

PAPER – 1: ACCOUNTING

PART – I: ANNOUNCEMENTS STATING APPLICABILITY & NON-APPLICABILITY
FOR MAY, 2014 EXAMINATION

A. Applicable for May, 2014 examination

Revision in the Criteria for classifying Level II Non-Corporate Entities

Due to recent changes in the enhancement of tax audit limit, the Council of the ICAI has recently decided to change the 1st criteria of Level II Non-Corporate Entities i.e. determination of SME on turnover basis from ₹ 40 lakhs to ₹ 1 Crore vide announcement "Revision in the Criteria for classifying Level II Non-Corporate Entities" issued by ICAI on 7th March, 2013. This revision is applicable with effect from the accounting year commencing *on or after April 1, 2012*.

B. Not applicable for May, 2014 examination

Ind ASs issued by the Ministry of Corporate Affairs

The MCA has hosted on its website 35 converged Indian Accounting Standards (Ind AS) without announcing the applicability date. These are the standards which are being converged by eliminating the differences of the Indian Accounting Standards vis-à-vis IFRS. These standards shall be applied for all companies falling under Phase I to Phase III as prescribed under the roadmap issued by the core group. **These Ind ASs are not applicable for the students appearing in May, 2014 Examination.**

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Financial Statements of Companies

1. The following balance appeared in the books of Oliva Company Ltd. as on 31-03-2014.

Particulars		₹	Particulars		₹
Inventory 01-04-2013			Sales		17,10,000
-Raw Material	30,000		Interest		3,900
-Finished goods	<u>46,500</u>	76,500	Profit and Loss A/c		45,000
Purchases		12,15,000	Share Capital		3,15,000
Manufacturing Expenses		2,70,000	Loans: Short-term	4,500	
Salaries and wages		40,200	Long-term	<u>21,000</u>	25,500
General Charges		16,500	Unclaimed Dividend		3,000
			Deposits:		

Dividend for 2012-13		27,000	Short -Term	1,500	
Building		1,01,000	Long -term	<u>3,300</u>	4,800
Plant and Machinery		70,400	Trade payables		3,27,000
Furniture		10,200			
Motor Vehicles		40,800			
Stores and Spare Parts Consumed		45,000			
Investments:					
Current	4,500				
Non Current	<u>7,500</u>	12,000			
Trade receivables		2,38,500			
Cash in Bank		<u>2,71,100</u>			
		<u>24,34,200</u>			<u>24,34,200</u>

From the above balance and the following information, prepare the company's Profit and Loss Account for the year ended 31st March, 2014 and Company's Balance Sheet as on that date:

- Inventory on 31st March, 2014 Raw material ₹ 25,800 & finished goods ₹ 60,000.
- Outstanding Expenses: Manufacturing Expenses ₹ 67,500 & Salaries & Wages ₹ 4,500.
- Interest accrued on Securities ₹ 300.
- General Charges prepaid ₹ 2,490.
- Provide depreciation: Building @ 2% p.a., Machinery @ 10% p.a., Furniture @ 10% p.a. & Motor Vehicles @ 20% p.a.
- Current maturity of long term loan is ₹ 1,000.
- The Taxation provision of 40% on net profit is considered.

Cash Flow Statements

- 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 (₹)	Credit (₹)
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 ₹ 54,000 against which Depreciation Provision of ₹ 40,500 was lying was sold for ₹ 21,000.
- During the middle of the year, ₹ 1,50,000 Debentures were issued for cash at a discount of ₹ 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 ₹ 2,11,500 during the year end, ignore taxation.

Profit or Loss Pre and Post Incorporation

3. From the following information, calculate the ratio of Sales in each case separately.
- (a) (i) Date of acquisition – 1st April, 2013; date of incorporation – 1st July, 2013 and date of closing the books of accounts – 31st March, every year.
- (ii) The sales for the year ending on 31st March, 2014 were ₹ 24,00,000 of which ₹ 4,80,000 goods were sold during the first six months of the accounting period.
- (b) (i) The accounts were made up to 31st December, 2013. The company was incorporated on 1st May, 2013 to take over a business from the preceding 1st January.
- (ii) Total sales for the year were ₹ 12,00,000. It is ascertained that the sales for November and December are one and half times the average of those for the year, whilst those for February and April are only half the average.
- (c) (i) Hello Ltd. was incorporated on 1st July, 2013 to take the existing business of X

from 1st April, 2013. Date of closing the books of account – 31st March, 2014.

- (ii) Monthly sales in April 2013, February 2014 and March 2014 are double the average monthly sales for remaining months of the year.

Accounting for Bonus Issue

4. Following is the extract of the Balance Sheet of Preet Ltd. as at 31st March, 2014

Authorised capital:	₹
15,000 12% Preference shares of ₹ 10 each	1,50,000
1,50,000 Equity shares of ₹ 10 each	<u>15,00,000</u>
	<u>16,50,000</u>
Issued and Subscribed capital:	
12,000 12% Preference shares of ₹ 10 each fully paid	1,20,000
1,35,000 Equity shares of ₹ 10 each, ₹ 8 paid up	10,80,000
Reserves and surplus:	
General Reserve	1,80,000
Capital Reserve	1,12,500
Securities premium	37,500
Profit and Loss Account	3,00,000

On 1st April, 2014, the Company has made final call @ ₹ 2 each on 1,35,000 equity shares. The call money was received by 20th April, 2014. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held. Capital reserves include ₹ 60,000, being profit realized on sale of plant and machinery.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 30th April, 2014 after bonus issue.

Internal Reconstruction of a Company

5. The ledger balance of Casio Ltd. as on 31st March, 2014 are:

Profit & loss account (Dr.) balance 10,20,000, Fixed Assets ₹ 7,00,000, Investment ₹ 10,000, Inventory ₹ 3,90,000 Trade receivables ₹ 4,60,000. Equity Share Capital (60% paid) ₹ 6,00,000, 10% First Debentures ₹ 2,00,000, 12% Second Debentures ₹ 5,00,000, Bank overdraft ₹ 50,000, Trade payables (including Y for ₹ 8,50,000) ₹ 11,50,000, Outstanding interest for one year on both type of debentures.

Due to heavy losses, the following scheme of re-construction is agreed:

- (a) To make the existing ₹ 100 equity shares fully paid up and then to reduce them to ₹ 20 each.

- (b) To settle the claims of first Debenture-holders by issuing 2,000, 13.5% Debentures of ₹ 100 each.
- (c) To discharge the claims of the second debenture-holders by issuing 15% 4,000 debentures of ₹ 100 each.
- (d) To pay ₹ 3,00,000 to Mr. Y in full settlement of his account,
- (e) To allot 15,000 fresh equity shares of ₹ 20 each to discharge the remaining trade payables,
- (f) Market value of investments is ₹ 20,000, and
- (g) To reduce the value of fixed assets.

Assuming all formalities are duly complied with, pass journal entries to give effect to the above scheme and prepare the post-reconstruction Balance Sheet.

Amalgamation of Companies

6. Alia Limited was wound up on 31.3.2014 and its draft Balance Sheet as on that date was given below:

Balance Sheet of Alia Limited as on 31.3.2014

<i>Liabilities</i>	₹	<i>Assets</i>		₹
Share capital: 60,000 Equity shares of ₹ 10 each	6,00,000	Fixed assets		4,82,000
Reserves and surplus:		Current assets:		
Contingency reserve	1,56,000	Inventory	3,87,500	
Profit and loss A/c	1,26,000	Trade receivables	91,000	
Current liabilities:		Cash at bank	<u>1,64,500</u>	6,43,000
Trade payables	1,33,000			
Provisions:				
Provision for income tax	<u>1,10,000</u>			
	<u>11,25,000</u>			<u>11,25,000</u>

Details of Trade receivables and Trade payables:

Trade Receivables			
Sundry debtors	80,000		
Less: Provision for bad and doubtful debts	<u>4,000</u>	76,000	
Bills receivable		<u>15,000</u>	91,000

Trade payables			
Sundry creditors		1,13,000	
Bills payable		<u>20,000</u>	1,33,000

Burger Limited took over the following assets at values shown as under:

Fixed assets ₹ 6,40,000, Inventory ₹ 3,85,000 and Bills Receivable ₹ 15,000.

Purchase consideration was settled by Burger Limited: ₹ 2,55,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of ₹ 100 each. The balance was settled by issuing equity shares of ₹ 10 each at ₹ 8 per share paid up.

Sundry debtors realised ₹ 75,000. Bills payable was settled for ₹ 19,000. Income tax authorities fixed the taxation liability at ₹ 1,11,000.

Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to ₹ 4,000.

You are required to:

- Calculate the number of equity shares and preference shares to be allotted by Burger Limited in discharge of purchase consideration.
- Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Burger Limited account in the books of Alia Limited.
- Pass journal entries in the books of Burger Limited.

Average Due Date

7. 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	
	₹		₹
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.

Account Current

8. From the following prepare an account current, as sent by A to B on 30th June, 2012 by means of products method charging interest @ 6% p.a:

2012		₹
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

Self – Balancing Ledgers

9. From the following particulars, prepare Total Debtors Account in the general ledger:

Balance as on 1-4-2013	Dr. (₹)	Cr.(₹)
Sundry Debtors	20,000	300

Transactions during April, 2013	₹
Sales (including cash ₹ 6,000)	25,000
Cash received from customers (in full settlement of claims of ₹15,000)	14,100
Bills receivable received	3,000
Bills receivable endorsed	800
Endorsed B/R dishonoured	300
B/R discounted	1,400
Bills receivable dishonoured	400
Interest charged on dishonoured B/R	30
Transfer from Debtors Ledger to Creditors Ledger	600
Balance as on 30-4-2013	
Sundry Debtors (Cr.)	450

Financial Statements of Not-For-Profit Organizations

10. The accountant of Tiger Club gave the following information about the receipts and payments of the club for the year ended 31st March, 2014:

Receipts:	₹
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 ₹ 18,000)	75,600

The following additional information could be obtained:-

	1.4.2013	31.3.2014
	₹	₹
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 ₹ 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 31.3.2014.

Accounts from Incomplete Records

11. Mr. Hemant had ₹ 1,65,000 in the bank account on 1.1.2013 when he started his business. He closed his accounts on 31st March, 2014. His single entry books (in which he did not maintain any account for the bank) showed his position as follows:

	31.3.2013 ₹	31.3.2014 ₹
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 1.2.2013, he began drawings ₹ 385 per month for his personal expenses from the cash box of the business. His account with the bank had the following entries:

	<i>Deposits</i> ₹	<i>Withdrawals</i> ₹
1.1.2013	1,65,000	-
1.1.2013 to 31.3.2013		1,22,650
1.4.2013 to 31.3.2014	1,26,500	1,48,500

The above withdrawals included payment by cheque of ₹ 1,10,000 and ₹ 33,000 respectively during the period from 1.1.2013 to 31.3.2013 and from 1.4.2013 to 31.3.2014 respectively for the purchase of machineries for the business. The deposits after 1.1.2013 consisted wholly of sale price received from the customers by cheques.

Draw up Mr. Hemant's statement of affairs as at 31.3.2013 and 31.3.2014 respectively and work out his profit or loss for the year ended 31.3.2014.

Hire -Purchase

12. Computer point sells computers on Hire-purchase basis at cost plus 25%. Terms of Sale are ₹5,000 down payment and eight monthly instalments of ₹2,500 for each computer.

Two Computers on which five instalments were due and two instalments not yet due were repossessed out of Sales effected during current year. Repossessed inventory is valued at 50% of cost. Calculate the value of repossessed computers.

Investment Accounts

13. Alpha Ltd. purchased 5,000, 13.5% Debentures of Face Value of ₹ 100 each of Pergot Ltd. on 1st May 2013 @ ₹ 105 on cum interest basis. The interest on these instruments is payable on 31st & 30th of March & September respectively. On August 1st 2013 the company again purchased 2,500 of such debentures @ ₹ 102.50 each on cum interest

basis. On October 1st, 2013 the company sold 2,000 Debentures @ ₹ 103 each. The market value of the debentures as at the close of the year was ₹ 106. Prepare the Debenture Investment Account in the books of Alpha Ltd. for the year ended 31st Dec. 2013 on Average Cost Basis.

Insurance Claim

14. A fire engulfed the premises of a business of M/s Preet on the morning of 1st July 2013. The building, equipment and stock were destroyed and the salvage recorded the following:

Building – ₹ 4,000; Equipment – ₹ 2,500; Stock – ₹ 20,000. The following other information was obtained from the records saved for the period from 1st January to 30th June 2013:

	₹
Sales	11,50,000
Sales Returns	40,000
Purchases	9,50,000
Purchases Returns	12,500
Cartage inward	17,500
Wages	7,500
Stock in hand on 31 st December, 2012	1,50,000
Building (value on 31 st December, 2012)	3,75,000
Equipment (value on 31 st December, 2012)	75,000
Depreciation provision till 31 st December, 2012 on:	
Building	1,25,000
Equipment	22,500

No depreciation has been provided since December 31st 2012. The latest rate of depreciation is 5% p.a. on building and 15% p.a. on equipment by straight line method.

Normally business makes a profit of 25% on net sales. You are required to prepare the statement of claim for submission to the Insurance Company.

Partnership: Retirement of a partner

15. On 31st March, 2014, the Balance Sheet of A, B and C sharing profits and losses in proportion to their Capital stood as below:

<i>Liabilities</i>	₹	<i>Assets</i>	₹
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, 2014, 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 ₹ 20,000.
- (iv) Old credit balances of Sundry creditors, ₹ 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 ₹ 15,100.
- (vii) Goodwill of the entire firm is valued at ₹ 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 1.04.2014.

Accounting in Computerized Environment

16. "Prepackaged accounting software is required to be selected intelligently". Explain the statement in brief.

Applicability of AS

17. (a) 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 ₹ 12 crores and borrowings of ₹ 5 crores.
 - (ii) B Pvt. Ltd., has a turnover of ₹ 45 crores, other income of ₹ 7 crores and bank borrowings of ₹ 9 crores.

AS 1 "Disclosure of Accounting Policies"

- (b) Omega Ltd. projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 2013. 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 ₹ 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 ₹ 27 crores is lower than the amount of ₹ 45 crores which would have been provided had the old method been followed, by ₹ 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 ₹ 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 2012-2013.

AS 2 "Valuation of Inventories"

- (c) Alpha Ltd. sells beer to customers; some of the customers consume the beer in the bars run by Alpha 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'?

AS 6 "Depreciation Accounting"

18. (a) An item of machinery was purchased on 1-4-2012 for ₹ 2,00,000. The WDV depreciation rate applicable to the machinery was 15%. The written down value of the machinery as on 31-3-2014 was ₹ 1,44,500. On 1-4-2014, the enterprise decided to change the method from written down value (WDV) to straight line method (SLM). The enterprise decided to write off the book value of ₹ 1,44,500, over the remaining useful life of machinery i.e. 5 years. Out of the total useful life of 7 years, 2 years have already elapsed. Comment, whether the accounting treatment is correct. If not, give the correct accounting treatment with reasons.

AS 7 “Construction Contracts

- (b) PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2014:

	(₹ crore)
Total Contract Price	2,400
Work Certified	1,250
Work pending certification	250
Estimated further cost to completion	1,750
Stage wise payments received	1,100
Progress payments in pipe line	300

Using this data and applying the relevant Accounting Standard you are required to:

- Compute the amount of profit/loss for the year ended 31st March, 2014.
- Arrive at the contract work in progress as at the end of financial year 2013-14.
- Determine the amount of revenue to be recognized out of the total contract value

AS-9 “Revenue Recognition”

19. (a) A Ltd. has sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 2014, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

AS 10 “Accounting for Fixed assets”

- (b) During the year 2013-14, P Limited incurred ₹ 2,50,000 as routine repairs and ₹ 75,000 on partial replacement of a part. ₹ 5,00,000 on replacement of part of machinery which will improve the efficiency of the machine. Which amount should be capitalized as per AS 10?

AS 13 “Accounting for Investment”

- 20 (a) X Ltd. on 1-1-2014 had made an investment of ₹ 600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2014 became ₹ 200 lakhs as X Ltd. lost a case of copyright. How will you recognize the reduction in financial statements for the year ended on 31-3-2014 assuming that this decline in value is not temporary in nature?

AS 14 "Accounting for Amalgamation"

- (b) X Co. Ltd. having share capital of ₹ 50 lakhs divided into equity shares of ₹ 10 each was taken over by Y Co. Ltd. Y Co. Ltd. issued 11 equity shares of ₹ 10 each for every 10 shares of X Co. Ltd. Explain how the difference will be adjusted in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interests method' of amalgamation as per AS 14.

SUGGESTED ANSWERS / HINTS

1. **Oliva Company Ltd.**
Statement of Profit and loss for the year ended 31.03.2014

(₹)

	Particulars	Note	Amount
I	Revenue from operations		17,10,000
II	Other income (3,900 +300)		<u>4,200</u>
III	Total Revenue (I +II)		<u>17,14,200</u>
IV	Expenses:		
	Cost of materials consumed	10	12,64,200
	Purchases of inventory-in-trade		--
	Changes in inventories of finished goods work-in-progress and inventory-in-Trade	11	(13,500)
	Employee benefit expenses	12	44,700
	Finance costs		--
	Depreciation and amortization expenses		18,240
	Other expenses	13	<u>3,51,510</u>
	Total Expenses		<u>16,65,150</u>
V	Profit before exceptional and extraordinary items and tax		49,050
VI	Exceptional items		--
VII	Profit before extraordinary items and tax		49,050
VIII	Extraordinary items		--
IX	Profit before tax		49,050
X	Tax expense (40% of 49,050)		19,620
XI	Profit/Loss for the period from continuing operation		29,430
XII	Profit/(Loss) from discontinuing operations		--

XIII	Tax expenses of discontinuing operations		--
XIV	Profit/(Loss) fro discontinuing operations (after tax)		--
XV	Profit (Loss) for the period		29,430

Oliva Company Ltd.
Balance Sheet for the year ended 31.03.2014

	Particulars	Note	Amount
1	Equity and Liabilities		
	(i) Shareholders' funds		
	(a) Share Capital		3,15,000
	(b) Reserves and surplus	1	47,430
2)	Non-current liabilities		
	(a) Long-term borrowings	2	23,300
(3)	Current Liabilities		
	(a) Short -term borrowings	3	6,000
	(b) Trade payables		3,27,000
	(c) Other current liability	4	76,000
	(d) Short term provision	5	<u>19,620</u>
			<u>8,14,350</u>
II	ASSETS		
(1)	Non current assets		
	(a) Fixed assets		
	(i) Tangible assets	6	2,04,160
	(b) Non-current investments		7,500
(2)	Current assets		
	(a) Current investments		4,500
	(b) Inventories	7	85,800
	(c) Trade receivables		2,38,500
	(d) Cash and cash equivalents		2,71,100
	(e) Short-term loans and advances	8	2,490
	(f) Other current assets	9	<u>300</u>
			<u>8,14,350</u>

Notes to accounts

No	Particulars		Amount	Amount
1.	Reserve & Surplus:			
	Profit & Loss Account : Balance b/f		45,000	
	Net Profit for the year		29,430	
	Less : Dividend 2012-13		<u>(27,000)</u>	47,430
2.	Long term borrowings:			
	Secured loans (21,000 less current maturities 1,000)		20,000	
	Fixed Deposits:- Unsecured		<u>3,300</u>	23,300
3.	Short term borrowings:			
	Secured loans		4,500	
	Fixed Deposits -Unsecured		<u>1,500</u>	6,000
4.	Other current liabilities			
	Unclaimed Dividend		3,000	
	Expenses Payable (67,500 + 4,500)		72,000	
	Current maturities of long term borrowings		<u>1,000</u>	76,000
5.	Short term provisions:			
	Provision for Income tax			19,620
6.	Fixed Assets: Tangible Assets			
	Building	1,01,000		
	Less: Depreciation	<u>2,020</u>	98,980	
	Plant & Machinery	70,400		
	Less: Depreciation	<u>7,040</u>	63,360	
	Furniture	10,200		
	Less: Depreciation	<u>1,020</u>	9,180	
	Motor vehicles	40,800		
	Less: Depreciation	<u>8,160</u>	<u>32,640</u>	2,04,160
7	Inventory:			
	Raw Material		25,800	
	Finished goods		<u>60,000</u>	85,800

8.	Short term Loans & Advances:			
	General Charges prepaid			<u>2,490</u>
9.	Other Current Assets:			
	Interest accrued		300	300
10.	Cost of material consumed:			
	Opening inventory of Material & Stores	30,000		
	Add : Purchased	12,15,000		
	Stores & spare parts consumed	<u>45,000</u>	12,90,000	
	Less : Closing inventory		<u>(25,800)</u>	12,64,200
11.	Changes in inventory of Finished Goods & WIP			
	Closing Inventory:			
	Finished Goods		60,000	
	Less: Opening Inventory:			
	Finished Goods		<u>46,500</u>	(13,500)
12.	Employee Benefit expenses:			
	Salary & Wages (40,200 + 4,500)			44,700
13.	Other Expenses:			
	Manufacturing Expenses (2,70,000 + 67 500)		3,37,500	
	General Charges (16,500 – 2,490)		<u>14,010</u>	3,51,510

2. Cash Flow Statement of Leela Ltd.

	₹	₹
<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 x 8% x 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 (WN 3)	(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:

1. Profit on Sale of Plant = Net Book Value (i.e, Gross Block less Accumulated Depreciation) Less Sale Value
= (54,000-40,500) less 21,000
= ₹ 7,500 Gain/Profit
 2. Depreciation for current year = Increase in Depreciation as given above + Accumulates Depreciation on Plant Sold
= 43,200 + 40,500 = ₹ 83,700
 3. Cash Outflow towards assets purchase = Increase in Plant and Machinery at Cost + Gross Block of Plant sold
= 1,80,000 +54,000 = ₹ 2,34,000.
- 3 (a) Sales of first 6 months = ₹ 4,80,000. Average sale of first 6 months = ₹4,80,000/6 = ₹80,000 per month. Pre-incorporation period consist of 3 months (i.e., April, May and June). The sales of those 3 months = ₹ 80,000 x 3 = ₹ 2,40,000. Sales of remaining 9 months = ₹ 24,00,000 – ₹ 2,40,000 = ₹ 21,60,000.
Therefore, the ratio of sales = ₹ 2,40,000 : ₹ 21,60,000 or 1: 9.

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

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

Date of incorporation is May, 2013

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

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

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

- (c) 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, 2013

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

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

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

4. **Journal Entries in the books of Preet Ltd.**

			₹	₹
1-4-2014	Equity share final call A/c	Dr.	2,70,000	
	To Equity share capital A/c			2,70,000
	(For final calls of ₹ 2 per share on 1,35,000 equity shares due as per Board's Resolution dated....)			
20-4-2014	Bank A/c	Dr.	2,70,000	
	To Equity share final call A/c			2,70,000
	(For final call money on 1,35,000 equity shares received)			
	Securities Premium A/c	Dr.	37,500	
	Capital Reserve A/c	Dr.	60,000	
	General Reserve A/c	Dr.	1,80,000	
	Profit and Loss A/c	Dr.	60,000	
	To Bonus to shareholders A/c			3,37,500
	(For making provision for bonus issue of one share for every four shares held)			

Bonus to shareholders A/c To Equity share capital A/c (For issue of bonus shares)	Dr.	3,37,500	3,37,500
---	-----	----------	----------

Extract of Balance Sheet as at 30th April, 2014 (after bonus issue)

	₹
<i>Authorised Capital</i>	
15,000 12% Preference shares of ₹10 each	1,50,000
1,83,750 Equity shares of ₹10 each (W.N.2)	<u>18,37,500</u>
<i>Issued and subscribed capital</i>	
12,000 12% Preference shares of ₹10 each, fully paid	1,20,000
1,68,750 Equity shares of ₹10 each, fully paid (Out of above, 33,750 equity shares @ ₹10 each were issued by way of bonus)	16,87,500
<i>Reserves and surplus</i>	
Capital Reserve	52,500
Profit and Loss Account	2,40,000

Working Notes:

- As per SEBI Guidelines, securities premium collected in cash and capital reserve realized in cash only is to be utilized for issue of bonus shares.
- The authorized capital should be increased as per details given below:

Existing authorized Equity share capital	15,00,000
Add: Issue of bonus shares to equity shareholders (25% of ₹ 13,50,000)	<u>3,37,500</u>
	<u>18,37,500</u>

5. Journal entries in the books of Casio Ltd.

Particulars	L.F	Dr. (₹)	Cr. (₹)
Equity Share Final Call A/c To Equity Share Capital A/c (Final Call made for the balance on equity share)	Dr.	4,00,000	4,00,000
Bank A/c To Equity Share Final Call A/c (Receipt of Final Call money)	Dr.	4,00,000	4,00,000

Equity Share Capital (₹100) A/c To Equity Shares (₹ 20) A/c To Reconstruction A/c (Reduction of ₹100 share capital to ₹ 20 each)	Dr.	10,00,000	2,00,000 8,00,000
10% First Debentures A/c To Debentureholders' A/c (Redemption due for First Debentures)	Dr.	2,00,000	2,00,000
Debentureholders' A/c To 13.5% Debentures A/c (Redemption of First Debentures)	Dr.	2,00,000	2,00,000
12% Second Debentures A/c To Debentureholders' A/c (Transfer of second debentures account to debentureholders account)	Dr.	5,00,000	5,00,000
Debentureholders' A/c To 15% Debentures A/c To Reconstruction A/c (Settlement of second debentureholders' claims)	Dr.	5,00,000	4,00,000 1,00,000
Trade payables A/c To Bank A/c To Equity Share Capital A/c To Reconstruction A/c (Settlement of trade payables account)	Dr.	11,50,000	3,00,000 3,00,000 5,50,000
Debenture Interest (Outstanding) A/c To Reconstruction A/c (Writing off the interest on debentures on settlement of account of debentureholders)	Dr.	80,000	80,000
Reconstruction A/c To Profit and Loss A/c To Fixed Assets A/c (balance in Reconstruction A/c) (Utilisation of reconstruction account for writing of past losses and value of fixed assets)	Dr.	15,30,000	10,20,000 5,10,000

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

		<i>Note No.</i>	₹
1	Equity and liabilities (1) Shareholders' funds: (a) Share Capital	1	5,00,000

	(1) Non-current liabilities:		
	(a) Long term borrowings		
	13.5% Debentures		2,00,000
	15% Debentures		<u>4,00,000</u>
			<u>11,00,000</u>
II	Assets		
	(1) Non-current Assets		
	(a) Fixed assets:	2	1,90,000
	(b) Non-current investments		10,000
	(2) Current assets		
	(a) Inventories		3,90,000
	(b) Trade receivables		4,60,000
	(c) Cash & cash equivalent		50,000
	[(50,000) + 4,00,000 – 3,00,000]		
			<u>11,00,000</u>

Notes to Accounts

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

6. (i) Calculation of number of equity and preference shares

	₹
Fixed assets	6,40,000
Inventory	3,85,000
Bills receivable	<u>15,000</u>
Purchase consideration	<u>10,40,000</u>

Amount discharged by issue of preference shares = ₹ 2,55,000

No. of preference shares to be allotted = $\frac{₹ 2,55,000}{100} = 2,550$ shares

Amount discharged by allotment of equity shares = ₹ 10,40,000 – ₹ 2,55,000
= ₹ 7,85,000

Paid up value of equity share = ₹ 8

Hence, number of equity shares to be issued = $\frac{₹ 7,85,000}{8} = 98,125$ shares

(ii) **In the books of Alia Ltd.**
Realisation Account

	₹		₹
To Fixed assets	4,82,000	By Provision for bad and doubtful debts	4,000
To Inventory	3,87,500	By Trade payable	1,33,000
To Trade receivables	95,000	By Provision for taxation	1,10,000
To Bank account:		By Burger Ltd. account	
Liquidation expenses	4,000	(Purchase consideration)	10,40,000
Bills payable	19,000	By Bank account: Sundry debtors	75,000
Tax liability	1,11,000		
Sundry creditors	1,05,500		
To Equity shareholders (profit transferred)	<u>1,58,000</u>		
	<u>13,62,000</u>		<u>13,62,000</u>

Cash/Bank Account

Dr.			Cr.
	₹		₹
To Balance b/d	1,64,500	By Realisation account:	
To Realisation account:		Liquidation expenses	4,000
Sundry debtors	75,000	Bills payable	19,000
		Tax liability	1,11,000
		Sundry creditors (Balancing figure)	<u>1,05,500</u>
	<u>2,39,500</u>		<u>2,39,500</u>

Equity Shareholders Account

Dr.			Cr.
	₹		₹
To 10% Preference shares in Burger Ltd.	2,55,000	By Equity share capital account	6,00,000
To Equity shares in	7,85,000	By Contingency reserve	1,56,000

Burger Ltd.		By Profit and loss account	1,26,000
		By Realisation account(Profit)	<u>1,58,000</u>
	<u>10,40,000</u>		<u>10,40,000</u>

Burger Limited Account

<i>Dr.</i>	₹		<i>Cr.</i>
			₹
To Realisation account	10,40,000	By 10% Preference shares in Burger Ltd.	2,55,000
		By Equity shares in Burger Ltd.	<u>7,85,000</u>
	<u>10,40,000</u>		<u>10,40,000</u>

(iii)

Journal Entries

in the books of Burger Ltd.

<i>Particulars</i>		<i>Amount(₹)</i>	<i>Amount(₹)</i>
Business purchase account	Dr.	10,40,000	
To Liquidator of Alia Ltd. account			10,40,000
(Being the amount of purchase consideration payable to liquidator of Alia Ltd. for assets taken over)			
Fixed assets account	Dr.	6,40,000	
Inventory account	Dr.	3,85,000	
Bills receivable account	Dr.	15,000	
To Business purchase account			10,40,000
(Being assets taken over)			
Liquidator of the Alia Ltd. account	Dr.	10,40,000	
To 10% Preference share capital account			2,55,000
To Equity share capital account			7,85,000
(Being the allotment of 10% fully paid up preference shares and equity shares of ₹ 10 each, ₹ 8 each paid up as per agreement for discharge of purchase consideration)			

7. Taking May 18th as the zero or base date:

For Krishna's payments:

<i>Date of Transactions</i>	<i>Due Date</i>	<i>Amount</i>	<i>No. of days from the base date</i>	<i>Products</i>
(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.

<i>Date of Transactions</i>	<i>Due Date</i>	<i>Amount</i>	<i>No. of days from the base date</i>	<i>Products</i>
(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>

$$\begin{aligned} \text{Excess of Krishna's products over Abhinav's} &= 10,02,000 - 3,16,500 \\ &= 6,85,500 \end{aligned}$$

$$\text{Excess amount due to Abhinav's ₹ } 31,500 - 15,300 = ₹ 16,200.$$

Number of days from the base date to the date of settlement is

$$\frac{6,85,500}{16,200} = 42 \text{ days}$$

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, ₹ 16,200 to clear the account.

8. **B in Account Current with A**
for the period ending on 30th June, 2012

Date	Particulars	Amount	Days	Products	Date	Particulars	Amount	Days	Products
2012		₹.			2012		₹		
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:

$$\text{Interest} = \frac{96,050}{366} \times \frac{6}{100} = ₹ 15.75$$

9. **Total Debtors Account**

2013	Particulars	₹	2013	Particulars	₹
April 1	To Balance b/d	20,000	April 1	By Balance b/d	300
April 30	To Sales (Credit)	19,000	April 30	By Cash	14,100
	To Total creditors (endorsed B/R dishonoured)	300		By Discount	900
	To B/R (Dishonoured)	400		By Bills receivable	3,000
	To Interest	30		By Total creditors (Transfer)	600
	To Balance c/d	450		By Balance c/d	21,280
		40,180			40,180

Notes:

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

10.

Tiger Club
Receipts and Payments Account
for the year ended 31st March, 2014

<i>Receipts</i>	₹	<i>Payments</i>	₹
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, 2014

<i>Expenditure</i>	₹	₹	<i>Income</i>	₹	₹
To Rent		4,800	By Subscriptions	1,24,260	
To Rates and taxes		7,560	<i>Add: Due as on 31.3.14</i>	<u>5,880</u>	
To Printing and stationary		2,820		1,30,140	
To Wages		5,040	<i>Less: Due as on 31.3.13</i>	<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	<i>Less: Fair expenses</i>	<u>14,340</u>	60
To Depreciation on Premises @ 5% *	6,060		By Surplus from variety show		25,620

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

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>

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

<i>Dr.</i>			<i>Cr.</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

	₹	₹
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

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

11. (a) Statement of Affairs as on 31st March, 2013

<i>Liabilities</i>	₹	<i>Assets</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
	<u>1,64,450</u>		<u>1,64,450</u>

(b) Calculation of loss for 3 months (1.1.2013 to 31.3.2013)

	₹
Capital as on 31.3.2013	1,61,700
Add: Drawings for 3 months	770
	1,62,470
Less: Capital as on 1.1.2013	(1,65,000)
Loss for 3 months	2,530

(c) Statement of Affairs as on 31st March, 2014

<i>Liabilities</i>	₹	<i>Assets</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
	<u>1,82,050</u>		<u>1,82,050</u>

(d) Statement of Profit and Loss for the year ended 31.3.2014

<i>Particulars</i>	₹
Capital as on 31.3.2014	1,80,400
Add: Drawings (₹ 385 x 12)	<u>4,620</u>
	1,85,020
Less: capital as on 31.3.2013	(1,61,700)
Net profit for the year ended 31.3.14	<u>23,320</u>

Working Notes:

	₹
1. Bank balance as on 31.3.2013	
Balance as on 1.1.2013	1,65,000
Less: Withdrawals during 1.1.2013 to 31.3.2013	(1,22,650)
Balance as on 31.3.2013	42,350
2. Bank Balance as on 31.3.2014:	
Balance as on 1.4.2013	42,350
Add: Deposits during the year	1,26,500
	1,68,850
Less: Withdrawals during the year	(1,48,500)
Bank Balance as on 31.3.2014	<u>20,350</u>

12. Value of repossessed computers:

H.P. Price of two repossessed computers

$$= [₹ 5,000 + (8 \times ₹ 2,500)] \times 2 \text{ computers}$$

$$= ₹ 50,000$$

$$\text{Cost price of the repossessed computers} = \frac{₹ 50,000}{125} \times 100 = ₹ 40,000$$

$$\text{Value of repossessed computers} = ₹ 40,000 \times 50\% = ₹ 20,000$$

13. Books of Alpha Ltd.

Investment in 13.5% Debentures in Pergot Ltd. Account

(Interest payable on 31st March & 30th September)

Date	Particulars	Nominal	Interest	Amount	Date	Particulars	Nominal	Interest	Amount
		₹	₹	₹			₹	₹	₹
2013					2013				
May 1	To Bank	5,00,000	5,625	5,19,375	Sept.30	By Bank (6 months Int)		50,625	
Aug.1	To Bank	2,50,000	11,250	2,45,000	Oct.1	By Bank	2,00,000		2,06,000
Oct.1	To P&L A/c			2,167					
Dec.31	To P&L A/c		52,313		Dec.31	By Balance c/d	<u>5,50,000</u>	<u>18,563</u>	<u>5,60,542</u>
		<u>7,50,000</u>	<u>69,188</u>	<u>7,66,542</u>			<u>7,50,000</u>	<u>69,188</u>	<u>7,66,542</u>

Note : Cost being lower than Market Value the debentures are carried forward at Cost.

Working Notes:

- Interest paid on ₹ 5,00,000 purchased on May 1st, 2013 for the month of April 2013, as part of purchase price: $5,00,000 \times 13.5\% \times 1/12 = ₹ 5,625$
- Interest received on 30th Sept. 2013

$$\text{On ₹ 5,00,000} = 5,00,000 \times 13.5\% \times \frac{1}{2} = 33,750$$

$$\text{On ₹ 2,50,000} = 2,50,000 \times 13.5\% \times \frac{1}{2} = \underline{16,875}$$

Total ₹ 50,625
- Interest paid on ₹ 2,50,000 purchased on Aug. 1st 2013 for April 2013 to July 2013 as part of purchase price:

$$2,50,000 \times 13.5\% \times 4/12 = ₹ 11,250$$

4. Loss on Sale of Debentures

Cost of acquisition

$$(\text{₹ } 5,19,375 + \text{₹ } 2,45,000) \times \text{₹ } 2,00,000 / \text{₹ } 7,50,000 = 2,03,833$$

$$\text{Less: Sale Price (2000 x 103)} = \underline{2,06,000}$$

$$\text{Profit on sale} = \underline{\text{₹ } 2,167}$$

5. Cost of Balance Debentures

$$(\text{₹ } 5,19,375 + \text{₹ } 2,45,000) \times \text{₹ } 5,50,000 / \text{₹ } 7,50,000 = \text{₹ } 5,60,542$$

6. Interest on Closing Debentures for period Oct.-Dec. 2013 carried forward (accrued interest)

$$\text{₹ } 5,50,000 \times 13.5\% \times 3/12 = \text{₹ } 18,563$$

14. Memorandum Trading Account for the Period from 1.1.2013 to 30.6.2013

	₹		₹
To Opening Stock (1.1.2013)	1,50,000	By Sales	11,50,000
To Purchases	9,50,000	Less: Sales	
Less: Returns	<u>(12,500)</u>	Returns	<u>(40,000)</u>
To Cartage Inwards	17,500	By Closing Stock	2,80,000
To Wages	7,500	(Bal. Fig.)	
To Gross Profit	2,77,500		
(25% of ₹ 11,10,000)			
	<u>13,90,000</u>		<u>13,90,000</u>

Stock Destroyed Account

	₹		₹
To Trading Account	2,80,000	By Stock Salvaged Account	20,000
		By Balance c/d (For Claim)	2,60,000
	<u>2,80,000</u>		<u>2,80,000</u>

Statement of Claim

Items	Cost (₹)	Depreciation (₹)	Salvage (₹)	Claim (₹)
A	B	C	D	(E=B-C-D)
Stock	2,80,000		20,000	2,60,000
Buildings	3,75,000	1,25,000 + 9,375	4,000	2,36,625
Equipment	75,000	22,500 + 5,625	2,500	44,375
				<u>5,41,000</u>

15. (a) Revaluation Account

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

(b) Partners' Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
	(₹)	(₹)	(₹)		(₹)	(₹)	(₹)
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 01.04.2014

Liabilities		₹	Assets		₹
Partners' Capital accounts			Land and Building	60,000	
Mr. B	70,000		<i>Add:</i> 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 Account		26,000	<i>Less:</i> Depreciation 30%	<u>12,000</u>	28,000
Sundry Creditors		16,000	Inventory of goods	24,000	
			<i>Less:</i> devalued	<u>4,000</u>	20,000
			Sundry Debtors	22,000	
			<i>Less:</i> Provision for bad debts 5%	<u>1,100</u>	20,900
			Cash & Bank balances		<u>41,100</u>
		<u>1,82,000</u>			<u>1,82,000</u>

Working Notes:

Adjustment for Goodwill:	₹
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 ₹ 2,000

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

16. 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.
- 17 (a) 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 ₹ 50 crores or borrowings do not exceed ₹ 10 crore. For calculating this turnover, other income is not to be included. Since B Pvt. Ltd., has a turnover of ₹ 45 crores and borrowing of ₹ 9 crores, it will satisfy the definition and can be classified as SMC.
- (b) 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 ₹ 27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by ₹ 18 crores. To that extent, the profit for the year is increased.
 - (ii) The company has decided to provide ₹ 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 ₹ 10 crores.
- (c) (i) Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. Alpha 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 Alpha 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.
18. (a) As per para 15 of AS 6, 'Depreciation Accounting', when the method of depreciation is changed, depreciation is recalculated in accordance with the new method from

the date of the assets coming into use. The deficiency or surplus arising from retrospective re-computation of depreciation in accordance with the new method is adjusted in the statement of profit and loss in the year in which the method of depreciation is changed.

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

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

Deficiency of ₹ 1,642 should be charged to Profit and Loss account.

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

Note: It is assumed that when the company changed the method of depreciation from WDV to SLM, it re-calculated the depreciation amount on the basis of useful life and has not continued with WDV rate of depreciation.

(b) (i) Calculation of profit/ loss for the year ended 31st March, 2014

	(₹ in crores)
Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
Less: Total contract price	<u>(2,400)</u>
Total foreseeable loss to be recognized as expense	<u>850</u>

According to para 35 of AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii) Contract work-in-progress i.e. cost incurred to date

	(₹ in crores)
Work certified	1,250
Work not certified	<u>250</u>
	<u>1,500</u>

(iii) Proportion of total contract value recognised as revenue

Percentage of completion of contract to total estimated cost of construction

$$= (1,500 / 3,250) \times 100 = 46.15\%$$

Revenue to be recognized till date = 46.15% of ₹ 2,400 crores = ₹ 1,107.60 crores.

19. (a) The economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. A Ltd. should record the sale and recognize the profit of ₹ 20 lakhs in its profit and loss account. The building should be eliminated from the balance sheet.

- (b) As per Para 12 of AS 10 "Accounting for Fixed Assets" expenditure that increases the future benefits from the existing assets, is included in the gross book value.

Hence, in the given case, repairs of ₹ 2,50,000 as routine repairs and ₹ 75,000 on partial replacement of the part of the machinery should be charged to Profit and Loss Account. ₹ 5,00,000 incurred on a part of the machinery, which will increase the efficiency, should be capitalized.

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

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

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

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

Here, Y Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quite a substantial figure. Losing the case of

copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹ 200 lakhs and shown the investments at ₹ 100 lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of ₹ 200 lakhs in the carrying value of long term investment will be included in the profit and loss account.

(b)

	₹
Purchase consideration = $5,00,000 \times 11/10 = 55,000$ shares of ₹ 10 each	55,00,000
<i>Less:</i> Share capital of X Co. Ltd.	<u>50,00,000</u>
Difference Adjusted through General Reserve	<u>5,00,000</u>

PAPER – 2: BUSINESS LAWS, ETHICS & COMMUNICATION
QUESTIONS

PART – I: BUSINESS LAWS

The Indian Contract Act, 1872

1. State the nature of the contract in the following cases with reasons:
 - (a) A threatened B to shoot if he does not lend him ₹ 2000 and B agreed to it.
 - (b) A husband promised to pay maintenance allowance every month to his wife, which he failed to perform.
 - (c) Threat to publish a defamatory statement against a person to enter into an agreement.
 - (d) Mr. X agrees to write a book with a publisher but X dies in an accident.
 - (e) 'B' agrees to purchase the car from 'A' as per his proposal, subject to availability of valid Registration Certificate for the car.
2. Under what circumstances guarantee made will be treated as invalid?

The Negotiable Instruments Act, 1881

3. What are the characteristics of any negotiable instruments?
4. Mr. X executed an account payee cheque on the name of the Mr. B for the amount of rupees 20,000. Mr. B submitted the cheque in the bank. Later B finds that no amount have been credited to his account. In fact the amount has been credited to some other person with the same name.

State the legal position of B with respect to the Negotiable Instruments Act, 1881.

The Payment of Bonus Act, 1965

5. A builder employed a labour on the daily wages for 2 months for the construction of the site on the payment of ₹ 300 per day. Throw a light with respect to the Payment of Bonus Act, 1965 whether a labour is entitled for the bonus in the given instance.
6. Enumerate the procedure concluding Presumption with respect to the accuracy of balance sheet and profit and loss account of corporations and companies as per the Payment of Bonus of Act, 1965.

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

7. State the matters for which Provisions are made in the Pension Scheme under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

The Payment of Gratuity Act, 1972

8. Mr. X was an employee in a company for past 10 years and was assisting the director of a company in an assignment. In the mean time, he received a better opportunity from an abroad company. He put the resignation from service with prior notice and applied for the claim of gratuity. Company not accepted the resignation on the reason that assignment is incomplete and due to non acceptance of the resignation, the company also refused to pay the gratuity.

Examine whether the Contention of company is valid as per the Payment of Gratuity Act, 1972.

The Companies Act, 1956

9. A public Limited has been incorporated with 7 shareholders having fully paid-up shares in 2011. On 30th April, 2013, all the shares of X (a shareholder of the company) are sold to Y (another shareholder of the company) in an auction by the order of the court. Z, (a shareholder of the company) was in abroad for a business trip from January and thus he was not aware of the developments. The company continues to carry on its business thereafter. In December, 2013, the company borrowed a sum of ₹5 lac from the Bank. Later, the company was wound up and the assets of the company were not sufficient for the payment of its liabilities. The Bank filed a suit against Y and Z for recovery of the said loan from them. Decide the liabilities of Y and Z under the provisions of Companies Act, 1956.
10. An allottee of shares in a Company brought action against a Director in respect of false statements in prospectus. The director contended that the statements were prepared by the promoters and he has relied on them. Is the Director liable under the circumstances? Decide referring to the provisions of the Companies Act, 1956.
11. A Ltd. company owed to Mr. X ₹2,000. On becoming this debt payable, the company offered Mr. X 10 shares of ₹200 each in full settlement of the debt. The said shares were fully paid and were allotted to Mr. X. Examine the validity of these allotments in the light of the provisions of the Companies Act, 1956.
12. When can a Public Company offer the new shares (further issue of shares) to persons other than the existing shareholders of the Company? Can these shares be offered to the Preference Shareholders?
13. The Directors of Ltd. company desire to alter capital clause of Memorandum of Association of their company. Advise them, under the provisions of the Companies Act, 1956 about the ways in which the said clause may be altered and the procedure to be followed for the said alteration.
14. A company was incorporated on 1.4.2013. No General Meeting of the company has been held so far. Explain the provisions of the Companies Act, 1956 regarding the time limit for

holding the first annual general meeting of the Company and the power of the Registrar to grant extension of time for the First Annual General Meeting.

15. The Board of Directors of XYZ Ltd, have passed resolution to the effect that no member who is indulging in activities detrimental to the interest of the company be permitted to examine the records or obtain certified copies thereof. A member of the company, considered by the company to be acting against the interests of the company, demands inspection of the register of members and minutes of General Meeting and certified true copies thereof. The company refuses the inspection etc. on the strength of the resolution referred to above. Examine the correctness of the refusal by the company referring to the provisions of the Companies Act, 1956.

PART – II: ETHICS

16. Explain the statement "Ethical behaviour creates a positive reputation that expands the opportunities for profit".
17. What the key strategies that companies can use while implementing CSR policies and practices.
18. In what manner the behavior of business persons towards the others in their workplace may generate ethical concerns?
19. State whether the given statement is correct/ incorrect:
 - (i) Conservation looks primarily to the future.
 - (ii) Fair treatment to whistle blowers is unnecessary to keep check on fraud.
20. State the forums available for promoting and protecting the right of the consumers at various levels.

PART – III: COMMUNICATION

21. State the merit and demerit of grapevine phenomenon?
22. Explain the statement 'Interpersonal communication is contextual'.
23. Explain how ethical communicators have a "well developed sense of social responsibility".
24. Board of Directors of -----Private Limited proposes to convene an Extraordinary General Meeting for changing the name of the company to ----- Private Limited. Draft the notice for calling the Extraordinary General Meeting of the Members.
25. Draft the performa of a bond for a loan repayable in instalments.

SUGGESTED ANSWER/HINTS

1. (a) The word 'Consent' generally means 'knowledge and approval' of the parties concerned. Whereas the Indian Contract Act, 1872 defines the term 'consent' as meeting of the minds on the same thing in the same sense viz *consensus ad idem*. Further such consent must be free. Consent would be considered as free consent if it is not vitiated by coercion, undue influence, fraud, misrepresentation or mistake. Wherever the consent of any party is not free, the contract is voidable at the option of that party.

Accordingly in the case, A threatened to shoot B if he (B) does not lend him ₹ 2000 and B agreed to it. Here the agreement is entered into under coercion and hence voidable at the option of B.
 - (b) The Indian Contract Act, 1872 says that such an agreement which can be enforced by law, legally binds the parties. Thus in the given instance, a husband promised to pay maintenance allowance every month to his wife and later he failed to perform the promise. As this is an agreement of domestic nature creating no legal obligation between them. Thus such an agreement is void.
 - (c) Threat to publish a defamatory statements in order to make him to enter into agreement is opposed to the public policy, and therefore are illegal in nature. The Indian Contract Act, 1872 says that all illegal contracts are void.
 - (d) As per the Indian Contract Act, 1872, a contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. Thus in the given case, Mr. X agrees to write a book with a publisher but in the mean time, he dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract.
 - (e) As per the provision give under section 7 of the Indian Contract Act, 1872 acceptance is valid only when it is absolute and unqualified . Accordingly, in the given case where 'B' agrees to purchase the car from 'A' as per his proposal, depending on availability of valid Registration Certificate for the car, the acceptance given to the proposal of 'A' is in place though the offer contained no reference of R.C. book. This is because expecting a valid title for the car is not a condition. Therefore the acceptance given by B, in this case is unconditional. Thus agreement is valid.
2. The Indian Contract Act, 1872 prescribes following circumstances, when a guarantee can be treated as invalid.
 - (i) **Mis-representation:** when the guarantee has been obtained by means of mis-representation made directly by the creditor or made with his knowledge and the mis-representation relates to a material part of the transaction.

- (ii) **Silence as to material circumstances:** when the creditor has obtained any guarantee by means of keeping silence as to material circumstances. The expression “keeping silence” implies intentional concealment of a material fact, as distinct from a mere non-disclosure thereof. There must exist some element of fraud. [*Balakrishna vs. Bank of Bengal (1891) 15 Bom. 585*].
 - (iii) **Failure of joining of other person as co-surety:** when a contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.
3. (i) **Written instrument with signature:** A negotiable instrument is a written document and is considered as complete and effective only when it is duly signed.
- (ii) **Negotiable Instrument made or drawn for consideration:** It is presumed by law that every negotiable instrument is made or drawn for a consideration. Consequently, there is no necessity to state such a position. But it is not an irrebuttable presumption. It must be rebutted by proof that the instrument had been obtained from its lawful owner by means of fraud, undue influence or for an unlawful consideration. The onus of proof is on the person who challenges the existence of consideration (i.e., the defendant).
- (iii) **Transfer by endorsement/ delivery:** A negotiable instrument can be transferred from one person to another by endorsement and delivery if it is an instrument payable to order, and by mere delivery, if it is a bearer instrument.
- (iv) **Bonafide and valuable consideration entitles good title to transferee:** The transferee, who takes the instrument bona fide and for valuable consideration, obtains a good title despite any defects in the title of the transferor.
4. As per the Negotiable Instruments Act, 1881, a cheque marked “Account Payee” is a form of restrictive crossing, represented by the words “Account Payee” entered on the face of the cheque. Such a crossing acts as a warning to the collecting bankers that the proceeds are to be credited only to the account of the payee. If the collecting banker allows the proceeds of the cheque so crossed to be credited to pay any other account, he may be held guilty of a negligence in the event of an action for wrongful conversion of funds being brought against him. These words are not an addition to the crossing but are mere direction to the receiving or collecting bankers. These do not affect the paying banker who is under no duty to ascertain that the cheque in fact has been collected for the account of the person named as the payee.
- Thus accordingly Mr. B can hold the bank with whom the cheque is deposited for the credit(collecting banker), liable for negligence for wrongful conversion of funds to the other account.
5. As per the Payment of Bonus Act, 1965, Every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment-(i) for not less than thirty working days in that year, (ii)

on a salary or wage not exceeding ₹ 10,000 per mensem. [Section 2(13) read with Section 8].

The Act does not make any distinction as to whether an employee is daily wager, temporary, permanent, weekly paid, monthly paid etc. the only precondition is that he should have worked in the establishment for not less than 30 working days in an accounting year. [*Himachal Pradesh State Electricity Board and Others Vs Krishan Dutt 2010 (127) FLR 577(H.P.)*].

According to the given facts, labour who was on daily wages, have fulfilled the requirements of the above stated provisions. He has worked for the 2 months i.e., more than 30 working days and on the daily wages of Rs. 300 which amounts the wages (Rs. 300 x 30 days = Rs. 9000 p.m) not exceeding Rs. 10,000 p.m.

Thus it can be concluded that labour is entitled for the payment of bonus.

6. Section 23 of the Payment of Bonus Act, 1965 lay down the procedure for concluding the presumption as to the accuracy of balance sheet and profit and loss account of corporations and companies.
 - (i) **Authority to presume audited accounts to be accurate:** During the course of settlement of the dispute, before any arbitrator or Tribunal under the Industrial Disputes Act or under any corresponding law relating to investigation and settlement of industrial disputes, the balance sheet and the profit and loss account of an employer, being a corporation or a company (other than a banking company), duly audited by the Comptroller and Auditor General of India, or by auditors duly qualified to act as auditors of companies under Section 226(1) of the Companies Act, 1956, are produced before it, then, the above mentioned authority may presume that those are accurate and it shall not be necessary for the corporation or the company to prove the accuracy of such statements and particulars by the filing of an affidavit or by any other mode.
 - (ii) **Steps to find out the accuracy:** where if the State is satisfied that those statements are not accurate, it may take such steps as it thinks necessary to find out the accuracy thereof.
 - (iii) **Clarification by union:** Situation may demand a clarification relating to any item in the balance sheet or the profit and loss account. In such a situation, where trade union or the employees who are a party to the dispute, may make an application to the authority requiring any clarification relating to any item in the balance sheet or profit and loss account from the employer, company or corporation. The authority shall then satisfy itself as to the necessity of such clarification. It shall direct the corporation or the company to furnish such clarification to the trade union or the employees within a specified time limit. Thereupon, the company or the corporation must comply with such direction of the authority.
7. Matters for which Provision may be made in the Pension Scheme (Schedule III)

1. The employees or class of employees to whom the Pension Scheme shall apply.
 2. The time within which the employees who are not members of the Family Pension Scheme under Section 6A shall opt for the Pension Scheme.
 3. The portion of employers' contribution to the Provident Fund which shall be credited to the Pension Fund and the manner in which it is credited.
 4. The minimum qualifying service for being eligible for pension and the manner in which the employees may be granted the benefit of their past service under Section 6A..
 5. The regulation of the manner in which, the period of service for which no contribution is received.
 6. The manner in which employees' interest will be protected against default in payment of contribution by the employer.
 7. The manner in which the accounts of the pensions fund shall be kept and investment of moneys belonging to pension fund to be made subject to such pattern of investment as may be determined by the Central Government.
 8. The form in which an employee shall furnish particulars about himself and the members of his family whenever required.
 9. The forms, registers and records to be maintained in respect of employees, required for the administration of the Pension Scheme.
 10. The scale of pension and pensionary benefits and the conditions relating to grant of such benefits of the employees.
 11. The manner in which the exempted establishments have to pay contribution towards the Pension Scheme and the submission of return relating thereto.
 12. The mode of disbursement of pension and arrangements to be entered into with such disbursing agencies as may be specified for the purpose.
 13. The manner in which the expenses for administering the Pension Scheme will be met from the income of the Pension Fund.
 14. Any other matter which is to be provided for in the Pension Scheme or which may be, necessary or proper for the purpose of implementation of the Pension Scheme."
8. As per the Payment of Gratuity Act,1972 , gratuity shall be payable to an 'employee' on the termination of his employment after he has rendered continuous service for not less than five years –
- ◆ On his superannuation, or
 - ◆ On his retirement or resignation, or
 - ◆ On his death or disablement due to accident or disease;

The condition of the completion of five years continuous service is not essential in case of the termination of the employment of any employee due to death or disablement.

According to the above provision, the payability of Gratuity to the employee is his right as well as the obligation of the employer. An employee resigning from service is also entitled to gratuity; [*Texmaco Ltd. Vs Sri Ram Dhan 1992 LLR 369(Del)*] and non-acceptance of the resignation is no hurdle in the way of an employee to claim gratuity [*Mettur Spinning Mills Vs Deputy Commissioner of Labour, (1983) 11 LLJ 188*].

Thus in the given case, the contention of the company is not valid. The non- acceptance of the resignation cannot the deprive Mr. X from claiming the gratuity.

9. The problem relates to reduction of membership below the statutory minimum. Section 12 of the Companies Act, 1956 requires a public company to have a minimum of seven members. It at any time the membership of a public company falls below seven and it continues its business for more than six months, then according to Section 45 of the Act every such member who was aware of this fact would be personally and severally liable for all debts contracted by the company during the period and may be severally sued for all debts contracted after six months.

Accordingly in the given problem:

- (i) Y is personally liable for the payment of loan to the Bank because the members of the public Limited continued to carry on the business of the company with that reduced membership beyond the six months period and Y knows this fact.
 - (ii) Z is not responsible for any debt because he is not aware about the reduced membership.
10. Yes, the Director shall be held liable. A director can escape liability for mis-statements in a prospectus only on the grounds specified under Section 62(2) of the Companies Act, 1956. Relying on statements prepared by promoters is not a ground included there under. Accordingly, no defence shall be available to the Director. A Director shall not be liable if he puts up the following defences:
- (i) If he withdrew his consent before the issue of the prospectus and it was issued without his authority or consent.
 - (ii) If after the issue of the prospectus and before allotment thereunder, he on becoming aware of any untrue statement therein, withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and reasons therefor.
 - (iii) If he had reasonable grounds to believe that the statement was true, and he, in fact, believed it to be true up to the time of allotment.
 - (iv) If the statement is a correct and fair representation or extract or copy of the statement made by an expert who is competent to make it, the Director is not liable.

11. **Allotment of Shares:** As per the section 75 of the Companies Act, 1956 when shares are allowed to a person by a company, payment may be made – (i) in cash, or (ii) in kind (with the consent of the company).

'Cash' here does not necessarily mean the current coin of the country. It means "such transaction as would in an action at law for calls, support a plea of payment." On the basis of the above provision and decision of the related case *Coregam Gold Mining Co. of India V. Roper, (1892), A.C. 125*, the allotment of fully paid up shares in full satisfaction of Mr. X's debt is valid.

12. **Issue of Further Shares:** Section 81 of the Companies Act, 1956 provides that if, at any time after the expiry of 2 years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier, it is proposed to increase the subscribed capital by allotment of further shares, it should be offered to the existing equity shareholders of the company in proportion to the capital paid up on those shares.

The new shares of a company may be offered to outsiders or any persons (including the equity shareholders) if-

- (a) a special resolution to that effect is passed by the company.
- (b) an ordinary resolution is passed and the approval of the Central Government is obtained. The Central Government will accord its approval if it is satisfied that the proposal is most beneficial to the company.
- (c) if any shareholder to whom the shares are offered declines to accept the shares. In such a case the Board of Directors may dispose of the shares in such a manner as they think most beneficial to the company.
- (d) if the new shares are issued within 2 years from the formation of the company or 1 year of the allotment made for the first time.

Preference Shareholders - whether (Further Issue of Capital) be offered to: From the wordings of Section 81, it is quite clear that these shares can be issued only to equity shareholders, unless procedure as stated above has been adopted for issue of these shares to outsiders, etc. Therefore, in general these shares cannot be offered to preference Shareholders.

13. **Alteration of Capital (Section 94 of the Companies Act, 1956):** A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, provided authority to alter is given by the articles.

- (i) it may increase its capital by issuing new shares
- (ii) consolidate the whole or any part of its shares capital into shares of larger amount
- (iii) convert shares into stock or vice versa
- (iv) sub-divide the whole or any part of its share capital into shares of smaller amount

- (v) cancel those shares which have not been taken up and reduce its capital accordingly.

Procedure regarding confirmation, resolution and notices for alteration: Any of the above things can be done by the company by passing a resolution at general meeting, but do not require to be confirmed by the Court. Within thirty days of alteration notice must be given to the Registrar who will record the same and make necessary alteration in the company's memorandum and articles. Notice to the Registrar has similarly to be given when redeemable preference shares have been redeemed. Similar information is also required to be sent where the capital has been increased beyond the authorized limit, or where a company, being not limited by shares, has increased the number of its members.

14. According to Section 166 of the Companies Act, 1956, every company shall hold its first annual general meeting within a period of 18 months from the date of incorporation. Since company was incorporated on 1.4.2013, the first annual general meeting of the company should be held on or before 30th September, 2014. Even though the Registrar of Companies is empowered to grant extension of time for a period not exceeding 3 months for holding the annual general meeting, such a power is not available to the Registrar in the case of the first annual general meeting. Thus, the company and its directors will be liable for the default if the annual general meeting was held after 30th September, 2014.
15. According to the provisions contained in Section 16 of the Companies Act, 1956, every member of the Company is entitled to inspect the Register of Members without payment of any fee. They can also ask for copies of extracts from the Register of Members on payment of the prescribed fee. Similarly, as per Section 196 of the Companies Act, 1956, the minutes book of the General Meetings are also to be made available for inspection of the members of the company without any charge. Applying these provisions to the given case, XYZ Ltd., have no right to refuse the inspection of the Register of Members and minutes book of General Meeting. The resolution passed by the said Company is not valid as it cannot go beyond the provisions of the Act.

PART II: ETHICS

16. It is now a well accepted fact that ethical behaviour creates a positive reputation that expands the opportunities for profit. An organisation is not only its buildings, assets, capital or even profit. It is living and creative, evolving over time and having a vision about its future role in society, nation and the world. In the broad sense ethics in business is simply the application of everyday moral or ethical norms to business. Being ethical in business requires acting with an awareness of how the products and services of an organization, and the actions of its employees, can affect its stakeholders and society as a whole and developing codes of conduct for doing business in an ethical manner. Amongst the thinkers of modern times, an invaluable contribution to practising business ethically is provided by Mahatma Gandhi, the father of our nation. He sought to

unite mankind in common interest of justice and establishment of a moral order in world-society. He advised the citizens to observe truthfulness in business and reminded them of their responsibility which was greater since their conduct would be seen as a reflection of their country.

17. Below are some key strategies that companies can use while implementing CSR policies and practices-

Mission, Vision and Values Statements: If CSR is to be regarded as an integral part of business decision-making, it merits a prominent place in a company's core mission, vision and values documents. These states a company's goals and aspirations and provides insight into a company's values, culture and strategies for achieving its aims.

Cultural Values: Many companies now understand that corporate social responsibility cannot flourish in an environment where innovation and independent thinking are not welcome. There must be a commitment to close the gap between what the company says it stands for and the reality of its actual performance.

Management Structures: The goal of a CSR management system is to integrate corporate responsibility concerns into a company's values, culture, operations and business decisions at all levels of the organization.

Strategic Planning: A number of companies are beginning to incorporate CSR into their long-term planning processes, identifying specific goals and measures of progress or requiring CSR impact statements for any major company proposals.

General Accountability: In some companies, in addition to the efforts to establish corporate and divisional social responsibility goals, there are attempts to address these issues in the job description and performance objectives of employees. This helps everyone understand how each person can contribute to the company's overall efforts to be socially responsible.

Employee Recognition and Rewards: Most companies understand that employees tend to engage in behaviour that is recognized and rewarded and avoid behaviour that is penalized. The system of recruiting, hiring, promoting, compensating and publicly honouring employees can be designed to promote corporate social responsibility.

Communications, Education and Training: Employees to be provided with the information and tools they need to act appropriately in carrying out their job requirements. These companies are emphasising the importance of corporate social responsibility internally, have a code of conduct, provide managers and employees with adequate decision-making processes that help them achieve responsible outcomes.

CSR Reporting: Many companies have come to understand the value of assessing their social and environmental performance on a regular basis. Annual CSR reports can build trust among stakeholders and encourage internal efforts to comply with a company's CSR goals.

18. **Business Relationships:** The behaviour of businesspersons toward customers, suppliers, and others in their workplace may also generate ethical concerns. Ethical behaviour within a business involves keeping company secrets, meeting obligations and responsibilities, and avoiding undue pressure that may force others to act unethically.

Managers, in particular, because of the authority of their position, have the opportunity to influence employees' actions. For example, a manager can influence employees to use pirated computer software to save costs. The use of illegal software puts the employee and the company at legal risk, but employees may feel pressured to do so by their superior's authority. Customer's need should be considered most when it comes to ethical business practices. In the long run, a company will reap great profits from a customer base that feels it is being treated fairly and truthfully. Organizational pressures may encourage a person to engage in activities that he or she might otherwise view as unethical, such as invading others' privacy or stealing a competitor's secrets.

19. (i) Conservation looks primarily to the future.

Correct: Conservation refers to the saving or rationing of natural resources for later uses. Conservation, therefore, looks primarily to the future: to the need to limit consumption now to have resources available for tomorrow. In a sense, pollution control is a form of conservation. Pollution "consumes" pure air and water, and pollution control "conserves" them for the future. Consequently, our concern over the depletion of resources is primarily a concern for future generations. Conservation, therefore, is the only way of ensuring a supply for tomorrow's generations.

- (ii) Fair treatment to whistle blowers is unnecessary to keep check on fraud.

Incorrect: For creating a sound ethical environment in any company, fair treatment to whistle blowers is perhaps the most important and sensitive issue. When Sherron had raised questions at Enron, she was demoted. Similar fate would have met all those who had followed Sherron. Fair treatment to whistle blowers is a basic necessity to check fraud. It is reassuring that two of the three persons of the year, selected by the popular Time magazine were accountants from Enron and World Com who had dared to blow the whistle, however, needless to say that the appreciation is much more needed from within the company rather than outside. Thus ensuring fair treatment to whistle blowers is necessary to keep check on fraud.

20. Following forums are established for promoting and protecting the right of the consumers at various levels:

1. **The Central Consumer Protection Council:** The objects of the Central Council shall be to promote and protect the rights of the consumers such as,-

- (a) the right to be protected against the marketing of goods and services which are hazardous to life and property;

- (b) the right to be informed about the quality, quantity, potency, purity, standard and price of goods(or services, as the case may be) so as to protect the consumer against unfair trade practices;
 - (c) the right to be assured, wherever possible, access to a variety of goods, and services at competitive prices;
 - (d) the right to be heard and to be assured that consumer's interest will receive due consideration at appropriate terms;
 - (e) the right to seek redressal against unfair trade practices (or restrictive trade practices) or unscrupulous exploitation of consumers; and
 - (f) the right to consumer education.
2. **The State Consumer Protection Council:** The objects of every State shall be to promote within the State the rights of the consumers laid down in point (a) to (f) mentioned above.
3. **The District Consumer Protection Council:** The objects of every District Council shall be to promote within the State the rights of the consumers laid down in point (a) to (f) mentioned above.

PART- III: COMMUNICATION

21. Merits of the grapevine phenomenon

- (a) **Speedy transmission:** The greatest merit of this phenomenon is that it transmits information very speedily. The very moment a worker comes to know that something is 'top secret' or 'confidential' he tries to look into it or have some idea of it and pass it on to others.
- (b) **Feedback value:** It is primarily through the grapevine that the managers or top bosses of an organisation get the feedback regarding their policies, decisions, memos etc. The feedback reaches them much faster through the informal channel than through the formal channel.
- (c) **Support to other channels:** The grapevine or informal channel functions as a supplementary or parallel channel of communication. The formal channels not only take more time but also impose certain constraints on the process of communication.
- (d) **Psychological satisfaction:** The grapevine gives immense psychological satisfaction to the workers and strengthens their solidarity. It draws them nearer to each other and thus keeps the organisation intact as a social entity.

Demerits of the grapevine phenomenon

- (a) **Less credible:** The information spread through the grapevine is less credible than the one given by the formal channel. Since the grapevine spreads information through the word of mouth it cannot always be taken seriously.

- (b) **Incomplete information:** The grapevine does not always carry the complete information. Thus one may not get the complete picture on its basis.
- (c) **Misleading:** The grapevine often distorts the picture or often misinforms. As its origin lies in the rumour mill it may spread any kind of stories about responsible people. In this way it may spoil the image of the organisation.
22. The statement 'Interpersonal communication is contextual' which means that any communication does not happen in isolation. There are following context of communications:
- psychological context**, which is who the communicators are and what they bring to the interaction. Their needs, desires, values, personality, etc., all form the psychological context.
- Relational context**, which concerns reactions to each other.
- Situational context** deals with the "psycho-social-where" one is communicating. For example, an interaction that takes place in a classroom will be very different from one that takes place in a Board room.
- Environmental context** deals with the "physical -where" one is communicating. Furniture, location, noise level, temperature, season, time of day, all are examples of factors in the environmental context.
- Cultural context** includes all the learned behaviours and rules that affect the interaction. If you come from a culture (foreign or within your own country) where it is considered rude to make long, direct eye contact, you will out of politeness avoid eye contact. If the other person comes from a culture where long, direct eye contact signals trustworthiness, then we have in the cultural context a basis for misunderstanding.
23. Following is an ethical communication which an ethical communicators may include in communication with others:
- ◆ all relevant information,
 - ◆ true in every sense and is not deceptive in any way.
 - ◆ accurate and sincere. Avoids language that manipulates,, discriminates or exaggerates.
 - ◆ not hide negative information behind an optimistic attitude .
 - ◆ not state opinions as facts,
 - ◆ portrays graphic data fairly.
- In a nutshell, ethical communicators have a "well developed sense of social responsibility".
24. **Notice for Extraordinary General Meeting of the Members**

Notice is hereby given that extraordinary General Meeting of the members of ----- Private Limited will be held on -----, theday of 2013, at the registered office of the company at..... at.....P.M. to transact the following business.

Special Business

To consider and if thought fit, to pass with or without modification the following resolution as special resolution.

“Resolved that, subject to the approval of the Central Government under section 21 of the Companies Act, 1956, the name of the company be and is changed from ----- Traders Private Limited to -----Private Limited and that consequent to this change, the Memorandum and Articles of Association of the company be altered accordingly.

By order of the Board of Directors of ----- Private Limited.

Secretary.....

Place:.....

Date:.....

25. This Bond is made on the -----day of -----between -----(details of party to be called as debtor) and -----(details of the other party to be called as creditor).

Whereas the debtor has this day borrowed a sum of Rupees----- (₹.....) only from the creditor with the condition to repay the same with interest at the rate of ----- percent per annum by monthly instalments. The debtor has agreed to pay the same.

Whereas in case of default in the payment of any consecutive instalments, the penalty shall be levied with double rate of interest on the remaining unpaid amount.

Signature of debtor

Signature of creditor

Witnesses:

1.....

2.....

PAPER – 3 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

PART I : COST ACCOUNTING

QUESTIONS

Material

1. Aditya Ltd. is engaged in heavy engineering works on the basis of job order received from industrial customers. The company has received a job order of making turbine from a power generating company. Below are some details of stores receipts and issues of copper wire, used in the manufacturing of turbine:

Feb. 1	Opening stock of 1,200 Kgs. @ ₹ 475 per kg.
Feb. 5	Issued 975 kgs. to mechanical division vide material requisition no. Mec 09/13
Feb. 6	Received 3,500 kgs. @ ₹ 460 per kg vide purchase order no. 159/2013
Feb. 7	Issued 2,400 kgs. to electrical division vide material requisition no. Ele 012/13
Feb. 9	Returned to stores 475 kgs. by electrical division against material requisition no. Ele 012/13.
Feb. 15	Received 1,800 kgs. @ ₹ 480 per kg. vide purchase order no. 161/ 2013
Feb. 17	Returned to supplier 140 kgs. out of quantity received vide purchase order no. 161/2013.
Feb. 20	Issued 1,900 kgs. to electrical division vide material requisition no. Ele 165/ 2013

On 28th February, 2014 it was found that 180 kgs. of wire was fraudulently misappropriated by the stores assistant and never recovered by the company.

From the above information you are required to prepare the Stock Ledger account using 'Weighted Average' method of valuing the issues.

Labour

2. A, B and C are three industrial workers working in Sports industry and are experts in making cricket pads. A, B and C are working in Mahi Sports, Virat Sports and Sikhar Sports companies respectively. Workers are paid under different incentive schemes. Company wise incentive schemes are as follows:

Company	Incentive scheme
Mahi Sports	Emerson's efficiency system
Virat Sports	Merrick differential piece rate system
Sikhar Sports	Taylor's differential piece work system

The relevant information for the industry is as under:

Standard working hours	8 hours a day
Standard output per hour (in units)	2
Daily wages rate	₹ 360
No. of working days in a week	6 days

Actual outputs for the week are as follows:

A	B	C
132 units	108 units	96 units

You are required to calculate effective wages rate and weekly earnings of all the three workers.

Overheads

3. Arnav Ltd. has three production departments M, N and O and two service departments P and Q. The following particulars are available for the month of September, 2013:

	(₹)
Lease rental	35,000
Power & Fuel	4,20,000
Wages to factory supervisor	6,400
Electricity	5,600
Depreciation on machinery	16,100
Depreciation on building	18,000
Payroll expenses	21,000
Canteen expenses	28,000
ESI and Provident Fund Contribution	58,000

Followings are the further details available:

Particulars	M	N	O	P	Q
Floor space (square meter)	1,200	1,000	1,600	400	800
Light points (nos.)	42	52	32	18	16
Cost of machines (₹)	12,00,000	10,00,000	14,00,000	4,00,000	6,00,000
No. of employees (nos.)	48	52	45	15	25
Direct Wages (₹)	1,72,800	1,66,400	1,53,000	36,000	53,000
HP of Machines	150	180	120	-	-
Working hours (hours)	1,240	1,600	1,200	1,440	1,440

The expenses of service department are to be allocated in the following manner:

	M	N	O	P	Q
P	30%	35%	25%	-	10%
Q	40%	25%	20%	15%	-

You are required to calculate the overhead absorption rate per hour in respect of the three production departments.

Operating Costing

4. Voyager Cabs Pvt. Ltd. is a New Delhi based cab renting company, provides cab facility on rent for cities Delhi, Agra and Jaipur to the tourists. To attract more tourists it has launched a new three days tour package for Delhi-Jaipur-Agra-Delhi. Following are the relevant information regarding the package:

Distance between Delhi to Jaipur (Km.)	274
Distance between Delhi to Agra (Km.)	242
Distance between Agra to Jaipur (Km.)	238
Price of diesel in Delhi	₹ 54 per litre
Price of diesel in Jaipur	₹ 56 per litre
Price of diesel in Agra	₹ 58 per litre
Mileage of cab per litre of diesel (Km.)	16
Chauffeur's salary	₹ 12,000 per month
Cost of the cab	₹ 12,00,000
Expected life of the cab	24,00,000 kms.
Servicing cost	₹ 30,000 after every 50,000 kilometres run.
Chauffeur's meal allowance	₹ 50 for every 200 kilometres of completed journey
Other set up and office cost	₹ 2,400 per month.

Voyager Cabs has made tie-up with fuel service centres at Agra, Jaipur and Delhi to fill diesel to its cabs on production of fuel passbook to the fuel centre. Company has a policy to get fuel filled up sufficient to reach next destination only.

You are required to calculate the price inclusive of service tax @ 12.36% to be quoted for the package if company wants to earn profit of 25% on its net takings i.e. excluding service tax.

Process & Operation Costing

5. Following details are related to the work done in Process-I of Walker Ltd. during the month of January, 2014:

	(₹)
Opening work-in progress (1,500 units)	
Materials	60,000
Labour	35,000
Overheads	30,000
Materials introduced in Process-I (35,000 units)	14,00,000
Direct Labour	3,46,000
Overheads	6,37,000
Units scrapped : 1,800 units	
Degree of completion :	
Materials	100%
Labour and overheads	80%
Closing work-in progress : 1,500 units	
Degree of completion :	
Materials	100%
Labour and overheads	80%

Units finished and transferred to Process-II : 32,000 units

Normal Loss:

5% of total input including opening work-in-progress.

Scrapped units fetch ₹ 8 per piece.

You are required to prepare :

- (i) Statement of equivalent production
- (ii) Statement of costs
- (iii) Statement of distribution of costs and
- (iv) Process-I Account, Normal and Abnormal Loss Accounts.

Standard Costing

6. Jigyasa Pharmaceuticals Ltd. is engaged in producing dietary supplement 'Funkids' for growing children. It produces 'Funkids' in a batch of 10 kgs. Standard material inputs required for 10 kgs. of 'Funkids' are as below:

Material	Quantity (in kgs.)	Rate per kg. (in ₹)
Vita-X	5	110
Proto-D	3	320
Mine-L	3	460

During the month of March, 2014, actual production was 5,000 kgs. of 'Funkids' for which the actual quantities of material used for a batch and the prices paid thereof are as under:

Material	Quantity (in kgs.)	Rate per kg. (in ₹)
Vita-X	6	115
Proto-D	2.5	330
Mine-L	2	405

You are required to calculate the following variances based on the above given information for the month of March, 2014 for Jigyasa Pharmaceuticals Ltd.:

- (i) Material Cost Variance;
- (ii) Material Price Variance;
- (iii) Material Usage Variance;
- (iv) Material Mix Variance;
- (v) Material Yield Variance.

Marginal Costing

7. Maryanne Petrochemicals Ltd. is operating at 80 % capacity and presents the following information:

Break-even Sales	₹ 400 crores
P/V Ratio	30 %
Margin of Safety	₹ 120 crores

Maryanne's management has decided to increase production to 95 % capacity level with the following modifications:

- (a) The selling price will be reduced by 10%.
- (b) The variable cost will be increased by 2% on sales

- (c) The fixed costs will increase by ₹ 50 crores, including depreciation on additions, but excluding interest on additional capital.

Additional capital of ₹ 100 crores will be needed for capital expenditure and working capital.

Required:

- (i) Indicate the sales figure, with the working, that will be needed to earn ₹ 20 crores over and above the present profit and also meet 15% interest on the additional capital.
- (ii) What will be the revised
- Break-even Sales
 - P/V Ratio
 - Margin of Safety

Budget and Budgetary Control

8. Concorde Ltd. manufactures two products using two types of materials and one grade of labour. Shown below is an extract from the company's working papers for the next month's budget:

	Product-A	Product-B
Budgeted sales (in units)	2,400	3,600
Budgeted material consumption per unit (in kg):		
Material-X	5	3
Material-Y	4	6
Standard labour hours allowed per unit of product	3	5

Material-X and Material-Y cost ₹ 4 and ₹ 6 per kg and labours are paid ₹ 25 per hour. Overtime premium is 50% and is payable, if a worker works for more than 40 hours a week. There are 180 direct workers.

The target productivity ratio (or efficiency ratio) for the productive hours worked by the direct workers in actually manufacturing the products is 80%. In addition the non-productive down-time is budgeted at 20% of the productive hours worked.

There are four 5-days weeks in the budgeted period and it is anticipated that sales and production will occur evenly throughout the whole period.

It is anticipated that stock at the beginning of the period will be:

Product-A	400 units
Product-B	200 units
Material-X	1,000 kgs.
Material-Y	500 kgs.

The anticipated closing stocks for budget period are as below:

Product-A	4 days sales
Product-B	5 days sales
Material-X	10 days consumption
Material-Y	6 days consumption

Required:

Calculate the Material Purchase Budget and the Wages Budget for the direct workers, showing the quantities and values, for the next month.

Contract Costing

9. Hut-to-Palace Ltd. undertook a contract in last year. In the agreement between the Hut-to-Palace Ltd. and the contractee, there is a clause stating that Hut-to-Palace Ltd. will receive total cost plus 40% as contract consideration. The following are the details of the contract as on 31st March, 2014:

	(₹)
Total expenditure to date	17,64,525
Estimated further expenditure to complete the contract	8,38,645
Value of work certified	21,07,500
Cost of work not certified	3,11,075
Progress payment received from the contractee	14,75,250

From the above information calculate the

- (i) Conservative estimate of profit for the management of Hut-to-Palace Ltd.
- (ii) What would be the estimated profit from the contract if management of Hut-to-Palace Ltd has come to know that the contractee has liquidity crunch and it is not able to pay further payments.

Miscellaneous

10. (a) What are the essential features of a good Cost Accounting System?
- (b) Steel Heart Pvt. Ltd. is manufacturing TMT bars from MS Ingots and MS Billets. After production of TMT bars, sorting is carried out to find any defects or units do not match with standard specification. The products which do not match with the standard product specification are treated as scrap. You are required to state the treatment of the products which do not match with the product specifications in Cost Accounts.
- (c) What are the essential pre-requisites of integrated accounting system?

SUGGESTED HINTS/ANSWERS

1. Store Ledger of Aditya Ltd. (Weighted Average Method)

Date	Receipts			Issues			Balance of Stock		
	Qty (kg.)	Rate (₹)	Amount (₹)	Qty (kg.)	Rate (₹)	Amount (₹)	Qty (kg.)	Rate (₹)	Amount (₹)
1	-	-	-	-	-	-	1,200	475.00	5,70,000
5	-	-	-	975	475.00	4,63,125	225	475.00	1,06,875
6	3,500	460.00	16,10,000	-	-	-	3,725	460.91	17,16,875
7	-	-	-	2,400	460.91	11,06,175	1,325	460.91	6,10,700
9	475	460.91	2,18,932	-	-	-	1,800	460.91	8,29,632
15	1,800	480.00	8,64,000	-	-	-	3,600	470.45	16,93,632
17	-	-	-	140	480.00	67,200	3,460	470.07	16,26,432
20	-	-	-	1,900	470.07	8,93,133	1,560	470.06	7,33,299
28	-	-	-	180*	470.06	84,611	1,380	470.06	6,48,688

* 180 kgs. is abnormal loss, hence it will be transferred to Costing Profit & Loss A/c.

2. Calculation of effective wages rate and weekly earnings of the workers A, B and C

Workers	A	B	C
Standard Output	96 units (8 hrs. × 2 units × 6 days)	96 units (8 hrs. × 2 units × 6 days)	96 units (8 hrs. × 2 units × 6 days)
Actual Output	132 units	108 units	96 units
Efficiency (%)	$\frac{132\text{units}}{96\text{units}} \times 100 = 137.5$	$\frac{108\text{units}}{96\text{units}} \times 100 = 112.5$	$\frac{96\text{units}}{96\text{units}} \times 100 = 100$
Daily wages Rate	₹ 360	₹ 360	₹ 360
Incentive system	Emerson's Efficiency System	Merrick differential piece rate system	Taylor's differential piece work system
Rate of Bonus	57.5% of time rate (20% + 37.5%)	20% of ordinary piece rate	25% of ordinary piece rate
Effective Wage Rate	₹ 70.875 per hour $\left(\frac{₹ 360}{8\text{hours}} \times 157.5\% \right)$	₹ 27 per piece $\left(\frac{₹ 360}{16\text{units}} \times 120\% \right)$	₹ 28.125 per piece $\left(\frac{₹ 360}{16\text{units}} \times 125\% \right)$
Total weekly earnings	₹ 3,402 (8 hours × 6 days × ₹ 70.875)	₹ 2,916 (108 units × ₹ 27)	₹ 2,700 (96 units × ₹ 28.125)

3. Primary Distribution Summary

Item of cost	Basis apportionment of	Total (₹)	Production Dept.			Service Dept.	
			M (₹)	N (₹)	O (₹)	P (₹)	Q (₹)
Lease rental	Floor space (6 : 5 : 8 : 2 : 4)	35,000	8,400	7,000	11,200	2,800	5,600
Power & Fuel	HP of Machines × Working hours (93: 144 : 72)	4,20,000	1,26,408	1,95,728	97,864	-	-
Supervisor's wages*	Working hours (31 : 40 : 30)	6,400	1,964	2,535	1,901	-	-
Electricity	Light points (21: 26: 16 : 9 : 8)	5,600	1,470	1,820	1,120	630	560
Depreciation on machinery	Value of machinery (6 : 5 : 7 : 2 : 3)	16,100	4,200	3,500	4,900	1,400	2,100
Depreciation on building	Floor space (6 : 5 : 8 : 2 : 4)	18,000	4,320	3,600	5,760	1,440	2,880
Payroll expenses	No. of employees (48: 52: 45: 15: 25)	21,000	5,448	5,903	5,108	1,703	2,838
Canteen expenses	No. of employees (48: 52: 45: 15: 25)	28,000	7,265	7,870	6,811	2,270	3,784
ESI and PF contribution	Direct wages (864: 832: 765: 180: 265)	58,000	17,244	16,606	15,268	3,593	5,289
		6,08,100	1,76,719	2,44,562	1,49,932	13,836	23,051

* Wages to supervisor is to be distributed to production departments only.

Let 'P' be the overhead of service department P and 'Q' be the overhead of service department Q.

$$P = 13,836 + 0.15 Q$$

$$Q = 23,051 + 0.10 P$$

Substituting the value of Q in P we get

$$P = 13,836 + 0.15 (23,051 + 0.10 P)$$

$$P = 13,836 + 3,457.65 + 0.015 P$$

$$0.985 P = 17,293.65$$

$$\begin{aligned} \therefore P &= ₹ 17,557 \\ \therefore Q &= 23,051 + 0.10 \times 17,557 \\ &= ₹ 24,806.70 \text{ or } ₹ 24,807 \end{aligned}$$

Secondary Distribution Summary

Particulars	Total	M	N	O
	(₹)	(₹)	(₹)	(₹)
Allocated and Apportioned over-heads as per primary distribution	5,71,213	1,76,719	2,44,562	1,49,932
P (90% of ₹17,557)	15,801	5,267	6,145	4,389
Q (85% of ₹24,807)	<u>21,086</u>	<u>9,923</u>	<u>6,202</u>	<u>4,961</u>
		1,91,909	2,56,909	1,59,282

Overhead rate per hour

	M	N	O
Total overheads cost (₹)	1,91,909	2,56,909	1,59,282
Working hours	1,240	1,600	1,200
Rate per hour (₹)	154.77	160.57	132.74

4. Calculation of Price of the Delhi-Jaipur-Agra-Delhi tour package

Particulars	Amount (₹)	Amount (₹)
Diesel Cost (Working Note-2)		2,635.00
Servicing Cost $\left(\frac{₹ 30,000}{50,000 \text{ kms}} \times 754 \text{ kms.} \right)$		452.40
Chauffeur's meal cost (three 200 km. completed journey \times ₹ 50)		150.00
<u>Other Allocable costs:</u>		
Depreciation $\left(\frac{₹ 12,00,000}{24,00,000 \text{ kms}} \times 754 \text{ kms.} \right)$	377.00	
Other set-up and office cost $\left(\frac{₹ 2,400}{30 \text{ days}} \times 3 \text{ days} \right)$	240.00	

Chauffeur's salary $\left(\frac{₹12,000}{30\text{days}} \times 3\text{days} \right)$	<u>1,200.00</u>	<u>1,817.00</u>
Total Cost		<u>5,054.40</u>
Add: Profit (25% of net takings or 1/3 rd of total cost)		<u>1,684.80</u>
		6,739.20
Add: Service Tax @12.36%		<u>832.97</u>
Price of the package (inclusive of service tax)		<u>7,572.17</u>

Working Notes

(1) Total distance of journey

From	To	Distance (in Km.)
Delhi	Jaipur	274
Jaipur	Agra	238
Agra	Delhi	<u>242</u>
Total Distance		754

(2) Cost of Diesel

From	To	Distance (in Km.)	Price of diesel per litre (₹)	Total diesel Cost (₹)
I	II	III	IV	V= (III ÷ 16 km) × IV
Delhi	Jaipur	274	54	924.75
Jaipur	Agra	238	56	833.00
Agra	Delhi	242	58	<u>877.25</u>
Total cost				2,635.00

5. (i) Statement of Equivalent Production

Input	Units	Output	Units	Equivalent production			
				Material		Labour & Overheads	
				%	Units	%	Units
Opening WIP	1,500	Completed and transfer to Process-II	32,000	100	32,000	100	32,000
Units introduced	35,000	Normal loss (5% of 36,500)	1,825		—		—
		Abnormal loss	1,175	100	1,175	80	940
		Closing WIP	<u>1,500</u>	100	<u>1,500</u>	80	<u>1,200</u>
	<u>36,500</u>		<u>36,500</u>		<u>34,675</u>		<u>34,140</u>

(ii) Statement of Cost

Details	Cost at the beginning of process	Cost added	Total cost	Equivalent Units	Cost per unit
	(₹)	(₹)	(₹)	(units)	(₹)
Material	60,000	14,00,000	14,60,000	34,675	41.6842
Less: Value of normal loss (1,825 units × ₹ 8)			(14,600) 14,45,400		
Labour	35,000	3,46,000	3,81,000	34,140	11.1599
Overheads	30,000	6,37,000	6,67,000	34,140	<u>19.5372</u>
					<u>72.3813</u>

(iii) Statement of distribution of costs:

(a) <u>Completed and transferred to Process- II</u> : 32,000 units @ ₹ 72.3813	₹ 23,16,202
(b) <u>Abnormal loss 1,175 units</u>	
Materials 1,175 units @ ₹ 41.6842	₹ 48,979
Labour 940 units @ ₹ 11.1599	₹ 10,491
Overheads 940 units @ ₹ 19.5372	₹ <u>18,365</u>
	₹ <u>77,835</u>
(c) <u>Closing WIP 1,500 units</u>	
Materials 1,500 units @ ₹ 41.6842	₹ 62,526
Labour 1,200 units @ ₹ 11.1599	₹ 13,392
Overheads 1,200 units @ ₹ 19.572	₹ <u>23,445</u>
	₹ <u>99,363</u>

(iv) Process-I Account

Dr.			Cr.		
Particulars	Units	Amount	Particulars	Units	Amount
To Opening WIP	1,500	1,25,000*	By Normal Loss	1,825	14,600
To Material introduced	35,000	14,00,000	By Abnormal loss	1,175	77,835
To Direct labour		3,46,000	By Process-II A/c	32,000	23,16,202
To Overheads		6,37,000	By Closing WIP	1,500	99,363
	36,500	25,08,000		<u>36,500</u>	<u>25,08,000</u>

*Materials + Labour + Overheads = ₹ (60,000 + 35,000 + 30,000) = ₹ 1,25,000.

Normal Loss Account

Dr.

Cr.

Particulars	Units	Amount	Particulars	Units	Amount
To Process-I A/c	1,825	14,600	By Cost Ledger Control A/c	1,825	14,600
	1,825	14,600		1,825	14,600

Abnormal Loss Account

Dr.

Cr.

Particulars	Units	Amount	Particulars	Units	Amount
To Process-I A/c	1,175	77,835	By Cost Ledger Control A/c (1,175 units × ₹ 8)	1,175	9,400
			By Costing Profit and Loss A/c		68,435
	1,175	77,835		1,175	77,835

6.

Material	SQ* × SP	AQ** × SP	AQ** × AP	RSQ*** × SP
Vita-X	₹ 2,75,000 (2,500 kg. × ₹ 110)	₹ 3,30,000 (3,000 kg. × ₹ 110)	₹ 3,45,000 (3,000 kg. × ₹ 115)	₹ 2,62,460 (2,386 kg. × ₹ 110)
Proto-D	₹ 4,80,000 (1,500 kg. × ₹ 320)	₹ 4,00,000 (1,250 kg. × ₹ 320)	₹ 4,12,500 (1,250 kg. × ₹ 330)	₹ 4,58,240 (1,432 kg. × ₹ 320)
Mine-L	₹ 6,90,000 (1,500 kg. × ₹ 460)	₹ 4,60,000 (1,000 kg. × ₹ 460)	₹ 4,05,000 (1,000 kg. × ₹ 405)	₹ 6,58,720 (1,432 kg. × ₹ 460)
Total	₹ 14,45,000	₹ 11,90,000	₹ 11,62,500	₹ 13,79,420

* Standard Quantity of materials for actual output :

Vita-X	$= \frac{5\text{kgs.}}{10\text{kgs}} \times 5,000\text{kgs.} = 2,500\text{kgs.}$
Proto-D	$= \frac{3\text{kgs.}}{10\text{kgs}} \times 5,000\text{kgs.} = 1,500\text{kgs.}$
Mine-L	$= \frac{3\text{kgs.}}{10\text{kgs}} \times 5,000\text{kgs.} = 1,500\text{kgs.}$

** Actual Quantity of Material used for actual output:

Vita-X	$= \frac{6\text{kgs.}}{10\text{kgs}} \times 5,000\text{kgs.} = 3,000\text{kgs.}$
Proto-D	$= \frac{2.5\text{kgs.}}{10\text{kgs}} \times 5,000\text{kgs.} = 1,250\text{kgs.}$
Mine-L	$= \frac{2\text{kgs.}}{10\text{kgs}} \times 5,000\text{kgs.} = 1,000\text{kgs.}$

*** Revised Standard Quantity (RSQ):

Vita-X	$= \frac{5\text{kgs.}}{11\text{kgs}} \times 5,250\text{kgs.} = 2,386\text{kgs.}$
Proto-D	$= \frac{3\text{kgs.}}{11\text{kgs}} \times 5,250\text{kgs.} = 1,432\text{kgs.}$
Mine-L	$= \frac{3\text{kgs.}}{11\text{kgs}} \times 5,250\text{kgs.} = 1,432\text{kgs.}$

(i) Material Cost Variance = (Std. Qty. × Std. Price) – (Actual Qty. × Actual Price)

Or	$= (\text{SQ} \times \text{SP}) - (\text{AQ} \times \text{AP})$		
Vita-X	$= ₹ 2,75,000 - ₹ 3,45,000$	$= ₹ 70,000$	(A)
Proto-D	$= ₹ 4,80,000 - ₹ 4,12,500$	$= ₹ 67,500$	(F)
Mine-L	$= ₹ 6,90,000 - ₹ 4,05,000$	$= ₹ 2,85,000$	(F)
		<u>₹ 2,82,500</u>	(F)

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

	$= (\text{AQ} \times \text{SP}) - (\text{AQ} \times \text{AP})$		
Vita-X	$= ₹ 3,30,000 - ₹ 3,45,000$	$= ₹ 15,000$	(A)
Proto-D	$= ₹ 4,00,000 - ₹ 4,12,500$	$= ₹ 12,500$	(A)
Mine-L	$= ₹ 4,60,000 - ₹ 4,05,000$	$= ₹ 55,000$	(F)
		<u>₹ 27,500</u>	(F)

(iii) Material Usage Variance = Std. Price (Std. Qty. – Actual Qty.)

Or	$= (\text{SQ} \times \text{SP}) - (\text{AQ} \times \text{SP})$		
Vita-X	$= ₹ 2,75,000 - ₹ 3,30,000$	$= ₹ 55,000$	(A)
Proto-D	$= ₹ 4,80,000 - ₹ 4,00,000$	$= ₹ 80,000$	(F)
Mine-L	$= ₹ 6,90,000 - ₹ 4,60,000$	$= ₹ 2,30,000$	(F)
		<u>₹ 2,55,000</u>	(F)

(iv) **Material Mix Variance** = Std. Price (Revised Std. Qty. – Actual Qty.)

Or	= (RSQ × SP) – (AQ × SP)		
Vita-X	= ₹ 2,62,460 - ₹ 3,30,000	= ₹ 67,540	(A)
Proto-D	= ₹ 4,58,240 - ₹ 4,00,000	= ₹ 58,240	(F)
Mine-L	= ₹ 6,58,720 - ₹ 4,60,000	= ₹ 1,98,720	(F)
		<u>= ₹ 1,89,420</u>	<u>(F)</u>

(v) **Material Yield Variance** = Std. Price (Std. Qty. – Revised Std. Qty.)

Or	= (SQ × SP) – (RSQ × SP)		
Vita-X	= ₹ 2,75,000 - ₹ 2,62,460	= ₹ 12,540	(F)
Proto-D	= ₹ 4,80,000 - ₹ 4,58,240	= ₹ 21,760	(F)
Mine-L	= ₹ 6,90,000 - ₹ 6,58,720	= ₹ 31,280	(F)
		<u>= ₹ 65,580</u>	<u>(F)</u>

7. Working Notes:

- Total Sales = Break -even Sales + Margin of Safety
= ₹ 400 crores + ₹ 120 crores
= ₹ 520 crores
- Variable Cost = Total Sales × (1- P/V Ratio)
= ₹ 520 crores × (1 – 0.3)
= ₹ 364 crores
- Fixed Cost = Break-even Sales × P/V Ratio
= ₹ 400 crores × 30%
= ₹ 120 crores
- Profit = Total Sales – (Variable Cost + Fixed Cost)
= ₹ 520 crores – (₹ 364 crores + ₹ 120 crores)
= ₹ 36 crores

(i) Revised Sales figure to earn profit of ₹ 56 crores (i.e. ₹ 36 crores + ₹ 20 crores)

$$\begin{aligned} \text{Revised Sales} &= \frac{\text{Revised Fixed Cost}^* + \text{Desired Profit}}{\text{Revised P / V Ratio}^{**}} \\ &= \frac{\text{₹ 185 crores} + \text{₹ 56 crores}}{28\%} \\ &= \text{₹ 860.71 Crores} \end{aligned}$$

*Revised Fixed Cost = Present Fixed Cost + Increment in fixed cost + Interest on additional Capital
 = ₹ 120 crores + ₹ 50 crores + 15% of ₹ 100 crores
 = ₹ 185 crores

**Revised P/V Ratio : Let current selling price per unit be ₹ 100.

Therefore, Reduced selling price per unit = ₹ 100 × 90% = ₹ 90

Revised Variable Cost on Sales = 70%+ 2% = 72%

Variable Cost per unit = ₹ 90 × 72% = ₹ 64.80

Contribution per unit = ₹ 90 - ₹ 64.80 = ₹ 25.20

$$\text{Revised P/V Ratio} = \frac{\text{Contribution}}{\text{Sales}} \times 100 = \frac{\text{₹}25.2}{\text{₹}90} \times 100 = 28\%$$

- (ii) (a) Revised Break-even Sales = $\frac{\text{Fixed Cost}}{\text{P/V Ratio}} \times 100$
 = $\frac{\text{₹}185 \text{ crores}}{28\%} = \text{₹}660.71 \text{ crores}$
- (b) Revised P/V Ratio = 28 % (as calculated above)
- (c) Revised Margin of safety = Total Sales – Break-even Sales
 = ₹ 860.71 crores - ₹ 660.71 crores
 = ₹ 200 crores.

8. Number of days in budget period = 4 weeks × 5 days = 20 days

Number of units to be produced

	Product-A (units)	Product-B (units)
Budgeted Sales	2,400	3,600
Add: Closing stock $\left(\frac{2,400 \text{ units}}{20 \text{ days}} \times 4 \text{ days} \right) \left(\frac{3,600 \text{ units}}{20 \text{ days}} \times 5 \text{ days} \right)$	480	900
Less: Opening stock	400	200
	2,480	4,300

(i) Material Purchase Budget

	Material-X (Kg.)	Material-Y (Kg.)
Material required :		
Product-A	12,400 (2,480 units × 5 kg.)	9,920 (2,480 units × 4 kg.)
Product-B	12,900 (4,300 units × 3 kg.)	25,800 (4,300 units × 6 kg.)
	25,300	35,720
Add: Closing stock $\left(\frac{25,300\text{kgs.}}{20\text{days}} \times 10\text{days}\right)$ $\left(\frac{35,720\text{kgs.}}{20\text{days}} \times 6\text{days}\right)$	12,650	10,716
Less: Opening stock	1,000	500
Quantity to be purchased	36,950	45,936
Rate per kg. of Material	₹ 4	₹ 6
Total Cost	₹ 1,47,800	₹ 2,75,616

(ii) Wages Budget

	Product-A (Hours)	Product-B (Hours)
Units to be produced	2,480 units	4,300 units
Standard hours allowed per unit	3	5
Total Standard Hours allowed	7,440	21,500
Productive hours required for production	$\frac{7,440\text{hours}}{80\%} = 9,300$	$\frac{21,500\text{hours}}{80\%} = 26,875$
Add: Non-Productive down time	1,860 hours. (20% of 9,300 hours)	5,375 hours. (20% of 26,875 hours)
Hours to be paid	11,160	32,250

Total Hours to be paid

$$= 43,410 \text{ hours } (11,160 + 32,250)$$

Hours to be paid at normal rate = 4 weeks × 40 hours × 180 workers = 28,800 hours

Hours to be paid at premium rate = 43,410 hours – 28,800 hours = 14,610 hours

Total wages to be paid = 28,800 hours × ₹ 25 + 14,610 hours × ₹ 37.5

$$= ₹ 7,20,000 + ₹ 5,47,875$$

$$= ₹ 12,67,875$$

9. Working Notes:

1. Calculation of Notional Profit:

	(₹)
Value of work certified	21,07,500
Cost of work not certified	3,11,075
	24,18,575
Less: Total expenditure to date	17,64,525
Notional Profit	6,54,050

2. Calculation of total Contract Price:

	(₹)
Total expenditure to date	17,64,525
Estimated further expenditure	8,38,645
Total estimated cost	26,03,170
Add: Margin@40%	10,41,268
Total contract Price	36,44,438

3. Calculation of percentage (%) of contract completion:

$$= \frac{\text{Value of work certified}}{\text{Total Contract Price}} \times 100$$

$$= \frac{₹ 21,07,500}{₹ 36,44,438} \times 100 = 57.83\%$$

(i) Conservative estimate of profit for the management

$$= \frac{2}{3} \times \text{Notional Profit} \times \frac{\text{Cash Received}}{\text{Value of Work of certified}}$$

$$= \frac{2}{3} \times ₹ 6,54,050 \times \frac{₹ 14,75,250}{₹ 21,07,500} = ₹ 3,05,223$$

(ii) When the management of Hut-to-Palace appreciates the fact that the contractee is having liquidity crunch and it may not be able to pay further cash Payment. In this situation, following the concept of conservatism it has to recognise loss if any immediately i.e.

$$\text{Cash Received} - \text{Expenditure to date} = \text{Profit/ (Loss)}$$

$$₹ 14,75,250 - ₹ 17,64,525 = (₹ 2,89,275)$$

10. (a) The essential features, which a good Cost Accounting System should possess, are as follows:

- (a) **Informative and Simple:** Cost Accounting System should be tailor-made, practical, simple and capable of meeting the requirements of a business concern. The system of costing should not sacrifice the utility by introducing meticulous and unnecessary details.
- (b) **Accuracy:** The data to be used by the Cost Accounting System should be accurate; otherwise it may distort the output of the system and a wrong decision may be taken.
- (c) **Support from Management and subordinates:** Necessary cooperation and participation of executives from various departments of the concern is essential for developing a good system of Cost Accounting.
- (d) **Cost-Benefit:** The Cost of installing and operating the system should justify the results.
- (e) **Procedure:** A carefully phased programme should be prepared by using network analysis for the introduction of the system.
- (f) **Trust:** Management should have faith in the Costing System and should also provide a helping hand for its development and success.

(b) Scrap has been defined as the incidental residue from certain types of manufacture, usually of small amount and low value, recoverable without further processing.

Scrap may be treated in cost accounts in the following ways:-

- (i) **When the scrap value is negligible:** It may be excluded from costs. In other words, the cost of scrap is borne by good units and income from scrap is treated as other income.
- (ii) **When the scrap value is not identifiable to a particular process or job:** The sales value of scrap net of selling and distribution cost, is deducted from overhead to reduce the overhead rate. A variation of this method is to deduct the net realisable value from material cost.
- (iii) **When scrap is identifiable with a particular job or process and its value is significant:** The scrap account should be charged with full cost. The credit is given to the job or process concerned. The profit or loss in the scrap account, on realisation, will be transferred to the Costing Profit and Loss Account.

(c) Essential pre-requisites of Integrated Accounting System:

The essential pre-requisites of integrated accounting system include the following:

1. The management's decision about the extent of integration of the two sets of books. Some concerns find it useful to integrate upto the stage of primary cost or factory cost while other prefer full integration of the entire accounting records.

2. A suitable coding system must be made available so as to serve the accounting purposes of financial and cost accounts.
3. An agreed routine, with regard to the treatment of provision for accruals, prepaid expenses, other adjustment necessary for preparation of interim accounts.
4. Perfect coordination should exist between the staff responsible for the financial and cost aspects of the accounts and an efficient processing of accounting documents should be ensured.

Under this system there is no need for a separate cost ledger. Of course, there will be a number of subsidiary ledgers; in addition to the useful Customers Ledger and the Bought Ledger, there will be : (a) Stores Ledger; (b) Stock Ledger and (c) Job Ledger.

PART II: FINANCIAL MANAGEMENT

QUESTIONS

1. Answer the following, supporting the same with reasoning/working notes:
 - (a) "Floating-rate bonds are designed to minimize the holders' interest rate risk; while convertible bonds are designed to give the investor the ability to share in the price appreciation of the company's stock." Do you agree with this statement?
 - (b) Should companies use their weighted average cost of capital (WACC) as the discount rate when assessing the acceptability of new projects?
 - (c) The earnings of Alpha Limited were ₹ 3 per share in year 1. They increased over a 10 year period to ₹ 4.02. You are required to compute the rate of growth or compound annual rate of growth of the earnings per share.
 - (d) "An EBIT-EPS indifference analysis chart is used for determining the impact of a change in sales on EBIT." Comment.
 - (e) The trade terms "2/15, net 30" indicate that a 2 percent discount is offered if payment is made within 30 days. Comment.

Management of Working Capital

2. The present credit terms of Beta Limited are 1/10 net 30. Its annual sales are ₹ 80 lakhs, its average collection period is 20 days. Its variable costs and average total costs to sales are 0.85 and 0.95 respectively and its cost of capital is 10 per cent. The proportion of sales on which customers currently take discount is 0.5. Beta Limited is considering relaxing its discount terms to 2/10 net 30. Such relaxation is expected to increase sales by ₹ 5 lakhs, reduce the average collection period to 14 days and increase the proportion of discount sales to 0.8. What will be the effect of relaxing the discount policy on Beta Limited's profit? Take year as 360 days.

Investment Decisions

3. Gamma Limited is considering building an assembly plant and the company has two options, out of which it wishes to choose the best plant. The projected output is 10,000 units per month. The following data is available:

		₹
	<i>Plant A</i>	<i>Plant B</i>
Initial Cost	60,00,000	44,00,000
Direct Labour Cost p.a. (1st Shift)	30,00,000	15,00,000
(Second Shift)	-	19,00,000
Overhead (per year)	5,00,000	4,20,000

Both the plants have an expected life of 10 years after which there will be no salvage value. The cost of capital is 10 percent. The present value of an ordinary annuity of Re. 1 for 10 years @ 10 percent is 6.1446. Ignore effect of taxation.

You are required to determine:

- What would be the desirable choice?
- What other important elements are to be considered before the final decision is taken?

Financing Decisions

4. The following figures of Theta Limited are presented as under:

		₹
Earnings before Interest and Tax		23,00,000
Less: Debenture Interest @ 8%	80,000	
Long Term Loan Interest @ 11%	<u>2,20,000</u>	<u>3,00,000</u>
		20,00,000
Less: Income Tax		<u>10,00,000</u>
Earnings after tax		10,00,000

No. of Equity Shares of ₹ 10 each	5,00,000
EPS	₹ 2
Market Price of Share	₹ 20
P/E Ratio	10

The company has undistributed reserves and surplus of ₹ 20 lakhs. It is in need of ₹ 30 lakhs to pay off debentures and modernise its plants. It seeks your advice on the following alternative modes of raising finance.

Alternative 1 - Raising entire amount as term loan from banks @ 12%.

Alternative 2 - Raising part of the funds by issue of 1,00,000 shares of ₹ 20 each and the rest by term loan at 12 percent.

The company expects to improve its rate of return by 2 percent as a result of modernisation, but P/E ratio is likely to go down to 8 if the entire amount is raised as term loan.

- Advise the company on the financial plan to be selected.
- If it is assumed that there will be no change in the P/E ratio if either of the two alternatives is adopted, would your advice still hold good?

Financing Decisions

5. The following is an extract from the financial statements of Zeta Limited:

	<i>Amount (₹ lakhs)</i>
Operating Profit	105.0
<i>Less: Interest on Debentures</i>	<u>33.0</u>
Earnings before Taxes	72.0
<i>Less: Income Tax (35%)</i>	<u>25.2</u>
Earnings after Taxes	<u>46.8</u>
Equity Share Capital (shares of ₹ 10 each)	200.0
Reserves and Surplus	100.0
15% Non-Convertible Debentures (of ₹ 100 each)	<u>220.0</u>
	520.0

The market price per equity share is ₹ 12 and per debenture is ₹ 93.75.

You are required to calculate:

- The earnings per share.
- The percentage cost of capital to the company for debentures and the equity.

Financial Analysis and Planning

6. Bodhi Limited provides you the following information. You are required to prepare cash flow statement as at 31st December, 2013 by using direct method:

Balance Sheets

<i>Liabilities</i>	<i>2012</i>	<i>2013</i>	<i>Assets</i>	<i>2012</i>	<i>2013</i>
Share Capital	5,00,000	5,00,000	Fixed Assets	8,50,000	10,00,000
Profit & Loss A/c	4,25,000	5,00,000	Stock	3,40,000	3,50,000
Long Term Loans	5,00,000	5,30,000	Debtors	3,60,000	3,30,000
Creditors	1,75,000	2,00,000	Cash	30,000	35,000
	<u> </u>	<u> </u>	Bills Receivable	<u>20,000</u>	<u>15,000</u>
	<u>16,00,000</u>	<u>17,30,000</u>		<u>16,00,000</u>	<u>17,30,000</u>

Income Statement for the year ended 31st December, 2013

Sales	20,40,000
<i>Less: Cost of Sales</i>	<u>13,60,000</u>
Gross Profit	6,80,000

<i>Less:</i> Operating Expenses:	
Administrative Expenses	(2,30,000)
Depreciation	<u>(1,10,000)</u>
Operating Profit	3,40,000
<i>Add:</i> Non-Operating Incomes (dividend received)	<u>25,000</u>
	3,65,000
<i>Less:</i> Interest Paid	<u>(70,000)</u>
	2,95,000
<i>Less:</i> Income Tax	<u>1,30,000</u>
Profit after Tax	<u>1,65,000</u>

Statement of Retained Earnings

Opening Balance	4,25,000
<i>Add:</i> Profit	<u>1,65,000</u>
	5,90,000
<i>Less:</i> Dividend Paid	<u>90,000</u>
Closing Balance	<u>5,00,000</u>

Investment Decisions

7. Fibroplast Limited, a toy manufacturing company, is considering replacing an older machine which was fully depreciated for tax purposes with a new machine costing ₹ 40,000. The new machine will be depreciated over its eight-year life. It is estimated that the new machine will reduce labour costs by ₹ 8,000 per year. The management believes that there will be no change in other expenses and revenues of the firm due to the machine. The company requires an after-tax return on investment of 10 per cent. Its rate of tax is 35 per cent. The company's income statement for the current year is given for other information.

Income statement for the current year:

		₹
Sales		5,00,000
Costs:		
Materials	1,50,000	
Labour	2,00,000	
Factory and Administrative	40,000	
Depreciation	<u>40,000</u>	<u>4,30,000</u>

Net Income before Taxes		70,000
Taxes (0.35)		<u>24,500</u>
Earnings after Taxes		45,500

Should the Fibroplast Limited buy the new machine? You may assume the company follows straight-line method of depreciation and the same is allowed for tax purposes.

Financial Analysis and Planning

8. Following is the abridged Balance Sheet of Ganesha Limited:

Balance Sheet as on 31-3-2013

<i>Liabilities</i>	₹	<i>Assets</i>		₹
Share Capital	1,00,000	Land and Buildings		80,000
Profit and Loss Account	17,000	Plant and Machinery	50,000	
Current Liabilities	40,000	<i>Less: Depreciation</i>	<u>15,000</u>	<u>35,000</u>
				1,15,000
		Current Assets		
		Stock	21,000	
		Debtors	20,000	
		Bank	<u>1,000</u>	<u>42,000</u>
Total	<u>1,57,000</u>	Total		<u>1,57,000</u>

With the help of the additional information furnished below, you are required to prepare Trading and Profit & Loss Account and a Balance Sheet as on 31st March, 2014:

(i) The company went in for reorganisation of capital structure, with share capital remaining the same as follows:

Share Capital	50%
Other Shareholders' Funds	15%
5% Debentures	10%
Trade Creditors	25%

Debentures were issued on 1st April, interest being paid annually on 31st March.

(ii) Land and Buildings remained unchanged. Additional plant and machinery has been bought and a further ₹ 5,000 depreciation written off.

(The total fixed assets then constituted 60% of total gross fixed and current assets.)

(iii) Working capital ratio was 8 : 5.

(iv) Quick assets ratio was 1 : 1.

- (v) The debtors (four-fifth of the quick assets) to sales ratio revealed a credit period of 2 months. There were no cash sales.
- (vi) Return on net worth was 10%.
- (vii) Gross profit was at the rate of 15% of selling price.
- (viii) Stock turnover was eight times for the year.

Ignore Taxation.

Management of Working Capital

9. The following are the ratios relating to the activities of Technopak Limited:

Debtors Velocity	3 months
Stock Velocity	8 months
Creditors Velocity	2 months
Gross Profit Ratio	25 per cent

Gross profit for the current year ended December 31 amounts to ₹ 4,00,000. Closing stock of the year is ₹ 10,000 above the opening stock. Bills receivables amount to ₹ 25,000 and bills payable to ₹ 10,000. Calculate: (a) Sales, (b) Sundry Debtors, (c) Sundry Creditors.

10. Answer the following:
- (a) Funds Flow Statement versus Cash Flow Statement.
 - (b) Basic Functions of Financial Management.
 - (c) Advantages of Debt Securitisation.

SUGGESTED ANSWERS / HINTS

1. (a) Floating rate bonds allow the investor to earn a rate of interest income tied to current interest rates, thus negating one of the major disadvantages of fixed income investments while Convertible bonds allow the investor to benefit from the appreciation of the stock price, either by converting to stock or holding the bond, which will increase in price as the stock price increases.
- (b) When we mention the WACC in this context, we can assume we are talking about an historic WACC, i.e. one referring to the cost of funds already raised. There are certain conditions that must be met in order for it to be appropriate to use an historic cost of capital to appraise new projects, as follows:
- The new project must have a similar level of risk to the average risk of a company's existing projects;

- The amount of finance needed for the new project must be small relative to the amount of finance already raised.
- The company must be intending to finance the new project by using a similar financing mix to its historical financing mix.

(c) **Compound Annual Rate of Growth in Earnings per Share**

$$F_n = P \times FVIF_{i,n}$$

$$FVIF_{i,n} = \frac{F_n}{P}$$

$$FVIF_{i,10} = \frac{\text{₹ } 4.02}{\text{₹ } 3} = 1.340$$

An FVIF of 1.340 at 10 years is at 3 percent interest. The compound annual rate of growth in earnings per share is, therefore, 3 percent.

- (d) The statement is incorrect as an EBIT-EPS indifference analysis chart is used for examining EPS results for alternative financing plans at varying EBIT levels.
- (e) The statement is incorrect. The trade terms "2/15, net 30" indicate that a 2 percent discount is offered if payment is made within 15 days.

2. **Working Notes****Calculation of Reduction in Investment in Receivables (Rs.)**

Present Investment in Receivables		
$\left[\text{₹ } 80 \text{ lakhs} \times 0.95 \times \frac{20 \text{ days}}{360 \text{ days}} \right]$		4,22,222
Proposed Investment in Receivables		
$\left[(\text{₹ } 80 \text{ lakhs} \times 0.95) + (\text{₹ } 5 \text{ lakhs} \times 0.85) \right] \times \frac{14 \text{ days}}{360 \text{ days}}$		3,12,083
Reduction in Investment in Receivables		<u>1,10,139</u>

Calculation of Increase in Discount (₹)

Present Discount	$(\text{₹ } 80 \text{ lakhs} \times 1/100 \times 0.5)$	40,000
Proposed Discount	$(\text{₹ } 85 \text{ lakhs} \times 2/100 \times 0.8)$	<u>1,36,000</u>
Net Increase in Discount		<u>96,000</u>

Statement Showing Evaluation of Effect of Relaxing the Discount Policy on Company's Profit

		(₹)
Incremental Revenue:		
Increase in Contribution	(₹ 5 lakhs × 15/100)	75,000
Cost of Savings on Investment In Receivables	(₹ 1,10,139 lakhs × 10/100)	<u>11,014</u>
Total Incremental Cost	Total (A)	86,014
Net Increase in Discount	(B)	<u>96,000</u>
Incremental Loss		<u>9,986</u>

Analysis: There will be an incremental loss by relaxing the discount policy. Hence, it is not suggested to release the Beta Limited's present discount policy.

3. (A) Computation of Differential Cash Flow

			(₹)
	Plant A	Plant B	Differential Cash Outflow
Direct Labour Cost:			
1 st shift	30,00,000	15,00,000	(15,00,000)
2 nd shift		19,00,000	19,00,000
Overhead	5,00,000	4,20,000	<u>(80,000)</u>
Net Saving for using Plant A			<u>3,20,000</u>

Present value of net saving of (₹ 3,20,000 × 6.1446) = ₹ 19,66,272 for Plant A @ 10% (cost of capital).

(B) Additional Cash Outlay for Plant A over Plant B

	₹
Cost of Plant A	60,00,000
Cost of Plant B	44,00,000
Additional Outlay for using Plant A	16,00,000

Analysis: The net saving for the company in choosing Plant A = ₹ 19,66,272 – ₹ 16,00,000 = ₹ 3,66,272. Hence, Plant A should be implemented.

4. Working Notes:

(i) Capital Employed

		₹
Equity Capital	(5,00,000 shares of ₹ 10 each)	50,00,000
Debentures	(₹ 80,000×100/8)	10,00,000
Term Loan	(₹ 2,20,000×100/11)	20,00,000
Reserves and Surplus		20,00,000
Total Capital Employed		1,00,00,000

(ii) Rate of Return

Earnings before Interest and Tax = ₹ 23,00,000

Rate of Return on Capital Employed = $\frac{\text{₹ } 23,00,000}{\text{₹ } 1,00,00,000} \times 100 = 23\%$

(iii) Expected Rate of Return after Modernisation = 23% + 2% = 25%

Alternative 1: Raise Entire Amount as Term Loan

	₹
Original Capital Employed	1,00,00,000
Less: Debentures	10,00,000
	90,00,000
Add: Additional Term Loan	30,00,000
Revised Capital Employed	1,20,00,000

		₹
EBIT on Revised Capital Employed (@ 25% on ₹ 120 lakhs)		30,00,000
Less: Interest		
Existing Term Loan (@11%)	2,20,000	
New Term Loan (@12%)	<u>3,60,000</u>	<u>5,80,000</u>
		24,20,000
Less: Income Tax (@ 50%)		<u>12,10,000</u>
Earnings after Tax (EAT)		12,10,000

Earnings per Share (EPS) = $\frac{\text{EAT}}{\text{No. of Equity Shares}} = \frac{\text{₹ } 12,10,000}{5,00,000 \text{ Shares}} = \text{₹ } 2.42$

$$\text{P/E Ratio} = \frac{\text{Market Price per Share}}{\text{E P S}} = 8$$

$$8 = \frac{\text{Market Price}}{\text{₹ 2.42}}$$

$$\text{Market Price} = \text{₹ 19.36}$$

Alternative 2: Raising Part by Issue of Equity Shares and Rest by Term Loan

		₹
Earnings before Interest and Tax (@ 25% on Revised Capital Employed i.e., ₹ 120 lakhs)		30,00,000
<i>Less:</i> Interest		
Existing Term Loan @ 11%	2,20,000	
New Term Loan @ 12%	<u>1,20,000</u>	<u>3,40,000</u>
		26,60,000
<i>Less:</i> Income Tax @ 50%		<u>13,30,000</u>
Earnings after Tax		13,30,000

$$\text{EPS} = \frac{\text{₹ 13,30,000}}{5,00,000 \text{ (existing)} + 1,00,000 \text{ (new)}} = \text{₹ 2.217}$$

$$\text{P/E Ratio} = 10$$

$$\text{Market Price} = \text{₹ 22.17}$$

Advise:

- (i) From the above computations it is observed that the market price of Equity Shares is maximised under Alternative 2. Hence this alternative should be selected.
 - (ii) If, under the two alternatives, the P/E ratio remains constant at 10, the market price under Alternative 1 would be ₹ 24.20. Then Alternative 1 would be better than Alternative 2.
5. (a) $\text{EPS} = \text{EAT/Number of shares} = \text{₹ 46.8 lakhs} / 20 \text{ lakhs} = \text{₹ 2.34}$
- (b) (i) $\text{Cost of Debentures (book value)} = \text{₹ 33 lakhs} (1 - 0.35) / \text{₹ 220 lakhs} = 9.75 \text{ per cent}$
- (ii) $\text{Cost of Debentures (market value)} = \text{₹ 15} (1 - 0.35) / \text{₹ 93.75} = 10.4 \text{ per cent}$
- (iii) $\text{Cost of Equity (earnings-approach)} = \text{EPS/MPS} = \text{₹ 2.34/₹ 12} = 19.5 \text{ per cent.}$
- (Note: Cost of debentures based on market value is more appropriate).

6. Cash Flow Statement for the year ended December 31, 2013

Cash Flows from Operating Activities	₹	₹
Received from Customers: Sales		20,40,000
<i>Add:</i> Decrease in Debtors	30,000	
Decrease in B/R	<u>5,000</u>	<u>35,000</u>
		20,75,000
<i>Less:</i> Payments to Suppliers: Cost of Sales	13,60,000	
<i>Add:</i> Increase in Stock	10,000	
<i>Less:</i> Increase in Creditors	<u>(25,000)</u>	<u>(13,45,000)</u>
		7,30,000
<i>Less:</i> Payment for Expenses	(2,30,000)	
Tax Paid	<u>(1,30,000)</u>	<u>(3,60,000)</u>
Cash Provided by Operating Activities		3,70,000
Cash Flows from Investing Activities		
Purchase of Fixed Assets (10,00,000 + 1,10,000 – 8,50,000)	(2,60,000)	
Dividend on Investments	<u>25,000</u>	
Cash Used in Investing Activities		(2,35,000)
Cash Flows from Financing Activities		
Long Term Loan taken	30,000	
Interest Paid	(70,000)	
Dividend Paid	<u>(90,000)</u>	
Cash Flows from Financing Activities		<u>(1,30,000)</u>
Net Increase in Cash during the year		5,000
<i>Add:</i> Opening Cash Balance		<u>30,000</u>
Closing Cash Balance		<u>35,000</u>

7. Cash Inflows:

(i)	Present Earnings after Taxes	₹ 45,500
	<i>Add:</i> Depreciation	<u>40,000</u>
	Present CFAT	<u>85,500</u>
(ii)	Estimated CFAT, if the New Machine is Purchased:	
	Sales	5,00,000

	Costs:		
	Material	₹ 1,50,000	
	Labour	1,92,000	
	Factory and Administrative	40,000	
	Depreciation (including ₹ 5,000 on new machine)	<u>45,000</u>	<u>4,27,000</u>
	Net Income before Taxes (@ 35 %)		73,000
	Taxes		<u>25,550</u>
	Earnings after Taxes		47,450
	Add: Depreciation		<u>45,000</u>
	CFAT (expected)		<u>92,450</u>
(iii)	Differential cash flow: (₹ 92,450 – ₹ 85,500)		6,950

(iv)	<i>Determination of NPV:</i>			
	Years	CFAT	PV factor (0.10)	Total PV
	1-8	₹ 6,950	5.335	₹ 37,078
	Less: Cost of New Machine			<u>40,000</u>
	NPV			<u>(2,922)</u>

Advise: Since the NPV is negative, the new machine should not be purchased.

8. Preparation of Financial Statements

Particulars		%	(₹)
Share capital		50%	1,00,000
Other shareholders funds		15%	30,000
5% Debentures		10%	20,000
Trade creditors		25%	50,000
	Total	100%	2,00,000

Land and Buildings = ₹ 80,000

Total Liabilities = Total Assets

₹ 2,00,000 = Total Assets

Fixed Assets = 60% of Total Gross Fixed Assets and Current Assets

= ₹ 2,00,000 × 60/100

= ₹ 1,20,000

Calculation of Additions to Plant & Machinery

	₹
Total Fixed Assets	1,20,000
<i>Less:</i> Land and Building	80,000
Plant and Machinery (after providing depreciation)	40,000
Depreciation on Machinery up to 31-3-2013	15,000
<i>Add:</i> Further Depreciation	5,000
Total	20,000

$$\begin{aligned} \text{Current Assets} &= \text{Total Assets} - \text{Fixed Assets} \\ &= ₹ 2,00,000 - ₹ 1,20,000 = ₹ 80,000 \end{aligned}$$

Calculation of Stock

$$\begin{aligned} \text{Quick Ratio} &= \frac{\text{Current Assets} - \text{Stock}}{\text{Current Liabilities}} = 1 \\ &= \frac{₹ 80,000 - \text{Stock}}{₹ 50,000} = 1 \end{aligned}$$

$$₹ 50,000 = ₹ 80,000 - \text{Stock}$$

$$\begin{aligned} \text{Stock} &= ₹ 80,000 - ₹ 50,000 \\ &= ₹ 30,000 \end{aligned}$$

$$\begin{aligned} \text{Debtors} &= \frac{4}{5}^{\text{th}} \text{ of Quick Assets} \\ &= (\text{₹ } 80,000 - 30,000) \times \frac{4}{5} \\ &= ₹ 40,000 \end{aligned}$$

Debtors Turnover Ratio

$$= \frac{40,000 \times 12}{\text{Credit Sales}} = 2 \text{ months}$$

$$2 \text{ Credit Sales} = 4,80,000$$

$$\begin{aligned} \text{Credit Sales} &= 4,80,000/2 \\ &= 2,40,000 \end{aligned}$$

Gross Profit (15% of Sales)

$$₹ 2,40,000 \times \frac{15}{100} = ₹ 36,000$$

Return on Networth (profit after tax)

$$\text{Networth} = ₹ 1,00,000 + ₹ 30,000$$

$$= ₹ 1,30,000$$

$$\text{Net Profit} = ₹ 1,30,000 \times 10/100 = ₹ 13,000$$

$$\text{Debenture Interest} = ₹ 20,000 \times 5/100 = ₹ 1,000$$

Projected Profit and Loss Account for the year ended 31-3-2014

To Cost of Goods Sold	2,04,000	By Sales	2,40,000
To Gross Profit	36,000		
	2,40,000		2,40,000
To Debenture Interest	1,000	By Gross Profit	36,000
To Administration and Other Expenses	22,000		
To Net Profit	13,000		
	36,000		36,000

Ganesha Limited
Projected Balance Sheet as on 31st March, 2014

<i>Liabilities</i>	₹	<i>Assets</i>		₹
Share Capital	1,00,000	Fixed Assets		
Profit and Loss A/c (17,000+13,000)	30,000	Land & Buildings		80,000
5% Debentures	20,000	Plant & Machinery	60,000	
Current Liabilities		Less: Depreciation	<u>20,000</u>	40,000
Trade Creditors	50,000	Current Assets:		
		Stock	30,000	
		Debtors	40,000	
		Bank	10,000	80,000
	2,00,000			2,00,000

9. (a) *Determination of Sales:* $\text{Sales} = \frac{₹ 4,00,000}{25} \times 100 = ₹ 16,00,000$
- (b) *Determination of Sundry Debtors:* Debtors velocity is 3 months. In other words, debtors' collection period is 3 months, or debtors' turnover ratio is 4. Assuming all sales to be credit sales and debtors turnover ratio being calculated on the basis of year-end figures,

$$\text{Debtors Turnover Ratio} = \frac{\text{Credit Sales}}{\text{Closing Debtors} + \text{Bills Receivables}}$$

Or,

$$\text{Closing Debtors + Bills Receivable} = \frac{\text{Credit Sales}}{\text{Debtors Turnover Ratio}} = \frac{\text{₹ 16,00,000}}{4} = \text{₹ 4,00,000}$$

$$\text{Closing Debtors} = \text{₹ 4,00,000} - \text{₹ 25,000} = \text{₹ 3,75,000}.$$

- (c) *Determination of Closing Stock:* Stock velocity of 8 months signifies that the inventory holding period is 8 months, stock turnover ratio is 1.5 = (12 months ÷ 8).

$$\text{Stock turnover} = \frac{\text{Cost of Goods Sold (Sales – Gross profit)}}{\text{Average Stock}}$$

$$1.5 = \frac{\text{₹ 12,00,000}}{\text{Average Stock}}$$

$$\text{Average Stock} = \frac{\text{₹ 12,00,000}}{1.5} = \text{₹ 8,00,000}$$

$$\text{Closing Stock} - \text{Opening Stock} = \text{₹ 10,000}$$

$$\frac{\text{Closing Stock} + \text{Opening Stock}}{2} = \text{₹ 8,00,000}$$

$$\text{Or, Closing Stock} + \text{Opening Stock} = \text{₹ 16,00,000}$$

$$2 \text{ Opening Stock} = \text{₹ 15,90,000}$$

$$\text{Opening Stock} = \text{₹ 7,95,000}$$

$$\text{Therefore, Closing Stock} = \text{₹ 8,05,000}$$

- (d) *Determination of Sundry Creditors:* Creditors velocity of 2 months signifies that the credit payment period is 2 months. In other words, creditors' turnover ratio is 6 (12 months ÷ 2). Assuming all purchases to be credit purchases and creditors turnover is based on year-end figures,

$$\text{Creditors Turnover Ratio} = \frac{\text{Creditors Purchases}}{\text{Credits + Bills Payable}}$$

$$6 = \frac{\text{₹ 12,10,000}}{\text{Creditors} + \text{₹ 10,000}}$$

$$\text{Creditors} + \text{₹ 10,000} = \frac{\text{₹ 12,10,000}}{6} = \text{₹ 2,01,667}$$

$$\text{Creditors} = \text{₹ 2,01,667} - \text{₹ 10,000} = \text{₹ 1,91,667}$$

Credit Purchases are calculated as follows:

$$\text{Cost of Goods Sold} = \text{Opening Stock} + \text{Purchases} - \text{Closing Stock}$$

$$₹ 12,00,000 = ₹ 7,95,000 + \text{Purchases} - ₹ 8,05,000$$

$$₹ 12,00,000 + ₹ 10,000 = \text{Purchases}$$

$$₹ 12,10,000 = \text{Purchases (credit)}.$$

10. (a) Both funds flow and cash flow statements are used in analysis of past transactions of a business firm. The difference between these two statements is given below:

Funds flow statement is based on the accrual accounting system. In case of preparation of cash flow statements all transactions effecting the cash or cash equivalents only is taken into consideration.

Funds flow statement analyses the sources and application of funds of long-term nature and the net increase or decrease in long-term funds will be reflected on the working capital of the firm. The cash flow statement will only consider the increase or decrease in current assets and current liabilities in calculating the cash flow of funds from operations.

Funds Flow analysis is more useful for long range financial planning. Cash flow analysis is more useful for identifying and correcting the current liquidity problems of the firm.

Funds flow statement tallies the funds generated from various sources with various uses to which they are put. Cash flow statement starts with the opening balance of cash and reaches to the closing balance of cash by proceeding through sources and uses.

- (b) **Basic Functions of Financial Management:** Financial Management deals with the procurement of funds and their effective utilization in the business. The first basic function of financial management is procurement of funds and the other is their effective utilization.

(i) *Procurement of Funds:* Funds can be procured from different sources, their procurement is a complex problem for business concerns. Funds procured from different sources have different characteristics in terms of risk, cost and control. The cost of funds should be at the minimum level for that a proper balancing of risk and control factors must be carried out.

(ii) *Effective Utilisation of Funds:* The finance manager is also responsible for effective utilisation of funds. He has to point out situations where the funds are being kept idle or where proper use of funds is not being made. All the funds are procured at a certain cost and after entailing a certain amount of risk. If these funds are not utilised in the manner so that they generate an income higher than the cost of procuring them, there is no point in running the business. Hence, it is crucial to employ the funds properly and profitably.

- (c) **Advantages of Debt Securitisation:** Debt securitisation is a method of recycling of funds and is especially beneficial to financial intermediaries to support lending volumes.

The advantages of debt securitisation to the originator are the following:

- (i) The assets are shifted off the Balance Sheet, thus giving the originator recourse to off balance sheet funding.
- (ii) It converts illiquid assets to liquid portfolio.
- (iii) It facilitates better balance sheet management; assets are transferred off balance sheet facilitating satisfaction of capital adequacy norms.
- (iv) The originator's credit rating enhances.

For the investors, securitisation opens up new investment avenues. Though the investor bears the credit risk, the securities are tied up to definite assets.

PAPER – 4: TAXATION

PART – I: NOTIFICATIONS

Significant Notifications in income-tax issued between 1st May 2013 and 31st October, 2013

1. Notification No. 39/2013 dated 31.05.2013

Time and mode of, payment of tax deducted at source under section 194-IA to the credit of Central Government, furnishing challan-cum-statement and TDS Certificate [Rules 30, 31A & 31]

New section 194-IA has been inserted by the Finance Act, 2013, requiring every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate 1% of such sum, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to a resident transferor, whichever is earlier.

Accordingly, the time and mode of, payment of tax deducted at source under section 194-IA, furnishing challan-cum-statement and TDS Certificate have been provided, by amending Rules 30, 31A & 31, respectively -

- (i) Such sum deducted under section 194-IA shall be paid to the credit of the Central Government within a period of seven days from the end of the month in which the deduction is made and shall be accompanied by a challan-cum-statement in Form No.26QB [Rule 30].
- (ii) The amount so deducted has to be deposited to the credit of the Central Government by electronic remittance within the above mentioned time limit, into RBI, SBI or any authorized bank [Rule 30].
- (iii) Every person responsible for deduction of tax under section 194-IA shall furnish to the DGIT (Systems) or any person authorized by him, a challan-cum-statement in Form No.26QB electronically within seven days from the end of the month in which the deduction is made [Rule 31A].
- (iv) Every person responsible for deduction of tax under section 194-IA shall furnish the TDS certificate in Form No.16B to the payee within 15 days from the due date for furnishing the challan-cum-statement in Form No.26QB under Rule 31A, after generating and downloading the same from the web portal specified by the DGIT (Systems) or the person authorized by him [Rule 31].

2. Notification No. 40/2013 dated 6.06.2013

Notification of Cost Inflation Index for F.Y.2013-14

Clause (v) of *Explanation* to section 48 defines "Cost Inflation Index", in relation to a previous year, to mean such Index as the Central Government may, by notification in the

Official Gazette, specify in this behalf, having regard to 75% of average rise in the Consumer Price Index for urban non-manual employees.

Accordingly, the Central Government has, in exercise of the powers conferred by clause (v) of *Explanation* to section 48, specified the Cost Inflation Index for the financial year 2013-14 as 939.

S. No.	Financial Year	Cost Inflation Index	S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100	18.	1998-99	351
2.	1982-83	109	19.	1999-2000	389
3.	1983-84	116	20.	2000-01	406
4.	1984-85	125	21.	2001-02	426
5.	1985-86	133	22.	2002-03	447
6.	1986-87	140	23.	2003-04	463
7.	1987-88	150	24.	2004-05	480
8.	1988-89	161	25.	2005-06	497
9.	1989-90	172	26.	2006-07	519
10.	1990-91	182	27.	2007-08	551
11.	1991-92	199	28.	2008-09	582
12.	1992-93	223	29.	2009-10	632
13.	1993-94	244	30.	2010-11	711
14.	1994-95	259	31.	2011-12	785
15.	1995-96	281	32.	2012-13	852
16.	1996-97	305	33.	2013-14	939
17.	1997-98	331			

3. Notification No. 64/2013, dated 19.08.2013

Notification of foreign company for claiming exemption under section 10(48)

Income received by a foreign company in India in Indian currency from sale of crude oil, any other goods or rendering of services, as may be notified by the Central Government in this behalf, to any person in India is exempt under section 10(48). For this purpose, the foreign company, as well as the arrangement or agreement, should be notified by the Central Government having regard to the national interest. The foreign company should not be engaged in any other activity in India, except receipt of income under such arrangement or agreement.

Accordingly, vide this notification, the Central Government, having regard to the national interest, has notified for the purposes of the said clause, the National Iranian Oil Company, as the foreign company and the Memorandum of Understanding entered into between the Government of India in the Ministry of Petroleum and Natural Gas and the Central Bank of

Iran on 20th January, 2013, as the agreement subject to the condition that the said foreign company shall not engage in any activity in India, other than the receipt of income under the agreement aforesaid.

The Notification is deemed to be effective from 20th January, 2013.

4. Notification No.79/2013 dated 07.10.2013

Reverse Mortgage Scheme amended to include within its scope, disbursement to an annuity sourcing institution for periodic payments by way of annuity to the Reverse Mortgagor

The Central Government had notified the Reverse Mortgage Scheme, 2008 in exercise of the powers conferred by clause (xvi) of section 47 of the Income-tax Act, 1961. Reverse Mortgage means mortgage of a capital asset by an eligible person against a loan obtained by him from an approved lending institution. Such kind of a transaction is not regarded as transfer under section 47(xvi) and amounts received by the Reverse Mortgagor as loan, either in lump-sum or in installment, are exempt under section 10(43).

The Central Government has, vide this notification, amended the Reverse Mortgage Scheme, 2008, to include within its scope, disbursement of loan by an approved lending institution, in part or in full, to the annuity sourcing institution, for the purposes of periodic payments by way of annuity to the reverse mortgagor. This would be an additional mode of disbursement, i.e., in addition to direct disbursements by the approved lending institution to the Reverse Mortgagor by way of periodic payments or lump sum payment in one or more tranches.

An annuity sourcing institution has been defined to mean Life Insurance Corporation of India or any other insurer registered with the Insurance Regulatory and Development Authority.

Maximum Period of Reverse Mortgage Loan

	Mode of disbursement	Maximum period of loan
(a)	Where the loan is disbursed directly to the Reverse Mortgagor	20 years from the date of signing the agreement by the reverse mortgagor and the approved lending institution.
(b)	Where the loan is disbursed, in part or in full, to the annuity sourcing institution for the purposes of periodic payments by way of annuity to the Reverse Mortgagor	The residual life time of the borrower.

PART – II: QUESTIONS AND ANSWERS

QUESTIONS

Residential Status and Scope of total income

1. Mr. Hansraj, an Indian citizen, is a Government employee serving in the Ministry of External Affairs. He left India for the first time on 22.02.2013 due to his transfer to Indian Embassy in Germany. He did not visit India any time during the previous year 2013-14. He has received the following income during the Financial Year 2013-14:

S. No.	Particulars	₹
(i)	Salary for the year	6,50,000
(ii)	Foreign Allowance	3,50,000
(iii)	Income from house property in Nepal	2,50,000
(iv)	Income from agriculture in Bhutan	2,00,000
(v)	Interest on fixed deposit with State Bank of India	80,000

Compute his gross total income for Assessment Year 2014-15.

Income which do not form part of total income

2. Examine the following, with reference to the provisions of the Income-tax Act, 1961:
- Paras Ltd. had taken a Keyman Insurance policy on the life of its Chief Executive Officer, Mr. Dayal. Subsequently, during the term of the policy, it assigned the policy to Mr. Dayal. The proceeds of ₹ 25 lakhs on matured policy were received by Mr. Dayal on 31st January 2014. Mr. Dayal claimed exemption under section 10(10D) in respect of the said sum of ₹ 25 lakhs. Is his claim tenable in law?
 - A charitable trust, registered under section 12AA, whose main object is "advancement of any other object of general public utility" receives ₹ 27 lakhs in aggregate during the P.Y. 2013-14 from commercial activities. The trust wants to claim benefit of exemption in respect of its income for the P.Y.2013-14 on the basis of its registration as a charitable trust under section 12AA. Can it do so?
 - A foreign company received ₹ 10 lakhs from an Indian company on account of sale of crude oil. Can the foreign company avail exemption of the said sum under the Income-tax Act, 1961?
Would your answer be different if the said sum was received not on account of sale of crude oil but on account of provision of services to the Indian company?
 - Mr. Sumeet held 100 unlisted shares of A Ltd., a domestic company. On 31.08.2013, he received ₹ 25,000 from A Ltd. for buy back of the unlisted shares held by him. Is the amount chargeable to tax in the hands of Mr. Sumeet?

Salaries

3. Mr. Madhav is the Finance Head of Gamma Ltd. at Ahmedabad. From the following details, compute his total income for the Assessment Year 2014-15:

Basic salary	₹ 22,500 per month
Dearness allowance	1/4 th of basic salary
Transport allowance (for commuting between place of residence and office)	₹ 2,000 per month
Cost of laptop facility provided for both official and personal use	₹ 40,000
Conveyance allowance (out of the said amount ₹ 10,000 was incurred on conveyance for his official duties)	₹ 12,000
Expenditure on accommodation in hotels while touring on official duties met by the employer	₹ 45,000
Lunch provided by the employer during office hours. Cost to the employer	₹ 13,500
Gamma Ltd. had taken a house on lease for which it paid a rent of ₹ 3,500 p.m. The said accommodation was provided to Mr. Madhav, who pays rent @ ₹ 1,000 p.m to the company. Gamma Ltd. also hired furniture @ ₹ 500 p.m and provided the same to Mr. Madhav free of cost. In addition, the company provided a television owned by it (Cost ₹ 20,000) to Mr. Madhav, free of cost.	
Mr. Madhav made the following payments:	
Medical insurance premium : Paid in cash	₹ 1,500
Paid by cheque	₹ 4,500
Contribution to Public Provident Fund (PPF)	₹ 1,00,000

Income from house property

4. Mrs. Dholakia owns a house property whose Municipal Value, Fair Rent and Standard Rent are ₹ 1,02,000 p.a., ₹ 1,32,000 p.a. and 1,14,000 p.a., respectively.

During the Financial Year 2013-14, one-third of the portion of the house was let out for residential purpose at a monthly rent of ₹ 7,000. The remaining two-third portion was self-occupied by her. Municipal tax @ 15% of municipal value was paid by her during the year.

The construction of the house began in May, 2007 and was completed on 31-8-2010. Mrs. Dholakia took a loan of ₹ 1,00,000 on 1-5-2007 for the construction of house. She paid interest on loan @ 12% per annum and such interest was paid every month.

Compute income from house property of Mrs. Dholakia for the Assessment Year 2014-15.

Profits and gains of business or profession

5. State with reasons, the deductibility or otherwise of the following expenses/payments under the Income-tax Act, 1961, while computing income under the head "Profits and gains of business or profession" for the Assessment Year 2014-15:
- (i) ₹ 120 crore invested in new plant & machinery by ABC Ltd., a manufacturing company, during P.Y. 2013-14.
 - (ii) Bad debts written off by a scheduled bank for the first time in P.Y. 2013-14 amounted to ₹ 85 lakhs. Provision for bad and doubtful debts allowed as deduction under section 36(1)(vii) upto P.Y. 2012-13 is ₹ 70 lakhs and for the current year is ₹ 10 lakhs. The bank claims deduction of the entire bad debts of ₹ 85 lakhs under section 36(1)(vii) for A.Y. 2014-15 on the reasoning that such bad debts relate to urban advances, whereas the provision for bad and doubtful debts allowed as deduction under section 36(1)(vii) was in relation to rural advances.
 - (iii) Murugan paid ₹ 75,000 as commodity transaction tax in respect of sale of commodity derivatives during the previous year 2013-14.
 - (iv) Deenu & Co. has set up a warehousing facility for storage of food grains. It commenced operations on 01.04.2013. For this purpose, Deenu & Co. incurred capital expenditure of ₹ 50 lakhs on purchase of building in March 2013.
 - (v) Clean (P) Ltd. incurred an amount of ₹ 2,50,000 on a notified project to enhance skill development of its employees.

Capital Gains

6. (i) Mohanlal purchased a house property on 14th April, 1980 for ₹ 1,50,000. He entered into an agreement with Madhav for the sale of house on 27th October, 1985 and received an advance of ₹ 35,000. However, since Madhav did not remit the balance amount, Mohanlal forfeited the advance.

Later on, he gifted the house property to his friend Natwarlal on 30th July, 1990.

Following renovations were carried out by Mohanlal and Natwarlal to the house property:

	₹
By Mohanlal during F.Y. 1980-81	15,000
By Mohanlal during F.Y. 1983-84	65,000
By Natwarlal during F.Y. 2001-02	2,65,000

The fair market value of the property as on 1.4.1981 is ₹ 2,00,000.

Natwarlal entered into an agreement with Chirag for sale of the house on 31st December, 2001 and received an advance of ₹ 1,00,000. The said amount was forfeited by Natwarlal, since Chirag could not fulfil the terms of the agreement.

Finally, the house was sold by Natwarlal to Narang on 22nd February, 2014 for a consideration of ₹ 20,00,000.

Compute the capital gains chargeable to tax in the hands of Natwarlal for the assessment year 2014-15. Cost inflation indices are as under:

Financial Year	Cost inflation index
1981-82	100
1983-84	116
1985-86	133
1990-91	182
2001-02	426
2013-14	939

- (ii) Pinto possesses agricultural land situated within urban limits, which is used for agricultural purposes during the preceding 3 years by his father. On 5.5.2013, this land is compulsorily acquired by the Central Government of India for a compensation of ₹ 15 lakhs, fixed and paid by it. Advise Pinto as to the tax consequences, assuming that the entire amount is invested in purchase of shares.

Income from Other Sources

7. Shri. Laxman reports the following transactions to you:
- Received cash gifts on the occasion of his marriage on 15-6-2013 of ₹ 1,08,000. It includes gift of ₹ 28,000 received from non-relatives.
 - On 15-8-2013, being his birthday, he received a gift by means of cheque from his mother's maternal aunt for an amount of ₹ 49,000.
 - On 25-12-2013 he acquired a vacant site from his friend for ₹ 1,50,000. The State stamp valuation authority fixed the value of site at ₹ 2,25,000 for stamp duty purpose.
 - He bought 200 equity shares of a listed company from another friend for ₹ 75,000. The value of shares in the stock exchange on the date of purchase was ₹ 1,75,000.
 - A cell phone worth ₹ 21,000 is gifted by his friend on 16.8.2013

Determine the amount chargeable to tax in the hands of Shri Laxman for the Assessment Year 2014-15.

Your answer should be supported with reasons.

Profits and gains of business or profession, Capital Gains & Income from Other Sources

8. Mr. Sunil sold his house property in Hyderabad as well as his rural agricultural land for a consideration of ₹ 70 lakh and ₹ 20 lakh, respectively, to his friend Mr. Ravi on 1.10.2013. He has purchased the house property and the land in the year 2011 for ₹ 45 lakh and ₹ 12 lakh, respectively. The stamp duty value on the date of transfer, i.e.,

1.10.2013, is ₹ 78 lakh and ₹ 22 lakh for the house property and rural agricultural land, respectively. Determine the tax implications in the hands of Mr. Sunil and Mr. Ravi and the TDS implications, if any, in the hands of Mr. Ravi, assuming that both Mr. Sunil and Mr. Ravi are resident Indians.

Income of Other Persons included in the Assessee's Total Income

9. Mr. Avinash, entered into the following transactions during the previous year 2013-14:
- Mr. Avinash had a fixed deposit of ₹ 8,00,000 with State Bank of India. He instructed the bank to credit the interest on the deposit @ 9% from 1-4-2013 to 31-3-2014 to the savings bank account of Ms. Sheetal, his niece, to help her in her higher education.
 - Mr. Avinash holds 51% share in a partnership firm. Mrs. Alka (wife of Mr. Avinash) received a remuneration of ₹ 45,000 from the firm for writing its books of accounts. Mrs. Alka, being a fashion designer, does not possess any qualification or training in the accountancy field.
 - Mr. Avinash gifted a flat to Mrs. Alka on April 1, 2013. During the previous year 2013-14, she received rent of ₹ 8,500 p.m. from letting out of the flat.
 - Mr. Avinash gifted ₹ 4,00,000 to his minor son who invested the same in a business and he derived income of ₹ 40,000 from the investment.
 - Mr. Avinash's minor daughter derived an income of ₹ 25,000 from participation in music shows.

During the year, Mr. Avinash got a monthly pension of ₹ 18,000. He had no other income. Mrs. Alka received salary of ₹ 25,000 per month from a part time job as a fashion designer.

Discuss the tax implications of each transaction and compute the total income of Mr. Avinash and Mrs. Alka.

Set off and Carry Forward of Losses

10. Mr. Prakash, a resident individual, furnishes the following particulars of his income and other details for the previous year 2013-14:

Sl. No.	Particulars	₹
(i)	Income from salary	25,000
(ii)	Net Annual Value of house property	85,000
(iii)	Income from business	1,80,000
(iv)	Income from speculative business	12,500
(v)	Long term capital gain on sale of land	17,500
(vi)	Loss on maintenance of race horse	12,000
(vii)	Loss on gambling	10,500

Depreciation allowable under the Income-tax Act, 1961, comes to ₹ 20,000, for which no treatment is given above.

The other details of unabsorbed depreciation and brought forward losses (pertaining to A.Y. 2013-14) are:

Sl.No.	Particulars	₹
(i)	Unabsorbed depreciation	15,000
(ii)	Loss from speculative business	15,000
(iii)	Short term capital loss on sale of shares	19,500

Compute the gross total income of Mr. Prakash the Assessment year 2014-15, and the amount of loss that can or cannot be carried forward.

Deductions from Gross Total Income

11. (i) Compute the eligible deduction under section 80C for A.Y.2014-15 in respect of life insurance premium paid by Mr. Himesh during the P.Y.2013-14, the details of which are given hereunder –

	Date of issue of policy	Person insured	Actual capital sum assured (₹)	Insurance premium paid during 2013-14 (₹)
(i)	1/6/2011	Mr. Himesh	3,00,000	75,000
(ii)	1/5/2012	Mrs. Himani, his wife	1,00,000	25,000
(iii)	1/7/2013	Ms. Shweta, his handicapped daughter (section 80U disability)	2,00,000	60,000
(iv)	1/7/2013	Mr. Siddhartha, his son	1,00,000	<u>25,000</u>
Total Premium paid				<u>1,85,000</u>

- (ii) Mr. Aayush purchased a residential house property for self-occupation at a cost of ₹ 28 lakh on 1.5.2013, in respect of which he took a housing loan of ₹ 20 lakh from the State Bank of India (SBI) @12% p.a. on the same date. The SBI had sanctioned housing loan of ₹ 22 lakhs on 29th April, 2013. Compute the eligible deduction in respect of interest on housing loan for A.Y.2014-15 under the provisions of the Income-tax Act, 1961, assuming that the entire loan was outstanding as on 31.3.2014 and he does not own any other house property.

Computation of Total Income of an individual

12. Mr. Rahul, aged 55 years, a resident individual and practicing Chartered Accountant, furnishes you the receipts and payments account for the financial year 2013-14.

Receipts and Payments Account

Receipts	₹	Payments	₹
Opening balance 1.4.2013)	16,500	Staff salary, bonus and stipend to articled clerks	1,77,000
Cash on hand and at bank		Other administrative expenses	51,500
Fee from professional services	8,51,500	Office rent	48,000
Rent	72,000	Housing loan repaid to SBI (includes interest of ₹ 65,000)	1,00,000
Motor car loan from Vyasa Bank (@ 11% p.a.)	3,00,000	Life insurance premium	30,000
		Motor car (acquired in Dec. 2013)	4,00,000
		Medical insurance premium (for self and wife)	15,000
		Books purchased (annual publications)	18,500
		Laptop acquired on 1.12.2013 (for professional use)	40,000
		Domestic drawings	2,82,000
		Public provident fund subscription	45,000
		Motor car maintenance	12,500
		Closing balance (31.3.2014)	
		Cash on hand and at bank	20,500
	<u>12,40,000</u>		<u>12,40,000</u>

Following further information is given to you:

- (1) He occupies the first floor of the building for own residence and has let out ground floor for residential use at a monthly rent of ₹ 6,000. Both the floors have the same area. The building was constructed during the year 1997-98.
- (2) Motor car was put to use both for official and personal purpose. One-fourth of the motor car use is for personal purpose. No car loan interest was paid during the year.
- (3) The written down value of assets as on 1-4-2013 are given below:

Furniture & Fittings	₹ 75,000
Plant & Machinery (Air-conditioners, Photocopiers, etc.)	₹ 90,000
Computers	₹ 60,000

Compute the total income of Mr. Rahul for the assessment year 2014-15, assuming that he follows cash system of accounting regularly.

Provisions concerning deduction of tax at source

13. State, in brief, the applicability of tax deduction at source provisions, the rate and amount of tax deduction in the following cases for the financial year 2013-14:
- (i) Mr. Jack sold his house property in Chennai for a consideration of ₹ 75 lakh to Mr. David on 31.01.2014.
 - (ii) ₹ 2,50,000 paid to Mr. Bansi on 05.05.2013 by State Government on compulsory acquisition of his urban land.
 - (iii) Madona, a non-resident, received ₹ 40 lakh for her stage shows in India from Optimistic Ltd., an event management company in India, on 26.12.2013.
 - (iv) A Ltd. paid retainership fees of ₹ 25,000 to its director, Mr. Ram Sharma, on 30.01.2014.

Provisions for filing of Return of Income

14. (i) During the P.Y. 2013-14, Mrs. Lal, a resident and ordinarily resident in India, aged 45 years, holds 18% of equity shares in a company registered in London. She also owns a house in London. She contends that since her total income computed as per the Income-tax Act, 1961, before allowing deduction under Chapter VIA, is less than the basic exemption limit of Rs.2 lakh, she is not required to file return of income for A.Y. 2014-15. Discuss the correctness of her contention.
- (ii) State with reasons whether you agree or disagree with the following statements:
- (a) The return of income of a Limited Liability Partnership (LLP) can be signed by any partner.
 - (b) Time limit for filing return under section 139(1) in the case of a firm having total turnover of ₹ 80 lakhs for the year ended 31.03.2014, whether or not opting to offer presumptive income under section 44AD, is 30th September 2014.

Negative list of services

15. Examine the chargeability of service tax in each of the following independent cases:-
- (i) Mr. Raju, an employee provides his service on contract basis to an associate company of Vikram Enterprises, the employer.
 - (ii) Shubhika enjoys an amusement ride set up in a mall. There is no other amusement ride in the mall.
 - (iii) AVB Institute is engaged in providing private tuitions to the students of Graduation Level.

All the above activities are being carried out in lieu of specific monetary consideration.

Point of taxation

16. Sam Limestone Ltd. is the owner of a limestone-mine in Jaisalmer. It obtained a patent from the concerned competent authorities in relation to the limestone mine in January, 2011. Further, the company entered into an agreement with LMN Ltd in May, 2011 for allowing the latter party to extract limestone for the next three years. The consideration payable by LMN Ltd. for using the limestone mine has been fixed @ ₹ 2000 per tonne of the limestone extracted. The quantum of limestone extracted by LMN Ltd and other relevant details are given in the following table:

Relevant Year	Relevant output [in tonnes]	Consideration for using the coal-mine @ ₹ 2000/- per tonne	Date of issuance of invoice	Date of receipt of payment
2011-12	1,000	20,00,000	08.08.2012	23.09.2012
2012-13	2,000	40,00,000	15.05.2013	05.05.2013
2013-14	3,000	60,00,000	13.02.2014	28.03.2014

You are required to determine the point of taxation in the above case.

Valuation of taxable service

17. Mr. Ramvilas Mehta, a Chartered Accountant, rendered professional advice to its client MN Ltd. on the matters relating to tax optimization. As a consideration for the said services, MN Ltd. gave a souvenir to Mr. Ramvilas Mehta. The said souvenir was an artifact especially designed and made by the craftsmen as per the specifications suggested by MN Ltd.

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

Assume that Mr. Ramvilas Mehta is not entitled to the exemption available to small service providers.

Interest on delayed payment of service tax

18. Compute the interest payable by the service providers in the following cases on account of delay in payment of service tax:

Name of the service provider	MNO Ltd.	Mr. Rohan
Service tax liability	₹ 1,25,800	₹ 2,46,000
Delay in payment of service tax	15 days	30 days

The aggregate value of taxable services rendered in the previous financial year 2012-13 by MNO Ltd. and Mr. Rohan is ₹ 48 lakh and ₹ 65 lakh respectively.

Assume that the service tax liability and the delay given above relates to a period in the financial year 2013-14.

Service tax liability of sub-contractor

19. Star Ltd. entered into a contract for rendering taxable services for ₹ 45,00,000. It sub-contracted a part of the work to Galaxy Ltd. for a sum of ₹ 18,00,000. Star Ltd. paid service tax on the amounts realized and advised the sub-contractor Galaxy Ltd. not to raise bill inclusive of service tax since it had paid service tax on the total amount of contract. Examine the correctness of advice given by Star Ltd. to Galaxy Ltd.

Filing of returns

20. (i) Mr. Lavi, a taxable service provider submitted the return for the half year April – September, 2013 on 5th October, 2013. However, he desires to submit a revised return on 20th January, 2014 to correct a mistake. Examine whether he can do so.
- (ii) Mr. Abhi, a service provider has filed a half-yearly service tax return where he has furnished consolidated details – lump sum amount pertaining to the half year - relating to value of taxable service, gross amount charged and service tax payable. Comment on the validity of the return.

Liability under VAT

21. The following particulars are provided by Mr. Maanu of Jaipur who is engaged in the manufacture of ABS pipes and PVC Pipes. He has purchased raw materials for manufacturing the same from Mr. Anki. The State VAT rate for raw materials and other materials was 12.5%.

	Particulars	₹
1.	Cost of raw materials purchased	2,00,000
2.	VAT paid by Mr. Anki	25,000
3.	Cost of other materials:	
	Local	40,000
	Interstate purchases	80,000
4.	VAT paid on local materials purchased - 12.5%	5,000
5.	CST paid @ 2%	1,600
6.	Manufacturing expenses	38,400
7.	Profit margin (on sale value)	20%

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

What would be the invoice value of sales charged by Mr. Maanu if all the manufactured goods were sold within the State? What would be his VAT liability?

Input tax credit

22. Tarun Enterprises, a dealer in Rajasthan dealing in consumer goods, submits the following information pertaining to the month of December, 2013:

- (i) Exempt goods 'X' purchased for ₹ 1,75,000 and sold for ₹ 3,50,000.
- (ii) Goods 'Y' purchased for ₹ 2,25,000 (including VAT) and sold at a margin of 20% profit on purchases (VAT rate for purchases and sales is 12.5%)
- (iii) Goods 'Z' purchased for ₹ 2,00,000 (excluding VAT) and sold for ₹ 2,50,000 (VAT rate for purchases and sales is 4%);
- (iv) His unutilized balance of input VAT credit on 1.12.2013 was ₹ 3,000.

Compute the turnover, Input VAT, Output VAT and Net VAT payable by Tarun Enterprises.

Registration under VAT

23. M/s Swabhiman Enterprises, a paper merchant, was a registered VAT dealer. However, due to financial problems, he discontinued his business. Can his registration be cancelled? If yes, enumerate other circumstances under which VAT registration can be cancelled as per the White Paper on VAT?

Stock transfer under VAT

24. Dinar Enterprises, a dealer in Hyderabad, purchased raw material worth ₹ 90,00,000 (excluding VAT) and manufactured finished goods worth ₹ 1,60,00,000 from such raw material in the month of December, 2013. It received an order for the said finished goods from its Bangalore branch in January, 2014. Hence, it transferred these finished goods to Bangalore in the same month.

Compute the amount of input tax credit available and net VAT payable under the State VAT Law by Dinar Enterprises for the month of January, 2014 and the balance input tax credit carried forward to next month, if any. Input VAT rate is 12.5% and output VAT rate is 4%.

Audit provisions under VAT

25. Explain the manner in which an independent auditor can ensure that the tax payer has discharged his tax liability properly while filing the returns.

Input tax credit on capital goods

26. Examine whether the dealers are entitled to set off on capital goods like any other purchases. If yes, explain the procedural requirements for claiming the set off of input tax on capital goods.

SUGGESTED ANSWERS/HINTS

1. Computation of Gross Total Income of Mr. Hansraj for A.Y. 2014-15

Particulars	₹
Salaries [See Note 2]	6,50,000
Foreign Allowance [See Note 3]	Nil
Income from other sources (Interest on fixed deposit in India)	<u>80,000</u>
Gross Total Income	<u>7,30,000</u>

Notes:

- (1) As per section 6(1), Mr. Hansraj is a non-resident for the F.Y. 2013-14, since he was not present in India at any time during the previous year 2013-14.

As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

- (i) Income received or deemed to be received in India; and
- (ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, income from agriculture in Bhutan and income from house property in Nepal would not be chargeable to tax in the hands of Hansraj, assuming that the same were received in Bhutan and Nepal, respectively.

- (2) Income from 'Salaries' payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. Hansraj, even though he is a non-resident.
- (3) Allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India are exempt under section 10(7). Hence, foreign allowance of ₹ 3,50,000 is exempt under section 10(7).
2. (i) Under section 10(10D), any sum received under a life insurance policy is exempt, except, *inter alia*, any sum received under a Keyman Insurance Policy.

The scope of the term "Keyman Insurance Policy" has been amplified to include a Keyman Insurance Policy which has been assigned by the person who had taken the policy (Paras Ltd., in this case), to any employee during its term. Such policies shall continue to be treated as Keyman Insurance Policy even after the same is assigned to a keyman. Therefore, Mr. Dayal will not be entitled to exemption under section 10(10D), in respect of the proceeds of ₹ 25,00,000 received by him under Keyman Insurance Policy.

- (ii) A charitable trust having "advancement of any other object of general public utility" as its main object, will lose its status as a charitable trust for the previous year in

which its receipts from commercial activities exceed ₹ 25 lakhs and therefore, would not be entitled to get benefit of exemption in respect of its income for that previous year, whether or not its registration is cancelled. When the receipts from commercial activities exceed ₹ 25 lakhs in any previous year, the denial of exemption for that year is compulsory by operation of law and is not dependent on cancellation of registration.

- (iii) As per the provisions of section 10(48), any income received in India in Indian currency by a foreign company on account of sale of crude oil to any person in India is exempt. However, one of the conditions necessary for claiming such an exemption is that the foreign company as well as the agreement should be notified by the Central Government having regard to the national interest. Therefore, ₹ 10 lakh received by the foreign company on account of sale of crude oil would be exempt under section 10(48), only if the said foreign company as well as the agreement under which it is entitled to receive the income are notified by the Central Government. Further, the foreign company should not be engaged in any other activity, other than the receipt of such income, in India.

If the said sum of ₹ 10 lakh was received by the foreign company on account of provision of services, then, the exemption under section 10(48) would be available only if the services in respect of which the payment is made, is notified by the Central Government. In this case also, the foreign company as well as the agreement should be notified by the Central Government. Further, the foreign company should not be engaged in any other activity, other than the receipt of such income, in India.

- (iv) The buyback of unlisted shares would attract additional income-tax under section 115QA in the hands of the domestic company, i.e., A Ltd. in this case. Consequently, the income arising to Mr. Sumeet in respect of such buyback of unlisted shares by A Ltd. would be exempt under section 10(34A).

3. **Computation of total income of Mr. Madhav for the A.Y. 2014-15**

Particulars	₹	₹
Basic salary (₹ 22,500 x 12)		2,70,000
Dearness allowance (1/4 th of basic salary)		67,500
Transport allowance (₹ 2,000 x 12)	24,000	
Less: Exemption under section 10(14) read with Rule 2BB ₹ 800 p.m.	9,600	14,400
Facility for use of laptop [See Note 1]		Nil
Conveyance Allowance [See Note 2]		2,000
Expenditure on accommodation while on official duty not a perquisite and hence, not chargeable to tax		Nil
Value of lunch provided during working hours [See Note 3]		Nil

Value of concessional accommodation [See Note 4]		38,000
Gross Total Income		3,91,900
<i>Less</i> : Deduction under Chapter VI-A		
Under section 80C		
Contribution to PPF	1,00,000	
Under section 80D		
Medical insurance premium paid by cheque	4,500	
Premium paid in cash not eligible for deduction	Nil	1,04,500
Total income		2,87,400

Notes:

- (1) As per Rule 3(7)(vii), facility for use of laptop is not a taxable perquisite, even if it is used for personal purposes.
- (2) As per section 10(14), conveyance allowance granted to meet expenditure incurred on conveyance for official duties of an employee is exempt. Hence, ₹ 10,000 would be exempt under section 10(14) in the hands of Mr. Madhav and the balance of ₹ 2,000 would be taxable.
- (3) As per Rule 3(7)(iii), free food provided by the employer during working hours will not be treated as perquisite provided the value thereof does not exceed fifty rupees per meal. In this case, assuming that the value per meal does not exceed ₹ 50, the cost to employer would not be chargeable to tax.
- (4) **Perquisite Value of Furnished Accommodation provided at concessional rent:**

Particulars	₹	₹
Basic Salary		2,70,000
Transport Allowance (the portion which is chargeable to tax)		14,400
Conveyance Allowance		<u>2,000</u>
"Salary" for the purpose of perquisite value of accommodation		<u>2,86,400</u>
15% of salary (A)	42,960	
Rent paid by the company for the accommodation @ ₹ 3,500 p.m. (B)	42,000	
Lower of (A) and (B) would be taken as the perquisite value of accommodation i.e.		42,000
<i>Less</i> : Rent paid by Madhav (₹ 1,000 × 12)		<u>12,000</u>
		30,000
Add : Value of furniture provided by employer:		
Rent for furniture (₹ 500 × 12)	6,000	
Television (₹ 20,000 × 10% p.a.)	<u>2,000</u>	<u>8,000</u>
Value of furnished accommodation given at concessional rent		38,000

Note - It is assumed that dearness allowance does not form part of retirement benefits and therefore, the same has not been considered for computation of value of furnished accommodation.

4. Computation of income from house property of Mrs. Dholakia for the A.Y. 2014-15

Particulars	₹	₹
Income from house property		
I. Self-occupied portion (Two third)		
Net Annual value		Nil
Less: Deduction under section 24(b)		
Interest on loan (See Note below) (₹ 19,000 x 2/3)		<u>12,667</u>
Loss from self occupied property		<u>(12,667)</u>
II. Let-out portion (One third)		
Gross Annual Value		
(a) Actual rent received (₹ 7,000 x 12) = ₹ 84,000		
(b) Annual Letting Value (ALV) [Higher of municipal valuation (i.e. ₹ 1,02,000) and fair rent (i.e. ₹ 1,32,000) but restricted to standard rent (i.e. ₹ 1,14,000)] = ₹ 1,14,000 x 1/3 = ₹ 38,000		
Higher of (a) or (b)	84,000	
Less: Municipal taxes (₹ 1,02,000 x 15% x 1/3)	<u>5,100</u>	
Net Annual Value	78,900	
Less: Deductions under section 24		
(a) 30% of NAV	23,670	
(b) Interest on loan (See Note below) (₹ 19,000 x 1/3)	<u>6,333</u>	<u>48,897</u>
Income from house property		<u>36,230</u>

Note: Interest on loan taken for construction of building

Interest for the year (1.4.2013 to 31.3.2014) = 12% of ₹ 1,00,000 = ₹ 12,000

Pre-construction period interest = 12% of ₹ 1,00,000 for 35 months (from 1.05.2007 to 31.3.2010) = ₹ 35,000

Pre-construction period interest to be allowed in 5 equal annual installments of ₹ 7,000 from the year of completion of construction i.e. from F.Y. 2010-11 to F.Y. 2014-15.

Therefore, total interest deduction under section 24 = ₹ 12,000 + ₹ 7,000 = ₹ 19,000.

5. (i) ₹ 120 crores invested in new plant and machinery is a capital expenditure, in respect of which investment allowance and depreciation are allowable under the provisions of the Income-tax Act, 1961.

As per section 32AC, manufacturing companies would be entitled to deduction @ 15% of aggregate amount of actual cost of new plant and machinery acquired and

installed during the F.Y. 2013-14 and F.Y. 2014-15, if the same exceeds ₹ 100 crore.

In this case, ABC Ltd. is entitled to a deduction of ₹ 18 crore under section 32AC (i.e. 15% of ₹ 120 crore) for the A.Y.2014-15, assuming that the new plant and machinery does not include any plant or machinery which is previously used at any time within or outside India or which is installed in any office premises or residential accommodation or guest house or any office appliance or any vehicle, ship or aircraft.

The deduction under section 32AC would be in addition to the deduction under section 32 in respect of depreciation and additional depreciation.

Particulars		₹ (in crores)
Depreciation	15% of ₹ 120 crore	18
Additional Depreciation	20% of ₹ 120 crore	<u>24</u>
Total deduction under section 32		<u>42</u>

It has been assumed that the new plant and machinery was put to use for more than 180 days during the P.Y. 2013-14.

- (ii) *Explanation 2* to section 36(1)(vii) clarifies that in the case of an assessee to which section 36(1)(vii) applies (a scheduled bank, as in this case), the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the provision for bad and doubtful debts made under section 36(1)(vii) without any distinction between rural advances and other advances.

Therefore, the bank can claim deduction of only ₹ 5 lakhs under section 36(1)(vii) for A.Y. 2014-15 [i.e., the excess of bad debts of ₹ 85 lakhs written off in the books of accounts over ₹ 80 lakhs (i.e., ₹ 70 lakhs + ₹ 10 lakhs), being the provision for bad and doubtful debts allowed as deduction under section 36(1)(vii)].

- (iii) An amount equal to commodity transaction tax paid by the assessee shall be allowable as deduction, under new section 36(1)(xvi), if the income arising from taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession". In the given case, Murugan, is entitled to claim deduction in respect of commodity transaction tax of ₹ 75000 paid by him, on sale of commodity derivatives, if the income arising from taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".
- (iv) As per section 35AD, investment linked tax deduction is available in respect of any of the specified businesses defined thereunder. Further, as per section 35AD(1A), a weighted deduction of 150% of the capital expenditure (including expenditure incurred before commencement of operations) is available in respect of certain

specified businesses which include *inter alia* business of warehousing facility for storage of agricultural produce. Therefore, in this case, Deenu and Co. would be eligible for deduction of ₹ 75,00,000 (150% of ₹ 50 lakhs), in the year in which it commenced operations i.e., P.Y. 2013-14, provided it has capitalised the amount in its books of accounts on 1.4.2013, being the date of commencement of operations. No other deduction is allowable in respect of the said sum under any other provision of the Income-tax Act, 1961.

- (v) Clean (P) Ltd. is entitled to a weighted deduction of a sum equal to 150% of the expenditure incurred by it on notified skill development project, under section 35CCD. Therefore, it can claim ₹ 3,75,000 (i.e., 150% of ₹ 2,50,000) as deduction under section 35CCD for the P.Y.2013-14.
6. (i) **Computation of capital gains chargeable to tax in the hands of Mr. Natwarlal for the A.Y. 2014-15**

Particulars	₹
Sale consideration	20,00,000
Less: Indexed cost of acquisition (See Note 1 below)	<u>5,15,934</u>
	14,84,066
Less: Indexed cost of improvement (See Note 2 below)	<u>11,10,284</u>
Long term capital gain	<u>3,73,782</u>

Note 1:

Indexed cost of acquisition is determined as under:	
Cost to the previous owner i.e. Mohanlal is ₹ 1,50,000	
Fair Market Value on 1 st April, 1981 is ₹ 2,00,000	
Cost to the previous owner or FMV on 1 st April, 1981, whichever is more, is to be taken as cost of acquisition of Natwarlal	₹ 2,00,000
Less: Advance money forfeited by Natwarlal (as per section 51) ¹	<u>₹ 1,00,000</u>
Cost of acquisition	<u>₹ 1,00,000</u>

Indexed cost of acquisition (₹ 1,00,000 × 939/182) ₹ 5,15,934

[182 is the Cost Inflation Index for F.Y. 1990-91, being the first year in which property is held by Natwarlal and 939 is the Cost Inflation Index for F.Y. 2013-14, being the year in which the property is sold.]

¹ Advance forfeited by Mohanlal, the previous owner, should, however, not be deducted

Alternative view: In the case of CIT v. Manjula J. Shah 204 Taxman 691, the Bombay High Court held that the indexed cost of acquisition in case of gifted asset can be computed with reference to the year in which the previous owner first held the asset. As per this view, the indexation cost of acquisition of house would be ₹ 9,39,000 taking Cost Inflation Index of 100 for the F.Y. 1981-82 since F.M.V. as on 1st April, 1981 is taken as cost of acquisition of Natwarlal.

Note 2	₹
Indexed cost of improvement is determined as under:	
Expenditure incurred before 1 st April, 1981 should not be considered	NIL
Expenditure incurred on or after 1 st April, 1981	
- During 1983-84 Indexed cost of Improvement [₹ 65,000 × 939/116]	5,26,164
- During 2001-02 Indexed cost of Improvement [₹ 2,65,000 × 939/426]	<u>5,84,120</u>
Total Indexed cost of improvement	<u>11,10,284</u>

- (ii) Section 10(37) exempts the capital gains arising to an individual or a Hindu Undivided Family from transfer of urban agricultural land by way of compulsory acquisition, or a transfer, the consideration for which is determined or approved by the RBI or the Central Government.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1st April, 2004 and the land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such Hindu undivided family.

Since all the above conditions are fulfilled in this case, Pinto is entitled to exemption under section 10(37) in respect of the entire capital gains arising on sale of urban agricultural land, without any further condition of re-investment of capital gains or net sale consideration.

7. Computation of amount chargeable to tax in hands of Shri. Laxman for A.Y. 2014-15

	Particulars	₹
(i)	Cash gift of ₹ 1,08,000 received on the occasion of his marriage is not taxable since gifts received by an individual on the occasion of marriage are excluded under section 56(2)(vii), even if the same are from non-relatives.	Nil
(ii)	Even though mother's maternal aunt does not fall within the definition of "relative" under section 56(2)(vii), gift of ₹ 49,000 received from her by cheque is not chargeable to tax since the aggregate sum of money received by Shri. Laxman without consideration from non-relatives (other than on the occasion of marriage) during the previous year 2013-14 does not exceed ₹ 50,000.	Nil

(iii)	Purchase of land for inadequate consideration on 25.12.2013 would attract the provisions of section 56(2)(vii). Where any immovable property is received for a consideration which is less than the stamp duty value of the property by an amount exceeding ₹ 50,000, the difference between the stamp duty value and consideration is chargeable to tax in the hands of the individual. Therefore, in the given case ₹ 75,000 is taxable in the hands of Shri. Laxman.	75,000
(iv)	Since shares are included in the definition of "property" and difference between the purchase price and fair market value of shares is ₹ 1,00,000 (₹ 1,75,000 - ₹ 75,000) i.e. it exceeds ₹ 50,000, the difference would be taxable under section 56(2)(vii).	1,00,000
(v)	Cell phone is not included in the definition of "property" as per <i>Explanation</i> to section 56(2)(vii). Hence, it is not taxable.	Nil
Amount chargeable to tax		1,75,000

8. Tax implications on sale of house property and rural agricultural land at a price lower than the stamp duty value

(i)	<u>Tax implications in the hands of Mr. Sunil</u>
	As per section 50C, the stamp duty value of house property (i.e. ₹ 78 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, ₹ 33 lakh (i.e. ₹ 78 lakh – ₹ 45 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y. 2014-15. Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. Sunil.
(ii)	<u>Tax implications in the hands of Mr. Ravi</u>
	In case immovable property is received for inadequate consideration, the difference between the stamp value and actual consideration would be taxable under section 56(2)(vii), if such difference exceeds ₹ 50,000. Therefore, in this case ₹ 8 lakh (₹ 78 lakh – ₹ 70 lakh) would be taxable in the hands of Mr. Ravi under section 56(2)(vii). Since rural agricultural land is not a capital asset, the provisions of section 56(2)(vii) are not attracted in respect of receipt of rural agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(vii) includes only the capital assets specified thereunder.
(iii)	<u>TDS implications in the hands of Mr. Ravi</u>
	Since the sale consideration of house property exceeds ₹ 50 lakh, Mr. Ravi is required to deduct tax at source under section 194-IA. The tax to be deducted under section 194-IA would be ₹ 70,000, being 1% of ₹ 70 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

9. Computation of Total Income of Mr. Avinash and Mrs. Alka for the A.Y. 2014-15

Particulars	Mr. Avinash (₹)	Mrs. Alka (₹)
Salary income (of Mrs. Alka)	-	3,00,000
Pension income (of Mr. Avinash) (₹ 18,000×12)	2,16,000	
Income from House Property [See Note (3)]	71,400	-
Income from other sources		
Interest on Mr. Avinash's fixed deposit with Bank of India (₹ 8,00,000×9%) [See Note (1)]	72,000	
Remuneration received by Mrs. Alka from a partnership firm, in which Mr. Avinash has substantial interest [See Note (2)]	45,000	1,17,000
Income before including income of minor child under section 64(1A)	4,04,400	3,00,000
Income of the minor son from the investment made in the business out of the amount gifted by Mr. Avinash [See Note (4)]	38,500	-
Income of the minor daughter from music shows, being an activity involving application of her skill and talent [See Note (5)]	-	-
Total Income	4,42,900	3,00,000

Notes:

- (1) As per section 60, in case there is a transfer of income without transfer of asset from which such income is derived, such income shall be treated as income of the transferor. Therefore, the fixed deposit interest of ₹ 72,000 transferred by Mr. Avinash to Ms. Sheetal shall be included in the total income of Mr. Avinash.
- (2) As per section 64(1)(ii), in case the spouse of the individual receives any amount by way of income from any concern in which the individual has substantial interest (i.e. holding shares carrying at least 20% voting power or entitled to at least 20% of the profits of the concern), then, such income shall be included in the total income of the individual. The only exception is in a case where the spouse possesses any technical or professional qualifications and the income earned is solely attributable to the application of her technical or professional knowledge and experience, in which case, the clubbing provisions would not apply.

In this case, the remuneration of ₹ 45,000 received by Mrs. Alka from the partnership firm, for writing its books of account, has to be included in the total income of Mr. Avinash, as Mrs. Alka is a fashion designer and does not possess any qualification

or training in the accountancy filed for earning such remuneration and Mr. Avinash has substantial interest in the partnership firm as he holds 51% share in the firm.

- (3) According to section 27(i), an individual who transfers any house property to his or her spouse otherwise than for adequate consideration or in connection with an agreement to live apart, shall be deemed to be the owner of the house property so transferred. Hence, Mr. Avinash shall be deemed to be the owner of the flat gifted to Mrs. Alka and hence, the income arising from the same shall be computed in the hands of Mr. Avinash.

Rent received (i.e. ₹ 1,02,000) is taken as Gross Annual Value in the absence of other information. Deduction @ 30% of Net Annual Value is allowed u/s 24. The net income from house property would be ₹ 71,400 (i.e. ₹ 1,02,000- ₹ 30,600 being 30% of NAV).

Note: The provisions of section 56(2)(vii) would not be attracted in the hands of Mrs. Alka, since she has received immovable property without consideration from a relative i.e., her husband.

- (4) As per section 64(1A), the income of the minor child is to be included in the total income of the parent whose total income (excluding the income of minor child to be so clubbed) is greater. Further, as per section 10(32), income of a minor child which is includible in the income of the parent shall be exempt to the extent of ₹ 1,500 per child.

Therefore, the income of ₹ 40,000 received by minor son from the investment made out of the sum gifted by Mr. Avinash shall, after providing for exemption of ₹ 1,500 under section 10(32), be included in the income of Mr. Avinash, since Mr. Avinash's income of ₹ 4,04,400 (before including the income of the minor child) is greater than Mrs. Alka's income of ₹ 3,00,000. Therefore, ₹ 38,500 (i.e., ₹ 40,000 – ₹ 1,500) shall be included in Mr. Avinash's income. It is assumed that this is the first year in which clubbing provisions are attracted.

- (5) In case the income earned by the minor child is on account of any activity involving application of any skill or talent, then, such income of the minor child shall not be included in the income of the parent, but shall be taxable in the hands of the minor child.

Therefore, the income of ₹ 25,000 derived by Mr. Avinash's minor daughter from music shows, which involve application of her skill and talent shall not be clubbed in the hands of either parent. Such income shall be taxable in the hands of the minor daughter.

10. Computation of Gross Total Income of Mr. Prakash for the A.Y. 2014-15

	Particulars	₹	₹
(i)	Salaries		25,000
(ii)	Income from house property		
	Net annual value	85,000	
	Less : Deduction under section 24 (30% of ₹ 85,000)	<u>25,500</u>	59,500

(iii)	Profits and gains of business or profession		
	(a) Income from business	1,80,000	
	Less: Current year depreciation	<u>20,000</u>	
		1,60,000	
	Less: Unabsorbed depreciation	<u>15,000</u>	1,45,000
	(b) Income from speculative business	12,500	
	Less: Brought forward loss from speculative business	<u>12,500</u>	Nil
	(Balance loss of ₹ 2,500 (i.e. ₹ 15,000 – ₹ 12,500) can be carried forward to the next year)		
(iv)	Capital gains		
	Long term capital gain on sale of land	17,500	
	Less: Brought forward short term capital loss		
	(Balance loss of ₹ 2,000 (i.e., ₹ 19,500 - ₹ 17,500) can be carried forward to the next year)	<u>17,500</u>	<u>Nil</u>
	Gross total income		<u>2,29,500</u>

Amount of loss to be carried forward to the next year

Particulars	₹
Loss from speculative business <i>[to be carried forward as per section 73]</i>	2,500
Short term capital loss <i>[to be carried forward as per section 74(1)]</i>	2,000
Loss on maintenance of race horses <i>[to be carried forward as per section 74A]</i>	12,000

Notes:

- (i) Loss on gambling can neither be set-off nor be carried forward.
- (ii) As per section 74A(3), the loss incurred on maintenance of race horses 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 period of 4 assessment years.
- (iii) Brought forward speculative business loss can set off only against income from speculative business of the current year and the balance loss can be carried forward to A.Y. 2015-16. It may be noted that speculative business loss can be carried forward for a maximum of four years as per section 73(4).
- (iv) Short- term capital loss can be set off against both short term capital gains and long term capital gains. Therefore, brought forward short term capital loss of ₹ 19,500 can be set off against long term capital gains of ₹ 17,500. The remaining short term capital loss of ₹ 2,000 can be carried forward to the next assessment year for set-off against capital gains arising in that year.

11. (i) Computation of eligible deduction under section 80C for A.Y. 2014-15
(in respect of life insurance premium paid by Mr. Himesh)

	Date of issue of policy	Person insured	Actual capital sum assured	Insurance premium paid during 2013-14	Restricted to % of sum assured)	Deduction u/s 80C for A.Y.2014-15
(i)	1/6/2011	Mr. Himesh	3,00,000	75,000	20%	60,000
(ii)	1/5/2012	Mrs. Himani	1,00,000	25,000	10%	10,000
(iii)	1/7/2013	Handicapped daughter	2,00,000	60,000	15%	30,000
(iv)	1/7/2013	Son	1,00,000	25,000	10%	10,000
Total						1,10,000
Maximum deduction u/s 80C restricted to						1,00,000

Note:

In respect of policies issued	Maximum deduction u/s 80C (% of actual capital sum assured)
between 01-04-2003 and 31-03-2012	20%
between 01-04-2012 and 31-03-2013	10%
on or after 01-04-2013	
- Insurance on life of person with disability u/s 80U	15%
- Others	10%

- (ii) Computation of eligible deduction in respect of interest on housing loan for A.Y. 2014-15

Particulars	₹
Deduction under section 24(b) [See Note 1] ₹ 2,20,000 [₹ 20,00,000 × 12% × 11/12]	
Restricted to	1,50,000
Deduction under section 80EE (₹ 2,20,000 – ₹1,50,000) [See Note 2]	70,000

Note:

- (1) Mr. Aayush is entitled to deduction under section 24(b) in respect of interest on loan taken for purchase of self-occupied property, subject to a maximum of ₹ 1,50,000.

(2) Mr. Aayush is also entitled to deduction under section 80EE under Chapter VIA (i.e. deductions from gross total income), in addition to deduction under section 24(b) since –

- (1) the loan is sanctioned by State Bank of India, being a financial institution, during the period between 1.4.2013 and 31.3.2014;
- (2) the loan amount sanctioned is less than ₹ 25 lakh;
- (3) the value of the house property is less than ₹ 40 lakh;
- (4) he does not own any other residential house property.

Note: The maximum deduction under section 80EE is ₹ 1,00,000. Since Mr. Aayush has availed only ₹ 70,000 in the P.Y. 2013-14, he can avail the balance ₹ 30,000 as deduction under section 80EE in the P.Y.2014-15 (A.Y. 2015-16) in addition to deduction of ₹ 1,50,000 under section 24 for that year.

12. Computation of total income of Mr. Rahul for the assessment year 2014-15

Particulars	₹	₹	₹
Income from house property			
Self-occupied			
Annual value	Nil		
<i>Less:</i> Deduction under section 24(b)			
Interest on housing loan			
50% of ₹ 65,000 = 32,500 but limited to	<u>30,000</u>		
Loss from self occupied property		(30,000)	
Let out property			
Annual value (Rent receivable has been taken as the annual value in the absence of other information)	72,000		
<i>Less:</i> Deductions under section 24			
(a) 30% of Net Annual Value	21,600		
(b) Interest on housing loan			
(50% of ₹ 65,000)	<u>32,500</u>	<u>17,900</u>	
Loss from house property			(12,100)
Profits and gains of business or profession			
Fees from professional services		8,51,500	
<i>Less:</i> Expenses allowable as deduction			
Staff salary, bonus and stipend	1,77,000		
Other administrative expenses	51,500		
Office rent	48,000		
Motor car maintenance (12,500 x 3/4)	9,375		

Car loan interest – not allowable (since the same has not been paid and the assessee follows cash system of accounting)	<u>Nil</u>	<u>2,85,875</u>	
		5,65,625	
Less: Depreciation			
Furniture and fittings @ 10% of ₹ 75,000	7,500		
Plant & Machinery			
Opening W.D.V @ 15% of ₹ 90,000	13,500		
<i>Add:</i> Additions during the year			
Motor Car @ 15% × ½ × 4,00,000 × ¾	<u>22,500</u>	36,000	
Computer			
Opening W.D.V @ 60% of ₹ 60,000	36,000		
<i>Add:</i> Additions during the year			
Laptop @ 60% of ₹ 40,000 for ½ year	<u>12,000</u>	48,000	
Books being annual publications @ 100%	<u>18,500</u>	<u>1,10,000</u>	<u>4,55,625</u>
Gross Total income			4,43,525
Less: Deductions under Chapter VI-A			
Deduction under section 80C			
Housing loan principal repayment	35,000		
PPF subscription	45,000		
Life insurance premium	<u>30,000</u>		
Total ₹ 1,10,000 but limited to		1,00,000	
Deduction under section 80D			
Medical insurance premium paid ₹ 15,000 (fully allowed since it is within the permissible limit)		<u>15,000</u>	<u>1,15,000</u>
Total income			<u>3,28,525</u>

13. (i) Since the sale consideration of house property exceeds ₹ 50 lakh, Mr. David is required to deduct tax at source under section 194-IA at the time of credit of such sum to the account of Mr. Jack or at the time of payment, whichever is earlier. Tax @ 1% of the sale consideration is required to be deducted by Mr. David under section 194-IA.
- Tax deductible under section 194-IA = ₹ 75 lakh × 1% = ₹ 75,000
- (ii) As per section 194LA, tax shall be deducted at source @ 10%, if the compensation/consideration or enhanced compensation/consideration on compulsory acquisition of immovable property (other than agricultural land) during the year exceeds ₹ 2,00,000. Therefore, in this case, since there has been a compulsory acquisition of urban land, tax has to be deducted at source under section 194LA.
- Tax deductible under section 194LA = ₹ 2,50,000 × 10% = ₹ 25,000

- (iii) Payments made to a non-resident entertainer, shall be subject to tax deduction @ 20% under the provisions of section 194E plus education cess@2% and secondary and higher education cess@1%.

Tax deductible under section 194E = ₹ 40 lakh × 20.6% = ₹ 8,24,000

- (iv) As per section 194J, a company shall be liable to deduct tax at source @ 10% on any remuneration or fees or commission paid to a director, on which the tax is not deductible under section 192. The limit of ₹ 30,000 under section 194J is not applicable on any remuneration or fees or commission payable to director of a company.

Tax deductible under section 194J = ₹ 25,000 × 10% = ₹ 2,500

14. (i) The contention of Mrs. Lal is incorrect.

As per section 139(1), every person who is a resident, other than not-ordinarily resident in India, having –

- (a) any asset (including financial interest in any entity) located outside India or
(b) signing authority in any account located outside India

is required to file a return of income in the prescribed form compulsorily on or before the due date of filing the return of income.

Hence, the contention of Mrs. Lal is not correct, as she-

- (i) holds financial interest in a company in London and
(ii) owns a house property in London.

Therefore, she has to compulsorily file her return of income for A.Y 2014-15 on or before the due date of filing return of income.

- (ii) (a) **Disagree:** The return of income of LLP should be signed by a designated partner.

Any other partner can sign the Return of Income of LLP **only in** the following cases:-

- (i) where for any unavoidable reason such designated partner is not able to sign and verify the return, or,
(ii) where there is no designated partner.

- (b) **Disagree:** In case an assessee opts to offer his income as per the presumptive taxation provisions of section 44AD, then, the due date under section 139(1) for filing of return of income for the year ended 31.03.2014 shall be 31st July, 2014.

It is only in case where the assessee does not opt for presumptive taxation provisions under section 44AD and offers income to be lower than 8% of total

turnover and his total income exceeds the basic exemption limit, he has to keep books of account as per section 44AA and get his accounts audited under section 44AB, in which case the due date for filing return would be 30th September, 2014.

15. (i) Section 65(44) of the Finance Act, 1994, which defines service, specifically excludes from its scope the services that are provided by the employee to the employer in the course of employment. However, services provided outside the ambit of employment for a consideration would be a service. Since, services provided on contract basis i.e. principal-to-principal basis are not services provided in the course of employment, services provided on contract basis by a person to another would be treated as provision of "service".

Thus, services provided by Mr. Raju, an employee, on contract basis to the associate company of Vikram Enterprises, the employer, would be treated as provision of service and charged to service tax.

- (ii) Admission to entertainment events or access to amusement facilities are covered in the negative list under clause (j) of section 66D. A standalone amusement ride set up in a mall qualifies as an amusement facility in which fun or recreation is provided by means of a ride. Access to such amusement ride on payment of charges would be covered in the negative list. Hence, service tax is not chargeable in the instant case.
- (iii) Providing private tuitions to the students of Graduation Level for a consideration is a service. However, the following services relating to education are covered in the negative list of services under clause (l) of section 66D of the Finance Act, 1994:
- (i) pre-school education and education up to higher secondary school or equivalent;
 - (ii) education as a part of a curriculum for obtaining a qualification recognized by any law for the time being in force;
 - (iii) education as a part of an approved vocational education course;
- Since, private tuitions are not covered in the above entry of the negative list, they would be chargeable to service tax.

16. Rule 8 of the Point of Taxation Rules, 2011 *inter alia*, applies in respect of payments pertaining to patents, where the **whole amount of the consideration** for the provision of service is not ascertainable at the time when service was performed, and subsequently the use or the benefit of these services by a person other than the provider gives rise to any payment of consideration. As per rule 8, in such a case, the service would be treated as provided each time when a payment in respect of such use or the benefit is received by the provider in respect thereof, or an invoice is issued by the provider, whichever is earlier.

Since in the given case, whole amount of the consideration for the provision of patent is not ascertainable at the time when service was performed and subsequently the use of these services by LMN Ltd. gives right to payment of consideration, both the conditions specified in rule 8 get satisfied. Therefore, the point of taxation of Sam Limestone Ltd. for various financial years, determined as per rule 8, is as under:

Point of Taxation	Reason/Remarks
08.08.2012	Date of issuance of invoice [08.08.2012] falls before the date of payment [23.09.2012]
05.05.2013	Date of receipt of payment [05.05.2013] precedes the date of issuance of invoice [15.05.2013]
13.02.2014	Date of issuance of invoice [13.02.2014] falls before the date of payment [28.03.2014]

17. Non payment of service tax on the plea of non-ascertainability of the value of service is not permissible under service tax law.

Rule 3 of the Service Tax (Determination of Value) Rules, 2006 provides that where the value of a taxable service is not ascertainable, the same shall be determined by the service provider in the following manner:-

- (a) The value of such taxable service would be equivalent to the gross amount charged by the service provider to provide similar service to any other person subject to fulfillment of the conditions below:
1. Such service is in the ordinary course of trade.
 2. The gross amount charged is the sole consideration.
- (b) Where the value cannot be determined in accordance with clause (a), the service provider will determine the equivalent money value of such consideration. However, such value should, in no case be less than the cost of provision of such taxable service.

Therefore, Mr. Ramvilas Mehta's contention is not correct. He should value the service in the manner provided by Rule 3 of Service Tax (Determination of Value) Rules, 2006 and pay service tax. Accordingly, he should value the service provided by him on the basis of similar services and if that is not possible, he should value the service on the basis of equivalent money value of consideration and pay service tax on the same.

18. As per section 75 of the Finance Act, 1994, failure to pay service tax, including a part thereof within the prescribed period attracts simple interest @ 18%. However, the applicable rate gets reduced to 15% for service providers whose turnover of services does not exceed ₹ 60 lakh during any of the financial years covered in the notice or during the preceding financial year. Such interest is payable for the period by which such crediting of the tax or any part thereof is delayed.

Computation of interest on delayed payment of service tax

Name of the service provider	MNO Ltd.	Mr. Rohan
Service tax liability	₹ 1,25,800	₹ 2,46,000
Delay in payment of service tax	15 days	30 days
Value of taxable services in the previous financial year	₹ 48,00,000	₹ 65,00,000
Rate of interest	15%	18%
Interest	$[1,25,800 \times (15/100) \times (15/365)] = ₹ 775$	$[2,46,000 \times (18/100) \times (30/365)] = ₹ 3,639$

19. The advice given by Star Ltd. to sub-contractor Galaxy Ltd. is not tenable in law.

A sub-contractor providing taxable service is essentially a service provider who is liable to pay tax on the services so provided by him. The fact that services provided by such sub-contractors are used by the main service provider for completion of his work does not in any way alter the fact of provision of taxable service by the sub-contractor.

Since, services provided by sub-contractors are in the nature of input services, the sub contractor's service tax charge can be availed as credit by the main contractor whose burden of paying tax would reduce to that extent.

20. (i) No, he cannot do so. As per rule 7B of the Service Tax Rules, 1994, an assessee can submit a revised return, to correct a mistake or omission, within a period of 90 days from the date of submission of the original return.

Since, Mr. Lavi has submitted the half-yearly return on 5th October, 2013, he cannot file the revised return after 3rd January, 2014. The period of 90 days starts from the date of submission of the original return and not from the due date of filing the return.

- (ii) The return filed by Mr. Abhi is not valid. Return must indicate *inter alia*, **monthwise**:

- (i) the value of taxable services charged/billed;
- (ii) the value of taxable service realised;
- (iii) the amount of service tax payable/paid etc.

Since, Mr. Abhi has not furnished month-wise details of value of taxable service, gross amount charged and service tax payable but consolidated details in lump sum for the half year in question, the return filed by him is an invalid return.

21. Computation of invoice value of sales charged by Mr. Maanu

Particulars	ABS pipes (12.5% VAT)	PVC Pipes (exempt)
	(₹) (75%)	(₹) (25%)
Cost of raw materials purchased	1,50,000	50,000
VAT paid	NIL (refer Note 2)	6,250 (refer Note 3)
Cost of other materials local	30,000	10,000
VAT paid	NIL (refer Note 2)	1,250 (refer Note 3)
Interstate purchases	60,000	20,000
CST paid (Refer Note 4)	1,200	400
Manufacturing expenses	28,800	9,600
Cost of goods sold	2,70,000	97,500
Add: Profit is 20% on sales (i.e., 25% of cost)	67,500	24,375
Sale price	3,37,500	1,21,875
Add: VAT payable (rounded off to nearest rupee)	42,188	NIL
Invoice value	3,79,688	1,21,875

Computation of VAT liability for ABS pipes

Particulars	(₹)
Output VAT	42,188
Less: Input VAT = [(25,000 × 75%)+(5,000×75%)] refer Note 5	22,500
Net VAT liability	19,688

Notes:-

- All the expenses have been apportioned in the ratio of 3:1 on pro-rata basis as 75% of production has been utilized and manufactured as ABS pipes and 25% of production as PVC pipes.
- Since ABS pipes 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.
- 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.
- Input tax credit is not available on CST. Therefore it will form part of total cost.
- Input tax credit to the extent (75%) used in the production of taxable ABS pipes is allowed.

22.

Goods	Purchases [A]	Input VAT rate [B]	Input VAT credit [C] = [A] x [B]	Sales (Turnover) [D]	Output VAT rate [E]	Output VAT [F] = [C] x [D]
	₹	%	₹	₹	%	₹
X	1,75,000	-	-	3,50,000	-	-
Y (See Note)	2,00,000	12.5	25,000	2,40,000	12.5	30,000
Z	<u>2,00,000</u>	4	<u>8,000</u>	<u>2,50,000</u>	4	<u>10,000</u>
Total	5,75,000		33,000	8,40,000		40,000

Computation of Net VAT payable by Tarun Enterprises

	₹
Opening balance of input VAT credit	3,000
<i>Add:</i> Input VAT credit for December, 2013 [C]	<u>33,000</u>
Total Input VAT credit available	36,000
<i>Less:</i> Output VAT payable on taxable turnover [F]	<u>40,000</u>
Net VAT payable	4,000

Note:

	₹
Purchase value of goods 'Y' (including VAT)	2,25,000
<i>Less:</i> VAT included in above $\left(2,25,000 \times \frac{12.5}{112.5} \right)$	25,000
Purchase price excluding VAT	<u>2,00,000</u>

23. VAT registration of M/s Swabhiman Enterprises may be cancelled as he has discontinued his business. Other circumstances under which VAT registration can be cancelled are as follows:

- (i) Disposal of business;
- (ii) Transfer of business to a new location;
- (iii) Annual turnover of a manufacturer or a trader dealing in designated goods or services falling below the specified amount.

24. Computation of input tax credit and Net VAT payable for January, 2014:

Particulars	Amount(₹)
Output VAT payable (Note-1)	Nil
Less: Input tax credit $\left[90,00,000 \times \frac{(12.5-2)}{100} \right]$ [Note-2]	<u>9,45,000</u>
Net VAT payable	<u>Nil</u>
Balance input tax credit carried forward to next month	9,45,000

Notes:

1. Inter-State stock transfers do not involve sale and, therefore they are not subjected to VAT or CST.
 2. VAT paid on inputs used in the manufacture of finished goods which are stock transferred (inter-State) will be available as input tax credit after retention of 2% of such tax by the State Government.
25. An independent auditor can ensure that the tax payer has discharged his tax liability properly while filing the returns only when the particulars furnished by the tax payer are verified by him in minute details in the following manner:
- by going through the books of account and
 - analysing and interpreting the provisions of the State-Level VAT laws and
 - reporting the under-assessment, if any, made by the dealer requiring additional payment or reporting any excess payment of tax warranting refund to the tax payer.
26. Yes, the dealers are entitled to set off on capital goods like any other purchases. However, the set off is not allowed in respect of the capital goods covered in the negative list and is also subject to retention rules, if any, applicable under the particular State VAT law.

In order to claim set off on capital goods, the dealers have to first bifurcate their purchase into capital goods eligible for set off and capital goods not so eligible (being items covered in the negative list). The purchase of capital goods must be supported with a tax invoice. The set off must be claimed as per the applicable provisions in respect of installments and after obtaining prior permission, if required under the applicable State VAT law. Set off on capital goods should not exceed the tax paid by the vendor on the same in the Government Treasury.