Test Series: March, 2016

MOCK TEST PAPER – 2

INTERMEDIATE (IPC) : GROUP – I

PAPER – 1: ACCOUNTING

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

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

Wherever necessary suitable assumptions may be made and disclosed by way of a note.

Working Notes should form part of the answer.

(Time allowed: Three hours) ***(Maximum Marks: 100)***

1 (a) Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 2013-14 the Company used 12,000 MT of raw material costing Rs. 150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. Explain in the context of AS 2 the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss if any.

(b) Progressive Company Limited has not charged depreciation for the year ended on 31st March, 2015, in respect of a spare bus purchased during the financial year 2014-15 and kept ready by the company for use as a stand-by, on the ground that, it was not actually used during the year. State your views with reference to Accounting Standard 6 "Depreciation Accounting".

(c) During the year Progressive Company Limited made additions to its factory by using its own workforce, at a cost of Rs. 4,50,000 as wages and materials. The lowest estimate from an outside contractor to carry out the same work was Rs. 6,00,000. The directors contend that, since they are fully entitled to employ an outside contractor, it is reasonable to debit the Factory Building Account with Rs. 6,00,000. Comment whether the directors' contention is right in view of the provisions of Accounting Standard 10 "Accounting for Fixed Assets"?

(d) The Board of Directors of X Ltd. decided on 31.3.2015 to increase sale price of certain items of goods sold retrospectively from 1st January, 2015. As a result of this decision the company has to receive Rs. 5 lakhs from its customers in respect of sales made from 1.1.2015 to 31.3.2015. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

(4 x 5 = 20 Marks)

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2 (a) On 01-04-2014, Mr. T. Shekharan purchased 5,000 equity shares of Rs. 100 each in V Ltd. @ Rs. 120 each from a broker, who charged 2% brokerage. He incurred 50 paisa per Rs. 100 as cost of shares transfer stamps. On 31-01-2015 bonus was declared in the ratio of 1 : 2. Before and after the record date of bonus shares, the shares were quoted at Rs. 175 per share and Rs. 90 per share respectively. On 31-03-2015, Mr. T. Shekharan sold bonus shares to a broker, who charged 2% brokerage.

Show the Investment Account in the books of T. Shekharan, who held the shares as Current Assets and closing value of investments shall be made at cost or market value whichever is lower.

(b) Roshan has a current account with partnership firm. It has debit balance of Rs. 75,000 as on 01-07-2015. He has further deposited the following amounts:

Date	**Amount (Rs.)**
14-07-2015	1,38,000
18-08-2015	22,000

He withdrew the following amounts :

Date	**Amount (Rs.)**
29-07-2015	97,000
09-09-2015	11,000

Show Roshan's A/c in the ledger of the firm. Interest is to be calculated at 10% on debit balance and 8% on credit balance. You are required to prepare current account as on 30th September, 2015 by means of product of balances method.

(8 + 8 = 16 Marks)

3 From the following information furnished by Shri Ramji, prepare Trading and Profit and Loss account for the year ended 31.3.2016. Also draft his Balance Sheet as at 31.3.2016:

	1.4.2015	31.3.2016
	Rs.	Rs.
Creditors	3,15,400	2,48,000
Expenses outstanding	12,000	6,600
Fixed assets (includes machinery)	2,32,200	2,40,800
Stock in hand	1,60,800	2,22,400
Cash in hand	59,200	24,000

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Cash at bank	80,000	1,37,600
Sundry debtors	3,30,600	?
Details of the year's transactions are as follows:		
Discount credited to debtors		30,000
Returns from debtors		29,000
Bad debts		8,400
Sales (Both cash and credit)		14,36,200
Discount allowed by creditors		14,000
Returns to creditors		8,000
Capital introduced by cheque		1,70,000
Collection from debtors (Deposited into bank after receiving cash)		12,50,000
Cash purchases		20,600
Expenses paid by cash		1,91,400
Drawings by cheque		8,600
Machinery acquired by cheque		63,600
Cash deposited into bank		1,00,000
Cash withdrawn from bank		1,84,800
Cash sales		92,000
Payment to creditors by cheque		12,05,400

Note: Ramji has not sold any Fixed Asset during the year. *(16 Marks)*

4 (a) Following is the extract of the Balance Sheet of Preet Ltd. as at 31st March, 2015

Authorised capital:	Rs.
15,000 12% Preference shares of Rs. 10 each	1,50,000
1,50,000 Equity shares of Rs. 10 each	15,00,000
	16,50,000
Issued and Subscribed capital:	
12,000 12% Preference shares of Rs. 10 each fully paid	1,20,000
1,35,000 Equity shares of Rs. 10 each, Rs. 8 paid up	10,80,000
Reserves and surplus:	
General Reserve	1,80,000
Capital Reserve (profit realized on sale of plant)	60,000
Securities premium	37,500
Profit and Loss Account	3,00,000

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On 1st April, 2015, the Company has made final call @ Rs. 2 each on 1,35,000 equity shares. The call money was received by 20th April, 2015. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held. Company decides to use Capital Reserve for bonus issue as it has been realized in cash.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2015 after bonus issue.

(b) On 29th August, 2015, the godown of a trader caught fire and a large part of the stock of goods was destroyed. However, goods costing Rs. 1,08,000 could be salvaged incurring fire fighting expenses amounting to Rs. 4,700.

The trader provides you the following additional information:

	Rs.
Cost of stock on 1st April, 2014	7,10,500
Cost of stock on 31st March, 2015	7,90,100
Purchases during the year ended 31st March, 2015	56,79,600
Purchases from 1st April, 2015 to the date of fire	33,10,700
Cost of goods distributed as samples for advertising from 1st April, 2015 to the date of fire	41,000
Cost of goods withdrawn by trader for personal use from 1st April, 2015 to the date of fire	2,000
Sales for the year ended 31st March, 2015	80,00,000
Sales from 1st April, 2015 to the date of fire	45,36,000

The insurance company also admitted fire fighting expenses. The trader had taken the fire insurance policy for Rs. 9,00,000 with an average clause.

Calculate the amount of the claim that will be admitted by the insurance company.

(8 + 8 = 16 Marks)

5. The Balance Sheet of Amit, Bhushan and Charan, who share profits and losses as 3 : 2 : 1 respectively, as on 01.04.2015 is as follows:

Liabilities	Amount (Rs.)	Assets		Amount (Rs.)
Capital Accounts: Amit	1,80,000	Machinery		1,50,000
Bhushan	1,60,000	Furniture		1,50,000

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Charan	1,40,000	Debtors	80,000	
Current Accounts: Bhushan	16,000	Less: Provision for doubtful Debts	4,000	76,000
Creditors	1,20,000	Stock		2,10,000
		Cash		20,000
	-	Current Account: Charan		10,000
	6,16,000			6,16,000

Dev is admitted as a partner on the above date for $\frac{1}{5}$th share in the profit and loss. Following are agreed upon:

(1) The profit and loss sharing ratio among the old partners will be equal.

(2) Dev brings in Rs. 1,50,000 as capital but is unable to bring the required amount of premium for goodwill.

(3) The goodwill of the firm is valued at Rs. 60,000.

(4) Assets and liabilities are to be valued as follows:

Machinery Rs. 2,06,000 : Furniture Rs. 1,28,000 : Provision for doubtful debts @ 10% on debtors.

(5) Necessary adjustments regarding goodwill and Profit / loss on revaluation are to made through the Partner's Current Accounts.

(6) It is decided that the revalued figures of assets and liabilities will not appear in the Balance Sheet of the new firm.

(7) Capital Accounts of the old partners in the new firm should be proportionate to the new profit and loss sharing ratio, taking Dev's Capital as base. The existing partners will not bring cash for further capital. The necessary adjustments are to be made through the partner's Current Account.

Prepare Partner's Capital & Current Accounts and the Balance Sheet of the new firm after admission. *(16 Marks)*

6. The following is the summarised Balance Sheet of Weak Ltd. as on 31.3.2015:

Liabilities	Rs.	Assets	Rs.
Equity shares of Rs. 100 each	1,00,00,000	Fixed assets	1,25,00,000
12% cumulative preference shares of Rs. 100 each	50,00,000	Investments (Market value Rs. 9,50,000)	10,00,000
10% debentures of Rs. 100	40,00,000	Current assets	1,00,00,000

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each			
Trade payables	50,00,000	P & L A/c	6,00,000
Provision for taxation	1,00,000		
	2,41,00,000		2,41,00,000

The following scheme of reorganization is sanctioned:

(i) All the existing equity shares are reduced to Rs. 40 each.

(ii) All preference shares are reduced to Rs. 60 each.

(iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of Rs. 100 each and exchange the same for fresh debentures of Rs. 70 each for every debenture held by them.

(iv) One of the creditors of the company to whom the company owes Rs. 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of Rs. 40 each in full satisfaction of his claim.

(v) Fixed assets are to be written down by 30%.

(vi) Current assets are to be revalued at Rs. 45,00,000.

(vii) The taxation liability of the company is settled at Rs. 1,50,000.

(viii) Investments to be brought to their market value.

(ix) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and show the Balance sheet of the company after giving effect to the above. *(16 Marks)*

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

(a) X Ltd. purchased debentures of Rs. 10 lacs of Y Ltd., which are redeemable within three months. How will you show this item as per AS 3 while preparing cash flow statement for the year ended on31st March, 2015?

(b) Sudha Ltd. has purchased Plant & Machinery in the year 2011-2012 for Rs. 45 lakhs. A balance of Rs. 5 lakhs is still payable to the suppliers for the same. The supplier waived off the balance amount during the financial year 2014-15. Sudha Ltd. treated it as income and credited to profit and loss account during 2014-15. Whether, accounting treatment of Sudha Ltd. is correct?

(c) Explain the factors to be considered before selecting the pre-packaged accounting software.

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(d) Lion Ltd. was incorporated on 1.8.2014 to take over the running business of M/s Happy with assets from 1.4.2014. The accounts of the company were closed on 31.3.2015.

The average monthly sales during the first four months of the year (2014-15) was twice the average monthly sales during each of the remaining eight months.

Calculate time ratio and sales ratio for pre and post incorporation periods.

(e) Big Systematic Ltd. maintains self-balancing ledgers preparing control accounts at the end of each calendar month.

On 3rd January, 2015 the accountant of the company located the following errors in the books of account:

(i) An amount of Rs. 8,700 received from customer Mehra was credited to Mehta, another customer.

(ii) The sales book for December, 2014 was under cast by Rs. 1,000.

(iii) Goods invoiced at Rs. 15,600 were returned to supplier, Mega Ltd., but no entry was made in the books for this return made on 28th December, 2014.

Pass the necessary Journal Entries to rectify the above mentioned errors.

(4 x 4 = 16 Marks)

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MOCK TEST PAPER - 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 1: ACCOUNTING

SUGGESTED ANSWERS/HINTS

1 **(a)** As per AS 2 (Revised) 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

Amount of Abnormal Loss:

Material used	12,000 MT @ Rs.150 = Rs.18,00,000
Normal Loss (4% of 12,000 MT)	480 MT
Net quantity of material	11,520 MT
Abnormal Loss in quantity	150 MT
Abnormal Loss	Rs.23,437.50

[150 units @ Rs.156.25 (Rs.18,00,000/11,520)]

Amount Rs.23,437.50 will be charged to the Profit and Loss statement.

(b) According to AS 6, 'Depreciation Accounting', depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable assets arising from use, effluxion of time or obsolescence through technology and market changes. Accordingly, depreciation may arise even the asset is not used in the current year but was ready for use in that year.

The need for using the stand by bus may not have arisen during the year but that does not imply that the useful life of the bus has not been affected. Therefore, non-provision of depreciation on the ground that the bus was not used during the year is not tenable. So, depreciation should be changed on Spare Parts.

(c) AS 10, 'Accounting for Fixed Assets', clearly states that the gross book value of the self constructed fixed asset includes the cost of construction that relate directly to the specific asset and the costs that are attributable to the construction activity in general can be allocated to the specific asset. If any internal profit is there it should be eliminated. Thus, only Rs.4,50,000 should be debited to the factory building account and not Rs.6,00,000. Hence, the contention of the directors of the company to capitalize Rs.6,00,000 as cost of factory building, on the ground that the company is fully entitled to employ an outside contractor is not justifiable.

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(d) As per AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of Rs.5 lakhs to be recognised as income for financial year 2014-15, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

2. (a) **In the books of T. Shekharan**

Investment Account
for the year ended 31st March, 2015
(Script: Equity Shares of V Ltd.)

Date	*Particulars*	*Nominal Value (Rs.)*	*Cost (Rs.)*	*Date*	Particulars	*Nominal Value (Rs.)*	*Cost (Rs.)*
1.4.2014	To Bank A/c (W.N.1)	5,00,000	6,15,000	31.3.2015	By Bank A/c (W.N.2)	2,50,000	2,20,500
31.1.2015	To Bonus shares	2,50,000	–	31.3.2015	By Balance c/d (W.N.4)	5,00,000	4,10,000
31.3.2015	To Profit and Loss A/c (W.N.3)		15,500				
		7,50,000	6,30,500			7,50,000	6,30,500

Working Notes:

1. **Cost of equity shares purchased on 1st April, 2014**

   = Cost + Brokerage + Cost of transfer stamps

   = 5,000 ×Rs.120 + 2% of Rs.6,00,000 + ½% of Rs.6,00,000

   = Rs.6,15,000

2. **Sale proceeds of equity shares sold on 31st March, 2015**

   = Sale price – Brokerage

   = 2,500 ×Rs.90 – 2% of Rs.2,25,000

   = Rs.2,20,500.

3. **Profit on sale of bonus shares on 31st March, 2015**

   = Sales proceeds – Average cost

   Sales proceeds= Rs.2,20,500

   Average cost = Rs.[6,15,000× 2,50,000/7,50,000]

   = Rs.2,05,000

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Profit = Rs.2,20,500 – Rs.2,05,000= Rs.15,500.

4. **Valuation of equity shares on 31st March, 2015**

Cost = Rs.[6,15,000× 5,00,000/7,50,000]= Rs.4,10,000 i.e Rs.82 per share

Market Value = 5,000 shares × Rs.90 = Rs.4,50,000

Closing stock of equity shares has been valued at Rs.4,10,000 i.e. cost being lower than the market value.

(b) Roshan's Current Account with Partnership firm (as on 30.9.2015)

Date	*Particulars*	*Dr (Rs.)*	*Cr (Rs.)*	*Balance (Rs.)*	*Dr. or Cr.*	*Days*	*Dr Product (Rs.)*	*Cr Product (Rs.)*
01.07.15	To Bal b/d	75,000		75,000	Dr.	13	9,75,000	
14.07.15	By Cash A/c		1,38,000	63,000	Cr.	15		9,45,000
29.07.15	To Self	97,000		34,000	Dr.	20	6,80,000	
18.08.15	By Cash A/c		22,000	12,000	Dr.	22	2,64,000	
09.09.15	To Self	11,000		23,000	Dr.	22	5,06,000	
30.09.15	To Interest A/c	457		23,457	Dr.			
30.09.15	By Bal. c/d		23,457					
		1,83,457	1,83,457				24,25,000	9,45,000

Interest Calculation:

On Rs.24,25,000x 10% x 1/365 = Rs.664

On Rs.9,45,000 x 8% x 1/365 = (Rs.207)

Net interest to be debited = (Rs.457)

3. In the books of Shri Ramji

Trading and Profit and Loss Account

for the year ended 31st March, 2016

		Rs.	*Rs.*			*Rs.*	*Rs.*
To	Opening stock		1,60,800	By	Sales:		
To	Purchases:				Cash	92,000	
	Cash	20,600			Credit	13,44,200	
	Credit (W.N. 3)	11,60,000				14,36,200	
		11,80,600			*Less:* Returns	(29,000)	14,07,200
	Less: Returns	(8,000)	11,72,600				

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To	Gross Profit c/d	2,96,200	By	Closing stock	2,22,400
		16,29,600			16,29,600
To	Discount allowed	30,000	By	Gross profit b/d	2,96,200
To	Bad debts	8,400	By	Discount	14,000
To	General expenses (W.N. 5)	1,86,000			
To	Depreciation (W.N. 4)	55,000			
To	Net profit	30,800			
		3,10,200			3,10,200

Balance Sheet as at 31st March, 2016

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital (W.N. 1)	5,35,400		Sundry Assets	2,32,200	
Add: Additional capital	1,70,000		*Add:* New machinery	63,600	
Net profit	30,800			2,95,800	
	7,36,200		*Less:* Depreciation	(55,000)	2,40,800
Less: Drawings	(8,600)	7,27,600	Stock in trade		2,22,400
Sundry creditors		2,48,000	Sundry debtors (W.N. 2)		3,57,400
Expenses outstanding		6,600	Cash in hand		24,000
			Cash in Bank		1,37,600
		9,82,200			9,82,200

Working Notes:

(1) **Statement of Affairs as at 31st March, 2015**

Liabilities	*Rs.*	*Assets*	*Rs.*
Sundry creditors	3,15,400	Sundry Assets	2,32,200
Outstanding expenses	12,000	Stock	1,60,800
Ramji's Capital		Debtors	3,30,600
(Balancing figure)	5,35,400	Cash in hand	59,200
		Cash at Bank	80,000
	8,62,800		8,62,800

(2) **Sundry Debtors Account**

	Rs.		*Rs.*
To Balance b/d	3,30,600	By Cash	12,50,000

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To	Sales (14,36,200 – 92,000)	13,44,200	By	Discount	30,000
			By	Returns (sales)	29,000
			By	Bad debts	8,400
			By	Balance c/d (Bal. fig.)	3,57,400
		16,74,800			16,74,800

(3) **Sundry Creditors Account**

		Rs.			*Rs.*
To	Bank – Payments	12,05,400	By	Balance b/d	3,15,400
To	Discount	14,000	By	Purchases credit	11,60,000
To	Returns	8,000		(Balancing figure)	
To	Balance c/d (closing balance)	2,48,000			
		14,75,400			14,75,400

(4)

Depreciation on Fixed Assets:	*Rs.*
Opening balance	2,32,200
Add: Additions	63,600
	2,95,800
Less: Closing balance	(2,40,800)
Depreciation	55,000

(5) **Expenses to be shown in profit and loss account**

Expenses (in cash)	1,91,400
Add: Outstanding of 2016	6,600
	1,98,000
Less: Outstanding of 2015	12,000
	1,86,000

(6) **Cash and Bank Account**

		Cash	*Bank*			*Cash*	*Bank*
		Rs.	*Rs.*			*Rs.*	*Rs.*
To	Balance b/d	59,200	80,000	By	Purchases	20,600	–
To	Capital		1,70,000	By	Expenses	1,91,400	
To	Debtors		12,50,000	By	Plant and Machinery		63,600

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To Bank	1,84,800		By Drawings		8,600
To Cash		1,00,000	By Creditors		12,05,400
To Sales	92,000		By Cash		1,84,800
			By Bank	1,00,000	
			By Balance c/d	24,000	1,37,600
	3,36,000	16,00,000		3,36,000	16,00,000

4. (a) Journal Entries in the books of Preet Ltd.

			Rs.	*Rs.*
1-4-2015	Equity share final call A/c	Dr.	2,70,000	
	To Equity share capital A/c			2,70,000
	(For final calls of Rs.2 per share on 1,35,000 equity shares due as per Board's Resolution dated….)			
20-4-2015	Bank A/c	Dr.	2,70,000	
	To Equity share final call A/c			2,70,000
	(For final call money on 1,35,000 equity shares received)			
	Securities Premium A/c	Dr.	37,500	
	Capital Reserve A/c	Dr.	60,000	
	General Reserve A/c	Dr.	1,80,000	
	Profit and Loss A/c	Dr.	60,000	
	To Bonus to shareholders A/c			3,37,500
	(For making provision for bonus issue of one share for every four shares held)			
	Bonus to shareholders A/c	Dr.	3,37,500	
	To Equity share capital A/c			3,37,500
	(For issue of bonus shares)			

Extract of Balance Sheet as at 30th April, 2015 (after bonus issue)

	Rs.
Authorised Capital	
15,000 12% Preference shares of Rs.10 each	1,50,000
1,83,750 Equity shares of Rs.10 each (W.N.)	18,37,500
Issued and subscribed capital	

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12,000 12% Preference shares of Rs.10 each, fully paid	1,20,000
1,68,750 Equity shares of Rs.10 each, fully paid	16,87,500
(Out of above, 33,750 equity shares @ Rs.10 each were issued by way of bonus)	
Reserves and surplus	
Profit and Loss Account	2,40,000

Working Notes:

The authorized capital should be increased as per details given below:	*Rs.*
Existing authorized Equity share capital	15,00,000
Add: Issue of bonus shares to equity shareholders (25% of Rs.13,50,000)	3,37,500
	18,37,500

(b) Memorandum Trading Account for the period 1st April, 2015 to 29th August 2015

		Rs.		*Rs.*
To Opening Stock		7,90,100	By Sales	45,36,000
To Purchases	33,10,700		By Closing stock (Bal. fig.)	8,82,600
*Less:*Advertisement	(41,000)			
Drawings	(2,000)	32,67,700		
To Gross Profit [30% of Sales - Refer Working Note]		13,60,800		
		54,18,600		54,18,600

Statement of Insurance Claim

	Rs.
Value of stock destroyed by fire	8,82,600
*Less:*Salvaged Stock	(1,08,000)
*Add:*Fire Fighting Expenses	4,700
Insurance Claim	7,79,300

Note: Since policy amount is more than claim amount, average clause will not apply. Therefore, claim amount of Rs.7,79,300 will be admitted by the Insurance Company.

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Working Note:

Trading Account for the year ended 31st March, 2015

	Rs.		*Rs.*
To Opening Stock	7,10,500	By Sales	80,00,000
To Purchases	56,79,600	By Closing stock	7,90,100
To Gross Profit	24,00,000		
	87,90,100		87,90,100

Rate of Gross Profit in 2014-15

$$\frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{24,00,000}{80,00,000} \times 100 = 30\%$$

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5. **In the books of Firm**

Partners' Capital Accounts

	Amit	Bhushan	Charan	Dev		Amit	Bhushan	Charan	Dev
To Balance c/d (Working Note 1)	2,00,000	2,00,000	2,00,000	1,50,000	By Balance b/d	1,80,000	1,60,000	1,40,000	
					By Bank A/c	-	-	-	1,50,000
					By Partners' Current A/cs (bal. fig)	20,000	40,000	60,000	
	2,00,000	2,00,000	2,00,000	1,50,000		2,00,000	2,00,000	2,00,000	1,50,000

Partners' Current Accounts

	Amit	Bhushan	Charan	Dev		Amit	Bhushan	Charan	Dev
To Balance b/d	-	-	10,000	-	By Balance b/d	-	16,000	-	-
To Memorandum Revaluation A/c	8,000	8,000	8,000	6,000	By Memorandum Revaluation	15,000	10,000	5,000	-
To Amit and Bhushan (Goodwill adjustment)	-	-	6,000	12,000	By Dev and Charan (Goodwill adjustment)	14,000	4,000	-	-
To Partners CapitalA/cs	20,000	40,000	60,000	-	By Balance c/d	-	18,000	79,000	18,000
To Balance c/d	1,000	-	-						
	29,000	48,000	84,000	18,000		29,000	48,000	84,000	18,000

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Balance Sheet of new firm

After Dev's Admission

Liabilities	Rs.	Assets		Rs.
Capital Accounts: A/cs		Machinery		1,50,000
Amit 2,00,000		Furniture		1,50,000
Bhushan 2,00,000		Stock		2,10,000
Charan 2,00,000		Debtors	80,000	
Dev 1,50,000	7,50,000	*Less:* Provision for doubtful debts	4,000	76,000
Current Account: Amit	1,000	Cash		1,70,000
Creditors	1,20,000	Current Accounts:		
		Bhushan	18,000	
		Charan	79,000	
		Dev	18,000	
				1,15,000
	8,71,000			8,71,000

Working Notes:

1. Dev. joins the business for 1/5th share and brings Rs.1,50,000 as capital. Thus, total capital of new firm will be Rs.7,50,000 (1,50,000 × 5). Total capital of Amit, Bhushan & Charan will be Rs.6,00,000 (7,50,000 – 1,50,000) which will be shared by them equally i.e. 2,00,000 each.

2. **Calculation of New profit sharing ratio**

Amit	Bhushan	Charan	Dev
$\frac{4}{5}\times\frac{1}{3}$ $\frac{4}{15}$	$\frac{4}{5}\times\frac{1}{3}$ $\frac{4}{15}$	$\frac{4}{5}\times\frac{1}{3}$ $\frac{4}{15}$	$\frac{1}{5}$ $\frac{3}{15}$
4:4:4:3			

3. **Adjustment of Goodwill**

Sacrificing/gaining ratios of old partners

Amit	Bhushan	Charan	Dev
$\frac{4}{15}-\frac{3}{6}$	$\frac{4}{15}-\frac{2}{6}$	$\frac{4}{15}-\frac{1}{6}$	$\frac{1}{5}$

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$\frac{24-45}{90}$	$\frac{24-30}{90}$	$\frac{24-15}{90}$	
$\frac{21}{90}$ Sacrifice	$\frac{6}{90}$ Sacrifice	$\frac{9}{90}$ Gain	$\frac{18}{90}$ Gain

Entry for adjustment for goodwill of Rs.60,000

Charan	Dr.	6,000	
Dev	Dr.	12,000	
To Amit			14,000
To Bhushan			4,000

(Being goodwill adjusted in partners sacrificing/gaining ratios)

4. **Memorandum Revaluation A/c**

	Amount Rs.		*Amount Rs.*
To Furniture	22,000	By Machinery	56,000
To Provision for doubtful debts	4,000		
To Partners' Current A/cs:			
Amit 15,000			
Bhushan 10,000			
Charan 5,000	30,000		
	56,000		56,000
To Machinery	56,000	By Furniture	22,000
		By Provision for doubtful debts	4,000
		By Partners' Current A/cs:	
		Amit 8,000	
		Bhushan 8,000	
		Charan 8,000	
		Dev 6,000	30,000
	56,000		56,000

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6. **Journal Entries in the books of Weak Ltd.**

		Rs.	*Rs.*
(i)	Equity share capital (Rs.100) A/c Dr.	1,00,00,000	
	To Equity Share Capital (Rs.40) A/c		40,00,000
	To Capital Reduction A/c		60,00,000
	(Being conversion of equity share capital of Rs.100 each into Rs.40 each as per reconstruction scheme)		
(ii)	12% Cumulative Preference Share capital (Rs.100) A/c Dr.	50,00,000	
	To 12% Cumulative Preference Share Capital (Rs.60) A/c		30,00,000
	To Capital Reduction A/c		20,00,000
	(Being conversion of 12% cumulative preference share capital of Rs.100 each into Rs.60 each as per reconstruction scheme)		
(iii)	10% Debentures A/c Dr.	40,00,000	
	To 12% Debentures A/c		28,00,000
	To Capital Reduction A/c		12,00,000
	(Being 12% debentures issued to 10% debenture-holders for 70% of their claims. The balance transferred to capital reduction account as per reconstruction scheme)		
(iv)	Trade payables A/c Dr.	20,00,000	
	To Equity Share Capital A/c		12,00,000
	To Capital Reduction A/c		8,00,000
	(Being a creditor of Rs.20,00,000 agreed to surrender his claim by 40% and was allotted 30,000 equity shares of Rs.40 each in full settlement of his dues as per reconstruction scheme)		
(v)	Provision for Taxation A/c Dr.	1,00,000	
	Capital Reduction A/c Dr.	50,000	
	To current assets(bank A/c) A/c		1,50,000
	(Being liability for taxation settled)		
(vi)	Capital Reduction A/c Dr.	99,00,000	
	To P & L A/c		6,00,000

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	To Fixed Assets A/c		37,50,000
	To Current Assets A/c		55,00,000
	To Investments A/c		50,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) Balance, Fixed Assets, Current Assets, Investments through capital reduction account)		
(vii)	Capital Reduction A/c Dr	50,000	
	To capital Reserve A/c		50,000
	(Being balance in capital reduction account transferred to capital reserve account)		

Balance Sheet of Weak Ltd. (and reduced) as on 31.3.2015

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	82,00,000
	b	Reserves and Surplus	2	50,000
2		**Non-current liabilities**		
	a	Long-term borrowings	3	28,00,000
3		**Current liabilities**		
	a	Trade Payables		30,00,000
		Total		**1,40,50,000**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	4	87,50,000
	b	Investments	5	9,50,000
2		**Current assets**	6	43,50,000
		Total		**1,40,50,000**

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Notes to accounts

		Rs.
1. Share Capital		
Equity share capital		
Issued, subscribed and paid up		
1,30,000 equity shares of Rs.40 each		52,00,000
Preference share capital		
Issued, subscribed and paid up		
50,000 12% Cumulative Preference shares of Rs.60 each		30,00,000
Total		**82,00,000**
2. Reserves and Surplus		
Capital Reserve		50,000
3. Long-term borrowings		
Secured		
12% Debentures		28,00,000
4. Tangible assets		
Fixed Assets	1,25,00,000	
Adjustment under scheme of reconstruction	(37,50,000)	87,50,000
5. Investments	10,00,000	
Adjustment under scheme of reconstruction	(50,000)	9,50,000
6. Current assets	45,00,000	
Adjustment under scheme of reconstruction	(1,50,000)	43,50,000

Working Note:

Capital Reduction Account

	Rs.		Rs.
To Current Asset	50,000	By Equity share capital	60,00,000
To P & L A/c	6,00,000	By 12% Cumulative preference share capital	20,00,000
To Fixed assets	37,50,000	By 10% Debentures	12,00,000

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To Current assets	55,00,000	By Trade payables	8,00,000
To Investment	50,000		
To Capital Reserve (bal. fig.)	50,000		
	1,00,00,000		1,00,00,000

7. **(a)** As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments*. If investment, of Rs.10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'. However, if investment of Rs.10 lacs made in debentures is for long-term period then as per AS 3, it should be shown as cash flow from investing activities.

(b) As per AS 10 'Accounting for Fixed Assets,' the cost of fixed assets may undergo changes subsequent to its acquisition or construction, price adjustments, changes in duties or similar factors Therefore, the treatment done by company is not correct as per the provisions of AS 10. Rs.5 lakhs should be deducted from the cost of fixed assets.

(c) 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.

**As per AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say three months or less from the date of acquisition.*

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(d) Time ratio:

Pre-incorporation period (1.4.2014 to 31.7.2014) = 4 months

Post incorporation period (1.8.2014 to 31.3.2015) = 8 months

Time ratio = 4 : 8 or 1 : 2

Sales ratio:

Average monthly sale before incorporation was twice the average sale per month of the post incorporation period. If weightage for each post-incorporation month is x, then

Weighted sales ratio $= 4 \times 2x : 8 \times 1x$

$= 8x : 8x$ or 1 : 1

(e) Journal Entries

In the books of M/s Big. Systematic Ltd.

			Rs.	*Rs.*
(i)	Mehta (In Sales/ Debtors Ledger)	Dr.	8,700	
	To Mehra (In Sales/ Debtors Ledger)			8,700
	(Being amount received from Mehra was wrongly credited to Mehta, now rectified)			
(ii)	(a) Suspense Account (In Sales / Debtors Ledger)	Dr.	1,000	
	To Sales Account (In General Ledger)			1,000
	(b) Sales/Debtors Ledger Adjustment Account (In General Ledger)	Dr.	1,000	
	To General Ledger Adjustment Account (In Sales/ Debtors Ledger)			1,000
	(Being rectification of the error resulting from under casting of the Sales Book)			
(iii)	(a) M/s. Mega Ltd. A/c (In Creditors/Bought Ledger)	Dr.	15,600	
	To Purchase Returns A/c (In General Ledger)			15,600
	(b) Creditors/Bought Ledger Adjustment A/c (In General Ledger)	Dr.	15,600	
	To General Ledger Adjustment A/c (In Creditors/Bought Ledger)			15,600
	(Being goods returned to supplier not recorded earlier, now recorded)			

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Test Series: March, 2016

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) M Ltd., contracts with Shanti Traders to make and deliver certain machinery to them by 30th June, 2015 for Rs. 11.50 lakhs. Due to labour strike, M Ltd. could not manufacture and deliver the machinery to Shanti Traders. Later, Shanti Traders procured the machinery from another manufacturer for Rs. 12.75 lakhs. Shanti Traders was also prevented from performing a contract which it had made with Zenith Traders at the time of their contract with M Ltd. and were compelled to pay compensation for breach of contract. Advise Shanti Traders the amount of compensation which it can claim from M Ltd., referring to the legal provisions of the Indian Contract Act, 1872. *(5 Marks)*

   (b) Some of the creditors of 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 the concept of "Negotiation". What are its techniques? *(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. An 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)*

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

(c) Explain clearly the different types of grapevine chains in an informal communication. *(4 Marks)*

3. (a) (i) What are the essential elements of a "Promissory note" under the Negotiable Instruments Act, 1881? Whether the following notes may be considered as valid Promissory notes:

(1) "I promise to pay Rs. 5,000 or 7,000 to Mr. Ram."

(2) I promise to pay to Mohan Rs. 500, if he secures 60% marks in the examination.

(3) I promise to pay Rs. 3,000 to Ravi after 15 days of the death of A.

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

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(b) State whether the following statement is correct/incorrect with reasons:

1 A company is a person same as its members'

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

(c) Draft a notice for calling the Board of Directors meeting of 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) 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)*

(ii) 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)*

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

(d) Explain the extent to which it is possible to observe ethical behaviour in marketing.

(4 Marks)

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

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Test Series: March, 2016

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 2 : BUSINESS LAWS, ETHICS AND COMMUNICATION

SUGGESTED ANSWERS/HINTS

1. **(a)** Section 73 of the Indian Contract Act, 1872 provides for consequences of breach of contract. According to it, when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract, to be likely to result from the breach of it. Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach. It is further provided in the explanation to the section that in estimating the loss or damage from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

Applying the above principle of law to the given case, M Ltd is obliged to compensate for the loss of Rs. 1.25 lakhs (i.e. Rs. 12.75 minus Rs. 11.50 = Rs. 1.25 lakhs) which had naturally arisen due to default in performing the contract by the specified date.

Regarding the amount of compensation which Shanti Traders were compelled to make to Zenith Traders, it depends upon the fact whether M Ltd., knew about the contract of Shanti Traders for supply of the contracted machinery to Zenith Traders on the specified date. If so, M Ltd. is also obliged to reimburse the compensation which Shanti Traders had to pay to Zenith Traders for breach of contract. Otherwise M Ltd is not liable.

(b) **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.

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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) 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.

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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.

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.

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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) **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.

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(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.

3. (a) (i) A promissory note is an instrument (not being a bank note or currency note) in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to or the holder of, a certain person or to the bearer of the instrument, (Section 4 of the Negotiable Instruments Act, 1881).

In view of the above provision of the said Act, following are the essential elements of a promissory note-

1. It must be in writing.
2. The promise to pay must be unconditional.
3. The amount promised must be a certain and a definite sum of money.
4. The instrument must be signed by the maker.
5. The person to whom the promise is made must be a definite person.

Thus:

(1) In case (1), it is not a valid promissory note because the amount is not certain.

(2) In case (2), it is not a valid promissory note because it is conditional.

(3) In case (3), it is a valid promissory note because death of A is a certainty even if time of death is not certain.

(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 1^{st} January, Bharat was required to pay only on the 4^{th} and not on 3^{rd} 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

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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 of 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

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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.

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(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) 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.

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.

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(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) (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.

(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:

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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) 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.

(ii) Under section 105 (8) of the Companies 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.

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(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

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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) 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.

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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.

(d) Ethical behaviour in Marketing: 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) 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.

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Test Series: March, 2016

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) The following are the details in respect of Process A and Process B of a processing factory:

	Process A (Rs.)	Process B (Rs.)
Materials	40,000	--
Labour	40,000	56,000
Overheads	16,000	40,000

The output of Process A is transferred to Process B at a price calculated to give a profit of 20% on the transfer price and the output of Process B is charged to finished stock at a profit of 25% on the transfer price. The finished stock department realized Rs. 4,00,000 for the finished goods received from Process B.

You are asked to show process accounts and total profit, assuming that there was no opening or closing work-in-progress.

(b) Two workers 'A' and 'B' produce the same product using the same material. Their normal wage rate is also the same. 'A' is paid bonus according to Rowan scheme while 'B' is paid bonus according to Halsey scheme. The time allowed to make the product is 120 hours. 'A' takes 90 hours while 'B' takes 100 hours to complete the product. The factory overhead rate is Rs. 50 per hour actually worked. The factory cost of product manufactured by 'A' is Rs. 80,200 and for product manufactured by 'B' is Rs. 79,400.

Required:

(i) Compute the normal rate of wages.

(ii) Compute the material cost.

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(iii) Prepare a statement comparing the factory cost of the product as made by two workers.

(c) The proportion and required return of debt and equity was recorded for a company with its increased financial leverage as below:

Debt (%)	Required return (K_d)(%)	Equity (%)	Required return (K_e)(%)	Weighted Average Cost of Capital (WACC) (K_o)(%)
0	5	100	15	15
20	5	80	16	?
40	5	60	18	?
60	10	40	23	?
80	15	20	35	?

You are required to complete the table and identify which capital structure is most beneficial for this company. (Based on traditional theory, i.e., capital structure is relevant).

(d) A company is considering raising of funds of about Rs.250 lakhs by any of two alternative methods, viz., 14% institutional term loan and 13% non-convertible debentures. The term loan option would attract no major incidental cost and can be ignored. The debentures would have to be issued at a discount of 2.5% and would involve cost of issue of 2% on face value.

Advise the company as to the better option based on the effective cost of capital in each case. Assume a tax rate of 50%. *(4 × 5 = 20 Marks)*

2. (a) A store keeper has prepared the below list of items kept in the store of the factory.

Item	Units	Unit cost (Rs)
A	12,000	30.00
B	18,000	3.00
C	6,000	35.00
D	750	220.00
E	3,800	75.00
F	400	105.00
G	600	300.00
H	300	350.00
I	3,000	250.00
J	20,000	7.50
K	11,500	27.50
L	2,100	75.00

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The store keeper requires your help to classify the items for prioritization. You are required to apply ABC analysis to classify the store items as follows:

Store items which constitutes approx 70%, 20% and 10% of total value as A, B and C respectively. *(8 Marks)*

(b) Some of the financial figures for Harsha & Co. for three years are given below:

	2013	**2014**	**2015**
Gross profit ratio (G.P.)	30%	25%	20%
Stock turnover	20 times	25 times	16 times
Opening Stock (Rs.)	33,000	30,400	53,000
Closing stock (Rs.)	37,000	34,400	57,000
Tax	30%	30%	30%

Administrative expenses in 2013 amounted to 5% of sales and the annual increase was 5% over the previous year.

Prepare a statement of profits in a comparative form for all the three years, and comment on the reasons for decrease in profitability. *(8 Marks)*

3 (a) R Limited is presently operating at 50% capacity and producing 60,000 units. The entire output is sold at a price of Rs. 200 per unit. The cost structure at the 50% level of activity is as under:

	(Rs)
Direct Material	75 per unit
Direct Wages	25 per unit
Variable Overheads	25 per unit
Direct Expenses	15 per unit
Factory Expenses (25% fixed)	20 per unit
Selling and Distribution Exp. (80% variable)	10 per unit
Office and Administrative Exp. (100% fixed)	5 per unit

The company anticipates that the variable costs will go up by 10% and fixed costs will go up by 15%.

You are required to prepare an Expense budget, on the basis of marginal cost for the company at 50% and 60% level of activity and find out the profits at respective levels. *(8 Marks)*

(b) Navya Ltd has annual credit sales of Rs. 45 lakhs. Credit terms are 30 days, but its management of receivables has been poor and the average collection period is 50 days, Bad debt is 0.4 per cent of sales. A factor has offered to take over the task of debt administration and credit checking, at an annual fee of 1 per cent of credit sales. Navya Ltd. estimates that it would save Rs. 35,000 per year in administration

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costs as a result. Due to the efficiency of the factor, the average collection period would reduce to 30 days and bad debts would be zero. The factor would advance 80 per cent of invoiced debts at an annual interest rate of 11 per cent. Navya Ltd. is currently financing receivables from an overdraft costing 10 per cent per year.

If occurrence of credit sales is throughout the year, calculate whether the factor's services should be accepted or rejected. Assume 365 days in a year. *(8 Marks)*

4. (a) Following information have been extracted from the cost records of XYZ Pvt. Ltd.

	(Rs.)
Stores: Opening balance	1,08,000
Purchases	5,76,000
Transfer from WIP	2,88,000
Issue to WIP	5,76,000
Issue for repairs	72,000
Deficiency found in stock	21,600

Work-in-progress:	**(Rs.)**
Opening balance	2,16,000
Direct wages applied	2,16,000
Overheads charged	8,64,000
Closing balance	1,44,000

Finished Production:	**(Rs.)**
Entire production is sold at a profit of 15% on cost of WIP	
Wages paid	2,52,000
Overheads incurred	9,00,000

Draw the Stores Ledger Control Account, Work-in-Progress Control Account, Overheads Control Account and Costing Profit and Loss Account. *(8 Marks)*

(b) Rio Ltd has a maximum of Rs. 8,00,000 available to invest in new projects. Three possibilities have emerged and the business finance manager has calculated Net present Value (NPVs) for each of the projects as follows :

Investment	**Initial cash outlay Rs.**	**NPV Rs.**
Alfa (α)	5,40,000	1,00,000
Beta(β)	6,00,000	1,50,000
Gama (γ)	2,60,000	58,000

Which investment/combination of investments should the company invest in, if we assume that the projects can be divided? *(8 Marks)*

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5. (a) Discuss cost classification based on variability.

   (b) Explain Single and Multiple Overhead Rates.

   (c) Write short notes on Bridge Finance.

   (d) What is Virtual Banking? State its advantages. *(4 × 4 =16 Marks)*

6. (a) The standard labour component and the actual labour component engaged in a week for a job are as follows:

	Skilled Workers	Semi-skilled Workers	Un-Skilled workers
Standard number of workers in the gang	32	12	6
Standard wage rate per hour (Rs.)	3	2	1
Actual number of workers employed in the gang during the week	28	18	4
Actual wages rate per hour (Rs.)	4	3	2

During the 40 hours working week the gang produced 1,800 standard labour hours of work.

Calculate:

(i) Total labour cost variance;

(ii) Labour yield variance;

(iii) Labour mix variance; and

(iv) Labour wage rate variance. *(8 Marks)*

   (b) The following are the Balance Sheets of Alfa Limited for the year ending March 31, 2015 and March 31, 2016:

Balance Sheet as on 31st March

	2015 (Rs.)	2016 (Rs.)
Capital and Liabilities:		
Share Capital	6,75,000	7,87,500
General Reserves	2,25,000	2,81,250
Capital Reserve (Profit on Sale of investment)	-	11,250
Profit & Loss Account	1,12,500	2,25,000
15% Debentures	3,37,500	2,25,000
Accrued Expenses	11,250	13,500
Creditors	1,80,000	2,81,250
Provision for Dividends	33,750	38,250
Provision for Taxation	78,750	85,500

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Total	16,53,750	19,48,500
Assets:		
Fixed Assets	11,25,000	13,50,000
Less: Accumulated depreciation	(2,25,000)	(2,81,250)
Net Fixed Assets	9,00,000	10,68,750
Long-term Investments (at cost)	2,02,500	2,02,500
Stock (at cost)	2,25,000	3,03,750
Debtors (net of provision for doubtful debts of Rs. 45,000 and Rs. 56,250 respectively for 2015 and 2016 respectively)	2,53,125	2,75,625
Bills receivables	45,000	73,125
Prepaid Expenses	11,250	13,500
Miscellaneous Expenditure	16,875	11,250
	16,53,750	19,48,500

Additional Information:

(i) During the year 2015-16, fixed assets with a net book value of Rs. 11,250 (accumulated depreciation, Rs. 33,750) was sold for Rs. 9,000.

(ii) During the year 2015-16, Investments costing Rs. 90,000 were sold, and also Investments costing Rs. 90,000 were purchased.

(iii) Debentures were retired at a Premium of 10%.

(iv) Tax of Rs. 61,875 was paid for 2014-15.

(v) During the year 2015-16, bad debts of Rs. 15,750 were written off against the provision for Doubtful Debt account.

(vi) The proposed dividend for 2014-15 was paid in 2015-16.

Required:

Prepare a Funds Flow Statement (Statement of changes in Financial Position on working capital basis) for the year ended March 31, 2016. *(8 Marks)*

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

(a) Discuss the four different methods of costing alongwith their applicability to concerned industry?

(b) Discuss the advantages of raising funds by issue of equity shares.

(c) Elaborate the practical application of Marginal Costing.

(d) Explain the 'Aging Schedule' in the context of monitoring of receivables.

(e) How Economic Batch Quantity is determined? *(4 × 4 =16 Marks)*

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Test Series: March, 2016

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 3: COST ACCOUNTING AND FINANCIAL MANAGEMENT

Suggested Answers/ Hints

1. (a)

Dr. **Process A Account** Cr.

	Rs.		Rs.
To Materials	40,000	By Transfer to Process B A/c	1,20,000
To Labour	40,000		
To Overheads	16,000		
	96,000		
To Profit (20% of transfer price, i.e., 25% of cost)	24,000		
	1,20,000		1,20,000

Dr. **Process B Account** Cr.

	Rs.		Rs.
To Transferred from Process A A/c	1,20,000	By Transfer to Finished Stock A/c	2,88,000
To Labour	56,000		
To Overhead	40,000		
	2,16,000		
To Profit (25% of transfer price i.e., 33.33% of cost)	72,000		
	2,88,000		2,88,000

Statement of Total Profit

	Rs.
Profit from Process A	24,000
Profit from Process B	72,000
Profit on Sales (Rs. 4,00,000 – Rs. 2,88,000)	1,12,000
Total Profit	2,08,000

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(b) Let *x* be the cost of material and *y* be the normal rate of wage/hour

	Worker A (Rs)	Worker B (Rs)
Material cost	x	x
Labour wages	90 y	100 y
Bonus	Rowan system	Halsey system
	$\frac{\text{Time saved}}{\text{Time allowed}} \times \text{hour worked} \times \text{rate}$	Hours saved × 50% × rate
	$\frac{30}{120} \times 90 \times y = 22.5y$	$20 \times \frac{1}{2} \times y = 10y$
Overheads	90 × Rs. 50 = 4,500	100 × Rs. 50 = 5,000
Factory cost	x + 112.5y + 4,500 = 80,200 ∴ x + 112.5y = 75,700…….. (1)	x + 110y + 5,000 = 79,400 ∴ x + 110y = 74,400…. (2)

Solving (1) and (2) we get x = Rs.17,200 and y = Rs. 520

(i) Normal rate of wages is Rs. 520 per hour.

(ii) Cost of materials = Rs. 17,200.

(iii) **Comparative Statement of factory cost**

	Worker A (Rs)	Worker B (Rs)
Material cost	17,200	17,200
Wages	46,800 (90 × Rs. 520)	52,000 (100 × Rs. 520)
Bonus	11,700 $(\frac{30}{120} \times 90 \times 520)$	5,200 $(20 \times \frac{1}{2} \times 520)$
Overheads	4,500 (90 × Rs. 50)	5,000 (100 × Rs. 50)
Factory cost	80,200	79,400

(c) Computation of Weighted Average Cost of Capital (WACC) for each level of Debt-equity mix.

Debt (%)	Required return (K_d)(%)	Equity (%)	Required return (K_e) (%)	K_d× Proportion of debt + K_e Proportion and equity	Weighted Average Cost of Capital (WACC)(K_o)(%)
0	5	100	15	0%(5%)+100%(15%)	15

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20	5	80	16	20%(5%)+80%(16%)	13.8
40	5	60	18	40%(5%)+60%(18%)	12.8
60	10	40	23	60%(10%)+40%(23%)	15.2
80	15	20	35	80%(15%)+20%(35%)	19

The optimum mix is 40% debt and 60% equity, as this will lead to lowest WACC value i.e., 12.8%.

(d) Calculation of Effective Cost of Capital

Particulars	**Option 1 14% institutional Term loan (Rs. in Lakhs)**	**Option 2 13% Non-convertible Debentures (Rs. in lakhs)**
(A) Effective capital to be raised Face value	250.00	250.00
Less: Discount	Nil	(6.25)
	250.00	243.75
Less: Cost of issue	Nil	5.00
Effective amount of capital	250.00	238.75
(B) Annual interest charges on face value of Rs. 250 lakhs	35.0	32.50
Less: Tax benefit on interest @ 50%	17.5	16.25
	17.5	16.25
(C) Effective cost of capital after tax	$\frac{B}{A}$ x 100 = 7.0%	$\frac{16.25}{238.75}$x100 = 6.81% (approx)

So, the better option is raising of funds of Rs.250 lakhs by issue of 13% Non-convertible Debenture

2. (a) Statement of Total Cost and Ranking

Item	**Units**	**% of Total units**	**Unit cost (₹)**	**Total cost (₹)**	**% of Total cost**	**Ranking**
A	12,000	15.30%	30.00	3,60,000	12.97%	2
B	18,000	22.94%	3.00	54,000	1.95%	11
C	6,000	7.65%	35.00	2,10,000	7.57%	5
D	750	0.96%	220.00	1,65,000	5.95%	7

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E	3,800	4.84%	75.00	2,85,000	10.27%	4
F	400	0.51%	105.00	42,000	1.51%	12
G	600	0.76%	300.00	1,80,000	6.49%	6
H	300	0.38%	350.00	1,05,000	3.78%	10
I	3,000	3.82%	250.00	7,50,000	27.03%	1
J	20,000	25.49%	7.50	1,50,000	5.41%	9
K	11,500	14.66%	27.50	3,16,250	11.40%	3
L	2,100	2.68%	75.00	1,57,500	5.68%	8
	78,450	100.00%		27,74,750	100.00%	

Statement of classification of Inventory

Ranking	Item	% of Total units	Cost (₹)	% of Total Cost	Category
1	I	3.82%	7,50,000	27.03%	
2	A	15.30%	3,60,000	12.97%	
3	K	14.66%	3,16,250	11.40%	
4	E	4.84%	2,85,000	10.27%	
5	C	7.65%	2,10,000	7.57%	
Total		**46.27%**	**19,21,250**	**69.24%**	**A**
6	G	0.76%	1,80,000	6.49%	
7	D	0.96%	1,65,000	5.95%	
8	L	2.68%	1,57,500	5.68%	
9	J	25.49%	1,50,000	5.41%	
Total		**29.89%**	**6,52,500**	**23.53%**	**B**
10	H	0.38%	1,05,000	3.78%	
11	B	22.94%	54,000	1.95%	
12	F	0.51%	42,000	1.51%	
Total		**23.84%**	**2,01,000**	**7.24**	**C**
	12	100%	27,74,750	100%	

(b) Comparative Statement of Profit (Rs.) for three years

Particulars	2013	2014	2015
Sales	10,00,000	10,80,000	11,00,000
Cost of goods sold	7,00,000	8,10,000	8,80,000

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Gross Profit	3,00,000	2,70,000	2,20,000
Less: Admin. Exp. 5% of sales (increase of 5% from 2013	50,000	52,500	55,125
Profit Before Tax (P.B.T.)	2,50,000	2,17,500	1,64,875
Tax at 30%	75,000	65,250	49,463
Profit After Tax (P.A.T.)	1,75,000	1,52,250	1,15,412

Working Notes:

Particulars	2013 (Rs.)	2014 (Rs.)	2015 (Rs.)
1. Average Stock = $\frac{\text{Op. Stock + Cl. Stock}}{2}$	$\frac{33,000 + 37,000}{2}$ = 35,000	$\frac{30,400 + 34,400}{2}$ = 32,400	$\frac{53,000 + 57,000}{2}$ = 55,000
2. Cost of Goods sold = Stock Turnover × Avg. Stock	20 ´ 35,000 = 7,00,000	25 ´ 32,400 = 8,10,000	16 ´ 55,000 = 8,80,000
3. Sales = $\frac{\text{Cost of good Sold}}{\text{100\% - GP ratio}}$	$\frac{7,00,000}{100\% - 30\%}$ = $\frac{7,00,000 \times 100}{70}$ =10,00,000	= $\frac{8,10,000}{100\% - 25\%}$ = $\frac{8,10,000 ´ 100}{75}$ = 10,80,000	= $\frac{8,80,000}{100\% - 20\%}$ = $\frac{8,80,000 ´ 100}{80}$ = 11,00,000
4. Gross profit = Sales ´ G.P ratio Or (Sales - Cost of Goods sold)	10,00,000 ´ 30% = 3,00,000	10,80,000 ´ 25% = 2,70,000	11,00,000 ´ 20% = 2,20,000

Comments: Reasons for decrease in Profitability are as follows:

1. Cost of goods sold is increasing from (2013 70% of sales, 2014 75% of sales, 2015 80% of sales,) Hence gross profit ratio reduced from 30% to 20% of Sales
2. Average stock increased to Rs. 55,000 in the year 2015 i.e., there was increase in inventory, resulted in additional borrowings and subsequently, the interest burden will be higher.
3. Administrative expenses also increased form Rs. 50,000 to Rs. 55,125

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3. (a) Expense Budget of R Ltd. for the period

	Per unit (Rs)	60,000 units	72,000 units
		Amount (Rs)	Amount (Rs)
Sales **(A)**	200.00	1,20,00,000	1,44,00,000
Less: Variable Costs:			
- Direct Material	82.50	49,50,000	59,40,000
- Direct Wages	27.50	16,50,000	19,80,000
- Variable Overheads	27.50	16,50,000	19,80,000
- Direct Expenses	16.50	9,90,000	11,88,000
- Variable factory expenses (75% of Rs 20 p.u.)	16.50	9,90,000	11,88,000
- Variable Selling & Dist. exp. (80% of Rs 10 p.u.)	8.80	5,28,000	6,33,600
Total Variable Cost **(B)**	179.30	1,07,58,000	1,29,09,600
Contribution **(C) = (A – B)**	20.70	12,42,000	14,90,400
Less: Fixed Costs:			
- Office and Admin. exp. (100%)	--	3,45,000	3,45,000
- Fixed factory exp. (25%)	--	3,45,000	3,45,000
- Fixed Selling & Dist. exp. (20%)	--	1,38,000	1,38,000
Total Fixed Costs **(D)**	--	8,28,000	8,28,000
(C – D)	--	4,14,000	6,62,400

(b)

	Rs.
Present level of receivables is $45 \text{ lakh} \times (50/365)$	6,16,438
In case of factor, receivables would reduce to $45 \text{ lakhs} \times (30/365)$	3,69,863
The costs of the existing policy are as follows:	
Cost of financing existing receivables: $6,16,438 \times 10\%$	61,644
Cost of bad debts: 45 lakhs × 0.4%	18,000
Cost of current policy	79,644
The cost under the factor are as follows:	

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Cost of financing new receivable through factor:	
(Rs. 3,69,863 × 0.8 × 0.11) + (Rs. 3,69,863 × 0.2 × 0.10) = (32,548 + 7,397)	39,945
Factor's annual fee: 45 Lakhs × 0.01	45,000
Administration costs saved:	(35,000)
Net cost under factor:	49,945

From the above analysis it is clear that the factor's services are cheaper than Existing policy by Rs. 29,699 (Rs. 79,644 - Rs.49,945) per year. Hence, the services of the factor should be accepted.

4. (a) Stores Ledger Control A/c

Particulars	(Rs)	Particulars	(Rs)
To Balance b/d	1,08,000	By Work in Process A/c	5,76,000
To General Ledger Adjustment A/c	5,76,000	By Overhead Control A/c	72,000
To Work in Process A/c	2,88,000	By Overhead Control A/c (Deficiency)	21,600*
		By Balance c/d	3,02,400
	9,72,000		9,72,000

*Deficiency assumed as normal (alternatively can be treated as abnormal loss)

Work in Progress Control A/c

Particulars	(Rs)	Particulars	(Rs)
To Balance b/d	2,16,000	By Stores Ledger Control a/c	2,88,000
To Stores Ledger Control A/c	5,76,000	By Costing P/L A/c (Balancing figures being Cost of finished goods)	14,40,000
To Wages Control A/c	2,16,000	By Balance c/d	1,44,000
To Overheads Control A/c	8,64,000		
	18,72,000		18,72,000

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Overheads Control A/c

Particulars	(Rs)	Particulars	(Rs)
To Stores Ledger Control A/c	72,000	By Work in Process A/c	8,64,000
To Stores Ledger Control A/c	21,600	By Balance c/d (Under absorption)	1,65,600
To Wages Control A/c (Rs 2,52,000- Rs 2,16,000)	36,000		
To Gen. Ledger Adjust. A/c	9,00,000		
	10,29,600		10,29,600

Costing Profit & Loss A/c

Particulars	(Rs)	Particulars	(Rs)
To Work in progress	14,40,000	By Gen. ledger Adjust. A/c (Sales) (Rs 14,40,000 × 115%)	16,56,000
To Gen. Ledger Adjust. A/c (Profit)	2,16,000		
	16,56,000		16,56,000

(b) Since funds available are restricted, the normal Net Present Value (NPV) rule of accepting investments decisions with the highest NPVs cannot be adopted straight way. Further, as the projects are divisible, a Profitability Index (PI) can be utilized to provide the most beneficial combination of investment for Rio Ltd**.**

Project	PV Per Rs.	Rank as per PI
Alfa (α)	Rs. 6,40,000 / Rs. 5,40,000 = 1.185	III
Beta(β)	Rs. 7,50,000 / Rs. 6,00,000 = 1.250	I
Gama (γ)	Rs. 3,18,000 / Rs. 2,60,000 = 1.223	II

Therefore Rio Ltd should invest Rs. 6,00,000 into project β (Rank I) earning Rs. 1,50,000 and Rs. 2,00,000 into project γ (Rank II) earning Rs. 44,615 ((Rs. 2,00,000 / Rs. 2,60,000) × Rs. 58,000).

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So, total NPV will be Rs.1,94,615 (Rs. 1,50,000 + Rs. 44,615) from Rs. 8,00,000 of investment.

5. (a) Cost classification based on variability

(i) Fixed Costs – These are the costs which are incurred for a period, and which, within certain output and turnover limits, tend to be unaffected by fluctuations in the levels of activity (output or turnover). They do not tend to increase or decrease with the changes in output. For example, rent, insurance of factory building etc., remain the same for different levels of production.

(ii) Variable Costs – These costs tend to vary with the volume of activity. Any increase in the activity results in an increase in the variable cost and vice-versa. For example, cost of direct labour, etc.

(iii) Semi-variable Costs – These costs contain both fixed and variable components and are thus partly affected by fluctuations in the level of activity. Examples of semi variable costs are telephone bills, gas and electricity etc.

(b) Single and Multiple Overhead Rates:

Single overhead rate: It is one single overhead absorption rate for the whole factory.

It may be computed as follows:

$$\text{Single overhead rate} = \frac{\text{Overhead costs for the entire factory}}{\text{Total quantity of the base selected}}$$

The base can be total output, total labour hours, total machine hours, etc.

The single overhead rate may be applied in factories which produces only one major product on a continuous basis. It may also be used in factories where the work performed in each department is fairly uniform and standardized.

Multiple overhead rate: It involves computation of separate rates for each production department, service department, cost center and each product for both fixed and variable overheads. It may be computed as follows:

$$\text{Multiple overhead rate} = \frac{\text{Overhead allocated / appportioned to each department/ cost centre or product}}{\text{Corresponding base}}$$

Under multiple overheads rate, jobs or products are charged with varying amount of factory overheads depending on the type and number of departments through which they pass. However, the number of overheads rate which a firm may compute would depend upon two opposing factors viz. the degree of accuracy desired and the clerical cost involved.

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(c) Bridge finance refers, normally, to loans taken by the business, usually from commercial banks for a short period, pending disbursement of term loans by financial institutions, normally it takes time for the financial institution to finalise procedures of creation of security, tie-up participation with other institutions etc. even though a positive appraisal of the project has been made. However, once the loans are approved in principle, firms in order not to lose further time in starting their projects arrange for bridge finance. Such temporary loan is normally repaid out of the proceeds of the principal term loans. It is secured by hypothecation of moveable assets, personal guarantees and demand promissory notes. Generally rate of interest on bridge finance is higher as compared with that on term loans.

(d) Virtual Banking and its Advantages

Virtual banking refers to the provision of banking and related services through the use of information technology without direct recourse to the bank by the customer.

The advantages of virtual banking services are as follows:

- Lower cost of handling a transaction.
- The increased speed of response to customer requirements.
- The lower cost of operating branch network along with reduced staff costs leads to cost efficiency.

Virtual banking allows the possibility of improved and a range of services being made available to the customer rapidly, accurately and at his convenience.

6. (a) Work produced by the gang 1,800 standard labour hours, i.e.,

$$\frac{1,800}{32+12+6} \text{ or 36 gang hours}$$

Standard hours of Skilled Labour	(36×32)	1,152 hours
Standard hours of Semi-skilled Labour	(36×12)	432 hours
Standard hours of Un-skilled Labour	(36×6)	216 hours
Total		1,800 hours
Actual hours of Skilled Labour	(40×28)	1,120 hours
Actual hours of Semi-skilled Labour	(40×18)	720 hours
Actual hours of Un-skilled Labour	(40×4)	160 hours
Total		2,000 hours

Revised Standard hours (actual hours worked expressed in standard ratio)

Skilled Labour	$\frac{1,152}{1,800} \times 2,000$	1,280 hours

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Semi-skilled Labour	$\frac{432}{1,800} \times 2,000$	480 hours
Unskilled Labour	$\frac{216}{1,800} \times 2,000$	240 hours
		2,000 hours

Standard Cost for Actual Output:

		Rs.
Skilled Labour	1,152 hours @ Rs. 3	3,456
Semi-skilled Labour	432 hours @ Rs. 2	864
Unskilled Labour	216 hours @ Re. 1	216
	1,800 hours	4,536

Actual Cost:

Skilled Labour	1,120 hours @ Rs. 4	4,480
Semi-skilled Labour	720 hours @ Rs. 3	2,160
Unskilled Labour	160 hours @ Rs. 2	320
	2,000 hours	6,960

(i) **Total Labour Cost Variance**

Standard Cost - Actual Cost	**Rs.**
Rs. 4,536 - Rs. 6,960	2,424 (A)

(ii) **Labour Yield Variance:**

(Standard hours for Actual Output - Revised Standard hours) × Standard Rate

Skilled	(1,152 - 1,280) × Rs. 3	384 (A)	
Semi -skilled	(432 - 480) × Rs. 2	96 (A)	
Un-skilled	(216 - 240) × Re. 1	24 (A)	
		504 (A)	504 (A)

(iii) **Labour Mix Variance:**

(Revised Standard Hours - Actual Hours) × Standard Rate

Skilled	(1,280 - 1,120) × Rs. 3	480 (F)	
Semi-skilled	(480 - 720) × Rs. 2	480 (A)	
Un-skilled	(240 - 160) × Re. 1	80 (F)	
		80 (F)	80 (F)

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(iv) **Labour Wage Rate Variance:**

(Standard Rate - Actual Rate) × Actual Hours

Skilled	(Rs. 3 - Rs. 4) × 1,120	1,120 (A)	
Semi-skilled	(Rs. 2 - Rs. 3) × 720	720 (A)	
Un-skilled	(Re 1 - Rs. 2) × 160	160 (A)	
		2,000 A	2,000 (A)

Check : Total Labour Cost Variance = Yield + Mix + Rate 2,424 (A)

Note: The question does not want the calculation of total labour efficiency variance. If desired, the variance may be calculated as under:

(Standard hours for Actual output - Actual hours) × Standard Rate

Skilled	(1,152 - 1,120) × Rs. 3	96 (F)
Semi-skilled	(432 - 720) × Rs. 2	576 (A)
Un-skilled	(216 - 160) × Re. 1	56 (F)

Check : Total Efficiency Variance = Yield + Mix 424 (A)

(b) Computation of Funds from Operation

	Rs.
Profit and loss balance on March 31, 2016	2,25,000
Add: Depreciation	90,000
Loss on Sale of Asset	2,250
Misc. Expenditure written off	5,625
Transfer to Reserves	56,250
Premium on Redemption of debentures	11,250
Provision for Dividend	38,250
Provision for Taxation	68,625
	4,97,250
Less: P/L balance on March 31, 2015	1,12,500
Funds from operations	3,84,750

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Accumulated Depreciation A/c

	Rs.		Rs.
To Fixed Asset A/c	33,750	By Bal. b/d	2,25,000
To Bal. c/d	2,81,250	By P/L A/c (Pro (Prov. for dep.) (Bal. Fig.)	90,000
	3,15,000		3,15,000

Fixed Assets A/c

	Rs.		Rs.
To Bal. b/d	11,25,000	By Accumulated Depreciation A/c	33,750
To Bank (Purchase of Fixed Asset) (Bal. fig.)	2,70,000	By Cash	9,000
		By P/L (Loss on sale)	2,250
		By Bal. c/d	13,50,000
	13,95,000		13,95,000

Provision for Tax A/c

	Rs.		Rs.
To Cash (tax paid)	61,875	By Bal. b/d	78,750
		By P/L A/c (Prov.)	
To Bal. c/d	85,500	(Bal. fig.)	68,625
	1,47,375		1,47,375

Statement of Changes in Working Capital

	March 31, 2015	March 31, 2016	Change in W/C	
			+	-
Current Assets				
Stock	2,25,000	3,03,750	78,750	
Debtors	2,53,125	2,75,625	22,500	
Bills Receivables	45,000	73,125	28,125	
Prepaid Expenses	11,250	13,500	2,250	
	5,34,375	6,66,000	1,31,625	-

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Less: Current liabilities				
Accrued Expenses	11,250	13,500	-	2,250
Creditors	1,80,000	2,81,250	-	1,01,250
	1,91,250	2,94,750	1,31,625	1,03,500
Working Capital	3,43,125	3,71,250	-	-
Increase in Working Capital				28,125
			1,31,625	1,31,625

Funds Flow Statement for the year ended March 31, 2016

Sources	**Rs.**
Working Capital from Operations	3,84,750
Sale of Fixed Assets	9,000
Sale of Investments	1,01,250
Share Capital Issued	1,12,500
Total Funds Provided (A)	6,07,500
Uses	**Rs.**
Purchase of Fixed Assets	2,70,000
Purchase of Investments	90,000
Payment of Debentures (at a premium of 10%)	1,23,750
Payment of Dividends	33,750
Payment of Taxes	61,875
Total Funds Applied (B)	5,79,375
Increase in Working Capital (A-B)	Rs. 28,125

7. (a) Four different methods of costing along with their applicability to concerned industry have been discussed as below:

(i) Job Costing: The objective under this method of costing is to ascertain the cost of each job order. A job card is prepared for each job to accumulate costs. The cost of the job is determined by adding all costs against the job it is incurred. This method of costing is used in printing press, foundries and general engineering workshops, advertising etc.

(ii) Batch Costing: This system of costing is used where small components/ parts of the same kind are required to be manufactured in large quantities. Here batch of similar products is treated as a job and cost of such a job is

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ascertained as discussed under (1), above. If in a cycle manufacturing unit, rims are produced in batches of 2,500 units each, then the cost will be determined in relation to a batch of 2,500 units.

(iii) Contract Costing: If a job is very big and takes a long time for its completion, then method used for costing is known as Contract Costing. Here the cost of each contract is ascertained separately. It is suitable for firms engaged in the construction of bridges, roads, buildings etc.

(iv) Operating Costing: The method of Costing used in service rendering undertakings is known as operating costing. This method of costing is used in undertakings like transport, supply of water, telephone services, hospitals, nursing homes etc.

(b) Advantages of Raising Funds by Issue of Equity Shares

(i) It is a permanent source of finance. Since such shares are not redeemable, the company has no liability for cash outflows associated with its redemption.

(ii) Equity capital increases the company's financial base and thus helps further the borrowing powers of the company.

(iii) The company is not obliged legally to pay dividends. Hence in times of uncertainties or when the company is not performing well, dividend payments can be reduced or even suspended.

(iv) The company can make further issue of share capital by making a right issue.

(c) Practical applications of Marginal costing:

(i) Pricing Policy: Since marginal cost per unit is constant from period to period, firm decisions on pricing policy can be taken particularly in short term.

(ii) Decision Making: Marginal costing helps the management in taking a number of business decisions like make or buy, discontinuance of a particular product, replacement of machines, etc.

(iii) Ascertaining Realistic Profit: Under the marginal costing technique, the stock of finished goods and work-in-progress are carried on marginal cost basis and the fixed expenses are written off to profit and loss account as period cost. This shows the true profit of the period.

(iv) Determination of production level: Marginal costing helps in the preparation of break-even analysis which shows the effect of increasing or decreasing production activity on the profitability of the company.

(d) Ageing Schedule: An important means to get an insight into collection pattern of debtors is the preparation of their 'Ageing Schedule'. Receivables are classified according to their age from the date of invoicing e.g. 0 – 30 days, 31 – 60 days, 61

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– 90 days, 91 – 120 days and more. The ageing schedule can be compared with earlier month's figures or the corresponding month of the earlier year.

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

(e) In batch costing the most important problem is the determination of 'Economic Batch Quantity'

The determination of economic batch quantity involves two types of costs viz, (i) set up cost and (ii) carrying cost. With the increase in the batch size, there is an increase in the carrying cost but the set-up cost per unit of the product is reduced; this situation is reversed when the batch size is reduced. Thus there is one particular batch size for which both set up and carrying costs are minimum. This size of a batch is known as economic or optimum batch quantity.

Economic batch quantity can be determined with the help of a table, graph or mathematical formula. The mathematical formula usually used for its determination is as follows:

$$EBQ= \sqrt{\frac{2DC}{C}}$$

Where, D = Annual demand for the product

S = Setting up cost per batch

C = Carrying cost per unit of production per annum

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Test Series: March, 2016

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – I

PAPER – 4: TAXATION

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

1. (a) Mr. Ravi carries on his own business. Compute the total income of Mr. Ravi for the assessment year 2016-17. An analysis of his trading and profit & loss for the year ended 31-3-2016 revealed the following information.

(1) The net profit for the year ended 31-3-2016 was Rs. 11,20,000.

(2) It was found that the value of opening stock of Rs 8,000 and closing stock of Rs. 12,000 were omitted to be included in books.

(3) Total expenses on car was Rs. 78,000. The car was used both for business and personal purposes. ¾th is for business purposes.

(4) Salary includes Rs. 22,500 paid to his brother which is unreasonable to the extent of Rs. 2,500.

(5) Advertisement expenses include 28 gift packets of sweets costing Rs. 1,000 per packet presented to important customers.

(6) Rs. 1,00,000 was debited in the profit and loss account, being contribution to a University approved and notified under section 35(1)(ii).

(7) Depreciation debited in the books was Rs. 55,000. Depreciation allowed as per Income-tax Rules, 1962 was Rs. 50,000.

(8) Miscellaneous expenses included Rs. 33,000 paid to Gupta& Co., a goods transport operator in cash on 11-2-2016 for distribution of the company's product to the warehouses.

(9) The following incomes were credited in the profit and loss account:

(a) Dividend from UTI Rs. 22,000.

(b) Interest on debentures Rs. 17,500.

(c) Winnings from races Rs. 15,000.

(10) Drawings Rs. 10,000.

(11) Investment in NSC Rs. 15,000. *(10 Marks)*

(b) Hanuman & Co. is a firm engaged in the business of recruitment and supply of manpower. It furnishes the following details pertaining to the quarter ended 30.09.20XX:

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		Rs.
(i)	Amount collected from clients for recruitment of	
	Permanent staff	5,00,000
	Temporary staff	3,00,000
(ii)	Amounts collected from clients for pre-recruitment screening	2,50,000
(iii)	Domestic helps arranged for friends & relative (Value of similar services when provided to other customers is Rs. 45,000)	-
(iv)	Amount collected from a warehouse of agricultural produce for labour provided for loading and unloading	1,75,000
(v)	Advance received from prospective employers for conducting campus interviews in colleges to be held in November, 20XX	2,00,000
	(Such campus interviews could not be conducted due to student's strike in those colleges. Hence, the advance received was later on returned to the employers.)	

None of the clients of Hanuman & Co. was a body corporate during the relevant quarter. Compute the value of taxable services rendered and the total service tax payable @ 14% for the relevant quarter assuming that Hanuman & Co. is not eligible for the small service provider's exemption. All above amounts are inclusive of service tax, wherever applicable. *(6 Marks)*

(c) Base Enterprises imported goods from Bangladesh in a vehicle. Determine the rate of import duty to be considered for computation of import duty from the following information:-

Particulars	Date	Rate of customs duty
Date of filing of Bill of Entry	15.09.20XX	10%
Date of arrival of vehicle	20.09.20XX	12%
Date on which goods were allowed to be cleared from the land customs station	28.09.20XX	11%
Date of payment of the value of the goods imported	30.09.20XX	8%

(4 Marks)

2. (a) Mr. Garg, an employee of PQR Co. Ltd. at Chennai and covered by Payment of Gratuity Act, retires at the age of 63 years on 31-12-2015 after completing 34 years and 7 months of service. At the time of retirement, he is entitled for monthly pension of Rs. 8,000. He gets 80% of pension commuted for Rs. 4,50,000 on 1st February, 2016. His employer also pays Rs. 20,51,640 as Gratuity and Rs. 6,00,000 as accumulated balance of Recognised Provident fund. Determine the salary

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chargeable to tax for Mr. Garg for the Assessment Year 2016-17 with the help of following information:

	Rs.
Basic Salary (Rs. 80,000 x 9)	7,20,000
Bonus	72,000
Employer contribution towards Recognized Provident Fund	1,10,000
Rent paid by Mr. Garg (Rs. 12,000 x 12)	1,44,000
House Rent Allowance (Rs. 20,000 x 9)	1,80,000
Professional Tax paid by Mr. Garg	5,000

Note: Salary and Pension falls due on the last day of each month. *(8 Marks)*

(b) Great India Ltd. sold a machine, manufactured by it, to Indira Industries Ltd. (IIL) at a price of Rs. 10,00,000 (excluding taxes and duties). Further, following additional amounts were also charged from IIL:

	Rs.
Expenses pertaining to installation and erection of the machine at premises of IIL (machine was permanently affixed to earth)	30,000
Special packing charges	12,500
Design and engineering charges	40,000
Dharmada (charged in the invoice and recovered from IIL)	10,000

Determine the total amount of central excise duty payable on the machine from the aforesaid information. *(5 Marks)*

(c) Arun, a service provider, had received Rs. 2,50,000 in advance from Raju. Arun had deposited service tax on such amount in the relevant half year. He finally rendered services valuing to Rs. 2,20,000 only and refunded balance amount to Raju. Arun want to adjust service tax on Rs. 30,000 refunded by him against his current dues of service tax. Advise him. *(3 Marks)*

3. (a) State with reasons in brief whether the following statements are true or false with reference to the provisions of the Income-tax Act, 1961:

(i) Pension received by Mr. A, a recipient of gallantry award is exempt from income-tax.

(ii) Mr. Saurav received a sum of Rs. 20 lakh on 25.2.2016 from Life Insurance Corporation of India in respect of a policy, where the sum assured was Rs. 15 lakh, taken on 19.07.2003 and for which a one time premium of Rs. 8 lakh was paid. Mr. Saurav claims that the amount is totally exempt under section 10(10D)(c) of the Income-tax Act, 1961.

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(iii) In respect of voluntary contributions in excess of Rs. 20,000 received by a political party, exemption under section 13A is available where proper details about the donations are maintained; there is no need to maintain books of account.

(iv) Mr. P, a member of a HUF, received Rs. 20,000 as his share from the income of the HUF. The same is to be included in his chargeable income. *(4 Marks)*

(b) Ms. Pratika, a non-resident, residing in Australia since 1996, came back to India on 09-02-2014 for permanent settlement in India. Explain the residential status of Ms. Pratika for the Assessment Year 2016-17 in accordance with the various provisions of Income-tax Act, 1961. *(4 Marks)*

(c) Shiv, an advocate, rendered professional advice to its client XY Ltd. on the matters relating to tax optimization. As a consideration for the said services, XY Ltd. gave a souvenier to Shiv. The said souvenier was an artifact especially designed and made by the craftsmen as per the specifications suggested by XY Ltd.

Shiv contends that he need not pay service tax on the services provided by him as value thereof could not be ascertained. Is Shiv's contention correct? Critically examine the case.

Assume that Shiv is not entitled to the exemption available to small service providers. *(4 Marks)*

(d) Mr. Vihaan reported inter-State sales of Rs. 45,00,000 (inclusive of central sales tax) for the current financial year. In this regard following additional information is available:

(i) Freight Rs. 2,30,000 (Rs. 80,000 is not shown separately on invoices)

(ii) Goods sold to Mr. X for Rs. 45,000 on 15.05.20XX were returned on 18.10.20XX.

(iii) Mr. Z, a buyer to whom goods worth Rs. 30,000 were dispatched on 17.04.20XX, rejected such goods. The said goods were received back on 18.11.20XX.

Determine the taxable turnover and CST payable, assuming that all the transactions were covered by valid "C" forms and sales tax rate within the State is 5%. *(4 Marks)*

4. (a) You are required to advise Mr. Vineet retail trader of Ranchi whether he can offer his business income under section 44AD i.e., presumptive taxation. Trading and Profit and Loss Account for the year ended 31st March, 2016 is as follows:

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Trading and Profit and Loss Account for the year ended 31.03.2016

Particulars	Rs.	Particulars	Rs.
To Opening stock	90,000	By Sales	12,11,500
To Purchases	10,04,000	By Income from UTI	2,400
To Gross Profit	3,06,000	By Closing stock	1,86,100
	14,00,000		14,00,000
To Salary	60,000	By Gross profit b/d	3,06,000
To Rent and rates	36,000		
To Interest on loan	15,000		
To Depreciation	1,05,000		
To Printing & stationery	23,200		
To Postage & telegram	1,640		
To Loss on sale of shares (Short term)	8,100		
To Other general expenses	7,060		
To Net Profit	50,000		
	3,06,000		3,06,000

Additional Information:

(i) The depreciation provided in the Profit and Loss Account Rs. 1,05,000 was based on the following information :

The written down value of plant and machinery is Rs .4,20,000 as on 01.04.2015.A new plant falling under the same block of depreciation was bought on 1.7.2015 for Rs.70,000.Two old plants were sold on 1.10.2015 for Rs.50,000.

(ii) Salary includes Rs.10,000 paid to his brother, which is unreasonable to the extent of Rs.2,000.

(iii) The whole amount of printing and stationery was paid in cash by way of one-time payment.

(iv) Rent and rates includes sales tax liability of Rs. 3,400 paid on 7.4.2016.

(v) It was found that some stocks were omitted to be included in both the Opening and Closing Stock, the values of which were:

Opening stock	Rs.9,000
Closing stock	Rs.18,000

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(vi) Other general expenses include Rs.2,000 paid as donation to a Public Charitable Trust. *(8 Marks)*

(b) Mr. Pankaj boarded Rajdhani Express (fully AC train) from Kanpur on July 5, 20XX and disembarked at New Delhi. He hired a car from a local cab operator for the whole day on a lumpsum consideration and visited Delhi's historical monuments. In the night, he took the Metro to International Airport and boarded a flight to Mumbai. At Mumbai Airport, he used a radio taxi for going to his Hotel. Mr. Pankaj returned to Kanpur from a different train, Pushpak Express in sleeper class.

With reference to the provisions of Finance Act, 1994, examine the leviability of service tax on the various modes of travel undertaken by Mr. Pankaj. *(8 Marks)*

5. (a) Mr. Kartik has four minor children consisting of three daughters and one son. Compute the amount of Income earned by minor children to be clubbed in the hands of Mr. Kartik. The annual income of all the children for the Assessment Year 2016-17 were as follows:

	Rs.
Son	50,000
First daughter (Including Scholarship received Rs. 5,000)	15,000
Second Daughter	8,500
Third Daughter (Suffering from disability specified U/s 80U)	4,500

Mr. Kartik gifted Rs. 2,00,000 to his minor son who invested the same in the business and derived income of Rs. 40,000 which is included above.

(4 Marks)

(b) Ms. Shikha is a co-owner of a house property along with her brother holding equal share in the property.

Particulars	**Rs.**
Fair rent	1,55,000
Rent received	16,000 p.m.
Standard rent under the Rent Control Act	1,70,000
Municipal value of the property	1,60,000

The loan for the construction of this property is jointly taken and the interest charged by the bank is Rs. 25,000, out of which Rs. 21,000 has been paid. Interest on the unpaid interest is Rs. 700. To repay this loan, Shikha and her brother have taken a fresh loan and interest charged on this loan is Rs. 5,000. The municipal taxes of Rs. 6,500 have been paid by the tenant.

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Compute the income from this property chargeable in the hands of Ms. Shikha for the A.Y. 2016-17. *(4 Marks)*

(c) Smart Hero Motors Ltd. purchases raw material and supplies it to CBK Engineering Company. CBK Engineering Company manufactures automobile components as per the design supplied by Smart Hero Motors. Such components bear brand name of Smart Hero Motors Ltd. namely, 'Smart Hero'. CBK Engineering Company supplies these components to Smart Hero Motors Ltd., who in turn sells them in market as spare parts of automobiles. Who is liable to pay central excise duty on such components? *(3 Marks)*

(d) Examine the validity of following statements with reference to service tax law:

(i) Consultancy services provided to Government in relation to slum improvement and upgradation is exempt from service tax.

(ii) The transport of goods in a vessel attracts service tax at 40% of the gross amount charged.

(iii) Both service providers and service receivers need to satisfy the condition of non-availment of CENVAT credit for claiming abatement of 70% of gross amount charged in case of GTA service.

(iv) Service provided for transport of passengers by air conditioned buses is exempt from service tax. *(5 Marks)*

6. (a) Mr. Chawla own eight machines, put in use for business in March, 2015. The depreciation on these machines is charged @ 15%. The written down value of these machines as on 1st April, 2015 was Rs. 8,50,000. Four of the old machines were sold on 14th August, 2015 for Rs. 11,00,000. A new plant was bought for Rs. 5,50,000 on 8thDecember, 2015.

You are required to:

(i) Determine the claim of depreciation and capital gains liable to tax for Assessment Year 2016-17.

(ii) If Mr. Chawla had sold the four machines in June, 2015 for Rs. 18,00,000, will there be any difference in your above workings? Explain.

(8 Marks)

(b) Kichak, purchased raw material 'A' for Rs. 30,00,000 plus VAT @ 4%. Out of such raw material 60% was used for manufacture of taxable goods and the remaining for manufacture of goods which are exempt from VAT.

Another raw material 'B' was purchased for Rs. 15,00,000 on which VAT was paid at 1%. Entire raw material' 'B' was used for manufacture of taxable goods only.

The entire taxable goods were sold for Rs. 50,00,000 plus VAT @ 12.5%.

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Compute net VAT liability of Kichak on the assumption that there was no opening or closing inventory. *(4 Marks)*

(c) Mr. Tirupati has conducted a market survey for Mr. Shubh. However, Mr. Tirupati has not charged any fee for such services as Mr. Shubh happens to be his best friend. Is service tax payable on such free service? Explain. *(4 Marks)*

7. (a) Mr. Sambhav sold his house property in Jaipur as well as his rural agricultural land for a consideration of Rs.80 lakhs and 35 lakhs, respectively, to Mr. Sanjay on 10-11-2015. He has purchased the house property for Rs. 35 lakhs and the land for Rs. 15 lakhs, in the year 2013. There was no difference in the stamp valuation. You are required to determine TDS implications, if any, assuming both persons are resident Indians. *(4 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) Where the Karta of a HUF is absent from India, the return of income can be verified by any male member of the family.

(ii) The Assessing Officer has the power, inter alia, to allot PAN to any person by whom no tax is payable. *(4 Marks)*

(c) With reference to the Point of Taxation Rules, 2011 (POTR), explain what will be the point of taxation in case of continuous supply of services? *(4 Marks)*

(d) Compute the CENVAT credit available with Sai Services Ltd. in respect of the following services availed by it in the month of August, 20XX:-

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

(4 Marks)

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MOCK TEST – 2

INTERMEDIATE (IPC) – GROUP – I

PAPER – 4: TAXATION

SUGGESTED ANSWERS/HINTS

1. (a) **Computation of total income of Mr. Ravi for the A.Y. 2016-17**

Particulars	Rs.
Profits and gains of business or profession **(See Working Note 1 below)**	10,46,500
Income from other sources **(See Working Note 2 below)**	32,500
Gross Total Income	**10,79,000**
Less: Deduction under section 80C (Investment in NSC)	15,000
Total Income	**10,64,000**

Working Notes :

1. Computation of profits and gains of business or profession

Particulars		Rs.	Rs.
Net profit as per profit and loss account			11,20,000
Add:	**Expenses debited to profit and loss account but not allowable as deduction**		
	Salary paid to brother disallowed to the extent considered unreasonable [Section 40A(2)]	2,500	
	Motor car expenses attributable to personal use not allowable (Rs. 78,000 × ¼)	19,500	
	Depreciation debited in the books of account	55,000	
	Drawings (not allowable since it is personal in nature) **[See Note (iii)]**	10,000	
	Investment in NSC **[See Note (iii)]**	15,000	1,02,000
			12,22,000
Add:	Under statement of closing stock		12,000
			12,34,000
Less:	Under statement of opening stock		8,000
			12,26,000

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Less:	Contribution to a University approved and notified under section 35(1)(ii) is eligible for weighted deduction@175%. Since only the actual contribution (100%) has been debited to profit and loss account, the additional 75% has to be deducted.		75,000
			11,51,000
Less:	**Incomes credited to profit and loss account but not taxable as business income**		
	Income from UTI [Exempt under section 10(35)]	22,000	
	Interest on debentures (taxable under the head "Income from other sources")	17,500	
	Winnings from races (taxable under the head "Income from other sources")	15,000	54,500
			10,96,500
Less:	Depreciation allowable under the Income-tax Rules, 1962		50,000
			10,46,500

Notes:

(i) Advertisement expenses of revenue nature, namely, gift of sweets to important customers, is incurred wholly and exclusively for business purposes. Hence, the same is allowable as deduction under section 37.

(ii) Disallowance under section 40A(3) is not attracted in respect of cash payment ofRs.33,000 to Gupta& Co., a goods transport operator, since, in case of payment made for plying, hiring or leasing goods carriages, an increased limit of Rs. 35,000 is applicable (i.e. payment of upto Rs. 35,000 can be made in cash without attracting disallowance under section 40A(3))

(iii) Since drawings and investment in NSC have been given effect to in the profit and loss account, the same have to be added back to arrive at the business income.

2. Computation of "Income from other sources"

Particulars	***Rs.***
Interest on debentures	17,500
Winnings from races	15,000
	32,500

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Note:

The following assumptions have been made in the above solution:

1. The figures of interest on debentures and winnings from races represent the gross income (i.e., amount received plus tax deducted at source).
2. In point no. 7 of the question, it has been given that depreciation as per Income-tax Rules, 1962 is Rs. 50,000. It has been assumed that, in the said figure of Rs. 50,000, only the proportional depreciation (i.e., 75% for business purposes) has been included in respect of motor car.

(b) Computation of value of taxable service and service tax payable by Hanuman & Co. for the quarter ended 30.09.20XX

Particulars	**Rs.**
Amount collected from clients for recruitment of	
Permanent staff	5,00,000
Temporary staff	3,00,000
Amounts collected from clients for pre-recruitment screening	2,50,000
Domestic helps arranged for friends & relative for free [Note-1]	Nil
Amount collected from a warehouse of agricultural produce for labour provided for loading and unloading [Note-2]	1,75,000
Advances received from prospective employers for conducting campus interviews in colleges to be held in November, 20XX [Note-3]	2,00,000
Value of taxable service including service tax	14,25,000
Value of taxable service (Rs. 14,25,000 × 100/114)	**12,50,000**
Service tax (Rs. 12,50,000× 14/100) [rounded off]	**1,75,000**

Notes:

1. Free services are not liable to service tax as there is no consideration involved.
2. Since labour supplied to a warehouse for loading and unloading of agricultural produce can neither be considered as supply of farm labour nor loading, unloading of agricultural produce, such service is not covered in the negative list of services and hence, is taxable [Section 66D of the Finance Act, 1994].
3. Since services agreed to be provided are also chargeable to service tax, advance received will also be liable to service tax. Such advance received from prospective employers will be taxable at the time when it is received irrespective of the fact that no campus interviews were subsequently

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conducted and advances received were returned to employers.

4. Since none of the clients of Hanuman & Co. was a body corporate in the relevant quarter, reverse charge provisions will not be applicable.

(c) Section 15 of the Customs Act, 1962 provides that in case the goods have been imported in a vehicle, the rate of duty shall be the rate in force on:-

(i) the date on which Bill of Entry is presented

or

(ii) the date on which arrival of vehicle takes place

whichever is later.

Therefore, the relevant date for determination of the rate of import duty, in the given case, is 20.09.20XX. Hence, the rate of import duty applicable in the given case is 12%.

2. (a) Computation of taxable salary of Mr. Garg for the Assessment Year 2016-17

Particulars	**Rs.**
Basic Salary (Rs. 80,000 x 9)	7,20,000
Bonus	72,000
House Rent Allowance **(Working Note 1)**	1,44,000
Employer's contribution towards recognized provident fund in excess of 12% of salary [i.e., Rs. 1,10,000 – Rs. 86,400 (12% of Rs. 7,20,000)]	23,600
Gratuity **(Working Note 2)**	10,51,640
Uncommuted Pension [(Rs. 8,000 x 1)+(Rs.1,600 x 2)]	11,200
Commuted Pension **(Working Note 3)**	2,62,500
Gross Salary	**22,84,940**
Less: Professional tax paid by Mr. Garg [deductible under section 16(iii)]	5,000
Taxable salary	**22,79,940**

Working Notes:

Particulars		**Rs.**	**Rs.**
(1)	**Taxable House Rent Allowance**		
	Actual HRA Received		1,80,000
	As per section 10(13A),least of the following is exempt:		
	Actual HRA received	1,80,000	

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	Excess of rent paid over 10% of salary (basic pay, in this case)			
	- Rent paid (Rs. 12,000 x 9)	Rs.1,08,000		
	- *Less*: 10% of salary (i.e., 10% of Rs. 7,20,000)	Rs. 72,000	36,000	
	50% of salary (i.e., 50% of Rs. 7,20,000)		3,60,000	
	Least of the above			36,000
	Taxable HRA			**1,44,000**
(2)	**Taxable Gratuity**			
	Actual Gratuity received			20,51,640
	As per section 10(10), least of the following is exempt:			
	Statutory limit		10,00,000	
	Actual gratuity received		20,51,640	
	15 days salary for each completed year of service or part thereof in excess of 6 months i.e., 15/26 x 80,000 x 35		16,15,385	
	Least of the above			10,00,000
	Taxable Gratuity			**10,51,640**
(3)	**Commuted Pension**			
	Since Mr. Garg is a non-government employee in receipt of gratuity, exemption under section 10(10A), would be available to the extent of 1/3rd of the amount of the pension which he would have received had he commuted the whole of the pension.			
	Amount received (Commuted value of 80% of pension)			4,50,000
	Amount exempt from tax = (Rs. 4,50,000 x 100/80) x 1/3			1,87,500
	Taxable amount			**2,62,500**
(4)	**Accumulated balance of Recognized Provident Fund (RPF)**			
	Rs. 6 lakh, representing the accumulated balance of RPF, received on retirement is exempt since Mr. Garg has rendered a continuous service for a period of 5 years or more (34 years and 7 months) in PQR Ltd.			

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(b) Computation of central excise duty payable

Particulars	Rs.
Price of machine excluding taxes and duties	10,00,000
Add: Installation and erection expenses [Note 1]	-
Special packing charges [Note 2]	12,500
Design and engineering charges of the machine [Note 2]	40,000
Dharmada charged in the invoice	10,000
Assessable value	10,62,500
Excise duty payable @ 12.5% [rounded off]	**1,32,813**

Notes:

1. Installation and erection expenses have not been included in the assessable value as after the installation and erection, machine has been permanently affixed to earth and thus, it has resulted in an immovable property.
2. Special packing charges and design and engineering charges have been included in the assessable value as such payments are 'in connection with sale'.

(c) Where an assessee has received any payment against a service to be provided which is not so provided by him either wholly or partially for any reason, the assessee may take the credit of such excess service tax paid by him, if the assessee has refunded the payment or part thereof, so received for the service not provided to the person from whom it was received [Rule 6 of the Service Tax Rules, 1994].

Since, in the given case, service provider Arun has refunded the payment relatable to the value of services not provided (Rs. 30,000) to service receiver Raju, he can take the credit of excess service tax paid by him on the said amount and adjust the same against his current service tax dues.

3. (a) (i) True: Section 10(18) exempts any income by way of pension received by Mr. A who has been awarded "Paramvir Chakra" or "Mahavir Chakra" or "Vir Chakra" or such other gallantry award as the Central Government, may, by notification in the Official Gazette, specify in this behalf.

(ii) False: As per section 10(10D)(c), any sum received under an insurance policy issued on or after 1.4.2003 but before 31.03.2012, in respect of which the premium payable for any year during the term of the policy exceeds 20% of actual capital sum assured, shall not be exempt from tax. Hence, the contention of Mr. Saurav is not correct since the one-time premium of Rs. 8 lakh paid by him is in excess of 20% of the sum assured [i.e. it exceeds Rs. 3 lakh, being 20% of Rs. 15 lakh]. Further, tax is deductible @2% under

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section 194DA on such sum paid to Mr. Saurav, since the same is not exempt under section 10(10D).

(iii) False: The obligation under section 13A to maintain proper details of voluntary contributions in excess of Rs. 20,000 is over and above the obligation to maintain such books of account and other documents as would enable the Assessing Officer to properly deduce its income therefrom.

(iv) False: Section 10(2) exempts any sum received by an individual as a member of a HUF where such sum has been paid out of the income of the family. Therefore, Rs. 20,000 should not be included in Mr. P's chargeable income.

(b) (ii) Determination of residential status of Ms. Pratika for the A.Y. 2016-17

Ms. Pratika is a resident since she has stayed in India for 365 days during the P.Y.2015-16. Therefore she satisfies the condition of stay in India for a period of 182 days or more in the relevant previous year as per the requirement under section 6(1).

As per section 6(6), an individual is said to be "not ordinarily resident" in India in any previous year, if he has:

(a) been a non-resident in India in nine out of ten previous years preceding the relevant previous year; or

(b) during the seven previous years immediately preceding the relevant previous year, been in India for a period of, or periods amount in all to, 729 days or less.

Ms. Pratika must, therefore, satisfy either of the conditions to qualify as a not-ordinarily resident.

Ms. Pratika was a non-resident in India up to A.Y.2014-15.

She was resident in India only for P.Y. 2014-15 (A.Y.2015-16) out of the ten previous years preceding P.Y. 2015-16 (A.Y.2016-17). This implies that she has been a non-resident in India in nine out of ten previous years preceding P.Y. 2015-16 (A.Y. 2016-17).

Further, she was in India only for a period of 416 days [i.e., 20 days in February, 2014 + 31 days in March 2014 + 365 days during the P.Y.2014-15] in the seven previous years preceding P.Y. 2015-16 (A.Y.2016-17).

Therefore, since Ms. Pratika satisfies both the conditions for "not-ordinarily resident", her residential status for A.Y.2016-17 would be "Resident but not ordinarily resident"

(c) No, Shiv's contention is not correct. He should value the service in the manner provided by rule 3 of the Service Tax (Determination of Value) Rules, 2006 and pay service tax. Accordingly, he should value the service provided by him on the basis of similar services and if that is not possible, he should value the service on the basis of equivalent money value of consideration and pay service tax on the same.

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However, such value should, in no case, be less than the cost of provision of such taxable service.

(d) Computation of Mr. Vihaan's taxable turnover and CST payable

Particulars	Rs.	Rs.
Total inter-State sales		45,00,000
Less: Freight shown separately in the invoices [Freight not shown separately in invoices is not deductible]	1,50,000	
Goods returned by Mr. X [deductible as returned within 6 months]	45,000	
Goods rejected by Mr. Z after 6 months [deductible although returned after 6 months, as it is a case of an un-fructified sale]	30,000	2,25,000
Turnover (including CST)		42,75,000
Taxable turnover (rounded off) [Rs. 42,75,000 × 100/102]		**41,91,176**
CST @ 2% [Rs. 42,75,000 × 2/102] Since transactions are covered by valid 'C' Form, CST is 2% or sales tax rate within the State (5%), whichever is lower, i.e., 2%		
CST payable(rounded off)		**83,824**

4. (a) Computation of business income of Mr. Vineet for the A.Y. 2016-17

Particulars	Rs.	Rs.
Net Profit as per profit and loss account		50,000
Add: Inadmissible expenses / losses		
Under valuation of closing stock	18,000	
Salary paid to brother – unreasonable [Section 40A(2)]	2,000	
Printing and stationery paid in cash [Section 40A(3)]	23,200	
Depreciation (considered separately)	1,05,000	
Short term capital loss on shares	8,100	
Donation to public charitable trust	2,000	1,58,300
		2,08,300
Less: Deductions items:		
Under valuation of opening stock	9,000	

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Income from UTI [Exempt under section 10(35)]	2,400	11,400
Business income before depreciation		1,96,900
Less: Depreciation **(See Note 1)**		66,000
Business Income		**1,30,900**

Computation of business income as per section 44AD -

As per section 44AD, the business income would be 8% of turnover i.e., 12,11,500 x 8 /100 = Rs. 96,920

The business income under section 44AD is **Rs. 96,920.**

As the business income under section 44AD is lower than the business income as per the normal provisions of the Act, it is advisable for Mr. Vineet to offer his business income under section 44AD.

Note 1:

Calculation of depreciation

Particulars	Rs.
WDV of the block of plant & machinery as on 1.4.2015	4,20,000
Add : Cost of new plant & machinery	70,000
	4,90,000
Less : Sale proceeds of assets sold	50,000
WDV of the block of plant & machinery as on 31.3.2016	4,40,000
Depreciation @ 15%	66,000
No additional depreciation is allowable as the assessee is not engaged in manufacture or production of any article.	

(b) As per section 66D of Finance Act, 1994, service of transportation of passengers, with or without accompanied belongings, by *inter alia*-

(i) railways in a class other than an air conditioned coach;

(ii) metro, monorail or tramway;

(iii) metered cabs or auto rickshaws.

are included in the negative list of services.

Therefore in the given case, service tax leviability on the various passenger transportation services used by Mr. Pankaj will be determined as under:

(i) Rail travel in AC train – Not covered under negative list and thus, liable to service tax.

(ii) Travel in a car rented for the whole day on a lumpsum consideration – Since

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travel by only metered cabs is covered in negative list, travel in a car rented for the whole day on a lumpsum consideration will be liable to service tax.

(iii) Metro travel – Covered in negative list and hence, not taxable.

(iv) Air travel – Not covered under negative list and thus, liable to service tax.

(v) Radio taxi travel – Not covered in negative list and thus, liable to service tax.

(vi) Rail travel in sleeper class - Covered in negative list and hence, not taxable.

5. (a) Computation of income earned by minor children to be clubbed with the income of Mr. Kartik

	Particulars	Rs.
(i)	Income of son **[See Note 1]**	50,000
	Less: Income exempt under section 10(32) **[See Note 5]**	1,500
	Income to be clubbed	48,500
(ii)	Income of first daughter **[See Notes 2 & 3]**	10,000
	Less: Income exempt under section 10(32) **[See Note 5]**	1,500
	Income to be clubbed	8,500
(iii)	Income of second daughter **[See Note 2]**	8,500
	Less: Income exempt under section 10(32) **[See Note 5]**	1,500
	Income to be clubbed	7,000
	Total Income to be clubbed as per section 64(1A) [(i)+(ii)+(iii)]	**64,000**

Notes:

(1) The specific provision under *Explanation 3* to section 64 for inclusion of income from business where the assets transferred directly or indirectly by an individual are invested by the transferee in business are applicable in cases of transfer to spouse or son's wife only. In case of minor, all income accruing or arising to him or her is, in any case, includible in the hands of the parent.

(2) As per section 64(1A), in computing the total income of an individual, all such income accruing or arising to his minor child shall be included.

(3) The income accruing or arising to a minor child on account of activity involving application of their skill, talent or specialized knowledge and experience is not includible in the total income of the parent. Therefore scholarship received by the first daughter is not includible in the hands of Mr. Kartik, assuming that the same is received on account of skill, talent or specialized knowledge of the minor daughter. The balance income of Rs.10,000 (Rs. 15,000 – Rs. 5,000) is includible in the hands of Mr. Kartik after providing deduction of Rs. 1,500

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under section 10(32).

(4) Further, as per the provisions of section 64(1A), income of a minor child suffering from any disability of the nature specified in section 80U would not be included in the total income of the parent. Therefore, in this case, the income of third daughter suffering from disability specified under section 80U is not includible in the total income of Mr. Kartik.

(5) Under section 10(32), income of each minor child includible in the hands of the parent under section 64(1A) would be exempt to the extent of the actual income or Rs.1,500, whichever is lower.

(b) Computation of income from house property of Ms. Shikha for A.Y. 2016-17

Particulars	Rs.	Rs.
Gross Annual Value **(See Note 1 below)**		1,92,000
Less: Municipal taxes – paid by the tenant, hence not deductible		Nil
Net Annual Value (NAV)		1,92,000
Less: Deductions under section 24		
30% of NAV	57,600	
Interest on housing loan **(See Note 2 below)**		
- Interest on loan taken from bank	25,000	
- Interest on fresh loan to repay old loan for this property	5,000	87,600
Income from house property		**1,044,00**
50% share taxable in the hands of Ms. Shikha **(See Note 3 below)**		**52,200**

Notes:

1. **Computation of Gross Annual Value (GAV):** GAV is the higher of Expected rent and actual rent received. Expected rent is the higher of municipal value and fair rent, but restricted to standard rent.

Particulars	Rs.	Rs.	Rs.	Rs.
(a) Municipal value of property	1,60,000			
(b) Fair rent	1,55,000			
(c) Higher of (a) and (b)		1,60,000		
(d) Standard rent		1,70,000		
(e) Expected rent [lower of			1,60,000	

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	(c) and (d)]				
(f)	Actual rent [16,000 x 12]			1,92,000	
(g)	Gross Annual Value [higher of (e) and (f)]				1,92,000

2. Interest on housing loan is allowable as a deduction under section 24 on accrual basis. Further, interest on fresh loan taken to repay old loan is also allowable as deduction. However, interest on unpaid interest is not allowable as deduction under section 24.

3. Section 26 provides that where a house property is owned by two or more persons whose shares are definite and ascertainable, the share of each such person in the income of house property, as computed in accordance with sections 22 to 25, shall be included in his respective total income. Therefore, 50% of the total income from the house property is taxable in the hands of Ms. Shikha since she is an equal owner of the property.

(c) Liability to pay central excise duty falls on actual manufacturer of goods. Therefore, in this case, CBK Engineering Company, being actual manufacturer, will be liable to pay excise duty. This would be so even if raw material does not belong to them and goods manufactured by them bear the brand name of Smart Hero Motors Ltd. as in case of central excise, ownership of goods is not the relevant criterion to determine duty liability.

(d) **(i)** **The said statement is not valid**. Mega Exemption *Notification No. 25/2012 ST dated 20.06.2012*, provides that services provided, *inter alia*, to Government by way of water supply, public health, sanitation conservancy, solid waste management or slum improvement and up-gradation are exempt but the exemption is not extendable to other services such as consultancy, designing, etc., not directly connected with these specified services.

(ii) **The said statement is not valid**. Abatement *Notification No. 26/2012 ST dated 20.06.2012* provides an abatement of 70% in respect of transport of goods in a vessel. Thus, transport of goods in a vessel would attract service tax at 30% of the value of taxable service provided CENVAT on inputs, capital goods and input service has not been taken.

(iii) **The said statement is not valid**. Abatement *Notification No. 26/2012 ST dated 20.06.2012* provides that the condition for non-availment of CENVAT credit is required to be satisfied by the service providers only.

(iv) **The said statement is not valid**. Mega Exemption *Notification No. 25/2012 ST dated 20.06.2012*, provides that, transport of passengers, with or without accompanied belongings, by non-airconditioned contract carriage other than radio taxi, for transportation of passengers, excluding tourism, conducted tour,

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charter or hire, is exempt from service tax. Therefore, any service provided for transport of passengers by air-conditioned contract carriages like buses including the ones used for point to point travel, attracts service tax.

6. (a) (i) Computation of depreciation for A.Y.2016-17

Particulars	Rs.
W.D.V. of the block as on 1.4.2015	8,50,000
Add: Purchase of new plant during the year	5,50,000
	14,00,000
Less: Sale consideration of old machinery during the year	11,00,000
W.D.V of the block as on 31.03.2016	3,00,000

Since the value of the block as on 31.3.2016 comprises of a new asset which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is Rs. 22,500, being 7½% of Rs. 3,00,000.

The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:

(a) When one or some of the assets in the block are sold for consideration more than the value of the block.

(b) When all the assets are transferred for a consideration more than the value of the block.

(c) When all the assets are transferred for a consideration less than the value of the block.

Since in the first two cases, the sale consideration is more than the written down value of the block, the computation would result in short term capital gains.

In the third case, since the written down value exceeds the sale consideration, the resultant figure would be a short term capital loss.

In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

(ii) If the four machines are sold in June, 2015 for Rs.18,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.

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Particulars	Rs.	Rs.
Sale consideration		18,00,000
Less:		
W.D.V. of the machines as on 1.4.2015	8,50,000	
Purchase of new plant during the year	5,50,000	14,00,000
Short term capital gains		**4,00,000**

(b) **Computation of Net VAT liability of Kichak**

Particulars	Rs.	Rs.
Output VAT (50,00,000 × 12.5%) [A]		6,25,000
Input VAT [B]		
Raw material 'A' (30,00,000 × 60% × 4%) [Refer Note]	72,000	
Raw material 'B' (15,00,000 × 1%)	15,000	87,000
Net VAT payable by Kichak [A] – [B]		**5,38,000**

Note: Input tax credit is allowed only in respect of the raw material used in manufacture of taxable goods and hence, the same has been restricted to the extent of 60%.

(c) 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. Tirupati to Mr. Shubh as Mr. Tirupati has not charged any fee from Mr. Shubh.

7. (a) As per section 194-IA, any person, being a transferee, responsible for paying to a resident transferor any sum by way of consideration for transfer of any immovable property (other than rural agricultural land) is required to deduct tax at source@1% of such sum, if the consideration for transfer is Rs. 50 lakhs or more. The deduction of tax at source has to be made at the time of credit of such sum to the account of the transferor or at the time of payment of such sum, whichever is earlier.

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Accordingly, in this case, since the sale consideration of house property exceeds Rs. 50 lakh, Mr. Sanjay, the transferee, is required to deduct tax at source at 1% of Rs. 80 lakhs, being the consideration for transfer of house property.

The tax to be deducted under section 194-IA would be Rs. 80,000, being 1% of Rs. 80 lakh.

Since TDS provisions under section 194-IA are attracted in respect of transfer of any immovable property, other than rural agricultural land, no tax is required to be deducted by Mr. Sanjay from the sale consideration payable for transfer of rural agricultural land.

(b) **(i)** **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.

(ii) **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.

(c) In case of continuous supply of service, the date of completion of each event which requires the service receiver to make any payment to service provider, as specified in the contract is deemed to be the date of completion of provision of service.

The point of taxation will, then, be determined accordingly in terms of provisions of rule 3 of the Point of Taxation Rules (POTR).

As per rule 3 of the POTR, if the invoice is issued within 30 days of the completion of the provision of the service, point of taxation is:-

(i) date of invoice

or

(ii) date of payment,

whichever is earlier.

However, if the invoice is not issued within 30 days of the completion of the provision of the service, point of taxation is:-

(i) date of completion of service

or

(ii) date of payment,

whichever is earlier.

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(d) Computation of CENVAT credit available with Sai Services Ltd.:

Particulars	Rs.
Accounting and auditing services [Note 1]	10,00,000
Legal services [Note 1]	5,00,000
Security services [Note 1]	50,000
Motor vehicles taken on rent [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 renting of motor vehicles which are not eligible capital goods.

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