} = 15,00,000 \times \frac{1}{5} = \text{Rs. } 3,00,000$$

$$\text{Reserves and Surplus} = 15,00,000 \times \frac{4}{5} = \text{Rs. } 12,00,000$$

Profit and Loss Account of PQR Ltd.
for the year ended 31st December, 2006

	Particulars	*Rs.*	*Particulars*	*Rs.*
To	Direct Materials	13,26,000	By Sales	78,00,000
To	Direct Wages	6,63,000		
To	Works (Overhead) Balancing figure	46,41,000		
To	Gross Profit c/d (15% of Sales)	11,70,000		
		78,00,000		78,00,000
To	Selling and Distribution Expenses (Balancing figure)	5,46,000	By Gross Profit b/d	11,70,000
To	Net Profit (8% of Sales)	6,24,000		
		11,70,000		11,70,000

Balance Sheet of PQR Ltd.
as at 31st December, 2006

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital	3,00,000	Fixed Assets	26,00,000
Reserves and Surplus	12,00,000	Current Assets:	
Long term loans	22,00,000	Stock of Raw Material	3,31,500
Current liabilities	11,00,000	Stock of Finished Goods	3,97,800
		Debtors	12,82,192
		Cash	1,88,508
	48,00,000		48,00,000

(b) Debt Securitisation

It is a method of recycling of funds. It is especially beneficial to financial intermediaries to support the lending volumes. Assets generating steady cash flows are packaged together and against this asset pool market securities can be issued.

The basic debt securitisation process can be classified in the following three functions:

(i) *The origination function:* A borrower seeks a loan from a finance company, bank or a lease from a leasing company. The credit worthiness of the borrower is evaluated and a contract is entered into with repayment schedule over the life of the loan.

(ii) *The pooling function:* Similar loans or receivables are clubbed together to create an underlying pool of assets. This pool is transferred in favour of a SPV – (Special Purpose Vehicle), which acts as a trustee for the investor.

(iii) *The securitisation function:* It is the SPV's job now to structure and issue the securities on the basis of the asset pool. The securities carry a coupon and an expected maturity which can be asset based or mortgage based. These are generally sold to investors through merchant bankers.

Question 7

(a) JKL Ltd. is considering the revision of its credit policy with a view to increasing its sales and profit. Currently all its sales are on credit and the customers are given one month's time to settle the dues. It has a contribution of 40% on sales and it can raise additional funds at a cost of 20% per annum. The marketing manager of the company has given the following options along with estimates for considerations:

Particulars	*Current Position*	*I Option*	*II Option*	*III Option*
Sales (Rs. in lakhs)	*200*	*210*	*220*	*250*
Credit period (in months)	*1*	*1½*	*2*	*3*

Bad debts (% of sales)	*2*	*2½*	*3*	*5*
Cost of Credit administration				
(Rs. in lakhs)	*1.20*	*1.30*	*1.50*	*3.00*

You are required to advise the company for the best option.

(b) What do you mean by factoring? Describe the benefits of factoring.

(8 + 4 = 12 Marks)

Answer

(a) Evaluation of the Different Options in Credit Policy of JKL Ltd.

(Rs. in lakhs)

Credit period	1 month Current position	1.5 months Option I	2 months Option II	3 months Option III
Sales	200	210	220	250
Contribution @ 40%	80	84	88	100
Increase in contribution over current level	–	4	8	20 (A)
Debtors = $\frac{\text{Average Collection Period} \times \text{Credit Sales}}{12}$	$\frac{1\times 200}{12}=16.67$	$\frac{1.5\times 210}{12}=126.25$	$\frac{2\times 220}{12}=36.67$	$\frac{3\times 250}{12}=62.50$
Increase in debtors over current level	–	9.58	20.00	45.83
Cost of funds for additional amount of debtors @ 20%	–	1.92	4.00	9.17 (B)
Credit administrative cost	1.20	1.30	1.50	3.00
Increase in credit administration cost over present level	–	0.10	0.30	1.80 (C)
Bad debts	4.00	5.25	6.60	12.50
Increase in bad debts over current levels	–	1.25	2.60	8.50 (D)
Net gain/loss A – (B + C + D)	–	0.73	1.10	0.53

Advise: It is suggested that the company JKL Ltd. should implement Option II which has a credit period of 2 months.

(b) Factoring

Factoring involves provision of specialised services relating to credit investigation, sales ledger management, purchase and collection of debts, credit protection as well as provisions of finance against receivables and risk bearing. In factoring, accounts

receivables are generally sold to a financial institution that charges commission and bears the credit risks associated with it.

Thus, factoring is not just a single service, rather a portfolio of complimentary financial services available to clients i.e. sellers. The sellers are free to avail of any combination of services offered by the factoring organisations according to their individual requirements.

Benefits of Factoring

(i) The firm can convert accounts receivables into cash without bothering about repayment.

(ii) Factoring ensures a definite pattern of cash inflows.

(iii) Continuous factoring virtually eliminates the need for credit department.

(iv) Unlike an unsecured loan, compensating balances are not required in this case. Another advantage consists of relieving the borrowing firm of substantial credit and collection costs and to a degree from a considerable part of cash management.

Question 8

(a) You are required to determine the weighted average cost of capital of a firm using (i) book-value weights and (ii) market value weights. The following information is available for your perusal:

Present book value of the firm's capital structure is:

	Rs.
Debentures of Rs. 100 each	*8,00,000*
Preference shares of Rs. 100 each	*2,00,000*
Equity shares of Rs. 10 each	*10,00,000*
	20,00,000

All these securities are traded in the capital markets. Recent prices are:

Debentures @ Rs. 110, Preference shares @ Rs. 120 and Equity shares @ Rs. 22.

Anticipated external financing opportunities are as follows:

(i) Rs. 100 per debenture redeemable at par : 20 years maturity 8% coupon rate, 4% floatation costs, sale price Rs. 100.

(ii) Rs. 100 preference share redeemable at par : 15 years maturity, 10% dividend rate, 5% floatation costs, sale price Rs. 100.

(iii) Equity shares : Rs. 2 per share floatation costs, sale price Rs. 22.

In addition, the dividend expected on the equity share at the end of the year is Rs. 2 per share; the anticipated growth rate in dividends is 5% and the firm has the practice of paying all its earnings in the form of dividend. The corporate tax rate is 50%.

(b) Explain briefly the propositions made in Modigliani and Miller approach on cost of capital.

(9 + 3 = 12 Marks)

Answer

(a) Working Notes:

Determination of Specific Costs:

(i) *Cost of Debentures before tax (k_d)*

$$k_d = \frac{I + \frac{(P - NP)}{n}}{\frac{(P + NP)}{2}}$$

Where,

I = Annual interest payment

P = Redeemable/payable value of debenture at maturity

NP = Net sale value from issue of debenture/face value – expenses

$$k_d = \frac{8 + \frac{(100 - 96)}{20}}{\frac{(100 + 96)}{2}}$$

$$= \frac{8 + .20}{98} = .0836 \text{ or } 8.36\%$$

Cost of debenture after tax = K_d (1– t)

= 8.36 (1– .50) = 4.18%.

(ii) *Cost of Preference Shares (k_p)*

$$k_p = \frac{D + \frac{(P - NP)}{n}}{\frac{(P + NP)}{2}}$$

Where,

D = Fixed annual dividend

P = Redeemable value of preference shares

n = Number of years to maturity.

$$K_p = \frac{10 + \frac{(100-95)}{15}}{\frac{(100+95)}{2}}$$

$$= \frac{10.33}{97.5} = .1059 \text{ or } 10.59\%$$

(iii) *Cost of Equity (k_e)*

$$k_e = \frac{D}{NP} + g$$

Where,

D = Expected dividend per share

NP = Net proceeds per share

g = Growth expected in dividend

$$k_e = \frac{2}{22-2} + .05 = \frac{2}{20} + .05 = .10 + .05 = .15 \text{ or } 15\%.$$

(i) Computation of Weighted Average Cost of Capital based on Book Value Weights

Source of Capital	*Book Value Rs.*	*Weights to Total Capital*	*Specific Cost*	*Total Cost*
Debentures (Rs. 100 per debenture)	8,00,000	0.40	0.0418	0.0167
Preference Shares (Rs. 100 per share)	2,00,000	0.10	0.1059	0.0106
Equity Shares (Rs. 10 per share)	10,00,000	0.50	0.1500	0.0750
	20,00,000	1.00		0.1023

Cost of Capital = 10.23%

(ii) Computation of Weighted Average Cost of Capital based on Market Value Weights

Source of Capital	*Market Value Rs.*	*Weights to Total Capital*	*Specific Cost*	*Total Cost*
Debentures (Rs. 110 per debenture)	8,80,000	0.2651	0.0418	0.01108
Preference Shares (Rs. 120 per share)	2,40,000	0.0723	0.1059	0.00766
Equity Shares (Rs. 22 per share)	22,00,000	0.6626	0.1500	0.09939
	33,20,000	1.00		0.11813

Cost of Capital = 11.81%

(b) Propositions made by Modigliani and Miller on Cost of Capital

The propositions made by Modigliani and Miller on cost of capital are:

(i) The total market value of a firm and its cost of capital are independent of its capital structure. The total market value of the firm is given by capitalising the expected stream of operating earnings at a discount rate considered appropriate for its risk class.

(ii) The cost of equity (Ke) is equal to capitalisation rate of pure equity stream plus a premium for financial risk. The financial risk increases with more debt content in the capital structure. As a result, Ke increases in a manner to offset exactly the use of less expensive source of funds.

(iii) The cut-off rate for investment purposes is completely independent of the way in which the investment is financed.

Question 9

(a) A company is considering the proposal of taking up a new project which requires an investment of Rs. 400 lakh on machinery and other assets. The project is expected to yield the following earnings (before depreciation and taxes) over the next five years:

Year	*Earnings (Rs. in lakh)*
1	*160*
2	*160*
3	*180*
4	*180*
5	*150*

The cost of raising the additional capital is 12% and assets have to be depreciated at 20% on 'Written Down Value' basis. The scrap value at the end of the five years' period may be taken as zero. Income-tax applicable to the company is 50%.

You are required to calculate the net present value of the project and advise the management to take appropriate decision. Also calculate the Internal Rate of Return of the Project.

Note: Present value of Re. 1 at different rates of interest are as follows:

Year	*10%*	*12%*	*14%*	*16%*
1	*0.91*	*0.89*	*0.88*	*0.86*
2	*0.83*	*0.80*	*0.77*	*0.74*
3	*0.75*	*0.71*	*0.67*	*0.64*
4	*0.68*	*0.64*	*0.59*	*0.55*
5	*0.62*	*0.57*	*0.52*	*0.48*

(b) State the differences between Global Depository Receipts and American Depository Receipts. *(8 + 4 = 12 Marks)*

Answer

(a) (i) Calculation of Net Cash Flow

(Rs. in lakhs)

Year	*Profit before dep. and tax*	*Depreciation (20% on WDV)*	*PBT*	*PAT*	*Net cash flow*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(3) + (5)*
1	160	400 × 20% = 80	80	40	120
2	160	(400 − 80)× 20% = 64	96	48	112
3	180	(320 − 64)× 20% = 51.2	128.8	64.4	115.6
4	180	(256 − 51.2)× 20% = 40.96	139.04	69.52	110.48
5	150	(204.8 − 40.96) = 163.84*	−13.84	−6.92	156.92

*including depreciation and loss on disposal of assets.

(ii) Calculation of Net Present Value (NPV)

(Rs. in lakhs)

Year	*Net Cash Flow*	*12%*		*14%*		*16%*	
		D.F	*P.V*	*D.F*	*P.V*	*D.F*	*P.V*
1	120	.89	106.8	.88	105.60	.86	103.2
2	112	.80	89.6	.77	86.24	.74	82.88
3	115.6	.71	82.08	.67	77.45	.64	73.98
4	110.48	.64	70.70	.59	65.18	.55	60.76
5	156.92	.57	89.44	.52	81.60	.48	75.32
			438.62		416.07		396.14
	Less: Initial Investment		400.00		400.00		400.00
	NPV		38.62		16.07		−3.86

(iii) *Advise:* Since Net Present Value of the project at 12% = 38.62 lakhs, therefore the project should be implemented.

(iv) Calculation of Internal Rate of Return (IRR)

$$\text{IRR} = 14\% + \frac{16.07 \times 2\%}{16.07 - (-3.86)}$$

$$= 14\% + \frac{32.14}{19.93}$$

= 14% + 1.61% = 15.61%.

(b) Global Depository Receipts and American Depository Receipts

Global Depository Receipts (GDR) are basically negotiable certificates denominated in US dollars, that represent a non-US company's publicly traded local currency equity shares. These are created when the local currency shares of Indian company are delivered to the depository's local custodian bank, against which the depository bank issues Depository Receipts in US dollars.

Whereas, American Depository Receipts (ADR) are securities offered by non-US companies who want to list on any of the US exchange. Each ADR represents a certain number of a company's regular shares. ADRs allow US investors to buy shares of these companies without the costs of investing directly in a foreign stock exchange. ADRs are issued by an approved New York bank or trust company against the deposit of the original shares. These are deposited in a custodial account in the US. Such receipts have to be issued in accordance with the provisions stipulated by the SEC USA which are very stringent.

The Indian companies have preferred the GDRs to ADRs because the US market exposes them to a higher level or responsibility than a European listing in the areas of disclosure, costs, liabilities and timing.

The Suggested Answers for Paper – 5: Income-tax and Central Sales Tax are based on the provisions applicable for A.Y.2007-08, which is the assessment year relevant for May 2007 examination.

PAPER – 5 : INCOME TAX AND CENTRAL SALES TAX

Answer all questions

Question 1

(a) *Dr. Sparsh Kumar is running a clinic. His Income and Expenditure account for the year ending 31st March, 2007 is given below:*

Expenditure	Amount Rs.	Income	Amount Rs.
To Staff Salary	4,30,000	By Fees Receipts	12,63,600
To Consumables	9,250	By Dividend from Indian Companies	9,500
To Medicine consumed	3,64,800	By Winning from Lotteries Net of TDS (TDS Rs.12,240)	27,760
To Depreciation	91,000	By Income-tax refund	2,750
To Administrative Expenses	1,46,000		
To Donation to Prime Minister's Relief Fund	15,000		
To Excess of Income over expenditure	2,47,560		
Total	13,03,610	Total	13,03,610

(i) *Depreciation in respect of all assets has been ascertained at Rs.50,000 as per Income-tax Rules.*

(ii) *Medicines consumed include medicine of (cost) Rs.16,000 used for his family.*

(iii) *Fees Receipts include Rs.14,000 honorarium for valuing medical examination answer books.*

(iv) *He has also received Rs.80,000 on account of Agricultural Income which had not been included in the above Income and Expenditure Account.*

(v) *He has also received Rs.57,860 on maturity of one LIC Policy, not included in the above Income and Expenditure Account.*

(vi) *He received Rs.6,000 per month as salary from a City Care Centre. This has not been included in the 'Fees Receipts' credited to Income and Expenditure Account.*

(vii) He has sold land in June, 2006 for Rs.6,00,000 (valuation as per stamp valuation authority Rs.8,00,000). The land was acquired by him in October, 1998 for Rs.4,50,000.

(viii) He has paid premium of one LIC Policy Rs.12,000 (sum assured Rs.50,000).

(ix) He has paid Rs.2,500 for purchase of lottery tickets.

From the above compute the income and tax payable of Dr. Sparsh Kumar for the Asst. year 2007-08.

Cost Inflation Index: F.Y. 1998-99 – 351; F.Y. 2006-07 - 519. *(20 Marks)*

(b) M/s Sidhant & Co., a sole proprietary concern is converted into a company, Sidhant Co. Ltd. with effect from November 29, 2006. The written down value of assets as on April 1, 2006 is as follows:

Items	*Rate of Depreciation*	*WDV as on 1st April, 06*
Building	*10%*	*Rs.3,50,000*
Furniture	*10%*	*Rs.50,000*
Plant and Machinery	*15%*	*Rs.2,00,000*

Further, on October 15, 2006, M/s Sidhant & Co. purchased a plant for Rs.1,00,000 (rate of depreciation 15%). After conversion, the company added another plant worth Rs.50,000 (rate of depreciation 15%).

Compute the depreciation available to (i) M/s Sidhant & Co. and (ii) Sidhant Co. Ltd. for Asst. year 2007-08. *(10 Marks)*

Answer

(a) Computation of total income and tax liability of Dr. Sparsh Kumar for the A.Y. 2007-08

Particulars	Rs.
Income from salary (Working Note – 1)	72,000
Income from business (Working Note – 2)	2,65,550
Long-term capital gains (Working Note – 3)	1,34,615
Income from other sources (Working Note – 4)	54,000
Gross Total Income	5,26,165
Less: Deduction under Chapter VI-A (Working Note – 5)	25,000
Total Income	5,01,165
Tax on total income (Working Note - 6)	99,888
Add: Education cess @ 2%	1,998
Total tax liability	1,01,886
Less: Tax deducted at source (TDS)	12,240
Tax payable	89,646

Working Notes:

1. Computation of salary income

Particulars	Rs.
Gross Salary (6,000×12)	72,000
Less: Deduction under section 16	Nil
Net Salary	72,000

2. Computation of income under the head "Profits and gains of business or profession"

Particulars	Rs.	Rs.
Net Income as per Income and Expenditure Account		2,47,560
Add: Expenses disallowed:		
Depreciation (91,000 - 50,000)	41,000	
Cost of medicine for self-use	16,000	
Donation to Prime Minister's Relief Fund	15,000	72,000
		3,19,560
Less:Dividend from Indian companies	9,500	
Income-tax refund	2,750	
Winning from Lotteries	27,760	
Honorarium for valuing answer books	14,000	54,010
		2,65,550

3. Computation of Capital Gains

Particulars	Rs.	Rs.
Sale consideration	6,00,000	
Valuation as per Stamp Valuation Authority	8,00,000	
(Value to be taken higher of actual sale consideration or valuation adopted for stamp duty purposes as per section 50C)		
Consideration for the purpose of capital gain		8,00,000
Less:		
Cost of acquisition = $\frac{4,50,000 \times 519}{351}$		6,65,385
Long term capital gain		1,34,615

4. Computation of income under the head "Income from other sources"

Particulars	Rs.	Rs.
Dividend from Indian Companies [Exempt u/s 10(34)]		-
Honorarium for valuing answer books		14,000
Winning from Lotteries (Net)	27,760	
Add: TDS	12,240	40,000
Income from other sources		54,000

Note – As per section 58(4), no expense or deduction is allowable in respect of winnings from lotteries.

5. Computation of deduction under Chapter VI-A

Particulars	Rs.
U/s 80C Life Insurance Premium (maximum 20% of sum assured)	10,000
U/s 80G Donation to Prime Minister's Relief Fund [See Note below]	15,000
Total deduction under Chapter VI-A	25,000

Note – It is assumed that the donation is made to the Prime Minister's National Relief Fund and therefore, 100% deduction has been allowed under section 80G. It is also possible to compute the deduction under section 80G assuming that donation has been made to Prime Minister's Drought Relief Fund. In such a case, the exemption would be restricted to 50% of Rs.15,000. The calculation of total income and tax liability would accordingly change.

6. Computation of tax on total income

Particulars	Rs.
Tax on agricultural income plus non-agricultural income	
i.e. tax on Rs.5,81,165, being Rs.80,000 + 5,01,165 [See Note below]	1,10,888
Less: Tax on agricultural income plus basic exemption limit	
i.e. tax on Rs.1,80,000, being Rs.80,000 + 1,00,000	11,000
Tax on total income	99,888

Note - Tax on Rs.5,81,165 is computed hereunder -

Particulars	Rs.
Tax on long term capital gain	
Rs.1,34,615 @ 20%	26,923
Tax on winnings from lotteries	
Rs.40,000 @ 30%	12,000
Tax on balance income of Rs.4,06,550	71,965
	1,10,888

Note - Agricultural income is exempt from tax. It is considered for rate purpose only.

7. It is assumed that the sum received under a life insurance policy is one wholly exempt from tax under section 10(10D), fulfilling the conditions therein.

(b) In the case of conversion of sole proprietary concern into a company as per section 47(xiv), the depreciation should be first calculated for the whole year assuming that no succession had taken place. Thereafter, the depreciation should be apportioned between the sole proprietary concern and the company in the ratio of the number of days for which the assets were used by them. It is assumed that in this case, the conditions specified in section 47(xiv) are satisfied and the assets have been used on all days.

Computation of depreciation allowable to Sidhant & Co. for A.Y.2007-08

Particulars	Rs.	Rs.
Building		
WDV as on 1.4.2006	3,50,000	
Depreciation@10%		35,000
Furniture		
WDV as on 1.4.2006	50,000	
Depreciation@10%		5,000
Plant and Machinery		
WDV as on 1.4.2006	2,00,000	
Add: Additions during the year (purchased on 15.10.06)	1,00,000	
	3,00,000	
Less: Depreciation for the year		
(15% of Rs.2,00,000 + 50% of 15% of Rs.1,00,000)		37,500
(Depreciation on new machinery is restricted to 50% of eligible depreciation, since the asset is put to use for less than 180 days in that year)		
Total depreciation for the year		77,500
Proportionate depreciation allowable to Sidhant & Co. for 242 days (i.e. 1.4.06 to 28.11.06) (i.e. 242/365 x Rs.77,500)		51,384

Computation of depreciation allowable to Sidhant Co. Ltd. for A.Y.2007-08

	Particulars	Rs.
(i)	Depreciation on the assets on conversion	
	Proportionately for 123 days i.e. after conversion period	
	123/365 x Rs.77,500	26,116
(ii)	Depreciation @ 50% of normal rate of 15% on Rs.50,000, being the value of plant purchased after conversion, which was put to use for less than 180 days	3,750
	Depreciation allowable to Sidhant Co. Ltd.	29,866

Question 2 (First Alternative)

(a) Explain marginal relief and calculate the amount of tax payable and amount of marginal relief availed on the income of Rs.10,30,000 by an individual for A.Y. 2007-08. (6 Marks)

(b) List out the conditions for availing deduction under section 80QQB of Income-tax Act, 1961. (6 Marks)

Answer

(a) In case of individuals/HUFs/AOPs/BOIs having a total income exceeding Rs.10,00,000, the additional amount of income-tax payable (together with surcharge) on the excess of income over Rs.10,00,000 should not be more than the amount of income exceeding Rs.10,00,000. This is called marginal relief.

In case an individual has a total income of Rs.10 lakhs, tax on his income would be = 10% of Rs.50,000 + 20% of Rs.1,00,000 + 30% of Rs.7,50,000 = Rs.2,50,000. Surcharge is not attracted on this tax since the total income does not exceed Rs.10 lakh.

However, if his total income is Rs.10,30,000, then tax on this income = 10% of Rs.50,000 + 20% of Rs.1,00,000 + 30% of Rs.7,80,000 = Rs.2,59,000

Add: Surcharge = Rs. 25,900 [10% of Rs.2,59,000]

Total tax plus surcharge = Rs.2,84,900

On comparing the two situations, it can be seen that for Rs.30,000 (i.e. Rs.10,30,000 – Rs.10,00,000] increase in the total income, the tax liability including surcharge has increased by Rs.34,900 (i.e. Rs.2,84,900 – 2,50,000). In such a case, the tax payable cannot exceed Rs.2,80,000, being Rs.2,50,000 + Rs.30,000.

Therefore, tax payable = Rs.2,50,000 + Rs.30,000 = Rs.2,80,000

Marginal relief = Rs.34,900 – Rs.30,000 = Rs.4,900

(b) Conditions for availing deduction under section 80QQB

(i) Under section 80QQB, deduction upto a maximum of Rs.3,00,000 is allowed to an individual resident in India in respect of income derived as author. The deduction shall be the income derived as author or Rs.3,00,000, whichever is less.

(ii) This income may be received either by way of a lumpsum consideration for the assignment or grant of any of his interests in the copyright of any book or by way of royalties or copyright fees (whether receivable in lump sum or otherwise) in respect of such book.

(iii) Such book should be a work of literary, artistic or scientific nature.

(iv) This deduction shall not be available in respect of royalty income from text book for schools, guides, commentaries, newspapers, journals, pamphlets and publication of similar nature.

(v) For the purpose of calculating the deduction under this section, the amount of eligible income (before allowing expenses attributable to such income) shall not exceed 15% of the value of the books sold during the previous year. However, this condition is not applicable where the royalty or copyright fees is receivable in lump sum in lieu of all rights of the author in the book.

(vi) For claiming the deduction, the assessee has to furnish a certificate in the prescribed form, duly verified by the person responsible for making such payment, setting forth such particulars as may be prescribed.

(vii) Where the assessee earns any income from any source outside India, he should bring such income into India in convertible foreign exchange within a period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf for the purpose of claiming deduction under this section.

Question 2 (Second Alternative)

(a) Explain the provisions relating to multiplex theatres and convention centres under section 80-IB of the Income-tax Act, 1961. (6 Marks)

(b) Discuss the tax implications arising consequent to conversion of a capital asset into stock-in-trade of business and its subsequent sale. (6 Marks)

Answer

(a) "Multiplex theatre" means a building of a prescribed area, comprising of two or more cinema theatres and commercial shops of such size and number and having such other facilities and amenities as may be prescribed. Multiplex theatres located in cities other than Kolkata, Chennai, Delhi or Mumbai are eligible for tax incentive contained in section 80-IB(7A).

"Convention centre" means a building of a prescribed area comprising of convention halls to be used for the purpose of holding conferences and seminars being of such size and number and having such facilities and amenities as may be prescribed. Convention

centres situated in any place in India are eligible for tax incentive contained in section 80-IB(7B) on fulfillment of the conditions specified therein.

The following conditions have to be satisfied for availing the tax incentives under clauses (7A) & (7B) of section 80-IB -

(i) The multiplex theatre / convention centre should be constructed at any time between 1.4.2002 and 31.03.2005.

(ii) The business of the multiplex theatre / convention centre should not be formed by the splitting up, or the reconstruction, of a business already in existence or by the transfer of any building or machinery or plant previously used, to the new business.

(iii) The assessee should furnish along with the return of income, an audit report from a chartered accountant in the prescribed form and manner certifying that the deduction has been correctly claimed.

Quantum of deduction: The amount of deduction shall be 50% of the profits from the business of building, owning and operating the multiplex theatre / convention centre. The deduction shall be available for 5 consecutive years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in which -

(i) a cinema hall, being a part of the multiplex theatre, starts operating on a commercial basis;

(ii) the convention centre starts operating on a commercial basis.

(b) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade. However, as per section 45(2), the profits or gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold. For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

On subsequent sale of such stock-in-trade, business profits would arise. The business income chargeable to tax would be the difference between the price at which the stock-in-trade is sold and the fair market value on the date of conversion of the capital asset into stock-in-trade.

Question 3

(a) State with reasons in brief whether the following statements are true or false with reference to the provisions of the Income-tax Act, 1961:

(i) Voluntary contributions received by charitable trusts, universities and educational institutions are not taxable as the definition of income in section 2(24) does not cover the same.

(ii) Surcharge payable by a foreign company on total income is 2.5% for A.Y. 2007-08.

(iii) Income escaping assessment relating to assessment year 2004-05 is Rs.2,00,000. The time limit for issue of the notice under section 148 is 31st March, 2006.

(iv) Mr. S is employed with T Ltd. as a Chartered Accountant. The annual membership fee of Mr. S paid by T Ltd. is not a perquisite and hence not chargeable to tax.

(v) An assessee being aggrieved by the order of Assessing Officer can file a revision petition to the Commissioner of Income-tax within a period of two years.

(5 x 2 =10 Marks)

(b) Fill in the blanks with reference to the provisions of the Income-tax Act:

(i) The maximum period for which speculation loss can be carried forward is ..... years.

(ii) M Ltd. gives a gift of Rs.7,500 to its employee Ganesh on his birthday. The taxable value of the gift in the hands of Ganesh is .....

(iii) The exemption limit of income available to a senior citizen is Rs. ..... for Asst. year 2007-08.

(iv) The time limit for filing an appeal before Income-tax Appellate Tribunal is ..... days of the receipt of appeal order from Commissioner of Income-tax (Appeals).

(v) Mr. Z has paid a sum of Rs.65,000 on 30.11.2006 as tuition fees to a university in Australia. The amount deductible under section 80C for A.Y. 2007-08 is Rs.....

(1 x 5 = 5 Marks)

Answer

(a) (i) False - Section 2(24) defining the term 'income' includes voluntary contributions received by any trust, university or educational institution. Hence, the statement is not correct.

(ii) True - Foreign companies have to pay 2.5% as surcharge on tax payable for A.Y.2007-08 as per Part III of the First Schedule to the Finance Act, 2006.

Note - Alternatively, it can be answered that the statement is false since surcharge @ 2.5% is calculated on tax payable and not on total income.

(iii) False - As per section 149(1)(b), where the income escaping the assessment is Rs.1,00,000 or more, the time limit for issue of notice under section 148 is 6 years from the end of the relevant assessment year in which the income has escaped assessment.

(iv) False - The membership fee payable to the Institute is an obligation of Mr. S, which is paid by his employer i.e. T Ltd. Under the definition of perquisite, an obligation of the employee paid off by the employer is treated as a perquisite and is hence chargeable to tax.

(v) False - Under section 264 of the Income-tax Act, the assessee should file a revision petition within a period of one year.

(b) (i) 4

(ii) Nil

(iii) 1,85,000

(iv) 60

(v) Nil

Question 4

Write short notes on any three of the following:

(a) Deduction to be allowed on actual payment basis (Section 43B)

(b) Scheme of submission of return through Tax Return Preparer (Section 139B)

(c) Deduction from Gross Total Income under section 80GG

(d) Incentives for newly established units in Special Economic Zone (Section 10AA).

(6 x 3 = 18 Marks)

Answer

(a) Deductions to be allowed on actual payment basis (Section 43B)

The following sums are allowed as deduction only on the basis of actual payment within the time limit specified in section 43B, irrespective of the method of accounting followed by the assessee -

(i) Any sum payable by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force.

(ii) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.

(iii) Any sum paid to an employee as bonus or commission for services rendered.

(iv) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State Financial Corporation or a State Industrial Investment Corporation.

(v) Any sum payable by the assessee as interest on any loan or advance from a scheduled bank.

(vi) Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee.

The above sums should be paid by the assessee on or before the due date for furnishing the return of income under section 139(1), for the purpose of claiming deduction in the previous year in which the liability to pay such sum was incurred and the evidence of such payment should be furnished by the assessee along with such return. If the payment is made after the due date for filing the return, deduction can be claimed only in the year of actual payment.

(b) Scheme of submission of return through Tax Return Preparer (Section 139B)

(i) A new section 139B has been inserted with effect from June 1, 2006 so as to provide that, for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income, the CBDT may notify a Scheme to provide that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

(ii) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return.

(iii) A Tax Return Preparer can be an individual, other than -

(1) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(2) any legal practitioner who is entitled to practice in any civil court in India.

(3) a chartered accountant.

(4) an employee of the 'specified class or classes of persons.'

(iv) The "specified class or classes of persons" for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.

(v) The Scheme notified under the said section may provide for the following -

(1) the manner in which and the period for which the Tax Return Preparers shall be authorized.

(2) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer.

(3) the code of conduct for the Tax Return Preparers,

(4) the duties and obligations of the Tax Return Preparers

(5) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

(6) any other relevant matter as may be specified by the Scheme.

(c) Deduction from Gross Total Income under section 80GG

In order to claim deduction under section 80GG, the assessee should fulfill the following conditions:

(i) He should be an individual, who pays rent for his residential accommodation.

(ii) He should not be in receipt of any house rent allowance

(iii) He or his spouse or his minor child or HUF of which he is a member should not own any residential house at the place where he ordinarily resides or at the place of his business or employment.

(iv) No claim for self-occupied property should be made in respect of any accomodation.

(v) The assessee should file a declaration in Form No.10BA wherein he confirms the details of rent paid and fulfillment of the other conditions (Rule 11B).

The amount of deduction available to the assessee is restricted to the least of the following:

(i) Rs.2,000 per month

(ii) 25% of total income

(iii) Excess of rent paid over 10% of total income.

Total income, for this purpose, means gross total income as reduced by all deductions under Chapter VIA except section 80GG.

(d) Incentives for newly established units in Special Economic Zone [Section 10AA]

(i) This section applies to any undertaking, being the Unit, which has begun or begins to manufacture or produce articles or things or provide any services during the previous year relevant to the assessment year commencing on or after 1st April, 2006 in any Special Economic Zone (SEZ).

(ii) It provides for a tax holiday in computing the total income of an assessee, being an entrepreneur, from his Unit set up in a SEZ.

(iii) Such assessee should be an entrepreneur referred to in section 2(j) of the SEZ Act, 2005 i.e., a person who has been granted a letter of approval by the Development Commissioner under section 15(9).

(iv) Sub-section (1) provides for the quantum of deduction under this section, which is

(1) 100% of profits and gains derived from the export of such articles or things or from services for a period of 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and .

(2) 50% of such profits and gains for further 5 assessment years and

(3) Thereafter, for the next 5 consecutive assessment years, so much of the amount not exceeding 50% of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Reinvestment Reserve Account") to be created and utilised for the purposes of the business of the assessee in the prescribed manner.

(v) The profits derived from the export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of

the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the assessee.

(vi) The profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Question 5

(a) State with brief reasons whether the following statements are true/false in the light of Central Sales-tax Act:

(i) Hides and skins are declared goods. .

(ii) Subsidy given by Government to manufacturers to compensate cost of production will form part of sale price.

(iii) Packing charges realised by the dealer is an integral part of sale price.

(iv) There is no time limit prescribed for liquidator on his assumption of charge for intimation to sales-tax authorities.

(v) When goods are sent by VPP, the sale is said to take place in the State from where the parcel is sent. (2 x 5 = 10 Marks)

(b) Fill in the blanks in the light of the provisions of Central Sales-tax Act:

(i) Hari of Chennai made a sale of goods to an Export House in Delhi. These goods were later exported by the Export House to Canada. To enable Hari to claim the exemption under CST Act, the Export House should provide to Hari ……..

(ii) One of the essential features of an inter-State sale is that a transaction should be.....

(iii) Vikas effected the first inter-State sale on 22.3.2007 and applied for registration on 20.4.2007. The effective date for registration will be .....

(iv) Charity or Dharmada collected by the dealer……..form part of sale price.

(v) The authority to declare goods of special importance lies with .....

(1x 5 = 5 Marks)

Answer

(a) (i) True - Hides and Skins, whether in a raw or dressed state, are declared goods as per section 2(c) read with section 14.

(ii) False - Government subsidy does not constitute amount payable to the dealer (by his customer) as consideration for the sale of goods. Hence, it is not includible in sale price.

(iii) True - According to section 2(h), Sale Price includes any sum charged for anything done by the dealer in respect of the goods at the time of or before the delivery

thereof. Packing has been done before delivery and is hence includible. Packing charges realised by the dealer constitute an integral part of the sale price.

(iv) False - The liquidator must give a notice of his having assumed charge to the appropriate authority within thirty days after he has become such liquidator.

(v) False – The sale transaction is complete only when the buyer/consignee accepts the VPP, since in the case of a sale by VPP, the property in the goods is passed at the time of payment of the price of the goods by the buyer and not before that. Hence, sale is said to take place in the State where goods are accepted and delivered.

(b) (i) Form H

(ii) a completed sale of goods/the cause of movement of goods from one State to another / effected by transfer of documents of title to the goods during their movement from one State to another.

(iii) 22.3.2007

(iv) Will / shall

(v) Parliament / Central Government

Question 6

Explain any two of the following with reference to the provisions of the Central Sales-tax Act:

(a) Act or omission for which penalties can be levied.

(b) On what consideration goods of special importance are selected?

(c) What are the relevant provisions under Central Sales-tax for forfeiture of security by the authority granting certificate of registration? (5 x 2 = 10 Marks)

Answer

(a) Penalties can be levied under the Central Sales Tax Act for the following acts/omissions -

(i) Furnishing a false certificate or declaration under section 6(2), 6A(1), 8(4) or 8(8), which he knows or has reason to believe to be false.

Section	Particulars	Form
6(2)	Transit sale	E I / E II Form
6A(1)	Consignment	F Form
8(4)	Inter-State sale	C Form / D Form
8(8)	Sale to Special Economic Zone	Prescribed form

(ii) Failure to get registration or failure to furnish security as required under section 7.

(iii) False representation by a registered dealer that goods purchased by him are covered by his certificate of registration.

(iv) False representation by a dealer, who is not registered, that he is a registered dealer.

(v) Failure without reasonable cause, by a dealer who has purchased goods for any of the purposes specified in section 8(3) or section 8(6), to make use of the goods for any such purpose.

(vi) Possession of any form prescribed for the purpose of section 8(4) or section 8(8), but not obtained in accordance with the provisions of Act or Rules.

(vii) Collection of taxes by an unregistered dealer or by a registered dealer in violation of the provisions of the Act or Rules.

Note – Any five of the above may be given in the answer.

(b) Goods of special importance covered by section 14 are selected based on the following considerations, -

(1) It should be raw material or largely in the nature of raw material.

(2) Such raw material or finished goods made based on such raw material should, in terms of volume of inter-State transaction, be of special importance in inter-State trade or commerce and

(3) Such goods should be of special importance for the country as a whole, from the stand point of the consumer or of industry.

(c) The security, either in whole or in part, can be forfeited by the authority granting the certificate of registration -

(i) for realising any amount of tax or penalty payable by the dealer; or

(ii) misuse of the forms (E I, E II, C, F) by the dealer; or

(iii) Failure by the dealer to keep the forms in proper custody.

Before any such order of forfeiture is passed, the dealer shall be given an opportunity of being heard. On account of any such order passed if the security is rendered insufficient, the dealer shall make up the deficiency, in such manner and within such time as may be prescribed by the concerned authority.

PAPER – 6 : INFORMATION TECHNOLOGY

Question No. 1 is compulsory.

Answer any four questions from remaining six questions.

Question 1

(a) *Convert the following from one number system to another system alongwith the Working Notes:*

(i) $(3CB\ .\ 98)_{16}$ = ($)_2$

(ii) $(AF\ .\ 16C)_{16}$ = ($)_8$

(iii) $(111.12)_8$ = ($)_2$

(iv) $(10101010.101)_2$ = ($)_{10}$

(v) $(123.15)_{10}$ = ($)_{16}$

(b) *Describe briefly, the following terms with reference to Information Technology:*

(i) *FTP*

(ii) *DBMS*

(iii) *Duplex Printing*

(iv) *Gateways*

(v) *Asymmetric Crypto System.*

(c) *Give one or two reasons for each of the following:*

(i) *Use of Firewall in the system*

(ii) *Need of Macro in spread sheet*

(iii) *Use of USB port*

(iv) *Use of Router*

(v) *Use of Multiplexer.*

(d) *Write True or False for each of the following statements:*

(i) *Network database structure can be used to answer ad hoc queries.*

(ii) *Computer Output Microfilm (COM) is Input as well as Output device.*

(iii) *One GB represents 10,48,567 bytes.*

(iv) *Laser printers speed is measured in PPM.*

(v) *Screen resolution is measured in terms of Picture elements.*

(5 + 5 + 5 + 5 = 20 Marks)

Answer

(a) (i) $(1111001011.10011000)_2$

(ii) $(257.0554)_8$

(iii) $(1001001.00101)_2$

(iv) $(170.625)_{10}$

(v) $(7B.26)_{16}$

Working of the above answers is given below:

(i) $(3\ CB.98_{16}) = (\quad)_2$

To convert the given number from Hexadecimal Number System to Binary Number System, each digit of the number will be represented in Binary form using a group of four bits. Adding or removing leading zeros if required.

(3 CB.98) = 0011 1100 1011 1001 1000

Hence, $(3\ CB.98)_{16}$ = $(11\ 11001011.10011000)_2$

(ii) $(AF.16\ C)_{16}$ = $(\quad)_8$

To convert the given number from Hexadecimal Number System to Octal Number System, each digit of the number will be represented in Binary form using a group of three bits. Adding or removing leading zeros if required.

(AF.16 C) = 1010 1111 0001 0110 1100

= 010 101 111 000 101 101 100

= 2 5 7 0 5 5 4

Hence, $(AF.16\ C)_{16}$ = $(257.0554)_8$

(iii) $(111.12)_8 = (\quad)_2$

To convert the given number from Octal Number System to Binary Number System, each digit of the number will be represented in Binary form using a group of three bits. Adding or removing leading zeros if required.

(111.12) = 001 001 001 001 010

Hence, $(111.12)_8$ = $(1001001.00101)_2$

(iv) $(10101010.101)_2 = (\quad)_{10}$

= $2^7 \times 1 + 2^6 \times 0 + 2^5 \times 1 + 2^4 \times 0 + 2^3 \times 1 + 2^2 \times 0 + 2^1 \times 1 + 2^0 \times 0.\ 2^{-1} \times 1 + 2^{-2} \times 0 + 2^{-3} \times 1$

= $128 + 0 + 32 + 0 + 8 + 0 + 2 + 0\ .\ \frac{1}{2} + \frac{0}{4} + \frac{1}{8}$

Hence, $(10101010.101)_2 = (170.625)_{10}$

(v) $(123.15)_{10} = (\quad)_{16}$

Step I

16	123	Remainder	
16	7	11	= B
	0	7	= 7

Step II

$.15 \times 16 = 2.40 \rightarrow 2$

$.40 \times 16 = 6.40 \rightarrow 6$

Hence,

$(123.15)_{10} = (7B.26)_{16}$

(b) (i) FTP: It stands for File Transfer Protocol. It is used to upload the files from client computer to remote Web-server.

(ii) DBMS: It is a complex system software package which allows the user to create and maintain the database files. Data security is defined with the help of DBMS using passwords and access rights. DBMS allows only authorized users to access the data according to their access privileges.

(iii) Duplex Printing: Printing on both sides of a paper at the same time is called Duplex Printing.

(iv) Gateways: It is used to connect two dissimilar networks but do not possess network management facilities. They are used to connect LANs of different topologies e.g. Bus and Ring Network.

(v) Asymmetric Crypto System: In this cryptography technique, both the parties use different keys for encryption/decryption. The key known to the sender is called Private key and receiver key is called Public key. A person using asymmetric crypto system publishes his Public key so that it can be known to all the persons who want to confirm the identity of the sender.

(c) (i) Use of Firewall in the system: Firewalls are systems that control the flow of traffic between the Internet and organisation's Local Area Network and Systems. Firewalls are packaged as turnkey hardware and software packages and are setup to enforce specific security policies that are desired. Firewall is an effective means of protecting the internal resources from unwanted intrusion.

(ii) Need for Macro in Spreadsheet: Macro is a small programme that carries out predefined and prerecorded series of steps by giving a few keyboard shortcuts. We can say that Macro is like a recorded movie, which can be run any number of times. Macro is just a way of doing work in a series of steps, which it carries out

automatically once it is triggered. Hence, the need of Macro is to automate the tasks, thus saving lot of precious time.

(iii) Use of USB port: USB stands for Universal Serial Bus. These ports provide the user with higher data transfer speeds for different USB devices like keyboard, mouse, scanners or digital camera.

(iv) Use of Router: Router is a special purpose computer or software package that handles the connection between two or more networks. Routers spend all their time looking at the destination addresses of the packets passing through them and deciding on which route the packets should be sent.

(v) Use of Multiplexer: This is a device that enables several devices to share one communication line. It scans each device to collect data for transmission on a single communication line. It is often used with a complementary demultiplexer on the receiving end. As such it restricts the need of multiple communication lines.

(d) (i) False

(ii) False

(iii) False

(iv) True

(v) True

Question 2

Distinguish between the following:

(i) Master file and Transaction file

(ii) Logical record and Physical record

(iii) Audio conferencing and Video conferencing

(iv) Sequential file organization and Direct file organization

(v) Client-server model and Peer to Peer model. *(4 × 5 = 20 Marks)*

Answer

(i)

No.	Master File	Transaction File
1.	This file stores the permanent records of an organization which show the current status.	This file stores daily transactions of an organization.
2.	This file consists of static data and is less volatile in nature.	This file is frequently changed to store current transaction i.e. this file is highly volatile.
3.	Master file is updated on the basis of transaction file.	Transaction file is used to update Master file.

4.	It is necessary to take the backup of Master files for security purpose.	Transaction files are no longer required after updation and transaction entries can deleted after updation. Therefore, it is not essential to take the backup of these files.
5.	Records in master file are stored in ascending order of primary key.	Transaction file stores the entries in the order in which they arrive.
6.	Master file stores one record corresponding to each primary key.	There can be more than one entry for a particular master record.
7.	Examples of Master files are Item file, Customer file, Employee file etc.	Sales file, Day Book, deductions file etc. are example of transaction files.

(ii)

No.	Logical Record	Physical Record
1.	The record defined by user is called Logical Record.	Storage of Logical Record in the computer is called Physical Record.
2.	It is the collection of those fields which are accessed by a single primary key.	It is the collection of those fields which are stored in adjacent memory location.
3.	Logical records are linked together with the help of File pointers.	Physical records are linked together with the help of Address Pointers.
4.	It may consist of Fixed length fields and Variable length fields.	All fixed length fields of Logical record are stored in one Physical record and each variable length field of Logical record is considered as separate physical record.
5.	Field Names, their data type and width are defined by user according to the requirements.	Physical record size is defined by Database Administrator (DBA) in such a way that it results in faster accessing of data.
6.	User is concerned with Logical record for insertion, deletion and updation of data.	Computer performs the required manipulation in the physical record.
7.	Sequence of fields in Logical record may be according to the convenience of user.	Sequence of fields in Physical record may not be same as Logical record.

(iii) Audio Conferencing: It is the use of audio communication equipments which allow the user to communicate with geographically dispersed persons. Audio conferencing does not require a computer but requires a two way audio communication facility.

Guidelines to make Audio conferencing more efficient are as stated below:

(a) All the participants must have an opportunity to speak.

(b) Number of participants must be kept to manageable size.

(c) Copy of conferencing agenda must be sent to all the participants in advance through FAX.

(d) Participants must identify themselves.

(e) Conferencing discussion must be recorded.

(f) Hard copy of the discussion must be prepared and should be sent to all the participants for approval.

Video Conferencing: It is the use of television equipment which allow the user to communicate with geographically dispersed persons. The equipment provides both sound and picture. The participant can see and hear each other and it does not required computers. Participants gather in specially equipped rooms having audio and video facility.

There are three types of Video Conferencing:

(a) One way Video and Audio: In this case, audio and video is traveled only in one direction e.g. Television.

(b) One way Video and Two way Audio: In this case, audio is transferred in both directions but video is transferred in one direction e.g. Discussion of News Reader with field correspondent.

(c) Two way Video and Audio: In this case, audio and video is transferred in both directions between sender and receiver e.g. Discussion of persons between different studios of a News Channel.

(iv)

No.	Sequential File Organisation	Direct File Organisation
1.	There exists a definite relationship among adjacent records.	No relationship exists among adjacent records, as records are stored randomly.
2.	Desired record is searched by sequential access. Hence, more time is required to find the desired record.	Desired record is accessed by direct access, hence desired record is searched quickly.
3.	Updation of Master file on the basis of Transaction file takes place by Brought-forward Carried-forward file method, in which original master file is retained.	Updation of Master file on the basis of Transaction file takes place by Overlaying in disk, in which original master file is overwritten by updated master records.
4.	Tape devices support sequential file organization.	Direct Access Storage Devices (DASD) like Magnetic disk, Floppy disk, Optical

	organization.	Laser disk support Direct File Organisation.
5.	This file organization is suitable for batch processing like payroll application and is not used for on-line queries like Banking System, Railway/Airlines Reservation system.	This file organization is suitable for on-line applications like Banking System, Railway/Airlines Reservation System where immediate response is required.

(v)

No.	Client-Server model	Peer-to-Peer model
1.	In this model, number of computers, known as clients are connected to a single host computer known as server.	In this model, all the computers are interconnected with each other. There is no concept of server and clients. All computers behave as server as well as clients.
2.	It uses a dedicated server which provides various services to clients like hardware, software and data access. Different types of servers can be File, Fax, Print or Database server.	It uses non-dedicated server. Non-dedicated server can also be used as a node for data entry, processing and output operations.
3.	Clients can share disk storage and printers attached with the server.	All computers can share the data/resources of each other.
4.	It is suitable for large organization having large number of nodes.	It is suitable in small organisation having less number of nodes upto ten.
5.	Data transfer speed is more.	Data transfer speed is less which decreases even further with the increase in number of computers.
6.	Failure of server results in break-down of entire network.	Failure of one computer will not affect the working of other, only the data stored on the faulty computer will not be accessible to other computers.
7.	Server can not be used for data entry/result purposes, hence it can be said that all the computers are not fully employed.	All the computers are fully employed.
8.	Clients are required to be connected with server in a particular structure like Star Network.	Computers can be connected at any convenient point in the network like Ring Network.
9.	Clients can be dumb terminal or	All computers are intelligent terminals.

	Intelligent terminals.	
10.	This architecture is employed where data security is of prime importance.	This architecture is used when security is not a bigger issue.

Question 3

(a) Explain in brief, the floppy disk as an auxiliary device.

(b) What is database structure? Explain relational database structure.

(c) A company offers discounts to customers on the following basis:

Quantity ordered	*Normal discount*
Less than 101	*5%*
From 101 to 500	*10%*
From 501 to 1,000	*15%*
More than 1,000	*20%*

The normal discount as given above is admissible only if the Customer's account balance in below Rs. 1,000 and the order value is Rs. 10,000 or more. If the account does not satisfy both of these conditions, the discount is reduced by 2% and if only one condition is violated, the discount is reduced by 1%.

Draw a Flow Chart to print customer name, discount offered and net amount payable for 25 customers. (5 + 5 + 10 = 20 Marks)

Answer

(a) Floppy Disk (Diskette): It consists of a circular plate, known as platter made of mylar plastic and coated with magnetic material like Ferrous Oxide on both the surfaces. The platter is enclosed in a protective jacket to avoid scratching on the magnetic surface. The circular plate is divided into number of concentric circles, known as tracks. Each track is divided into number of equal parts, known as sectors. Although different tracks vary in sizes but the volume of data stored on each track is same because the packing density of data goes on increasing as we move from outer to inner tracks. Outer track is called track 0. Any location on the floppy disk i.e. Physical address is identified by Surface number, Track number and Sector number.

Data recorded on the floppy disk is read with the help of a device, known as Floppy Disk Drive (FDD). There are two types of floppies – 5.25" (1.2 MB) and 3.5" (1.44 MB). In both cases, FDD required to read/write the data on floppy disks is different. Sony, IBM, Imation are the reputed manufacturers of floppy disks.

Different portions of the floppy disks are explained below:

(i) Spindle hole: This hole is used to rotate the circular plate at very high speed, usually at the speed of 300 RPM (Rotations/revolutions per minute). Due to the movement of circular plate, each sector of a track comes under the R/W head of FDD.

(ii) Read/Write Access position: This is the position where R/W head of FDD touches the magnetic surface for the purpose of reading/writing. Initially, R/W head is adjusted on the outermost track i.e. track 0 and when this track is completely read or written, then R/W head moves horizontally to adjust itself on the next inner track i.e. Track 1 and so on.

(iii) Index Hole: It is used as a marker of first sector. If an imaginary line passing through the center of spindle hole and Index hole is drawn, then the sector starting from this line in the clockwise direction is called first sector.

(iv) Write protect button: It is used to write-protect the floppy. If floppy is write protected, then nothing can be written on the floppy but contents already stored on the floppy disk can be read.

(b) The approach used to organize records and their relationships logically, is called Database Structure.

The three traditional data base structures are:

(i) Hierarchical database structure.

(ii) Network database structure.

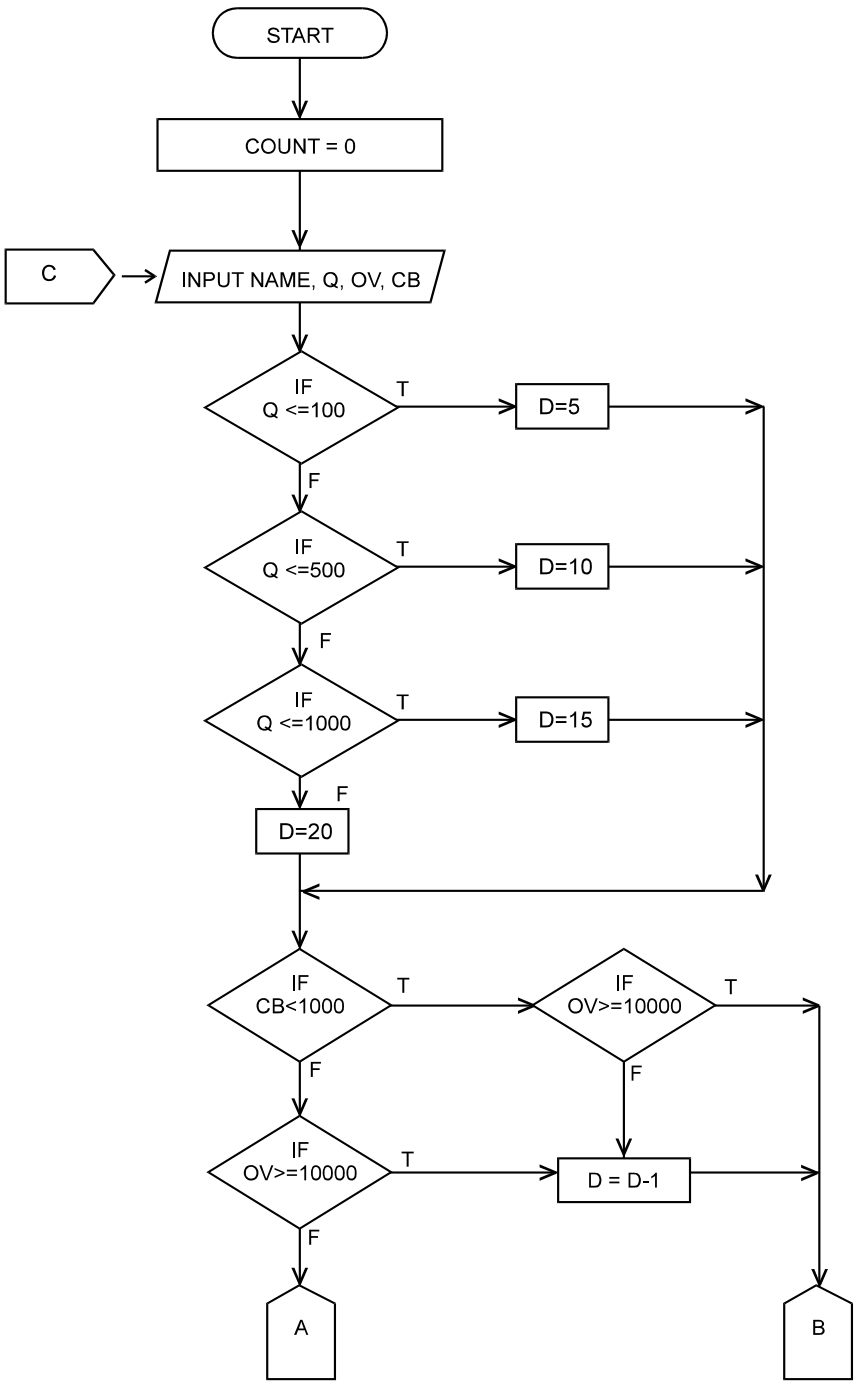
(iii) Relational database structure.

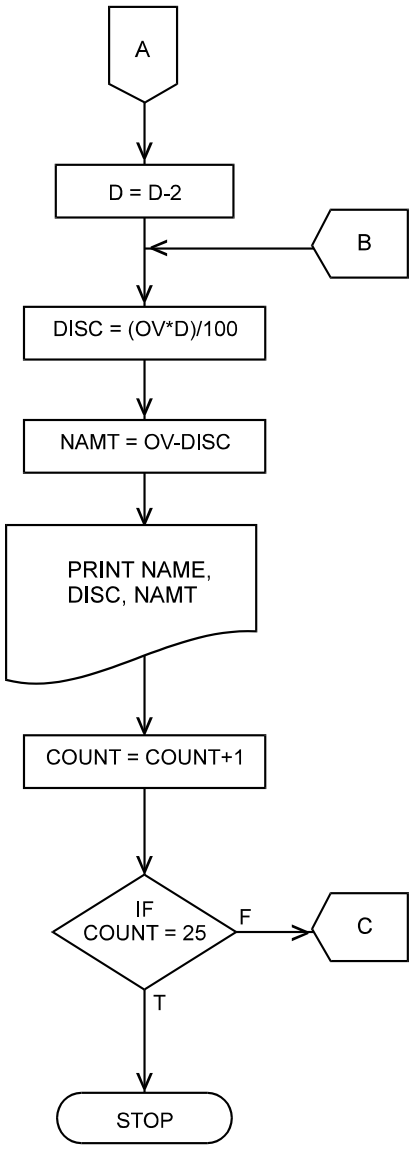
Relational database structure: In this database structures, records are stored in the form of two dimensional tables. The table is a file, in which each row represents one record and each column represents a field. In this database structure, relationships between the records need not to be specified in advance. Relational databases provide the flexibility in performing database queries and creating reports from more than one file by establishing the relationship among them on the basis of primary key. This relationship among the files can be created at any time according to the requirement and need not to be specified at the time of creation of database files.

The relational database structure is more flexible than hierarchical or network database structures in providing answers of ad hoc reports but it does not process the large batch applications with the speed of hierarchical or network databases. Examples of Relational Database Management Systems (RDBMS) include Oracle, IBM DB2, SQL Server, MS-Access etc.

(c) Flowchart

The following Flow chart is on the next page.


START
COUNT = 0
C
INPUT NAME, Q, OV, CB
IF
Q <=100
T
D=5
F
IF
Q <=500
T
D=10
F
IF
Q <=1000
T
D=15
F
D=20
IF
CB<1000
T
IF
OV>=10000
T
F
IF
OV>=10000
T
D = D-1
F
A
B



Abbrivations:

Q = Quantity

OV = Order Value

CB = Customer's Accounts Balance

NAMT = Net Amount

D = Disscount

Disc = Discount offered

True = T

False = F

Question 4

(a) Explain briefly various language tools available in MS-Word.

(b) Define an operating system and explain various functions performed by it.

(c) What are the integrity controls that DBMS package may offer? Explain in brief.

(5 + 5 + 10 = 20 Marks)

Answer

(a) MS-Word offers following useful language tools to aid writing and to increase efficiency:

(i) Auto Correct: Auto correct has a dictionary of its own which contains a list of commonly mistyped words. Adding words we mistype, one can customize this dictionary. Correct spellings of the word is to be provided with which MS-Word should replace the mistyped word. Once the entry in the Auto Correct dictionary is made, word automatically makes corrections of such words. This saves the trouble of going back to make corrections every time the word is mistyped.

(ii) Auto Text: This is a unique feature of the word. It allows storing formatted text even paragraphs and graphics. These can be recalled by pressing some keys. Auto Text is like auto correct in that it also has dictionary of its own and can be customized. Auto text has an Auto complete tip that will complete the text without you having to type the entire word. New Auto text entries can be made for any text in the document using the Create Auto Text entry dialog box.

(iii) Spelling and Grammar: The spell checking function checks each word in the article against the dictionary and underlines it with a red curly line if the word with wrong spelling appears. Words not found in the dictionary are also marked with a read curly line. User on running the spell check function will be able to get the right spelling and rectify it. Additional words can also be added to the dictionary.

(iv) Thesaurus: Thesaurus is a book in which words and phrases of similar meaning are grouped together. It comes with Word package. With the help of Thesaurus, one can select the more precise word.

(v) Find and Replace Text: 'Find' command helps to locate specific text in a document while 'Replace' command helps to substitute it with new text. This has the option of replacing all found words with one keystroke if one is sure that all the entries of that word need to be replaced.

(b) Operating systems are devised to optimize the man machine capabilities. An operating system is defined as an integrated system of programs, which supervises the operation of CPU, controls the input/output functions of computer system and provides various supports services. Without loading the operating system into the memory of the computer

system, the computer cannot be used. There are six basic functions that an operating system can perform.

(i) Job scheduling: Operating system decides the sequence in which different jobs are executed, using priorities established by the organizations.

(ii) Manage hardware and software resources: Operating system helps in loading the application programme into the primary memory and helps the various hardware units to perform as specified in the application programme.

(iii) Maintain system security: Operating system identifies the authorized users by recognizing the password entered by the user and thereby authorizing the user to have access to the system.

(iv) Enable multiple users resource sharing: Operating system can handle the scheduling and execution of the application programmes for many users at the same time (Multi programming).

(v) Handle interrupts: An interrupt is a technique used by the operating system to temporarily suspend the processing of the progamme in order to allow other programmes to be executed. Interrupts are issued when a programme requests an operation that does not require the CPU i.e., input/output devices or when the programme exceeds the pre-defined time limit.

(vi) Maintains usage records: Operating system can keep track of the amount of the time used by each user for each resource – processor, memory, Input/Output devices. Such information is usually maintained for the purpose of charging for the use of computing resources.

(c) Data Integrity Controls (i.e. controls on the possible value a field can assume) can be built into the physical structure of the fields. In order to have the correct database, DBMS needs to have certain controls on the data fields. Some of the security controls that DBMS imposes on data fields are as follows:

(i) Data Type: In the data field, the data type defines the type of data to be entered in the field. It may be numeric, character etc.

(ii) Length of data field: The length of data field defines the maximum number of characters or digits (depending upon the data type) to be entered in the data field. It may be 256, 65536 etc.

(iii) Default value: It is the value a field will assume unless a user enters an explicit value for an instance of that field. Assigning a default value to a field can reduce data entry time and entry of a value to that field can be skipped. Default value helps in reducing the probability of data entry errors for most common values.

(iv) Range Control: This limits the set of permissible values a field can assume. The range may be numeric lower to upper bound or a set of specific values. Range control must be used with caution since the limits of range may change with time. A combination of range control and coding led to Y2K problem, in which a field for the year was represented by only the numbers 00 to 99.

(v) Null Value Control: Null value is an empty value. Each primary key field must have an integrity control that prohibits a null value. Any other required field may also have a null value control placed on it depending upon the policy of the organization. For example, a university may prohibit adding a course to its database unless that course has a title as well as value to the primary key, course-ID. Many fields legitimately may have null values so this control is to be used only when truly required.

(vi) Referential Integrity: This control on a field is a form of range control in which the value of that field must exist as the value in some field in another row of same or different table. That is the range of legitimate values comes from the dynamic contents of a field in a data base table, not from some pre-specified set of values. Referential integrity guarantees that only some existing cross-referencing value is used, not that it is the correct one.

Question 5

(a) Describe the benefits of SAN.

(b) Explain the various views of a slide in MS-POWER POINT.

(c) Explain the various tools available to protect the information from intrusion and misuse.

(d) Define the following functions used in MS-EXCEL:

(i) NPV

(ii) LOG

(iii) LEN

(iv) ROUND

(v) COUNT *(5 + 5 + 5 + 5 = 20 Marks)*

Answer

(a) A Storage Area Network (SAN) is a dedicated, centrally managed, secure information infrastructure, which enables any-to-any interconnection of servers and storage systems. Following are the benefits of SAN:

(i) Removes data traffic: Like back up processes, from the production network giving IT managers a strategic way to improve system performance and application availability.

(ii) Improves data access: Using fiber Channel connections, SAN provides high speed network communication and distance needed by remote workstations and servers to easily access shared data storage pools.

(iii) Centralised Management of Data: IT managers can more easily centralize the management of their storage systems and consolidate backups, increasing overall system efficiency. The increased distances provided by Fiber Channel Technology

makes it easier to deploy remote disaster recovery sites. Fiber Channel and switched fabric technology eliminate single point of failure on the network.

(iv) Unlimited network expansion: Unlimited expansion is possible with hubs and switches. Nodes can be removed or added with minimal disruption to the network.

(b) PowerPoint offers five views:

(1) Normal View: This view gives small pane for text. It allows the user to frequently switch between text and objects on the slide.

(2) Outline View: This view gives largest pane for text, hence it is easy to work on a presentation. On the other hand, text is spread over several lines in normal view because the space for text is less.

(3) Slide View: This view makes it convenient to insert objects and modify them. This view shows how the text and objects appear on each slide. Using this view, user can work only on one slide at a time.

(4) Slide Sorter View: This view helps in moving the slides around but text/objects can not be rearranged on individual slides. This view shows all the slides at one time.

(5) Slide Show View: This view shows all the slides of the presentation one by one automatically if the time of each slide has been set up or slides can be viewed one by one on mouse click.

(c) Various tools available to protect the information from intrusion and misuse are discussed below:

(1) Firewalls: These are the software which are installed on the web server to protect the server from hacking. Hackers are mischief makers who intentionally disable the site and whenever any user tries to open that site, its home page is not displayed. However, Firewall can also be implemented with the help of hardware like Nokia Checkpoint.

(2) Encryption: Before the transmission of data like transfer of credit card number on telephone line during E-Commerce transactions, data is encrypted so that no person can trap the data on the way. Encryption of data can be performed with the help of hardware as well as with the help of software.

(3) Message Authentication: Before providing access of data to the user, authentication of user can be done with the help of passwords. Organisation server may also be configured to accept the message only from the known persons.

(4) Site blocking: It is a software based approach which restricts the users to access certain sites. For example, in certain organisations, servers are configured in such a manner so that user cannot open the site. For example resume posting sites like Naukri.com, jobahead.com etc.

(d) (i) NPV (values, rate): This function is used to calculate net present value of an

investment based on discount rate and a series of future payments.

(ii) LOG(x): Returns the logarithm of a number to the base 10.

(iii) LEN (text string): It returns the number of characters in the text string e.g. if text string = 'Examination', then this function will return 11.

(iv) ROUND (x, n): To round off the number x to n number of decimal places e.g. if x = 2.1752 and n = 2 then = ROUND (x, n) will return 2.18.

(v) Count (range): This function is used to count the number of items in the range of cells ignoring the blank cells.

Question 6

(a) What is Image processing? Explain the steps required for image processing.

(b) Discuss the objectives of Information Technology Act, 2000.

(c) Explain the following techniques of audit used by internal auditors:

(i) System activity file interrogation.

(ii) Program comparison

(d) Explain general management concerns in E-commerce. (5 + 5 + 5 + 5 = 20 Marks)

Answer

(a) Image Processing: It is the process of entering an image, graph, design, drawing or photograph into the computer with the help of digitizing. Digitizing is a process of converting the graphical information into digital form. Image processing also known as Document Imaging is a step towards paperless office. There are five steps required for document imaging.

(1) Data Capture: Paper documents are entered into the computer with the help of image scanner. Image scanner converts the graphical information into digital form. Printers are available in the market having removable printing head which can be replaced with scanning head, enabling the printer to work as image scanner. There are two types of scanners:

(a) Page Scanner (Flat bed scanner): This scanner is used to scan the large images by placing the document on a flat surface and giving the command with the help of scanner software using computer.

(b) Hand held scanner: This scanner is used to scan small images by holding the scanner in hand and moving the scanner on the document.

(2) Indexing: For fast retrieval of the stored documents, scanned images are indexed on the basis of some criteria like Vendor Code or purchase order number.

(3) Storage: Scanned document files are stored on auxiliary storage media for future reference. Since size of the scanned files is more, therefore, compact disk (CD's) or DVD's are used as storage media.

(4) Retrieval: Document management software allows the user to access any required information from the stored files on the basis of various parameters like Indexed key, key word etc. The software can automatically mark the optical disks (CD's) so that when any information is required to be accessed, then software may tell the number of that CD storing the desired information.

(5) Output: Hard copy of the scanned documents can be printed with the help of printers and even can be sent to another person through E-mail.

(b) Objectives of the Information Technology Act, 2000

(a) To grant legal recognition to transactions carried out by means of EDI and E-Commerce in place of paper based methods of communication.

(b) To give legal recognition to digital signatures for authentication of any information.

(c) To facilitate electronic filing of documents with Government Departments.

(d) To facilitate electronic storage of data.

(e) To facilitate and give the legal recognition to electronic fund transfers between bank and financial institutions.

(f) To give legal recognition for keeping books of accounts in electronic form by bankers.

(g) To amend the Indian Penal Code, the Indian Evidence Act, the Banker's Book Evidence Act and Reserve Bank of India Act.

(c) i) System Activity File Interrogation: Many computer operating systems automatically create a log file listing all the exceptional events occurring in the system. This log file is stored on hard disk and review of this file helps in identification of exceptional events as listed below:

- The use of utility program instead of application program to change the data file.
- Attempt to break password to gain access of the system.
- The running of an application program without normal sequence.
- Change in application programs.

(ii) Program Comparison: This tool compares two different versions of the same program to check that they are identical. Software is available to do this comparison on source code as well as on object code. This tool can be used in the following situations:

- Comparing the program actually implemented with the one tested and accepted by user.
- Comparing the programs installed at different locations.
- Comparing the presently installed version with a copy of previously tested version under the control of the auditor.

Any difference between the two copies will require programming skill to know the impact of changes on the output.

(d) General Management Concerns in E-Commerce are as follows:

(1) Loss of Paper audit trail: Since no paper work is involved in doing the business transactions electronically, hence keeping the track of business activities will be difficult.

(2) Business Continuity: In E-Commerce, all the transactions are done with the help of computers, hence if computer system fails then entire business organization will be paralyzed.

(3) Exposure of data to third parties: Due to sharing of data among organisations, there is possibility of exposure of secret information to other parties.

(4) Record retention: Electronic information is required to be kept safely as a statutory requirement, therefore organisations will have to take appropriate measures for the safety of data.

(5) Segregation of duties: There are more chances of fraud in an electronic environment. Hence, duties of various persons working in electronic environment must be properly defined, in order to fix their responsibilities at later stages.

(6) Legal Liability: The inability to complete transactions or meet deadlines, or the risk of inadvertently exposing information of trading partners poses legal risks.

(Note: Students are required to give any 5 points)

Question 7

Write short notes on the following. Answer any four:

(i) Voice messaging

(ii) Wireless networks

(iii) File management system

(iv) Diagnostic routines

(v) White box approach for audit. *(5 × 4 = 20 Marks)*

Answer

(i) Voice Messaging: This communication approach is similar to Electronic mail except in this approach, audio messages rather than text messages are processed. A sender speaks on the phone giving the name of the recipient and message. Sender's voice signals are converted to digital signals and stored. The system then transfers the message to the recipient. The message is converted back to analog form when it is received by the recipient. Recipient hears the same voice as it had been spoken by the sender. Voice messaging requires a computer with the ability to store the message by converting it into digital form and converting back to analog form upon retrieval. Main

advantage of voice messaging over electronic mail is that the sender need not have to type the message.

(ii) Wireless Networks: People on the road often want to use their portable computers like Laptop or Notebook computers to send and receive electronic mails, read remote files from the server of their office and to surf the Internet from anywhere on land, sea or air. Since a wired network is impossible in cars and aeroplanes, hence it resulted in the development of wireless network. WAP (Wireless Application Protocol) is the protocol used in Wireless communication. Laptop computers with wireless card are available in the market. Wireless technology known as Bluetooth allows the user to transfer the data between computer and Mobile Phone/Digital Camera. Airports and some Indian Universities have been converted to Wireless fidelity (Wi-Fi) zones which are allowing users to use Internet services anywhere within the premises of Airport.

Wireless networks are of great use for those persons who remain away from their home/office for most of the time. Another use of wireless network is for the rescue workers at the disaster sites like fires, floods or earthquake sites where telephone system gets destroyed.

(iii) File Management System: In this system, different users work on their independent computers and maintain their own data files. Each user has its own application software according to the requirements which was either developed in-house or got developed from external software agency according to the requirements. Instead of getting integrated software developed, different users have independent modules for data processing. Such system of maintaining files creates many problems as discussed below:

(a) Data redundancy: When same data files are stored at different locations, then it is called data redundancy. It causes problem when the data has to be updated. Different users may use same data as to occur inconsistency among different files.

(b) Lack of Data integration: Data files of different users are not integrated with each other, therefore changes made by one user are not made in each file automatically. It is an expensive and time consuming process for an organisation.

(c) Data inconsistency: Lack of Data integration create data inconsistency. When at a particular time, data stored in different files does not reconcile with each other, then it is called data inconsistency.

(d) Program-data dependence: Software modules being used by different users are developed in high level programming languages like BASIC, COBOL etc. These high level languages use different file formats. Therefore, when program written in one programming language is required to be changed in another language, then it becomes essential to change the format of data files also.

(iv) Diagnostic Routines: It is a system software which is usually a part of operating system and is provided by the computer manufacturer. These are those programs which help the user in debugging of program as well as to find out the details of various equipments used in the computer, like:

1. What type of Processor is installed in the computer like P-III or P-IV and its speed?
2. What is total amount of main memory like 128MB/256MB?
3. What type of keyboard is attached with the computer like 101 Keys/104 keys/Multimedia Keyboard?
4. What is display type like VGA/SVGA?
5. What type of mouse is attached with computer like 2 buttons/3buttons/scroll mouse/Mechanical Mouse/Optical Mouse?
6. Is separate math coprocessor present in computer?
7. Where is BIOS (Basic I/O) manufacture like AWARD BIOS or ANI BIOS?

(v) White Box Approach for Audit: Presently, computer system has progressed to a point where entire processing cycle occurs within the computer system. Therefore, traditional audit trial has disappeared. Hence, it becomes necessary to examine the internal working of the computer system. The auditor can verify the progress himself and get technically satisfied that the system, internal checks, controls, error detection and data security procedures are satisfactory. Auditor can use test checks to keep the system in operation. By acquiring the necessary skills, the auditor can use the computer itself as an audit tool to improve the quality of his own audit and can reduce time spent on detailed verification of transactions.

In this type of white box approach, the auditor's primary concern includes the system of controls, examination and testing of computer implemented controls.

SUMMARY OF EXAMINERS' COMMENTS ON THE PERFORMANCE OF CANDIDATES

PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

General Comments

Overall performance of the candidates was average. Candidates are required to practice as many practical questions as possible under examination conditions by referring to the Study material, Revision Test Papers, Suggested Answers and Reference books. Performance revealed lack of in-depth knowledge and rigorous study. The candidates need to understand each and every topic of the subject conceptually and also fine tune their writing skills including presentation of data.

Specific Comments

Question 1.(a) This was a practical question part requiring a sound understanding of Process Costing. Most of the examinees were unable to compute the equivalent production units and statement of cost correctly. Subsequently, Process account, Normal loss accounts and Abnormal loss accounts were not made correctly by the students.

(b) This theoretical part required basic knowledge of Activity Based Costing. Many of the examinees explained Unit costing in place of Unit level activities and Batch costing in place of Batch level activities.

Question 2. (a) This question requires basic understanding of Integrated accounting system. In this theory question part some of the examinees wrote about the advantages of double accounting system instead of Integrated Accounting. However most of the candidates have attempted the answer well.

(b) This numerical part requires fundamental understanding of Operating Costing. Very few students answered all the three parts correctly. The words 'per month' and 'per year' given in the question were ignored by majority of the students. They were confused regarding number of club members and number of library members resulting in wrong calculation of subsidy.

Question 3.(a) In this question examinees were required to compute the ratio of the new material mix at the same quantum of profit as at the existing level. This numerical part was attempted by a handful number of candidates and many out of them could not calculate the material mix properly.

(b) In this theoretical part conceptual understanding of different types of cost, audit and preliminary understanding of inventory management was required. Many students have given vague and sketchy answers for 'discretionary costs' and 'proprietary audit'. In other parts of this question examples were not cited by the candidates.

Question 4.(a) This was a practical question part requiring basic understanding of Operating Costing. Majority of the candidates failed to find out the total cost and subsequently cost of each type of room. Many students were not able to formulate the equation to find out the cost of one suite correctly.

(b) In this theoretical part related to labour, majority of the students have written formula of

Rowan premium bonus system instead of explaining what has been asked for in the question.

Question 5.(a) In this numerical question part examinees are required to have a basic knowledge of concepts of reconciliation between cost accounting records and financial accounting records. Many of the candidates could not calculate the costing profit correctly. However, reconciliation part was attempted well by most of the examinees.

(b) This theoretical question part requires a sound understanding of Contract Costing and Inventory Management. Examiners have reported a lack of understanding of concepts related to Contract Costing. Retention money in Contract Costing has not been explained correctly by majority of the candidates. A few candidates were confused between 'Economic batch quantity' and 'Economic Order Quantity' and have answered on wrong lines.

Question 6.(a) Being a compulsory question, it was attempted by a number of candidates. Majority of the candidates computed the Balance Sheet items on correct lines. However only a few candidates correctly computed the items of Profit and Loss A/c and presented them in a proper manner.

(b) This theoretical question was also not attempted properly by most of the candidates.

Question 7.(a) A large percentage of the candidates attempted this question. However, only a very few candidates computed cost of funds for additional amount of debtors correctly. Therefore majority of the candidates arrived at the wrong conclusion.

(b) This part of the question was well attempted by a majority of candidates however few candidates properly covered all the services provided by the factoring agencies in their answers.

Question 8.(a) This practical question part required candidates to compute the WACC. A conceptual understanding of cost of capital was needed to solve the problem on correct lines. However, most of the candidates could not work out correctly the cost of equity and cost of preference share capital.

(b) A large number of candidates did not attempt this part of the question satisfactorily. Majority of the candidates confused 'Propositions made by Modigliani and Miller' as 'Assumptions made by Modigliani and Miller' and hence answered the question on wrong lines.

Question 9.(a) Majority of the candidates attempted this question and majority of candidates calculated cash flows upto 4 years correctly but faltered in the calculation of depreciation (including the loss on disposal of asset) in the 5th year (terminal year). Therefore majority of the candidates incorrectly computed the NPVs at the given rates and IRR was computed wrongly.

(b) This theory part required understanding of Global Financial Market. Most of the candidates were not able to attempt the question on correct lines and majority of the candidates gave vague answers.

PAPER – 5 : INCOME-TAX AND CENTRAL SALES TAX

General comments

Overall performance of the candidates was not very satisfactory, particularly in problem oriented questions. Most of the candidates have not properly presented the solution to computational problems stepwise in an orderly manner. In the case of True/False questions, many candidates have simply answered True or False, without giving proper reason for their answer by mentioning relevant provisions of the Act. Candidates have exhibited poor knowledge of the basic provisions of the Act and also of the recent amendments to the Income Tax Act. Other deficiencies are very poor handwriting, lack of expression and spelling and grammatical mistakes.

Specific Comments

Question 1.(a) Most of the candidates have not understood the problem and failed to compute income-tax correctly. Some common mistakes were:

(i) Most of the candidates have not considered stamp valuation as sale consideration for calculating capital gain.

(ii) Income from salary from a City Care Centre was included under the head 'Income from other sources'.

(iii) Winnings from Lotteries have not been grossed up and lottery expenses have been wrongly deducted.

(iv) Candidates have not considered agricultural income for rate purposes.

(v) Majority of the candidates have taken the maturity value of LIC as income from other sources, though it is exempt from tax.

(vi) Some of the candidates have shown honorarium of Rs. 14,000/- for valuing medical examination answer books, under the head 'Profits and gains from business and profession' instead of showing the same under the head 'Income from other sources'.

(b) Most of the candidates were not aware of the provisions regarding apportionment of depreciation when there is conversion of proprietary business into a company. Block of assets concept was not clear to many candidates.

Question 2. (First Alternative)

(a) Many candidates have not understood the concept of Marginal Relief. Hence, calculations with regard to the same were also not correct.

(b) Most of the candidates were not aware of the provisions of the section 80QQB and have got confused with deduction for political parties. Their answers were very general without explaining the relevant provisions of the Act.

Question 2. (Second Alternative)

(a) Many candidates were not aware of the provisions contained in section 80IB. They have not mentioned the specific provisions contained in section 80-IB(7A) and (7B) relating to multiplex theatres and convention centres.

(b) Most of the candidates have not answered correctly since they have not understood the provisions contained in section 45(2). Some of the candidates have wrongly treated the entire income on conversion of capital assets into stock in trade as business income.

Question 3.(a) (i) Most of the candidates were not aware of the amendment made in section 2(24) by the Finance Act, 2006 and have written that voluntary contribution received by charitable trusts are exempt. Some have explained the distinction between charitable trust, university and educational institutions. Some others have written false without any reasons.

(iii) Most of the candidates were not aware of the provisions of section 148 regarding the time limit to issue notice in case of an amount exceeding Rs.1 lakh. Except a few candidates, none of them could mention that the time limit was 6 years.

(v) Some of the candidates have given lengthy reasoning, without stating true or false.

(b) (iii) Most of the candidates have answered Rs.195,000 instead of Rs.185,000 as exemption limit of income available to a senior citizen for A.Y. 2007-08.

(iv) Most of the candidates have not correctly answered the time limit for filing an appeal.

(v) Some of the candidates have considered the amount of Rs. 65,000/- as deductible under section 80C.

Question 4.(a) Most of the candidates were not able to answer correctly since they were not aware of the provisions of section 43B. Many candidates wrote the wrong answer by giving the provisions of section 40A(3) on disallowance of cash expenditure exceeding Rs. 20,000/- instead of section 43B on deduction to be allowed on actual payment basis.

(b) This question pertains to the Scheme of submission of return through Tax Return Preparer (TRP), which was introduced by the Finance Act, 2006. Most of the candidates have misunderstood TRP as Electronic filing system. Some of the candidates have wrongly explained provisions of Section 139(1A) and 139(1B).

(c) Most of the candidates misunderstood section 80GG with section 80G on deduction on account of donation.

(d) Most of the candidates have not explained the provisions of section 10AA clearly. They have written vague answers and other benefits derived by the units in SEZ on account of sales tax and other taxes.

Question 5. (a)(ii) Most of the candidates have stated 'False', but reasons were not correct.

(v) This pertains to VPP sale. Candidates have not correctly understood the statement and have answered on the basis of normal inter state sale movement from one State to another.

Question 5. (b)(v) Some candidates have wrongly written that the authority to declare goods of special importance lies with the Central Sales Tax Authority.

Question 6. (a) Most of the candidates have not answered this part with reference to provisions contained in Central Sales Tax Act and have discussed penalties in general.

(b) This question pertains to consideration for selection of goods of special importance. Most of the candidates have got confused and explained section 14 in detail, without mentioning the points to be considered for selection of goods of special importance. Some of the candidates have misunderstood consideration as something in return (i.e. sale price)

(c) Most of the candidates do not have proper knowledge of the provisions relating to forfeiture of security. Some of the candidates explained provisions regarding procedure of registration and taking of security instead of on forfeiture of security.

PAPER – 6 : INFORMATION TECHNOLOGY

General Comments

Adequate subject knowledge and competency is required to attempt the question correctly that was not reflected in answer sheet prepared by the student. Student wrote answer without understanding the requirement of the question. Student need to understand the basic concepts of the usages of Information Technology in the particular domain. They have to improve the subject knowledge as well as language skill for better performance.

Specific Comments

Question 1.(a) Most of the student attempted this question and performed well.

(b) Some of the students fails to explain the meaning of 'Gateways', 'Duplex Printing' and 'Asymmetric Crypto System' correctly. The understanding of the technical things are required for the student to give appropriate answers.

(c) Very few students did not explain the meaning of 'Use of Firewall' and 'Use of Routers'. Although the performance is satisfactory.

(d) Very good performance by majority of the students.

Question 2. (i) Answered given by most of the students with an average performance. Lack of giving technical words at the right places is major problem of the students.

(ii) Average number of students do not know the technical differences between 'Logical Record and physical record'.

(iii) The answers are readily available in the course material and hence, generally, well answered by almost all the students.

(iv) Answered by majority of the students and performed well.

(v) More than average number of students attempted this question nicely.

Question 3.(a) Most of the students attempted this question and performed well.

(b) More than average number of students attempted this question and performed well.

(c) Average number of students attempted this question and the performance is not satisfactory. Students are required to understand the importance and utility of 'Flow Charts' in programming. They must understand the basic symbol used in Flow chart.

Question 4.(a) Answered by most of the students with average performance.

(b) Attempted by the majority of the student and performed satisfactory.

(c) Performance is not satisfactory. Most of the students lacked in understanding of the question. Description is given more on DBMS rather than Data Integrity Control.

Question 5.(a) Mostly all the students has given corrected answers and secured goods marks.

(b) Answered by most of the students with good performance.

(c) Many of the students attempted this question nicely.

(d) Some of the students were not able to explain most of the MS-Excel function with syntax command.

Question 6.(a) Most of the students attempted the question nicely and performed well.

(b) Most of the students answered as it is given in study material.

(c) Students lacked understanding the questions and answered wrongly. They must go through with the procedure and techniques used in computer based auditing.

(d) Performance is not satisfactory. Only few students answered 'Management concern of e-commerce' and rest answered the 'Benefit of e-commerce' i.e. wrong.

Question 7.(i) Mostly all the students attempted this question correctly and performed well.

(ii) Satisfactory performance by majority of the students.

(iii) Most of the students attempted the question but answer was not satisfactory. Only few stated about the Data Integrity and Inconsistency'.

(iv) Many of the students have answered wrongly without understanding the basic concept of operating system.

(v) Attempted by the majority of the students and performed well.

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PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

Question 1 and 6 are compulsory.

Attempt three questions out of the remaining Question Numbers 2, 3, 4 and 5 and attempt two questions from the remaining Question Nos. 7, 8 and 9.

Working notes should form part of the answer.

Question 1

(a) *PQR Ltd. manufactures four products, namely A, B, C and D using the same plant and process. The following information relates to production period October, 2007:*

Product	*A*	*B*	*C*	*D*
Output in units	*1440*	*1200*	*960*	*1008*
Cost per unit:				
Direct Materials	*Rs. 42*	*Rs. 45*	*Rs. 40*	*Rs. 48*
Direct Labour	*Rs. 10*	*Rs. 9*	*Rs. 7*	*Rs. 8*
Machine hours per unit	*4*	*3*	*2*	*1*

The four products are similar and are usually produced in production runs of 48 units per batch and are sold in batches of 24 units. Currently, the production overheads are absorbed using machine hour rate. The production overheads incurred by the company for the period October, 2007 are as follows:

	Rs.
Machine department costs	
(rent, deprecation and supervision)	*1,26,000*
Set-up Costs	*40,000*
Store receiving costs	*30,000*
Inspection	*20,000*
Material handling and dispatch	*5,184*

During the period October, 2007, the following cost drivers are to be used for allocation of overheads cost:

Cost	*Cost driver*
Set-up Costs	*Number of production runs (batches)*
Stores receiving	*Requisition raised*
Inspection	*Number of production runs (batches)*
Material handling and dispatch	*Orders executed*

It is also determined that:

(i) Machine department costs should be apportioned among set-up, stores receiving and inspection activities in proportion of 4 : 3 : 2.

(ii) The number of requisitions raised on stores are 50 for each product. The total number of material handling and dispatch orders executed during the period are 192 and each order being for a batch size of 24 units of product.

Required:

(i) Calculate the total cost of each product, if all overhead costs are absorbed on machine-hour rate basis.

(ii) Calculate the total cost of each product using activity-based costing.

(iii) Comment briefly on as to how an activity-based costing might benefit PQR Ltd.

(b) Distinguish between Cost control and Cost reduction.

(c) Discuss the reasons for disagreement of profits as per Cost Accounting and Financial Accounting. *(11 + 3 + 4 = 18 Marks)*

Answer

(a) (i) Total Overhead = Rs. 1,26,000 + 40,000 + 30,000 + 20,000 + 5,184 = Rs. 2,21,184

Total machine hours = 1,440 × 4 + 1,200 × 3 + 960 × 2 + 1,008 × 1

= 5,760 + 3,600 + 1,920 + 1,008 = 12,288.

$\therefore$ Overhead recovery rate / M.H. = $\frac{2,21,184}{12,288}$ = Rs. 18

Cost Statement when overheads are absorbed on machine hours rate basis

(Traditional Costing)

Product	*A*	*B*	*C*	*D*
Output in units	1,440	1,200	960	1,008
Cost per unit:				
Direct material Rs.	42	45	40	48
Direct labour Rs.	10	9	7	8
Overhead (@ Rs.18) Rs.	4× 18 = 72	3 × 18 = 54	2× 18 = 36	1× 18 = 18
Total cost per unit Rs. (Material + Laour + overhead	124	108	83	74
Total cost Rs. (Output in units × Total cost per unit)	1,78,560	1,29,600	79,680	74,592

(ii) (1) Machine department costs of Rs. 1,26,000 to be apportioned to set-up cost, store receiving and inspection in 4 : 3 : 2 i.e. Rs. 56,000, Rs. 42,000 and Rs. 28,000 respectively.

(2) One production run = 48 units. Hence, the number of production runs of different products:

$A = \frac{1,440}{48} = 30$, $B = \frac{1,200}{48} = 25$, $C = \frac{960}{48} = 20$, $D = \frac{1,008}{48} = 21$ or total 96 runs.

(3) One batch order is of 24 units. So the number of batches of different products:

$A = \frac{1,440}{24} = 60$, $B = \frac{1,200}{24} = 50$, $C = \frac{960}{24} = 40$, $D = \frac{1,008}{24} = 42$ or total 192 batches.

(4) Computation of Cost driver rates

Activity	*Activity Cost (Rs.)*	*Cost driver*	*Quantity*	*Cost driver rate*
Set-up	40,000 + 56,000 = 96,000	No. of production run	96	Rs. 1,000 per production run
Store-receiving	30,000 + 42,000 = 72,000	Requisition raised	50 × 4 = 200	Rs. 360 per requisition
Inspection	20,000 + 28,000 = 48,000	No. of production run	96	Rs. 500 per production run
Material handling	5,184	Orders executed (No. of batches)	192	Rs. 27 per batch

(5) Cost statement under Activity Based Costing:

Product	*A*	*B*	*C*	*D*
Out-put in units	1,440	1,200	960	1,008
	Rs.	*Rs.*	*Rs.*	*Rs.*
Material	1,440 × 42 = 60,480	1,200 × 45 = 54,000	960 × 40 = 38,400	1,008 × 48 = 48,384
Labour	1,440 × 10 = 14,400	1,200 × 9 = 10,800	960 × 7 = 6,720	1,008 × 8 = 8,064
Overhead cost:				
Set up	1,000 × 30 = 30,000	1,000 × 25 = 25,000	1,000 × 20 = 20,000	1,000 × 21 = 21,000

Store receiving	360 × 50 = 18,000	360 × 50 = 18,000	360 × 50 = 18,000	360 × 50 = 18,000
Inspection	500 × 30 = 15,000	500 × 25 = 12,500	500 × 20 = 10,000	500 × 21 = 10,500
Material handling	27 × 60 = 1,620	27 × 50 = 1,350	27 × 40 = 1,080	27 × 42 = 1,134
Total overhead cost	64,620	56,850	49,080	50,634
Total cost	1,39,500	1,21,650	94,200	1,07,082
Total cost per unit, (Total cost / Output)	96.875	101.375	98.125	106.232

(iii) Comparison of Overhead cost differences

Overhead cost per unit under Traditional Absorption Costing system	(Rs. 18 × 4 machine hours) 72.00	(Rs. 18 × 3 machine hours) 54.00	(Rs. 18 × 2 machine hours) 36.00	(Rs. 18 × 1 machine hour) 18.00
Overhead cost under Activity Based Costing system	$\frac{64,620}{1,440} = 44.875$	$\frac{56,850}{1,200} = 47.375$	$\frac{49,080}{960} = 51.125$	$\frac{50,634}{1,008} = 50.2$
Overhead Cost difference	27.125	6.625	(15.125)	(32.232)
Overhead difference due to absorption system	–37.68% over cost	–12.27% over cost	+42.10% under cost	+179.07% under cost

Comments:

(i) There is a wide difference between the overhead cost as traced by the two systems. ABC is a superior method of tracing overhead costs since it relates the overhead costs with activities and resources consumed rather than just the machine hours rate.

(ii) Products A and B have been over costed under absorption costing since machine hours per unit are higher than that of products C and D.

(b) Distinction between Cost Control and Cost Reduction: Cost control is operated through setting standards of targets and comparing actual performance therewith, with a view to identify deviations from standards or norms and taking corrective action in order to ensure that future performance conforms to standards or norms.

Cost reduction is a continuous process of critical cost examination, analysis and challenge of standards. Each aspect of business viz., products, process, procedures,

methods, organization, personnel, etc. is critically examined and reviewed with a view of improving efficiency and effectiveness and reducing the costs.

Cost control lacks the dynamic approach which planned cost reduction demands. In cost reduction, standards which are the basis of control are constantly challenged for improvement.

(c) Reasons for disagreement of profits as per Cost Accounting and Financial Accounting:

Items included in the financial accounts but not in Cost Accounts

(i) Appropriation of profits

(i) Income tax

(ii) Transfer to General Reserve

(iii) Dividend paid

(iv) Amount written off e.g. goodwill, preliminary expenses, debenture discount etc.

(ii) Matters of pure finance

(i) Interest received on bank deposits/investments

(ii) Dividends received

(iii) Losses on sale of investment, building.

(iv) Profit on sale of fixed assets

(v) Transfer fees

(vi) Damages/penalties

(iii) Items included in Cost Accounting

(i) Opportunity cost of building owned.

(ii) Interest on capital employed in production

(iii) Salary of proprietor.

(iv) Under / over absorbed overheads in Cost Accounting

(v) Differences due to varying basis of valuation of inventory.

Question 2

(a) A Company manufactures a special product which requires a component 'Alpha'. The following particulars are collected for the year 2008:

(i)	*Annual demand of Alpha*	*:*	*8,000 units*
(ii)	*Cost of placing an order*	*:*	*Rs. 200 per order*
(iii)	*Cost per unit of Alpha*	*:*	*Rs. 400*
(iv)	*Carrying cost % p.a.*	*:*	*20%*

The company has been offered a quantity discount of 4% on the purchase of 'Alpha', provided the order size is 4,000 components at a time.

Required:

(i) Compute the economic order quantity.

(ii) Advise whether the quantity discount offer can be accepted.

(b) Two workers 'A' and 'B' produce the same product using the same material. Their normal wage rate is also the same. 'A' is paid bonus according to Rowan scheme while 'B' is paid bonus according to Halsey scheme. The time allowed to make the product is 50 hours. 'A' takes 30 hours while 'B' takes 40 hours to complete the product. The factory overhead rate is Rs. 5 per person-hour actually worked. The factory cost of product manufactured by 'A' is Rs. 3,490 and for product manufactured by 'B' is Rs. 3,600.

Required:

(i) Compute the normal rate of wages.

(ii) Compute the material cost.

(iii) Prepare a statement comparing the factory cost of the product as made by two workers.

(c) Discuss the treatment of by-product Cost in Cost Accounting. (5 + 6 + 3 = 14 Marks)

Answer

(a) $EOQ = \sqrt{\frac{2AO}{C \times i}}$

$= \sqrt{\frac{2 \times 8{,}000 \times 200}{400 \times 20\%}}$

= 200 units.

Calculation of total inventory cost p.a. at EOQ.

	Rs.
Purchase cost = 8,000 × 400	32,00,000
Ordering cost $\left(\frac{A}{Q} \times O = \frac{8{,}000}{200} \times 200\right)$ =	8,000
Carrying cost $\left(\frac{Q}{2} \times c \times i = \frac{200}{2} \times 400 \times 20\%\right)$ =	8,000
	32,16,000

Calculation of total inventory cost p.a. with quantity discount

	Rs.
Purchase cost = 8,000 × (400 − 4%)	30,72,000
Ordering cost $\left(\frac{A}{Q}\times O=\frac{8,000}{4,000}\times 200\right)$ =	400
Carrying cost = $\left(\frac{Q}{2}\times c\times i=\frac{4,000}{2}\times 384\times 20\%\right)$ =	1,53,600
	32,26,000

Quantity discount offered should not be accepted as it results in increase in total cost of inventory management by Rs. 10,000.

(b) Let *x* be the cost of material and *y* be the normal rate of wage/hour

	Worker A	*Worker B*
	Rs.	*Rs.*
Material cost	*x*	*x*
Labour wages	30 y	40 y
Bonus	Rowan system	Halsey system
	$\frac{\text{Time saved}}{\text{Time allowed}}\times\text{hour worked}\times\text{rate}$	Hours saved × 50% × rate
	$=\frac{20}{50}\times 30\times y=12y$	$=10\times\frac{1}{2}\times y=5y$
Overheads	30 × 5 = 150	40 × 5 = 200
Factory cost	x + 42y + 150 = 3,490	x + 45y + 200 = 3,600
	∴ x + 42y = 3,340 – (1)	∴ x + 45y = 3,400 – (2)

Solving (1) and (2) we get

X = 2,500 and y = 20

(i) Normal rate of wages is Rs. 20 per hour.

(ii) Cost of materials = Rs. 2,500.

(iii) Comparative Statement of factory cost

	Worker A	*Worker B*
	Rs.	*Rs.*
Material cost	2,500	2,500
Wages	30 × 20 = 600	40 × 20 = 800

Bonus	$\left(\frac{20}{50}\times 30\times 20\right)=240$	$\left(10\times\frac{1}{2}\times 20\right)=100$
Overheads	30 × 5 = 150	40 × 5 = 200
Factory cost	3,490	3,600

(c) Treatment of by-product cost in Cost Accounting:

(i) When they are of small total value, the amount realized from their sale may be dealt as follows:

- Sales value of the by-product may be credited to Profit and Loss Account and no credit be given in Cost Accounting. The credit to Profit and Loss Account here is treated either as a miscellaneous income or as additional sales revenue.
- The sale proceeds of the by product may be treated as deduction from the total costs. The sales proceeds should be deducted either from production cost or cost of sales.

(ii) When they require further processing:

In this case, the net realizable value of the by product at the split-off point may be arrived at by subtracting the further processing cost from realizable value of by products. If the value is small, it may be treated as discussed in (i) above.

Question 3

(a) RST Limited processes product Z through two distinct process – Process I and Process II. On completion, it is transferred to finished stock. From the following information for the year 2006-07, prepare Process I, Process II and Finished Stock A/c:

Particulars	*Process I*	*Process II*
Raw materials used	*7,500 units*	–
Raw materials cost per unit	*Rs. 60*	–
Transfer to next process/finished stock	*7,050 units*	*6,525 units*
Normal loss (on inputs)	*5%*	*10%*
Direct wages	*Rs. 1,35,750*	*Rs. 1,29,250*
Direct expenses	*60% of direct wages*	*65% of direct wages*
Manufacturing overheads	*20% of direct wages*	*15% of direct wages*
Realisable value of scrap per unit	*Rs. 12.50*	*Rs. 37.50*

6,000 units of finished goods were sold at a profit of 15% on cost. Assume that there was no opening or closing stock of work-in-progress.

(b) Discuss the three methods of calculating labour turnover. *(10 + 4 = 14 Marks)*

Answer

(a)

Process I Account

		Qty.	Rate	Amount			Qty.	Rate	Amount
To	Raw material	7,500	60	4,50,000	By	Normal Loss (5% × 7,500)	375	12.50	4,688
To	Direct wages			1,35,750	By	Abnormal Loss	75	96.79	7,260
To	Direct expenses 60% of direct wages			81,450	By	Process II Account	7,050	96.79	6,82,402
To	Manufacturing Overheads (20% of direct wages)			27,150					
		7,500		6,94,350			7,500		6,94,350

Planned output – Process I = 7,500 – 375 = 7,125 units

Actual output = 7,050 units

Abnormal loss = (7,125 units – 7,050 units) 75 units.

$$\text{Cost per unit} = \frac{6,94,350 - 4,688}{7,125} = \text{Rs. } 96.7947. \quad (96.80 \text{ approx.})$$

Process II Account

		Qty.	Rate	Amount			Qty.	Rate	Amount
To	Process I	7,050	96.79	6,82,402	By	Normal Loss (10%)	705	37.50	26,438
To	Direct wages			1,29,250	By	Finished Stock A/c	6,525	140.05	9,13,823
To	Direct expenses 65% of direct wages			84,013					
To	Manufacturing Overheads (15% of direct wages)			19,387					
				9,15,052					
To	Abnormal gain	180	140.05	25,209					
		7,230		9,40,261			7,230		9,40,261

Planned output of Process II = 7,050 – 705 = 6,345 units

$$\text{Cost per unit} = \frac{9,15,052 - 26,438}{6,345} = \text{Rs. } 140.05.$$

Abnormal gain = Actual output – Planned output

= 6,525 – 6,345

= 180 units.

Finished Stock Account

		Qty.	*Rate*	*Amount*			*Qty.*	*Rate*	*Amount*
To	Process II	6,525	140.05	9,13,823	By	Sales A/c	6,000	161.06	9,66,341
To	Profit and Loss Account			1,26,044	By	Balance c/d	525	140.05	73,526
		6,525		10,39,867			6,525		10,39,867

(b) Methods of calculating labour turnover

(i) $\text{Replacement method} = \frac{\text{Number of employees replaced}}{\text{Average number of employees on roll}} \times 100$

(ii) $\text{Separation method} = \frac{\text{Number of employees separated during the year}}{\text{Average number of employees on roll during the year}} \times 100$

(iii) $\text{Flux method} = \frac{\text{Number of employees separated} + \text{Number of employees replaced}}{\text{Average number of employees on roll during the year}} \times 100$

Workers joining a business concern on account of its expansion do not account for labour turnover.

Question 4

(a) Discuss the treatment of spoilage and defectives in Cost Accounting.

(b) Compute a conservative estimate of profit on contract (which has been 90% complete) from the following particulars:

	Rs.
Total expenditure to date	*22,50,000*
Estimated further expenditure to complete the contract (including contingencies)	*2,50,000*
Contract Price	*32,50,000*
Work certified	*27,50,000*
Work uncertified	*1,75,000*
Cash received	*21,25,000*

(c) Discuss the various reports provided by Cost Accounting department

(4 + 6 + 4 = 14 Marks)

Answer

(a) Treatment of spoilage and defectives in Cost Accounting: The normal spoilage cost (i.e. which is inherent in the operation) are included in cost either by charging the loss due to spoilage to production order or charging it to production overhead so that it is spread over all the products. Any value realized from sale of spoilage is credited to production order or production overhead account, as the case may be. The cost of abnormal spoilage (i.e. arising out of causes not inherent in manufacturing process) are charged to costing Profit and Loss Account.

The problem of accounting for defective work is that of accounting of the costs of rectification or rework.

The possible ways of treatment are as under:

For normal defectives:

(i) Charge to good products.

(ii) Charge to general overheads.

(iii) Charge to departmental overheads

(iv) Charge to Costing Profit and Loss Account if defectives are abnormal and due to causes beyond the control of organization.

Where defectives are easily identifiable with specific jobs, the works cost are debited to job.

(b) The contract is 90% complete, the method used for transfer of profit to Profit and Loss Account for the current year will be on the basis of estimated profit on completed contract basis.

$$\text{Credit to Proift and Loss Account} = \text{Estimated profit on completed contract} \times \frac{\text{Work certified}}{\text{Contract price}} \times \frac{\text{Cash received}}{\text{Work certified}}$$

Estimated profit on completed contract basis = Contract Price – (Total expenditure to date + Estimated further expenditure to completed contract)

= 32,50,000 – (22,50,000 + 2,50,000)

= Rs. 7,50,000.

$$\text{Credit to Proift and Loss Account} = 7,50,000 \times \frac{27,50,000}{32,50,000} \times \frac{21,25,000}{27,50,000} = \text{Rs. } 4,90,385$$

(c) The following are the various Reports provided by Cost Accounting Department:

(i) Cost sheet setting out the total cost, analysed into various elements, giving comparative figure of previous period and other plants under the same management.

(ii) Consumption of material statements.

(iii) Labour utilization statements, details about total number of hours paid for, standard hours for output, idle time and causes thereof.

(iv) Overheads incurred compared with budgets.

(v) Reconciliation of actual profit earned with estimated or budgeted profit.

(vi) Total cost of abnormally spoiled work in the factory and abnormal loss and store.

(vii) Total cost of inventory carried, number of monthly stocks would be sufficient.

(viii) Labour turnover and cost of recruitment and training of new employee.

(ix) Expenses incurred on R & D as compared to budgeted amount.

Question 5

(a) ABC Ltd. has three production departments P_1, P_2 and P_3 and two service departments S_1 and S_2. The following data are extracted from the records of the Company for the month of October, 2007:

	Rs.
Rent and rates	*62,500*
General lighting	*7,500*
Indirect Wages	*18,750*
Power	*25,000*
Depreciation on machinery	*50,000*
Insurance of machinery	*20,000*

Other Information:

	P_1	P_2	P_3	S_1	S_2
Direct wages (Rs.)	*37,500*	*25,000*	*37,500*	*18,750*	*6,250*
Horse Power of Machines used	*60*	*30*	*50*	*10*	–
Cost of machinery (Rs.)	*3,00,000*	*4,00,000*	*5,00,000*	*25,000*	*25,000*
Floor space (Sq. ft)	*2,000*	*2,500*	*3,000*	*2,000*	*500*
Number of light points	*10*	*15*	*20*	*10*	*5*
Production hours worked	*6,225*	*4,050*	*4,100*	–	–

Expenses of the service departments S_1 and S_2 are reapportioned as below:

	P_1	P_2	P_3	S_1	S_2
S_1	20%	30%	40%	–	10%
S_2	40%	20%	30%	10%	–

Required:

(i) Compute overhead absorption rate per production hour of each production department.

(ii) Determine the total cost of product X which is processed for manufacture in department P_1, P_2 and P_3 for 5 hours, 3 hours and 4 hours respectively, given that its direct material cost is Rs. 625 and direct labour cost is Rs. 375.

(b) Discuss the essential requisites for the installation of Uniform Costing System.

(10 + 4 = 14 Marks)

Answer

(a) Primary Distribution Summary

Item of cost	*Basis of apportionment*	*Total (Rs.)*	*P_1 (Rs.)*	*P_2 (Rs.)*	*P_3 (Rs.)*	*S_1 (Rs.)*	*S_2 (Rs.)*
Rent and Rates	Floor area 4 : 5 : 6 : 4 : 1	62,500	12,500	15,625	18,750	12,500	3,125
General lighting	Light points 2 : 3 : 4 : 2 : 1	7,500	1,250	1,875	2,500	1,250	625
Indirect wages	Direct wages 6 : 4 : 6 : 3 : 1	18,750	5,625	3,750	5,625	2812.5	937.5
Power	Horse Power of machines used 6 : 3 : 5 : 1	25,000	10,000	5,000	8,333	1,667	–
Depreciation of machinery	Value of machinery 12 : 16 : 20 : 1 : 1	50,000	12,000	16,000	20,000	1,000	1,000
Insurance of machinery	Value of machinery 12 : 16 : 20 : 1 : 1	20,000	4,800	6,400	8,000	400	400
		1,83,750	46,175	48,650	63,208	19,630	6,088

Overheads of service cost centres Let S_1 be the overhead of service cost centre S_1 and S_2 be the overhead of service cost centre S_2.

$S_1 = 19,630 + 0.10\ S_2$

$S_2 = 6,088 + 0.10\ S_1$

Substituting the value of S_2 in S_1 we get

$S_1 = 19,630 + 0.10\ (6,088 + 0.10\ S_1)$

$S_1 = 19,630 + 608.8 + 0.01\ S_1$

$0.99\ S_1 = 20,238.8$

$\therefore S_1$ = Rs. 20,443.

$\therefore S_2$ = 6,088 + 0.10 × 20,443.

= Rs. 8,132.

Secondary Distribution Summary

Particulars	*Total*	*P_1*	*P_2*	*P_3*
	Rs.	*Rs.*	*Rs.*	*Rs.*
Allocated and Apportioned overheads as per primary distribution	1,58,033	46,175	48,650	63,208
S_1	20,443	4,089	6,133	8,177
S_2	8,132	3,253	1,626	2,440
		53,517	56,409	73,825

Overhead rate per hour

	P_1	*P_2*	*P_3*
Total overheads cost	Rs. 53,517	Rs. 56,409	Rs. 73,825
Production hours worked	6,225	4,050	4,100
Rate per hour (Rs.)	Rs. 8.60	Rs. 13.93	Rs. 18.01

Cost of Product X

Direct material	Rs. 625
Direct labour	Rs. 375
Prime cost	Rs. 1,000
Production on overheads	
P_1 5 hours × Rs. 8.60 = 43	
P_2 3 hours × Rs. 13.93 = 41.79	
P_3 4 hours × Rs. 18.01 = 72.04	Rs. 156.83
Factory cost	Rs. 1,157

(b) Essential requisites for an installation of uniform Costing system:

(i) The firms in the industry should be willing to share/furnish relevant data/information.

(ii) A spirit of cooperation and mutual trust should prevail among the participating firms.

(iii) Mutual exchange of ideas, methods used, special achievements made, research and know-how etc. should be frequent.

(iv) Bigger firms should take the lead towards sharing their experiences and know-how with the smaller firms to enable the latter to improve their performance.

(v) Uniformity must be established with regard to several points before the introduction of uniform costing in an industry. In fact, uniformity should be with regard to following points:

(a) Size of the various units covered by uniform costing.

(b) Production methods.

(c) Accounting methods, principles and procedures used.

Question 6

(a) Consider the following mutually exclusive projects:

		Cash flows (Rs.)			
Projects	C_0	C_1	C_2	C_3	C_4
A	*–10,000*	*6,000*	*2,000*	*2,000*	*12,000*
B	*–10,000*	*2,500*	*2,500*	*5,000*	*7,500*
C	*–3,500*	*1,500*	*2,500*	*500*	*5,000*
D	*–3,000*	*0*	*0*	*3,000*	*6,000*

Required:

(i) Calculate the payback period for each project.

(ii) If the standard payback period is 2 years, which project will you select? Will your answer differ, if standard payback period is 3 years?

(iii) If the cost of capital is 10%, compute the discounted payback period for each project. Which projects will you recommend, if standard discounted payback period is (i) 2 years; (ii) 3 years?

(iv) Compute NPV of each project. Which project will you recommend on the NPV criterion? The cost of capital is 10%. What will be the appropriate choice criteria in this case? The PV factors at 10% are:

Year	*1*	*2*	*3*	*4*
PV factor at 10% (PV/F 0.10, t)	*0.9091*	*0.8264*	*0.7513*	*0.6830*

(b) Consider the following information for Omega Ltd.:

	Rs. in lakhs
EBIT (Earnings before Interest and Tax)	*15,750*
Earnings before Tax (EBT):	*7,000*
Fixed Operating costs:	*1,575*

Required:

Calculate percentage change in earnings per share, if sales increase by 5%.

(c) Discuss Miller-Orr Cash Management Model. *(10 + 3 + 3 = 16 Marks)*

Answer

(a) (i) Payback Period of Projects

	C_0	C_1	C_2	C_3	
A	− 10,000 +	6,000 +	2,000 +	2,000	= 3 years
B	− 10,000 +	2,500 +	2,500 +	5,000	= 3 years
C	− 3,500 +	1,500 +	2,500		= 1 year and 9.6 months
		i.e. $\frac{12}{2,500} \times 2,000$			
D	− 3,000 +	0 +	0 +	3,000	= 3 years.

(ii) If standard payback period is 2 years, Project C is the only acceptable project. But if standard payback period is 3 years, all the four projects are acceptable.

(iii) Discounted Payback Period (Cash flows discounted at 10%)

A − 10,000 + 5,454.6 + 1,652.8 + 1,502.6 + 8,196

$$3 \text{ years} + \frac{12}{8,196} \times 1,390 = 3 \text{ years and } 2 \text{ months}$$

B − 10,000 + 2,272.75 + 2,066 + 3,756.5 + 5,122.50

$$3 \text{ years} + \frac{12}{5,122.55} \times 1,904.75 = 3 \text{ years and } 4.6 \text{ months}$$

C − 3,500 + 1,363.65 + 2,066 + 375.65 + 3,415

$$2 \text{ years} + \frac{12}{375.65} \times 70.35 = 2 \text{ years and } 2.25 \text{ months}$$

D − 3,000 + 0 + 0 + 2,253.9 + 4,098

$$3 \text{ years} + \frac{12}{4,098} \times 746.10 = 3 \text{ years and } 2.18 \text{ months}$$

If standard discounted payback period is 2 years, no project is acceptable on discounted payback period criterion.

If standard discounted payback period is 3 years, Project 'C' is acceptable on discounted payback period criterion.

(iv) Evaluation of Projects on NPV criterion

A = – 10,000 + 5,454.6 + 1,652.8 + 1,502.60 + 8,196

NPV = Rs. 6,806.2

B = – 10,000 + 2,272.75 + 2,066 + 3,756.5 + 5,122.5

NPV = Rs. 3,217.75

C = – 3,500 + 1,363.65 + 2,066 + 3, 75.65 + 3,415

NPV = Rs. 3,720.3

D = – 3,000 + 0 + 0 + 2,253.9 + 4,098

NPV = Rs. 3,351.9

Ranking of Projects on NPV Criterion

	NPV	*Rank*
	Rs.	
A	6,806.2	I
B	3,217.75	IV
C	3,720.3	II
D	3,351.9	III

Analysis: Project A is acceptable under the NPV method. The NPV technique is superior to any other technique of capital budgeting, whether it is PI or IRR. The best project is the one which adds the most, among available alternatives, to the shareholders wealth. The NPV method, by its very definition, will always select such projects. Therefore, the NPV method gives a better mutually exclusive choice than PI method. The NPV method guarantees the choice of the best alternative.

(b) Degree of Operating Leverage (DOL)

$$= \frac{\text{Contribution}}{\text{EBIT}} = \frac{\text{EBIT} + \text{Fixed Cost}}{\text{EBIT}}$$

$$= \frac{15,750 + 1,575}{15,750} = 1.1$$

Degree of Financial Leverage (DFL)

$$= \frac{EBIT}{EBT} = \frac{15,750}{7,000} = 2.25$$

Degree of Combined Leverage (DCL)

= DOL × DFL

= 1.1 × 2.25

= 2.475

Percentage Change in Earnings per share

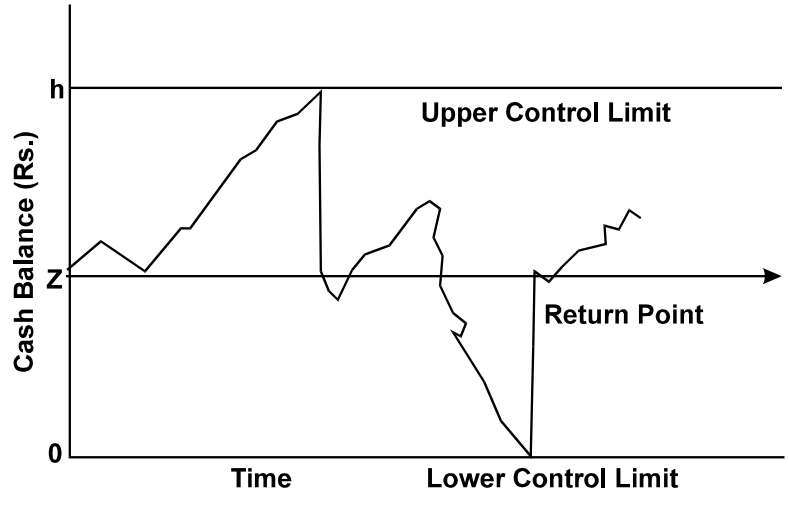
$$DCL = \frac{\%\ change\ in\ EPS}{\%\ change\ in\ Sales}$$

$$2.475 = \frac{\%\ change\ in\ EPS}{5\%}$$

∴ % change in EPS = 12.375%.

(c) Miller Orr Cash Management Model

According to this model the net cash flow is completely stochastic. When changes in cash balance occur randomly, the application of control theory serves a useful purpose. The Miller – Orr model is one of such control limit models. This model is designed to determine the time and size of transfers between an investment account and cash account. In this model control limits are set for cash balances. These limits may consist of 'h' as upper limit, 'z' as the return point and zero as the lower limit.



MILLER-ORR CASH MANAGEMENT MODEL

When the cash balance reaches the upper limit, the transfer of cash equal to 'h – z' is invested in marketable securities account. When it touches the lower limit, a transfer

from marketable securities account to cash account is made. During the period when cash balance stays between (h, z) and (z, 0) i.e. high and low limits, no transactions between cash and marketable securities account is made. The high and low limits of cash balance are set up on the basis of fixed cost associated with the securities transaction, the opportunities cost of holding cash and degree of likely fluctuations in cash balances. These limits satisfy the demands for cash at the lowest possible total costs. The formula for calculation of the spread between the control limits is:

$$\text{Spread} = 3\left(\frac{3/4 \times \text{Transaction Cost} \times \text{Variance of Cashflows}}{\text{Interest rate}}\right)^{1/3}$$

And, the return point can be calculated using the formula:

$$\text{Return point} = \text{Lower limit} + \frac{\text{Spread}}{3}$$

Question 7

(a) A proforma cost sheet of a Company provides the following data:

	Rs.
Raw material cost per unit	*117*
Direct Labour cost per unit	*49*
Factory overheads cost per unit (includes depreciation of Rs. 18 per unit at budgeted level of activity)	*98*
Total cost per unit	*264*
Profit	*36*
Selling price per unit	*300*

Following additional information is available:

Average raw material in stock	:	*4 weeks*
Average work-in-process stock	:	*2 weeks*
(% completion with respect to		
Materials : 80%		
Labour and Overheads : 60%)		
Finished goods in stock	:	*3 weeks*
Credit period allowed to debtors	:	*6 weeks*
Credit period availed from suppliers	:	*8 weeks*
Time lag in payment of wages	:	*1 week*
Time lag in payment of overheads	:	*2 weeks*

The company sells one-fifth of the output against cash and maintains cash balance of Rs. 2,50,000.

Required:

Prepare a statement showing estimate of working capital needed to finance a budgeted activity level of 78,000 units of production. You may assume that production is carried on evenly throughout the year and wages and overheads accrue similarly.

(b) Discuss the major considerations in Capital structure planning. (9 + 3 = 12 Marks)

Answer

(a) Estimation of Working Capital Needs

			Rs.
I	*Investment in Inventory*		
	(i)	Raw material Inventory $= 78,000 \times \frac{4}{52} \times$ Rs.117	7,02,000
	(ii)	Work-in-Process Inventory	
		Material $= 78,000 \times \frac{2}{52} \times 0.80 \times 117 =$ 2,80,800	
		Labour and Overheads Cost (other than depreciation)	
		$= 78,000 \times \frac{2}{52} \times 0.60 \times 129 =$ 2,32,200	5,13,000
	(iii)	Finished Goods Inventory (Cash Cost)	
		$= 78,000 \times \frac{3}{52} \times 246$	11,07,000
II	Investment in Debtors (Cash Cost)		
		$= 78,000 \times \frac{6}{52} \times 0.8 \times 246$	17,71,200
III	Cash Balance		2,50,000
	Investment in Current Assets		43,43,200

Current Liabilities and Deferred Payment

		Rs.
(i)	Creditors $= 78,000 \times \frac{8}{52} \times 117$	14,04,000
(ii)	Wages outstanding $= 78,000 \times \frac{1}{52} \times 49$	73,500
(iii)	Overheads outstanding (cash cost) $= 78,000 \times \frac{2}{52} \times 80$	2,40,000
	Total Deferred Payments	17,17,500

Net Working Capital (Current assets – Non-interest bearing current liabilities)

43,43,200 – 17,17,500 = Rs. 26,25,700

(b) Major Considerations in Capital Structure Planning

There are three major considerations, i.e. risk, cost of capital and control, which help the finance manager in determining the proportion in which he can raise funds from various sources.

Although these three factors 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. Structuring capital is a shrewd financial management decision and is something which makes or mars the fortunes of the company.

As discussed earlier, the three major 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.

The other considerations which the finance manager has to keep in mind while planning for capital structure are corporate taxation, trading on equity i.e. $ROE = ROA + \frac{D}{E}[(ROA - V_d \times (1 - T_c)]$, Government policies on interest rates and lending priority sectors, legal requirements, marketability, maneuverability, flexibility, timing, dilution in EPS, BVPS and control, size of company, purpose of financing, period of finance, nature of enterprise, requirement of investors and provision for future.

Question 8

Following are the financial statements of Zed Ltd.:

Balance Sheet as on

	March 31, 2007	*March 31, 2006*
	Rs.	*Rs.*
Capital and Liabilities:		
Share capital, Rs. 10 par value	*1,67,500*	*1,50,000*
Share premium	*3,35,000*	*2,37,500*
Reserves and Surplus	*1,74,300*	*1,23,250*
Debentures	*2,40,000*	–

Long-term loans	*40,000*	*50,000*
Creditors	*28,800*	*27,100*
Bank Overdraft	*7,500*	*6,250*
Accrued expenses	*4,350*	*4,600*
Income-tax payable	*48,250*	*16,850*
	10,45,700	*6,15,550*

	March 31, 2007	*March 31, 2006*
	Rs.	*Rs.*
Assets:		
Land	*3,600*	*3,600*
Building, net of depreciation	*6,01,800*	*1,78,400*
Machinery, net of depreciation	*1,10,850*	*1,07,050*
Investment in 'A' Ltd.	*75,000*	*–*
Stock	*58,800*	*46,150*
Prepaid expenses	*1,900*	*2,300*
Debtors	*76,350*	*77,150*
Trade Investments	*40,000*	*1,05,000*
Cash	*77,400*	*95,900*
	10,45,700	*6,15,550*

Income Statement
for the year ended March 31, 2007

	Rs.
Net Sales	*13,50,000*
Less: Cost of goods sold and operating expenses (including depreciation on buildings of Rs. 6,600 and depreciation on machinery of Rs. 11,400)	*12,58,950*
Net operating profit	*91,050*
Gain on sale of trade investments	*6,400*
Gain on sale of machinery	*1,850*
Profits before tax	*99,300*
Income-tax	*48,250*
Profits after tax	*51,050*

Additional information:

(i) Machinery with a net book value of Rs. 9,150 was sold during the year.

(ii) The shares of 'A' Ltd. were acquired by issue of debentures.

Required:

Prepare a Funds Flow Statement (Statement of changes in Financial position on Working capital basis) for the year ended March 31, 2007. (12 Marks)

Answer

Schedule of Changes in Working Capital

	March 31, 2007	*March 31, 2006*	*Impact on Working Capital*	
			Increase	*Decrease*
Current Assets				
Stock	58,800	46,150	12,650	–
Prepaid expenses	1,900	2,300	–	400
Debtors	76,350	77,150	–	800
Trade Investments	40,000	1,05,000	–	65,000
Cash	77,400	95,900	–	18,500
	2,54,450	3,26,500	12,650	84,700
Current Liabilities				
Creditors	28,800	27,100	–	1,700
Bank overdraft	7,500	6,250	–	1,250
Accrued expenses	4,350	4,600	250	–
Income tax payable	48,250	16,850	–	31,400
	88,900	54,800	250	34,350
Net Working Capital	1,65,550	2,71,700	12,900	1,19,050
Decrease in net working capital	1,06,150	–	1,06,150	–
	2,71,700	2,71,700	1,19,050	1,19,050

Machinery Account

	Rs.		*Rs.*
Balance b/d	1,07,050	Sale of machinery (given)	9,150
Purchase of machinery (plug)	24,350	Depreciation (given)	11,400
		Balance c/d	1,10,850
	1,31,400		1,31,400

Trade Investments Account

	Rs.		*Rs.*
Balance b/d	1,05,000	Cash (sale of trade investments)	65,000
		Balance c/d	40,000
	1,05,000		1,05,000

Estimation of Funds flow from Operations

		Rs.
Profits after tax		51,050
Add: Depreciation on Buildings	6,600	
Depreciation on Machinery	11,400	18,000
		69,050
Less: Gain on sale of machinery		1,850
Funds from Operations		67,200

Gain on sale of trade investments has been considered as an operating income. Trade investments have been considered as part of current assets.

Statement of Changes in Financial Position (Working Capital basis)
for the year ended March 31, 2007

	Rs.
Sources:	
Funds from operations	67,200
Sale of machinery on gain (9,150 + 1,850)	11,000
Debentures issued (Rs. 2,40,000 – 75,000)	1,65,000
Investment in 'A' Ltd. financial transaction and hence not affecting working capital	
Issue of share capital (including share premium)	1,15,000
Financial Resources Provided	3,58,200
Uses:	
Purchase of building (6,01,800 + 6,600 – 1,78,400)	4,30,000
Purchase of machinery	24,350
Payment of long-term loan	10,000
Financial Resources Applied	4,64,350
Net Decrease in Working Capital	1,06,150

Question 9

(a) Discuss the conflicts in Profit versus Wealth maximization principle of the firm.

(b) Using the following information, complete the Balance Sheet given below:

(i)	*Total debt to net worth*	*:*	*1 : 2*
(ii)	*Total assets turnover*	*:*	*2*
(iii)	*Gross profit on sales*	*:*	*30%*
(iv)	*Average collection period (Assume 360 days in a year)*	*:*	*40 days*
(v)	*Inventory turnover ratio based on cost of goods sold and year-end inventory*	*:*	*3*
(vi)	*Acid test ratio*	*:*	*0.75*

Balance Sheet
as on March 31, 2007

Liabilities	*Rs.*	*Assets*	*Rs.*
Equity Shares Capital	*4,00,000*	*Plant and Machinery and other Fixed Assets*	*–*
Reserves and Surplus	*6,00,000*		
Total Debt:		*Current Assets:*	
Current Liabilities	*–*	*Inventory*	*–*
		Debtors	*–*
		Cash	*–*

(4 + 8 = 12 Marks)

Answer

(a) Conflict in Profit versus Wealth Maximization Principle of the Firm

The company may pursue profit maximisation goal but that may not result into creation of shareholder value. The profits will be maximized if company grows through diversification and expansion. But all growth may not be profitable. Only that growth is profitable where

ROA > WACC or ROE > K_E or Firms invest in positive NPV profits.

However, profit maximisation cannot be the sole objective of a company. It is at best a limited objective. If profit is given undue importance, a number of problems can arise like the term profit is vague, profit maximisation has to be attempted with a realisation of risks

involved, it does not take into account the time pattern of returns and as an objective it is too narrow.

Whereas, on the other hand, wealth maximisation, as an objective, means that the company is using its resources in a good manner. If the share value is to stay high, the company has to reduce its costs and use the resources properly. If the company follows the goal of wealth maximisation, it means that the company will promote only those policies that will lead to an efficient allocation of resources.

(b) Networth = Capital + Reserves and surplus

= 4,00,000 + 6,00,000 = Rs. 10,00,000

$$\frac{\text{Total Debt}}{\text{Networth}} = \frac{1}{2}$$

$\therefore$ Total debt = Rs. 5,00,000

Total Liability side = 4,00,000 + 6,00,000 + 5,00,000

= Rs. 15,00,000

= Total Assets

$$\text{Total Assets Turnover} = \frac{\text{Sales}}{\text{Total assets}}$$

$$2 = \frac{\text{Sales}}{15,00,000}$$

$\therefore$ Sales = Rs. 30,00,000

Gross Profit on Sales : 30% i.e. Rs. 9,00,000

$\therefore$ COGS = Rs. 30,00,000 – Rs. 9,00,000

= Rs. 21,00,000

$$\text{Inventory turnover} = \frac{\text{COGS}}{\text{Inventory}}$$

$$3 = \frac{21,00,000}{\text{Inventory}}$$

$\therefore$ Inventory = Rs. 7,00,000

$$\text{Average collection period} = \frac{\text{Average debtors}}{\text{Sales / day}}$$

$$40 = \frac{\text{Debtors}}{30,00,000 / 360}$$

$\therefore$ Debtors = Rs. 3,33,333.

$$\text{Acid test ratio} = \frac{\text{Current Assets} - \text{Stock}}{\text{Current liabilities}}$$

$$0.75 = \frac{\text{Current Assets} - 7,00,000}{5,00,000}$$

$\therefore$ Current Assets = Rs. 10,75,000.

$\therefore$ Fixed Assets = Total Assets – Current Assets

= 15,00,000 – 10,75,000 = Rs. 4,25,000

Cash and Bank balance = Current Assets – Inventory – Debtors

= 10,75,000 – 7,00,000 – 3,33,333 = Rs. 41,667.

Balance Sheet as on March 31, 2007

Liabilities	*Rs.*	*Assets*	*Rs.*
Equity Share Capital	4,00,000	Plant and Machinery and other	
Reserves & Surplus	6,00,000	Fixed Assets	4,25,000
Total Debt:		Current Assets:	
Current liabilities	5,00,000	Inventory	7,00,000
		Debtors	3,33,333
		Cash	41,667
	15,00,000		15,00,000

The Suggested Answers for Paper – 5: Income-tax and Central Sales Tax are based on the provisions applicable for A.Y.2007-08, which is the assessment year relevant for November 2007 examination.

PAPER – 5 : INCOME TAX AND CENTRAL SALES TAX

Answer all questions

Question 1

(a) *Rosy and Mary are sisters, born and brought up at Mumbai. Rosy got married in 1969 and settled at Canada since 1969. Mary got married and settled at Mumbai. Both of them are below 60 years. The following are the details of their income for the previous year ended 31.3.2007:*

S.No.	Particulars	Rosy Rs.	Mary Rs.
1.	Pension received from State Government	-	10,000
2.	Pension received from Canadian Government	20,000	--
3.	Long-term capital gain on sale of land at Mumbai	1,00,000	50,000
4.	Short-term capital gain on sale of shares of Indian listed companies in respect of which STT was paid	20,000	2,00,000
5.	LIC premium paid	--	10,000
6.	Premium paid to Canadian Life Insurance Corporation at Canada	10,000	--
7.	Mediclaim policy premium paid	--	5,000
8.	Tax saving bond purchased in March, 2007	30,000	20,000
9.	Rent received in respect of house property at Mumbai	60,000	30,000

Compute the taxable income of Mrs. Rosy and Mrs. Mary for the Assessment Year 2007-08 and tax thereon. *(15 Marks)*

(b) (i) *Mr. Khanna, an employee of IOL, New Delhi, a private sector company, received the following for the financial year 2006-07 :*

		Rs.
1.	Basic pay	1,20,000
2.	House rent allowance	90,000
3.	Special allowance	30,000

Mr. Khanna was residing at New Delhi and was paying a rent of Rs.10,000 a month.

Compute the eligible exemption under section 10(13A) of the Income-tax Act, 1961, in respect of house rent allowance received.

(ii) If Mr. Khanna opts for rent free accommodation whereby IOL would be paying a rent of Rs.10,000 per month to the landlord and recovers a sum of Rs.2,500 per month from Mr. Khanna which was in excess of his entitlement, what will be the perquisite value in respect of such rent free accommodation?

(iii) Which of the above would be beneficial to Mr. Khanna i.e, house rent allowance or rent free accommodation? (8 Marks)

(c) Mr. Nigamanth, an employee, furnishes the following particulars for the previous year ending 31.03.2007:

		Rs.
(a)	*Salary income as computed (after all deductions) for the year*	*6,60,000*
(b)	*Arrears of salary received during the year (not included in the above) relating to Financial Year 2004-2005*	*25,000*
(c)	*Assessed income of Financial Year 2004-2005*	*1,20,000*

You are requested to compute relief under section 89 of the Income-tax Act, 1961, in terms of tax payable.

The rates of income-tax for the Assessment Year 2005-06 are:

	Tax Rate (%)
On first Rs.50,000	*--*
On 50,000-60,000	*10%*
On 60,000-1,50,000	*20%*
Above 1,50,000	*30%*
Education cess	*2% (of tax payable)*

(7 Marks)

Answer

(a) Computation of taxable income of Mrs. Rosy and Mrs. Mary for the A.Y.2007-08

S. No.	Particulars	Mrs. Rosy Non-resident Rs.	Mrs. Mary Resident Rs.
(I)	Salaries		
	Pension received from State Government		10,000
	Pension received from Canadian Government is not taxable in the case of a non-resident since it is earned and received outside India	-	
		-	10,000

(II)	Income from house property		
	Rent received from house property at Mumbai (assumed to be the annual value in the absence of other information i.e. municipal value, fair rent and standard rent)	60,000	30,000
	Less: Deduction under section 24(a) @ 30%	18,000	9,000
		42,000	21,000
(III)	Capital gains		
	Long-term capital gain on sale of land at Mumbai	1,00,000	50,000
	Short term capital gain on sale of shares of Indian listed companies in respect of which STT was paid	20,000	2,00,000
		1,20,000	2,50,000
(A)	Gross Total Income [(I)+(II)+(III)]	1,62,000	2,81,000
	Less: Deductions under Chapter VIA		
1.	Deduction under section 80C		
	1. LIC Premium paid	-	10,000
	2. Premium paid to Canadian Life Insurance Corporation	10,000	
	3. Tax Saving Bond (assuming that they are notified infrastructure bonds eligible for deduction under section 80C)	30,000	20,000
		40,000	30,000
2.	Deduction under section 80D – Mediclaim premium paid (assuming that the same is paid by cheque)	-	5,000
		40,000	35,000
(B)	Total deduction under Chapter VIA is restricted to income other than capital gains taxable under sections 111A & 112	40,000	31,000
(C)	Total Income (A-B)	1,22,000	2,50,000

Computation of tax liability of Mrs. Rosy for A.Y.2007-08

On Rs.2,000 (i.e. 42,000 – 40,000) at regular rates	-
On Rs.1,00,000 long-term capital gain @ 20% *[See Note 1 below]*	20,000

On Rs.20,000 short-term capital gain@ 10% *[See Note 2 below]*	2,000	
Tax payable	22,000	
Education cess @ 2%	440	
Total tax payable (including education cess)	22,440	

Computation of tax liability of Mrs. Mary for A.Y.2007-08	
Tax on long-term capital gains *[See Notes 3 and 4 below]*	Nil
Tax on short-term capital gains @ 10% of Rs.1,15,000 [i.e. Rs.2,00,000 less Rs.85,000, being the unexhausted basic exemption limit as per proviso to section 111A]	11,500
Tax payable	11,500
Education cess @ 2%	230
Total tax payable (including education cess)	11,730

Notes –

(1) Long-term capital gains is chargeable to tax @20% as per section 112.

(2) Short-term capital gains on transfer of equity shares in respect of which securities transaction tax is paid is subject to tax @ 10% as per section 111A.

(3) In case of resident individuals, if the basic exemption limit is not fully exhausted against other income, then the long-term capital gains/short-term capital gains will be reduced by the unexhausted basic exemption limit and only the balance will be taxed at 20%/10% respectively.

(4) Since long-term capital gains is taxable at the rate of 20% and short-term capital gains is taxable at the rate of 10%, it is more beneficial for Mrs.Mary to first exhaust her basic exemption limit of Rs.1,35,000 against long-term capital gains of Rs.50,000 and the balance limit of Rs.85,000 (i.e., 1,35,000 – 50,000) against short-term capital gains.

However, it is not possible for Mrs. Rosy to adjust her unexhausted basic exemption limit against capital gains, since such adjustment is possible only in the case of residents. Further, the basic exemption limit available to her is only Rs.1,00,000 and not Rs.1,35,000.

(b) (i) The eligible exemption under section 10(13A) in respect of house rent allowance received would be least of the following:

		Rs.	Rs.
(a)	Actual house rent allowance (HRA) received		90,000
(b)	Excess of rent paid over 10% of basic salary		
	Rent paid (10,000 x 12)	1,20,000	
	Less: 10% of basic pay (i.e. 10% of Rs.1,20,000)	12,000	1,08,000
(c)	50% of salary (i.e. 50% of Rs.1,20,000)		60,000

Least of the above is Rs.60,000.

The house rent allowance received by Mr. Khanna would be exempt to the extent of Rs.60,000 under section 10(13A). The balance of Rs.30,000 is includible in his total income.

(ii) Perquisite value in respect of concessional accommodation

As per rule 3(1), where the accommodation is taken on lease or rent by the employer, the actual amount of lease rental paid or payable by the employer or 20% of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee is the value of the perquisite.

(a) Actual rent paid by the employer = 10,000 x 12 = 1,20,000

(b) 20% of salary = 20% of basic pay plus special allowance

= 20% of Rs.1,50,000 = 30,000

Lower of the above is Rs.30,000, which should be reduced by the rent of Rs.30,000 paid by the employee (i.e. 2,500 × 12 = 30,000). The perquisite value is, therefore, nil.

(iii) We have to see the cash flow from both the options to find out which is more beneficial.

Option 1: HRA	Rs.	Rs.
Cash inflows [Basic Pay + HRA + Special Allowance]		2,40,000
Less: Cash outflows:		
Rent paid	1,20,000	
Tax (See Working Note 1 below)	11,220	1,31,220
Net cash flow		1,08,780

Option 2: Concessional accommodation		
Cash inflows [Basic Pay + Special Allowance]		1,50,000

Less:	Cash outflows:		
	Rent recovery	30,000	
	Tax (See Working Note 2 below)	5,100	35,100
Net cash flow			1,14,900

Since the net cash flow is higher in Option 2, Mr. Khanna should opt for concessional accommodation, which would be more beneficial to him.

Working Notes –

1. Computation of tax under Option 1 (HRA):

	Rs.
Salary:	
Basic Pay	1,20,000
HRA (taxable)	30,000
Special allowance	30,000
Total salary	1,80,000
Tax on Rs.1,80,000	11,000
Add: Education cess@2%	220
Tax payable (including education cess)	11,220

2. Computation of tax under Option 2 (Concessional accommodation):

	Rs.
Salary:	
Basic Pay	1,20,000
Special allowance	30,000
Concessional accommodation	Nil
Total salary	1,50,000
Tax on Rs.1,50,000	5,000
Add: Education cess@2%	100
Tax payable (including education cess)	5,100

(c) Computation of relief under section 89

Particulars	Rs.
Computation of tax payable for A.Y. 2007-08	
Salary as computed excluding the arrears	6,60,000
Arrears relating to financial year 2004-05	25,000
Total Income (including arrears)	6,85,000
Tax thereon	1,55,500
Add: Education cess@2%	3,110
Tax payable including education cess (I)	1,58,610
Total income (excluding arrears)	6,60,000
Tax thereon	1,48,000
Add: Education cess@2%	2,960
Tax payable including education cess (II)	1,50,960
Difference between the two [(I) – (II)] = [1,58,610 – 1,50,960] (A)	7,650
Computation of tax payable for A.Y. 2005-06	
Total Income (including arrears)	1,45,000
Tax thereon	18,000
Add: Education cess@2%	360
Tax payable including education cess (III)	18,360
Total Income (excluding arrears)	1,20,000
Tax thereon	13,000
Add: Education cess@2%	260
Tax payable including education cess (IV)	13,260
Difference between the two [(III) – (IV)] = [18,360-13,260] (B)	5,100
Relief under section 89 = (A – B) = (Rs.7,650 – Rs.5,100)	2,550

Question 2 (First Alternative)

(a) Explain the provisions of the Income-tax Act, 1961, with regard to clubbing of income of spouse under section 64.

(b) Elaborate the procedure for revision by the Commissioner of income-tax of orders erroneous and prejudicial to revenue under section 263 of the Income-tax Act, 1961.

(2 x 6 = 12 Marks)

Answer

(a) As per section 64(1)(ii), any income arising directly or indirectly to the spouse of an individual by way of salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has a substantial interest, would be clubbed. However, such rule does not apply where the spouse possesses technical or professional qualification and the income of the spouse is solely attributable to the application of his or her technical or professional knowledge and experience.

Where both husband and wife have substantial interest in a concern and both are in receipt of salary etc. from the said concern, such income will be clubbed with the income of the spouse whose total income, excluding such income, is greater.

An individual shall be deemed to have substantial interest in a concern under the following circumstances -

(a) If the concern is a company, equity shares carrying not less than 20% of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of his relatives.

(b) In any other case, if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than 20% of the profits of such concern.

As per section 64(1)(iv), where there is a transfer of an asset other than house property, directly or indirectly from one spouse to another, otherwise than for adequate consideration or in connection with an agreement to live apart, any income that arises either directly or indirectly to the transferee from the transfer of the asset shall be included in the total income of the transferor.

However, any income on the accretion of transferred asset is not liable to be clubbed. It may be noted that natural love and affection will not constitute adequate consideration for the purpose of section 64(1).

(b) (i) The Commissioner may call for and examine the record of any proceeding under the Act. If he considers that any order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as may be necessary, pass a suitable order.

(ii) He can enhance, modify or cancel an assessment. He can also direct that a fresh assessment should be made.

(iii) The term 'record' shall include and shall be deemed always to have included all records relating to any proceedings under the Act available at the time of examination by the Commissioner.

(iv) Where any order referred to in section 263(1) passed by the Assessing Officer had been the subject-matter of any appeal, the powers of the Commissioner under section 263(1) shall extend and shall be deemed always to have extended to such matters as had not been considered and decided in such appeal.

(v) No order shall be made after the expiry of 2 years from the end of the financial year in which the order sought to be revised was passed.

(vi) In computing the period of 2 years, the time taken in giving an opportunity to the assessee to be reheard under section 129 and any period during which the revision proceeding is stayed by an order or injunction of any court shall be excluded.

(vii) The time limit, however, does not apply in a case where the Commissioner has to give effect to a finding or direction contained in the order of the Appellate Tribunal, High Court or the Supreme Court.

Question 2 (Second Alternative)

(a) Explain the provisions of carry forward and set off of business losses under section 72 of the Income-tax Act, 1961.

(b) Write briefly about the provisions regarding deductions from gross total income in respect of medical treatment of dependent disabled under section 80DD of the Income-tax Act, 1961 and in respect of medical treatment of assessee himself/dependent under section 80DDB of the Income-tax Act, 1961. *(2 x 6 = 12 Marks)*

Answer

(a) (i) Section 72 applies where the net result of the computation under the head "Profits and gains of business and profession" for any assessment year is a loss to the assessee and such loss cannot be wholly set off against income under any head of income in accordance with the provisions of section 71. Such unabsorbed business loss can be carried forward to the subsequent previous year for set off against the business income of that year and so on.

(ii) However, such loss should not be in the nature of speculation business loss

(iii) Business loss carried forward can be set off only against the income under the head "Profits and gains of business or profession", though not necessarily against the income from same business in which the loss was incurred.

(iv) Business loss can be carried forward and set off even if the business in respect of which it was incurred and computed has been discontinued.

(v) Business loss cannot be carried forward for more than 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

(vi) Under section 72(2), business loss carried forward should be adjusted first and thereafter unabsorbed depreciation, unabsorbed scientific research expenditure etc. should be adjusted.

(b) Deduction under section 80DD

(i) Deduction is allowable to a resident individual or HUF in respect of maintenance including medical treatment of a dependent disabled.

(ii) The amount paid or deposited with LIC or any other insurer is also eligible for deduction.

(iii) Quantum of deduction is Rs.50,000 and in case severe disability (with 80% or more disability) deduction shall be Rs.75,000.

(iv) The assessee has to produce a certificate issued by the medical authority under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 along with the return of income under section 139.

(v) Where the condition of disability requires reassessment, a fresh certificate has to be produced after the expiry of the period mentioned in the original certificate in order to continue to claim deduction.

(vi) Dependent includes in the case of an individual, spouse, children, parents, brothers and sisters and in the case of a HUF, a member thereof, dependent wholly or mainly on such individual or HUF for his support and maintenance and who has not claimed deduction under section 80U in computation of his total income.

Deduction under section 80DDB

(i) Deduction is allowable to an assessee, who is resident in India, being an individual or HUF, in respect of amount actually paid for medical treatment of specified diseases or ailments for the individual himself or his dependent or in the case of HUF, for any member thereof.

(ii) Deduction is the amount actually paid or Rs.40,000, whichever is lower. In case the amount is paid in respect of a senior citizen, a deduction of the amount actually paid or Rs.60,000, whichever is lower, is allowable.

(iii) Medical certificate in the prescribed form is to be furnished along with the return of income from a specialist doctor, as may be prescribed, working in a Government hospital.

(iv) If any amount is received under a insurance policy or reimbursed by the employer, the deduction under this section will be reduced by such amount.

(v) Dependent includes, in the case of an individual, spouse, children, parents, brothers and sisters of the individual and in the case of a HUF, a member thereof, dependent wholly or mainly on such individual or HUF for his support and maintenance.

Question 3

(a) Fill in the blanks with reference to the provisions of Income-tax Act, 1961 :

(i) Business loss is …….(eligible/not eligible) for set off against income from salaries.

(ii) The time limit for revision of order under section 154 is ……years from the end of the financial year in which the order was passed.

(iii) In the case of a person being a partner of a firm which is separately assessed as such, his share of total income of the firm is ……(exempt/not exempt).

(iv) Time limit for issue of notice under section 143(2) is …… months from the end of the month in which the return was filed by the assessee.

(v) Accounting standard notified under section 145 is applicable for those following …… system of accounting. *(5 x 1 = 5 Marks)*

(b) State whether True/False with proper reasons of the following statements with regard to provisions of Income-tax Act, 1961:

(i) Mr.Dey, a non-resident, residing in US since 1960, came back to India on 1.4.2005 for permanent settlement. What will be his residential status for assessment years 2007-08 and 2008-09?

(ii) Arrears of rent received shall be charged to income-tax as income of the previous year in which rent was received irrespective of whether the assessee is the owner of the property in that year or not.

(iii) The deduction on account of depreciation shall be made compulsorily, whether or not the assessee claimed the deduction or not.

(iv) Mr. Roy received a sum of Rs.20 lakh on 31.3.07 from Life Insurance Corporation of India in respect of a policy, where the sum assured was Rs.15 lakh, taken on 1.10.2003 and for which a one time premium of Rs.10 lakh was paid. Mr.Roy claims that the amount is totally exempt under section 10(10D)(c) of the Income-tax Act, 1961.

(v) "A" receives Rs.2 lakh from his friends on the occasion of his marriage on 22.2.07 and Rs.1 lakh from the brother of his father-in-law on 31.3.07. A's income includible under "other sources" for the previous year 2006-07 would be Rs.3 lakh.

(5 x 2 = 10 Marks)

Answer

(a) (i) not eligible

(ii) four

(iii) exempt

(iv) twelve

(v) mercantile

(b) (i) Mr. Dey is a resident in A.Y.2007-08 and A.Y.2008-09 since he has stayed in India for a period of 365 days during the P.Y.2006-07 and P.Y.2007-08, respectively.

As per section 6(6), a person will be "Not ordinarily Resident" in India in any previous year, if such person -

(a) has been a non-resident in nine out of ten preceding previous years; or

(b) has, during the seven preceding previous years, been in India for 729 days or less.

If he does not satisfy either of these conditions, he would be a resident and ordinarily resident.

In the instant case, applying the above, the status of Mr. Dey for the previous years 2006-07 and 2007-08 will be "Resident but not ordinarily resident" and "Resident and ordinarily resident", respectively.

Therefore his status for

A.Y. 2007-08 – "Resident but not ordinarily resident"

A.Y. 2008-09 – "Resident and ordinarily resident"

(ii) True - As per section 25B, the arrears of rent will be charged to tax in the year in which it was received, whether or not the assessee is the owner of the property at that time.

(iii) True - Explanation 5 to section 32(1) provides that depreciation has to be mandatorily allowed, whether or not the assessee has claimed the same in computing his total income.

(iv) False - As per section 10(10D)(c), any sum received under an insurance policy issued on or after 1.4.03, in respect of which the premium payable for any year during the term of the policy exceeds 20% of actual capital sum assured, shall not be exempt. Hence, the contention of Mr. Roy is not correct since the one-time premium of Rs.10 lakh paid by him is in excess of 20% of the sum assured [i.e. it exceeds Rs.3 lakh, being 20% of Rs.15 lakh].

(v) False - A new clause (vi) has been inserted in section 56(2) w.e.f. A.Y. 2007-08 to provide that where any sum of money is received without consideration on or after 1.4.2006 by an individual or a Hindu undivided family from any person or persons and the aggregate value of all such sums received during the previous year exceeds Rs.50,000/-, the whole of the aggregate value of such sum shall be included in the total income of such individual or Hindu undivided family under the head "Income from other sources".

However, in order to avoid hardship in genuine cases, certain sums of money received have been exempted, which includes, *inter-alia,* any sum received on the occasion of the marriage of the individual and any sum received from any relative. As such, Rs.2 lakh received from friends on the occasion of marriage is exempt. However, brother of father-in-law is not included in the definition of relative. Hence, Rs.1 lakh is taxable under the head "Income from other sources".

The statement that Rs.3 lakh is includible in A's income is, therefore, false.

Question 4

Write short notes on any three of the following with reference to the provisions of Income-tax Act, 1961:

(a) Amortisation of expenditure incurred under voluntary retirement scheme.

(b) Provisions of presumptive taxation for computing profits and gains of civil construction under section 44AD of the Income-tax Act, 1961.

(c) Restrictions on deductions allowable to the partnership firm in respect of salary and interest to its partners under section 40(b) of the Income-tax Act, 1961.

(d) Provisions of self-assessment under section 140A of the Income-tax Act, 1961.

(6 x 3 =18 Marks)

Answer

(a) Section 35DDA applies to an assessee who has incurred expenditure in any previous year in the form of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement.

The amount of deduction allowable is one-fifth of the amount paid during that previous year, and the balance in four equal installments in the four immediately succeeding previous years.

In case of amalgamation, demerger, reorganization or succession of business during the intervening period of the said 5 years, the benefit of deduction will be available to the "new company" for the balance period including the year in which such amalgamation/demerger/reorgainsation or succession takes place.

This will be applicable in the following situations:

(i) where the undertaking of an Indian company is transferred to another Indian company in a scheme of amalgamation;

(ii) where the undertaking of an Indian company is transferred to another company in a scheme of demerger;

(iii) where due to a re-organisation of business, a firm is succeeded by a company fulfilling the conditions in section 47(xiii) or a proprietary concern is succeeded by a company fulfilling the conditions in section 47(xiv).

In the above cases, the deduction shall be available to the successor company as such deduction would have applied to the original entity if such transfer had not taken place.

It is further provided that no deduction shall be available to the original entity being the amalgamating company, or the demerged company or the firm/ proprietary concern (as the case may be) for the previous year in which the amalgamation, demerger or succession takes place.

No deduction shall be allowed in respect of the above expenditure under any other provision of the Act.

(b) (i) Section 44AD provides for estimating the income of an assessee who is engaged in the business of civil construction or supply of labour for civil construction.

(ii) The income will be estimated at a sum equal to 8% of the gross receipts paid or payable to the assessee in the previous year on account of such business. However, if the assessee declares a higher amount in his return of income, that will be deemed to be his income.

(iii) This presumptive tax provision will apply only to such assesses, engaged in the business of civil construction or supply of labour for civil construction, whose gross receipts paid or payable do not exceed Rs.40 lakh.

(iv) The assessee will be deemed to have been allowed deductions under sections 30 to 38. Accordingly, the written down value of any asset used for the purpose of the business of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for each of the relevant assessment years.

(v) The provisions of sections 44AA and 44AB shall not apply in case of such business, where presumptive tax provisions of section 44AD are applicable.

(vi) In the case of a firm to which the provisions of section 44AD are applied, the salary and interest paid to its partners, subject to the conditions and limits specified in section 40(b), shall be deducted from the income computed under section 44AD(1).

(vii) An assessee may claim lower profits and gains than the deemed profits and gains specified in (ii) above subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.

(c) In the case of a partnership firm, the deduction on account of interest and salary paid to its partners are subject to the following restrictions contained in section 40(b) -

(i) It should be authorised by and in accordance with the terms of the partnership deed.

(ii) It should not relate to a period before the date of such deed.

(iii) Remuneration should be paid to a working partner.

(iv) The amounts allowable are subject to the following limits -

(1) In the case of interest

Simple interest up to 12% p.a. is allowable. This restriction is not applicable if a person is a partner in the firm in his representative capacity and he receives interest from the firm in his individual capacity. Similarly, the restriction is also not applicable if a person who is a partner in his individual capacity receives interest for and on behalf of someone else from the firm in which he is a partner.

(2) In the case of salary, bonus, commission or remuneration paid by a firm to its working partners – It should not exceed the amount specified in the table below -

(i)	In the case of a professional firm	
(a)	On the first one lakh of book profit or in case of a loss	Rs.50,000 or 90% of book profit, whichever is higher
(b)	On the next one lakh of book profit	@ 60%
(c)	On the balance of book profit	@ 40%
(ii)	In the case of any other firm	
(a)	On the first Rs.75,000 of book profit or in case of a loss	Rs.50,000 or 90% of book profit, whichever is higher
(b)	On the next Rs.75,000 of the book profit	@ 60%
(c)	On the balance of book profit	@ 40%

(d) (i) Where any tax is payable on the basis of any return required to be filed under section 139 or in response to a notice issued under section 142(1) or under section 148 or under section 153A, as the case may be, the assessee is required to compute the tax payable by him after considering the following:

(a) the amount of tax, if any, already paid under any provision of the Act;

(b) tax deducted at source and tax collected at source;

(c) double taxation relief;

(d) credit of minimum alternate tax available to companies.

(ii) Such tax should be paid together with interest, if any, before filing the return of income. Interest is attracted under section -

(1) 234A for delay in filing return of income;

(2) 234B for default in payment of advance tax; and

(3) 234C for deferment of advance tax.

(iii) The return shall be accompanied by proof of payment of such tax and interest.

(iv) When any amount paid by the assessee falls short of the aggregate of the tax and interest, the amount so paid shall first be adjusted towards interest and the balance, if any, shall be adjusted towards the tax payable.

(v) After a regular assessment is made under section 143 or section 144 or an assessment is made under section 153A, any amount paid under this section shall be deemed to have been paid towards such regular assessment or an assessment, as the case may be.

(vi) An assessee, who fails to pay the whole or any part of such tax or interest or both, shall be deemed to be an assessee in default.

Question 5

(a) State, with brief reasons, whether the following statements are true or false as per the provisions of Central Sales-tax Act, 1956:

(i) Works contracts are not liable for Central sales-tax.

(ii) A branch outside the State is also a dealer.

(iii) A dealer must obtain registration only if the turnover exceeds the limit prescribed in Sales-tax law of the 'Appropriate State'.

(iv) If the person furnishing surety dies, the dealer must inform the occurrence within 90 days.

(v) Insurance charges incurred prior to delivery of goods to the buyer would form part of the turnover. (5 x 2 = 10 Marks)

(b) Fill in the blanks in the light of the provisions of Central Sales-tax Act:

(i) A & Co. of Mumbai sold goods to B & Co. of Chennai. A & Co. is not a registered dealer under the CST Act. A & Co. ……. (can/cannot) collect tax from B & Co. for the inter-State sale.

(ii) Government gives subsidy to compensate the cost of production which is more than controlled sale price. The subsidy so received ……. (would/would not) form part of turnover.

(iii) Javed of Lucknow purchased goods from Bedi of Kanpur and paid State sales tax @8%. Later, Javed sold those goods to Jain of Mumbai. Javed……(can/cannot) claim refund of tax paid on within the State purchase as he has done inter-state sale of those goods subsequently.

(iv) Raj of Mysore sold paddy to Ram of Delhi. Ram converted paddy into rice and exported later. The sale by Raj to Ram is ……(sale in the course of export/an inter-state sale).

(v) World & Co. despatched goods to its agent Best Ltd. The onus of proving it as transfer to agent is on ……(principal/agent/sales tax authority).

(5 x 1 = 5 Marks)

Answer

(a) (i) False - According to section 2(g), "Sale", *inter-alia,* includes a transfer of property in goods involved in the execution of a works contract.

(ii) True - As per Explanation 1 to section 2(b), a branch office outside the State is also a dealer on deemed basis.

(iii) False - Section 7(1) provides that every dealer liable to pay tax shall apply for registration. A dealer is liable to pay tax when he effects an inter-State sale. Therefore, every dealer selling goods, even worth a rupee must apply for being registered. There is no exemption limit in this regard.

(iv) False - As per section 7(3C), where the security furnished by a dealer is in the form of a surety bond and the surety dies, the dealer should inform the registering authority about the occurrence of such event within 30 days.

(v) True - As per section 2(h), "Sale price" includes any sum charged for anything done by the dealer in respect of the goods at the time of or before the delivery thereof. Therefore, insurance charges incurred by the dealer prior to delivery of goods to the buyer would form part of the turnover.

(b) (i) cannot

(ii) would not

(iii) cannot

Note – Refund of State sales tax can be claimed only in respect of declared goods. Since the State sales tax in respect of the goods in question is more than 4%, the said goods are not declared goods. Therefore, Javed cannot claim refund of tax paid within the State.

(iv) sale in the course of export

Note – This answer is based on the assumption that a declaration in Form H is furnished to the prescribed authority.

(v) principal

Question 6

Explain any two of the following with reference to the provisions of the Central Sales-tax Act:

(a) State any five forms/declarations used by dealers for availing concessional rate of tax/exemption from tax.

(b) When is a sale said to take place in the course of inter-state trade or commerce?

(c) Hari, a Registered Dealer (with Head Office at Mumbai), furnishes the following information:

		Rs.
(i)	*Inter-state sale of goods (of this Rs.8,10,000 is the value of goods transferred to branch at Chennai and covered by Form "F")*	*38,00,000*
(ii)	*Dharmada collected*	*4,450*
(iii)	*Weightment dues charged separately from buyers*	*1,05,000*
(iv)	*Cash discount shown in invoice and allowed according to prevailing trade practice*	*50,000*
(v)	*Indemnity charges (recovered from buyers to cover transit loss at their request)*	*44,000*

Calculate the turnover and CST payable if all sales are made to registered dealers @ 4%. *(2x5 = 10 Marks)*

Answer

(a) Forms and declarations used by dealers for availing concessional rate of tax or exemption from tax

Form C: This is furnished by purchasing registered dealer to the selling dealer. Furnishing this form would entitle a concessional rate of tax on inter-State sale of goods.

Forms E-I and E-II: As per section 6(2) of the Central Sales Tax Act, the first inter-State sale is taxable. Subsequent sale by transfer of documents of title during the movement of goods from one State to another is exempt from tax, if the purchasing dealer obtains a declaration from the selling dealer i.e. registered dealer from whom goods were purchased. The selling dealer has to give a declaration to the purchasing dealer in Form E-I if it is a first sale and Form E-II if it is a second or subsequent sale.

Form F: It is a declaration issued by the dealer for transfer of goods to the branch or consignment agent. The principal need not pay tax on such movement of goods though the physical movement is between two States.

Form H: This is issued by exporter to the dealer. The dealer can get benefit of exemption as per section 5(3).

Form I: This form is obtained by the selling dealer from his customer in SEZ for getting tax benefit under section 8(6).

Form J: This is a form of declaration obtained by the selling dealer from embassies for availing the benefit of exemption under section 6(3).

Note – Any five of the above forms may be given in the answer.

(b) Sale in the course of inter-state trade or commerce

Section 3 states that a sale or purchase of goods shall be deemed to take place in the course of inter-State trade or commerce in the following two circumstances:

(i) If the sale or purchase occasions the movement of goods from one State to another; or

(ii) If the sale or purchase is effected by a transfer of documents of title to the goods during their movement from one State to another.

Where the movement of goods commences and terminates in the same State, it shall not be deemed to be a movement of goods from one State to another by reason merely of the fact that in the course of such movement the goods pass through the territory of any other State.

The movement of goods from a head office in one State to a branch office in another State is not an inter-State sale. However, if such movement from head office to branch is against a pre-existing purchase order with a branch office, it is an inter-State sale.

(c) Computation of taxable turnover and CST

Particulars	Rs.	Rs.
Total inter-State sale of goods		38,00,000
Less: Transfer of goods to branch covered by Form F as these are not inter-State sales		8,10,000
		29,90,000
Add: Dharmada (forms part of sale price)	4,450	
Weightment dues charged separately from buyers also forms part of sale price	1,05,000	
Indemnity charges do not form part of sale price – Hence, should not be added	-	1,09,450
		30,99,450
Less: Cash discount allowed as per trade practices – does not form part of sale price – Hence, should be deducted		50,000
Taxable turnover		30,49,450
Central Sales-tax @ 4%		1,21,978

Note - The above solution has been worked out on the assumption that dharmada, weightment dues and indemnity charges are shown separately in the invoice and have not been included in the total value of inter-State sale of Rs.38 lakh and cash discount has also not been deducted therefrom. It is also assumed that the sale value of Rs.38 lakh does not include Central Sales-tax.

PAPER – 6 : INFORMATION TECHNOLOGY

Question No. 1 is compulsory. Answer any four from the rest.

Question 1

(a) Convert the following from one number system to another system alongwith the working notes:

(i) $(2363.75)_{10}$ = ( )$_{16}$

(ii) $(23D.15)_{16}$ = ( )$_{8}$

(iii) $(1E12.12)_{16}$ = ( )$_{2}$

(iv) $(310.04)_{8}$ = ( )$_{2}$

(v) $(1111101111.11)_{2}$ = ( )$_{16}$ *(1 x 5 = 5 Marks)*

(b) Describe briefly, the following terms with reference to Information Technology:

(i) Band width

(ii) Rotational delay time

(iii) File Allocation Table

(iv) BIOS

(v) Concurrent Processing. *(1 x 5 = 5 Marks)*

(c) Give one or more reasons for each of the following:

(i) Need of auxiliary storage devices

(ii) Use of video RAM

(iii) Need of language translators

(iv) Use of operating system

(v) Use of intranet. *(1 x 5 = 5 Marks)*

(d) Write True or False for each of the following:

(i) Bubble memory is a volatile memory.

(ii) Bridge is used to connect two similar networks.

(iii) Optical laser disks use mechanical Read/write head for the purpose of reading and writing the data.

(iv) Contents of PROM can be erased by ultra-violet rays.

(v) Financial accounting software is a system software. *(1 x 5 = 5 Marks)*

Answer

(a) (i) $(93B.C)_{16}$

(ii) $(1075.052)_8$

(iii) $(1111000010010.0001001)_2$

(iv) $(11001000.0001)_2$

(v) $(3EF.C)_{16}$

Working Notes

(a) (i) $(2363.75)_{10}$ = ( )$_{16}$

16	2363	Remainder
16	147	11= B
16	9	3
	0	9

= 93 B

.75

× 16

12.00 = C

Hence, $(2363.75)_{10}$ = $(93\ B\ .\ C)_{16}$

(ii) $(23\ D.\ 15)_{16}$ = ( )$_8$

To convert the given number from hexadecimal number system to octal number system, each digit of the number will be represented in octal form.

$(23D.15)_{16}$ = 0010 0011 1101 . 0001 0101

= 001 000 111 101. 000 101 010

= 1 0 7 5 . 0 5 2

Hence, $(23D.15)_{16}$ = $(1075.052)_8$

(iii) $(1\ E12.12)_{16}$ = ( )$_2$

To convert the given number from Hexadecimal number system to Binary number system, each digit of the number will be represented in binary form.

= 0001 1110 0001 0010. 0001 0010

Hence, $(1E\ 12\ .12)_{16}$ = $(0001111000010010.0001001)_2$

(iv) $(310.04)_8$ = ( )$_2$

To convert the given number from Octal number system to Binary number system, each digit of the number will be represented in binary form.

$= 011 \quad 001\ 000.\ 000 \quad 100_2$

$(310.04)_8 = (11001000.0001)_2$

(v) $(111110\ 1111\ .\ 1100)_2 = (\quad\quad)_{16}$

To convert the given number from Binary number system to Hexadecimal number system, each digit of the number will be represented in binary form using a group of 4 digits.

$= 0011 \quad 1110 \quad 1111\ .\ 1100$

$= 3 \quad E \quad F \quad . \quad C$

$(1111101111\ .\ 1100)_2 = (3EF.C)_{16}$

(b) (i) Bandwidth: Bandwidth refers to information carrying capacity of the communication channel. Technically, bandwidth is the difference between highest and lowest frequencies used for transfer of data. It is measured in bps (bits per second). Higher the bandwidth, faster will be the data transfer speed. Higher bandwidth is required for audio and video applications.

(ii) Rotational delay Time: After adjusting the Read/Write head of the disk on the desired track, it is the time taken by Read/Write head to find the desired sector. It is considered as half of the time required in one revolution of the platter.

(iii) File allocation Table: It is a table which stores the physical address of all the files stored on the storage media. In order to access a file, this table is searched to find the physical address of that location, where the file is stored. This table is also searched to find the free area of the storage media at the time of storing a new file.

(iv) BIOS: BIOS stands for Basic Input Output System. It is a small chip on the motherboard which loads the hardware settings of various I/O devices such as Keyboard, VDU and Hard disk into the memory of computer system. Now a days, computer is having flash BIOS in order to support new hardware devices.

(v) Concurrent processing: It refers to the capability of a computer system to share memory among several programs and to execute the instructions, provided by each during the same time frame.

(c) (i) *Need of Auxiliary storage devices*: When user enters the data/program using input device, those are stored in RAM. RAM is a Volatile memory which means that all the contents of RAM are erased when the power is switched-off. Therefore, in order to store the entered data permanently for future reference, auxiliary memory is required. Auxiliary storage devices like Floppy disk, Magnetic disk and Magnetic tape have auxiliary memory.

(ii) *Use of video RAM:* Video RAM (VRAM) is used to accelerate the display of graphics on the screen. This RAM stores much of the data from main memory which is required to be displayed on VDU and transfers the same to the screen at faster rate to give the flicker free output.

(iii) *Need of language translator:* Computer understands only binary language or machine language. Therefore, in order to convert assembly language program or source program to object program, language translator is required. Assembler, Interpreter and compiler are known as language translators.

(iv) *Use of operating system:* It is system software which acts as an interface between user and Computer System. It manages the System resources namely Memory, Processor, I/O Devices and file system. Operating system files are stored on the hard disk of the computer.

(v) *Use of Intranet:* Intranet is a means of intra-office communication. It facilitates communication within the organisation and connects people together with Internet-technology in a single view. Through the Intranet, access to all information, applications and data can be made available through the same browser.

(d) (i) False

(ii) True

(iii) False

(iv) False

(v) False.

Question 2

Distinguish between the following:

(i) Personal computing and Network computing.

(ii) Online systems and Real time systems.

(iii) Synchronous transmission and Asynchronous transmission.

(iv) Intranet and Extranet.

(v) Voice synthesizer and Voice recognition system. *(4 x 5 = 20 Marks)*

Answer

(i) Personal Computing and Network computing:

Personal computing: The philosophy behind personal computing is that a computer should be readily available to an individual to perform his/her work at any time. Many tasks are individual by nature. Over the time, the range of tasks that a personal computer can accomplish has steadily increased largely because of the increasing availability of high-quality software. Some smaller businesses rely only on personal computers for all of their accounting, inventory management, customer database and transaction processing operations.

Network Computing: In network computing arrangement, individuals do their own work on personal computers, but are connected to other computers through a telecommunication network that allows them to share information and resources with others. Users in these environments may share databases, memos and other messages,

and work in progress. They can also share printers, fax machines and links to external data sources. Providing duplicates of these resources for each of the members of the work group can be very costly for many organisations. Sharing of resources saves lot of cost for the organisation.

(ii) Online Systems: Online processing refers to processing of individual transactions as they occur from their point of origin as opposed to accumulating them into batches. This is made possible by such direct access devices as Magnetic disk and number of terminals connected to, and controlled by a central processor. In this way, various departments in a company can be connected to the processor by cables. If operating companies are a number of miles away from the processor then they are linked by means of telegraph, telephone lines or even through satellite. This type of processing provides multi access to information files by terminal users and also enables them to update files with transactions data.

Real-time systems: The term real time refers to the technique of updating files with transaction data immediately after the event to which it relates occurs. Real-time systems are basically on-line systems with one specialty in inquiry processing. The response of the system to the inquiry itself is used to control the activity. An on-line production data collection system that simply accepts input and utilizes it for payroll and costing purposes cannot be termed real-time, but if, on the other hand, the system is designed to provide immediate information to monitor the production processes, it is a real-time system.

(iii) Synchronous Transmission: In this transmission, bits are transmitted at fixed rate. The transmitter and receiver both use the same clock signals for synchronization.

Synchronous transmission allows characters to be sent down the line without start-stop bits. It allows data to be sent as a multi-word blocks. It uses a group of synchronization bits, which is placed at the beginning and at the end of each block to maintain synchronisation. In transmission, timing is determined by a Modem.

Asynchronous Transmission: In this transmission, each data word is accompanied by stop (1) and start (0) bits that identify the beginning and ending of the word. When no information is being transmitted, the communication line is usually high (in binery 1), i.e., there is a continuous stream of 1's.

(iv)

	Intranet	Extranet
1.	It is the use of Internet technology like Web browsers and Web servers for effective communication and exchange of information within the employees of an organization.	It is the extension of intranet which makes the information of an organization accessible to outside companies and individuals with whom the company does business. It can also be defined as an Internet connection between business partners only.
2.	Intranet employs less security mechanisms as compared to	Extranet provides the privacy and security of Intranet using cryptography and

	mechanisms as compared to Extranet.	authorization procedures while retaining the global reach of Internet.
3.	Intranet extends among various branches and departments of the organization.	Extranet extends the Intranet from one location to another Intranet of a business partner across the Internet using controlled mechanisms.
4.	Data security is high with limited reach.	Data security is less with global reach.
5.	It results in reduced costs of printing, paper, telephone, easier and faster access of information from remote locations.	It results in better link with trading partners and faster exchange of information with them.

(v)

	Voice Synthesizer System	Voice Recognition System
1.	It is hardware device which is attached to the parallel port of the Computer.	It is software based approach of data entry into the computer by speaking using microphone attached with the computer.
2.	It is used to convert text to voice.	It is used to convert voice to text
3.	It is an output device.	It is an input technique of data entry.
4.	It is much helpful for blind persons who can not see the text on VDU.	It is helpful for those persons who find it difficult to use conventional devices like Keyboard, Mouse etc. for entry of data into the computer.
5.	It is a costly device.	The problem in the implementation of this system is that the persons are not uniform in their speech modulation which leads to error in data entry.

Question 3

(a) Explain the various advantages and disadvantages of direct access storage.

(b) Explain five components of Local Area Network (LAN).

(c) A computer file contains the customer name, type, bill number, bill date, amount and date of payment. The bill is generated according to the following rules:

If a customer is a dealer and pays his bill within 15 days, 5% discount is allowed. If he pays the bill between 15 and 30 days, the discount allowed is 2%. If payment period is more than 30 days but upto 60 days, 5% surcharge is levied. For payment after 60 days, 10% surcharge has to be paid.

If a customer is a manufacturer, the corresponding percentages are 7%, 5%, 7% and 12% respectively.

Draw a program flowchart to calculate discount, surcharge and net amount for each of the 20 customers. Also print total discount and surcharge paid by all the customers.

(5 + 5 + 10 = 20 Marks)

Answer

(a) Advantages of direct access storeage:

(i) Magnetic rigid disk is a direct access storage (DAS)medium; therefore, individual records can be retrieved without searching through the entire file.

(ii) The costs of DAS are steadily declining.

(iii) For real-time systems where direct access is required, disks are currently the only practical means of file storage.

(iv) Records can be readily updated by writing the new information over the area where the old information was stored.

(v) With removable disk packs, a single disk drive can store large quantities of data, although all but one of the disks is offline at any given point in time.

(vi) Interrelated files stored on magnetic disk can allow a single transaction to be processed against all of these files simultaneously.

Disadvantages: Updating a master file stored in DAS destroys the old information. Therefore, it does not provide an automatic audit trail. When disk is used, backup and audit trail require that each old master file records be copied to another medium prior to update.

(b) Components of a LAN: There are five components of a LAN:-

(i) File Server: The server stores all the programs and data required by different users. It allows different users to share data and system resources namely hard disk, printer etc. There are two types of file servers:

(a) Dedicated Server: This server is only used to manage the data as well as programs and can not be used as a node, therefore, this server is called passive device.

(b) Non-dedicated server: This server can be used as a node for data entry and obtaining the results as well as server, therefore, it is called active device.

(ii) Workstations or Nodes: These computers are used by different users for data entry and obtaining the results. Nodes are connected with file server using Network Interface card and network cabling. These terminals are usually intelligent terminals which process the data after accessing the data and programs from file server. After processing, files are stored on the server for sharing by the other workstations.

(iii) Network Operating system: This operating system is used to manage different nodes as well as various I/O devices. Commonly used network operating systems are Novell Netware, Windows NT, Sun Solaris etc.

(iv) Network Interface card: It is an electronic card which is installed in all the nodes and server to allow communication between them. Commonly used NIC in LAN is called Ethernet card which uses Linear bus topology.

(v) Cabling: There are three types of cables which can be used in LAN:-

(a) *Co-axial cable:* This is the same cable which is used in domestic homes for watching satellite channels. It has a rigid aluminium wire having spiral wire around. It is not a reliable cable and breaks on the way. In addition to this, data can not travel to long distance due to high resistance. Data transfer speed is also not high.

(b) *UTP (Unshielded twisted pair) cable:* This cable is similar to telephone cable used in domestic phones but instead of having two wires, it has 4 pairs of different color wires. RJ 45 (Registered Jack) connector is attached in front of this cable for connecting the cable to the NIC. CAT5 and CAT6 are commonly used UTP cables. It is inexpensive and easy to install. These cables are more reliable and result in faster data transfer. These are used in structured cabling of Local area network (LAN).

(c) *Optical Fiber cable (OFC):* These cables are very reliable and are used for higher data transfer speed but are expensive. Data passed through these cables remain unaffected by electromagnetic interference. OFC uses rapidly turned on and off light to create on and off bits on the communication channel. Data is more secure in fiber optic network.

(c) The required flow chart is given on next page.

Question 4

(a) Discuss the services provided by Data Centres.

(b) What is an expert system? Explain its various components.

(c) What is Teleconferencing? Explain different types of teleconferencing.

(5 + 5 + 10 = 20 Marks)

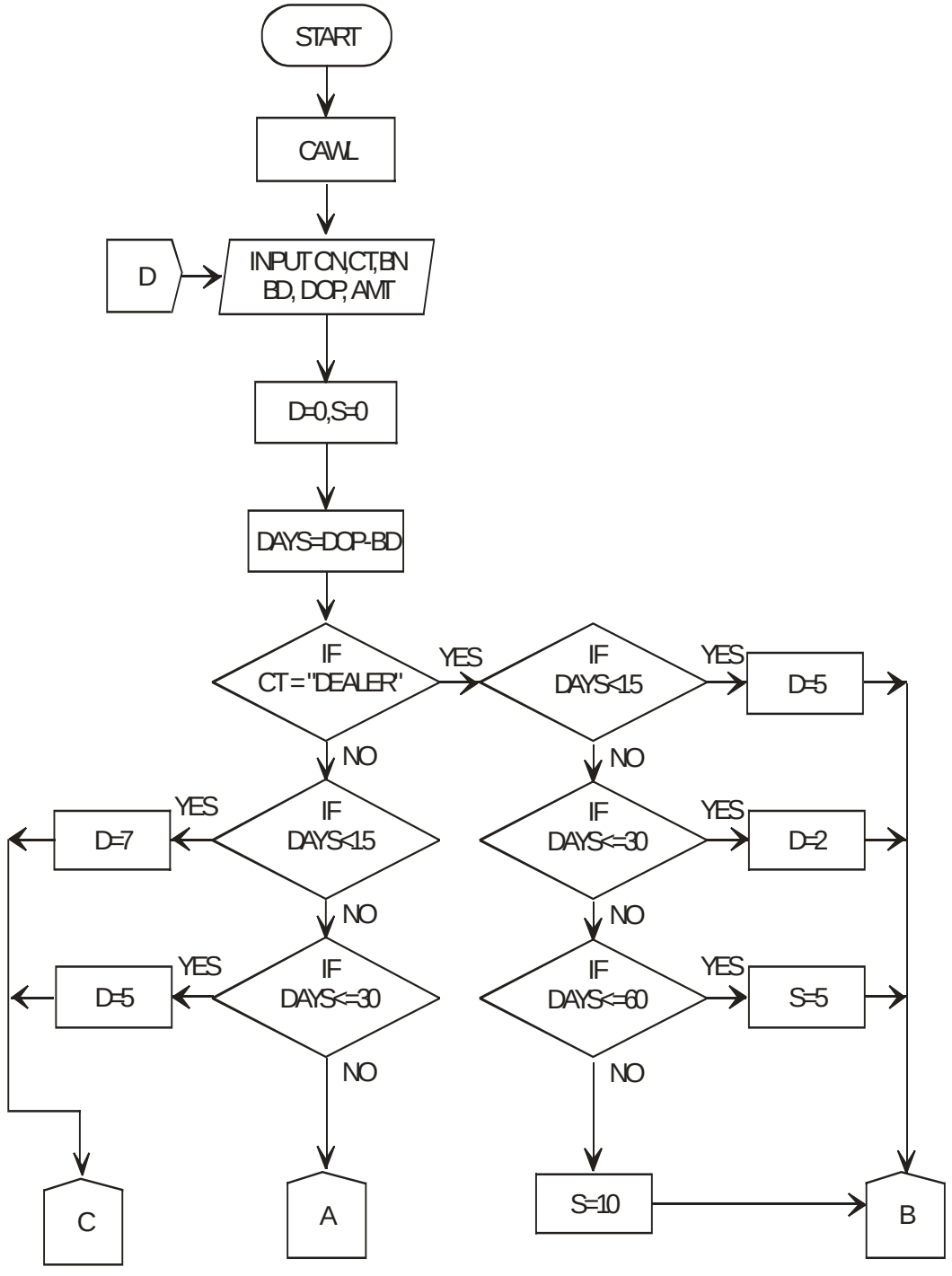
Answer

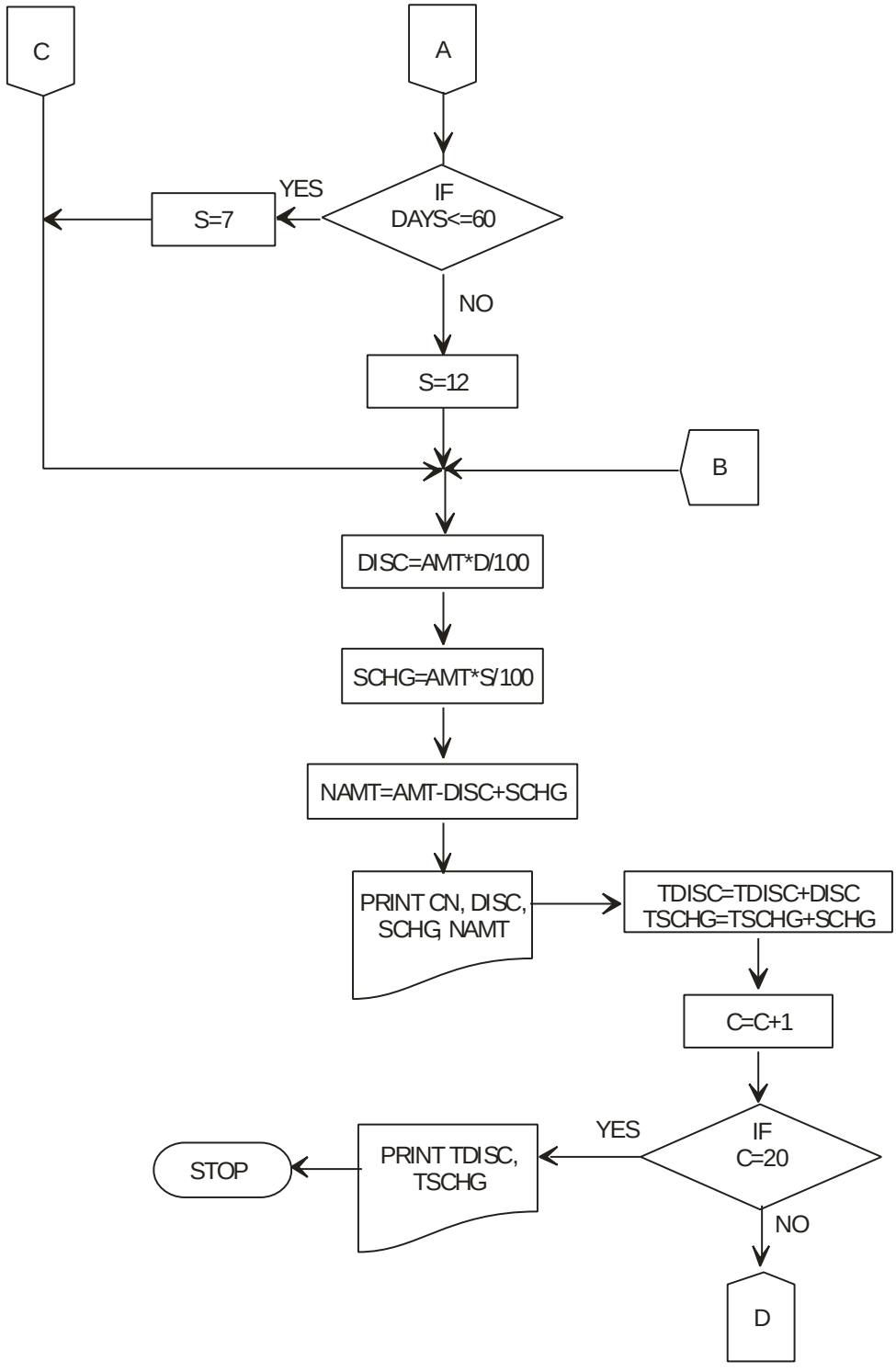
(a) Services provided by Data Centres: Data Centres provide the following services:-

(i) *Database Monitoring*: It provides the high availability of database through automated management.

(ii) *Web Monitoring:* It monitors website performance, availability and integrity.

(iii) *Backup and restore:* It provides centralized multi-system database and applications management for different organizations.


START
CAWL
D
INPUT CN,CT,BN
BD, DOP, AMT
D=0,S=0
DAYS=DOP-BD
IF
CT = "DEALER"
YES
IF
DAYS<15
YES
D=5
NO
NO
YES
D=7
IF
DAYS<15
IF
DAYS<=30
YES
D=2
NO
NO
YES
D=5
IF
DAYS<=30
IF
DAYS<=60
YES
S=5
NO
NO
C
A
S=10
B


C
A
IF
DAYS<=60
YES
S=7
NO
S=12
B
DISC=AMT*D/100
SCHG=AMT*S/100
NAMT=AMT-DISC+SCHG
PRINT CN, DISC,
SCHG, NAMT
TDISC=TDISC+DISC
TSCHG=TSCHG+SCHG
C=C+1
IF
C=20
YES
NO
PRINT TDISC,
TSCHG
STOP
D

(iv) *Intrusion detection system (IDS):* ID stands for Intrusion detection which is the art of detecting inappropriate and incorrect activity. Data Center provides automated network-based security features. Intrusion detection system (IDS) is scalable which can be implemented for smaller networks to large enterprise installation.

(v) *Storage on demand:* It provides best back-end infrastructure to give robust, easily manageable and cost effective storage solutions. It also provides security, reliability and availability of data.

(b) Expert System: Expert System (ES) is a computerized information system which allows the non-expert users to take decisions regarding unstructured problems which require experience and specialized knowledge like an expert. Expert system may work as an assistant for routine analysis or may work as a colleague for discussion of problem until both system and user agree on a solution. Expert system contains the following components:-

(a) *Knowledge base*: This includes the data, knowledge, relationships and decision rules used by experts to solve a particular problem.

(b) *Inference engine*: This program contains the logic to use the data from knowledge base and user to recommend a course of action.

(c) *User interface*: This program allows the user to design, create, update, use and communicate with the expert system.

(d) *Explanation facility*: This facility provides the user with explanation of decision recommended by the expert system. This facility helps the user in understanding how the expert system has recommended the action.

(e) *Knowledge acquisition facility*: Building a knowledge base known as knowledge engineering requires human expert and a knowledge engineer. The knowledge engineer is responsible of extracting the individual expertise into the knowledge base using knowledge acquisition facility.

(c) Teleconferencing: It refers to the electronic meeting between people who are geographically scattered. Telecommunication technology allows the people to interact with each other without traveling to the same location which saves a lot of money and valuable time.

There are three types of teleconferencing:

1. Audio conferencing: It is the use of audio communication equipments which allows the user to communicate with geographically dispersed persons. Audio conferencing does not require a computer but requires a two way audio communication facility.

   Guidelines to make Audio conferencing more efficient:

   (i) All the participants must have an opportunity to speak.

   (ii) Number of participants must be kept to manageable size.

(iii) Copy of conferencing agenda must be sent to all the participants in advance through FAX.

(iv) Participants must identify themselves.

(v) Conferencing discussion must be recorded.

(vi) Hard copy of the discussion must be prepared and should be sent to all the participants for approval.

2. Video conferencing: In this conferencing, participants can see and hear each other. It uses the television and does not require a computer. Participants gather in specially equipped rooms having audio and video facility.

There are three types of Video Conferencing:

(i) *One way Video and Audio*: In this case, audio and video is traveled only in one direction e.g. Television.

(ii) *One way Video and Two way Audio*: In this case, audio is transferred in both the directions but video is transferred only in one direction e.g. discussion of news reader with field correspondent.

(iii) *Two way video and Audio*: In this case, audio and video is transferred in both the directions between sender and receiver e.g. discussion of persons between different studios of a news channel.

3. Computer Conferencing: It is the use of networked computer that allows participants with some common characteristics to exchange information concerning a particular topic. It is more disciplined form of E-Mail. It can be used within single geographic site which is not practical in case of Audio and Video conferencing.

Question 5

(a) What is Electronic Data Interchange (EDI)? How it works?

(b) Define the following terms related to MS-WORD:

(i) Text Wrap

(ii) Headers and Footers

(iii) Tab

(iv) Indenting

(v) Paragraph alignment.

(c) Explain the following terms with reference to presentation package:

(i) Slide timings

(ii) Transition

(iii) Tri-pane view

(iv) Handouts

(v) Notes.

(d) Define the following functions used in MS-EXCEL:

(i) TRUNC

(ii) MOD

(iii) PMT

(iv) DISCOUNT

(v) UPPER. *(5 + 5 + 5 + 5 = 20 Marks)*

Answer

(a) Electronic Data Interchange (EDI): EDI is the transmission of business information in standard format between computers of independent organizations. There is no need to change the database structure by the companies for implementation of EDI. However, EDI software is required to be developed for translating the format used by one organisation to the format being used by another organizations. So EDI is computer-to-computer communication using a standard data format to exchange business information electronically between independent organizations.

EDI is a three step process :-

1. First of all, sender data is converted into standard format as defined by EDI translation software.
2. Data in standard format is transferred to the receiver using communication lines.
3. Finally, standard format data is converted according to the format of receiver data base files.

These three steps require following functions:-

1. *Communications:-* EDI requires communication software and EDI translation software. Communication software is responsible for transfer of data from source to destination, starting & termination of EDI transmission session and sending the acknowledgement of data on successful data transfer. EDI translation software converts the data fields of the sender according to the receiver format.
2. *Mapping:-* For data transfer between trading partners, EDI standard is required to be selected and mapping of sender fields with the receiver fields will have to be defined in the EDI translator.
3. *Profiles:-* In this step, it is defined in the system where to send the transactions and how to handle errors and exceptions during exchange of data among trading partners.

(b) (i) *Text Wrap*: This feature of word processing package restricts the appearance of characters between left and right margins. When the words in a line exceed than the words which can be accommodated in one line, then remaining words are

automatically shifted to next line.

(ii) *Headers & Footers:* Information like company name, report title is required to appear on every page of the document, and that information can be inserted on every page of the document using Header and Footer option. This kind of information appears either in the top or bottom margin. Headers are placed in the top margin and footers are placed in the bottom margin of a page.

(iii) *Tab:* In order to present the data in tabular form, space bar can be used. But this is very cumbersome and unreliable, particularly when the data to be tabulated is several lines long. All word processors have 'Tab' function similar to manual and electronic typewriter. Word allows the usage of 'Tab' according to the requirement. Depending upon the size of the text, the width of tab can be specified.

(iv) *Indenting:* It refers to the distance of text from the margin. By using indenting, the selected paragraph stands out from other text in the document. Word offers two types of Indents namely 'First-line' and 'Hanging' indents. In the case of 'First-line' option, the first line is indented more or less than the lines that follow it. 'Hanging' indent hangs the lines of paragraph to the right of left margin.

(v) *Paragraph alignment:* Word offers four types of alignment to text. They are Left, Right, Center and Justify. In Left alignment, text lines up with the left margin, leaving the right margin irregular. Right alignment means that the text lines up with the right margin, leaving the left margin irregular. Centered text is evenly placed between left and right margins. Justified text is fully aligned between left and right margin.

(c) (i) *Slide timings:* In order to run the presentation on its own, like presentation at a trade show where slides automatically change from one to another, slide timings are required to be set up for each slide of the presentation. Slide timings are considered by keeping in mind that, perfect co-ordination between speech and slides is maintained. Slide timings can be set up using the Rehearse Timing button on the Slide Sorter toolbar.

(ii) *Transitions:* Transitions are the way each slide appear on the screen like appearance of slide from the right, box in, box out or dissolve. For setting transitions, one can use 'Slide Transition' toolbar after selecting a slide in Slide sorter view. Speed of transition can be set as slow, medium or high. Slide transition can also be accompanied by special sound effects to enhance the presentation.

(iii) *Tri*-Pane View: It allows to view three different aspects of the presentation at the same time on the screen. These three views are Normal view, Outline view and Slide View.

(iv) *Handouts:* These are prints of slides or outline of the presentation which are given to the participants. On a handout, 2,3,4,6 or 9 slides can be printed. These are slides printed without any notes.

(v) *Notes:* These are the points that are made regarding a slide to help in remembering about a presentation or to help the participants with details of background information regarding a slide. Notes are printed along with a small version of slide.

(d) (i) TRUNC (number, num-digits): This mathematical function truncates a number to an integer by removing the fractional part of the number, if number of digits specified is zero otherwise number is truncated to specified number of digit e.g. = TRUCN (8.9,0) = 8 and = TRUNC (8.928,2) = 8.92.

(ii) Mod (x,y): This mathematical function gives the remainder after dividing x by y. e.g. if x=7 and y=2, then value returned will be 1.

(iii) PMT (rate, nper, pv): This financial function is used to calculate the payment for a loan at the given rate of interest and for particular time period where

pv: Total present value to be paid

rate: Rate of Interest

nper: No. of periods

(iv) DCOUNT(database, field, criteria): This database function is used to count the number of cells containing numbers in the field (column) of records in the database that match the conditions specified.

(v) UPPER (text string): This text function converts a text string to all uppercase letters e.g. if the text string is 'exam', then this function will return 'EXAM'.

Question 6

(a) Explain the concept of communication protocols.

(b) Explain the powers of Central Government to make rules as defined in Section 87 of IT Act, 2000.

(c) Explain "test data technique" of audit in a computerized environment with the help of test pack approach.

(d) Explain the facilities provided by financial accounting package.

(5 + 5 + 5 + 5 = 20 Marks)

Answer

(a) Communication Protocols: A protocol is a standard set of rules that govern the flow of data on a communication network. Communication protocol software performs a variety of actions necessary for data transmission between heterogeneous computers like PC to Mainframe. These standard sets of rules must be followed by both the communicating parties to ensure that the information exchanged between them is received and interpreted correctly.

Communication protocols consist of multiple layers, the first layer is a physical layer which defines the manner in which system components are interfaced with each other i.e.

the communication interface devices will be attached at Serial Port/Parallel Port/USB Port and at which voltage level, communication will take place. Middle layer of communication protocol define the establishment and termination of sessions and higher level layer defines the various encryption and compression techniques used during data transfer so that data is transferred properly. Both the communication software and Network Interface Card must follow the same set of protocols.

A protocol defines the following three aspects:

(a) *Syntax:* It refers to the format of the data being exchanged and various encryption/cryptography techniques. Format means whether data will be transferred in ASCII/EBCDIC/BCD form.

(b) *Semanties:* It means the type (Audio/video/Text) and order of messages to ensure reliable & error free data transfer.

(c) *Timing:* It defines the data transfer rate.

Commonly used communication protocols are TCP/IP, SMTP, HTTP, FTP, PPP etc.

(b) Section 87: This Section has been discussed in Chapter 13 – Miscellaneous of IT Act, 2000. According to this section, Central government has powers to make rules regarding the following:-

1. The manner in which any information may be authenticated by digital signature.
2. The electronic form in which filings, issue, grant or payment shall be effected.
3. The matter relating to the type of digital signature, manner and format in which it may be affixed.
4. Security procedure for creating secure electronic record.
5. Qualifications and experience of Controller, Deputy Controller & Assistant Controller.
6. Requirements for applying for a license to issue Digital Signature Certificate.
7. The format of application form for license, period of validity of license and amount of fees payable.
8. The form and fee for renewal of license.
9. The fee to be paid to the Certifying Authority for issue of a Digital Signature Certificate.
10 The qualification and experience of the adjudicating officer.
11. The salary, allowances and other terms and conditions of service of Presiding Officer.

(c) Test data techniques are used to conduct audit by way of entering sample of transactions into client's computer system and comparing the output with predetermined output to make sure that the output being generated by client's computer system is correct. Test

data may be dummy data or the transactions selected from the previously processed transactions.

Test packs: The use of test packs is the application of auditors test data (live or dummy) to clients application programs. A small sample of data is processed through the computer and output is compared with manually generated output using the same data. This audit approach requires little computer expertise but designing of test data which will represent all the possible combinations is a time consuming and difficult process. Use of test data generators can overcome this disadvantage.

(d) Facilities provided by Financial Accounting Package

Financial accounting package must be user friendly with on-line help facility so that even novice user can use it without any problem. Security must be of prime importance in a good financial accounting package so that no unauthorized user can enter/modify the financial data. It must provide the following facilities:-

a. It must offer well designed data entry screens with various verification/validations controls so that correct data could be entered easily and fastly.

b. It must have screen to create information about company such as its name, address, contract numbers, Income tax number, Sales tax number and other relevant details

c. It must have flexibility to modify the company's accounting and inventory features by the authorized users using their passwords.

d. It must be able to maintain the Group Accounts (Single Group & Multiple Groups) as well as single and multiple ledgers.

e. It must facilitate day-to-day accounting transactions through voucher entry like entry of sales, purchase, receipt, payment and journal vouchers without the need of remembering the accounting codes.

f. It must generate various financial statements like Day book, Cash book, Bank book, General ledger, Subsidiary ledger, Profit & Loss A/Cs, Trial balance, Balance sheet etc. In addition to these, the package must prepare various financial statements required by auditors and Government. It must be possible that all the required reports could be customized by user according to their requirements rather than generation of the same in standardized formats.

Question 7

Write short notes on the following. Answer any four.

(i) Virtual Memory

(ii) Firmware

(iii) Integrated Test Facility (ITF)

(iv) Light pen

(v) Distributed Database. *(5 × 4 = 20 Marks)*

Answer

(i) Virtual Memory: Programmer writes the program with the illusion that there is infinite main memory but main memory is always limited in size. Therefore, when the size of a program exceeds the size of available RAM, then the entire program is stored in secondary memory. Operating system divides the program into number of equal parts, known as pages. Main memory is also considered to be divided into no. of parts having same size as that of page, known as Blocks. Those pages which can be accommodated in available blocks are shifted from secondary memory to main memory and execution starts. When a page which is currently not in main memory is required, then the required page is brought in the main memory after shifting an unwanted page from main memory to secondary memory. This process is known as swapping. In this way, program having size more than the size of available RAM is executed. Since the size of the main memory is not same as the size of job, hence it gives rise to a concept of virtual memory.

(ii) Firmware: These are micro programs which are written in machine language and are permanently stored in ROM to perform complex operations like Multiplication, Division, Move data and Compare data etc. These micro programs deal with low level machine operations and provide the substitution for additional hardware circuits, thus reducing the cost of computer system. In ALU, there is a hardware circuit to perform 'addition' known as adder and hardware circuit to perform 'subtraction' known as subtractor but there is no hardware circuit to perform multiplication and division. These operations are performed by the way of repeated additions and repeated subtraction using basic electronic circuits namely adder and subtractor. Thus, firmware helps in reducing the cost of computer system and results in faster processing of data.

(iii) Integrated Test Facility (ITF): Integrated test facility (ITF) is a particular form of test data involving the creation of dummy entity like creation of a dummy branch in case of a Banking system. Once the dummy entity is created, the auditor can input the transactions related to this dummy entity and process these data using client's application program to obtain the output. The generated output is compared with the manually calculated results to determine the accuracy of the client's application programs.

(iv) Lightpen: A lightpen is a pointing device which can be used to select an option by simply pointing at it, or draw figures directly on the screen and move the figures around. A lightpen has a photo-detector at its tip. This detector can detect changes in brightness of the screen. When the pen is pointed at a particular point on the screen, it records the instant change in brightness that occurs and informs the computer about this. The computer can find out the exact spot with the information. Thus, the computer can identify where the user is pointing on the screen. Lightpens are useful for menu-based applications. Instead of moving the mouse around or using a keyboard, the user can select an option by pointing at it. A lightpen is also useful for drawing graphics in CAD.

(v) Distributed database: Distributed data processing refers to a system in which computer intelligence is located at more than one site and the actual running of application programs and processing of data are completed at more than one site. Distributed data processing may save a lot of time and money for an Organisation. When processing is distributed, the data to be processed usually must be located at the processing site. This means that the data base, or parts of the data base must be distributed. There are two ways to distribute a database. The first one is to provide duplicates of all data at all sites. This approach is called a replicated database. Another means of distributing the database is to partition it. The data base may be divided into segments that are appropriate for certain locations and these segments distributed only to those locations. This approach is called a partitioned database. Distributed database systems usually reduce costs for as organisation because they reduce transfer of data between remote site and the organisation's headquarters. Distributed database systems may also provide organisations with faster response times for filling orders, answering customer requests, or providing managers with information.

SUMMARY OF EXAMINERS' COMMENTS ON THE PERFORMANCE OF CANDIDATES

PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

General Comments

Overall performance of the candidates was not satisfactory. Performance revealed lack of in-depth knowledge and rigorous study. Candidates must practice numerical problems extensively and go through the theoretical part very carefully in order to provide precise and correct answers. It needs to be understood that knowledge of basic theoretical concepts is essential for attempting practical questions on desired lines. The candidates also need to fine tune their presentation skills.

Specific Comments

Question 1.(a) This was a practical question part requiring a sound understanding of the traditional methods of allocation of Overheads as well as Activity Based Costing. The question has been attempted well by most of the students; however, few students were able to compute correctly the total cost of each product. Some candidates failed to ascertain the Cost Driver rate of various activities. Very few students presented the comparison of cost as per Traditional Costing system and as per ABC system in tabular format.

(b) This theory question part was based on 'Cost Reduction'. This question was well attempted by most of the candidates.

(c) This theory question part related to 'Non-integrated Accounts' was attempted reasonably well by most of the candidates.

Question 2.(a) This practical question part related to 'Material' required examinees to compute the EOQ. Most of the candidates failed to work out the total inventory cost p.a. 'with quantity discount offer' correctly due to wrong computation of carrying cost.

(b) This practical question part required a sound knowledge of 'specific wage incentive Plans'. Majority of the candidates were unable to compute the normal rate of wages and cost of materials and hence went wrong while preparing comparative statement of factory cost of the product.

(c) This theory question part related to the 'treatment of By-Product cost in Cost Accounting' was attempted well by most of the candidates.

Question 3.(a) This was a practical problem based on Process Costing, where valuation of WIP, calculation of Abnormal loss (in Process I) and Abnormal Gain (in Process II) and preparation of Process Accounts (Both process I and process II) was required to be done. Few candidates were unable to compute the equivalent production units in Process II and hence prepared Process Account and Finished Stock Account wrongly.

(b) This theory question part related to 'labour turnover' was attempted reasonably well by most of the candidates.

Question 4.(a) This theory question part requires an understanding about the treatment of Spoilage and Defectives in Cost Accounting. Most of the candidates have answered this question part reasonably well.

(b) This was a practical part from 'Contract Costing' in which candidates were required to compute estimated profit. The amount of profit to be credited to the Profit and Loss Account was also required to be computed. Some students were confused between the term 'Estimated Profit' and 'Notional Profit' and hence answered this question on wrong lines.

(c) This theory question part regarding 'various reports prepared by the Cost Accounting department' was reasonably well answered by most of the candidates.

Question 5.(a) This practical question part required basic knowledge of secondary distribution of Overheads. Majority of the candidates failed to compute Overhead absorption rate per production hour of each production department.

(b) This theory question part required the knowledge of concepts regarding 'requisites for installation of Uniform Costing system'. Many candidates answered for 'requisites for installation of costing system' instead of what was required.

Question 6.(a) Being a compulsory question, it was attempted by a large percentage of candidates. Majority of the candidates calculated the pay back periods (non-discounted and discounted). However, a few candidates correctly gave decisions on the acceptability of projects. Only a few candidates answered the ranking of projects as per NPV correctly.

(b) This practical question part required candidates to compute the degree of operating, financial and combined leverages. Most of the candidates were able to compute correctly all the three leverages.

(c) Most of the candidates attempted the theory question well.

Question 7.(a) Only a few of the candidates prepared the statement showing estimate of working capital needed on correct lines. Majority of the candidates incorrectly computed investment in work-in-progress (WIP), finished goods and sundry debtors.

(b) A large number of candidates did not attempt this part of the question satisfactorily. It seems the candidates lacked knowledge of considerations in capital structure planning.

Question 8. Majority of the candidates could not prepare the statement of changes in working capital position on correct lines. They failed to consider trade investments and income tax payable in this statement. Only a few candidates prepared the statement of computation of funds from operations correctly. The figure of purchase of machinery was also computed incorrectly due to wrong treatment of profit on sale.

Question 9.(a) Most of the candidates gave roundabout answer to this question by stating only disadvantages of Profit Maximisation principle (objective) of a firm.

(b) This part of the question related to ratio analysis. Majority of the candidates have written only the formulae. Many candidates were unable to compute correctly the constituents of current assets. As a result, most of the candidates prepared the balance sheet on wrong lines.

PAPER – 5 : INCOME-TAX AND CENTRAL SALES TAX

General comments

Most candidates do not have a thorough understanding of the provisions of the Income-tax Act and Central Sales Tax Act. They were not up to date with the recent amendments. The presentation of answers was also very poor. Also, in the case of True/False questions, they have simply stated True/False, without substantiating the reasons for the same. Most candidates were found wanting in communication skills and usage of precise legal terminology.

Specific Comments

Question 1. (a) Some common mistakes are -

(i) Most of the candidates have not restricted the deduction under Chapter VIA available to Mrs. Mary to income other than capital gains taxable under sections 111A and 112.

(ii) Some of the candidates have failed to provide deduction under section 24 @ 30% of Net Annual Value in the case of income from house property.

(iii) A few candidates have treated pension received from Canadian Government as taxable income of the non-resident, Mrs. Rosy.

As a result, most candidates were not able to arrive at the correct total income and tax payable.

(b) Most of the candidates could not correctly compute the perquisite value of rent free accommodation and they have wrongly deducted the rent recovered from the employee from rent paid by the employer.

(c) Many of the candidates were not aware of the method for computing relief under section 89 of the Income tax Act.

Question 2 (First Alternative)

(a) Some of the candidates have not explained the meaning of substantial interest. They have not also explained the provisions of section 64(1)(iv).

(b) Most of the candidates have not explained the meaning of the term “record”. They have also not mentioned the time limit for passing such revision order and the provisions related thereto.

Question 2 (Second Alternative)

(a) Though the requirement of the question was to state the provisions of carry forward and set off of business losses under section 72, some candidates wrote about set off of losses under sections 70 and 71.

(b) Most candidates were confused between the provisions of sections 80DD and 80DDB and interchanged the answers.

Question 3.(a) (i) Some candidates have wrongly answered that business loss is eligible to be set-off against salary income.

(ii)/(iv) Only a very few candidates were aware of the time limit for revision of order under section 154 and issue of notice under section 143(2).

(v) Some candidates have wrongly answered that Accounting Standard notified under section 145 is applicable for those following double entry system of accounting.

(b) (i) Most of the candidates could not correctly determine the residential status of Mr. Dey for the two assessment years.

(ii) A few candidates have wrongly answered that the statement is false since ownership of house property is essential for taxing arrears of rent.

(iii) Some candidates have wrongly answered that the assessee has the discretion to claim depreciation on fixed assets.

Question 4.(a) Many candidates have wrongly explained the exemption available under section 10(10C) to an employee opting for VRS though the question was on amortization of expenditure incurred an employer under voluntary retirement scheme, which is covered under section 35DDA.

(b) Some candidates have not written that the assessee will be deemed to have been allowed deductions under sections 30 to 38.

(c) Most candidates have not written that salary and interest must be authorised by partnership deed and it should not relate to a period before the date of such deed.

Question 5.(a) Some candidates have simply stated true or false without giving reasons for their answer.

(i) A few candidates have wrongly answered as true stating that works contract is not liable for central sales-tax.

(iv) Many candidates have wrongly answered as true stating that the dealer must inform the occurrence within 90 days in case of death of surety.

(b) Many candidates have given wrong answers for most of the five "fill in the blanks" type of questions reflecting lack of conceptual knowledge on the areas examined.

Question 6.(a) Very few candidates were aware of the forms and declarations used by dealers for availing concessional rate of tax or exemption from tax.

(c) Most of the candidates were not aware of the treatment of weightment dues and indemnity charges.

PAPER – 6 : INFORMATION TECHNOLOGY

General Comments

Adequate subject knowledge and competency is required to attempt questions correctly that was not reflected in answers submitted by the examinees. Examinees are advised to learn and understand the fundamentals of the subject. They should apply the conceptual knowledge to their professional practice, which would be helpful in answering practical questions. They are required to improve the subject knowledge as well as language skills for achieving better performance.

Specific Comments

Question 1.(a) Most of the examinees attempted this question relating to conversion from one number system to another system and performed well.

(b) Some of the candidates were not able to explain the meaning of 'Rotational delay time', and 'file allocation table' correctly. They are required to understand the working procedure of the hardware and software to give appropriate answers.

(c) Few examinees could not explain the 'Need of auxiliary devices' and 'Use of Video RAM'.

(d) In this part, candidates were required to write true or false for various statements. Majority of the candidates exhibited very good performance .

Question 2

(i) Most of the candidates attempted this question nicely and secured good marks.

(ii) Some of the examinees did not know the technical differences between 'Online system and Real time system'.

(iii) This part was generally well answered by almost all the candidates.

(iv) This part was answered well by majority of the examinees.

(v) Some of the candidates could not give proper answer.

Question 3.(a) Quite a few of the examinees were not able to specify the advantages and disadvantages of Direct Access Storage.

(b) Most of the candidates attempted this question and performed well.

(c) Most of the examinees answered wrongly. They did not follow the procedures by which the flow chart is to be drawn. Examiners were of the opinion that the candidates must understand the basic symbols used to draw a flow chart. Candidates are also required to understand the importance and utility of 'Flow Charts' in programming.

Question 4.(a) Many candidates could not explain services provided by the data centre .

(b) Many of the candidates attempted this question with average performance.

(c) Most of the examinees were aware of the concept about the teleconferencing. Hence, performance was satisfactory.

Question 5.(a) Many of the examinees exhibited lack of the conceptual knowledge of EDI. Hence, the performance was poor.

(d) Many examinees were not able to explain most of the MS-Excel functions with correct syntax of the command.

Question 6. Some of the examinees attempted part(a) of this question wrongly. They failed to explain Communication Protocol correctly. Performance in other parts of the question was satisfactory.

Question 7.(i) Most of the examinees attempted this question correctly and explained Virtual memory well.

(ii) More than average number of examinees failed to give correct answer for Firmware.

(iii) Most of the examinees could not describe Integrated Test Facility(ITF) correctly.