Test Series: March, 2015

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 2 : BUSINESS LAWS, ETHICS AND COMMUNICATION

SUGGESTED ANSWERS/HINTS

1. (a) The problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in section 2(d) and on the principle of 'privity of consideration'. Consideration is one of the essential elements to make a contract valid and it can flow from the promisee or any other person. In view of the clear language used in definition of 'consideration' in Section 2(d) "…. the promisee or any other person…..", it is not necessary that consideration should be furnished by the promisee only. A promise is enforceable if there is some consideration for it and it is quite immaterial whether it moves from the promisee or any other person. The leading authority in the decision of the *Chinnaya Vs. Ramayya (1882) 4 Mad 137*., held that the consideration can legitimately move from a third party and it is an accepted principle of law in India.

In the given problem, Mr. Arvind has entered into a contract with Ms. Asha, but Mr. Aakash has not given any consideration to Ms. Asha but the consideration did flow from Mr. Arvind to Ms. Asha and such consideration from third party is sufficient to the enforce the promise of Ms. Asha, the daughter, to pay an annuity to Mr. Aakash. Further the deed of gift and the promise made by Ms. Asha to Mr. Aakash to pay the annuity were executed simultaneously and therefore they should be regarded as one transaction and there was sufficient consideration for it.

Thus, a stranger to the contract cannot enforce the contract but a stranger to the consideration may enforce it.

(b) **Corporate Veil:** After incorporation, the company in the eyes of law becomes a different person 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 they hold the entire share capital of the company. This recognition of the company as a separate legal entity and being liable for its own acts and liabilities is known as the "Corporate Veil". However, under certain exceptional circumstances the courts lift or pierce the corporate veil by ignoring the separate entity of the company and the promoters and other persons who have managed and controlled the affairs of the company. Thus, when the corporate veil is lifted by the courts, the promoters and persons exercising control over the affairs of the company are held personally liable for the acts and 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.

(c) Corporate Governance: Simply stated, 'Governance' means the process of decision making and the process by which decisions are implemented. The term corporate governance' is understood and defined in various ways. Corporate governance can be defined as the formal system of accountability and control for ethical and socially responsible organisational decisions and use of resources and accountability relates to how well the content of workplace decisions is aligned with the organisations strategic direction. Control involves the process of auditing and improving organisation decisions and actions. Good corporate governance has the following major characteristics:

(i) Participatory

(ii) Consensus oriented

(iii) Accountable

(iv) Transparent

(v) Responsive

(vi) Effective and efficient

(vii) Equitable and inclusive and

(viii) Follows the rule of law.

(d) Grapevine Chains: Specialists in this field have identified four types of grapevine chains in an informal communication:-

(1) **Single Strand Chain:** In this type of chain, ‘A’ tells something to ‘B’ who tells it to ‘C’ and so on. This type of chain is least accurate in passing on the information or message.

(2) **Gossip Chain:** In it, a person seeks out and tells everyone the information he has obtained. This chain is often used when information or a message regarding a 'not-on-job' nature is being conveyed.

(3) **Probability Chain:** In it, individuals are indifferent to the persons, to whom they are passing some information. This chain is found when the information is somewhat interesting but not really significant.

(4) **Cluster Chain:** In this type of chain, 'A' tells something to a few selected individuals and then some of these individuals inform a few other selected individuals. In fact, cluster chain is the dominant grapevine pattern in an organisation. Only few persons are 'liaison individuals' who pass on the information they have obtained and then they are likely to share it with the people they trust. Most informal communication flows through this chain.

2. (a) (i) (1) Incorrect. According to Section 31A of the Payment of Bonus Act, 1965 any such agreement 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 to receiving minimum bonus.

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

(ii) Computation of Gratuity of a disabled employee: According to Section 4 (4) of the Payment of Gratuity Act, 1972, when an employee becomes disabled due to any accident or disease and is not in a position to do the same work and re-employed on reduced wages on some other job, the gratuity will be calculated in two parts :-

- For the period preceding the disablement: on the basis of wages last drawn by the employee at the time of his disablement.
- For the period subsequent to the disablement: On the basis of the reduced wages as drawn by him at the time of the termination of services.

In the case of *Bharat Commerce and Industries Vs. Ram Prasad*, it was decided that if for the purposes of computation of quantum of the amount of gratuity the terms of agreement or settlement are better than the Act, the employee is entitled for that benefit.

However, the maximum statutory ceiling limit as providing under Sub-Section 3 of Section 4 of the Act, which is Rs. 10 Lakhs, cannot be reduced by mutual settlement or agreement.

(b) Pragmatic reasons for maintaining ethical behaviour: Marketing executives should practice ethical bahaviour because it is morally correct. To maintain ethical behaviour in marketing, the following positive reasons may be useful to the marketing executives:

1. **To reverse declining public confidence in marketing:** Sometime misleading package labels, false claim in advertisement, phony list prices, infringement of trademarks pervert the market trends and such behaviour damages the marketers' reputation. To reverse this situation, business leaders must demonstrate convincingly that they are aware of their ethical responsibility and will fulfill it. Companies must set high ethical standards and enforce them. Moreover, it is in management's interest to be concerned with the well being of consumers, since they are the lifeblood of a business.
2. **To avoid increase in government regulation:** Business apathy, resistance, or token responses to unethical behaviour increase the probability of more governmental regulation. The governmental limitations may also result from management's failure to live up to its ethical responsibilities. Moreover, once the government control is introduced, it is rarely removed.
3. **To retain power granted by society:** Marketing executives wield a great deal of social power as they influence markets and speak out on economic issues. However, there is a responsibility tied to that power. If marketers do not use their power in a socially acceptable manner, that power will be lost in the long run.
4. **To protect the image of the organisation:** Buyers often form an impression of an entire organisation based on their contact with one person. That person represents the marketing function. Some times a single sales clerk may pervert the market opinion in relation to that company which he represents.

Therefore, the ethical behaviour in marketing may be strengthened only through the behaviour of the marketing executives.

(c) Negotiation: Negotiation occurs when two or more parties either individuals or groups discuss specific proposals in order to find a mutually acceptable agreement. Whether it is with an employer, family member or business associate, we all negotiate for things each day like higher salary, letter service or solving a dispute with a co worker or family member Negotiation is a common way of settling conflicts in business. When handled skillfully, negotiation can improve the position of one or even both but when poorly handled; it can leave a problem still unsolved and perhaps worse than before.

Techniques for Negotiation:

(i) Spiraling agreements: Begin by reaching a minimums agreement even though it is not related to the objectives and build, hit by hit, on this first agreement.

(ii) Changing of position: Formulate the proposals in a different way, without changing the final result.

(iii) Gathering information: Ask for information from the other party to clarify their position

(iv) Making the cake bigger: Offer alternatives that may be agreeable to the other party, without changing the terms.

(v) Commitments: Formalize agreements orally and in writing before ending the negotiation.

3. (a) (i) Meaning of 'Holder' and the 'Holder in due course' of a negotiable instrument: 'Holder': "Holder" of a negotiable instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto.

'Holder in due course': (i) In the case of an instrument payable to bearer means any person who, for consideration became its possessor before the amount of an instrument payable. (ii) In the case of an instrument payable to order, 'holder in due course' means any person who became the payee or endorsee of the instrument before the amount mentioned in it became payable. (iii) He had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor from whom he derived his title.

The problem is based upon the privileges of a 'holder in due course'. Section 42 of the Negotiable Instrument Act, 1881, states that 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 endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer. In this problem, P is not a fictitious payee and D, the drawer can recover the amount of the cheque from A's bankers *[North and South Wales Bank B. Macketh (1908) A.C. 137; Town and Country Advance Co. B, Provincial Bank (1917) 2 Ir. R.421].*

(ii) Claim of Interest: Section 24 of the Negotiable Instruments Act, 1881 states that where a bill or note is payable after date or after sight or after happening of a specified event, the time of payment is determined by excluding the day from which the time begins to run.

Therefore, in the given case, Bharat will succeed in objecting to Bhushan's claim. Bharat paid rightly "three days after sight". Since the bill was presented on 1st January, Bharat was required to pay only on the 4th and not on 3rd January, as contended by Bharat.

(b) **Managing ethics and preventing whistle-blowing:** The focus on core values and sound ethics, the hall mark of ethical management, is being recognized as an important way to ensure the long term effectiveness of governance structures and procedures and to avoid the need for whistle blowing.

Employers, who understand the importance of work place ethics, provide their work force with an effective framework and guiding principles of identity and address ethical issues as they arise. These guidelines for managing ethics and to avoid the need for whistle-blowing in the work place may be summarized as follows:-

(i) Have a Code of Conduct and ethics.

(ii) Establishment open communication.

(iii) Make ethical decisions in group and make decision public whenever appropriate.

(iv) Integrate ethics with other management practices.

(v) Use of cross functional teams when developing and implementing the ethics management programme.

(vi) Appointing an ombudsman.

(vii) Creating an atmosphere of trust.

(viii) Regularly updating of policies and procedures

(ix) Include a grievance policy for employees

(x) Set an example from the top.

(c) **Tips for improving interpersonal skills:** Lines of communication must be open between people who rely on one another to get work done. Poor interpersonal communication skills, which include active listening, result in low productivity simply because one does not have the tools needed to influence, persuade and negotiate which are necessary for workplace success. To get this success the following tips are suggested:

(i) Congruency in communication elements: If the words used are incongruent with the other interpersonal communication dynamics interpersonal communication is adversely affected. Since communication is shared meaning, words must send the same message as the other interpersonal communication dynamics – body language, facial expression, posture, movement, tone of voice to help emphasize the truth, sincerity and reliability of the communication. A consistent message ensures effective communication.

(ii) Listening effectively: Effective or active listening is very important skill to enhance interpersonal communication. Listening helps to build strong personal relationships. The process of communication completes when the message as intended by the sender is understood by the receiver. Most of the persons assume that listening is natural trait, but practically very few of us listen properly. One needs to give the communicator of the message sufficient attention and make an effort to understand his view point.

4. (a) **Procedure for shifting the registered office from one state to another state (Section 13, of the Companies Act, 2013):** In order to shift the registered office from one State to another the following procedure will have to be followed:

(i) Hold a Board Meeting for the purpose of calling a general meeting of the members of the company in which the shifting of the registered office from one state to another will have to be approved;

(ii) The general meeting of the members will have to pass a special resolution approving the change of address of the registered office from one state to another as required by section 13 (1) of the Companies Act 2013.

(iii) Make an application to the Central Government in such form and manner as may be prescribed, for getting its approval under section 13 (4) of the Companies Act 2013.

(iv) Under section 13 (7) of the Companies Act 2013, where an alteration of the Memorandum results in the shifting of the registered office of the company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the registrar of each of the states, within such time and in such manner as may be prescribed, and the registrars shall register the same. The registrar of the state where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.

(v) The change in name will be effective only after the issue of the fresh certificate of incorporation by the Registrar of the State where the registered office is being shifted to.

(b) Self Interest Threats:

(i) Self interest threats for finance and accounting professionals working as consultants or auditors are given below:

(a) A financial interest in a client or jointly holding a financial interest with a client.

(b) Undue dependence on total fees from a client,

(c) Having a close business relationship with a client.

(d) Concern about the possibility of losing a client,

(e) Potential employment with a client.

(f) Contingent fees relating to an assurance engagement.

(ii) Self interest threats for finance and accounting professionals working as an employee are given below:

(a) Financial interests, loans and guarantees in the company in which the professional is working.

(b) Incentive compensation arrangements.

(c) Inappropriate personal use of corporate assets.

(d) Concern over employment security.

(e) Commercial pressure from outside the employing organization.

(c) Guidelines to handle communication ethics dilemmas:

(i) *Maintain candour*: Candour refers to truthfulness, honesty, frankness and one should stick to these elements while communicating with others.

(ii) *Keep message accurate*: At the time of relaying information from one source to another, communicate the original message as accurately as possible.

(iii) *Secrecy*: One has to maintain secrecy and confidence in communication. So one should not divulge such information to others

(iv) *Ensure timeliness of communication*: The timing of messages can be critical. Delay in sending messages can be assumed unethical.

(v) *Avoid deception*: Ethical communicators are always vigilant in their quest to avoid deception, fabrication, intentional distortion or withholding of information in their communication.

(vi) *Confront unethical behaviour*: One must confront an unethical behaviour in order to ensure a consistent ethical view point.

5. (a) Meaning of Undue Influence: Section 16 of the Indian Contract Act, 1872, states that a contract is said to be induced by undue influence where the relations subsisting between the parties are such that the parties are in a position to dominate the will of the other and used that position to obtain an unfair advantage over the other.

A person is deemed to be in that position:

(a) where he holds real or apparent authority over the other or stands in a fiduciary relation to him;

(b) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of old age, illness or mental or bodily distress.

(c) where a man who is in position to dominate the will of the other enters into contract with him and the transaction appears to be unconscionable, the burden of proving that it is fair, is on him, who is in such a position.

When one of the parties who has obtained the benefits of a transaction is in a position to dominate the will of the other, and the transaction between the parties appears to be unconscionable, the law raises a presumption of undue influence [section 16(3)]. Every transaction where the terms are to the disadvantage of one of the parties need not necessarily be considered to be unconscionable. If the contract is to the advantage of one of the parties but the same has been made in the ordinary course of business the presumption of under influence would not be raised.

In the given problem, Mr. Raj applies to the banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. Mr. Raj accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence. As between parties on an equal footing, the court will not hold a bargain to be unconscionable merely on the ground of high interest. Only where the lender is in a position to dominate the will of the borrower, the relief is granted on the ground of undue influence. But this is not the situation in this problem, and therefore, there is no undue influence

(b) Under section 47 (2) of the Companies Act, 2013, every member of a company limited by shares who is holding preference shares shall be entitled to vote on only those resolutions placed before the company which affect directly the rights attached to preference shares held by him. Further, in case of any resolution by a poll on the winding up of the company or for the repayment or reduction of equity or preference share capital, his voting right shall be proportionate to his share in the paid up preference share capital of the company.

Provided that where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

The above provision lays down the rights of preference share holders who have not been paid dividend for a continuous period of 2 years and this does not change whether the shares are cumulative or non cumulative.

(c) Notice: Meeting of Board of Directors:

Notice

Notice is hereby given that meeting of the Board of Directors of the NM Ltd. will be held at the registered office on…….at……a.m./p.m. to transact the following:

Agenda

1. Confirmation of the minutes of the previous Board Meeting held on……….to………
2. Discussion of the progress in business.
3. Co-option of Ms. Rajni as an Additional Director of the company.
4. Buy back of 10% of the equity shares of the company.
5. Any other matter with the permission of the chair.

Place:……………………. By Order of the Board of Directors

Date:……………………... Company Secretary of NM Ltd.

6. (a) (I) (i) Incorrect: A company in the eyes of law is regarded as an entity separate and distinct from its members. Any of its members can enter into contracts with the company in the same manner as with any other individual. Further, a shareholder or member of a company cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The company's money and property belong to the company, and not to the shareholders. *(Salomon v. Salomon & Co. Ltd.)*.

(ii) Incorrect: According to section 8 (1) of the Companies Act 2013, the Central Government may allow person or an association of persons to be registered as a Company under the Companies Act if it has been set up for promoting commerce, arts, science, sports, education, research, social welfare religion, charity protection of environment or any such other useful object and intends to apply its profits or other income in promotion of its objects. However, such company has to prohibit payment of any dividend to its members.

(II) A proxy is a person appointed by a member of a company, to attend a meeting of the company and vote thereat on his behalf.

The various provisions relating to the appointment of a proxy under the Companies Act, 2013 are as under:

1. Under section 105 (1) any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.
2. A proxy shall not have the right to speak at such meeting and shall not be entitled to vote except on a poll. This means that a proxy cannot vote on a resolution by a show of hands.
3. The Central Government may prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy

4. Under section 105 (6) the instrument appointing a proxy shall be in writing; and be signed by the appointer or his attorney duly authorised in writing or, if the appointer is a body corporate, be under its seal or be signed by an officer or an attorney duly authorised by it.
5. Under section 105 (7) an instrument appointing a proxy, if in the form as may be prescribed, shall not be questioned on the ground that it fails to comply with any special requirements specified for such instrument by the articles of a company.

(b) Note on Ecological Ethics: The problem of pollution and other environmental issues can best be framed in terms of our duty to recognize and preserve the ecological systems within which we live. An ecological system is an interrelated and interdependent set of organisms and environments, such as a lake, in which the fish depend on small aquatic organisms, which in turn live off decaying plant and fish waste products. Since the various parts of an ecological system are interrelated, the activities of one of its parts will affect all other parts. Business and all social firms are parts of a larger ecological system.

Business firms depend on the natural environment for their energy, material resources, waste disposal and that environment in turn is affected by the commercial activities of business firms. Unless business recognize the interrelationship and interdependencies of the ecological systems within which they operate and unless they ensure that their activities will not seriously injure these systems one cannot hope to deal with the problem of pollution.

Ecological ethics is based on the idea that the environment should be protected not only for the sake of human being but also for its own sake. The issue of environmental ethics goes beyond the problem relating to protection of environment or nature in terms of pollution, resource utilization or waste disposal. It is the issue of exploitive human nature and attitudes that should be addressed in a rational way. Problems like global warming, ozone depletion and disposal of hazardous waste concern the entire world. They require international co-operation and have to be tackled at the global level.

(c) Power of Attorney to appear before Income Tax Authorities:

I/we……………,residing at…………..hereby authorize………..,to represent me/my firm/my family in connection with…………….for the year………….His statement and explanation will be binding on me/us.

Place:

Date: Signature

I,………………hereby declare that I am duly qualified to represent the above-mentioned person.

Place:

Date:

Address of Power of attorney holder Signature of Power of attorney holder

7. **(a)** Under section 7L(1) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, the Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or annulling the orders appealed against or may refer the case back to the authority which passed such order with such directions as the Tribunal may think fit, for a fresh adjudication or order as the case may be, after taking additional evidence, if necessary.

Under sub section (2) a Tribunal may at any time within five years from the date of its order, with a view to rectifying any mistake apparent from the record amend any order passed by it under sub-section (1) and shall make such amendment in the order if the mistake is brought to the notice by the parties to the appeal.

However, an amendment which has the effect of enhancing the amount due from, or otherwise increasing the liability of, the employer shall not be made unless the Tribunal has given notice to him of its intention to do so and has allowed him reasonable opportunity of being heard.

Further, under sub section (3) a Tribunal shall send a copy of every order passed under this section to the parties to the appeal.

Section 7L (4) further provides that any order made by a Tribunal finally disposing of an appeal shall not be questioned in any court of law. In short, the order of the Tribunal shall be final and binding on all parties concerned.

(b) **Acts for which special resolutions are required:** Some matters may be so important and outside the ordinary course of the company's business, such as any important constitutional changes, that safeguards should be imposed to ensure that a larger majority than a simple majority of the members approve of them before they are given effect to. The Act requires that the following matters, *inter alia*, have to be resolved by the company, by a special resolution:

(1) To alter any provision contained in the memorandum, [Section 13(1)];

(2) To alter the articles of association [Section 14 (1)];

(3) Variation in the terms of contract or objects in the prospectus [section 27 (1)];

(4) Issue of Sweat Equity [Section 54 (1) (a)]

(5) To purchase its own shares or specified securities [Section 68 (2)];

(6) To issue debentures with an option of conversion into shares [Section 71 (1)].

(c) Under section 105 (8) of the Comapnies Act, 2013 every member entitled to vote at a meeting of the company or on any resolution to be moved thereat, shall be entitled during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged, at anytime during the business hours of the company. Provided not less than 3 days' notice in writing of the intention to inspect is given to the company.

In the given case, Mr. Jai who is a member approaches the company on 28th December, 2014 and demands inspection of proxies lodged with the company. Based on the above provisions since prior notice of 3 days had not been given by Mr. Jai to the company for inspecting the proxies, the company may refuse inspection of proxy forms.

(d) **Ethical behaviour in Marketing; Merits and Demerits:** Market is flooded with duplicate goods having fake labels for selling drugs, food stuffs, consumables like agarbathis, suparis etc. followed by misleading advertisements. This results in disrepute for the products of good companies even though such fake goods are small in quantities. Setting high ethical standard and enforcing them reverses the position. If government notices such depletion of ethical standard, rigid regulations are brought in and are never withdrawn. Marketing executives enjoy great amount of social power in influencing the society. They also are the emblems for the organization. Once the virtues are lost it is difficult to regain the social power, influence and image.

(e) The communicator should follow the following –

(a) Consider the objective.

(b) Think about the interest level of the receiver.

(c) Be sincere.

(d) Use simple language, familiar words.

(e) Be brief and precise.

(f) Avoid vagueness and generalities.

(g) Give full facts.

(h) Assume nothing.

(i) Use polite words and tone.

(j) Cut out insulting message.

(k) Say something interesting and pleasing to the recipient.

(l) Allow time to respond.

Test Series: March, 2015

MOCK TEST PAPER - 2

INTERMEDIATE (IPC) : GROUP – I

PAPER – 1: ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) (i) **Valuation of stock as on 31.3.2014 when general selling price is Rs. 49 each.**

Value 3,000 units at Rs. 45 each (lower of cost and net realizable value). Value of remaining stock 2,000 units at Rs. 49 each (lower of cost and net realizable value).

Units	*Cost*	*NRV*	*Lower of cost and NRV*	*Valuation*
1	*2*	*3*	*4*	*5 = 1x4*
3000	50	45	45	1,35,000
2000	50	49	49	98,000
				2,33,000

Valuation of stock should be Rs. 2,33,000.

(ii) **Valuation of stock as on 31.3.2014 when general selling price is Rs. 52 each**

Units	*Cost*	*NRV*	*Lower of cost and NRV*	*Valuation*
1	*2*	*3*	*4*	*5 = 1x4*
3000	50	45	45	1,35,000
2000	50	52	50	1,00,000
				2,35,000

Valuation of stock should be Rs. 2,35,000.

(b) Lucky Ltd. had sold goods to Victory Ltd on credit worth for Rs. 250 crores and the sale was completed in all respects. Victory Ltd's decision to sell the same in the domestic market at a discount does not affect the amount recorded as sales by Lucky Ltd. The price discount of 15% offered by Lucky Ltd. after request of Victory Ltd. was not in the nature of a discount given during the ordinary course of trade because otherwise the same would have been given at the time of sale itself. It is the special discount which is being allowed at the request of the buyer. Therefore, it would be appropriate to make a separate provision rather than to adjust the amount of revenue originally recorded. Therefore, such discount should be written off to the profit and loss account and not shown as deduction from the sales figure.

(c) As per provisions of AS 10 'Accounting for Fixed Assets', expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalized as an indirect element of the construction cost. However, the expenditure incurred after the plant has begun commercial production *i.e.,* production intended for sale or captive consumption, is not capitalized and is treated as revenue expenditure even though the contract may stipulate that the plant will not be finally taken over until after the satisfactory completion of the guarantee period. In the present case, the company did not stop production even when the output was not of the desired quality, and continued the sub-standard production due to huge investment involved in the project. Capitalization should cease at the end of the trial run, since the cut-off date would be the date when the trial run was completed.

(d) As per AS 1 "Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

(i) In view of the heavy capital intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change, depreciation has been provided at Rs. 27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by Rs. 18 crores. To that extent, the profit for the year is increased.

(ii) The company has decided to provide Rs. 10 crores for the permanent fall in the value of investments which has taken place over the period of past five years. The provision so made has reduced the profit disclosed in the accounts by Rs. 10 crores.

2 (a). **In the books of Meera**

Investment Account (Shares in Kumar Limited)

Date		Particulars	No. of Shares	Income	Amount	Date		Particulars	No. of Shares	Income	Amount
2013				Rs.	Rs.	2013				Rs.	Rs.
April 1	To	Bank (Purchases)	40,000	-	60,000	May 15	By	Bank (Sale)	8,000	-	15,200
May 15	To	Profit & Loss A/c (W.N.1)	-	-	3,200	Sept. 30	By	Bank (Sale of Right of 2,400 shares @ 40 paise per share)	-	-	960
June 15	To	Bonus Issue	8,000	-	Nil	2014					
July 15	To	Bank (@ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar. 15	By	Bank (Dividend @ 15% on Rs. 32,000)		4,800	-
Sept. 15	To	Bank (@ 75 p. paid on 4,000 shares)	-	-	3,000	Mar. 30	By	Bank (Sale)	20,000	-	28,000
2014 March 31	To	Profit & Loss A/c (W.N.2)			3,890	Mar. 31	By	Balance c/d $\left(\frac{24,000}{44,000} \times 53,040\right)$	24,000	-	28,930
	To	Profit & Loss A/c	-	4,800							
			52,000	4,800	73,090				52,000	4,800	73,090

Working Notes:

(1)	**Profit on Sale on 15-5-2013:**		
	Cost of 8,000 shares @ Rs.1.50	Rs. 12,000	
	Less: Sales price	Rs. 15,200	
	Profit		Rs. 3,200
(2)	**Cost of 20,000 shares sold:**		
	Cost of 44,000 shares (48,000 + 6,000)	Rs. 54,000	
	Less: Amount received from rights	Rs. 960	
	Cost of 44,000 shares		Rs. 53,040
	$\therefore$ Cost of 20,000 shares $\left(\frac{\text{Rs. } 53,040}{44,000 \text{ shares}} \times 20,000 \text{ shares}\right)$		Rs. 24,110
	Profit on sale of 20,000 shares (Rs. 28,000 – Rs. 24,110)		Rs. 3,890

(b) Ascertainment of rate of gross profit for the year 2012-13

Trading A/c for the year ended 31-3-2013

	Rs.		Rs.
To Opening stock	4,81,100	By Sales	26,00,000
To Purchased	22,62,500	By Closing stock	6,63,600
To Gross profit	5,20,000		
	32,63,600		32,63,600

Rate of gross profit = $\frac{\text{GP}}{\text{Sales}} \times 100$

$$= \frac{5,20,000}{26,00,000} \times 100 = 20\%$$

Memorandum Trading A/c for the period from 1-4-2013 to 22-01-2014

	Rs.	Rs.		Rs.	Rs.
To Opening stock		6,63,600	By Sales	24,58,500	
To Purchases	17,41,350		*Add*: Unrecorded cash sales (W.N.)	20,000	24,78,500
Less: Goods used for advertisement	(50,000)	16,91,350	By Closing stock		3,72,150
To Gross profit (20% of Rs. 24,78,500)		4,95,700			
		28,50,650			28,50,650

Estimated stock in hand on the date of fire was Rs. 3,72,150.

3. (a) Cash Flow Statement of Leela Ltd.

Cash flow from Operating Activities	**Rs.**	**Rs.**
Net profit before Taxation (given)		2,29,500
Adjustments for		
Depreciation (W.N.2)	83,700	
Debenture Interest (1,50,000 x 8% x 6/12)	6,000	
Provision for Doubtful Debts	9,900	
Profit/Gain on Sale of Plant(WN. 1)	(7,500)	92,100
Operating Profit before Working Capital Changes		3,21,600
Adjustments for		
Increase in Inventory	(1,15,500)	
Increase in Trade receivables	(1,50,000)	
Increase in Trade payables	35,400	(2,30,100)
Net Cash Flow from/(Used in) Operating Activities [A]		91,500
Cash flow from Investing Activities		
Purchase of Plant & Machinery (WN 3)	(2,34,000)	
Purchase of Trade Investments	(1,41,000)	
Sale of Machinery	21,000	
Net Cash Flow from/(used In) Investing Activities [B]		(3,54,000)
Cash flow from Financing Activities		
Proceeds from issue of 8% Debentures (1,50,000-3,000)	1,47,000	
Interest paid on 8% Debentures	(6,000)	
Dividends paid in respect of earlier year	(90,000)	
Net Cash Flow from/(used in) Financing Activities[C]		51,000
Net Increase/(Decrease) in Cash and Cash Equivalents (A+B+C)		(2,11,500)

Working Notes:

1. Profit on Sale of Plant = Net Book Value (i.e, Gross Block less Accumulated Depreciation) Less Sale Value

   = (54,000-40,500) less 21,000

   = Rs. 7,500 Gain/Profit

2. Depreciation for current year = Increase in Depreciation as given above + Accumulated Depreciation on Plant Sold

= 43,200 + 40,500 = Rs. 83,700

3. Cash Outflow towards assets purchase = Increase in Plant and Machinery at Cost + Gross Block of Plant sold

= 1,80,000 + 54,000 = Rs. 2,34,000.

(b) (a) Sales of first 6 months = Rs. 4,80,000. Average sale of first 6 months = Rs.4,80,000/6 = Rs.80,000 per month. Pre-incorporation period consist of 3 months (i.e., April, May and June). The sales of those 3 months = Rs. 80,000 x 3 = Rs. 2,40,000. Sales of remaining 9 months = Rs. 24,00,000 – Rs. 2,40,000 = Rs. 21,60,000.

Therefore, the ratio of sales = Rs. 2,40,000 : Rs. 21,60,000 or 1: 9.

(b) Let the average of monthly sales = X. The sales of different months can be shown as follows:

Month	Jan	Feb	Mar.	April	May	June	July	Aug	Sept	Oct	Nov	Dec
Sales	1x	0.5x	1x	0.5x	1x	1x	1x	1x	1x	1x	1.5x	1.5x

Date of incorporation is May, 2013

Pre incorporation period is from January to April i.e. 3 x

Post - incorporation period is from May to December i.e 9x

The ratio of Sales = 3x : 9x or 1:3.

4. **Journal entries in the books of Casio Ltd.**

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Equity Share Final Call A/c To Equity Share Capital A/c (Final Call made for the balance on equity share)	Dr.	4,00,000	 4,00,000
Bank A/c To Equity Share Final Call A/c (Receipt of Final Call money)	Dr.	4,00,000	 4,00,000
Equity Share Capital (Rs.100) A/c To Equity Shares (Rs. 20) A/c To Reconstruction A/c (Reduction of Rs.100 share capital to Rs. 20 each)	Dr.	10,00,000	 2,00,000 8,00,000
10% First Debentures A/c To Debentureholders' A/c (Redemption due for First Debentures)	Dr.	2,00,000	 2,00,000

Debentureholders' A/c To 13.5% Debentures A/c (Redemption of First Debentures)	Dr.	2,00,000	 2,00,000
12% Second Debentures A/c To Debentureholders' A/c (Transfer of second debentures account to debenturesholders account)	Dr.	5,00,000	 5,00,000
Debentureholders' A/c To 15% Debentures A/c To Reconstruction A/c (Settlement of second debentureholders' claims)	Dr.	5,00,000	 4,00,000 1,00,000
Trade payables A/c To Bank A/c To Equity Share Capital A/c To Reconstruction A/c (Settlement of trade payables account)	Dr.	11,50,000	 3,00,000 3,00,000 5,50,000
Debenture Interest (Outstanding) A/c To Reconstruction A/c (Writing off the interest on debentures on settlement of account of debentureholders)	Dr.	80,000	 80,000
Reconstruction A/c To Profit and Loss A/c To Fixed Assets A/c (balance in Reconstruction A/c) (Utilisation of reconstruction account for writing of past losses and value of fixed assets)	Dr.	15,30,000	 10,20,000 5,10,000

Balance Sheet of Casio Ltd. as at 31 March, 2014 (And Reduced)

		Note No.	Rs.
I	**Equity and liabilities**		
	(1) **Shareholders' funds**:		
	(a) Share Capital	1	5,00,000
	(1) **Non-current liabilities**:		
	(a) Long term borrowings		
	13.5% Debentures		2,00,000
	15% Debentures		4,00,000
			11,00,000
II	**Assets**		
	(1) **Non-current Assets**		

	(a) Fixed assets:	2	1,90,000
	(b) Non-current investments		10,000
	(2) **Current assets**		
	(a) Inventories		3,90,000
	(b) Trade receivables		4,60,000
	(c) Cash & cash equivalent		50,000
	[(50,000) + 4,00,000 – 3,00,000]		
			11,00,000

Notes to Accounts

1	**Share capital:**		
	25,000Equity Share Capital (shares of Rs. 20 each)		5,00,000
	(out of which 15,000 equity shares of Rs. 20 each issued to trade payables)		
2	**Fixed assets:**		
	Fixed Assets	7,00,000	
	Less: Amount written off under Reconstruction Scheme	(5,10,000)	1,90,000

5. (a) Revaluation Account

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

(b) Partners' Capital Accounts

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

(c) Cash and Bank Account

To Balance b/d	14,000	By A's Capital A/c - 50% dues paid	26,000
To Revaluation A/c – surrender value of joint life policy	15,100	By Balance b/d	41,100
To B's Capital A/c	6,000		
To C's Capital A/c	32,000		
	67,100		67,100

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

Liabilities		*Rs.*	*Assets*		*Rs.*
Partners' Capital accounts			Land and Building	60,000	
Mr. B	70,000		*Add*: Appreciation 20%	12,000	72,000
Mr. C	70,000	1,40,000			
Mr. A's Loan Account		26,000	Plant & Machinery	40,000	
Sundry Creditors		16,000	*Less*: Depreciation 30%	12,000	28,000

			Inventory of goods	24,000	
			Less: devalued	4,000	20,000
			Sundry Debtors	22,000	
			Less: Provision for bad debts 5%	1,100	20,900
			Cash & Bank balances		41,100
		1,82,000			1,82,000

Working Notes:

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

Therefore, B will bear = 1/4 × 8,000 or Rs. 2,000

C will bear = 3/4 × 8,000 or Rs. 6,000

6. (a) Tiger Club

Receipts and Payments Account

for the year ended 31st March, 2014

Receipts	*Rs.*	*Payments*	*Rs.*
To Opening balance:		By Premises	60,000
Cash on hand	900	By Rent	4,800
Bank balance	48,840	By Rates and taxes	7,560
To Subscriptions	1,24,260	By Printing and stationary	2,820
To Fair receipts	14,400	By Sundry expenses	10,700
To Variety show receipts (net)	25,620	By Wages	5,040
To Interest	1,380	By Fair expenses	14,340
To Bar collections	44,700	By Honorarium to secretary	22,000
To Sale proceeds of old car	18,000	By Bar purchases (payments)	34,620
		By Repairs	1,920
		By New Car	93,600

		By Closing balance	
		Cash in hand	Nil
		Bank balance	20,700
	2,78,100		2,78,100

Income and Expenditure Account

for the year ended 31st March, 2014

Expenditure	*Rs.*	*Rs.*	*Income*	*Rs.*	*Rs.*
To Rent		4,800	By Subscriptions	1,24,260	
To Rates and taxes		7,560	*Add:* Due as on 31.3.14	5,880	
To Printing and stationary		2,820		1,30,140	
To Wages		5,040	*Less*: Due as on 31.3.13	(7,200)	1,22,940
To Honorarium to secretary		24,000	By Surplus from fair:		
To Sundry expenses		10,700	Fair receipts	14,400	
To Repairs		1,920	*Less:* Fair expenses	14,340	60
To Depreciation on			By Surplus from variety show		25,620
Premises @ 5% *	6,060				
Car @20% of 93,600	18,720	24,780	By Interest		1,380
			By Profit from bar (W.N.2)		12,000
To Excess of income over expenditure		86,980	By Profit from sale of car (W.N. 3)		6,600
		1,68,600			1,68,600

Working Notes:

1. Calculation of bar purchases

Bar Creditors Account

Dr.			*Cr.*
	Rs.		*Rs.*
To Bank A/c	34,620	By Balance b/d	3,540
To Balance c/d	2,580	By Bar purchases	33,660
	37,200		37,200

* [(1,74,000-1,12,800) x 0.05 + 60,000 x 0.05]

2. Profit from bar

	Rs.	Rs.
Bar collections		44,700
Less: Bar inventory consumed-		
Opening inventory	4,260	
Add: Purchases	33,660	
	37,920	
Less: Closing inventory	5,220	32,700
		12,000

3. Profit on sale of car

	Rs.
Sale proceeds of old car	18,000
Less: W.D.V. of old car (Rs. 73,140-Rs. 61,740)	11,400
	6,600

(b) Total Debtors Account

2014	*Particulars*	*Rs.*	*2014*	*Particulars*	*Rs.*
April 1	To Balance b/d	20,000	April 1	By Balance b/d	300
April 30	To Sales (Credit)	19,000	April 30	By Cash	14,100
	To Total creditors (endorsed B/R dishonoured)	300		By Discount	900
				By Bills receivable	3,000
	To B/R (Dishonoured)	400		By Total creditors (Transfer)	600
	To Interest	30		By Balance c/d	21,280
	To Balance c/d	450			
		40,180			40,180

Notes:

1. B/R discounted and Cash sales will not be shown in the Total Debtors
2. Endorsed B/R dishonoured and transfers will be shown in the Total Debtors.

7. (a) As per para 15 of Accounting Standard 6, 'Depreciation Accounting', when the method of depreciation is changed, depreciation is recalculated in accordance with the new method from the date of the assets coming into use. The deficiency or surplus arising from retrospective re-computation of depreciation in accordance with the new method is adjusted in the statement of profit & loss in the year in which the method of depreciation is changed.

Calculation of Surplus/Deficiency due to change in method of depreciation

	Rs.
Purchase price of plant as on 01-04-2012	2,00,000
Less: Depreciation as per SLM, for the year 2012-13 (Rs. 2,00,000 ÷ 7 years)	28,571
Balance as on 31-3-2013	1,71,429
Less: Depreciation for the year 2013-14 (Rs. 2,00,000 ÷ 7 years)	28,571
Balance as on 31-3-2014	1,42,858
Book value as per WDV method	1,44,500
Book value as per SLM	1,42,858
Deficiency	1,642

Deficiency of Rs. 1,642 should be charged to Profit & Loss account.

Therefore, the accounting treatment done by the enterprises is wrong i.e. book value of Rs. 1,44,500 will not be written off over the remaining useful life of machinery i.e. 5 years.

Note: It is assumed that when the company changed method of depreciation from WDV to SLM, it re-calculated the depreciation amount on the basis of useful l

(b) There are many accounting softwares available in the market. To choose the accounting software appropriate to the need of the organization is a difficult task, some of the criteria for selection could be the following:

1. *Fulfillment of business requirements:* Some packages have few functionalities more than the others. The purchaser may try to match his requirement with the available solutions.
2. *Completeness of reports:* Some packages might provide extra reports or the reports match the requirements more than the others.
3. *Ease of Use:* Some packages could be very detailed and cumbersome compare to the others.
4. *Cost:* The budgetary constraints could be an important deciding factor. A package having more features cannot be opted because of the prohibitive costs.
5. *Reputation of vendor:* Vendor support is essential for any software. A stable vendor with good reputation and track records will always be preferred.
6. *Regular updates:* Law is changing frequently. A vendor who is prepared to give updates will be preferred to a vendor unwilling to give updates.

(c) X limited invested Rs. 600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. Rs. 300 lakhs and remaining as temporary (current) investment i.e. Rs. 300 lakhs. Irrespective of the fact that investment has been held by X Limited only for 3 months (from 1.1.2014 to 31.3.2014), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2014 became Rs. 200 lakhs i.e. Rs. 100 lakhs in respect of current investment and Rs. 100 lakhs in respect of long term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value. Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at Rs. 100 lakhs. The reduction of Rs. 200 lakhs in the carrying value of current investment will be included in the profit and loss account.

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by Rs. 200 lakhs and shown the investments at Rs. 100 lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of Rs. 200 lakhs in the carrying value of long term investment will be included in the profit and loss account.

(d) Note 6 (B) given under Part I of Schedule III provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative. In this case, the debit balance of profit and loss i.e. Rs. 250 lakhs exceeds the total of all the reserves i.e. Rs. 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by Rs. 20 lakhs, which should be disclosed on the face of the balance sheet.

(e) As per Schedule III, a liability shall be classified as current when it satisfies any of the following criteria:

(i) it is expected to be settled in the company's normal operating cycle;

(ii) it is held primarily for the purpose of being traded;

(iii) it is due to be settled within twelve months after the reporting date; or

(iv) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

In the given case, instalments due on 30.09.2015 and 31.03.2016 will be shown under the head 'other current liabilities' as per criteria (c).

Therefore, in the balance sheet as on 31.3.2015, Rs. 8,00,000 (Rs. 1,00,000 x 8 instalments) will be shown under the heading 'Long term Borrowings' and Rs. 2,00,000 (Rs. 1,00,000 x 2 instalments) will be shown under the heading 'Other Current Liabilities' as current maturities of loan from bank.

Test Series: March, 2015

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 2: BUSINESS LAWS, ETHICS AND COMMUNICATION

*Question No.**1** is compulsory.*

*Attempt any **five** questions from the remaining **six** questions.*

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) Mr. Arvind, an old man, by a registered deed of gift, granted certain land property to Ms. Asha, his daughter. By the terms of the deed, it was stipulated that an annuity of Rs. 5, 000 should be paid every year to Mr. Aakash, who was the brother of Mr. Arvind. On the same day Ms. Asha made a promise to Mr. Aakashand executed in his favour an agreement to give effect to the stipulation. Ms. Asha failed to pay the stipulated sum. In an action against her by Mr. Aakash, she contended that since B had not furnished any consideration, he has no right of action.

   Examining the provisions of the Indian Contract Act, 1872, decide, whether the contention of Ms. Asha is valid? *(5 Marks)*

   (b) Some of the creditors of M/s Glow 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, 2013. 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. *(5 Marks)*

   (c) What is meant by 'Corporate Governance'? State the major 'characteristics' of good corporate governance. *(5 Marks)*

   (d) Explain clearly the different types of grapevine chains in an informal communication.

   (5 Marks)

2. (a) (i) State whether following statements is correct or incorrect with respect to the Payment of Bonus Act, 1965.

   1. "Employees can relinquish their right to receive minimum bonus by an agreement with employer". *(2 Mark)*

   2. As employee by his misconduct caused financial loss to the employer. As of consequences employer denied to pay employee the bonus to compensate the financial loss. *(2 Marks)*

   (ii) When an employee becomes disabled due to any accident or disease and is unable to do the same work and re-employed on the reduced wages, how the gratuity of such employee shall be, computed under the provisions of the Payment of Gratuity Act, 1972? *(4 Marks)*

(b) Explain the pragmatic reasons for maintaining ethical behaviour in marketing through marketing executives. *(4 Marks)*

(c) Explain the concept of "Negotiation". What are its techniques? *(4 Marks)*

3. (a) (i) Explain the meaning of 'Holder' and 'Holder in due course' of a negotiable instrument. The drawer, 'D' is induced by 'A' to draw a cheque in favour of P, who is an existing person. 'A' instead of sending the cheque to 'P', forgoes his name and pays the cheque into his own bank. Whether 'D' can recover the amount of the cheque from 'A's banker. Decide. *(5 Marks)*

(ii) Bharat executed a promissory note in favour of Bhushan for Rs. 5 crores. The said amount was payable three days after sight. Bhushan, on maturity, presented the promissory note on 1st January, 2008 to Bharat. Bharat made the payments on 4th January, 2008. Bhushan wants to recover interest for one day from Bharat. Advise Bharat, in the light of provisions of the Negotiable Instruments Act, 1881, whether he is liable to pay the interest for one day?

(3 Marks)

(b) State in brief the guidelines for managing ethics and to prevent the need for whistle-blowing in the work place. *(4 Marks)*

(c) What are the tips for improving inter-personal skills in a business organization?

(4 Marks)

4. (a) State the procedure for shifting of registered office of the company from one State to another State under the provisions of the Companies Act, 2013 *(8 Marks)*

(b) Self interest threats may occur as a result of financial or other interests of finance and accounting professional. Give three examples each of such threats when the accounting professional is working as-

(i) An auditor or consultant

(ii) An employee in a company. *(4 Marks)*

(c) Suggest guidelines to handle communication ethics dilemmas. *(4 Marks)*

5. (a) What is meant by 'Undue Influence'? Mr. Raj applies to a banker for a loan at a time where there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. Mr. Raj accepts the loan on these terms. Whether the contract is induced by undue influence? Decide. *(8 Marks)*

(b) Sapphire Ltd. has not given dividend to its preference shareholders. In this regard state the rights of preference shareholders and non-cumulative Preference Shareholders on dividend. *(4 Marks)*

(c) Draft a notice for calling the Board of Directors meeting of M/s. NM Limited where Ms. Rajni is co-opted as an Additional Director and also to consider buy-back of company's equity shares to an extent of 10%, of issued share capital. *(4 Marks)*

6. (a) (I) State whether the following statement is correct/incorrect with reasons:

1. The company and its members are same in the eyes of Law.

2. A non-profit organization cannot be registered as a company under the Companies Act, 2013. *(2 x 2 = 4 Marks)*

(II) What do you mean by Proxy? Explain the provisions relating appointment of Proxy under the Companies Act, 2013. *(4 Marks)*

(b) Write a note on ecological ethics. *(4 Marks)*

(c) Draft a 'Power of Attorney' by an assesse authorising a Chartered Accountant to appear before Income-tax officer in respect of the pending taxation matter. *(4 Marks)*

7. Answer any **FOUR** of the following:

(a) What are the orders that can be passed by Employees' Provident Funds Appellate Tribunal on appeals against the orders passed by the Central Government or authorized officers? *(4 Marks)*

(b) Mention any five acts for which a special resolution is required under the Companies Act, 2013. *(4 Marks)*

(c) Annual General Meeting of MRF Limited is convened on 28th December, 2014. Mr. Jai, who is a member of the company, approaches the company on 28th December, 2014 and demands inspection of proxies lodged with the company. Explain the legal position as stated under the Companies Act, 2013 in this regard. *(4 Marks)*

(d) Explain the extent to which it is possible to observe ethical behaviour in marketing. Also explain in brief the merits and demerits of the above. *(4 Marks)*

(e) What principles you would keep in mind in oral communication? *(4 Marks)*

Test Series: April, 2014

Mock Test Paper – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 2: BUSINESS LAWS, ETHICS AND COMMUNICATION

SUGGESTED ANSWERS/HINTS

1. (a) The problem asked in the question is related to Cross offer which can be understood as, when two parties exchange identical offers in ignorance at the time of each other's offer, the offers are called cross offers.

According to the provisions given in the Indian Contract Act, 1872, when a person to whom proposal (offer) is made signifies his assent, the proposal is said to be accepted. Thus, assent can be only to a 'proposal'. If there was no proposal, question of its acceptance cannot arise.

Accordingly in the given case, H making a proposal to G to sell his car on the payment of ₹ 3 lacs and G, without knowing of the proposal of H, makes a proposal to G to purchase the same car at the price specified in the proposal of H. Thus, it is not an acceptance, as G was not aware of proposal made by H. It is only cross proposal (cross offer). And when two persons make offer to each other in this situation, it cannot be treated as mutual acceptance. Hence, there can be no binding contract in such a case.

Thus, the contention of G in the above case, is not tenable.

(b) According to the provisions of the Companies Act, 1956, a company may pay underwriting commission to any person who agrees to subscribe or procure subscription for an agreed number of shares or debentures of the company. Such commission may be paid to the underwriters who offer guarantee to procure applications for certain number of shares and guarantee to purchase the balance quantity of shares in case there is under subscription from the public. For this, the underwriter gets underwriting commission. Maximum total commission payable cannot exceed 5% of the price of shares or the underwriter may be paid a lower rate if so prescribed by articles. In case of debentures, it is 2½ % or a lower rate if so prescribed in the articles.

In the given problem the articles of Honest Automobiles Ltd., has prescribed 3% underwriting commission but the directors decided to pay 4% underwriting commission. The directors cannot do so because as aforesaid in the provision, such commission cannot be more than that prescribed in the articles. Therefore, the directors are not empowered to do so. Further, such amount of commission payable must be authorized by articles. The agreed commission should be disclosed in the prospectus or the statement in lieu of prospectus. Copy of the contract for payment of commission must be filed with Registrar of Companies at the time of the delivery of the prospectus or letter of offer. An underwriter must be also registered with SEBI.

(c) Group conflict : Group conflict is an 'express struggle' between two inter-dependent parties who perceive incompatible goals, scarce resources and interference from the other party in achieving their goals. There are two aspects in relation to conflict :

1. Expression : The two sides must communicate / express about the problem for there to be conflict.

2. Perception : Conflict evolves perceptions in the two sides may only perceive that their goals, resources and interference are incompatible with each other's.

Managing conflicts : The climate in which conflict is managed is important. It is essential to plan communications to foster a supportive climate, marked by emphasis on

i. Presenting ideas or options

ii. Problem orientation – focusing attention the task

iii. Spontaneity – Communicating openly and honestly

iv. Empathy – understanding another person's thoughts

v. Equality – asking for opinions

vi. Willing to listen to the ideas of others

Successfully managed conflicts can be constructive and can strengthen relationships in an organization.

(d) Environmental consideration has become a part of corporate strategy, which means incorporating environmental issues in the process of developing a product, in new investments and in the organizational set up. A good environmental practice improves corporate performance. In many industries it has been found that environmental friendly practices have resulted in more saving; for example the process of recycling the waste.

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

Thus, 'A good environmental practice improves corporate performance".

2. (a) (i) Recovery of the bonus due from an employer : As per the provisions of the Payment of Bonus Act, 1965, where an amount of bonus is due to an employee from his employer under a settlement or an award or agreement and it is not paid, there in such a case, the employee is to make an application for the recovery of the amount to the Appropriate Government.

This application can be made even by his assignee or heirs when the employee is dead. The application is to be made within one year from the date on which the money (Bonus) becomes due but it may be entertained even after the expiry of the said period of one year, if the Appropriate Government is satisfied that the applicant had sufficient cause for not making the application within the said period.

On receipt of the aforesaid application for the recovery of the bonus amount, the appropriate Government or such authority as it may specify in this connection is to be satisfied that the money is so due. On being thus satisfied, it must issue a certificate for that amount to the Collector. Thereupon, Collector shall proceed to recover the same in the same manner as an arrear of land revenue.

(ii) According to the Payment of Gratuity Act, 1972, where as soon as gratuity becomes payable, the employer shall, whether the application for the payment of gratuity has been given or not by the employee, determine the amount of gratuity and give notice in writing to the person to whom the gratuity is payable and also the controlling officer specifying the amount of gratuity so determined. The employer shall arrange to pay the amount of gratuity within 30 days from the date of its becoming due/ payable to the person to whom it is payable.

Provision of interest on gratuity amount : If the amount of gratuity is not paid by the employer within period specified i.e. 30 days, the employer shall pay, from the date on which the gratuity becomes payable to the date on which it is paid, simple interest at such rate, not exceeding the rate notified by the Central Government from time to time for repayment of long term deposits, as the Government may, by notification specify.

Thus, according to the above provisions, P will succeed to get the amount of gratuity along with the interest due.

(b) The term 'discrimination' generally means to distinguish one object from another or treating people differently. It is usually intended to refer to the wrongful act of making a difference in treatment or favour on a basis other than individual merit. Such discrimination may also be related in employment in business organization. The practices which create discrimination in a business organization may be summarized as follows :-

i. If the decision against one or more employees is taken which is not based on individual merit, such as the ability to perform a given job, seniority or other morally legitimate qualification.

ii. If the decision has been derived solely from racial or sexual prejudice, false stereotypes other kind of morally unjustified attitude against members of which the employee belongs.

iii. If the decision has a harmful or negative impact on the interests of the employees, perhaps costing them jobs, promotions or better pay.

(c) **(i)** The given statement is i**ncorrect**

Reason : In addition to oral communication, people can also relate and understand the non-verbal, by observing facial expressions, eye contact, gestures, postures etc., to understand the message better.

(ii) The given statement is **correct**

Reason : Communication is so fundamental that without it no organization can exist and function effectively towards achieving its objectives. Communication is the principal means by which members of an organisation work together.

(iii) The given statement is **correct**

Reason : An office order is a circular prepared and circulated for interdepartmental information to all the employees of the organization. Thus, it is correct that office order is meant for internal use.

(iv) The given statement is **correct**

Reason : A group is composed of individuals who interact verbally and non-verbally, occupy certain roles with respect to one another and co-operate to accomplish a definite goal. Thus, a group is like a tune, it is not constituted of individual sounds but the resulting symphony. Just like individuals, group also develops personality.

3. **(a)** As per the Negotiable Instruments Act, 1881, an alteration can be called a material alteration if it alters or attempts to alter the character of the instrument and affects or is likely to affect the contract which the instrument contains or is evidence of. Thus, it totally alters the business effect of the instrument. It makes the instrument speak a language other than that was intended.

The following material alterations have been authorized by the Act and do not require any authentication :

i. Filling blanks of inchoate instruments

ii. Conversion of a blank endorsement into an endorsement in full

iii. Crossing of cheque

As per the facts given in the question, B stated that he had paid the principal amount of ₹ 3,000/- to A and made endorsement on the back of the pronote which A erased and did a material alteration (total outstanding amount being ₹ 5,000/- that included a sum of ₹ 3,000/- as principal and the balance as interest).

The pronote consists of the principal and the interest amount which are important components of the debt. Erasure of the principal amount would alter the character of the instrument and affect the contract which the instrument contains or is evidence of. Thus, the erasure would be treated as material alteration.

Some of the grounds whereby the alteration will not be vitiate the pronote under Negotiable Instruments Act, 1881 are :

1. Conversion of instrument payable to bearer
2. Conversion of instrument payable to bearer into order
3. Elimination of the words 'or order' from an endorsement
4. Addition of the words 'or demand' to a note in which no time or payment is expressed.

(b) Following are the ancestry following different approaches of Ethical standards:

The Utilitarian Approach : The ethical corporate action is the one that produces the greatest good and does the least harm for all who are affected - customers, employees, shareholders, the community, and the environment. The utilitarian approach deals with consequences; it tries both to increase the good done and to reduce the harm done.

The Rights Approach (The Deontological Approach) : This approach starts from the belief that humans have a dignity based on their human nature per se or on their ability to choose freely what they do with their lives. On the basis of such dignity, they have a right to be treated as ends and not merely as means to other ends. The list of moral rights -including the rights to make one's own choices about what kind of life to lead, to be told the truth, not to be injured, to a degree of privacy, and so on. Also, it is often said that rights imply duties-in particular, the duty to respect others' rights.

The Fairness or Justice Approach : Aristotle and other Greek philosophers have contributed the idea that all equals should be treated equally. Today we use this idea to say that ethical actions treat all human beings equally-or if unequally, then fairly based on some standard that is defensible. We pay people more based on their harder work or the greater amount that they contribute to an organization, and say that is fair.

The Common Good Approach : This approach suggests that the interlocking relationships of society are the basis of ethical reasoning and that respect and compassion for all others-especially the vulnerable-are requirements of such reasoning. This approach also calls attention to the common conditions that are important to the welfare of everyone. This may be a system of Laws, effective police and fire departments, health care, a public educational system, or even public recreational areas.

The Virtue Approach : A very ancient approach to ethics is that ethical actions ought to be consistent with certain ideal virtues that provide for the full development of our humanity. These virtues are dispositions and habits that enable us to act according to the highest potential of our character and on behalf of values like truth and beauty. Honesty, courage, compassion, generosity, tolerance, love, fidelity, integrity, fairness, self-control, and prudence are all examples of virtues.

(c) Communication is a two-way process in which there is an exchange of ideas or thoughts linking the sender and receiver towards a mutually accepted direction or goal consisting of 7 elements which are as under:

1. **Sender:** The process of communication begins with a sender, the person who has an idea and desires to exchange it.
2. **Encoding:** The sender puts his/her ideas or facts into words, symbols, pictures or gestures that the receiver can understand.
3. **Message:** A message refers to what is being communicated. It may be verbal or non-verbal.
4. **Channel:** Channel is the medium through which message is transmitted to the sender. Channel may be in oral or written forms.
5. **Receiver:** It is any person who notices and attaches some meaning to a message.
6. **Decoding:** The receiver translates the words and symbols used in the message into ideas and interpret it to attain its meaning.
7. **Feedback:** Ultimately receiver reacts or responds to the communication sent by the sender. It could be based on clear interpretation of the symbols sent or misunderstanding or misinterpretation of the symbols sent.

4. (a) Return of Allotment (Section 75, Companies Act, 1956): Within thirty days of allotment of shares, a company is required to send the Registrar a report, known as the "return as to allotment". It must contain the following particulars:

1. The number of nominal amount of shares allotted; the names, addresses, the occupation of the allottees; the amount, if any, paid or payable on each share. No share should be shown as allotted for cash unless cash has actually been received in respect of the allotment.
2. Contracts in writing under which shares have been allotted for any consideration other than cash, must be produced for examination of the Registrar.
3. Where bonus shares have been issued, the returns must show the nominal amount of the shares allotted; names and addresses and occupations of the allottees and a copy of the resolution authorizing the issue of such shares.
4. Where the shares have been issued at a discount, the return must include a copy of the resolution authorizing such an issue, a copy of the Tribunal's order

sanctioning the issue, and where the rate of discount is more than ten percent, a copy of the order of the Central government permitting the issue.

(b) Economic growth has to be environmentally sustainable. There is no economic growth without ecological costs. Industrialization and rapid development have affected the environment. Everybody should realize that such development is related to environmental damage and resource depletion.

Therefore, an element of resource regeneration and positive approach to environment has to be incorporated in development programs. Sustainable development refers to maintaining development over time. Sustainable development is development that meets the needs of the present without comprising the ability of future generations to meet their own needs. A nation or society should satisfy its social, economic and other requirement without jeopardizing the interest of future generations.

High economic growth means high rate of extraction, transformation and utilization of non-renewable resources. Therefore it is suggested that economic growth has to be environmentally sustainable because it is sure that there is no economic growth without ecological cost.

(c) **Personal Competencies Associated with Emotional Intelligence:**

Personal Competencies – How You Manage Yourself

- *Emotional self-awareness*: Reading your own emotions and recognizing their impact; using 'gut sense' to guide decisions
- *Accurate self-assessment*: Knowing your strengths and weaknesses
- *Self-confidence:* A sound sense of your self-worth and capabilities
- *Self-Management*
- *Emotional self-control*: Keeping disruptive emotions and impulses under control
- *Transparency*: Displaying honesty and integrity; trustworthiness
- *Adaptability*: Flexibility in adapting to changing situations or overcoming obstacles
- *Achievement*: The drive to improve performance to meet inner standards of excellence
- *Initiative:* Readiness to act and seize opportunities
- *Optimism*: Seeing the upside in events

5. **(a)** Any person aggrieved by an order under Section 7A(1) can make application for review of the order in following cases – (a) if new and important evidence is discovered which could not be produced earlier as it was not within his knowledge even after due diligence (b) there is some mistake or error apparent on the records or (c) any other sufficient reason. – No application for review can be made if appeal was filed.

The officer can himself review the order on his own motion. [Section 7B(1)]. The officer can either reject the application for review if there are not sufficient grounds for review, or he can grant the review. [Section 7B(4)]. Appeal cannot be filed against order rejecting the application for review. However, if fresh order is passed after the review, appeal can be filed against such order [Section 7B(5)].Application for review should be made within 45 days in form 9. [Para 79A of EPF Scheme].

In *Balu Fire Clay Niwas v. U.O.I., 2003 LLR 578 (Jhar HC)*, it was held that when statute provides for review, it cannot be contended that petitioner should have filed appeal against the order. It was also held that review petition should be disposed of by a speaking order.

(b) Mode of registration/incorporation of company: In the case of a public company with or without limited liability any 7 or more persons can form a company by subscribing their names to memorandum and otherwise complying with the requirements of the Companies Act, 1956. In exactly the same way, 2 or more persons can form a private company [Section 12]. Persons who form the company, who conceive the idea of forming the company are known as promoters. They take all necessary step for its registration.

- **Lawful purpose:** The essence of validly incorporated company is that it must consist of a particular number of persons and be an association for a lawful purpose.
- **Applying for the name:** The promoters of the company should decide upon at least three suitable names in order of preference to afford flexibility to the Registrar to decide the availability of the name.
- **Documents to be filed:** After getting the name approved, the certain documents along with the application and prescribed fees, are to be filed with the Registrar.
- **Subscribing their names:** Section 15 stipulates that the Memorandum should be signed by each subscriber who should add his address, description and occupation in the presence of one witness.
- **Commencement of business**
- **Statement in Lieu of Prospectus: If** a public company does not issue a prospectus inviting the public to purchase its share because, the directors think they can sell the shares even without the issue of the prospectus, it can do so.
- **Certificate of incorporation:** Upon the registration of the documents mentioned earlier under the head “Documents to be filed for registration of the

company" and the payment of the necessary fees, the Registrar of Companies issues a certificate that the company is incorporated.

(c) <u>Indemnity Bond</u>

Mr. X, son of ………….resident of…………do hereby agree to indemnify the ABC bank Ltd., New Delhi for any loss that may occur on issuing a duplicate Demand Draft for a sum of ₹ 5,000/- (Rupees five thousand only).

I further declare that personally I have not encashed the Demand Draft in question.

Date : Signature

Place :

6 (a) (i) Period within which first and the subsequent AGM must be held :

(1) In accordance with the provisions of the Companies Act, 1956, the first Annual General Meeting of the company should be held within 18 months of incorporation of the company and so long as the company hold its first annual general meeting within that period, the company need not hold any general meeting in the year of incorporation or in the following year. Further, the date of the first AGM must be within 9 months from the date of the financial year for which profit and loss account has been made.

(2) Any subsequent AGM must be held not later than 6 months from the close of the financial year of the company. The gap between the two consecutive AGMs must not be more than 15 months. Further, the Registrar may, for any special reason, extend the time within which any AGM (not being the first AGM) shall be held by a period not exceeding 3 months.

(ii) Every AGM shall be called for a time during business, on a day that is not a public holiday, and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate.

The Central Government may exempt any class of companies from the provisions of this subsection subject to such conditions as it may impose. Further, a public company or a private company which is a subsidiary of a public company, may by its articles fix the time for its AGM and may also by a resolution passed in one AGM fix the time for its subsequent AGMs.

(b) The dynamic environment in which businesses operate today may usher a broad range of circumstances because of which compliance the fundamental principles may potentially be threatened. Such threats may be classified as follows:

- Self-interest threats, which may occur as a result of the financial or other interests of a finance and accounting professional or of an immediate or close family member;
- Self-review threats, which may occur when a previous judgment needs to be re-evaluated by the finance and accounting professional responsible for that judgment;
- Advocacy threats occur when a professional promotes a position or opinion to the point that subsequent objectivity may be compromised;
- Familiarity threats occur when a finance and accounting professional has close relationships in the work environment and such relationships impair his selfless attitude towards work.
- Intimidation threats occur when a professional may be prohibited from acting objectively by threats, actual or perceived.

(c) A number of elements that can be used to describe or influence Organizational Culture:

- **The Paradigm:** What the organization is about; what it does; its mission; its values.
- **Control Systems**: The processes in place to monitor what is going on.
- **Organizational Structures**: Reporting lines, hierarchies, and the way that work flows through the business.
- **Power Structures**: Who makes the decisions and how power is distributed across the organization.
- **Symbols:** These include the logos and designs, but would extend to symbols of power, such as car parking spaces and executive washrooms!
- **Rituals and Routines:** Management meetings, board reports and so on may become more habitual than necessary.
- **Stories and Myths:** build up about people and events, and convey a message about what is valued within the organization.

Communicating the corporate culture effectively is paramount. For example, at General Electric (GE), corporate values are so important to the company, that Jack Welch, the former legendary CEO of the company, had them inscribed and distributed to all GE employees at every level of the company.

7. (a) (i) Incorrect : A company is a juristic person with a perpetual succession. It never dies, nor does its life depend upon the life of its members. It is created by a process of law and can be put to an end only by the process of law. Members may come and go but the company can go on forever (until dissolved).

(ii) **Incorrect :** 'Shelf Prospectus' means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus. Thus, banks other than scheduled banks may also issue shelf prospectus.

(iii) **Incorrect :** Though, a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to the minor. Thus, a promissory note duly executed in favour of a minor is not void and can be sued upon by him, because he though incompetent to contract, may yet accept a benefit.

(iv) **Correct :** The test to decide whether a statement is an 'offer' or 'invitation to offer' is to see the 'intention'. If a person who makes the statement has the intention to be bound by it as soon as the other accepts, he is making an offer. If he however intends to do some other act, he is making only an invitation to offer. Thus, the intention to be bound is the important thing, which is to be seen.

(b) **Alteration of Share Capital :** A limited company having a share capital may, if so authorized by its articles, alter its share capital in the following manner :-

i. by increasing its nominal capital by issuing new shares;

ii. by consolidating and dividing all or any of its share capital into shares of larger denomination;

iii. by converting fully paid-up shares into stock or vice versa;

iv. by sub-dividing its shares or any of them into shares of smaller amount;

v. by cancelling shares which have not been taken up and diminishing the amount of its share capital by the amount of the shares so cancelled.

The powers conferred by above points shall be exercised by passing an ordinary resolution of the company in a general meeting and shall not require to be confirmed by the Court.

(c) 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.

Some points to be considered while calculating the quorum are :

1. 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 purpose of quorum.

2. 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.

3. 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.

4. 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.

With respect to the question, the following may be considered :

i. 'A' will be included for the purpose of quorum

ii. D will have three votes for the purpose of quorum as he represents three companies P. Ltd. Q. Ltd. and R. Ltd.,

iii. E will have two votes for the purpose of quorum as he represents two companies S. Ltd. and T. Ltd.

iv. F, G, H and I are not to be included as they are not members but representing as proxies for the members.

Thus, the number of persons being personally present would be as follows :-

Present Personally	Number
Mr. A	1
Mr. B & Mr. C	Nil
Mr. D	3
Mr. E	2
Proxies	Nil
Total	6

Thus, it can be said that a valid quorum for the Extra-ordinary General Meeting was not present.

(d) Letter of acknowledging the acceptance of the cheque book

The Manager,

-----------------bank,

---------New Delhi Date------------

Dear sir,

This is to acknowledge the acceptance of the Cheque book containing 20 cheques from no. 123450 to 123470 which I found to be correct.

Yours faithfully,

XYZ

(Customer)

(e) Legal drafting is of great importance to a person for entering into various types of agreements with different parties and in executing various types of documents in favour of the other.

This Legal drafting is a technical writing used by lawyers, judges, legislators and others in law to express legal analysis and legal rights, privileges, functions, status and duties.

Drafting is of importance for the three reasons:

(i) For obtaining legal consultations

(ii) For carrying out documentation

(iii) For interpretation of the documents

Legal Drafting have been catagorised into three forms-

1. Document
2. Instrument
3. Deed

Test Series: March, 2015

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 3: COST ACCOUNTING AND FINANCIAL MANAGEMENT

Answers are to be given only in English except in the case of the candidates who have opted for Hindi medium. If a candidate has not opted for Hindi medium his/ her answers in Hindi will not be valued.

*Question No. **1** is compulsory.*

*Attempt any **five** questions from the remaining **six** questions.*

Working notes should form part of the answer.

Time Allowed – 3 Hours **Maximum Marks – 100**

1. Answer the following:

(a) Sree Gopal Ltd. having fifteen different types of automatic machines furnishes information as under for 2014-2015

(i) Overhead expenses: Factory rent Rs. 1,80,000 (Floor area 1,00,000 sq. ft.), Heat and gas Rs. 60,000 and supervision Rs. 1,50,000.

(ii) Wages of the operator is Rs. 200 per day of 8 hours. Operator attends to one machine when it is under set up and two machines while they are under operation.

In respect of machine B (one of the above machines) the following particulars are furnished:

(i) Cost of machine Rs.1,80,000, life of machine - 10 years and scrap value at the end of its life will be Rs. 10,000.

(ii) Annual expenses on special equipment attached to the machine are estimated as Rs. 12,000.

(iii) Estimated operation time of the machine is 3,600 hours, while set up time is 400 hours per annum.

(iv) The machine occupies 5,000 sq. ft. of floor area.

(v) Power costs Rs. 5 per hour while machine is in operation.

Find out the comprehensive machine hour rate of Machine B. Also find out machine costs to be absorbed in respect of use of Machine B on the following two work orders.

	Work order- 1	Work order-2
Machine set up time (Hours)	15	30
Machine operation time (Hours)	100	190

(b) S Travels has been promised a contract to run a tourist car on a 20 km. long route for a multinational firm. He buys a car costing Rs. 4,50,000. The annual cost of insurance and taxes are Rs. 7,500 and Rs. 1800 respectively. He has to pay Rs. 2500 per month for a garage where he keeps the car when it is not in use. The annual repair costs are estimated at Rs. 12,000. The car is estimated to have a life of 10 years at the end of which the scrap value is likely to be Rs. 50,000.

He hires a driver who is to be paid Rs. 3,000 per month plus 10% of the takings as commission. Other incidental expenses are estimated at Rs. 2,000 per month.

Petrol and oil will cost Rs. 220 per 100 kms. The car will make 4 round trips each day. Assuming that a profit of 15% on takings is desired and that the car will be on the road for 25 days on an average per month, what should he charge per round-trip?

(c) Mr. Shyam invested Rs. 2,40,000 at annual rate of interest of 10 percent. What is the amount after 3 years if the compounding is done?

(i) Annually

(ii) Semi-annually.

(d) Alpha Limited issued 40,000 12% redeemable preference share of Rs. 100 each at a premium of Rs. 5 each, redeemable after 10 years at a premium of Rs. 10 each. The floatation cost of each share is Rs. 2. You are required to calculate cost of preference share capital ignoring dividend tax. *(4 × 5 = 20 Marks)*

2. (a) A Light Motor Vehicle manufacturer has prepared sales budget for the next few months, and the following draft figures are available:

Month	No. of vehicles
October	4,000
November	3,500
December	4,500
January	6,000
February	6,500

To manufacture a vehicle a standard cost of Rs. 2,85,700 is incurred and sold through dealers at an uniform selling price of Rs. 3,95,600 to customers. Dealers are paid 12.5% commission on selling price on sale of a vehicle.

Apart from other materials four units of Part - X are required to manufacture a vehicle. It is a policy of the company to hold stocks of Part-X at the end of the each month to cover 40% of next month's production. 4,800 units of Part-X are in stock as on 1st October.

There are 950 nos. of completed vehicles are in stock as on 1st October and it is policy to have stocks at the end of each month to cover 20% of the next month's sales.

You are required to

(i) Prepare Production budget (in nos.) for the month of October, November, December and January.

(ii) Prepare a Purchase budget for Part-X (in units) for the months of October, November and December.

(iii) Calculate the budgeted gross profit for the quarter October to December.

(8 Marks)

(b) You are a financial analyst for Beta Limited. The director of finance has asked you to analyse two proposed capital investments, Projects X and Y. Each project has a cost of Rs. 10,000 and the cost of capital for each project is 12 per cent. The project's expected net cash flows are as follows:

	Expected net cash flows	
Year	*Project X*	*Project Y*
	Rs.	*Rs.*
0	(10,000)	(10,000)
1	6,500	3,500
2	3,000	3,500
3	3,000	3,500
4	1,000	3,500

(i) Calculate each project's payback period, net present value (NPV) and internal rate of return (IRR).

(ii) Which project or projects should be accepted if they are independent?

(8 Marks)

3. (a) Aditya Ltd. manufactures Ordinary Portland Cement (OPC). The standard data for the raw materials that are used to manufacture OPC are as follows:

Raw Material	**Composition (%)**	**Rate per Metric Ton (Rs.)**
Limestone	65	565
Silica	20	4,800
Alumina	5	32,100
Iron ore	5	1,800
Others	5	2,400

During the month of February 2015, Aditya Ltd. produced 500 MT OPC. Actual data related with the consumption and costs are as follows:

Raw Material	Quantity (MT)	Total Cost (Rs.)
Limestone	340	1,90,400
Silica	105	5,09,250
Alumina	25	8,12,500
Iron ore	30	53,400
Others	23	51,750

You are required to find out the following variances related with the production of OPC for the month of February 2015:

(i) Material Price Variance

(ii) Material Mix Variance

(iii) Material Yield Variance

(iv) Material Cost Variance. *(8 Marks)*

(b) Gamma Limited has the following capital structure, which it considers to be optimal:

Capital Structure	*Weightage (in percentage)*
Debt	25
Preference Shares	15
Equity Shares	60
	100

Gamma Limited's expected net income this year is Rs. 34,285.72, its established dividend payout ratio is 30 per cent, its tax rate is 40 per cent, and investors expect earnings and dividends to grow at a constant rate of 9 per cent in the future. It paid a dividend of Rs. 3.60 per share last year, and its shares currently sell at a price of Rs. 54 per share.

Gamma Limited requires additional funds which it can obtain in the following ways:

- *Preference Shares*: New preference shares with a dividend of Rs. 11 can be sold to the public at a price of Rs. 95 per share.
- *Debt*: Debt can be sold at an interest rate of 12 per cent.

You are required to:

(i) Determine the cost of each capital structure component; and

(ii) Compute the weighted average cost of capital (WACC) of Gamma Limited.

(8 Marks)

4. (a) ZED Limited is working by employing 50 skilled workers. It is considering the introduction of incentive scheme-either Halsey scheme or Rowan scheme of wage

payment for increasing the labour productivity to cope up the increasing demand for the product. It is believed that proposed incentive scheme could bring about an average incentive of 20% on the basic wages to the workers; it could act as sufficient incentive for them to produce more.

Because of assurance, the increase in productivity has been observed as revealed by the figures for the month of April, 2014.

Hourly rate of wages (guaranteed)	Rs. 30
Average time for producing one unit by one worker at the previous performance (This may be taken as time allowed)	1.975 hours
Number of working days in the month	24
Number of working hours per day of each worker	8
Actual production during the month	6,120 units

Required:

(i) Calculate the effective rate of earnings under the Halsey scheme and the Rowan scheme.

(ii) Calculate the savings to the ZED Limited in terms of direct labour cost per piece.

(iii) Advise ZED Limited about the selection of the scheme to fulfill their assurance.

(8 Marks)

(b) Theta Limited provides the following information for your consideration:

	Rs.
Cost (per unit):	
Raw materials	52.0
Direct labour	19.5
Overheads	39.0
Total cost (per unit)	110.5
Profit	19.5
Selling price	130.0

Average raw material in stock is one month; average materials in process are half a month. Credit allowed by suppliers is one month; credit allowed to debtors is two months. Time lag in payment of wages is one and a half weeks and Overheads is one month. One-fourth of sales are on cash basis. Cash balance is expected to be Rs. 1,20,000.

You are required to prepare a statement showing the working capital needed to finance a level of activity of 70,000 units of output. You may assume that production is carried on evenly, throughout the year and wages and overheads accrue similarly. (For calculation purposes 1 month = 30 days). *(8 Marks)*

5. (a) Given below is a list of eight industries. Give the method of costing against each industry.

(i) Nursing Home

(ii) Coal

(iii) Bicycles

(iv) Bridge Construction

(v) Interior Decoration

(vi) Advertising

(vii) Furniture

(viii) Sugar company having its own sugarcane fields.

(b) You and Kunal have been asked by a CA firm where you are serving as articled assistants to visit to one of its client's factory for stock verification. Since, it is Kunal's first audit assignment he wants to know the difference between the Perpetual Inventory System and Continuous Stock taking. As a senior audit fellow of Kunal, you are required to satisfy his query.

(c) Discuss the factors to be considered by a venture capitalist before financing any risky project.

(d) Discuss the role of Chief Financial Officer (CFO) in an organisation. *(4 x 4 =16 Marks)*

6. (a) Abstruse Ltd. manufactures a product called Z9 which goes through three sequential processes namely P1, P2 and P3 before producing the final product. In P3 a by-product called BP arises. After further processing BP at a cost of Rs. 5 per kg., it can be sold at Rs. 25 per kg in the market. Rs. 3 per BP kg. has to be incurred as selling and distribution expenses.

Particulars	**P-1 (Rs.)**	**P- 2 (Rs.)**	**P- 3 (Rs.)**	**BP (Rs.)**
Direct Material introduced (12,000 kg.)	60,000	-	-	-
Other material added (ignore the weight)	18,000	20,000	30,000	-
Direct wages	16,000	20,000	36,000	-
Direct expenses	9,000	6,880	22,520	-
Scrap value	2	3	6	-
Output per month (kg.)	9,600	9,400	7,800	600
Normal loss (%)	10%	5%	10%	

Company has budgeted production overheads of Rs.2,70,000 per month, absorbed as a percentage of direct wages for each process.

Using the information given above prepare the accounts for processes P1, P2, P3 and the by- product BP. *(8 Marks)*

(b) The Balance Sheet of Zeta Limited as on 31st March, 2015 is as follows:

Liabilities	*Rs. ('000)*	*Assets*		*Rs. ('000)*
Equity Share Capital	6,000	Fixed Assets (at cost)	16,250	
8% Preference Share Capital	3,250	*Less:* Depreciation written off	5,200	11,050
Reserves and Surplus	1,400	Stock		1,950
10% Debentures	1,950	Sundry Debtors		2,600
Sundry Creditors	3,250	Cash		250
Total	15,850			15,850

The following additional information is available:

(i) The stock turnover ratio based on cost of goods sold would be 6 times.

(ii) The cost of fixed assets to sales ratio would be 1.4

(iii) Fixed assets costing Rs. 30,00,000 to be installed on 1st April, 2015 and payment would be made on March 31, 2016.

(iv) In March, 2016, a dividend of 7 per cent on equity capital would be paid.

(v) Rs. 5,50,000, 11% Debentures would be issued on 1st April, 2015.

(vi) Rs. 30,00,000, Equity shares would be issued on 31st March, 2016.

(vii) Creditors would be 25% of materials consumed.

(viii) Debtors would be 10% of sales.

(ix) The cost of goods sold would be 90 per cent of sales including material 40 per cent and depreciation 5 per cent of sales.

(x) The profit is subject to debenture interest and taxation @ 30 per cent.

You are required to prepare:

(i) The projected Balance Sheet as on 31st March, 2016.

(ii) The projected Cash Flow Statement in accordance with AS-3. *(8 Marks)*

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

(a) Explain the following:

(i) Advantages of cost plus contact.

(ii) Limitation of Marginal Costing.

(b) Treatment of spoiled and defective work in job costing method.

(c) Differentiate between Factoring and Bills Discounting

(d) Ratio Analysis can be used to study liquidity, turnover, profitability, etc. of a firm. What does Debt-Equity Ratio help to study?

(e) What are the forms of bank credit? *(4 x 4 =16 Marks)*

Test Series: March, 2015

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 3: COST ACCOUNTING AND FINANCIAL MANAGEMENT

Suggested Answers/ Hints

1. (a) Calculation of Comprehensive machine hour rate for Machine B

	(Rs.)
Standing Charges: Factory rent $\left(\frac{\text{Rs.}1,80,000}{1,00,000\,\text{sq. ft.}} \times 5,000\,\text{sq. ft.}\right)$	9,000
Heat and Gas (Rs. 60,000 ÷ 15 machines)	4,000
Supervision (Rs.1,50,000 ÷ 15 machines)	10,000
Depreciation [(Rs. 1,80,000 – Rs. 10,000) ÷ 10 years]	17,000
Annual expenses on special equipment	12,000
Total Standing Charges	52,000
Estimated working hours (Operation + set-up)	4,000 hours
Standing Charges per hour	13

	Set up rate Per hour (Rs.)	Operational rate Per hour (Rs.)
Standing charges	13.00	13.00
Power cost	--	5.00
Wages to operator	25.00	12.50
Comprehensive Machine hour rate per hr.	38.00	30.50

Machine costs to be absorbed on the two work orders

	Work order-1			Work order-2		
	Hours	Rate (Rs.)	Amount (Rs.)	Hours	Rate (Rs.)	Amount (Rs.)
Set up time cost	15	38	570	30	38	1,140
Operation time cost	100	30.5	3,050	190	30.5	5,795
			3,620			6,935

(b) Statement of Operating cost.

	Per Annum (Rs.)	Per Month (Rs.)
Standing charges:		
Depreciation [(4,50,000- 50,000)/10]	40,000	3,333.33
Insurance	7,500	625.00
Taxes	1,800	150.00
Garage (Rs. 2,500 × 12)	30,000	2,500.00
Annual repairs	12,000	1,000.00
Driver's Salary (Rs. 3,000× 12)	36,000	3,000.00
Incidental expenses (Rs. 2,000 × 12)	24,000	2,000.00
	1,51,300	12,608.33
Variable expenses:		
Petrol and Oil $\left(4{,}000^{*}\text{ kms} \times \frac{1}{100}\text{ kms.} \times \text{Rs. } 220\right)$		8,800.00
Total Cost (without commission)		21,408.33

[* 20 km. × 2 × 4 round trips × 25 days = 4,000 km.]

Let X be the total takings per month

Driver's Commission = 10% of X $= \frac{X}{10}$

Profit = 15% of X $= \frac{15}{100}X = \frac{3X}{20}$

Total takings per month = Total cost + Driver's Commission + Profit

or X = Rs. 21,408.33 + $\frac{X}{10} + \frac{3X}{20}$

or $X - \frac{3X}{20} - \frac{X}{10}$ = Rs. 21,408.33

or $\frac{20X - 3X - 2X}{20}$ = Rs. 21,408.33

or $\frac{15X}{20}$ = Rs. 21,408.33

or X $= \dfrac{\text{Rs. } 21{,}408.33 \times 4}{3}$

X = Rs. 28,544.44

Total number of round trips per month: 25 days × 4 round trips per day = 100 trips

Hence the charge per round trip $= \dfrac{\text{Rs. } 28{,}544.44}{100}$

= Rs. 285.44

(c) Computation of Future Value

Principal (P) = Rs. 2,40,000

Rate of Interest (i) = 10% p.a.

Time period (n) = 3 years

Amount if compounding is done:

(i) **Annually**

Future Value = P (1 + i)n

$= 2{,}40{,}000 \left(1 + \dfrac{10}{100}\right)^3$

$= 2{,}40{,}000\ (1 + 0.1)^3$

= 2,40,000 x 1.331

= Rs. 3,19,440

(ii) **Semi-Annually**

Future Value $= 2{,}40{,}000 \left(1 + \dfrac{10}{100x2}\right)^{3x2}$

$= 2{,}40{,}000\ (1 + 0.05)^6$

$= 2{,}40{,}000 \text{ x } (1.05)^6$

= 2,40,000 x 1.3401

= Rs. 3,21,624

(d) Calculation of Cost of Preference Shares (K_p)

Preference Dividend (PD) = 0.12 x 40,000 x 100

= 4,80,000

Floatation Cost = 40,000 x 2 = Rs. 80,000

Net Proceeds (NP) = 42,00,000 – 80,000 = 41,20,000

Redemption Value (RV) = 40,000 x 110 = 44,00,000

Cost of Redeemable Preference Shares = $\dfrac{PD + (RV - NP)/N}{\dfrac{RV + NP}{2}}$

$$K_p = \frac{4,80,000 + (44,00,000 - 41,20,000)/10}{\dfrac{44,00,000 + 41,20,000}{2}}$$

$$= \frac{4,80,000 + (2,80,000)/10}{85,20,000/2}$$

$$= \frac{4,80,000 + 28,000}{42,60,000} = \frac{5,08,000}{42,60,000}$$

= 0.1192

K_p = 11.92%

(**Note:** *K_p may be computed alternatively by taking the RV and NP for one unit of preference shares. Final figure would remain unchanged.*)

2. (a) (i) Preparation of Production Budget (in units)

	October	November	December	January
Demand for the month (Nos.)	4,000	3,500	4,500	6,000
Add: 20% of next month's demand	700	900	1,200	1,300
Less: Opening Stock	(950)	(700)	(900)	(1,200)
Vehicles to be produced	3,750	3,700	4,800	6,100

(ii) Preparation of Purchase budget for Part-X

	October	November	December
Production for the month (Nos.)	3,750	3,700	4,800
Add: 40% of next month's production	1,480 (40% of 3,700)	1,920 (40% of 4,800)	2,440 (40% of 6,100)
	5,230	5,620	7,240
No. of units required for	20,920	22,480	28,960

production	(5,230 × 4 units)	(5,620 × 4 units)	(7,240 × 4 units)
Less: Opening Stock	(4,800)	(5,920) (1,480 × 4 units)	(7,680) (1,920 × 4 units)
No. of units to be purchased	16,120	16,560	21,280

(iii) Budgeted Gross Profit for the Quarter October to December

	October	November	December	Total
Sales in nos.	4,000	3,500	4,500	12,000
Net Selling Price per unit*	3,46,150	3,46,150	3,46,150	
Sales Revenue (Rs. in lakh)	13,846	12,115.25	15,576.75	41,538
Less: Cost of Sales (Rs. in lakh) (Sales unit × Cost per unit)	11,428	9,999.50	12,856.50	34,284
Gross Profit (Rs. in lakh)	2,418	2,115.75	2,720.25	7,254

* Net Selling price unit = Rs. 3,95,600 – 12.5% commission on Rs. 3,95,600 = Rs. 3,46,150

(b) (i) Payback Period Method

The cumulative cash flows for each project are as follows:

	Cumulative Cash Flows	
Year	*Project X*	*Project Y*
	Rs.	*Rs.*
0	(10,000)	(10,000)
1	(3,500)	(6,500)
2	(500)	(3,000)
3	2,500	500
4	3,500	4,000

$$\text{Payback}_x = 2 + \frac{\text{Rs. } 500}{\text{Rs. } 3{,}000} = 2.17 \text{ years.}$$

$$\text{Payback}_y = 2 + \frac{\text{Rs. } 3{,}000}{\text{Rs. } 3{,}500} = 2.86 \text{ years.}$$

Net Present Value (NPV)

$$\text{NPV}_x = -\text{Rs. } 10{,}000 + \frac{\text{Rs. } 6{,}500}{(1.12)^1} + \frac{\text{Rs. } 3{,}000}{(1.12)^2} + \frac{\text{Rs. } 3{,}000}{(1.12)^3} + \frac{\text{Rs. } 1{,}000}{(1.12)^4}$$

= Rs. 966.01.

$$NPV_y = -\text{Rs. } 10{,}000 + \frac{\text{Rs. } 3{,}500}{(1.12)^1} + \frac{\text{Rs. } 3{,}500}{(1.12)^2} + \frac{\text{Rs. } 3{,}500}{(1.12)^3} + \frac{\text{Rs. } 3{,}500}{(1.12)^4}$$

= Rs. 630.72.

Internal Rate of Return (IRR)

To solve for each project's IRR, find the discount rates that equate each NPV to zero:

IRR_x = 18.0%.

IRR_y = 15.0%.

(ii) The following table summarizes the project rankings by each method:

	Project that ranks higher
Payback	X
NPV	X
IRR	X

Analysis: All methods rank Project X over Project Y. In addition, both projects are acceptable under the NPV and IRR criteria. Thus, both projects should be accepted if they are independent.

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

Limestone $= 340\left(\text{Rs.}565 - \frac{\text{Rs.}1{,}90{,}400}{340}\right)$

= 340 (Rs. 565 - Rs. 560) = 1,700 (F)

Silica $= 105\left(\text{Rs.}4{,}800 - \frac{\text{Rs.}5{,}09{,}250}{105}\right)$

= 105 (Rs. 4,800 - Rs. 4,850) = 5,250 (A)

Alumina $= 25\left(\text{Rs.}32{,}100 - \frac{\text{Rs.}8{,}12{,}500}{25}\right)$

= 25 (Rs. 32,100 - Rs. 32,500) = 10,000 (A)

Iron ore $= 30\left(\text{Rs.}1{,}800 - \frac{\text{Rs.}53{,}400}{30}\right)$

= 30 (Rs. 1,800 - Rs. 1,780) = 600 (F)

Others $= 23\left(\text{Rs.}2{,}400 - \frac{\text{Rs.}51{,}750}{23}\right)$

	=	23 (Rs. 2,400 - Rs. 2,250)	= 3,450 (F)
			9,500 (A)

(ii) Material Mix Variance = Std. Price (Revised Std. Quantity – Actual Quantity)

Limestone	=	Rs. 565 (523 × 65% - 340)	
	=	Rs. 565 (339.95 - 340)	= 28.25 (A)
Silica	=	Rs. 4,800 (523 × 20% - 105)	
	=	Rs. 4,800 (104.6 - 105)	= 1,920 (A)
Alumina	=	Rs. 32,100 (523 × 5% - 25)	
	=	Rs. 32,100 (26.15 - 25)	= 36,915 (F)
Iron ore	=	Rs. 1,800 (523 × 5% - 30)	
	=	Rs. 1,800 (26.15 - 30)	= 6,930 (A)
Others	=	Rs. 2,400 (523 × 5% - 23)	
	=	Rs. 2,400 (26.15 - 23)	= 7,560 (F)
			35,596.75 (F)

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

Limestone	=	Rs. 565 (500 × 65% - 523 × 65%)	
	=	Rs. 565 (325 - 339.95)	= 8,446.75 (A)
Silica	=	Rs. 4,800 (500 × 20% - 523 × 20%)	
	=	Rs. 4,800 (100 - 104.6)	= 22,080 (A)
Alumina	=	Rs. 32,100 (500 × 5% - 523 × 5%)	
	=	Rs. 32,100 (25 - 26.15)	= 36,915 (A)
Iron ore	=	Rs. 1,800 (500 × 5% - 523 × 5%)	
	=	Rs. 1,800 (25 - 26.15)	= 2,070 (A)
Others	=	Rs. 2,400 (500 × 5% - 523 × 5%)	
	=	Rs. 2,400 (25 - 26.15)	= 2,760 (A)
			72,271.75 (A)

(iv) Material Cost Variance = (Std. Quantity × Std. Price) – (Actual Quantity × Actual Price)

Limestone	=	Rs. 565 × (500 × 65%) - Rs. 1,90,400	
	=	Rs. 1,83,625 - Rs. 1,90,400	= 6,775 (A)
Silica	=	Rs. 4,800 × (500×20%) - Rs. 5,09,250	
	=	Rs. 4,80,000 – Rs. 5,09,250	= 29,250 (A)

Alumina	=	Rs. 32,100 (500 × 5%) – Rs. 8,12,500	
	=	Rs. 8,02,500 – Rs. 8,12,500	= 10,000 (A)
Iron ore	=	Rs. 1,800 (500 × 5%) – Rs. 53,400	
	=	Rs. 45,000 – Rs. 53,400	= 8,400 (A)
Others	=	Rs. 2,400 (500 × 5%) – Rs. 51,750	
	=	Rs. 60,000 – Rs. 51,750	= 8,250 (F)
			46,175 (A)

(b) (i) Computation of Costs of Different Components of Capital

Equity Shares

$$K_e = \frac{D_1}{P_0} + g = \frac{D_0(1+g)}{P_0} + g$$

$$= \frac{\text{Rs. } 3.60\,(1.09)}{\text{Rs. } 54} + 0.09$$

= 0.0727 + 0.09

= 16.27%.

Preference Shares

$$K_p = \frac{\text{Preference Share Dividend}}{P_p} = \frac{\text{Rs. } 11}{\text{Rs. } 95}$$

= 11.58%.

Debt at K_d = 12%

K_d (1 – T) = 12 (1 – 0.4) = 12% (0.6)

= 7.20%.

(ii) Weighted Average Cost of Capital (WACC)

WACC = $w_d k_d$ (1 – T) + $w_p k_p$ + $w_e k_e$

WACC = 0.25 (7.2%) + 0.15 (11.58%) + 0.60 (16.27%)

= 1.8 + 1.737 + 9.762 = 13.30%.

4. (a) Working notes:

1. **Computation of time saved (in hours) per month:**

= {(Standard production time of 6,120 units) – (Actual time taken by the workers)}

= {(6,120 units × 1.975 hours) – (24 days × 8 hrs per day × 50 skilled workers)}

= (12,087 hours – 9,600 hours)

= 2,487 hours

2. **Computation of bonus for time saved hours under Halsey and Rowan schemes:**

Time saved hours = 2,487 hours

(Refer to working note 1)

Wage rate per hour = Rs. 30

Bonus under Halsey Scheme = ½ × 2,487 hours × Rs. 30

= Rs. 37,305

Bonus under Rowan Scheme = $\frac{\text{Time saved}}{\text{Time allowed}} \times \text{Time taken} \times \text{Rate per hour}$

= $\frac{2{,}487 \text{ hours}}{12{,}087 \text{ hours}} \times 9{,}600 \text{ hours} \times \text{Rs.}30$

= Rs. 59,258.38

(i) **Computation of effective rate of earnings under the Halsey and Rowan schemes:**

Total earnings (under Halsey scheme) = Time wages + Bonus

(Refer to working note 2)

= (24 days × 8 hours × 50 skilled workers × Rs. 30) + Rs. 37,305

= Rs. 2,88,000 + Rs. 37,305 = Rs. 3,25,305

Total earnings (under Rowan scheme) = Time wages + Bonus

(Refer to working note 2)

= Rs. 2,88,000 + Rs. 59,258.38

= Rs. 3,47,258.38

Effective rate of earnings per hour (under Halsey Plan) = Rs. 33.89

(Rs. 3,25,305 ÷ 9,600 hrs)

Effective rate of earnings per hour (under Rowan Plan) = Rs. 36.17

(Rs. 3,47,258.38 ÷ 9,600 hrs)

(ii) **Savings to the ZED Ltd., in terms of direct labour cost per piece:**

	Rs.
Direct labour cost (per unit) under time wages system	59.25
(1.975 time per unit × Rs. 30)	
Direct labour cost (per unit) under Halsey Plan	53.15
(Rs. 3,25,305 ÷ 6,120 units)	
Direct labour cost (per unit) under Rowan Plan	56.74
(Rs. 3,47,258.38 ÷ 6,120 units)	
Saving of direct labour cost under:	
*Halsey Plan	Rs. 6.10
(Rs. 59.25 – 53.15)	
*Rowan Plan	Rs. 2.51
(Rs. 59.25 - 56.74)	

(iii) **Advise to ZED Ltd:** *(about the selection of the scheme to fulfill assurance)*

Though the bonus paid under the Halsey Scheme is lower as compared to Rowan Scheme and brings more savings to the ZED Ltd., yet not fulfilling the assurance given to the workers of 20% incentive to the basic wages. However, under Rowan Scheme, the incentive to the workers is more than 20% of the basic wages. Hence, Rowan scheme of incentive payment shall be implemented.

(b) Statement of Working Capital Requirements of Theta Limited

	Rs.
A. *Investment in Inventory*	
1. Raw Material Inventory: One month (30)days(RMC/360) x RMCP = [(70,000 x 52/360) x 30	3,03,333.33
2. Work-in-Process Inventory: Half-a-Month (15 days) (COP/360) x WIPC = {70,000 x 110.50/360] x 15	3,22,291.67
3. Finished Goods Inventory: One Month (30 days) (COS/360)x FGCP=[(70,000x110.5)/360] x 30	6,44,583.33
	12,70,208.33

B.	*Investment in Debtors:*	
	Two Months (60 days) (Credit sale (cost)/360) x BDCP = [(52,500x110.5)] x 60/360	9,66,875.00
C.	*Cash Balance*	1,20,000.00
D.	Investment in Current Assets (A+B+C)	23,57,083.33
E.	*Current Liabilities: Deferred Payment*	
	1. Creditors: One Month (30 days) (Purchase of raw material/360) x PDP = [(70,000 x 52)/360)] x 30	3,03,333.33
	2. Deferred Wages: 1½ weeks (10 days) = [(70,000 x 19.5)/360)] x 10	37,916.67
	3. Deferred Overheads: One Month (30 days) = [(70,000x39)/360)] x 30	2,27,500.00
F.	*Total Current Liabilities*	5,68,750.00
G.	**Net Working Capital (D – F)**	17,88,333.33

5. (a)

Industry	Method of costing
(i) Nursing Home	Operating
(ii) Coal	Single
(iii) Bicycles	Multiple
(iv) Bridge construction	Contract
(v) Interior Decoration	Job
(vi) Advertising	Job
(vii) Furniture	Multiple/ Job costing
(viii) Sugar company having its own sugar-cane fields	Process

(b) The following point of distinction may be explained to Kunal to satisfy his query:

Distinction between Perpetual Inventory System and Continuous Stock taking

Perpetual Inventory System: It is a system of stock control followed by the stores department. Under this system, a continuous record of receipt and issue of material is maintained by the stores department. In other words, in this system, stock control cards or bin cards and the stores ledger show clearly the receipts, issues and balance of all items in stock at all times. This system facilitates planning of production and ensures that production is not interrupted for want of materials and stores.

Continuous Stock taking: It means physical verification of stores items on a continuous basis to reveal the position of actual balances. Such verification is conducted round the year, thus covering each item of store twice or thrice. Any discrepancies, irregularities or shortages brought to the notice, as a result of continuous stock verification are reported to the appropriate authorities for initiating necessary rectification measures. This system works as a moral check as stores staff and acts as a deterrent to dishonesty.

A perpetual inventory system is usually supported by a programme of continuous stock taking. That is continuous stock taking is complementary to the perpetual inventory system. Sometimes the two terms are considered synonymous but it is not so. The success of the perpetual inventory system depends upon the maintenance and upto date writing up of (i) the stores ledger and (ii) bin cards/ stock control cards. Continuous stock taking, ensures the veracity of figures shown by the above records.

(c) Factors to be considered by a Venture Capitalist before Financing Any Risky Project

The factors that a venture capitalist should consider before financing any risky project are as follows:

(i) *Level of expertise of company's management:* Most of the venture capitalists believe that the success of a new project is highly dependent on the quality of its management team. They expect that the entrepreneur should have a skilled team of managers. Management is also required to show a high level of commitment to the project.

(ii) *Level of expertise in production*: Venture capital should ensure that entrepreneur and his team should have necessary technical ability to be able to develop and produce new product / service.

(iii) *Nature of new product / service*: The venture capitalist should consider whether the development and production of new product / service is technically feasible. They should employ experts in their respective fields to examine the idea proposed by the entrepreneur.

(iv) *Future Prospects*: Since the degree of risk involved in investing in the company is quite fairly high, venture capitalists should seek to ensure that the prospects for future profits compensate for the risk. Therefore, they should see a detailed business plan setting out the future business strategy.

(v) *Competition*: The venture capitalists should seek assurance that there is actually a market for a new product. Further, they should see the research carried on by the entrepreneur.

(vi) *Risk borne by entrepreneur*: The venture capitalist is expected to see that the entrepreneur bears a high degree of risk. This will assure them that the entrepreneur has the sufficient level of commitment to the project as he will incur a lot of loss, should the project fail.

(vii) *Exit Route*: The venture capitalist should try to establish a number of exist routes. These may include a sale of shares to the public, sale of shares to another business, or sale of shares to original owners.

(viii) *Board membership*: In case of companies, to ensure proper protection of their investment, venture s should seek a place on the Board of Directors. This will enable them to have their say on all significant matters affecting the business.

(**Note:** *Students may give any four of the above factors.*)

(d) Role of Chief Financial Officer (CFO)

The chief financial officer of an organisation plays an important role in the company's goals, policies, and financial success. His responsibilities include:

(i) *Financial analysis and planning:* Determining the proper amount of funds to employ in the firm, i.e. designating the size of the firm and its rate of growth.

(ii) *Investment decisions:* The efficient allocation of funds to specific assets.

(ii) *Financing and capital structure decisions:* Raising funds on favourable terms as possible, i.e., determining the composition of liabilities.

(iv) Management of financial resources (such as working capital).

(v) *Risk management*: Protecting assets.

6. (a) **P 1 Account**

Particulars	Kg.	Amount (Rs.)	Particulars	Kg.	Amount (Rs.)
To Direct Material	12,000	60,000	By Normal Loss [12,000 kg. × 10% × Rs. 2]	1,200	2,400
To Other Materials	-	18,000	By P 2	9,600	1,42,756
To Direct Wages	-	16,000	By Abnormal Loss [Balancing figure]	1,200	17,844
To Direct Expenses	-	9,000			
To Production OH	-	60,000			
	12,000	1,63,000		12,000	1,63,000

Rate per unit of output transferred to process P 2 and Abnormal loss:

$$\frac{\text{Total Cost} - \text{Re alisation on normal loss}}{\text{Units int roduced} - \text{Normal loss}} = \frac{\text{Rs.}1{,}63{,}000 - \text{Rs.}2{,}400}{12{,}000 - 1{,}200} = \text{Rs. } 14.87$$

P 2 Account

Particulars	Kg.	Amount (Rs.)	Particulars	Kg.	Amount (Rs.)
To P 1 A/c	9,600	1,42,756	By Normal Loss [9,600 kg. × 5% × Rs. 3]	480	1,440
To Other Materials	-	20,000	By P 2	9,400	2,71,277
To Direct Wages	-	20,000			
To Direct Expenses	-	6,880			
To Production OH	-	75,000			
To Abnormal Gain [Balancing figure]	280	8,081			
	9,880	2,72,717		9,880	2,72,717

Rate per unit of output transferred to process P 3 and Abnormal Gain:

$$\frac{\text{Total Cost} - \text{Realisation on normal loss}}{\text{Units introduced} - \text{Normal loss}} = \frac{\text{Rs.}2,64,636 - \text{Rs.}1,440}{9,600 - 480} = \text{Rs. } 28.8592$$

P 3 Account

Particulars	Kg.	Amount (Rs.)	Particulars	Kg.	Amount (Rs.)
To P 2	9,400	2,71,277	By Normal Loss [9,400 kg. × 10% × Rs. 6]	940	5,640
To Other Materials	-	30,000	By BP A/c [NRV]	600	10,200
To Direct Wages	-	36,000	By Finished Goods A/c	7,800	4,75,301
To Direct Expenses	-	22,520	By Abnormal loss A/c [Balancing figure]	60	3,656
To Production OH	-	1,35,000			
	9,400	4,94,797		9,400	4,94,797

1. Calculation of Net realizable value of by product BP at split-off point:

Sales Proceeds (600 kg. × Rs. 25)	= Rs. 15,000
Less: Further processing cost (600 kg. × Rs. 5)	= (Rs.3,000)
Selling & Distribution cost (600 kg. × Rs. 3)	= (Rs.1,800)
Net Realizable Value	Rs.10,200

2. Rate per unit of output transferred to finished goods and Abnormal loss:

$$= \frac{\text{Total Cost} - \text{Realisation on normal loss} - \text{Realisation on byproduct}}{\text{Units introduced} - \text{Normal loss} - \text{byproduct units}}$$

$$= \frac{Rs.4,94,797 - Rs.5,640 - Rs.10,200}{9,400 - 940 - 600} = Rs.\ 60.9360$$

BP Account

Particulars	Kg.	Amount (Rs.)	Particulars	Kg.	Amount (Rs.)
To P 3	600	10,200	To Costing P/L A/c	600	15,000
To Processing cost [600 kg. × Rs. 5]	-	3,000			
To S&D A/c [600 kg. × Rs. 3]	-	1,800			
	600	15,000		600	15,000

Working: Apportionment of Production OH to different Processes.

Total Direct Wages = P 1- Rs. 16,000 + P 2- Rs. 20,000 + P 3- Rs. 36,000 = Rs. 72,000

$$P\ 1 = \frac{Rs.2,70,000}{Rs.72,000} \times Rs.16,000\ ; P\ 2 = \frac{Rs.2,70,000}{Rs.72,000} \times Rs.20,000\ ; P\ 3 = \frac{Rs.2,70,000}{Rs.72,000} \times Rs.36,000$$

P 1 = Rs. 60,000, P 2 = Rs. 75,000 and P 3 = Rs. 1,35,000

(b) (i) Calculation of Sales

Fixed Assets Rs. (1,62,50,000 + 30,00,000) = 1,92,50,000

$$\text{Sales} = \frac{1,92,50,000}{1.4} = 1,37,50,000$$

Cost of Goods Sold	= 1,37,50,000 × .90	=	1,23,75,000
Material	= 1,37,50,000 × .40	=	55,00,000
Depreciation	= 1,37,50,000 × 0.05	=	6,87,500
Net profit	= 1,37,50,000 × 0.10	=	13,75,000

Calculation of Net Fixed Assets

	Rs.
Opening balance	1,62,50,000
Add: Purchases	30,00,000
	1,92,50,000

Less: Accumulated Depreciation	52,00,000	
Additional Depreciation	6,87,500	58,87,500
Closing balance of Fixed Assets		1,33,62,500

Calculation of Closing Stock

$$\text{Average stock} = \frac{\text{Cost of goods sold}}{\text{Stock turnover ratio}}$$

$$= \frac{1,23,75,000}{6} = 20,62,500$$

$$\text{Average stock} = \frac{(\text{Opening stock} + \text{Closing stock})}{2}$$

$$20,62,500 = \frac{(19,50,000 + \text{Closing stock})}{2}$$

Closing stock = 41,25,000 – 19,50,000 = 21,75,000

Calculation of Debtors = 1,37,50,000 × .10 = 13,75,000

Calculation of Creditors = 55,00,000 × .25 = 13,75,000

Calculation of Interest and Provision for Taxation

Net Profit	13,75,000
Less: Interest (19,50,000 × 10%)	2,55,500
(5,50,000 × 11%)	11,19,500
Less: Taxes	3,35,850
Net Profit Available for Dividend	7,83,650
Less: Preference share dividend	2,60,000
Less: Equity dividend @ 7%	4,20,000
Transfer to Reserves and Surplus	1,03,650

Reserves and Surplus

Opening Balance	14,00,000
Add: Current Balance	1,03,650
	15,03,650

Projected Cash Flow Statement

(i) **Cash flow from Operating Activities**

Profit after taxation		7,83,650
Depreciation added back		6,87,500
		14,71,150
Add: Increase in current liabilities and decrease in current assets		
Provision for taxation		3,35,850
Debtors (26,00,000 – 13,75,000)		12,25,000
Less: Increase in current assets and decrease in current liabilities		
Stock (21,75,000 – 19,50,000)	(2,25,000)	
Creditors (13,75,000 – 32,50,000)	(18,75,000)	(21,00,000)
Net Cash from Operating Activities		9,32,000

(ii) **Cash flow from Investing Activities**

Purchase of Fixed Assets	(30,00,000)

(iii) **Cash flow from Financing Activities**

Issue of Debenture	5,50,000	
Issue of Equity Share Capital	30,00,000	
Dividend Paid	(6,80,000)	28,70,000
Net Increase in Cash		8,02,000
Opening Balance of Cash		2,50,000
Closing Balance		10,52,000

Projected Draft Balance Sheet as on 31st March, 2016

Liabilities	*Rs. ('000)*	*Assets*		*Rs. ('000)*
Equity Share Capital	9,000	Fixed Assets (at cost)	19,250	
8% Preference Share Capital	3,250	*Less:* Depreciation written off	5,887.5	13,362.5
Reserves & Surplus	1,503.65	Stock		2,175
10% & 11% Debentures	2,500	Sundry Debtors Cash		1,375 1,052
Sundry Creditors	1,375			
Provision for Taxation	335.85			
Total	17,964.5	Total		17,964.5

7. (a) (i) Advantages of cost plus contract:

- The contractor is assured of a fixed percentage of profit. There is no risk of incurring any loss on the contract.
- It is useful specially when the work to be done is not definitely fixed at the time of making the estimate.
- Contractee can ensure himself about the 'cost of contract' as he is empowered to examine the books and documents of the contractor to ascertain the veracity of the cost of contract.

(ii) Limitations of Marginal Costing

- *Difficulty in classifying fixed and variable elements*: It is difficult to classify exactly the expenses into fixed and variable category.
- *Dependence on key factors:* Contribution of a product itself is not a guide for optimum profitability unless it is linked with the key factor.
- *Scope for Low Profitability:* Sales staff may mistake marginal cost for total cost and sell at a price; which will result in loss or low profits. Hence, sales staff should be cautioned while giving marginal cost.
- *Faulty valuation:* Overheads of fixed nature cannot altogether be excluded particularly in large contracts, while valuing the work-in-progress. In order to show the correct position fixed overheads have to be included in work-in-progress.
- *Unpredictable nature of Cost:* Some of the assumptions regarding the behaviour of various costs are not necessarily true in a realistic situation. Fixed cost may change from one period to another. The variable costs do not remain constant per unit of output. There may be changes in the prices of raw materials, wage rates etc. after a certain level of output has been reached due to shortage of material, shortage of skilled labour, concessions of bulk purchases etc.
- *Marginal costing ignores time factor and investment*: The marginal cost of two jobs may be the same but the time taken for their completion and the cost of machines used may differ. The true cost of a job which takes longer time and uses costlier machine would be higher. This fact is not disclosed by marginal costing.
- *Understating of W-I-P:* Under marginal costing stocks and work in progress are understated.

(b) Treatment of spoiled and defective work in job costing method:

Circumstances	Treatment
(1) Where a percentage of defective work is allowed in a particular job as it cannot be avoided.	When a normal rate of defectives has already been established, if the actual number of defectives is within the normal limit or is near thereto the cost of rectification will be charged to the whole job and spread over the entire output. If, on the other hand, the number of defective units substantially exceeds the normal, the cost of rectification of the number which exceeds the normal will be written off as a loss in the Costing Profit and Loss Account.
(2) Where defect is due to bad workmanship.	In this case cost of rectification will be abnormal cost, *i.e.,* not a legitimate element of the cost. Therefore, the cost of rectification shall be written off as a loss, unless by an arrangement, it is to be recovered as a penalty from the workman concerned. It is possible, however that the management did provide for a certain proportion of defectives on account of bad workmanship as an unavoidable feature of production. If that be the case, the cost of rectifying to the extent provided for by the management will be treated as a normal cost and charged to the batch.
(3) Where defect is due to the Inspection Department wrongly accepting incoming material of poor quality.	In this case the cost of rectification will be charged to the department and will not be considered as cost of manufacture. Being an abnormal cost, it will be written off to the Costing Profit and Loss Account.

(c) Differentiation between Factoring and Bills Discounting

The differences between Factoring and Bills discounting are:

(i) Factoring is called as “Invoice Factoring’ whereas Bills discounting is known as ‘Invoice discounting.”

(ii) In Factoring, the parties are known as the client, factor and debtor whereas in Bills discounting, they are known as drawer, drawee and payee.

(iii) Factoring is a sort of management of book debts whereas bills discounting is a sort of borrowing from commercial banks.

(iv) For factoring there is no specific Act, whereas in the case of bills discounting, the Negotiable Instruments Act is applicable.

(d) Debt-Equity Ratio is an indicator of leverage of a firm. A high ratio means less protection for creditors while a low ratio indicates a wider safety cushion.

Debt to Equity Ratio

$$\text{Debt to Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Shareholders' Equity}}$$

Note: Sometimes only interest-bearing, long term debt is used instead of total liabilities.

A high ratio here means less protection for creditors. A low ratio, on the other hand, indicates a wider safety cushion (i.e., creditors feel the owner's funds can help absorb possible losses of income and capital).

This ratio indicates the proportion of debt fund in relation to equity. This ratio is very often referred in capital structure decision as well as in the legislation dealing with the capital structure decisions (i.e. issue of shares and debentures). Lenders are also very keen to know this ratio since it shows relative weights of debt and equity.

(e) Forms of Bank Credit

Some of the forms of bank credit are:

(i) ***Short Term Loans:*** In a loan account, the entire advance is disbursed at one time either in cash or by transfer to the current account of the borrower. It is a single advance and given against securities like shares, government securities, life insurance policies and fixed deposit receipts, etc.

(ii) ***Overdraft:*** Under this facility, customers are allowed to withdraw in excess of credit balance standing in their Current Account. A fixed limit is therefore granted to the borrower within which the borrower is allowed to overdraw his account.

(iii) ***Clean Overdrafts:*** Request for clean advances are entertained only from parties which are financially sound and reputed for their integrity. The bank has to rely upon the personal security of the borrowers.

(iv) ***Cash Credits:*** Cash Credit is an arrangement under which a customer is allowed an advance up to certain limit against credit granted by bank. Interest is not charged on the full amount of the advance but on the amount actually availed of by him.

(v) ***Advances against goods:*** Goods are charged to the bank either by way of pledge or by way of hypothecation. Goods include all forms of movables which are offered to the bank as security.

(vi) ***Bills Purchased/Discounted:*** These advances are allowed against the security of bills which may be clean or documentary.

Usance bills maturing at a future date or sight are discounted by the banks for approved parties. The borrower is paid the present worth and the bank collects the full amount on maturity.

(vii) ***Advance against documents of title to goods:*** A document becomes a document of title to goods when its possession is recognised by law or business custom as possession of the goods like bill of lading, dock warehouse keeper's certificate, railway receipt, etc. An advance against the pledge of such documents is an advance against the pledge of goods themselves.

(viii) ***Advance against supply of bills:*** Advances against bills for supply of goods to government or semi-government departments against firm orders after acceptance of tender fall under this category. It is this debt that is assigned to the bank by endorsement of supply bills and executing irrevocable power of attorney in favour of the banks for receiving the amount of supply bills from the Government departments.

(**Note:** *Students may answer any four of the above forms of bank credit.*)

Test Series: March, 2015

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 4: TAXATION

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) Mr. Suraj, who does not maintain books of account for the year ended 31.3.2015, requests you to compute his total income and the tax payable thereon for the assessment year 2015-16 from the following: Rs.

(i) Basic Salary - 20,000 p.m.

CCA - 1,000 p.m.

HRA - 5,000 p.m.

(ii) Suraj resides in Mumbai, paying a rent of Rs. 6,000 per month.

(iii) Suraj is paid an education allowance of Rs. 500 per month per child for all the three of his children. Actual expenses (tuition fees only) amounts to Rs. 15,000, Rs. 10,000 and Rs. 5,000 respectively.

(iv) He bought a heavy goods vehicle on 7.6.2014 and has been letting it on hire from the same date. He declares an income of Rs. 34,900 from the same.

(v) Interest from company deposits is Rs. 15,000 and bank interest from saving bank account is Rs. 5,000.

(vi) Interest is payable on bank loans availed for buying the truck and making company deposits as follows:-

Purpose	Date of loan	Amount	Interest rate
Truck purchase	1.4.2014	5 lakhs	10% p.a.
Company deposit	1.10.2014	1 lakh	9 % p.a.

(vii) Loss carried forward arising from speculating in shares during the preceding previous year and eligible for set-off is Rs. 1,00,000.

(viii) Suraj has invested Rs. 12,000 in notified equity linked saving scheme of UTI, Rs. 52,000 in PPF, Rs. 9,000 as premium on life insurance policy taken on 31.07.2013 on his own life (sum assured Rs. 40,000) and Rs. 15,000 towards pension fund of LIC. *(10 Marks)*

(b) Compute the service tax liability of Mr. P, an air travel agent, for the quarter ended June 30, 2014 using the following details:-

Particulars	Amount (Rs.)
Basic air fare collected for domestic booking of tickets	50,00,000
Basic air fare collected for international booking of tickets	80,00,000
Commission received from the airlines on the sale of domestic and international tickets	5,00,000

In the above case, would the service tax liability of Mr. P be reduced if he opts for the special provision for payment of service tax as provided under rule 6 of the Service Tax Rules, 1994 instead of paying service tax @12%.

Note: Mr. P is not eligible for the small service provider's exemption under Notification No. 33/2012-ST dated 20.06.2012 and service tax has been charged separately. *(10 Marks)*

2. (a) State, with reasons, the allowability of the following expenses under the Income-tax Act, 1961 while computing income from business or profession for the Assessment Year 2015-16:

(i) Provision made on the basis of actuarial valuation for payment of gratuity Rs. 5,00,000. However, no payment on account of gratuity was made before due date of filing return.

(ii) Purchase of oil seeds of Rs. 50,000 in cash from a farmer on a banking day.

(iii) Tax on non-monetary perquisite provided to an employee Rs. 20,000.

(iv) Payment of Rs. 50,000 by using credit card for fire insurance.

(v) Salary payment of Rs. 2,00,000 outside India by a company without deduction of tax.

(vi) Sales tax deposited in cash Rs. 50,000 with State Bank of India.

(vii) Payment made in cash Rs. 30,000 to a transporter in a day for carriage of goods.

(viii) The mediclaim premium paid to GIC by Mr. Lomesh for his employees, by a draft, on 27.12.2014. *(8 Marks)*

(b) Smart Coaching Classes Ltd. is a coaching centre. During the year ended 31.3.2014, it has collected a sum of Rs. 10.2 lakh as service tax, out of which Rs. 70,000 was paid by utilizing the CENVAT credit and balance was paid by cheque on the respective due dates. The details pertaining to the month of April, 2014 are as under:

Particulars	Amount (Rs.)
Free coaching rendered to a batch of 100 students (Value of similar services is Rs. 20,000)	

Coaching fees collected from students for the classes to be held in May, 2014	14,50,000
Advance received from a college for teaching their students, on 30.04.2014. However, due to some unavoidable reasons, no coaching was conducted and the advance money (including service tax) was returned on 12.05.2014	3,37,080

Determine the service tax liability for the month of April, 2014 and indicate the date by which service tax has to be deposited by the assessee. *(4 Marks)*

(c) Shine India Pvt. Ltd.'s total inter-State sales @ 4 % CST for the Financial Year 2014-15 is Rs. 1,50,00,000 (CST not shown separately). In this regard, following additional information is available:

(i) Goods sold to Mr. X for Rs. 1,50,000, on 16.07.2014 were returned by him on 12.12.2014.

(ii) A buyer, Mr. Y, to whom goods worth Rs. 55,000 were dispatched on 16.04.2014, rejected such goods. The said goods were received back on 15.11.2014.

(iii) Goods sold to Mr. Z for Rs. 5,00,000, on 16.04.2014 were returned by him on 12.12.2014.

Determine the amount of taxable turnover and tax liability of Shine India Pvt. Ltd.

(4 Marks)

3. (a) Mr. Sahil, acquired a residential house in January, 2000 for Rs. 10,00,000 and made some improvements by way of additional construction to the house, incurring expenditure of Rs. 2,00,000 in October, 2004. He sold the house property in October, 2014 for Rs. 75,00,000. The value of property was adopted as Rs. 80,00,000 by the State stamp valuation authority for registration purpose. He acquired a residential house in January, 2014 for Rs. 25,00,000. He deposited Rs. 20,00,000 in capital gains bonds issued by National Highways Authority of India (NHAI) in June, 2015.

Compute the capital gain chargeable to tax for the assessment year 2015-16.

What would be the tax consequence and in which assessment year it would be taxable, if the house property acquired in January, 2014 is sold for Rs. 40,00,000 in March, 2016?

Cost inflation index : F.Y.1999-2000 : 389

F.Y. 2004-2005 : 480

F.Y. 2014-2015 : 1024 *(8 Marks)*

(b) Compute the CENVAT credit available with M/s PQ & Co. in respect of the following services billed to it in the month of August, 2014:-

S.No.	Services billed	Service tax paid* (Rs.)
(i)	Accounting and auditing services	10,00,000
(ii)	Legal services	5,00,000
(iii)	Security services	50,000
(iv)	Hiring of motor vehicles (Such motor vehicles are not eligible capital goods for the purposes of claiming CENVAT credit)	1,50,000

**including EC and SHEC* *(5 Marks)*

(c) Calculate assessable value and excise duty payable on the basis of following information:

	Rs.
Total invoice price	40,000
State VAT	4,000
Insurance charges for dispatch of final product	200
Packing charges	1,000
Freight charged from factory to the place of customer	2,000
Excise duty rate is 12% and education cesses as applicable	

(3 Marks)

4. (a) Two brothers Ajay and Vishnu are co-owners of a house property with equal share. The property was constructed during the financial year 1998-1999. The property consists of eight identical units and is situated at Cochin.

During the financial year 2014-15, each co-owner occupied one unit for residence and the balance of six units were let out at a rent of Rs. 12,000 per month per unit. The municipal value of the house property is Rs. 9,00,000 and the municipal taxes are 20% of municipal value, which were paid during the year. The other expenses were as follows:

		Rs.
(i)	Repairs	40,000
(ii)	Insurance premium (paid)	15,000
(iii)	Interest payable on loan taken for construction of house	3,00,000

One of the let out units remained vacant for four months during the year.

Ajay could not occupy his unit for six months as he was transferred to Chennai. He does not own any other house.

The other income of Mr. Ajay and Mr. Vishnu are Rs. 2,90,000 and Rs. 1,80,000, respectively, for the financial year 2014-15.

Compute the income under the head 'Income from House Property' and the total income of two brothers for the assessment year 2015-16. *(8 Marks)*

(b) Shree Industries Ltd. (SIL) is an Indian Company. It has received taxable services from a UK based company-George Ltd. on 01.01.2015. George Ltd. raised on SIL an invoice of £ 45,000 on 27.01.2015. SIL debited its books of accounts on 07.02.2015 and made the payment on 25.03.2015.

George Ltd. and SIL are associated enterprises. Determine the point of taxation using aforesaid details. *(4 Marks)*

(c) Shiv and Co., a manufacturer of product 'X', sold its goods to a distributor at Rs. 11,250. The distributor sold the goods to wholesaler for Rs. 13,500. The wholesaler sold the goods to a retailer for Rs. 16,875. The retailer sold the goods to consumer at Rs. 22,500. All the sales were inclusive of VAT @ 12.5%.

Compute total VAT payable under the subtraction method. *(4 Marks)*

5. (a) Mr. Sharma retired on 1.12.2014 after 20 years 10 months of service, receiving leave salary of Rs. 5,00,000. Other details of his salary income are:

Basic Salary	:	Rs. 5,000 p.m. (Rs. 1,000 was increased w.e.f. 1.4.2014)
Dearness Allowance	:	Rs. 3,000 p.m. (60% of which is for retirement benefits)
Commission	:	Rs. 500 p.m.
Bonus	:	Rs. 1,000 p.m.

Leave availed during service : 480 days

He was entitled to 30 days leave every year.

You are required to compute his taxable leave salary assuming:

(i) He is a government employee.

(ii) He is a non government employee. *(4 Marks)*

(b) Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(vii) the Income-tax Act, 1961 -

(i) Nikhil HUF received Rs. 75,000 in cash from niece of Nikhil (i.e., daughter of Nikhil's sister). Nikhil is the Karta of the HUF.

(ii) Soni, a member of her father's HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is Rs. 9,00,000.

(iii) Mr. Ravi received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was Rs. 100 per share. He also received jewellery worth Rs. 45,000 (FMV) from his nephew on the same day.

(iv) Sagar HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is Rs. 5,25,000. *(4 Marks)*

(c) Industrial Training Institute (ITI), Manikpuri offers a short term Modular Employable Skill Course in the Information & Communication Technology Sector. The said course is approved by the National Council of Vocational Training (NCVT). ITI, Manikpuri is registered with the Directorate General of Employment and Training, Ministry of Labour and Employment. Revenue raised a demand for service tax on the services provided by ITI Manikpuri.

Examine whether the demand raised by Revenue is correct in law. *(5 Marks)*

(d) Mr. Harsh has conducted a market survey for Mr. Varun. However, Mr. Harsh has not charged any fee for such services as Mr. Varun happens to be his best friend. Is service tax payable on such free service? Explain. *(3 Marks)*

6. (a) Mr. Rahul is an employee of Y Ltd. and has substantial interest in the company. His salary is Rs. 20,000 p.m. Mrs. Reena (wife of Mr. Rahul) is also working in Y Ltd. at a salary of Rs. 12,000 p.m. without any qualifications. Mr. Rahul also receives Rs. 30,000 as interest on securities. Mrs. Reena owns a house property which she has let out. Rent received from tenants is Rs. 6000 p.m. Compute the gross total income of Mr. Rahul and Mrs. Reena for the A.Y.2015-16. *(4 Marks)*

(b) Compute the gross total income of Mr. Farukh for the A.Y.2015-16 from the information given below –

Particulars	Rs.
Net income from house property	1,25,000
Income from business (before providing for depreciation)	1,35,000
Short term capital gains on sale of shares	56,000
Long term capital loss from sale of property (brought forward from A.Y.2014-15)	(90,000)
Income from tea business	1,20,000
Dividends from Indian companies carrying on agricultural operations	80,000
Current year depreciation	26,000
Brought forward business loss (loss incurred six years ago)	(45,000)

(4 Marks)

(b) An individual acts as a referee in a football match organized by Sports Authority of India. He has also acted as a referee in another charity football match organized by a local sports club. Discuss whether he is required to pay any service tax. *(4 Marks)*

(c) M purchases cloth and gives it to N, who is a tailor, to stitch a shirt as per measurements and requirements of M. N stitched the shirt and gave it to M. In the given case, who will be treated as manufacturer of the shirt for the purpose of levy of central excise duty? *(4 Marks)*

7. (a) Mr. Arjun sold his house property in Bangalore as well as his rural agricultural land for a consideration of Rs. 60 lakh and Rs. 15 lakh, respectively, to Mr. Mohan on 1.8.2014. He has purchased the house property and the land in the year 2012 for Rs. 40 lakh and Rs. 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 1.8.2014, is Rs. 85 lakh and Rs. 20 lakh for the house property and rural agricultural land, respectively. Determine the tax implications in the hands of Mr. Arjun and Mr. Mohan and the TDS implications, if any, in the hands of Mr. Mohan, assuming that both Mr. Arjun and Mr. Mohan are resident Indians.

(6 Marks)

(b) State with reasons, whether the following statements are true or false, with regard to the provisions of the Income-tax Act, 1961:

(i) The Assessing Officer has the power, inter alia, to allot PAN to any person by whom no tax is payable.

(ii) Where the Karta of a HUF is absent from India, the return of income can be verified by any male member of the family. *(2 Marks)*

(c) Mr. Aarav, a service provider, wants to furnish consolidated details of lumpsum amounts pertaining to the half year relating to value of taxable service charged, amount realised against the same and service tax payable, in his half-yearly service tax return. Explain whether he can do so. *(4 Marks)*

(d) Global Industries imported certain goods from Norway. The said goods were warehoused in a public warehouse for a period of 3 months after which it is cleared for home consumption on payment of applicable customs duty. While transporting the goods from customs warehouse to the factory of the importer, the said goods were damaged. Can duty paid on such goods be remitted to Global Industries?

(4 Marks)

MOCK TEST – 2

INTERMEDIATE (IPC) : GROUP – I

PAPER – 4: TAXATION

SUGGESTED ANSWERS/HINTS

1. (a) Computation of total income of Mr. Suraj for the Assessment Year 2015-16

Particulars	Rs.	Rs.
Income from Salary		
Basic Salary (Rs.20,000 × 12)		2,40,000
CCA (Rs.1,000 × 12)		12,000
HRA (Rs.5,000 × 12)	60,000	
Less: Exempt under section 10(13A) [See Note 1 below]	48,000	12,000
Education Allowance (Rs.500×12×3)	18,000	
Less: Exempt under section 10(14) (Rs.100×12×2)	2,400	15,600
Income from Salary		**2,79,600**
Profits and gains from business or profession		
Income from the business of letting on hire, a heavy vehicle under section 44AE (Rs.7,500×10) [See Note 2 below]		75,000
Income from Other Sources		
Interest from company deposits	15,000	
Interest from Saving Bank Account	5,000	
	20,000	
Less: Deduction under section 57		
Rs.1,00,000 @ 9% for 6 months–towards loan interest	4,500	15,500
Gross Total Income		**3,70,100**
Less: Deduction under Chapter VI-A		
Under section 80C [See Note 4 below]	93,000	
Under section 80CCC	15,000	
	1,08,000	
Under section 80TTA- Interest from Saving Bank Account (See Note-7 below)	5,000	1,13,000
Total Income		**2,57,100**
Tax on Rs.2,57,100		710

Less: Rebate under section 87A	710
	Nil
Add: Education cess @ 2% and SHEC @ 1%	Nil
Tax Payable	**Nil**

Notes:

(1) HRA is exempt to the extent of the least of the following under section 10(13A)

(i) 50% of salary (as the city is Mumbai) i.e. 50% of Rs.2,40,000 = Rs.1,20,000

(ii) Excess of rent paid over 10% of salary = Rs.72,000 – Rs.24,000 = Rs.48,000

(iii) Actual HRA received = 5,000 × 12 = Rs.60,000

Least of the above i.e.Rs.48,000 is exempt under section 10(13A)

(2) In the case of a person owning not more than 10 vehicles at any time during the previous year, estimated income from each vehicle, whether heavy goods vehicle or not, will be deemed to be Rs.7,500/- for every month or part of the month during which the heavy vehicle is owned by the assessee during the previous year [Section 44AE].

Presumptive income = Rs.7,500 × 10 = 75,000

If, however, the assessee declares a higher amount, such amount will be considered as income. In the instant case, since the assessee declares a lower amount, it cannot be considered, since no books of account are maintained. Also, interest is not deductible, since under section 44AE, all deductions under sections 30 to 38 are deemed to have been allowed.

(3) Brought forward loss from speculation business can be set off only against income from speculation business and not against other business income.

(4) Deduction under section 80C:

Investment in notified equity linked saving scheme of UTI	12,000
Investment in PPF	52,000
Life insurance premium on own life restricted to 10% of sum assured	4,000
Tuition fees paid for two of his children (Most beneficial to Suraj)	25,000
	93,000

(5) Contribution to pension fund of LIC Rs.15,000 is deductible under section 80CCC.

(6) Total deduction under sections 80C, 80CC and 80CCD is limited to Rs.1,50,000 as per section 80CCE.

(7) Deduction under section 80TTA is allowed in respect of interest from Saving Bank Account upto a maximum of Rs.10,000. Therefore, interest from Saving Bank Account of Rs.5,000 is allowed as deduction.

(b) As per rule 6 of the Service Tax (Determination of Value) Rules, 2006, only the commission received by the air travel agent from the airline is included in the value of taxable service. The air fare collected by the air travel agent in respect of the service provided by him does not from part of the value of taxable service. Accordingly, the service tax liability of Mr. P would be computed as under:

Particulars	**Rs.**
Basic air fare collected for domestic booking of tickets	Nil
Basic air fare collected for international booking of tickets	Nil
Commission received from the airlines on the sale of domestic and international tickets	5,00,000
Value of taxable service	5,00,000
Service tax @ 12% [Rs.5,00,000×12%]	60,000
Education cess @ 2% [Rs.60,000×2%]	1,200
Secondary and higher education cess @ 1% [Rs.60,000×1%]	600
Service tax payable	61,800

However, if Mr. P opts for the special provision for payment of service tax as provided under rule 6 of the Service Tax Rules, 1994, service tax liability would be computed as under:

Particulars	**Rs.**
0.6% of the basic air fare collected for domestic booking of tickets [Rs.50,00,000 × 0.6%]	30,000
1.2% of the basic air fare collected for international booking of tickets [Rs.80,00,000× 1.2%]	96,000
Service tax	1,26,000
Add: Education cess @ 2%	2,520
Add: Secondary and Higher Education cess @ 1%	1,260
Service tax payable	1,29,780

No, the service tax liability of Mr. P would not be reduced in the aforesaid option.

2. (a) (i) **Not allowable as deduction**

As per section 40A(7), no deduction is allowed in computing business income in respect of any provision made by the assessee in his books of account for the payment of gratuity to his employees except in the following two cases:

(1) where any provision is made for the purpose of payment of sum by way of contribution towards an approved gratuity fund or;

(2) where any provision is made for the purpose of making any payment on account of gratuity that has become payable during the previous year.

Therefore, in the present case, the provision made on the basis of actuarial valuation for payment of gratuity has to be disallowed under section 40A(7), since, no payment has been actually made on account of gratuity.

Note: It is assumed that such provision is not for the purpose of contribution towards an approved gratuity fund.

(ii) **Allowable as deduction**

As per Rule 6DD, in case the payment is made for purchase of agricultural produce directly to the cultivator, grower or producer of such agricultural produce, no disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds Rs.20,000.

Therefore, in the given case, disallowance under section 40A(3) is not attracted since, cash payment for purchase of oil seeds is made directly to the farmer.

(iii) **Not allowable as deduction**

Income-tax of Rs.20,000 paid by the employer in respect of non-monetary perquisites provided to its employees is exempt in the hands of the employee under section 10(10CC). As per section 40(a)(v), such income-tax paid by the employer is not deductible while computing business income.

(iv) **Allowable as deduction**

Payment for fire insurance is allowable as deduction under section 36(1). Since payment by credit card is covered under Rule 6DD, which contains the exceptions to section 40A(3), disallowance under section 40A(3) is not attracted in this case.

(v) **Not allowable as deduction**

Disallowance under section 40(a)(iii) is attracted in respect of salary payment of Rs.2,00,000 outside India by a company without deduction of tax at source.

(vi) **Allowable as deduction**

As per Rule 6DD, if the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender, no disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds Rs.20,000.

Therefore, in the given case, no disallowance under section 40A(3) is attracted since payment of sales tax is covered by the above mentioned exception contained in Rule 6DD.

(vii) Allowable as deduction

The limit for attracting disallowance under section 40A(3) for payment otherwise than by way of account payee cheque or account payee bank draft is Rs.35,000 in case of payment made for plying, hiring or leasing goods carriage. Therefore, in the present case, disallowance under section 40A(3) is not attracted for payment of Rs.30,000 made in cash to a transporter for carriage of goods.

(viii) Allowable as deduction

Section 36(1)(ib) provides deduction in respect of premium paid by an employer to keep in force an insurance on the health of his employees under a scheme framed in this behalf by GIC or any other insurer. The medical insurance premium can be paid by any mode other than cash, to be eligible for deduction under section 36(1)(ib).

(b) Computation of service tax liability of Smart Coaching Classes Ltd. for the month of April, 2014

Particulars	**Amount of service tax (Rs.)**
Free coaching rendered (Note-1)	Nil
Coaching fees collected from students (Note 2) $14,50,000 \times \frac{12.36}{112.36}$	1,59,505
Advance received from a college (Note 2 & 3) $3,37,080 \times \frac{12.36}{112.36}$	37,080
Total service tax liability for the month of April, 2014	1,96,585

Notes:

1. Service is an activity carried out *inter alia* for a consideration. Therefore, since no consideration is involved in case of free services, service tax is not payable thereon.

2. Since, services agreed to be provided are also chargeable to service tax, advance received will also be liable to service tax.

   Advanced received is taxable at the time when such advance is received [Rule 3 of the Point of Taxation Rules].

3. Advance received from a college for teaching their students will also be chargeable to service tax. It is immaterial that no coaching was conducted and the money was returned on 12.05.2014.

   The amount of service tax included in the amount refunded (Rs.37,080) in the next month i.e. May, 2014 would be adjusted against service tax liability of subsequent periods.

4. Since the service tax collected in preceding finanacial year is Rs.10.2 lakh, the aggregate value of taxable services must have exceeded Rs.10 lakh. Thus, Smart Coaching Classes Ltd. is not eligible for SSP exemption.

   Further, during the preceding financial year, the service tax liability met by the assessee, inclusive of CENVAT credit availed was more than Rs.10 lakh. Hence, during the current financial year, payment of service tax will have to be made electronically for all months. Therefore, the last date for making the payment of service tax by Smart Coaching Classes Ltd. (corporate assessee) for the month of April, 2014 is 6th May, 2014.

(c) Computation of taxable turnover and tax liability of Shine India Pvt. Ltd.

Particulars	**Amount (Rs.)**
Total sales	1,50,00,000
Less: Goods returned by Mr. X (deductible as returned within 6 months)	1,50,000
Less: Goods returned by Mr. Z (not deductible since returned after six months)	Nil
Less: Goods rejected by Mr. Y after six months (Refer note below)	55,000
	1,47,95,000
Less : Central sales tax $= 1,47,95,000 \times \frac{4}{104}$ (Rounded off)	5,69,038
Turnover	1,42,25,962

Note: The period of six months for return of goods is not applicable in respect of rejected goods as it is a case of un-fructified sale.

3. (a) (I) **Computation of Capital Gains Chargeable to tax for A.Y. 2015-16**

Particulars	Rs.	Rs.
Sale consideration (i.e. Stamp Duty Value) (Note 1)		80,00,000
Less: Indexed Cost of Acquisition		
Rs.10,00,000 × 1024/389	26,32,391	
Indexed Cost of Improvement		
Rs. 2,00,000 × 1024/480	4,26,667	30,59,058
		49,40,942
*Less: E*xemption under section 54 (Note 2)		25,00,000
Taxable Capital Gains		**24,40,942**

Notes:

1. As per the provisions of section 50C, in case the stamp duty value adopted by the stamp valuation authority is higher than the actual sale consideration, the stamp duty value shall be deemed as the full value of consideration.
2. Exemption under section 54 is available if a new residential house is purchased within one year before or two years after the date of transfer. Since the cost of new residential house is less than the capital gain, capital gain to the extent of cost of new asset is exempt under section 54.
3. Exemption under section 54EC is available in respect of investment in bonds of National Highways Authority of India only if the investment is made within a period of six months after the date of such transfer. In this case, since the investment is made after six months, exemption under section 54EC would not be available.

(II) If the new asset purchased by the assessee on the basis of which exemption under section 54 is claimed, is transferred within 3 years from the date of its acquisition, then for computing the taxable short-term capital gain on such transfer, the cost of acquisition of such asset shall be taken as Nil.

Particulars (A.Y.2016-17)	Rs.
Sale consideration	40,00,000
Less: Cost of acquisition	Nil
Short-term capital gains	40,00,000

(c) Computation of CENVAT credit available with M/s PQ & Co.:

Particulars	Amount [Rs.]
Accounting and auditing services [Note 1]	10,00,000
Legal services [Note 1]	5,00,000
Security services [Note 1]	50,000
Hiring of motor vehicles [Note 2]	Nil
Total CENVAT credit available	15,50,000

Notes:

1. As per the definition of the input services, there is a specific inclusion with regard to the following services:-
   (a) Accounting and auditing services
   (b) Legal services
   (c) Security services

   Hence, the CENVAT credit of the service tax paid on the aforesaid services is available.
2. The definition of input services specifically excludes the services of hiring of the motor vehicles, which are not eligible capital goods.

(d) Computation of excise duty payable

Particulars	Rs.
Total invoice price	40,000
Less: State VAT (Note 1)	4,000
Freight charges (Note 2)	2,000
Insurance charges (Note 2)	200
Price-cum-duty **(a)**	33,800
Less : Excise duty @ 12.36% (inclusive of 3% education cesses) [Rs.33,800 x 12.36/112.36]	3,718.12
Total excise duty including education cesses (rounded off) (b)	**3,718**
Assessable value (a) – (b)	**30,082**

Notes:

1. Invoice price includes State VAT. Thus for calculating assessable value, deduction has been allowed for State VAT.

2. Insurance charges for dispatch of final product and freight charged from factory to the place of customer are allowed as deduction as the same are incurred after the place of removal.
3. Since packing charges are includible in assessable value, deduction for the same has not been provided.

4. (a) Computation of total income for the A.Y. 2015-16

Particulars	Ajay (Rs.)	Vishnu (Rs.)
Income from house property		
I. Self-occupied portion (25%)		
Annual value	Nil	Nil
Less: Deduction under section 24(b)		
Interest on loan taken for construction Rs.37,500 (being 25% of Rs.1.5 lakh) restricted to maximum of Rs. 30,000 for each co-owner since the property was constructed before 1.04.1999)	30,000	30,000
Loss from self occupied property	(30,000)	(30,000)
II. Let-out portion (75%) – See Working Note below	1,25,850	1,25,850
Income from house property	**95,850**	**95,850**
Other Income	2,90,000	1,80,000
Total Income	**3,85,850**	**2,75,850**

Working Note – Computation of income from let-out portion of house property

Particulars	Rs.	Rs.
Let-out portion (75%)		
Gross Annual Value		
(a) Municipal value (75% of Rs.9 lakh)	6,75,000	
(b) Actual rent [(Rs.12000 x 6 x 12) – (Rs.12,000 x 1 x 4)] = Rs.8,64,000 - Rs. 48,000	8,16,000	
- whichever is higher		8,16,000
Less: Municipal taxes 75% of 1,80,000 (20% of Rs.9 lakh)		1,35,000
Net Annual Value (NAV)		6,81,000
Less: Deduction under section 24		
(a) 30% of NAV	2,04,300	
(b) Interest on loan taken for the house [75% of Rs.3 lakh]	2,25,000	4,29,300

Income from let-out portion of house property		2,51,700
Share of each co-owner (50%)		1,25,850

(b) In case of "associated enterprises", where the person providing the service is located outside India, the point of taxation shall be:-

(a) the date of debit in the books of account of the person receiving the service

or

(b) date of making the payment

whichever is earlier.

Hence, in the given case, the point of taxation shall be earlier of the following two dates:-

(a) the date of debit in the books of account of SIL i.e. 07.02.2015

or

(b) date of making the payment i.e. 25.03.2015

Thus, the point of taxation is 07.02.2015.

(c) Computation of VAT payable by Shiv & Co. under subtraction method

Particulars	**Value added (Rs.)**	**VAT (Rs.)**
Sale by manufacturer to distributor	11,250	$\left[11,250 \times \frac{12.5}{112.5}\right]$ = 1,250
Sale by distributor to wholesaler	13,500 - 11,250 = 2,250	$\left[2,250 \times \frac{12.5}{112.5}\right]$ = 250
Sale by wholesaler to retailer	16,875 - 13,500 = 3,375	$\left[3,375 \times \frac{12.5}{112.5}\right]$ = 375
Sale by retailer to consumer	22,500 - 16,875 = 5,625	$\left[5,625 \times \frac{12.5}{112.5}\right]$ = 625
Total VAT payable		**2,500**

5. (a) (i) He is a government employee.

Leave Salary received at the time of retirement	Rs. 5,00,000
Less: Exemption under section 10(10AA)	Rs. 5,00,000
Taxable Leave salary	Nil

(ii) He is a non-government employee

Leave Salary received at the time of retirement	Rs.5,00,000
Less: Exempt under section 10(10AA) [See Note below]	Rs. 26,400
Taxable Leave Salary	Rs.4,73,600

Note : Exemption under section 10(10AA) is least of the following:

(i)	Leave salary received	Rs.5,00,000
(ii)	Statutory limit	Rs.3,00,000

(iii) 10 months salary based on average salary of last 10 months

i.e. $\left[10 \times \frac{\text{Salary of last 10 months i.e. Feb - Nov}}{\text{10 months}}\right]$

$= \left[10 \times \frac{(5000 \times 8) + (4000 \times 2) + (60\% \times 3000 \times 10)}{\text{10 months}}\right]$ Rs.66,000

(iv) Cash equivalent of leave standing at the credit of the employee based on the average salary of last

10 months (max. 30 days per year of service)

Leave Due = Leave allowed – Leave taken

= (30 days per year × 20 years) – 480 days

= 120 days

i.e. $\left[\frac{\text{Leave due (in days)}}{\text{30 days}} \times \text{Average salary p.m.}\right]$

$= \left[\frac{\text{120 days}}{\text{30 days}} \times \frac{₹\ 66{,}000}{10}\right]$ = Rs.26,400

(b)

	Taxable/ Non-taxable	**Amount liable to tax** (Rs.)	**Reason**
(i)	Taxable	75,000	Sum of money exceeding Rs.50,000 received without consideration from a non-relative is taxable under section 56(2)(vii). Daughter of Mr. Nikhil's sister is not a relative of Nikhil HUF, since she is not a member of Nikhil HUF.
(ii)	Non-taxable	Nil	Immovable property received without

			consideration by a HUF from its relative is not taxable under section 56(2)(vii). Since Soni is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Soni under 64(2).
(iii)	Taxable	55,000	As per provisions of section 56(2)(vii), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds Rs.50,000, the whole of the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (Rs.10,000) and jewellery (Rs.45,000) exceeds Rs.50,000. Hence, the entire amount of Rs.55,000 shall be taxable.
(iv)	Non-taxable	Nil	Car is not included in the definition of property for the purpose of section 56(2)(vii), therefore, the same shall not be taxable.

(c) Services by way of education as a part of an approved vocational education course are included in the negative list. A Modular Employable Skill Course, approved by the National Council of Vocational Training, run by a person registered with the Directorate General of Employment and Training, Union Ministry of Labour and Employment is, *inter alia,* an approved vocational education course.

Since, the course offered by ITI Manikpuri falls under the definition of approved vocational education course, the same will be covered in the negative list of services and thus, ITI Manikpuri will not be liable to pay service tax.

Therefore, the demand raised by Revenue is not correct in law.

(d) Section 67 and Service Tax (Determination of Value) Rules, 2006 make provisions for valuation even when consideration is not ascertainable. However, these provisions apply only when there is consideration. If there is no consideration i.e., in case of free service, section 67 and Service Tax (Determination of Value) Rules, 2006 cannot apply.

Thus, no service tax is payable when value of service is zero. In other words, if the value is zero, the tax will also be zero even though the service may be taxable. However, this principle applies only when there is really a 'free service' and not when its cost is recovered through other means.

Therefore, service tax is not payable on service rendered by Mr. Harsh to Mr. Varun as Mr. Harsh has not charged any fee from Mr. Varun.

6. (a) Since Mrs. Reena is not professionally qualified for the job, the clubbing provisions shall be applicable.

Computation of Gross total income of Mr. Rahul

Particulars	Rs.
Income from Salary	
Salary received by Mr. Rahul (Rs.20,000 × 12)	2,40,000
Salary received by Mrs. Reena (Rs.12,000 × 12)	1,44,000
	3,84,000
Income from other sources	
Interest on securities	30,000
	4,14,000

Computation of Gross total income of Mrs. Reena

Particulars	Rs.	Rs.
Income from Salary		Nil
[clubbed in the hands of Mr. Rahul]		
Income from house property		
Gross Annual Value [Rs.6,000 × 12]	72,000	
Less: Municipal taxes paid	-	
Net Annual Value (NAV)	**72,000**	
Less: Deductions under section 24		
- 30% of NAV i.e., 30% of Rs.72,000	21,600	
- Interest on loan	-	50,400
Gross total income		**50,400**

(b) The gross total income of Mr. Farukh for the A.Y. 2015-16 is calculated as under:

Particulars	Rs.	Rs.
Income from house property		1,25,000
Income from business		
Profits before depreciation	1,35,000	
Less: Current year depreciation	26,000	
Less: Brought forward business loss	45,000	
	64,000	
Income from tea business (40% is business income)	48,000	1,12,000
Income from the capital gains		
Short term capital gains		56,000
Gross Total Income		**2,93,000**

Note:

(1) Dividend from Indian companies is exempt from tax. 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax;

(2) Long-term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss of Rs.90,000 brought forward from A.Y. 2014-15 cannot be set-off in the A.Y.2015-16. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2016-17.

(c) Services provided to a recognized sports body by an individual *inter alia* as a referee in a sporting event organized by a recognized sports body is exempt from service tax vide Mega Exemption *Notification No. 25/2012 ST dated 20.06.2012.*

Since in the first case, the football match is organized by Sports Authority of India, which is a recognized sports body, services provided by the individual as a referee in such football match will be exempt under the said notification. However, when he acts as a referee in a charity football match organized by a local sports club, he would not be entitled to afore-mentioned exemption as a local sports club is not a recognized sports body and thus, service tax will be payable in this case.

(d) A person who carries out actual manufacturing process is considered as 'manufacturer' for the purpose of levy of central excise duty even if raw material is supplied by someone else and goods are manufactured as per the specifications of such person. In other words, ownership of raw material is not relevant.

Therefore, in this case,N (tailor), being the actual manufacturer, will be treated as 'manufacturer' for purpose of levy of excise duty even though the cloth (raw material) for making shirt is provided by M and the shirt is stitched as per his specifications.

7. (a)

(i)	**<u>Tax implications in the hands of Mr. Arjun</u>**
	As per section 50C, the stamp duty value of house property (i.e. Rs.85 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, Rs.45 lakh (i.e., Rs.85 lakh – Rs.40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2015-16. Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. Arjun.
(ii)	**<u>Tax implications in the hands of Mr. Mohan</u>**
	In case immovable property is received for inadequate consideration, the difference between the stamp value and actual consideration would be taxable under section 56(2)(vii), if such difference exceeds Rs.50,000. Therefore, in this case Rs.25 lakh (Rs.85 lakh – Rs.60 lakh) would be

	taxable in the hands of Mr. Mohan under section 56(2)(vii). Since agricultural land is not a capital asset, the provisions of section 56(2)(vii) are not attracted in respect of receipt of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(vii) includes only capital assets specified thereunder.
(iii)	**TDS implications in the hands of Mr. Mohan**
	Since the sale consideration of house property exceeds Rs.50 lakh, Mr. Mohan is required to deduct tax at source under section 194-IA. The tax to be deducted under section 194-IA would be Rs.60,000, being 1% of Rs.60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

(b) **(i)** **True :** Section 139A(2) provides that the Assessing Officer may, having regard to the nature of transactions as may be prescribed, also allot a PAN to any other person, whether any tax is payable by him or not, in the manner and in accordance with the procedure as may be prescribed.

(ii) **False :** Section 140(b) provides that where the Karta of a HUF is absent from India, the return of income can be verified by any other adult member of the family; such member can be a male or female member.

(c) A service tax return must indicate *inter alia*, **monthwise:**

(i) the value of taxable services charged/billed;

(ii) the value of taxable service realised;

(iii) the amount of service tax payable/paid etc.

Therefore, Mr. Aarav cannot furnish consolidated details relating to value of taxable service charged, amount realised against the same and service tax payable in his half-yearly service tax return.

(d) No, duty paid on the goods, in the instant case, cannot be remitted as the goods have been damaged after their clearance for home consumption from the warehouse. The duty on the imported goods can be remitted only when such goods are destroyed at any time before clearance for home consumption.