

Test Series: September, 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) King Ltd. sells beer to customers; some of the customers consume the beer in the bars run by King Limited. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders. Keeping this in view:
- (i) Decide whether the inventory of empty bottles is an asset of the company;
 - (ii) If so, whether the inventory of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?
- (b) Full Ltd., has signed at 31st Dec., 2014, the Balance Sheet date, a contract where the total revenue is estimated at Rs. 15 crores and total cost is estimated at Rs. 20 crores. No work began on the contract. Is contractor required to give any accounting effect for the year ended 31st December, 2014 in his accounts?
- (c) E Ltd. constructed a fixed asset and incurred the following expenses on its construction:

	Rs.
Materials	16,00,000
Direct Expenses	3,00,000
Total Direct Labour (1/15th of the total labour time was chargeable to the construction)	6,00,000
Total Office & Administrative Expenses (4% of office and administrative expenses are specifically attributable to construction of a fixed asset)	9,00,000
Depreciation on assets used for the construction of this asset	15,000

Calculate the cost of the fixed asset.

- (d) The Managing Director of Anil Ltd. is entitled to 5% of the annual net profits, as his remuneration, subject to a minimum of Rs. 25,000 per month. The net profits, for this purpose, are to be taken without charging income-tax and his remuneration itself. During the year, Anil Ltd. made net profit of Rs. 43,00,000 before charging MD's remuneration, but after charging provision for taxation of Rs. 17,20,000. Compute remuneration payable to the Managing Director as per provisions of Companies Act, 2013. (4 x 5 = 20 Marks)
2. (a) Meera carried out the following transactions in the shares of Kumar Ltd.:
- (1) On 1st April, 2015 she purchased 40,000 equity shares of Rs. 1 each fully paid up for Rs. 60,000.
 - (2) On 15th May 2015, Meera sold 8,000 shares for Rs. 15,200.
 - (3) At a meeting on 15th June 2015, the company decided:
 - (i) To make a bonus issue of one fully paid up share for every four shares held on 1st June 2015, and
 - (ii) To give its members the right to apply for one share for every five shares held on 1st June 2015 at a price of Rs. 1.50 per share of which 75 paise is payable on or before 15th July 2015 and the balance, 75 paise per share, on or before 15th September, 2015.

The shares issued under (i) and (ii) were not to rank for dividend for the year ending 31st December 2015.

- (a) Meera received his bonus shares and took up 4000 shares under the right issue, paying the sum thereon when due and selling the rights of the remaining shares at 40 paise per share; the proceeds were received on 30th September 2015.
- (b) On 15th March 2016, he received a dividend from Kumar Ltd. of 15 per cent in respect of the year ended 31st Dec 2015.
- (c) On 30th March he received Rs. 28,000 from the sale of 20,000 shares.

You are required to record these transactions in the Investment Account in Meera's books for the year ended 31st March 2016 transferring any profits or losses on these transactions to Profit and Loss account. Apply average cost basis.

Expenses and tax to be ignored.

- (b) Mr. Hemant had Rs. 1,65,000 in the bank account on 1.1.2015 when he started his business. He closed his accounts on 31st March, 2016. His single entry books (in which he did not maintain any account for the bank) showed his position as follows:

	31.3.2015 Rs.	31.3.2016 Rs.
Cash in hand	1,100	1,650
Inventory in trade	10,450	15,950
Debtors	550	1,100
Creditors	2,750	1,650

On and from 1.2.2015, he began drawings Rs. 385 per month for his personal expenses from the cash box of the business. His account with the bank had the following entries:

	Deposits Rs.	Withdrawals Rs.
1.1.2015	1,65,000	-
1.1.2015 to 31.3.2015		1,22,650
1.4.2015 to 31.3.2016	1,26,500	1,48,500

The above withdrawals included payment by cheque of Rs. 1,10,000 and Rs. 33,000 respectively during the period from 1.1.2015 to 31.3.2015 and from 1.4.2015 to 31.3.2016 respectively for the purchase of machineries for the business. The deposits after 1.1.2015 consisted wholly of sale price received from the customers by cheques.

Draw up Mr. Hemant's statement of affairs as at 31.3.2015 and 31.3.2016 respectively and work out his profit or loss for the year ended 31.3.2016.

(10 + 6 = 16 Marks)

3. On 31st March, 2016, the Balance Sheet of A, B and C (sharing profits and losses in proportion to their Capital) stood as below:

Liabilities	Rs.	Assets	Rs.
Capital Account:		Land and Building	60,000
Mr. A	40,000	Plant and Machinery	40,000
Mr. B	60,000	Inventory of goods	24,000
Mr. C	40,000	Sundry debtors	22,000
Sundry Creditors	<u>20,000</u>	Cash and Bank Balances	<u>14,000</u>
	<u>1,60,000</u>		<u>1,60,000</u>

On 1st April, 2016, A desired to retire from the firm and remaining partners decided to carry on the business. It was agreed to revalue the assets and liabilities on that date on the following basis:

- (i) Land and Building be appreciated by 20%.
- (ii) Plant and Machinery be depreciated by 30%.
- (iii) Inventory of goods to be valued at Rs. 20,000.
- (iv) Old credit balances of Sundry creditors, Rs. 4,000 to be written back.
- (v) Provisions for bad debts should be provided at 5%.
- (vi) Joint life policy of the partners surrendered and cash obtained Rs. 15,100.
- (vii) Goodwill of the entire firm is valued at Rs. 28,000 and A's share of the goodwill is adjusted in the A/cs of B and C, who would share the future profits equally. No goodwill account being raised.
- (viii) The total capital of the firm is to be the same as before retirement. Individual capital is in their profit sharing ratio.
- (ix) Amount due to Mr. A is to be settled on the following basis:
50% on retirement and the balance 50% within one year.

Prepare (a) Revaluation account, (b) The Capital accounts of the partners, (c) Cash account and (d) Balance Sheet of the new firm M/s B & C as on 1.04.2016. (16 Marks)

4. (a) The following are the changes in the account balances taken from the balance sheets of Leela Ltd. as at the beginning and end of the year

	Debit (Rs.)	Credit (Rs.)
8% Debentures		1,50,000
Debenture Discount	3,000	
Plant and Machinery at cost	1,80,000	
Depreciation on Plant and Machinery		43,200
Trade receivables	1,50,000	
Inventory including Work-in-Progress	1,15,500	
Trade payables		35,400
Net Profit for the year		2,29,500
Dividend paid in respect of earlier year	90,000	
Provision for Doubtful Debts		9,900
Trade Investments at cost	1,41,000	
Bank		<u>2,11,500</u>
Total	<u>6,79,500</u>	<u>6,79,500</u>

You are informed that:

- During the year Plant costing Rs. 54,000 against which Depreciation Provision of Rs. 40,500 was lying was sold for Rs. 21,000.
- During the middle of the year, Rs. 1,50,000 Debentures were issued for cash at a discount of Rs. 3,000.
- The net Profit for the year was after crediting the profit on sale plant and charging Debenture Interest.

Prepare a Cash Flow Statement which will explain why Bank Borrowing has increased by Rs. 2,11,500 during the year end, ignore taxation.

(b) Following items appear in the Trial Balance of Saral Ltd. as on 31st March, 2016:

Particulars	Amount
4,500 Equity Shares of Rs. 100 each	4,50,000
Capital Reserve (including Rs.40,000 being profit on sale of Plant realized in cash)	90,000
Securities Premium	40,000
Capital Redemption Reserve	30,000
General Reserve	1,05,000
Profit and Loss Account (Cr. Balance)	65,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. Pass necessary Journal Entries in the books Saral Ltd.

(12 + 4 = 16 Marks)

5. (a) Following is the Draft Balance Sheet of ABC Ltd. Co. as at 31st March, 2015:

Liabilities	Rs.	Assets	Rs.
Share capital:		Plant and machinery	9,00,000
2,00,000 Equity shares of Rs. 10 each fully paid up	20,00,000	Furniture and fixtures	2,50,000
6,000 8% Preference shares of Rs. 100 each	6,00,000	Patents and copyrights	70,000
9% Debentures	12,00,000	Investments (at cost) (Market value Rs. 55,000)	68,000
Bank overdraft	1,50,000	Inventory	14,00,000
Trade payables	5,92,000	Trade receivables	14,39,000
		Cash and bank balance	10,000
		Profit and Loss Account	<u>4,05,000</u>
	<u>45,42,000</u>		<u>45,42,000</u>

The following scheme of reconstruction was finalized:

- (i) Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.
- (ii) Debentureholders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.
- (iii) Stock equal to Rs.5,00,000 in book value will be taken over by trade payables in full settlement of their dues.
- (iv) Investment value to be reduced to market price.
- (v) The company would issue 11% Debentures for Rs. 3,00,000 to augment its working capital requirement after settlement of bank overdraft.

Give necessary journal entries reflecting the above scheme of reconstruction in the books of the ABC Ltd. Co.

- (b) From the following prepare an account current, as sent by A to B on 30th June, 2016 by means of products method charging interest @ 6% p.a:

2016		Rs.
Jan. 1	Balance due from B	600
Jan.11	Sold goods to B	520
Jan. 18	B returns Goods	125
Feb 11	B Paid by cheque	400
Feb 14	B accepted a bill drawn by A for one month	300
Apr. 29	Goods sold to B	615
May 15	Received cash from B	700

(12 + 4 = 16 Marks)

6. The accountant of Tiger Club gave the following information about the receipts and payments of the club for the year ended 31st March, 2016:

Receipts:	Rs.
Subscriptions	1,24,260
Fair receipts	14,400
Variety show receipts (net)	25,620
Interest	1,380
Bar collections	44,700
Payments:	
Premises	60,000

Rent	4,800
Rates and taxes	7,560
Printing and stationary	2,820
Sundry expenses	10,700
Wages	5,040
Fair expenses	14,340
Honorarium to secretary	22,000
Bar purchases (payments)	34,620
Repairs	1,920
New car (less proceeds of old car Rs. 18,000)	75,600

The following additional information could be obtained:-

	1.4.2015	31.3.2016
	Rs.	Rs.
Cash in hand	900	Nil
Bank balance as per cash-book	48,840	20,700
Cheque issued for sundry expenses not presented to the bank (entry has been duly made in the cash book)	540	180
Subscriptions due	7,200	5,880
Premises (at cost)	1,74,000	2,34,000
Provision for depreciation on premises	1,12,800	-
Car (at cost)	73,140	93,600
Accumulated depreciation on car	61,740	-
Bar inventory	4,260	5,220
Creditors for bar purchases	3,540	2,580

Annual honorarium of secretary is Rs. 24,000. Depreciation on premises is to be provided at 5% on written down value. Depreciation on new car is to be provided at 20%.

You are required to prepare the Receipts and Payments Account and Income and Expenditure Account for the year ended 31.3.2016. (16 Marks)

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

- "Prepackaged accounting software is required to be selected intelligently". Explain the statement in brief.
- Comment whether the following Companies can be classified as a Small and Medium Sized Company (SMC) as per the Companies (Accounting Standards), Rules, 2006:

- (i) A Pvt. Ltd., a subsidiary of a multinational company listed on London Stock Exchange. It has a turnover of Rs. 12 crores and borrowings of Rs. 5 crores.
 - (ii) B Pvt. Ltd., has a turnover of Rs. 45 crores, other income of Rs. 7 crores and bank borrowings of Rs. 9 crores
- (c) Omega Ltd. projected a surplus of Rs. 40 crores during the accounting year to end on 31st March, 2016. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of Rs. 10 crores. The board in consultation with the managing director, decided on the following:
- (i) Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method, which was hitherto adopted. As a consequence, the charge for depreciation at Rs. 27 crores is lower than the amount of Rs. 45 crores which would have been provided had the old method been followed, by Rs. 18 cores.)
 - (ii) Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being Rs. 10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2015-2016.

- (d) (i) Hello Ltd. was incorporated on 1st July, 2015 to take the existing business of X from 1st April, 2015. Date of closing the books of account – 31st March, 2016.
- (ii) Monthly sales in April 2015, February 2016 and March 2016 are double the average monthly sales for remaining months of the year.

You are required to calculate Sales Ratio between pre and post interpretation periods.

- (e) Two traders Abhinav and Krishna buy goods from one another, each allowing the other one month's credit. At the end of 3 months the accounts rendered are as follows:

Goods sold by Abhinav to Krishna		Goods sold by Krishna to Abhinav	
	Rs.		Rs.
18 th April	9,000	23 rd April	7,800
15 th May	10,500	24 th May	7,500
16 th June	12,000		

Compute the date upon which the balance should be paid, so that no interest is due either to Abhinav or Krishna. (4 x 4 = 16 Marks)

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SUGGESTED ANSWERS/HINTS

1. (a) (i) Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. King Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.
- (ii) As per AS 2 “Valuation of Inventories”, inventories are assets held for sale in the ordinary course of business. Inventory of empty bottles existing on the Balance Sheet date is the inventory and King Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence inventory of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.
- (b) As per AS 7 ‘Construction Contracts’, when it is probable that total contract cost will exceed total contract revenue, the expected loss should be recognised as an expense immediately. The amount of such loss is determined irrespective of whether or not work has commenced on the contract. Thus, Full Ltd. should recognize loss amounting Rs. 5 crores for the year ended 31st December, 2014. The contract should be reviewed at the end of the each accounting period till completions for additional losses to be incurred, if any.

(c) **Calculation of cost of fixed asset**

	<i>Rs.</i>
Materials	16,00,000
Direct expenses	3,00,000
Direct labour (1/15 th of Rs. 6,00,000)	40,000
Office and administrative expenses (4% Rs. 9,00,000)	36,000
Depreciation on assets	<u>15,000</u>
Cost of fixed asset	<u>19,91,000</u>

(d)

Calculation of remuneration of the Managing Director	<i>Rs. in Lacs</i>
Net profit as per books	43.00
Add: Provision for taxation	<u>17.20</u>
Annual profit for the purpose of managerial remuneration	<u>60.20</u>

Managing Director's Remuneration @ 5% of above	3.01
Minimum remuneration to be paid to the Managing Director = Rs. 25,000 per month × 12	3.00

Hence, in this case, remuneration to be paid to the Managing Director of Anil Ltd. = Rs. 3,01,000 in the year.

2. (a) In the books of Meera Investment Account (Shares in Kumar Limited)

Date	Particulars	No. of Shares	Income	Amount	Date	Particulars	No. of Shares	Income	Amount
2015			Rs.	Rs.	2015			Rs.	Rs.
April 1	To Bank (Purchases)	40,000	-	60,000	May 15	By Bank (Sale)	8,000	-	15,200
May 15	To Profit & Loss A/c (W.N.1)	-	-	3,200					
June 15	To Bonus Issue	8,000	-	Nil	2016				
July 15	To Bank (@ 75 p. paid on 4,000 shares)	4,000	-	3,000	Mar. 15	By Bank (Dividend @ 15% on Rs. 32,000)		4,800	-
Sept. 15	To Bank (@ 75 p. paid on 4,000 shares)	-	-	3,000	Mar. 30	By Bank (Sale)	20,000	-	28,000
2016 Mar. 31	To Profit & Loss A/c (W.N.2)			3,455	Mar. 31	By Balance c/d $\left(\frac{24,000}{44,000} \times 54,000 \right)$	24,000	-	29,455
	To Profit & Loss A/c	-	4,800						
		<u>52,000</u>	<u>4,800</u>	<u>72,655</u>			<u>52,000</u>	<u>4,800</u>	<u>72,655</u>

Working Notes:

(1)	Profit on Sale on 15-5-2015: Cost of 8,000 shares @ Rs.1.50 Less: Sales price Profit	Rs. 12,000 <u>Rs. 15,200</u>	Rs. 3,200
(2)	Cost of 20,000 shares sold: Cost of 44,000 shares (48,000 + 6,000)		Rs. 54,000

∴ Cost of 20,000 shares $\left(\frac{\text{Rs. } 54,000}{44,000 \text{ shares}} \times 20,000 \text{ shares} \right)$	Rs. 24,545
Profit on sale of 20,000 shares (Rs. 28,000 – Rs. 24,545)	Rs. 3,455

(b) (i) **Statement of Affairs as on 31st March, 2015**

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Capital (bal.fig.)	1,61,700	Machinery	1,10,000
Sundry creditors	2,750	Inventory	10,450
		Debtors	550
		Cash at bank (W.N.1)	42,350
		Cash in hand	1,100
	1,64,450		1,64,450

(ii) **Calculation of loss for 3 months (1.1.2015 to 31.3.2015)**

	<i>Rs.</i>
Capital as on 31.3.2015	1,61,700
Add: Drawings for 3 months	770
	1,62,470
Less: Capital as on 1.1.2015	(1,65,000)
Loss for 3 months	2,530

(iii) **Statement of Affairs as on 31st March, 2016**

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Capital	1,80,400	Machinery	1,10,000
Sundry Creditors	1,650	Add: Additions	<u>33,000</u>
		Inventory	15,950
		Debtors	1,100
		Cash at bank (W.N.2)	20,350
		Cash in hand	1,650
	1,82,050		1,82,050

(iv) **Statement of Profit and Loss for the year ended 31.3.2016**

<i>Particulars</i>	<i>Rs.</i>
Capital as on 31.3.2016	1,80,400

Add: Drawings (Rs. 385 x 12)	<u>4,620</u>
	1,85,020
Less: capital as on 31.3.2015	(1,61,700)
Net profit for the year ended 31.3.16	23,320

Working Notes:

	Rs.
1. Bank balance as on 31.3.2015	
Balance as on 1.1.2015	1,65,000
Less: Withdrawals during 1.1.2015 to 31.3.2015	(1,22,650)
Balance as on 31.3.2015	<u>42,350</u>
2. Bank Balance as on 31.3.2016:	
Balance as on 1.4.2015	42,350
Add: Deposits during the year	1,26,500
	<u>1,68,850</u>
Less: Withdrawals during the year	(1,48,500)
Bank Balance as on 31.3.2016	<u>20,350</u>

3. (a)

Revaluation Account

Date	Particulars	Rs.	Date	Particulars	Rs.
2016			2016		
April	To Plant & Machinery	12,000	April	By Land and building	12,000
	To Inventory of goods	4,000		By Sundry creditors	4,000
	To Provision for bad and doubtful debts	1,100		By Cash & Bank - Joint life Policy surrendered	15,100
	To Capital accounts (profit on revaluation transferred)				
	Mr. A (2/7) 4,000				
	Mr. B (3/7) 6,000				
	Mr. C (2/7) <u>4,000</u>	<u>14,000</u>			
		<u>31,100</u>			<u>31,100</u>

(b) **Partners' Capital Accounts**

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

(c) **Cash and Bank Account**

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

(d) **Balance Sheet of M/s B & C as on 01.04.2016**

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

		Less: devalued Sundry Debtors	4,000 22,000	20,000
		Less: Provision for bad debts 5%	1,100	20,900
		Cash & Bank balances		<u>41,100</u>
	<u>1,82,000</u>			<u>1,82,000</u>

Working Notes:

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

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

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

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

	Rs.	Rs.
<i>Cash flow from Operating Activities</i>		
Net profit before Taxation (given)		2,29,500
Adjustments for		
Depreciation (W.N.2)	83,700	
Debenture Interest ($1,50,000 \times 8\% \times 6/12$)	6,000	
Provision for Doubtful Debts	9,900	
Profit/Gain on Sale of Plant (WN. 1)	<u>(7,500)</u>	<u>92,100</u>
Operating Profit before Working Capital Changes		3,21,600
Adjustments for		
Increase in Inventory	(1,15,500)	
Increase in Trade receivables	(1,50,000)	
Increase in Trade payables	<u>35,400</u>	<u>(2,30,100)</u>
Net Cash Flow from/(Used in) Operating Activities [A]		91,500
<i>Cash flow from Investing Activities</i>		

Purchase of Plant & Machinery	(2,34,000)	
Purchase of Trade Investments	(1,41,000)	
Sale of Machinery	<u>21,000</u>	
Net Cash Flow from/(used In) Investing Activities [B]		(3,54,000)
<i>Cash flow from Financing Activities</i>		
Proceeds from issue of 8% Debentures (1,50,000-3,000)	1,47,000	
Interest paid on 8% Debentures	(6,000)	
Dividends paid in respect of earlier year	<u>(90,000)</u>	
Net Cash Flow from/(used in) Financing Activities[C]		<u>51,000</u>
Net Increase/(Decrease) in Cash and Cash Equivalents (A+B+C)		(2,11,500)

Working Notes:

- Profit on Sale of Plant = Net Book Value (i.e, Gross Block less Accumulated Depreciation) Less Sale Value
= (54,000-40,500) less 21,000 = Rs. 7,500 Gain/Profit
- Depreciation for current year = Increase in Depreciation as given above + Accumulated Depreciation on Plant Sold = 43,200 + 40,500 = Rs. 83,700
- Cash Outflow towards assets purchase = Increase in Plant and Machinery at Cost + Gross Block of Plant sold
= 1,80,000 + 54,000 = Rs. 2,34,000.

(b) Journal Entries in the book of Saral Ltd.

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

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

<i>Particulars</i>		<i>Rs.</i>	<i>Rs.</i>
8% Preference share capital A/c To Preference shareholders A/c To Capital reduction A/c [Being 30% reduction in liability of preference share capital]	Dr.	6,00,000	4,20,000 1,80,000
Preference shareholders A/c To 11% Debentures A/c [Being the issue of debentures to preference shareholders]	Dr.	4,20,000	4,20,000
9% Debentures A/c To Debenture holders A/c [Being transfer of 9% debentures to debenture holders A/c]	Dr.	12,00,000	12,00,000
Debenture holders A/c To Plant & machinery A/c To Capital reduction A/c [Settlement of debenture holders by allotment of plant & Machinery]	Dr.	12,00,000	9,00,000 3,00,000
Trade payables A/c To Inventory A/c To Capital reduction A/c [Being settlement of creditors by giving stocks]	Dr.	5,92,000	5,00,000 92,000
Bank A/c To 11% Debentures A/c [Being fresh issue of debentures]	Dr.	3,00,000	3,00,000
Bank overdraft A/c To Bank A/c [Being settlement of bank overdraft]	Dr.	1,50,000	1,50,000
Capital reduction A/c To Investment A/c To Profit and loss A/c	Dr.	5,72,000	13,000 4,05,000

To Capital reserve A/c [Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]		1,54,000
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(b) **B in Account Current with A**
for the period ending on 30th June, 2016

Date	Particulars	Amount	Days	Products	Date	Particulars	Amount	Days	Products
2016		Rs.			2016		Rs.		
Jan. 1	To Balance b/d	600	182	1,09,200	Jan. 18	By Sales Returns	125	164	20,500
Jan. 11	To Sales A/c	520	171	88,920	Feb. 11	By Bank A/c	400	140	56,000
Apr 29	To Sales A/c	615	62	38,130	Feb. 14	By B/R A/c (due date: March 17)	300	105	31,500
June 30	To Interest A/c	15.75			May 15	By Cash A/c	700	46	32,200
					June 30	By Balance of products			96,050
						By Balance c/d	225.75		
		1,750.75		2,36,250			1,750.75		2,36,250

Calculation of interest: Interest = $\frac{96,050}{366} \times \frac{6}{100} = \text{Rs. } 15.75$

6.

Tiger Club

Receipts and Payments Account
for the year ended 31st March, 2016

Receipts	Rs.	Payments	Rs.
To Opening balance:		By Premises	60,000
Cash on hand	900	By Rent	4,800
Bank balance	48,840	By Rates and taxes	7,560
To Subscriptions	1,24,260	By Printing and stationary	2,820
To Fair receipts	14,400	By Sundry expenses	10,700
To Variety show receipts (net)	25,620	By Wages	5,040
To Interest	1,380	By Fair expenses	14,340

To Bar collections	44,700	By Honorarium to secretary	22,000
To Sale proceeds of old car	18,000	By Bar purchases (payments)	34,620
		By Repairs	1,920
		By New Car	93,600
		By Closing balance	
		Cash in hand	Nil
		Bank balance	<u>20,700</u>
	<u>2,78,100</u>		<u>2,78,100</u>

**Income and Expenditure Account
for the year ended 31st March, 2016**

<i>Expenditure</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Income</i>	<i>Rs.</i>	<i>Rs.</i>
To Rent		4,800	By Subscriptions	1,24,260	
To Rates and taxes		7,560	Add: Due as on 31.3.16	<u>5,880</u>	
To Printing and stationary		2,820		1,30,140	
To Wages		5,040	Less: Due as on 31.3.15	<u>(7,200)</u>	1,22,940
To Honorarium to secretary		24,000	By Surplus from fair:		
To Sundry expenses		10,700	Fair receipts	14,400	
To Repairs		1,920	Less: Fair expenses	<u>14,340</u>	60
To Depreciation on Premises @ 5% *	6,060		By Surplus from variety show		25,620
Car @20% of 93,600	<u>18,720</u>	24,780	By Interest		1,380
			By Profit from bar (W.N.2)		12,000
To Excess of income over expenditure		86,980	By Profit from sale of car (W.N. 3)		6,600
		<u>1,68,600</u>			<u>1,68,600</u>

* $[(1,74,000 - 1,12,800) \times 0.05 + 60,000 \times 0.05]$

Working Notes:1. **Calculation of bar purchases****Bar Creditors Account**

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

2.

Profit from bar

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

3.

Profit on sale of car

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

7. (a) 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.
- (b) As per the companies (Accounting Standards) Rules, 2006, “Small and Medium Sized Company” (SMC) means, a company:
- (i) Whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India’
 - (ii) Which is not a bank, financial institution or an insurance company;
 - (iii) Whose turnover (excluding other income) does not exceed rupee; fifty crore in the immediately preceding accounting year;
 - (iv) Which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and
 - (v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation: a company shall qualify as a Small and Medium Sized Company, if the condition mentioned, therein are satisfied as at the end of the relevant accounting period.

- (i) As per the definition of SMC, point (v), a company will be a SMC, if it is not holding or subsidiary company of another company which is not a SMC. Since A Pvt. Ltd., is a subsidiary of another Company which is listed, on London Stock Exchange (and is therefore not a SMC), A Pvt. Ltd., cannot be a SMC. The turnover and borrowings are not relevant in this case.
 - (ii) As per the definition of SMC, point (iii), a company will be a SMC if its turnover does not exceed Rs. 50 crores or borrowings do not exceed Rs. 10 crore. For calculating this turnover, other income is not to be included. Since B Pvt. Ltd., has a turnover of Rs. 45 crores and borrowing of Rs. 9 crores, it will satisfy the definition and can be classified as SMC.
- (c) As per AS 1 “Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

- (i) In view of the heavy capital intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change, depreciation has been provided at Rs. 27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by Rs. 18 crores. To that extent, the profit for the year is increased.
- (ii) The company has decided to provide Rs. 10 crores for the permanent fall in the value of investments which has taken place over the period of past five years. The provision so made has reduced the profit disclosed in the accounts by Rs. 10 crores.
- (d) Let the average monthly sales be x. The sales of different months can be shown as follows:

Month	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March
Sales	2x	1x	1x	1x	1x	1x	1x	1x	1x	1x	2x	2x

Date of incorporation is 1 July, 2015

Pre incorporation period is from April to June i.e. 4x

Post - incorporation period is from July to March i.e. 11x

The ratio of Sales = 4x : 11x or 4:11

- (e) Taking May 18th as the zero or base date:

For Krishna's payments:

Date of Transactions	Due Date	Amount	No. of days from the base date	Products
(1)	(2)	(3)	(4)	(5)
April 18	May 18	9,000	0	0
May 15	June 15	10,500	28	2,94,000
June 16	July 16	<u>12,000</u>	59	<u>7,08,000</u>
Amount Due to Abhinav		<u>31,500</u>	Total of products	<u>10,02,000</u>

For Abhinav's payments:

The base date will be May 18th in this case also.

Date of Transactions	Due Date	Amount	No. of days from the base date	Products
(1)	(2)	(3)	(4)	(5)
April 23	May 23	7,800	5	39,000

May 24	June 24	<u>7,500</u>	37	<u>2,77,500</u>
Amount Due to Krishna		<u>15,300</u>	Total products	<u>3,16,500</u>

Excess of Krishna's products over Abhinav's = 10,02,000 – 3,16,500
= 6,85,500

Excess amount due to Abhinav's Rs. 31,500 – 15,300 = Rs. 16,200.

Number of days from the base date to the date of settlement is $\frac{6,85,500}{16,200} = 42$ days

Hence the date of settlement of the balance is 42 days after May 18 i.e., on June 29.

On June 29, Krishna's has to pay Abhinav, Rs. 16,200 to clear the account.

MOCK TEST PAPER – 2
INTERMEDIATE (IPC): GROUP – I
PAPER – 2 : BUSINESS LAWS, ETHICS AND COMMUNICATION
SUGGESTED ANSWERS/HINTS

1. (a) **Communication and revocation of acceptance when complete:** The problem is related with the communication and time of acceptance and its revocation. As per Section 4 of the Indian Contract Act, 1872, the communication of an acceptance is complete as against the acceptor when it comes to the knowledge of the proposer.

Whereas section 5 of the Indian Contract Act, 1872 says that an acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

Referring to the above provisions

- (i) Yes, the revocation of acceptance by Mr. X (the acceptor) is valid.
 - (ii) If Mr. U opens the telegram first (and this would be normally so in case of a rational person) and reads it, the acceptance stands revoked. If he opens the letter first and reads it, revocation of acceptance is not possible as the contract has already been concluded.
- (b) **SMALL COMPANY:** Under Section 2 (85) of the Companies Act, 2013, “small company” means a company, other than a public company:-
- (i) having PAID-UP SHARE CAPITAL not exceeding fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; and
 - (ii) having TURNOVER as per its last profit and loss account not exceeding two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.

EXCEPTIONS: This section shall not apply to:

- (A) a holding company or a subsidiary company;
 - (B) a company registered under section 8, or
 - (C) a company or body corporate governed by any special Act.
- (c) **Sources of Ethical Standards:**
- 1. **The Utilitarian Approach:** Some ethicists emphasize that the ethical action is the one that provides the most good or does the least harm, or, to put it another way, produces the greatest balance of good over harm. The ethical corporate action, then, is the one that produces the greatest good and does

the least harm for all who are affected - customers, employees, shareholders, the community, and the environment. The utilitarian approach deals with consequences; it tries both to increase the good done and to reduce the harm done.

2. **The Rights Approach** (The Deontological Approach): Other philosophers and ethicists suggest that the ethical action is the one that best protects and respects the moral rights of those affected. This approach starts from the belief that humans have a dignity based on their human nature per se or on their ability to choose freely what they do with their lives. On the basis of such dignity, they have a right to be treated as ends and not merely as means to other ends. The list of moral rights -including the rights to make one's own choices about what kind of life to lead, to be told the truth, not to be injured, to a degree of privacy, and so on-is widely debated; some now argue that non-humans have rights, too. Also, it is often said that rights imply duties-in particular, the duty to respect others' rights.
3. **The Fairness or Justice Approach:** Aristotle and other Greek philosophers have contributed the idea that all equals should be treated equally. Today we use this idea to say that ethical actions treat all human beings equally-or if unequally, then fairly based on some standard that is defensible. We pay people more based on their harder work or the greater amount that they contribute to an organization, and say that is fair. But there is a debate over CEO salaries that are hundreds of times larger than the pay of others; many ask whether the huge disparity is based on a defensible standard or whether it is the result of an imbalance of power and hence is unfair.
4. **The Common Good Approach:** The Greek philosophers have also contributed the notion that life in community is a good in itself and our actions should contribute to that life. This approach suggests that the interlocking relationships of society are the basis of ethical reasoning and that respect and compassion for all others-especially the vulnerable-are requirements of such reasoning. This approach also calls attention to the common conditions that are important to the welfare of everyone. This may be a system of Laws, effective police and fire departments, health care, a public educational system, or even public recreational areas.
5. **The Virtue Approach:** A very ancient approach to ethics is that ethical actions ought to be consistent with certain ideal virtues that provide for the full development of our humanity. These virtues are dispositions and habits that enable us to act according to the highest potential of our character and on behalf of values like truth and beauty. Honesty, courage, compassion, generosity, tolerance, love, fidelity, integrity, fairness, self-control, and prudence are all examples of virtues. Virtue ethics asks of any action, "What

kind of person will I become if I do this?" or "Is this action consistent with my acting at my best?"

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

- (1) **Single Strand Chain:** In this type of chain, 'A' tells something to 'B' who tells it to 'C' and so on. This type of chain is least accurate in passing on the information or message.
- (2) **Gossip Chain:** In it, a person seeks out and tells everyone the information he has obtained. This chain is often used when information or a message regarding a 'not-on-job' nature is being conveyed.
- (3) **Probability Chain:** In it, individuals are indifferent to the persons, to whom they are passing some information. This chain is found when the information is somewhat interesting but not really significant.
- (4) **Cluster Chain:** In this type of chain, 'A' tells something to a few selected individuals and then some of these individuals inform a few other selected individuals. In fact, cluster chain is the dominant grapevine pattern in an organisation. Only few persons are 'liaison individuals' who pass on the information they have obtained and then they are likely to share it with the people they trust. Most informal communication flows through this chain.

2. (a) (i) (A) **TIME LIMIT FOR PAYMENT OF BONUS:** Section 19 of the Payment of Bonus Act, 1965 prescribes the time limit for the payment of bonus under the following conditions:

1. Under Section 19 (1) (a) of the said Act, where the dispute is between the employer and the employees regarding the payment of bonus and such dispute is under reference to the prescribed authority, the employer is bound to pay his employee bonus in cash within one month from the date on which the award becomes enforceable or the settlement comes into operation, in respect of such dispute.
2. Under Section 19 (1) (b) of the said Act, in all other cases, the payment of bonus is to be made within a period of 8 months from closing of the accounting year.

But this period of 8 months may be extended up to a maximum of 2 years by the Appropriate Government or by any authority prescribed by the Appropriate Government only on an application to it by the employer and is satisfied that sufficient reasons exist for granting extension. Moreover, the extension can be made only by an order.

(B) **Recovery of the bonus due from an employer (Section 21):** It may so happen that an amount to bonus is due to an employee from his employer under a settlement or an award or agreement and it is not paid by the employer. In such a case, the employee is required to make an application for the recovery of the amount to the Appropriate Government. This application can be made even by his assignee or heirs when the employee is dead.

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

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

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

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

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

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

(b) **The concept of Corporate Social Responsibility (CSR)** focuses on the idea that beyond making profit, a business has social obligations. It is the responsibility of the companies to produce an overall positive impact on the society. CSR is pursued by business to balance their economic, environmental and social objectives while at the same time addressing stakeholders' expectations and enhancing shareholders' values. Stakeholders, including shareholders, analysts, regulators, labour unions,

employees, community organisations and mass media expect companies to be accountable not only for their own performance but for the performance of their entire supply chain. Issues such as peace, sustainable development, security, poverty alleviation, environmental quality and human rights have a profound effect on business and its environment.

Corporate Social Responsibility is the continuing commitment by businesses to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.

Need for social responsibility:

1. The iron law of responsibility
2. To fulfil long term self-interest
3. To establish a better public image
4. To avoid government regulation and control
5. To avoid misuse of National Resources and Economic Power
6. To convert Resistances into Resources
7. To minimise Environmental damage.

- (c) **Active Listening:** - Most of us assume that listening is a natural trait, but practically very few of us listen properly. What we regularly do is-“we hear but do not listen”. Hearing is through ears and listening is by mind. Listening happens when we understand and message as intended by sender. Many managers are so used to helping people solve problems that their first cause of action is transforming solutions and giving advice instead of listening with full attention directed towards understanding what the co-worker or staff member needs. Therefore, every employer and worker needs a listening ear.

If one does not learn how to listen, a great deal of what people are trying to tell you would be missed. In addition, appropriate response would not be possible. Active listening is important for several reasons.

- (i) It aids the organization in carrying out its missions.
- (ii) It helps individuals to advance in their careers.
- (iii) It provides information that helps them to learn about important happenings in the organization, as well as assisting them in doing their own jobs well.
- (iv) It also helps in building strong personal relationships.

3. (a) (i) **LIABILITY OF A MINOR:** According to Section 26 of the Negotiable Instruments Act, 1881, every person competent to contract (according to the law to which he is subject to) has capacity to bind himself and be bound by

making, drawing, accepting, endorsing delivering and negotiating an instrument. A party having such capacity may himself put his signature or authorize some other person to do so.

A minor may draw, endorse, deliver and negotiate an instrument so as to bind all the parties except himself. A minor may be a drawer where the instrument is drawn or endorsed by him. In that case he does not incur any liability himself although other parties to the instrument can be made liable and the holder can receive payment from any other party thereto.

Therefore, in the instant case, the promissory note is valid and it is binding on 'P' but not on 'Q', a minor.

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

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

- (b) **Factors which influence the ethical behaviour at work-** Ethical decisions in an organization are influenced by three key factors:

1. **Individual moral standards:** One may have great control over personal ethics outside workplace.
2. **The influence of managers and co-workers:** The activities and examples set by co-workers along with rules and policies established by the firm are critical in gaining consistent ethical compliance in an organization.
3. **The opportunity to engage in misconduct:** If a company fails to provide good examples and direction for appropriate conduct; confusion and conflict will develop and result in the opportunity for unethical behavior.

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

1. **Expression:** The two sides must communicate/express about the problem for there to be conflict.
2. **Perception:** Conflict evolves perceptions in the two sides may only perceive that their goals, resources, and interference are incompatible with each other's.

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

- (i) Presenting ideas or options
- (ii) Problem orientation- focusing attention the task
- (iii) Spontaneity - Communicating openly and honestly
- (iv) Empathy - understanding another person's thoughts.
- (v) Equality- asking for opinions
- (vi) Willing to listen to the ideas of others.

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

4. (a) **Doctrine of Constructive Notice:** In consequences of the registration of the memorandum and articles of association of the company with the Registrar of Companies, a person dealing with the company is deemed to have constructive notice of their contents (*T.R. Pratt (Bombay) Ltd. v. E.D. Sassoon & Co. Ltd.*). This is because these documents are construed as 'public documents'. Accordingly if a person deals with a company in a manner incompatible with the provisions of the aforesaid documents or enters into transaction which is ultra vires these documents, he must do so at his peril.

The doctrine of constructive notice is not a positive one but a negative one like that of estoppels of which it forms parts. It operates only against the person who has been dealing with the company but not against the company itself; consequently he is prevented from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority ultra vires.

There is one limitation to the doctrine of constructive notice of the Memorandum and the Articles of a company. The outsiders dealing with the company are on their part entitled to assume that as far as the internal proceedings of the company are concerned, everything has been done properly in accordance with the Memorandum and Articles and the Act. They are only bound to read the registered documents and satisfy themselves that the proposed dealing is not inconsistent therewith, but are not bound to do more; they need not inquire into the regularity of the internal proceedings as required by the Memorandum and the Articles. This limitation of the doctrine of constructive notice is known as the 'doctrine of indoor management' or the rule laid down in the celebrated case of *Royal British Bank v. Turquand*. Thus, whereas the doctrine of constructive notice protects the company against outsiders, the doctrine of indoor management seeks to protect outsiders against the company.

- (b) **Different environmental phenomena of ethical concern:** 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 the other parts. Business firms (and all other social institutions) are parts of a larger ecological system. Business firms depend on the natural environment for their energy, material resources, and waste disposal, and that environment in turn is affected by the commercial activities of business firms.

The issue of environmental ethics goes beyond the problems relating to protection of environment or nature in terms of pollution, resource utilization or waste disposal. It is the issues of exploitive human nature and attitudes that should be addressed in a rational way. Problems like Global warming, Ozone depletion and disposal of hazardous wastes that concern the entire world. They require International cooperation and have to be tackled at the global level.

Few decades ago, the corporate world, the industry or others engaged in the use of natural resources or environmental services were mainly concerned with good business in economic sense. There is now a growing concern for Social responsibility and ethical norms in all spheres of human activities; be it public behaviour, business or environment and there are ethical concerns to look after not only the interest of stakeholders but also that of community; as the regulatory / mandatory requirements have also become more stringent. This translates into providing safety for the workers at workplace, concern for their health, reducing pollution and incorporating environmental values in governance.

- (c) (i) The given statement “**Rumour and gossip are synonymous**” is INCORRECT.

Rumours and gossip seem to be an inevitable part of everyday corporate life. Even though rumours and gossip often travel through the same network, there is a distinction between the terms. RUMOURS TEND TO FOCUS ON EVENTS AND INFORMATION, WHEREAS GOSSIP FOCUSES ON PEOPLE. Even though managers usually treat the information as “yet to be confirmed”, it may cloud judgments about the employee. The information has a way of creeping into performance evaluations and promotion decisions, even if unintended.

- (ii) The given statement “Lying breaks down the trust between individuals” is CORRECT.

A lie is a false statement intended to deceive. Of all the ethical dilemmas, lying would appear to be the least morally perplexing. Most would agree that “one ought not to lie”. Yet lies in business are more common than many would care to admit. Lying break down the trust between individuals, shaking the foundation of ethical communication.

5. (a) **Coercion and Undue Influence – Meaning and Differences:** “Coercion” is the committing, or threatening to commit any act forbidden by the Indian Penal Code 1860, or the unlawful detaining, or threatening to detain any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement. (Section 15, The Indian Contract Act, 1872).

A contract is said to be induced by “undue influence” where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage of the other. A person is deemed to be in a position to dominate the will of the other, when he holds authority, real or apparent over the other, or when he stands in a fiduciary relation to other (Section 16, The Indian Contract Act, 1872)

Differences between Coercion and Undue Influence

Nature of action: Coercion involves physical force and sometimes only threat. Undue influence involves only moral pressure.

Involvement of criminal action: Coercion involves committing or threatening to commit any act prohibited or forbidden by law, or detention or threatening to detain a person or property. In undue influence there is no such illegal act involved.

Relationship between parties: In coercion there need not be any relationship between parties; whereas in undue influence, there must be some kind of relationship between parties, which enables to exercise undue influence over the other.

Exercise by whom: Coercion need not proceed from the promisor. It also need not be directed against the promisee. Undue influence is always exercised by one on the other, both of whom are parties to a contract.

Enforceability: Where there is coercion, the contract is voidable at the option of the party whose consent has been obtained by coercion. Where there is undue influence the contract is voidable or court may set it aside or enforce it in a modified form.

Position of benefits received: In case of coercion, where the contract is rescinded by the aggrieved party any benefit received has to be restored back. In the case of undue influence, the court has discretion to pass orders for return of any such benefit or not to give any such directions.

- (b) (i) **A limited company can become a partner in a partnership firm**

Correct. According to Section 4 of the Indian Partnership Act, 1932, partnership is a contractual relationship between persons and a company falls within the definition of a person capable of contracting; therefore, there is no objection to a company in becoming a partner in a firm. Further, the limited liability element of a limited company is also not restrictive to a company

becoming a partner in a firm even with an unlimited liability of the partnership firm and partners. This is, because, in a company it is the liability of members which is limited and not the company itself.

- (ii) **A special resolution is one, to pass, requires the votes cast in favour be twice the votes cast against it.**

Incorrect. A resolution shall be a special resolution when the votes cast in favour of the resolution by members (whether on a show of hands, or on a poll, or by proxy), are not less than three times the number of votes, if any, cast against the resolution.

(c) Notice: Meeting of Board of Directors:

Notice

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

Agenda

1. Confirmation of the minutes of the previous Board Meeting held on.....to.....
2. Discussion of the progress in business.
3. Co-option of Mr. X 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) **QUORUM; CONSEQUENCES OF NO QUORUM:** Quorum means the minimum number of members who must be present in order to constitute a meeting and transact business thereat. Thus, quorum represents the number of members on whose presence the meeting of a company can commence its deliberations.

Section 103 of the Companies Act, 2013 provides the law with respect to the quorum for the meetings. The said section provides that where the Articles of the company do not provide for a larger number, there the quorum shall depend on number of members as on date of a meeting.

In case of a public company:

- (i) five members personally present if the number of members as on the date of meeting is not more than one hundred;
- (ii) fifteen members personally present if the number of members as on the date of meeting is more than one thousand but up to five thousand;
- (iii) thirty members personally present if the number of members as on the date of the meeting exceeds five thousand;

shall be the quorum for a meeting of the company.

CONSEQUENCES OF NO QUORUM: If the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company –

- (a) the meeting shall stand adjourned to the same day in the next week at the same time and place, or
- (b) to such other date and such other time and place as the Board may determine; or
- (c) the meeting, if called by requisitions (under section 100), shall stand cancelled.

In the instant case, KMP Limited is a public company with total number of 2750 members, hence atleast 15 members should have been personally present in order to constitute a valid quorum for the Annual General Meeting.

Thus, the meeting shall automatically stand adjourned to the same day in the next week at the same time and place, if the quorum is not present within half –an-hour from the time appointed for holding a meeting of the company. Further, the Board of Directors may decide for such other date and such other time and place, which they may deem fit. Section 103 of the said Act itself provides for automatic adjournment of the meeting to the same day in the next week at the same time and place, rather the Chairman obviating to take a decision on the matter of the meeting. The question of validity of Chairman’s decision does not arise.

- (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) 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) **Contribution to Provident Fund under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952:** Section 6 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 regulates contribution to Provident Fund Scheme established under the Act.

The employer's contribution shall be 10% of the basic wages, dearness allowance and retaining allowance, if any payable to each of the employees whether employed by him directly or by through a contractor.

The employee's contribution shall be equal to the contribution payable by the employer in respect of him.

In case the employee so desires, he may contribute an amount exceeding ten percent of his basic wages, dearness allowance and retaining allowance if any, subject to the condition that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this section.

Dearness allowance includes cash value of any food concession allowed to the employees. Retaining allowance means the sum paid for retaining the service, when the factory is not working.

The Central Government may by notification make the employer's contribution equal to 12% for certain establishments class of establishments.

(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) According to Section 105 (4) of the Companies Act, 2013, any provision in the Articles of a company which requires a longer period than 48 hours before a meeting of the company for depositing a proxy, shall have effect as if a period of 48 hours had been specified for such deposit. Therefore in the given case, the answer is a 'no'.

(d) The reasons which lead to unethical behaviour are as follows:

1. **Emphasis on short term results.**

This is one of the primary reasons which has led to the downfall of many companies like Enron and Worldcom.

2. **Ignoring small unethical issues.**

It is a known fact that most of the compromises we make are small but however they lead us into committing large infractions. And ignoring minor lapses, lead to bigger and more huge mistakes.

3. **Economic cycles.**

In good times, companies are relaxed in their accounting procedures or disclosures, as there is a pervasive feel-good effect. But when times of hardship follow, then the hit taken by them is almost fatal, as was proved in the Enron case. So companies need to watch out for economic cycles and be vigilant in good times as well as bad.

4. **Accounting rules.**

In the era of globalization and massive cross border flow of capital, accounting rules are changing faster than ever before. The rules have become more complex and it is difficult to identify deviations from these complex set of requirements. The complexity of these principles and rules and the difficulty associated with identifying abuse are reasons which may promote unethical behaviour.

(e) **The key elements in the innovation framework are:**

- (i) **Accessibility:** The major organizational challenge is to make everyone, particularly the workers as active participants in the work process. The innovative enterprise ensures everyone is accessible to each other at all levels within the organization.
- (ii) **Recognize and reward innovation:** One of the more radical steps an organization or manager can take is to make innovation a requirement of the job.
- (iii) **Develop company programs that encourage innovation:** Some companies allow their employees to take sabbaticals to work in a new environment or teach in a college. By placing employees in different environments, they can meet new people, come across new ideas and hopefully generate their own novel approaches.
- (iv) **Foster informal communication:** The paperwork involved in proposing or even pursuing a project can be a major roadblock to innovation. Employees often feel stifled when asked to fully justify ideas; they may be working on a hunch.
- (v) **Information:** The right kind of information is called innoinformation. This type of information is critical to the vitality of the enterprises. Innoinformation consists of the plans, vision, goals and all the new ideas affecting the enterprises. The innovative enterprise is looking forward continuously changing and adapting to the needs of the customer.
- (vi) **Framework:** The innovative enterprise must constantly adapt, create and innovate. Information and communication are the wind that sails the innovative enterprise towards its destination. Information and communication pose difficult challenges for most businesses. The difficulty lies in balancing the flow of information between providing too much or too little information.

Test Series: September, 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) Mr. U offered to sell his house to Mr. X for Rs. 15,00,000. Mr. X accepted the offer by post. On the very next day Mr. X sent a telegram revoking the acceptance which reached Mr. U before the letter of acceptance. Is the revocation of acceptance valid? Would it make any difference if both the letter of acceptance and the telegram of revocation of acceptance reach Mr. U at the same time? (5 Marks)
- (b) Define the term 'Small Company' as contained in the Companies Act, 2013. (5 Marks)
- (c) Explain any four sources of ethical standard. (5 Marks)
- (d) Explain clearly the different types of grapevine chains in an informal communication. (5 Marks)
2. (a) (i) State the provisions relating to the following items under the Payment of Bonus Act, 1965:
 - (A) Time Limit for Payment of Bonus.
 - (B) Recovery of Bonus due from an employer. (4 Marks)
- (ii) When an employee becomes disabled due to any accident or disease and is unable to do the same work and re-employed on the reduced wages, how the gratuity of such employee shall be, computed under the provisions of the Payment of Gratuity Act, 1972? (4 Marks)
- (b) What is Corporate Social Responsibility? Why it is needed in Indian Business environment? (4 Marks)
- (c) What is meant by "Active listening"? State the importance of 'Active listening' in the business communication skills. (4 Marks)
3. (a) (i) 'P', a major and 'Q', a minor executed a promissory note in favour of 'R', Examine with reference to the provisions of the Negotiable Instruments Act, 1881, the validity of the promissory note and whether it is binding on 'P' and 'Q'. (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) Describe the factors which influence the ethical behaviour at work in an organization
(4 Marks)
- (c) What do you understand by 'Group conflicts'? How shall these be managed effectively? Explain.
(4 Marks)
4. (a) Briefly explain the doctrine of "Constructive Notice" under the Companies Act, 2013. Are there any exceptions to the said doctrine?
(8 Marks)
- (b) Discuss different environmental phenomena of ethical concern?
(4 Marks)
- (c) State with reasons whether following statements are correct or incorrect.
- (i) Rumours and gossips are synonymous.
- (ii) Lying breaks down the trust between individuals.
(4 Marks)
5. (a) What do you understand by "coercion" and "undue influence" under the provisions of the Indian Contract Act, 1872? What are the differences between them?
(8 Marks)
- (b) State whether the following statements are correct or incorrect:
- (i) A limited company can become a partner in a partnership firm.
- (ii) A special resolution is one to pass, requires the votes cast in favour be twice the votes cast against it.
(2 x 2 = 4 Marks)
- (c) Draft a notice for calling the meeting of the Board of Directors of a NM Ltd.
In this meeting, following transactions have to be proposed:-
- (i) Mr. X to be co-opted as an Additional Director
- (ii) Decision to be taken to buy-back company's equity shares
(4 Marks)
6. (a) The Annual General Meeting of KMP Limited was held on 30th April, 2015. The Articles of Association of the company is silent regarding the quorum of the General Meeting. Only 10 members were personally present in the above meeting, out of the total 2,750 members of the company. The Chairman adjourned the meeting for want of quorum. Referring to the provisions of the Companies Act, 2013, examine the validity of Chairman's decision.
(8 Marks)
- (b) Explain the pragmatic reasons for maintaining ethical behaviour in marketing through marketing executives.
(4 Marks)

- (c) Draft a 'Power of Attorney' by an assessee 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) State the provisions of Employees' Provident Funds and Miscellaneous Provisions Act, 1952 regulating the quantum of contribution to be made by the employer and employee to the Provident Fund. Is it possible for an employee to increase the amount of his contribution to the Provident Fund more than the minimum contribution as statutorily prescribed? (4 Marks)
- (b) Mention any five acts for which a special resolution is required under the Companies Act, 2013. (4 Marks)
- (c) The Articles of Association of a public company require the instrument appointing a proxy to be received by the company 75 hours before the meeting. Is it a valid requirement? If not, what are its effect? (4 Marks)
- (d) Explain the reasons for unethical behaviour among finance and accounting professionals. (4 Marks)
- (e) Explain the key elements involved in the innovation frame work of an organisation. (4 Marks)

Test Series: September, 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) Calculate from the following figures:

- (i) Efficiency ratio
- (ii) Activity ratio and
- (iii) Capacity ratio.

Budgeted Production	880 units
Standard Hours per unit	10 hours
Actual Production	750 units
Actual Working Hours	6,000 hours

(b) You are required to calculate a suggested fare per passenger-km from the following information for a Mini Bus:

- (i) Length of route: 30 km
- (ii) Purchase price Rs. 4, 00,000
- (iii) Part of above cost met by loan, annual interest of which is Rs. 10,000 p.a.
- (iv) Other annual charges: Insurance Rs. 15,000, Garage rent Rs. 9,000, Road tax Rs. 3,000, Repairs & maintenance Rs. 15,000, Administrative charges Rs. 5,000.
- (v) Running Expenses: Driver & Conductor Rs. 5,000 p.m., Repairs/Replacement of tyre-tube Rs. 3,600 p.a., Diesel and oil cost per km Rs. 5.
- (vi) Effective life of vehicle is estimated at 5 years at the end of which it will have a scrap value of Rs. 10,000.

- (vii) Mini Bus has 20 seats and is planned to make Six no. two way trips for 25 days/p.m.
- (viii) Provide profit @ 20% of total revenue.
- (c) A Ltd. and B Ltd. are identical in every respect except capital structure. A Ltd. does not employ debt in its capital structure, whereas B Ltd. employs 12% debentures amounting to Rs. 10 lakh. Assuming that -
- All assumptions of M – M model are met
 - The income tax rate is 30%
 - EBIT is Rs. 2,50,000 and
 - The equity capitalization rate of A Ltd. is 20%.
- Calculate the average Value of both the companies.

- (d) NSG Ltd. has sales of Rs. 75,00,000 variable cost of Rs. 42,00,000, and fixed cost of Rs. 6,00,000. The Present capital structure of NSG is as follows:

Equity Shares	Rs. 55,00,000
Debt (12%)	Rs. 45,00,000
Total	Rs. 1,00,00,000

- What is the ROCE of NSG Ltd.
 - Does NSG have a favourable financial leverage?
 - If the industry average of asset turnover is 3, does it have a high or low asset leverage?
 - What are the leverages of NSG?
 - At what level of sales, will the EBT be zero? (4 × 5 = 20 Marks)
2. (a) The annual demand for an item of raw material is 4,000 units and the purchase price is expected to be Rs. 90 per unit. The incremental cost of processing an order is Rs. 135 and the annual cost of storage is estimated to be Rs. 12 per unit. What is the optimal order quantity and total relevant cost of this order quantity?
- Suppose that Rs. 135 as estimated to be the incremental cost of processing an order is incorrect and should have been Rs. 80. All other estimates are correct. What is the difference in cost on account of this error?
- Assume at the commencement of the period that a supplier offers 4,000 units at a price of Rs. 86. The materials will be delivered immediately and placed in the stores. Assume that the incremental cost of placing the order is zero and original estimate of Rs. 135 for placing an order for the economic batch is correct. Should the order be accepted? (8 Marks)

- (b) The Modern Chemicals Ltd. requires Rs. 25,00,000 for a new plant. This plant is expected to yield earnings before interest and taxes of Rs. 5,00,000. While deciding about the financial plan, the company considers the objective of maximising earnings per share. It has three alternatives to finance the project - by raising debt of Rs. 2,50,000 or Rs. 10,00,000 or Rs. 15,00,000 and the balance, in each case, by issuing equity shares. The company's share is currently selling at Rs. 150, but is expected to decline to Rs. 125 in case the funds are borrowed in excess of Rs. 10,00,000. The funds can be borrowed at the rate of 10% upto Rs. 2,50,000, at 15% over Rs. 2,50,000 and upto Rs. 10,00,000 and at 20% over Rs. 10,00,000. The tax rate applicable to the company is 50%. Which form of financing should the company choose? *(8 Marks)*
3. (a) Three products X,Y and Z alongwith a byproduct B are obtained again in a crude state which require further processing at a cost of Rs. 5 for X; Rs. 4 for Y; and Rs. 2.50 for Z per unit before sale. The byproduct is however saleable as such to a nearby factory. The selling prices for the three main products and byproduct, assuming they should yield a net margin of 25 percent of cost, are fixed at Rs. 13.75 Rs. 8.75 and Rs. 7.50 and Re. 1.00 respectively – all per unit quantity sold.

During a period, the joint input cost including the material cost was Rs. 90,800 and the respective outputs were:

X	8,000 units
Y	6,000 units
Z	4,000 units
B	1,000 units

By product should be credited to the joint cost and only the net joint costs are to be allocated to the main products.

Calculate the joint cost per unit of each product and the margin available as a percentage on cost. *(8 Marks)*

- (b) RST Limited is considering relaxing its present credit policy and is in the process of evaluating two proposed polices. Currently, the firm has annual credit sales of Rs 225 lakhs and accounts receivable turnover ratio of 5 times a year. The current level of loss due to bad debts is Rs.7,50,000. The firm is required to give a return of 20% on the investment in new accounts receivables. The company's variable costs are 60% of the selling price. Given the following information, which is a better option?

(Amount in lakhs)

	Present Policy	Policy Option I	Policy Option II
Annual credit sales (Rs)	225	275	350
Accounts receivable turnover ratio	5	4	3
Bad debt losses (Rs)	7.5	22.5	47.5

(8 Marks)

4. (a)

Fixed Cost	Rs. 1,20,000
Variable costs	Rs. 3 per unit
Selling price	Rs. 7 per unit
Output	Rs. 50,000 units

Determine the profit for each of the following situation with the above data:

- (i) with the data above
- (ii) with a 10% increase in output & sales.
- (iii) with a 10% increase in fixed costs.
- (iv) with a 10% increase in variable costs.
- (v) with a 10% increase in selling price.
- (vi) taking all the above situations.

(8 Marks)

(b) A person opened an account on April, 2015 with a deposit of Rs. 800. The account paid 6% interest compounded quarterly. On October 1, 2015, he closed the account and added enough additional money to invest in a 6-month Time Deposit for Rs. 1,000 earning 6% compounded monthly.

- (i) How much additional amount did the person invest on October 1?
- (ii) What was the maturity value of his Time Deposit on April 1, 2016?
- (iii) How much total interest was earned?

Given that $(1+i)^n$ is 1.03022500 for $i=1\frac{1}{2}\%$, $n=2$ and is 1.03037751 for

$i = \frac{1}{2}\%$ and $n=6$.

(8 Marks)

5. (a) Discuss how raw material quantity standard is set?
 (b) Differentiate between fixed budget and flexible budget.
 (c) Discuss in briefly any two long term sources of finance for a partnership firm.
 (d) Discuss the limitations of cash flow analysis. (4 × 4 = 16 Marks)
6. (a) Z. Ltd. uses standard costing system in manufacturing of its single product 'M'. The standard cost per unit of M is as follows:

	Rs.
Direct Material – 2 metres @ Rs. 6 per metre	12.00
Direct labour- 1 hour @ Rs. 4.40 per hour	4.40
Variable overhead- 1 hour @ Rs. 3 per hour	3.00

During July, 2016, 6,000 units of M were produced and the related data are as under:

Direct material acquired- 19,000 metres @ Rs.5.70 per metre.

Material consumed – 12,670 metres.

Direct labour – ? hours @ Rs. ? per hour Rs. 27,950

Variable overheads incurred Rs. 20,475

The variable overhead efficiency variance is Rs. 1,500 adverse. Variable overheads are based on direct labour hours. There was no stock of the material in the beginning

You are required to compute the missing figures and work out all the relevant variances. (8 Marks)

- (b) ABC Ltd. has supplied the following information at the beginning and at the end of the year 2014-15:

	1.4.2014	31.3.2015
	Rs.	Rs.
Plant less depreciation	95,000	2,13,000
Investment (long term)	1,98,000	4,35,000
Debentures	3,75,000	1,05,000
Equity capital	6,00,000	6,00,000
Reserves & Surplus	3,57,000	6,15,000

Although ABC Ltd. could not provide complete Balance Sheet and Profit & Loss Account, it supplied the following further information:

- (i) An interim dividend of Rs. 54,000 has been paid during the year 2014-15.

- (ii) The net income includes Rs. 20,000 on account of profit on sale of plant. There has been an increase of Rs. 1,40,000 in the gross value of plant after a plant having gross value of Rs.43,500, whose written down value was Rs. 28,500, was disposed off during the year.

From the information given above, you are required to prepare a Funds Flow Statement. (8 Marks)

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

- (a) Differentiate between cost control and cost reduction.
- (b) Discuss with example the level of activity method of segregating semi-variable costs into fixed and variable costs.
- (c) Discuss the three major decisions taken by a finance manager to maximize the wealth of shareholders.
- (d) Discuss the limitations of financial ratios.
- (e) (i) Write short note on Material Requisition Note.
(ii) Write short note on cash planning. (4 × 4 = 16 Marks)

MOCK TEST PAPER – 2
INTERMEDIATE (IPC): GROUP – I
PAPER – 3: COST ACCOUNTING AND FINANCIAL MANAGEMENT
SUGGESTED ANSWERS/HINTS

1. (a) (i) Efficiency Ratio = $\frac{\text{Actual Production in terms of standard hours}}{\text{Actual hours worked}} \times 100$

$$= \frac{750 \text{ units} \times 10 \text{ hours}}{6,000} \times 100 = 125\%$$

(ii) Activity ratio = $\frac{\text{Actual Production in terms of standard hours}}{\text{Budgeted production in terms of standard hours}} \times 100$

$$= \frac{7,500}{880 \times 10} \times 100 = 85.23\%$$

(iii) Capacity Ratio = $\frac{\text{Actual hours worked}}{\text{Maximum hours in a budget period}} \times 100$

$$= \frac{6,000}{8,800} \times 100 = 68.19$$

Activity ratio = Efficiency Ratio \times Capacity Ratio

Or, 85.23% = 125% \times 68.19%

(b) Working Notes:

1. Depreciation per annum: = $\frac{\text{Purchase price} - \text{Scrap value}}{\text{Estimated life}}$

$$= \frac{\text{Rs. } 4,00,000 - \text{Rs. } 10,000}{5 \text{ years}} = \text{Rs. } 78,000$$

2. Total distance travelled by mini-bus in 25 days:

= Length of the route (two -sides) \times No. of trips per day \times No. of days

= 60 km \times 6 trips \times 25 days = 9,000 km

3. Total Passenger-Km:
 = Total distance travelled by mini-bus in 25 days × No. of seats
 = 9,000 km × 20 seats = 1,80,000 passenger-km

Statement suggesting fare per passenger-km

	Cost per annum Rs.	Cost per month Rs.
Fixed expenses:		
Insurance	15,000	
Garage rent	9,000	
Road tax	3,000	
Administrative charges	5,000	
Depreciation	78,000	
Interest on loan	10,000	
	1,20,000	10,000
Running expenses:		
Repair and maintenance	15,000	1,250
Replacement of tyre-tube	3,600	300
Diesel and oil cost (9,000 km × Rs. 5)	-	45,000
Driver and conductor's salary	-	5,000
Total cost (per month)		61,550.00
Add: Profit 20% of total revenue cost or 25% of total cost		15,387.50
Total revenue		76,937.50

Rate per passenger-km Rs. 76,937.50/1,80,000 passenger km = 0.42743 i.e.,
 = 0.43 i.e., 43 paise

- (c) Firm A Ltd. (pure equity): unlevered firm:

$$\text{EAT} = \text{EBIT} (1 - t)$$

$$= \text{EBT} \times 0.7 = \text{Rs. } 2,50,000 \times 0.7 = \text{Rs. } 1,75,000$$

(since, EBIT = EBT as there is no debt)

$$\text{Value of unlevered firm A} = \frac{\text{EAT}}{\text{Equity capitalization rate}} = \frac{\text{Rs. } 1,75,000}{20\%} = \text{Rs. } 8,75,000$$

Firm B Ltd. (levered):

$$\begin{aligned} \text{Value of levered firm} &= \text{Value of equity} + \text{Value of debt} \\ &= \text{Rs. } 8,75,000 + (10,00,000) \times 0.3 \\ &= \text{Rs. } 11,75,000 \end{aligned}$$

$$(d) \quad (i) \quad \text{ROCE} = \frac{\text{EBIT}}{\text{Capital employed}} = \frac{\text{Rs. } 27,00,000}{\text{Rs. } 1,00,00,000} \times 100 = 27\%$$

Workings:

(I) Calculation of EBT:	Rs.
Sales	75,00,000
Less: Variable costs	42,00,000
Contribution	33,00,000
Less: Fixed costs	6,00,000
EBIT	27,00,000
Less: Interest (12 % of Rs. 45,00,000)	5,40,000
EBT	21,60,000

(II) Capital employed = Debt + Equity Shares = Rs. 1,00,00,000.

(ii) Since ROCE (27%) is higher than the interest payable on debt (12%). NSG has a favourable financial leverage.

(iii) Capital employed = Total assets = Rs. 1,00,00,000

Net sales = Rs. 75,00,000

$$\text{Therefore, turnover ratio} = \frac{\text{Rs. } 75,00,000}{\text{Rs. } 1,00,00,000} = 0.75$$

The industry average is 3 against NSG's ratio of 0.75. Hence NSG Ltd. has very low asset leverage.

$$(iv) \quad \text{Operating leverage} = \frac{\text{Contribution}}{\text{EBIT}} = \frac{\text{Rs. } 33,00,000}{\text{Rs. } 27,00,000} = 1.22$$

$$\text{Financial Leverage} = \frac{\text{EBIT}}{\text{EBT}} = \frac{\text{Rs. } 27,00,000}{\text{Rs. } 21,60,000} = 1.25$$

$$\text{Combined leverage} = \frac{\text{Contribution}}{\text{EBT}} = \frac{\text{Rs. } 33,00,000}{\text{Rs. } 21,60,000} = 1.53$$

Or

$$\text{DCL} = \text{DOL} \times \text{DFL} = 1.22 \times 1.25 = 1.53$$

- (v) For EBT to become zero, a 100% reduction in the EBT is required. As the combined leverage is 1.53, sales have to drop approx. by $100/1.53 = 65.36\%$. Hence, the new sales will be:

$$\text{Rs. } 75,00,000 \times (1 - 65.36\%) = \text{Rs. } 25,98,000$$

2. (a) (i) Optimal order quantity i.e. E.O.Q.

$$= \sqrt{\frac{2 \times 4,000 \times 135}{12}} = \sqrt{90,000} = 300 \text{ units}$$

Relevant Cost of this order quantity	Rs.
Ordering cost = $\frac{4,000}{300}$ 13.33 say 14 orders at Rs. 135	1,890
Carrying Cost = $\frac{1}{2} \times 300 \times 12$	1,800
Relevant cost	3,690

(ii) Revised EOQ = $\sqrt{\frac{2 \times 4,000 \times 80}{12}} = 231 \text{ units}$

Ordering cost = $\frac{4,000}{231} = 17.32$ say 18 orders at Rs. 80	1,440
Carrying cost = $\frac{1}{2} \times 231 \times 12$	1,386
	2,826

Different in cost on account of this error = $3,690 - 2,826 = \text{Rs. } 864$

- (iii) In case of discount in purchase price, the total cost of 3 *i.e.*, Purchase cost, ordering cost and carrying cost should be compared.

Original offer at Rs. 90 per unit		Supplier offered at Rs. 86 per unit	
	Rs.		Rs.
Purchase Cost	3,60,000	Purchase cost 4,000 × 86	3,44,000
Ordering cost	1,890	Ordering cost	Nil
Carrying cost	1,800	Carrying cost $\frac{1}{2} \times 4,000 \times 12$	24,000
Total cost	3,63,690		3,68,000

This special offer at Rs. 86 per unit should not be accepted as its total cost is higher by Rs. 4,310 (3,68,000 – 3,63,690).as compared to original offer.

(b) Calculation of Earnings per share for three alternatives to finance the project

Particulars	Alternatives		
	I To raise debt of Rs.2,50,000 and equity of Rs. 22,50,000 Rs.	II To raise debt of Rs. 10,00,000 and equity of Rs. 15,00,000 Rs.	III To raise debt of Rs. 15,00,000 and equity of Rs. 10,00,000 Rs.
Earnings before interest and tax	5,00,000	5,00,000	5,00,000
Less: Interest on debt at the rate of	25,000 (10% on Rs. 2,50,000)	1,37,500 (10% on Rs. 2,50,000) (15% on Rs. 7,50,000)	2,37,500 (10% on Rs. 2,50,000) (15% on Rs. 7,50,000) (20% on Rs. 5,00,000)
Earnings before tax	4,75,000	3,62,500	2,62,500
Less: Tax (@ 50%)	2,37,500	1,81,250	1,31,250
Earnings after tax: (A)	2,37,500	1,81,250	1,31,250
Number of shares :(B) (Refer to working note)	15,000	10,000	8,000
Earnings per share : (A)/(B)	15.833	18.125	16.406

So the earning per share (EPS) is higher in alternative II i.e. if the company finance the project by raising debt of Rs. 10,00,000 and issue equity shares of Rs. 15,00,000. Therefore the company should choose this alternative to finance the project.

Working Note:

	Alternatives		
	I	II	III
Equity financing : (A)	Rs. 22,50,000	Rs. 15,00,000	Rs. 10,00,000
Market price per share: (B)	Rs. 150	Rs. 150	Rs. 125
Number of equity share: (A)/(B)	15,000	10,000	8,000

3. (a) Working Notes:

(i) **Computation of Allocation Ratio for Joint Costs**

	Products		
	X Rs.	Y Rs.	Z. Rs.
Selling Price	13.75	8.75	7.50
Less anticipated margin@ 25% on cost of 20% on sales	2.75	1.75	1.50
Cost of sales	11.00	7.00	6.00
Less post split off cost	5.00	4.00	2.50
Joint cost per unit	6.00	3.00	3.50
Output (units)	8,000	6,000	4,000
Total output cost	48,000	18,000	14,000
Allocation ratio for joint costs	24	9	7

(ii) **Computation of net allocable joint costs**

	Rs.	Rs.
Joint input cost including material cost		90,800
Less: Credit for realization from by-product B: Sales revenue (1,000 × Re. 1)	1,000	
Less profit @ 25% on cost or 20% on sales	200	800
Net joint costs to be allocated		90,000

Determination of joint cost per unit of each product

Product	Net joint costs allocation Rs.	Output (units) Rs.	Joint cost per unit Rs.
X	54,000 (Note : 1)	8,000	6.75
Y	20,250	6,000	3.38
Z	15,750	4,000	3.94
	90,000		

Profit margin available on each product as a percentage on cost

Product	Joint Cost Rs.	Post spilt-off cost Rs.	Total Cost Rs.	Selling Price Rs.	Margin Rs.	Margin % on cost Rs.
X	6.75	5.00	11.75	13.75	2.00	17.02
Y	3.38	4.00	7.38	8.75	1.37	18.56
Z	3.94	2.50	6.44	7.50	1.06	16.46

Note: 1

$$X = \frac{24}{40} \times 90,000 = 54,000$$

$$Y = \frac{9}{40} \times 90,000 = 20,250$$

$$Z = \frac{7}{40} \times 90,000 = \underline{15,750}$$

90,000

(b) Statement showing Evaluation of Credit Policies (Amount in lakhs)

	Particulars	Present Policy (Rs.)	Proposed Policy I (Rs.)	Proposed Policy II (Rs.)
A	Expected Profit :			
	(a) Credit Sales	225.00	275.00	350.00
	(b) Total Cost other than Bad Debts:			
	Variable Costs	135.00	165.00	210.00
	(c) Bad Debts	7.50	22.50	47.50
	(d) Expected Profit [(a)-(b)-(c)]	82.50	87.50	92.50

B	Opportunity Cost of Investment in Receivables*	5.40	8.25	14.00
C	Net Benefits [A-B]	77.10	79.25	78.50

Recommendation: The Proposed Policy I should be adopted since the net benefits under this policy is higher than those under other policies.

Working Note:

***Calculation of Opportunity Cost of Average Investments**

$$\text{Opportunity Cost} = \text{Total Cost} \times \frac{\text{Collection Period}}{12} \times \frac{\text{Rate of Return}}{100}$$

$$\text{Present Policy} = \text{Rs. } 135 \text{ lakhs} \times 2.4/12 \times 20\% = \text{Rs. } 5.40 \text{ lakhs}$$

$$\text{Proposed Policy I} = \text{Rs. } 165 \text{ lakhs} \times 3/12 \times 20\% = \text{Rs. } 8.25 \text{ lakhs}$$

$$\text{Proposed Policy II} = \text{Rs. } 210 \text{ lakhs} \times 4/12 \times 20\% = \text{Rs. } 14.00 \text{ lakhs}$$

4. (a) (i)

	Rs.
Sales 50,000 units at Rs. 7	3,50,000
Variable cost 50,000 × 3	1,50,000
Contribution 50,000 × 4	2,00,000
Fixed costs	1,20,000
Profit	80,000

$$\text{P/V ratio} = \frac{S-V}{S} \times 100 = \frac{7-3}{7} \times 100 = \frac{4}{7} \times 100 = 57.14\%$$

$$\text{BEP (units)} = \frac{F}{\text{contribution per unit}} = \frac{1,20,000}{4} = 30,000 \text{ Units}$$

$$\text{BEP (Value)} = 30,000 \text{ Units} \times 7 = \text{Rs. } 2,10,000$$

Profit Rs. 80,000 (as calculated above)

(ii) with a 10% increase in output & sales

i.e., 50,000 + 5,000 = 55,000 units

Contribution 55,000 × Rs. 4 per unit	Rs. 2,20,000
Fixed costs	Rs. 1,20,000
Profit	Rs. 1,00,000

(iii) with a 10% increase in Fixed Cost

Contribution (50,000 × Rs. 4 per unit)	Rs. 2,00,000
Fixed cost (1,20,000 + 12,000)	Rs. 1,32,000
Profit	Rs. 68,000

(iv) with a 10% increase in variable costs

Selling price per unit	7.00
Less: variable cost (3 + 0.30)	3.30
Contribution per unit	3.70
Total contribution 50,000 × 3.70	1,85,000
Fixed costs	1,20,000
Profit	65,000

(v) with a 10% increase in selling price

Selling price per unit (7.00 + 0.70)	7.70
Variable cost per unit	3.00
Contribution per unit	4.70
Total contribution 50,000 × Rs. 4.70	2,35,000
Fixed costs	1,20,000
Profit	1,15,000

(vi) Effect of all the four above:-

Sales 55,000 × Rs. 7.70 per unit	Rs. 4,23,500
Variable cost 55,000 × 3.30	Rs. 1,81,500
Contribution 55,000 × 4.40	Rs. 2,42,000
Fixed cost 1,20,000 + 12,000	Rs. 1,32,000
Profit	Rs. 1,10,000

Note: It is assumed that the increased output of 55,000 units has been sold.

(b) (i) The initial investment earned interests for April – June and July – September quarter, i.e. for 2 quarters.

$$\text{In this case, } i = \frac{6}{4} = 1\frac{1}{2}\%, n = 2 \text{ and the compounded amount} = 800 \left(1 + 1\frac{1}{2}\%\right)^2$$

$$= 800 \times 1.03022500 = \text{Rs. } 824.18$$

The additional amount = Rs. (1,000 – 824.18) = Rs. 175.82

- (ii) In this case, the Time Deposit earned interest compounded monthly for 2 quarters.

$$\text{Here, } i = \frac{6}{12} = \frac{1}{2} \% , n = 6, P = 1,000$$

$$\text{Required maturity value } 1,000 \left(1 + \frac{1}{2} \% \right)^6 = 1,000 \times 1.03037751 = \text{Rs. } 1,030.38$$

- (iii) Total interest earned = (24.18 + 30.38) = Rs. 54.56

5. (a) The following procedure is usually followed for setting material quantity standards.
- Standardisation of products: At this phase products to be produced is decided based on production plan and customer's order. Generally following questions are answered at this stage: (i) What to be produced? (ii) Which type to be produced and (iii) How much to be produced?
 - Product study: Product to be produced is analysed and studied for developments and production. Product study is carried out by the engineering department or product consultants. At this phase answers to the following questions are satisfied: (i) How can it be produced? (ii) What are the pre-requisites? (iii) Which type of materials to be used? (iv) How products can be accepted in the market? Etc.
 - Preparation of specification list: After the product study a list of material is prepared. It specifies types (quality) and quantity of materials to be used, substitute of the materials, quantity and proportion of materials to be used, process to be followed, pre-requisites and condition required etc. While preparing specification list consideration to expected amount of wastage is given. It must be customised to adopt changes in the product.
 - Test runs: Sample or test runs under specified conditions are carried out and sample products are tested for the desired quality and quantity. Any deviation from the specification is noted down and specification list is updated.

(b) Difference between Fixed and Flexible Budgets:

Sl. No.	Fixed Budget	Flexible Budget
1.	It does not change with actual volume of activity achieved. Thus it is known as rigid or inflexible budget	It can be re-casted on the basis of activity level to be achieved. Thus it is not rigid.
2.	It operates on one level of activity and under one set of conditions. It	It consists of various budgets for different levels of activity

	assumes that there will be no change in the prevailing conditions, which is unrealistic.	
3.	Here as all costs like - fixed, variable and semi-variable are related to only one level of activity so variance analysis does not give useful information.	Here analysis of variance provides useful information as each cost is analysed according to its behaviour.
4.	If the budgeted and actual activity levels differ significantly, then the aspects like cost ascertainment and price fixation do not give a correct picture.	Flexible budgeting at different levels of activity facilitates the ascertainment of cost, fixation of selling price and tendering of quotations.
5.	Comparison of actual performance with budgeted targets will be meaningless specially when there is a difference between the two activity levels.	It provides a meaningful basis of comparison of the actual performance with the budgeted targets.

(c) The two sources of long-term finance for a partnership firm are as follows:

Loans from Commercial Banks: Commercial banks provide long term loans for the purpose of expansion or setting up of new units. Their repayment is usually scheduled over a long period of time. The liquidity of such loans is said to depend on the anticipated income of the borrowers.

As part of the long term funding for a partnership firm, the banks also fund the long term working capital requirement (it is also called WCTL i.e. working capital term loan).

Lease financing: Leasing is a general contract between the owner and user of the asset over a specified period of time. The asset is purchased initially by the lessor (leasing company) and thereafter leased to the user (lessee firm) which pays a specified rent at periodical intervals. Thus, leasing is an alternative to the purchase of an asset out of own or borrowed funds. Moreover, lease finance can be arranged much faster as compared to term loans from financial institutions.

(d) Cash flow analysis is a useful tool of financial analysis. However, it has its own limitations. These limitations are as under:

1. Cash flow statement cannot be equated with the Income Statement: An Income Statement takes into account both cash as well as non-cash items and, therefore, net cash flow does not necessarily mean net income of the business.

2. The cash balance as disclosed by the cash flow statement may not represent the real liquid position of the business since it can be easily influenced by postponing purchases and other payments.
3. Cash flow statement cannot replace the Funds Flow Statement. Each of them has a separate function to perform.

In spite of these limitations it can be said that cash flow statement is a useful supplementary instrument.

The technique of cash flow analysis, when used in conjunction with ratio analysis, serves as a barometer in measuring the profitability and financial position of the business.

6. (a) Working Notes

Standard Costs

	Rs.
Direct materials (6,000 × Rs. 12)	72,000
Direct labour (6,000 × Rs. 4.40)	26,400
Variable overheads (6,000 × Rs. 3)	18,000
Total	1,16,400

Actual Cost

Direct Materials 12,670 × 5.70	72,219
Direct wages	27,950
Variable overhead incurred	20,475
Total	1,20,644

Total Variance = SC- AC = 1,16,400 – 1,20,644 = Rs. 4,244 (A)

Missing Figures

1. Actual Direct Labour Hours (DLH)

We can find out this through Variable overhead efficiency variance of Rs. 1,500 adverse

VOH Efficiency Variance= SR (SH – AH)

1,500 A	=	3(6,000 – AH)
-1,500	=	18,000 – 3 AH
3AH	=	18,000 + 1,500 = 19,500
AH = 19,500/3	=	6,500 Actual Hours i.e. Actual DLH.

$$2. \text{ Actual Labour Rate per hour} = \frac{\text{Rs. } 27,950}{6,500 \text{ DLH}} = \text{Rs. } 4.30$$

Relevant Variances:

1	Material Variances:	
	(a) $MCV = SC - AC = 72,000 - 72,219 =$	Rs. 219 (A)
	(b) $MPV = AQ (SR - AR) = 12,670 (6 - 5.70) =$	Rs. 3,801 (F)
	or $= 19,000 (6 - 5.70) =$	Rs. 5,700 (F)
	(c) $MUV = SR (SQ - AQ) = 6 (6,000 \times 2 - 12,670)$	
	$= (12,000 - 12,670) =$	Rs. 4,020 (A)
2.	Labour Variances:	
	(a) $LCV = SC - AC = 26,400 - 27,950 =$	Rs. 1,550 (A)
	(b) $LRV = AHP (SR - AR) = 6,500 (4.40 - 4.30) =$	Rs. 650 (F)
	(c) $LEV = SR (SH - AHP) = 4.40 (6,000 - 6,500) =$	Rs. 2,200 (A)
3.	Variable Overhead Variances : (Output Basis)	
	(a) $VOH \text{ Variance} = SVO - AVO = 18,000 - 20,475$	Rs. 2,475 (A)
	(b) $\text{Efficiency Variance} = SR (SQ - AQ) \text{ (Note 1)}$	
	$= 3 (6,500 - 6,000) =$	Rs. 1,500 (A)
	(c) $\text{Expenditure Variance} = (SVOSP - AVO) \text{ (Note 2)}$	
	$= (19,500 - 20,475) =$	Rs. 975 (A)

Note :

- One unit of production in one hour. For 6,500 DLH, 6,500 units should have been produced (SQ). But AQ = 6,000 units. i.e. less than SQ. Hence, it is adverse variance of Rs. 1,500.
- Standard Variable Overhead on Standard Production = $6,500 \times 3 = \text{Rs. } 19,500$

(b) Working Notes:

Net Value of Plant Sold	Rs. 28,500
Profit on sale of plant	<u>20,000</u>
Sale proceeds of plant	<u>Rs. 48,500</u>
Gross value of plant sold	Rs. 43,500
Increase in Gross value of plant	<u>1,40,000</u>
Value of plant purchased	<u>Rs. 1,83,500</u>
Opening value of plant less depreciation	Rs. 95,000

Less: WDV of plant sold	<u>28,500</u>
	66,500
Add: Plant purchased	<u>1,83,500</u>
	2,50,000
Less: closing value of plant after depreciation	<u>2,13,000</u>
Depreciation for the year	<u>Rs. 37,000</u>

Profit from Operation

	Rs.
Closing value of reserves & surplus	6,15,000
Less: Opening value of reserves & surplus	3,57,000
Profit after depreciation	2,58,000
Add: Depreciation	37,000
Profit before depreciation	2,95,000
Less: profit on sale of plant	20,000
	2,75,000
Add: Interim dividend	54,000
Profit from operation	3,29,000

Fund flow statement for the year ended 31st March 2015

	Rs.
Sources of Fund	
Fund from operation	3,29,000
Decrease in working capital (bal. Figures)	3,67,000
Sale of plant	48,500
	7,44,500
Application of Fund	
Investment (Long term)	2,37,000
Purchase of Plant	1,83,500
Repayment of Debentures	2,70,000
Payment of interim dividend	54,000
	7,44,500

7. (a) Difference between cost control and cost reduction are tabulated as below:

Cost Control	Cost Reduction
1. Cost control aims at maintaining the costs in accordance with the established standards.	1. Cost reduction is concerned with reducing costs. It challenges all standards and endeavours to better them continuously
2. Cost control seeks to attain lowest possible cost under existing conditions.	2. Cost reduction recognises no condition as permanent, since a change will result in lower cost.
3. In case of Cost Control, emphasis is on past and present	3. In case of cost reduction it is on present and future.
4. Cost Control is a preventive function	4. Cost reduction is a corrective function. It operates even when an efficient cost control system exists.
5. Cost control ends when targets are achieved	5. Cost reduction has no visible end.

(b) **Level of activity method:** Under this method, the variable overhead may be determined by comparing two levels of output with the amount of expenses at those levels. Since the fixed element does not change, the variable element may be ascertained with the help of the following formula.

$$\frac{\text{Change in the amount of expense}}{\text{Change in the quantity of output}}$$

Suppose the following information is available:

	Production Units	Semi-variable expenses (Rs.)
January	100	260
February	140	300
Difference	40	40

The variable cost :

$$\frac{\text{Change in Semi – variable expenses}}{\text{Change in production volume}} = \frac{\text{Rs. 40}}{40 \text{ units}} = \text{Re. 1/ unit}$$

Thus, in January, the variable cost will be $100 \times \text{Re. 1} = \text{Rs. 100}$ and the fixed cost element will be $(\text{Rs. 260} - \text{Rs. 100})$ or Rs. 160. In February, the variable cost will be $140 \times \text{Re. 1} = \text{Rs. 140}$ whereas the fixed cost element will remain the same, i.e., Rs. 160.

(c) To achieve wealth maximization, a finance manager has to take careful decision in respect of:

- (i) **Investment decisions:** These decisions relate to the selection of assets in which funds will be invested by a firm. Funds procured from different sources have to be invested in various kinds of assets. Long term funds are used in a project for various fixed assets and also for current assets. The investment of funds in a project has to be made after careful assessment of the various projects through capital budgeting. A part of long term funds is also to be kept for financing the working capital requirements. Asset management policies are to be laid down regarding various items of current assets. The inventory policy would be determined by the production manager and the finance manager keeping in view the requirement of production and the future price estimates of raw materials and the availability of funds.
- (ii) **Financing decisions:** These decisions relate to acquiring the optimum finance to meet financial objectives and seeing that fixed and working capital are effectively managed. The financial manager needs to possess a good knowledge of the sources of available funds and their respective costs and needs to ensure that the company has a sound capital structure, i.e. a proper balance between equity capital and debt. Financing decisions also call for a good knowledge of evaluation of risk, e.g. excessive debt carried high risk for an organization's equity because of the priority rights of the lenders.
- (iii) **Dividend decisions:** These decisions relate to the determination as to how much and how frequently cash can be paid out of the profits of an organisation as income for its owners/shareholders. The dividend decision thus has two elements – the amount to be paid out and the amount to be retained to support the growth of the organisation, the latter being also a financing decision; the level and regular growth of dividends represent a significant factor in determining a profit-making company's market value, i.e. the value placed on its shares by the stock market.

All three types of decisions are interrelated, the first two pertaining to any kind of organisation while the third relates only to profit-making organisations, thus it can be seen that financial management is of vital importance at every level of business activity, from a sole trader to the largest multinational corporation.

(d) The limitations of financial ratios are listed below:

- (i) **Diversified product lines:** Many businesses operate a large number of divisions in quite different industries. In such cases ratios calculated on the basis of aggregate data cannot be used for inter-firm comparisons.
- (ii) **Financial data are badly distorted by inflation:** Historical cost values may be substantially different from true values. Such distortions of financial data are also carried in the financial ratios.
- (iii) **Seasonal factors may also influence financial data.**

- (iv) To give a good shape to the popularly used financial ratios (like current ratio, debt- equity ratios, etc.): The business may make some year-end adjustments. Such window dressing can change the character of financial ratios which would be different had there been no such change.
- (v) Differences in accounting policies and accounting period: It can make the accounting data of two firms non-comparable as also the accounting ratios.
- (vi) There is no standard set of ratios against which a firm's ratios can be compared: Sometimes a firm's ratios are compared with the industry average. But if a firm desires to be above the average, then industry average becomes a low standard. On the other hand, for a below average firm, industry averages become too high a standard to achieve.
- (vii) Financial ratios are inter-related, not independent: Viewed in isolation one ratio may highlight efficiency. But when considered as a set of ratios they may speak differently. Such interdependence among the ratios can be taken care of through multivariate analysis.

Financial ratios provide clues but not conclusions. These are tools only in the hands of experts because there is no standard ready-made interpretation of financial ratios.

- (e) (i) **Material Requisition Note:** It is also known as material requisition slip, It is the voucher of the authority regarding issue of materials for use in the factory or in any of its departments. Generally it is prepared by the production department and materials are withdrawn on the basis of material requisition list or bill of materials. If no material list has been prepared, it is desirable that the task of the preparation of material requisition notes be left to the planning department or by the department requires the materials. Usually, a foreman's authority is enough but, in the case of costly materials, it would be desirable to have such requisitions duly approved by some higher authority, like the superintendent or works manager before these are presented to Stores. Apart from sending a material requisition to store a copy is sent to cost accounting department and one copy is retained as office copy.
- (ii) Cash Planning is a technique to plan and control the use of cash. This protects the financial conditions of the firm by developing a projected cash statement from a forecast of expected cash inflows and outflows for a given period. This may be done periodically either on daily, weekly or monthly basis. The period and frequency of cash planning generally depends upon the size of the firm and philosophy of management. As firms grows and business operations become complex, cash planning becomes inevitable for continuing success.

The very first step in this direction is to estimate the requirement of cash. For this purpose cash flow statements and cash budget are required to be prepared.

Test Series: September, 2016

MOCK TEST PAPER – 2
INTERMEDIATE (IPC): GROUP – I
PAPER – 4: TAXATION

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) Madan working as Deputy Manager (Marketing) with Chilled Water Ltd., provides the following information for the year ended 31.03.2016

- | | |
|---|---------------------|
| - Basic Salary | Rs. 15,000 p.m. |
| - DA (50% of it is meant for retirement benefits) | Rs. 12,000 p.m. |
| - Commission as a percentage of turnover of the Company | 0.5 % |
| - Turnover of the Company | Rs. 50 lacs |
| - Bonus | Rs. 50,000 |
| - Gratuity | Rs. 30,000 |
| - Own Contribution to R.P.F. | Rs. 30,000 |
| - Employer's contribution to R.P.F. | 20% of basic salary |
| - Interest credited in the R.P.F. account @ 15% p.a. | Rs. 15,000 |
- Gold Ring worth Rs. 10,000 was given by employer on his 25th wedding anniversary.
- Music System purchased on 01.04.2015 by the company for Rs. 85,000 and was given to him for personal use.
- Two old heavy goods vehicles owned by him were leased to a transport company against the fixed charges of Rs. 6,500 p.m. Books of account are not maintained.
- Received interest of Rs. 5,860 on bank FDRs, dividend of Rs. 1,260 from shares of Indian Companies and interest of Rs. 7,540 from the debentures of Indian Companies.
- Made payment by cheques of Rs. 15,370 towards premium of Life Insurance policies and Rs. 12,500 for Mediclaim Insurance policy.
- Invested in NSC Rs. 30,000 and in FDR of SBI for 5 years Rs. 50,000.
- Donations of Rs. 11,000 to an institution approved u/s 80G and of Rs. 5,100 to Prime Minister's National Relief Fund were given during the year by way of cheque.

Compute the total income and tax payable thereon for the A.Y. 2016-17. (10 Marks)

- (b) Compute the service tax payable on the services provided in each of the following independent cases:-

Services	Rs.
Sale of space for advertisement in a leading newspaper	55,000
Services related to preparation of advertisement	65,000
Sale of space for advertisements on internet websites	50,000
Sale of time for advertisement to be broadcast on TV Channel	1,00,000
Advertising in business directories	25,000
Advertising on film screen in theatres	90,000

Note: All the amounts stated above are exclusive of service tax. Ignore exemption available to small service providers. (6 Marks)

- (c) Compute the CENVAT credit available with Keshavam Services Ltd. in respect of the following services availed by it in the month of August, 2015:-

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)

2. (a) Mr. Rajat, a sole proprietor, has one unit at Special Economic Zone (SEZ) and another unit at Domestic Tariff Area (DTA). The following are the details of the sole proprietorship for the previous year 2015-16.

Particulars	Mr. Rajat (Rs.)	Unit in DTA (Rs.)
Total Sales	9,00,00,000	3,00,00,000
Export Sales	4,80,00,000	2,20,00,000
Net Profit	1,20,00,000	30,00,000

Calculate the eligible deduction under section 10AA of the Income-tax Act, 1961, for the Assessment Year 2016-17, in the following situations:

- (i) If both the units were set up and start manufacturing from 18-08-2009.
(ii) If both the units were set up and start manufacturing from 23-09-2013. (8 Marks)

- (b) Calculate the assessable value and the excise duty payable from the following particulars:

	Rs.
(i) Total invoice price (inclusive of taxes)	55,000
(ii) State VAT	5,500
(iii) Insurance charges for dispatch of final product	275
(iv) Packing charges	1,200
(v) Outward freight beyond the place of removal	2,100

Charges mentioned in (ii) to (v) are included in (i) above. Excise duty rate is 12.5%. An exemption notification grants exemption of 50% of the duty payable on this product. (5 Marks)

- (c) Narayan has given his tempos on hire to Shiv Brothers for transportation of food stuff for Rs. 14,00,000. He has also transferred the right to use such tempos to Shiv Brothers. Narayan has not paid any service tax on the consideration so received. Discuss whether Narayan is liable to pay service tax on the said transaction. (3 Marks)
3. (a) Mr. Chauhan, a resident individual, furnishes the following particulars of his income and other details for the previous year 2015-16.

		Rs.
(1)	Income from Salary	70,000
(2)	Loss from house property (Computed)	25,000
(3)	Business loss	40,000
(4)	Long term capital gain on sale of land	82,700
(5)	Loss on maintenance of race horses	21,000
(6)	Loss from gambling	12,100

The other details of unabsorbed depreciation and brought forward losses pertaining to Assessment Year 2015-16 are as follows:

		Rs.
(1)	Unabsorbed depreciation	20,000
(2)	Loss from Speculative business	22,000
(3)	Short term capital loss	9,700

Compute the Gross total income of Mr. Chauhan for the Assessment Year 2016-17 and the amount of loss, if any, that can be carried forward or not. (8 Marks)

(b) Balaji India Pvt. Ltd.'s total inter-State sales @ 4 % CST for the current financial year is Rs.1,50,00,000 (CST not shown separately). In this regard, following additional information is available:

- (i) Goods sold to Mr. A for Rs.1,50,000, on 16.07.2015 were returned by him on 12.12.2015.
- (ii) A buyer, Mr. B, to whom goods worth Rs.55,000 were dispatched on 16.04.2015, rejected such goods. The said goods were received back on 15.11.2015.
- (iii) Goods sold to Mr. C for Rs.5,00,000, on 16.04.2015 were returned by him on 12.12.2015.

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

(4 Marks)

(c) 'Service tax cannot be paid provisionally'. Examine the correctness of the statement.

(4 Marks)

4. (a) Mr. Dhruv is a co-owner of a house property along with his brother holding equal share in the property.

Particulars	Rs.
Municipal value of the property	1,60,000
Fair rent	1,50,000
Standard rent under the Rent Control Act	1,70,000
Rent received	15,000 p.m.

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. 450. To repay this loan, Dhruv and his brother have taken a fresh loan and interest charged on this loan is Rs. 5,000.

The municipal taxes of Rs. 5,100 have been paid by the tenant.

Compute the income from this property chargeable in the hands of Mr. Dhruv for the A.Y. 2016-17.

(4 Marks)

(b) Discuss, on the basis of the provisions of Income-tax Act, 1961 as amended by the Finance Act, 2015, the correctness or otherwise of the following statements:

- (i) Where new plant and machinery acquired during the P.Y. 2015-16 is put to use for less than 180 days in that year, additional depreciation allowable under section 32(1)(ia) for A.Y.2016-17 is restricted to 10% (i.e., 50% of 20%). The balance additional depreciation cannot be claimed in future.

- (ii) A manufacturing company set up in Vaishali, a notified backward area in the State of Bihar, acquires and installs new plant and machinery for Rs. 30 crores in the P.Y. 2015-16. For A.Y.2016-17, it is entitled to deduction either under section 32AC or section 32AD, but not both. (4 Marks)
- (c) The following particulars are provided by Mr. Ganesh of Calcutta, who has purchased raw materials and other materials for manufacturing PVC Cans and PVC Pipes. The applicable State VAT rate and CST rate for raw materials and other materials is 12.5% and 2% respectively.

S. No.	Particulars	Rs.
1.	Purchase of raw materials [exclusive of tax]	1,00,000
2.	Purchase of other materials [exclusive of taxes]	
	-- Local	20,000
	-- Inter-State purchases	40,000
3.	Manufacturing expenses	39,200
4.	Profit margin (on Sale Value)	20%

Mr. Ganesh manufactured 75% of production as PVC cans and 25% of production as PVC pipes. While PVC cans are subject to 12.5% VAT, PVC pipes are exempt. All materials were used in production and there was no closing stock of raw materials and other materials.

What would be the invoice value of sales charged by Mr. Ganesh if all the manufactured goods were sold within the State? What would be his net liability to VAT? (8 Marks)

5. (a) Examine the implications of tax deduction at source under section 194A in the cases mentioned hereunder, based on the provisions of the Income-tax Act, 1961, as amended by the Finance Act, 2015 –
- (i) On 1.10.2015, Mr. Vikas made a six-month fixed deposit of Rs. 12 lakh @ 8% p.a. with Tilak Co-operative Bank. The fixed deposit matures on 31.3.2016.
- (ii) On 1.4.2015, Ms. Sheetal started a 1 year recurring deposit of Rs. 20,000 per month @ 10% p.a. with Trilok Bank. The recurring deposit matures on 31.3.2016. (4 Marks)
- (b) State with reasons whether the following transactions attract income-tax in India in the hands of recipients for A.Y.2016-17:
- (i) Post office savings bank interest of Rs. 15,000 received by a resident assessee, Mr. Pranay.
- (ii) Legal charges of Rs. 5,00,000 paid in Delhi to a lawyer of Tokyo who visited India to represent a case at the Delhi High Court.

- (iii) Royalty paid by Mr. Harshit, a resident, to Mr. Darwin, a non-resident, in respect of a business carried on in Japan.
- (iv) Salary paid by Central Government to Mr. Aditya, a citizen of India Rs. 11,00,000 for the services rendered in UK. *(4 Marks)*
- (c) Govindam Co. is buying oil in drums of 200 liters. They pack this oil in small tins of one litre each, put their label giving details of contents, volume and MRP. Advise whether Govindam Co. are liable to pay excise duty on small tins sold by them. *(4 Marks)*
- (d) The value of taxable services determined by the person responsible to pay service tax cannot be rejected by the Department. Examine the validity of the statement. *(4 Marks)*
6. (a) Mr. Raman, aged 55 years owned a Residential House in Kanpur. It was acquired by Mr. Raman on 10-10-1986 for Rs. 6,00,000. He sold it for Rs. 53,00,000 on 4-11-2015. The stamp valuation authority of the State fixed value of the property at Rs. 65,00,000. The assessee paid 2% of the sale consideration as brokerage on the sale of the said property.
- Mr. Raman acquired a residential house property at Meerut on 10-12-2015 for Rs. 7,00,000 and deposited Rs. 3,00,000 on 10-4-2016 and Rs. 5,00,000 on 15-6-2016 in the capital gains bonds of Rural Electrification Corporation Ltd. He deposited Rs. 4,00,000 on 6-7-2016 and Rs. 3,00,000 on 1-11-2016 in the capital gain deposit scheme in a Nationalized Bank for construction of an additional floor on the residential house property in Meerut.
- Compute the Capital Gain chargeable to tax for the Assessment Year 2016-17 and income-tax chargeable thereon assuming Mr. Raman has no other income.
- Cost Inflation Index for Financial Year 1986-87: 140 and Financial Year 2015-16: 1081 *(8 Marks)*
- (b) An importer has imported a machinery to be used for providing a taxable service. The assessable value of imported machinery as approved by customs is Rs. 1,00,000. Customs duty payable is 10%. If the machinery is manufactured in India, excise duty @ 12.5% is leviable on such machinery. Education cess and secondary and higher education cess are as applicable. Special CVD is payable on said machinery @ 4%. You are required to:-
- (i) calculate the total customs duty payable.
- (ii) examine whether the importer can avail any CENVAT credit? If yes, how much credit can he avail? *(8 Marks)*

7. (a) Explain with brief reasons whether the return of income can be revised under section 139(5) of the Income-tax Act, 1961 in the following cases:
- (i) Belated return filed under section 139(4).
 - (ii) Return already revised once under section 139(5).
 - (iii) Return of loss filed under section 139(3). *(6 Marks)*
- (b) Specify the persons who are authorized to verify under section 140, the return of income filed under section 139 of the Income-tax Act, 1961 in the case of:
- (i) Political party
 - (ii) Local authority *(2 Marks)*
- (c) Mr. X rendered a taxable service on 05.06.2015. The date of issue of invoice was 01.07.2015. He had received the payment for the same on 20.08.2015. The aggregate value of services provided by Mr. X in the preceding financial year was Rs. 60 lakh.
- Determine the point of taxation in the above case.
- Will your answer be different if the aggregate value of services provided by Mr. X in the preceding financial year was Rs. 40 lakh? *(4 Marks)*
- (d) An individual acts as a referee in a football match organized by Sports Authority of India. He has also acted as a referee in another charity football match organized by a local sports club, in lieu of a lump sum payment. Discuss whether he is required to pay any service tax. *(4 Marks)*

MOCK TEST PAPER- 2
INTERMEDIATE (IPC) – GROUP – I
PAPER – 4: TAXATION
SUGGESTED ANSWERS/HINTS

1. (a) Computation of Total Income for the A.Y. 2016- 17

Particulars	Rs.	Rs.
Income from Salaries		
Basic Salary (Rs.15,000 x 12)		1,80,000
Dearness Allowance (Rs.12,000 x12)		1,44,000
Commission on Turnover (0.5% of Rs.50 lacs)		25,000
Bonus		50,000
Gratuity (Note 1)		30,000
Employer's contribution to recognized provident fund		
Actual contribution [20% of Rs.1,80,000]	36,000	
Less: Exempt (Note 2)	<u>33,240</u>	2,760
Interest credited in recognized provident fund account @15% p.a.	15,000	
Less: Exempt upto 9.5% p.a.	<u>9,500</u>	5,500
Gift of gold ring worth Rs.10,000 on 25 th wedding anniversary by employer (See Note 3)		10,000
Perquisite value of music system given for personal use (being 10% of actual cost) i.e. 10% of Rs.85,000		<u>8,500</u>
		4,55,760
Profits and Gains of Business or Profession		
Lease of 2 trucks on contract basis against fixed charges of Rs.6,500 p.m. In this case, presumptive tax provisions of section 44AE will apply i.e. Rs.7,500 p.m. for each of the two trucks (7,500 x 2 x12). He cannot claim lower profits and gains since he has not maintained books of account.		1,80,000
Income from Other Sources		
Interest on bank FDRs	5,860	

Interest from debentures	7,540	
Dividend on shares [Exempt under section 10(34)]	<u>Nil</u>	<u>13,400</u>
Gross total Income		6,49,160
<i>Less: Deductions under Chapter VI-A</i>		
Section 80C		
Premium on life insurance policy	15,370	
Investment in NSC	30,000	
FDR of SBI for 5 years	50,000	
Employee's contribution to recognized provident fund	<u>30,000</u>	1,25,370
Section 80D - Medclaim Insurance		12,500
Section 80G (Note 4)		<u>10,600</u>
Total Income		5,00,690
Tax on total income		
Income-tax		25,138
Add: Education cess @ 2%		503
Add: Secondary and higher education cess @ 1%		<u>251</u>
Total Tax Payable		25,892
Tax Payable (rounded off)		25,890

Notes:

1. Gratuity received during service is fully taxable.
2. Employer's contribution in the recognized provident fund is exempt up to 12% of the salary i.e. 12% of (Basic Salary + DA for retirement benefits + Commission based on turnover)
= 12% of (Rs.1,80,000+ (50% of Rs.1,44,000)+ Rs.25,000)
= 12% of 2,77,000 = Rs.33,240
3. An alternate view possible is that only the sum in excess of Rs.5,000 is taxable in view of the language of *Circular No.15/2001 dated 12.12.2001* that such gifts upto Rs.5,000 in the aggregate per annum would be exempt, beyond which it would be taxed as a perquisite. As per this view, the value of perquisite would be Rs. 5,000. In such a case the Income from Salaries would be Rs. 4,50,760.

4. Deduction under section 80G is computed as under:

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

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

- (b) As per section 66D(g) of the Finance Act, 1994, selling of space for advertisements in print media is included in the negative list of services. In other words, advertisement in all media except print media is liable to service tax. Therefore, sale of space for advertisements on internet websites, sale of time for advertisement to be broadcast on TV Channel and advertising on film screen in theatres are liable to service tax.

Further, definition of print media specifically excludes business directories. Therefore, advertising in business directories attracts service tax.

Services related to preparation of advertisement are liable to service tax as they are not included in the negative list.

Computation of service tax payable

Services	Value of service (Rs.)	Service tax @ 14.5% (Rs.)
Sale of space for advertisement in a leading newspaper	55,000	Nil
Services related to preparation of advertisement	65,000	9,425
Sale of space for advertisements on internet websites	50,000	7,250
Sale of time for advertisement to be broadcast on TV Channel	1,00,000	14,500
Advertising in business directories	25,000	3,625
Advertising on film screen in theatres	90,000	13,050

(c) **Computation of CENVAT credit available with Keshavam 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]	<u>Nil</u>
Total CENVAT credit available	<u>15,50,000</u>

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 servicesHence, 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.
2. (a) As per section 10AA, in computing the total income of Mr. Rajat from its unit located in a Special Economic Zone (SEZ), which begins to manufacture or produce articles or things or provide any services during the previous year relevant to the assessment year commencing on or after 01.04.2006, there shall be allowed a deduction of 100% of the profit and gains derived from export of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and 50% of such profits for further five assessment years subject to fulfillment of other conditions specified in section 10AA.

Computation of eligible deduction under section 10AA [See Working Note below]:

(i) If Unit in SEZ was set up and began manufacturing from 18-08-2009:

Since A.Y. 2016-17 is the 7th assessment year from A.Y. 2010-11, relevant to the previous year 2009-10, in which the SEZ unit began manufacturing of articles or things, it shall be eligible for deduction of 50% of the profits derived from export of such articles or things, assuming all the other conditions specified in section 10AA are fulfilled.

$$= \text{Profits of Unit in SEZ} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}} \times 50\%$$

$$= 90 \text{ lakhs} \times \frac{260 \text{ lakhs}}{600 \text{ lakhs}} \times 50\% = \text{Rs. 19.50 lakhs}$$

(ii) If Unit in SEZ was set up and began manufacturing from 23-09-2013:

Since A.Y.2016-17 is the 3rd assessment year from A.Y. 2014-15, relevant to the previous year 2013-14, in which the SEZ unit began manufacturing of articles or things, it shall be eligible for deduction of 100% of the profits derived from export of such articles or things, assuming all the other conditions specified in section 10AA are fulfilled.

$$= \text{Profits of Unit in SEZ} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}} \times 100\%$$

$$= 90 \text{ lakhs} \times \frac{260 \text{ lakhs}}{600 \text{ lakhs}} \times 100\% = \text{Rs. 39 lakhs}$$

The unit set up in Domestic Tariff Area is not eligible for the benefit of deduction under section 10AA in respect of its export profits, in both the situations.

Working Note:

Computation of total sales, export sales and net profit of unit in SEZ

Particulars	Mr. Rajat (Rs.)	Unit in DTA (Rs.)	Unit in SEZ (Rs.)
Total Sales	9,00,00,000	3,00,00,000	6,00,00,000
Export Sales	4,80,00,000	2,20,00,000	2,60,00,000
Net Profit	1,20,00,000	30,00,000	90,00,000

(b) Computation of assessable value and excise duty payable

Particulars	Rs.
Total invoice price (inclusive of taxes)	55,000
Less: State VAT (Note 1)	5,500
Insurance charges (Note 2)	275
Outward freight charges (Note 2)	<u>2,100</u>
Price-cum-duty (a)	47,125
Less: Excise duty [Rate of excise duty will be 50% of 12.5%, i.e. 6.25%] [Rs.47,125 × 6.25/106.25]	<u>2,772.06</u>
Excise duty (rounded off) (b)	2,772
Assessable value (a) – (b)	44,353

Notes:

1. Invoice price includes State VAT. Thus for calculating assessable value, deduction has been allowed for State VAT.
 2. Insurance charges for dispatch of final product and outward freight beyond the place of removal are allowed as deduction as the same are incurred after the place of removal.
 3. Since packing charges are includible in assessable value, deduction for the same has not been provided.
- (c) No, Narayan is not liable to pay service tax on the transaction entered into by him with Shiv Brothers. The transfer of tempos by way of hiring along with right to use is a deemed sales as per article 366(29A) of the Constitution of India. Charging section 66B of the Finance Act, 1994 stipulates that service tax is leviable on the value of all 'services' provided by one person to another. However, transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of article 366(29A) of the Constitution is specifically excluded from the definition of 'service' under section 65B(44) of the Finance Act, 1994.

Therefore, the transaction entered into by Narayan with Shiv Brothers is not chargeable to service tax. Instead, VAT is leviable on the same.

3. (a) Computation of Gross Total Income of Mr. Chauhan for the A.Y. 2016-17

Particulars	Rs.	Rs.
(i) Income from salary	70,000	
Less: Loss from house property (set-off as per section 71)	<u>25,000</u>	45,000
(ii) Capital gains		
Long term capital gain on sale of land	82,700	
Less: Set-off of business loss as per section 71	<u>40,000</u>	
	42,700	
Less: Set-off of brought forward short term capital loss [Short-term capital loss can be set-off against both short-term capital gains and long-term capital gains as per section 74(1)]	<u>9,700</u>	
	33,000	
Less: Unabsorbed depreciation (can be set-off against any head of income other than salaries)	<u>20,000</u>	<u>13,000</u>
Gross total income		<u>58,000</u>

Losses to be carried forward to A.Y.2017-18

	Particulars	Rs.
(1)	<p>Loss from speculative business [to be carried forward as per section 73]</p> <p>[Loss from a speculative business can be set off only against income from another speculative business. Since there is no income from speculative business in the current year, the entire loss of Rs.22,000 brought forward from A.Y.2015-16 has to be carried forward to A.Y. 2017-18 for set-off against speculative business income of that year. It may be noted that speculative business loss can be carried forward for a maximum of four years as per section 73(4), i.e., upto A.Y.2019-20]</p>	22,000
(2)	<p>Loss on maintenance of race horses [to be carried forward as per section 74A]</p> <p>[As per section 74A(3), the loss incurred in the activity of owning and maintaining race horses in any assessment year cannot be set-off against income from any other source other than the activity of owning and maintaining race horses. Such loss can be carried forward for a maximum of four assessment years i.e., upto A.Y.2020-21]</p>	21,000
(3)	Loss from gambling can neither be set-off nor be carried forward.	

Notes:

- (1) Section 71 permits set-off of losses incurred under one head against income earned under any other head of income. Therefore, loss from house property has been set-off against salary income.
- (2) However, there are certain exceptions contained in section 71 on inter-head set-off of losses. Business loss and unabsorbed depreciation cannot be set-off against salary income as per section 71(2A). However, there is no bar in setting-off the business loss and unabsorbed depreciation against long term capital gain. Hence, business loss and unabsorbed depreciation have been set off against long term capital gain.

(b) Computation of taxable turnover and tax liability of Balaji India Pvt. Ltd.

Particulars	Rs.
Total sales	1,50,00,000
Less: Goods returned by Mr. A (deductible as returned within 6 months)	1,50,000

Goods returned by Mr. C (not deductible since returned after six months)	Nil
Goods rejected by Mr. B after six months (Refer note below)	55,000
Sale price including CST	1,47,95,000
Less : Central sales tax $[1,47,95,000 \times \frac{4}{104}]$ (Rounded off)	5,69,038
Taxable turnover	1,42,25,962

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

- (d) The statement is not correct. If an assessee is, for any reason, unable to correctly estimate, at the time of the deposit, the actual amount payable for any month or quarter, he may make a written request to Assistant/Deputy Commissioner of Central Excise giving reasons for payment of service tax on provisional basis. On receipt of such request, the Assistant/Deputy Commissioner of Central Excise may allow payment of service tax on provisional basis on such value of taxable service as may be specified by the assessee for making payment of service tax on provisional basis. Provisions of Central Excise Rules, 2002 relating to provisional assessment apply in case of provisional payment of service tax also, except the provisions relating to execution of bond.

4. (a) **Computation of income from house property of Mr. Dhruv for A.Y. 2016-17**

Particulars	Rs.	Rs.
Gross Annual Value (See Note 1 below)		1,80,000
Less: Municipal taxes – paid by the tenant, hence not deductible		<u>Nil</u>
Net Annual Value (NAV)		1,80,000
Less: Deductions under section 24		
(i) 30% of NAV	54,000	
(ii) 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	<u>5,000</u>	<u>84,000</u>
Income from house property		<u>96,000</u>
50% share taxable in the hands of Shri Raman (See Note 3 below)		<u>48,000</u>

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.

Notes:

Particulars	Rs.	Rs.	Rs.	Rs.
(a) Municipal value of property	1,60,000			
(b) Fair rent	1,50,000			
(c) Higher of (a) and (b)		1,60,000		
(d) Standard rent		1,70,000		
(e) Expected rent [lower of (c) and (d)]			1,60,000	
(f) Actual rent [15,000 x 12]			1,80,000	
(g) Gross Annual Value [higher of (e) and (f)]				1,80,000

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 Mr. Dhruv since he is an equal owner of the property.

(b) (i) The statement is not correct.

As per the third proviso to section 32(1)(ii), 50% of the additional depreciation on new plant and machinery acquired and used for less than 180 days in the year of acquisition and installation which has not been allowed as deduction in that previous year, shall be allowed in the immediately succeeding previous year.

Hence, the balance additional depreciation of 10% (i.e. 50% of 20%) can be claimed in the immediately succeeding previous year i.e., P.Y. 2016-17

(ii) **The statement is not correct.**

If an undertaking is set up in any notified backward area in the states of Andhra Pradesh or Bihar or Telangana or West Bengal by a company, it shall be eligible to claim deduction under section 32AC as well as under section 32AD, if it fulfills the conditions specified in section 32AC and the conditions specified in section 32AD.

In the given case, a manufacturing company set up in Vaishali i.e., a notified backward area in the State of Bihar, acquires and installs new plant and machinery for Rs.30 crores in P.Y. 2015-16. Hence, it will be entitled to deduction under section 32AC (since the investment in new plant and machinery exceeds Rs.25 crores) as well as under section 32AD (since the undertaking is set-up in a notified backward area in the State of Bihar), assuming that it fulfills the other conditions specified thereunder.

(c) **Computation of invoice value of sales charged by Mr. Ganesh**

Particulars	PVC Cans (12.5% VAT)	PVC Pipes (Exempt)
	Rs.	Rs.
Raw materials	(75%) 75000	(25%) 25000
VAT paid on the same [Rs.1,00,000 x 12.5% = Rs.12,500]	NIL (Refer Note 2)	3125 (Refer Note 3)
Other materials - Local	15000	5000
VAT paid on the same [Rs.20,000 x 12.5% = Rs.2,500]	NIL (Refer Note 2)	625 (Refer Note 3)
Other materials – Inter-State purchases	30000	10000
CST paid on the same [Rs.40,000 x 2% = Rs.800] (Refer Note 4)	600	200
Manufacturing expenses	<u>29400</u>	<u>9800</u>
Cost of goods sold	150000	53750
Add: Profit is 20% on sales (i.e., 25% of cost)	37500	13438
Sale price	187500	67188
Add: VAT payable (rounded off to nearest rupee)	23438	NIL
Invoice value	210938	67188

Computation of Net VAT liability for PVC Cans

Particulars	Rs.
Output VAT	23438
Less : Input VAT = $[(12500 \times 75\%)+(2500 \times 75\%)]$ (Refer Note 5)	11250
Net VAT liability	12188

Notes:-

1. All the expenses have been apportioned in the ratio of 3:1 on pro-rata basis.
 2. Since PVC Cans are taxable goods, VAT paid on raw materials is allowed as input tax credit and thus, the same will not form part of total cost.
 3. Since PVC pipes are exempt goods, VAT paid on raw materials will not be allowed as input tax credit and thus, the same will form part of total cost.
 4. Input tax credit is not available on CST. Therefore it will form part of total cost.
 5. Input tax credit to the extent (75%) used in the production of taxable PVC Cans is allowed.
5. (a) (i) Tilak Co-operative Bank has to deduct tax at source @10% on the interest of Rs.48,000 $(8\% \times \text{Rs.}12 \text{ lakh} \times \frac{1}{2})$ under section 194A.
- (ii) Tax has to be deducted @ 10% under section 194A by Trilok Bank on the interest of Rs.13,000 (See Working Note below) falling due on recurring deposit on 31.3.2016 to Ms. Sheetal, since –
- (1) “recurring deposit” has been included in the definition of “time deposit”; and
 - (2) such interest exceeds the threshold limit of Rs.10,000.

Working Note:

Computation of Interest

$$= \text{Rs.}20,000 \times 10\% \times [(12+11+10+9+8+7+6+5+4+3+2+1)/12]$$

$$= \text{Rs.}2,000 \times (78/12)$$

$$= \text{Rs.}13,000$$

(b)

	Taxable/Not Taxable	Amount liable to tax (Rs.)	Reason
(i)	Partly Taxable	1,500	The interest on Post Office Savings Bank Account, would be exempt under section

			10(15)(i), only to the extent of Rs.3,500 in case of an individual account. Hence, Rs.11,500 will be taxable under the head "Income from other sources" and will form part of Gross Total Income. Rs.10,000, however, would be allowed as deduction under section 80TTA from Gross Total Income.
(ii)	Taxable	5,00,000	In case of a non-resident, any income which accrues or arises in India or which is deemed to accrue or arise in India or which is received in India or is deemed to be received in India is taxable in India. Therefore, legal charges paid in India to a non-resident lawyer of Tokyo, who visited India to represent a case at the Delhi High Court would be taxable in India.
(iii)	Not Taxable	-	Royalty paid by a resident to a non-resident in respect of a business carried in Japan, would not be taxable in the hands of the non-resident provided the same is not received in India. This has been provided as an exception to deemed accrual mentioned in section 9(1)(vi)(b).
(iv)	Taxable	11,00,000	As per section 9(1)(iii), salaries payable by the Government to a citizen of India for service rendered outside India shall be deemed to accrue or arise in India. Therefore, salary paid by Central Government to Mr. Aditya for services rendered in UK would be deemed to accrue or arise in India, since he is a citizen of India.

- (c) Mere repacking from large container to small pack is not 'manufacture' of oil as oil continues to be oil – no new product comes into existence having a distinct name, character or use. Hence, the activity is not 'manufacture' and excise duty is not payable.

However, if such oil is covered under section 4A of Central Excise Act, 1944 (RSP based valuation provisions), the activity of labelling will be 'deemed manufacture' and Govindam Co. will be liable to pay excise duty on such containers of one litre each.

- (d) No, the statement is not valid. As per rule 4 of the Service Tax (Determination of Value) Rules, 2006, the value determined by the person responsible to pay service tax can be rejected by the Central Excise Officer if he is of the opinion that the value

determined by such service provider is not in accordance with the provisions of the Finance Act, 1994 or these rules.

In such a situation, the Central Excise Officer shall issue a show cause notice and the service provider would then be required to show cause why the value of taxable service should not be fixed at the amount specified in such notice.

The Central Excise Officer, after giving such service provider an opportunity of being heard, will determine the value of such taxable service in accordance with the provisions of the Finance Act, 1994 and these rules.

6. (a) Computation of Capital Gains chargeable to tax in the hands of Mr. Raman for the A.Y. 2016-17

Particulars	Rs.	Rs.
Gross Sale Consideration on transfer of residential house [As per section 50C, in case the actual sale consideration is lower than the stamp duty value fixed by the stamp valuation authority, the stamp duty value shall be deemed as the full value of consideration]		65,00,000
Less: Brokerage@2% of actual sale consideration of Rs.53,00,000		<u>1,06,000</u>
Net Sale Consideration		63,94,000
Less: Indexed cost of acquisition [Rs.6,00,000 x 1081/140]		<u>46,32,857</u>
Long-term capital gain		17,61,143
Less: Exemption under section 54		
- Acquisition of residential house property at Meerut on 10.12.2015 (i.e., within the prescribed time of two years from 4.11.2015, being the date of transfer of residential house at Kanpur).	7,00,000	
- Amount deposited in Capital Gains Accounts Scheme on or before the due date of filing return of income for construction of additional floor on the residential house property at Meerut. Since Mr. Raman has no other source of income, his due date for filing return of income is 31 st July, 2016	<u>4,00,000</u>	11,00,000
[Therefore, Rs.4,00,000 deposited on 6.7.2016 will be eligible for exemption whereas Rs.3,00,000 deposited on 1.11.2016 will not be eligible for exemption under section 54]		
Exemption under section 54EC		

Amount deposited in capital gains bonds of RECL within six months from the date of transfer (i.e., on or before 3.5.2016) would qualify for exemption. [Therefore, in this case, Rs.3,00,000 deposited in capital gains bonds of RECL on 10.4.2016 would be eligible for exemption under section 54EC, whereas Rs.5,00,000 deposited on 15.6.2016 would not qualify for exemption]	<u>3,00,000</u>
Long-term capital gain	3,61,143

Computation of tax liability of Mr. Raman for A.Y. 2016-17

Particulars	Rs.
Tax on Rs.1,11,143 (i.e. Long term capital gain Rs.3,61,143 less basic exemption limit of Rs.2,50,000) is charged @ 20% [Section 112] (Since long-term capital gains is the only source of income, the entire basic exemption limit can be exhausted against this income)	22,229
Less: Rebate under section 87A	<u>2,000</u>
	20,229
Add: Education cess@2% and Secondary & higher education cess @ 1%	<u>607</u>
Total tax liability	20,836
Total tax liability (rounded off)	20,840

Note: As per the decision of Gauhati High Court in *CIT vs Rajesh Kumar Jalan 286 ITR 274* and Haryana High Court in *CIT vs Jagriti Agarwal 245 CTR 629*, exemption under section 54 is allowable even if the amount of capital gain is deposited in Capital Gains Accounts Scheme within the period specified for filing a belated return under section 139(4) [i.e., on or before 31.3.2018, being one year from the end of A.Y.2016-17].

If we apply the above interpretation in this case, Mr. Raman would be eligible for exemption under section 54 in respect of Rs.3,00,000 deposited in Capital Gains Accounts Scheme on 01.11.2016 also, since the said date falls within the time specified under section 139(4). On the basis of this interpretation, the long term capital gain chargeable to tax in the hands of Mr. Raman would be Nil and the consequent tax liability would also be Nil.

(b) Computation of customs duty payable

Particulars	Duty %	Rs.	Duty Rs.
Assessable value		1,00,000	
Basic customs duty	10	10,000.00	10,000.00
Sub-Total for calculating CVD		1,10,000.00	

CVD (Rs.1,10,000 x excise duty rate)	12.5	13,750.00	13,750.00
Sub-total for education cess on customs (Rs.10,000 + Rs.13,750)		23,750.00	
Education cess of customs	2	475.00	475.00
Secondary and Higher Education cess of customs	1	237.50	237.50
Sub-total for Special CVD (Rs.1,00,000 + Rs.10,000 +Rs.13,750 + Rs.475 + Rs.237.50)		1,24,462.50	
Special CVD u/s 3(5)	4	4,978.50	<u>4,978.50</u>
Total customs duty			<u>29,441.00</u>
Customs duty payable			29,441

Since importer is a service provider, he can avail CENVAT credit of only CVD i.e. only of Rs.13,750 and not of special CVD.

7. (a) Any person who has furnished a return under section 139(1) or in pursuance of a notice issued under section 142(1) can file a revised return if he discovers any omission or any wrong statement in the return filed earlier. Accordingly,
- (i) A belated return filed under section 139(4) cannot be revised. Only a return furnished under section 139(1) or in pursuance of a notice issued under section 142(1) can be revised.
- (ii) A return revised earlier can be revised again as the first revised return replaces the original return. Therefore, if the assessee discovers any omission or wrong statement in such a revised return, he can furnish a second revised return within the prescribed time i.e. within one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier.
- (iii) A return of loss filed under section 139(3) is deemed to be return filed under section 139(1), and therefore, can be revised under section 139(5).
- (b) The following persons (mentioned in Column III below) are authorised as per section 140, to verify the return of income filed under section 139:

I	II	III
(i)	Political party	Chief Executive Officer of such party (whether known as secretary or by any other designation).
(ii)	Local authority	Principal Officer thereof.

- (c) As per rule 6 of the Service Tax Rules, 1994, in case of individuals and partnership firms whose aggregate value of taxable services provided from one or more premises is Rs.50 lakh or less in the previous financial year, the service provider

has the option to pay tax on taxable services provided or agreed to be provided by him upto a total of Rs.50 lakh in the current financial year on receipt basis. Since in the present case, aggregate value of services provided by Mr. X in the preceding financial year was Rs.60 lakh, he cannot exercise the said option.

Resultantly, he is required to pay service tax in accordance with Point of Taxation Rules, 2011(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 (01.07.2015), or
- (ii) date of receipt of payment (20.08.2015),

whichever is earlier.

Thus, point of taxation, in the given case, is date of invoice, i.e., 01.07.2015.

However, if the aggregate value of services provided by Mr. X in the preceding financial year was Rs.40 lakh, he has the option to pay tax on taxable services provided or agreed to be provided by him upto a total of Rs.50 lakh in the current financial year on receipt basis. In that case, point of taxation will be 20.08.2015.

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

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