

PRIME ACADEMY  
32ND SESSION PROGRESS TEST – ADVANCED MANAGEMENT ACCOUNTING

No. of Pages: 6

Total Marks: 75  
Time Allowed: 2Hrs

**PART – A**

**(Question Nos 1,8,10 & 12 carries 2 marks and others carries each 1 mark)**

1. T Ltd. produces and sells the finest quality golf clubs. The company expects the following revenues and costs in 2011 for its Elite Quality golf club sets:

Revenues (400 sets sold @ ₹600 per set)	₹240,000
Variable costs	₹160,000
Fixed costs	₹ 50,000

What amount of sales must T Ltd., have to earn a target net income of ₹63,000 if they have a tax rate of 30%?

- a. ₹489,000
  - b. ₹429,000
  - c. ₹420,000
  - d. ₹300,000
2. One way for managers to cope with uncertainty in profit planning is to
- a. Use CVP analysis because it assumes certainty.
  - b. Recommend management hire a futurist whose work it is to predict business trends.
  - c. Wait to see what does happen and prepare a report based on actual amounts.
  - d. Use sensitivity analysis to explore various what-if scenarios in order to analyze changes in revenues or costs or quantities.
3. M Products sells product A at a selling price of ₹40 per unit. The cost per unit based on the full capacity of 500,000 units is as follows:

	₹
Direct materials	6
Direct labor	3
Indirect manufacturing (60% of which is fixed)	<u>10</u>
	<u>19</u>

A one-time-only special order offering to buy 50,000 units was received from an overseas distributor. The only other costs that would be incurred on this order would be ₹4 per unit for shipping. M has sufficient existing capacity to manufacture the additional units. In negotiating a price for the special order, M should consider that the minimum selling price per unit should be

- a. ₹17
  - b. ₹19
  - c. ₹21
  - d. ₹23
4. Which of the following is not an assumption of cost-volume-profit analysis?
- a. The time value of money is incorporated in the analysis.
  - b. Costs can be classified into variable and fixed components.
  - c. The behavior of revenues and expenses is accurately portrayed as linear over the relevant range.
  - d. The number of output units is the only driver.
5. Contribution margin is calculated as
- a. Total revenue – total fixed costs.
  - b. Total revenue – total manufacturing costs (CGS).
  - c. Total revenue – total variable costs.
  - d. Operating income + total variable costs.
6. Which of the following statements is true?
- a. “Gross margin” can be used only in financial accounting income statements.
  - b. “Gross margin” implies a different cost classification usage than the term “contribution margin” when used in income statements.
  - c. “Contribution margin” can be used in place of “gross margin” if management prefers that terminology in their financial statements.
  - d. Only manufacturing-sector companies use the term “gross margin” in their income statements.
7. Which of the following items would NOT be considered in cost-volume-profit analysis?
- a. units of production
  - b. fixed costs
  - c. product mix
  - d. gross profit margin
8. Malone Printing Company projected the following information for next year:
- |                              |           |
|------------------------------|-----------|
| Selling price per unit       | ₹75.00    |
| Contribution margin per unit | ₹30.00    |
| Total fixed costs            | ₹1,20,000 |
| Tax rate                     | 40%       |
- How many units must be sold to obtain an after-tax profit of ₹67,500?
- a. 3,750 units
  - b. 7,750 units
  - c. 5,625 units
  - d. 5,167 units
9. Sales mix refers to
- a. The different volume of sales achieved during the year.
  - b. The contribution margins achieved on the different products during the year.
  - c. The relative proportions of different products that constitute total sales.
  - d. The mix of variable and fixed costs.

10. The following data pertain to the three products produced by Alberts Ltd:

	A ₹	B ₹	C ₹
Selling price per unit	5.00	7.00	6.00
Variable costs per unit	4.00	5.00	3.00
Contribution margin per unit	1.00	2.00	3.00

Fixed costs are ₹90,000 per month. 60 percent of all units sold are Product A, 30 percent are Product B, and 10 percent are Product C.

What is the monthly break-even point for total units?

- 45,000 units
  - 36,000 units
  - 60,000 units
  - 180,000 units
11. Which of the following assumptions does NOT pertain to cost-volume-profit analysis?
- The units produced will equal the units sold.
  - Inventories are constant
  - All costs are classified as fixed or variable.
  - Sales mix may vary during the related period.
12. The income statement for Thomas Manufacturing Company for 2004 is as follows:

	₹
Sales (10,000 units)	120,000
Variable expenses	<u>72,000</u>
Contribution margin	48,000
Fixed expenses	<u>36,000</u>
Operating income	<u>12,000</u>

If sales increase by ₹60,000, what will happen to profit?

- increase by ₹60,000
  - increase by ₹24,000
  - increase by ₹6,000
  - increase by ₹36,000
13. Assuming all other things are the same, selling price per unit must have \_\_\_\_\_ if there was a decrease in the break-even point.
- remained the same
  - increased first, then decreased
  - increased
  - decreased
14. Cost-volume-profit models assume that
- The sales mix may vary among multiple products.
  - Unit selling prices are constant.
  - Inventories are dynamic and subject to change.
  - The total cost function is quadratic.

15. When a company sells more units than the break-even point,
  - a. It moves above the relevant range.
  - b. Profits are positive.
  - c. There are no new variable costs incurred.
  - d. Profits are negative.
  
16. In an assignment problem N jobs are assigned to N facilities on
  - a. One to many basis
  - b. Many to one basis
  - c. One to one basis
  - d. None of the above
  
17. In an assignment problem if the value of any cell is less than the value of the cells in the previous row or column then the allocation lies at
  - a. Diagonals
  - b. Allocations are not possible
  - c. All of the above
  - d. None of the above
  
18. The optimal solution is arrived when the minimum number of lines drawn to cover all zeroes equal
  - a. Number of zeroes
  - b. Number of rows or columns
  - c. Number of positive values
  - d. Number of Negative values
  
19. An assignment problem is categorized as unbalanced if
  - a. Number of jobs equals number of facilities
  - b. Number of jobs does not equal number of facilities
  - c. All the elements in a row becomes zero
  - d. All the elements in a column becomes zero
  
20. In an assignment problem, after row and column reductions
  - a. There can be no negative values in the assignment table
  - b. There can be no positive values in the assignment table
  - c. There can be any value positive or negative
  - d. All values will be zero
  
21. A Ltd produces 4 articles, there is a loss of valuable machine time due to heavy power cut imposed by the government. The decision on which product to be produced will be based on
  - a. Contribution per unit
  - b. Profit per unit
  - c. Contribution as a percentage of machine time
  - d. Contribution as a percentage of labour

## PART – B

### (Answer all Questions)

1. The profits of X Ltd. for Period 1 and Period 2 are given as follows:

	Period 1 ₹	Period 2 ₹
Material consumed	60,000	77,000
Wages	30,000	45,000
Overheads:		
Fixed	15,000	16,000
Variable	10,000	13,000
Net Profit	10,000	14,000

Wage rate was 20% higher in Period 2 than in Period 1. Similarly, materials prices were higher 10% sales prices increased by 10% in Period 2. Analyse the causes of increase in profit in Period

**(15 Marks)**

2. F Ltd manufacture and sells four types of products under the brand names P, Q, R and S. On a turnover of ₹30 crores in 2010 the company earned a profit of 10% before interest and depreciation which are fixed. The details of product mix and other information are as follows.

Products	Mix (%) to total sales	PV Ratio (%)	Raw material as (%) on sales value
A	30	20	35
B	10	30	40
C	20	40	50
D	40	10	60

Interest and depreciation amounted to ₹225 lakhs and 115.50 lakhs respectively. Due to increase in prices in the international market the company anticipates that the cost of raw materials which are imported will increase by 10% during 2011. The company has been able to secure a license for the import of raw materials of a value of ₹1,535 lakhs at 2011 prices. In order to control the increase in costs of raw materials the company is contemplating to revise its product mix. The market survey report indicates that the sales potential of each of the products A, B and C can be increased upto 30% of total sales value of 2010. There was no inventory of finished goods or work in progress in both the year.

You are required to set an optimal product mix for 2011 and find the profitability.

**(20 Marks)**

3. Solve the following assignment problem to minimize and maximize total job completion time.  
Report all optimal assignments and total cost.

Person	Job		
	A	B	C
1	6	3	8
2	10	4	12
3	8	4	10
4	7	5	11

**(15 Marks)**

**PRIME ACADEMY  
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SUGGESTED ANSWERS**

**PART – A**

<b>Question</b>	<b>Answers</b>
1	c
2	d
3	b
4	a
5	c
6	d
7	d
8	b
9	c
10	c
11	d
12	b
13	c
14	b
15	b
16	c
17	a
18	b
19	b
20	a
21	c

**PART - B**

1.

**ANALYSIS OF INCREASE IN PROFITABILITY**

Particulars	Period 1	Period2 Volume compared with period 1 Prices & Cost	Period 2 without Price impact	Period 2
	₹	₹	₹	₹
Sales	125000	150000	150000	165000
Materials	60000	72000	70000	77000
Labour	30000	36000	37500	45000
Variable OHS	10000	12000	13000	13000
Fixed OHS	15000	15000	16000	16000
Profit	10000	15000	13500	14000

**Reconciliation**

Profit in Period 1  
10000

Add: factors contributing to the increase in profit

1. Selling price	15000	
2. Material usage	2000	
3. Increase in contribution on a/c of volume	5000	<u>22000</u>

32000

Less: factors contributing to the decrease in profit

4. Material price increase	7000	
5. Labour rate increase	7500	

6. Labour efficiency	1500	
7. Variable OH Expenditure	1000	
8. Fixed OH Expenditure		1000
<u>18000</u>		

Profit in Period 2  
14000

2.

Revised P/V ratio and ranking of products:

Product	Existing P/V ratio %	Increase in Raw material cost as % of sales value	Revised P/V Ratio	Revised raw material as % of sale value	Contribution per Rs. 100 of raw material %	Rank
A	20	3.5	16.5	38.50	42.86%	III
B	30	4	26	44.00	59.09%	II
C	40	5	35	55.00	63.64%	I
D	10	6	4	66.00	6.06%	IV

Maximum Sales potential

A	30 % ₹3000	900
B	30 % ₹3000	900
C	30 % ₹3000	900
D	40 % of 3000	1200

**Allocation of raw material whose supply is restricted to Rs. 1535 lacs in order of raw material profitability.**

Product	Rank	Sales ₹ In lacs	Raw Material per ₹100 Lacs Sales	Raw Material Equired	Balance Raw Material
C	I	900	55	495	1040
B	II	900	44	396	644

A	III	900	38.5	346.5	297.5
D	IV	451**	66	297.5*	0

\* Balancing figure, hence sales will be restricted to 451\*\* lakhs ( 297.5/66%)

<i>Profitability Statement</i>				<i>₹ In Lakhs</i>		
<i>Product</i>	<i>Existing</i>			<i>Proposed</i>		
	<i>Sales</i>	<i>P/V Ratio</i>	<i>Contribution</i>	<i>Sales</i>	<i>P/V Ratio</i>	<i>Contribution</i>
<i>A</i>	900	20	180	900	16.5	148.5
<i>B</i>	300	30	90	900	26	234
<i>C</i>	600	40	240	900	35	315
<i>D</i>	1200	10	120	451	4	18.04
<i>Total</i>	3000		630	3151		715.54
<i>Less : Fixed Costs*</i>			330			330
<i>Profit before Dep and Int.</i>			300			385.54
<i>Less :Depreciation</i>			225			225.00
<i>Less :Interest</i>			115.5			115.50
<i>Profit before tax</i>			(40.5)			45.04

\* Balancing figure(Contribution - Profit before Depreciation & Interest)

3.

Allocation

Minimization

1	C	8
2		
3	B	4
4	A	7
		19

Maximization

1		
2	A	10
3	B	4
4	C	11
		25

**PRIME ACADEMY**  
**32ND SESSION PROGRESS TEST - INFORMATION SYSTEMS CONTROL AND**  
**AUDIT**

No. of Pages: 5

Total Marks: 75

Time Allowed: 2Hrs

**PART-A**

- 1) Which of the following phases represents the optimum point for software base lining to occur
  - a) Testing
  - b) Design
  - c) Requirement
  - d) Development
  
- 2) Which of the following conversion practices creates a greatest risk while replacing a legacy system
  - a) Pilot
  - b) Parallel
  - c) Direct cut over
  - d) Phased
  
- 3) The method of testing by converting cause effect into test cases is called
  - a) Cause effect graph method
  - b) Black box testing
  - c) White box testing
  - d) Flow graphs
  
- 4) unit test is a method of testing
  - a) All aspects of system remain functional after testing.
  - b) The correctness of a particular module of source code.
  - c) Done to ensure that system performs correctly
  - d) All of the above
  
- 5) To ensure interconnection between application functions correctly----- is used
  - a) Inter system testing
  - b) Error handling testing
  - c) Regression testing
  - d) All of the above
  
- 6) Assessing under differing processing and configuration conditions in terms of response time and throughput rates is called
  - a) Stress Testing
  - b) Performance testing
  - c) Volume Testing

- d) Functional Testing
- 7) Interface Testing is a type of
- a) Parallel testing
  - b) Hardware testing
  - c) Intersystem testing
  - d) None of the above
- 8) Hardware performance monitoring can be seen from
- a) processing schedules,
  - b) job accounting system reports,
  - c) preventative maintenance schedules
  - d) all of the above
- 9) Adequacy of controls in Change procedures and Authorisation procedures can be determined by
- a) Review of and testing of systems software implementation
  - b) Review of authorisation documentation
  - c) Review of system software security
  - d) All of the above
- 10) Review of database will help in understanding
- a) Access to shared data is appropriate.
  - b) Data organisation is appropriate
  - c) Integrity of the database management system's
  - d) All of the above
- 11) Which of the following would be a risk specifically associated with the agile development process
- a) Lack of documentation
  - b) Lack of testing
  - c) Poor requirement definition
  - d) Poor project management practices
- 12) An employee is responsible for updating the interest rates in a finance application including the interest rate exceptions for preferred customers. The best control to ensure that all exception handling are approved is to
- a) Make the supervisor enter his/her password before a rate exception is validated
  - b) Ensure prior management approvals for rates outside the normal range
  - c) Log and verify every 30 days all interest rates
  - d) All of the above
- 13) The application developed being peer reviewed through the text of the program and explanation to detect software errors during development activity is called as
- a) Code inspection
  - b) Structured Walk through
  - c) Static Analysis Testing
  - d) Dynamic Analysis Testing

- 14) During unit testing, the test strategy applied is
- Black box
  - White box
  - Bottom up
  - Top-down
- 15) Ownership of system development process and the resulting system lies with
- User management
  - Senior management
  - Project steering Committee
  - System development management
- 16) A company uses a bank to process its monthly payroll. Time sheets and payroll adjustment forms are completed and delivered to the bank which prepares cheques and reports for distribution. The best method to ensure data accuracy is
- Payroll reports to be compared with input forms
  - Manual recalculation of gross payroll
  - Cheques to be compared with inputs
  - Cheques to be reconciled with output forms
- 17) In a good modular design
- Cohesion will be high and coupling low
  - Coupling will be high and cohesion will be low
  - Both has to complement each other
  - None of the above
- 18) Integrity and security of information stored in the database and its performance is the responsibility of the specialist called
- Programme developer
  - Data base administrator
  - Project Leader
  - Tester
- 19) Flowchart, showing controls at a physical or resource level is called as
- Program Flow Chart
  - System Flow Chart
  - Data flow chart
  - Control Flow charts
- 20) An evaluation of all the incremental costs and benefits expected if the proposed system is implemented is known as
- Economic feasibility
  - Financial feasibility
  - Operational feasibility
  - None of the above

- 21) The primary purpose of a system test is to
- a) Determine the documentation of the system is accurate
  - b) Ensure that system operators become familiar with the new system
  - c) Evaluate the system functionality
  - d) To ensure that all the requirements are met.
- 22) Access Controls are examples of
- a) Preventive control
  - b) Detective Control
  - c) Compensatory controls
  - d) Corrective control
- 23) Data integrity controls are best ensured by
- a) System controls
  - b) Input controls
  - c) Output Controls
  - d) Application Controls
- 24) Input controls ensure
- a) Accuracy and completeness of the data into the system
  - b) Accuracy and efficiency of the output
  - c) All of the above
  - d) None of the above
- 25) Spool is an acronym for
- a) Simultaneous Peripherals Operations Online
  - b) Similar peripheral online operations
  - c) Simultaneous peripherals online operations
  - d) Simultaneous printing of online operations

**(25x1=25 Marks)**

## PART B

### Answer any five Questions

- 1)
  - (a) Explain software testing and state its objectives
  - (b) Discuss the IS Audit categorisation in brief
- 2) What are data processing controls? Explain in brief
- 3) What is Prototyping? Discuss its advantages and disadvantages in brief
- 4) Write short notes on the following: - **any two**
  - (i) Audit Trails
  - (ii) Crypto systems
  - (iii) Preventive Controls
  - (iv) Public Key Infrastructure
- 5) Describe various types of firewalls in brief
- 6) As a system analyst, you need to assess the successful implementation and stakeholder's actual requirements of an enterprise system in a retail chain organization across its branches to provide the following features:
  - Lower operational costs,
  - Better information for managers, and
  - Smooth operations for users or better levels of service to customers.Justify your answer with the necessary techniques used to determine the requirements of a system.

**(5x10=50 Marks)**

**PRIME ACADEMY  
32ND SESSION PROGRESS TEST – INFORMATION SYSTEMS CONTROL &  
AUDIT  
SUGGESTED ANSWERS**

**PART A**

1	b
2	c
3	a
4	b
5	a
6	b
7	b
8	d
9	a
10	d
11	a
12	b
13	b
14	b
15	a
16	c
17	a
18	b
19	b
20	a
21	c
22	a
23	b
24	a
25	a

## PART- B

1.

a. **Explain software testing and state its objectives**

Testing is a process used to identify the correctness, completeness and quality of developed computer software. In other words, testing is nothing but CRITICISM or COMPARISON, i.e. comparing the actual value with expected one.

One definition of testing is "the process of questioning a product in order to evaluate it", where the "questions" are things the tester tries to do with the product, and the product answers with its behaviour in reaction to the probing of the tester. The word testing means the dynamic analysis of the product—putting the product through its paces.

Testing helps in verifying and validating if the software is working as it is intended to be working.

**Objectives of Software Testing include:**

- Testing is a process of executing a program with the intent of finding an error.
- A good test case is one that has a high probability of finding a yet undiscovered error.
- A successful test is one that uncovers a yet undiscovered error.
- The data collected through testing can also provide an indication of the software's reliability and quality. However, testing cannot show the absence of defect, it can only show that software defects are present.

b. **IS Audit has been categorised into five types viz.,**

- Systems and applications
- Information processing facilities
- System development
- Management of IT & Enterprise architecture
- Telecommunications, intranet and extranets – write briefly about each of them.

2. **Data processing controls are:**

**Run-to-run totals:** These stages. If the current balance of an invoices ledger is 150000/- and additional invoices for the period is of total ₹20,000 then the total sales value should be ₹170,000. A specific record (probably the last record) can be used to maintain the control total.

**Reasonableness verification:** Two or more fields can be compared and cross verified to ensure their correctness. For example the statutory percentage of provident fund can be calculated on the gross pay amount to verify if the provident fund contribution deducted is accurate.

**Edit checks:** Edit checks similar to the data validation controls can also be used at the processing stage to verify accuracy and completeness of data.

**Field initialization:** Data overflow can occur, if records are constantly added to a table or if fields are added to a record without initializing it, i.e., setting all values to Zero before inserting the field or record.

**Exception reports:** Exception reports are generated to identify errors in data processed. Such exception reports give the transaction code and why the particular transaction was not processed or what is the error in processing the transaction. For example, while processing a journal entry if only debit entry was updated and the credit entry was not up dated due to absence of one of the important fields, then the exception report would detail the transaction code, and why it was not updated in the database.

**Existence/Recovery Controls:** The check-point/restart logs, facility is a short-term backup and recovery control that enables a system to be recovered if failure is temporary and localized.

### 3. Prototyping Model

The traditional approach sometimes may take years to analyze, design and implement a system.

In order to avoid such delays, organizations are increasingly using prototyping techniques to develop smaller systems such as DSS, MIS and Expert systems. The goal of prototyping approach is to develop a small or pilot version called a prototype of part or all of a system. A prototype is a usable system or system component that is built quickly and at a lesser cost, and with the intention of being modifying or replacing it by a full-scale and fully operational system.

As users work with the prototype, they make suggestions about the ways to improve it. These suggestions are then incorporated into another prototype, which is also used and evaluated and so on. Finally, when a prototype is developed that satisfies all user requirements, either it is refined and turned into the final system or it is scrapped. If it is scrapped, the knowledge gained from building the prototype is used to develop the real system.

**Framework type:** Iterative.

**Basic Principles:** Prototyping can be viewed as a series of four steps, wherein Implementation and Maintenance phases take place once the prototype model is tested and found to be meet uses' requirements.

**Step 1 - Identify Information System Requirements:** In traditional approach, the system Requirements have to be identified before the development process starts. However, under Prototype approach, the design team needs only fundamental system requirements to build the initial prototype, the process of determining them can be less formal and time-consuming than when performing traditional systems analysis.

**Step 2 - Develop the Initial Prototype:** In this step, the designers create an initial base model and give little or no consideration to internal controls, but instead emphasize such system characteristics such as simplicity, flexibility, and ease of use. These characteristics enable users to interact with tentative versions of data entry display screens, menus, inputprompts, and source documents. The users also need to be able to respond to system prompts, make inquiries of the information system, judge response times of the system, and issue commands.

**Step 3 - Test and Revise :** After finishing the initial prototype, the designers first demonstrate the model to users and then give it to them to experiment

and ask users to record their likes and dislikes about the system and recommend changes. Using this feedback, the design team modifies the prototype as necessary and then resubmits the revised model to system users for re evaluation. Thus iterative process of modification and re valuation continues until the users are satisfied.

**Step 4 - Obtain User Signoff of the Approved Prototype:** At the end of Step 3, users formally approve the final version of the prototype, which commits them to the current design and establishes a contractual obligation about what the system will, and will not, do or provide. Prototyping is not commonly used for developing traditional applications such as accounts receivable, accounts payable, payroll, or inventory management, where the inputs, processing, and outputs are well known and clearly defined.

### **Strengths**

- i. Improves both user participation in system development and communication among project stakeholders.
  - ii. Especially useful for resolving unclear objectives; developing and validating user requirements; experimenting with or comparing various design solutions, or investigating both performance and the human computer interface.
  - iii. Potential exists for exploiting knowledge gained in an early iteration as later iterations are developed.
  - iv. Helps to easily identify confusing or difficult functions and missing functionality.
    - v. May generate specifications for a production application.
    - vi. Encourages innovation and flexible designs.
    - vii. Provides quick implementation of an incomplete, but functional, application.
  - viii. Prototyping requires intensive involvement by the system users. Therefore, it typically results in a better definition of these users' needs and requirements than does the traditional systems development approach.
  - ix. A very short time period (e.g., a week) is normally required to develop and start experimenting with a prototype. This short time period allows system users to immediately evaluate proposed system changes.
  - x. Since system users experiment with each version of the prototype through an interactive process, errors are hopefully detected and eliminated early in the developmental process. As a result, the information system ultimately implemented should be more reliable and less costly to develop than when the traditional systems development approach is employed.
- 4.
- i. **Audit Trails:** Audit trails are logs that can be designed to record activity at the system, application, and user level. When properly implemented, audit trails provide an important detective control to help accomplish security policy objectives. Many operating systems allow management to select the level of auditing to be provided by the system. This determines which events

will be recorded in the log. An Effective audit policy will capture all significant events without cluttering the log with trivial activity. Audit trails can be used to support security objectives in three ways:

- Detecting unauthorized access to the system,
- Facilitating the reconstruction of events, and
- Promoting personal accountability.

ii. **Cryptosystems:** A cryptosystem refers to a suite of algorithms needed to implement a particular form of encryption and decryption. Typically, a cryptosystem consists of three algorithms: one for key generation, one for encryption, and one for decryption. The term cipher (sometimes cipher) is often used to refer to a pair of algorithms, one for encryption and one for decryption. Therefore, the term "cryptosystem" is most often used when the key generation algorithm is important.

For this reason, the term "cryptosystem" is commonly used to refer to public key techniques; however both "cipher" and "cryptosystem" are used for symmetric key techniques.

iii. **Preventive Controls:** Preventive controls are those inputs, which are designed to prevent an error, omission or malicious act occurring. An example of a preventive control is the use of passwords to gain access to a financial system. The broad characteristics of preventive controls are:

- A clear-cut understanding about the vulnerabilities of the asset
- Understanding probable threats
- Provision of necessary controls for probable threats from materializing

Any control can be implemented in both a manual and computerized environment for the same purpose. Only, the implementation methodology may differ from one environment to the other. Some examples of preventive controls are as under:

- Employ qualified personnel
- Segregation of duties
- Access control
- Vaccination against diseases
- Documentation
- Prescribing appropriate books for a course
- Training and retraining of staff
- Authorization of transaction
- Validation, edit checks in the application
- Firewalls
- Anti-virus software (sometimes this acts like a corrective control also),etc
- Passwords

iv **Public Key Infrastructure (PKI):** Public key infrastructure, if properly implemented and maintained, can provide a strong means of authentication. By combining a variety of hardware components, system software, policies, practices, and standards, PKI can provide for authentication, data integrity,

defences against customer repudiation, and confidentiality. The system is based on public key cryptography in which each user has a key pair—a unique electronic value called a public key and a mathematically related private key. The public key is made available to those who need to verify the user's identity. The private key is stored on the user's computer or a separate device such as a smart card. When the key pair is created with strong encryption algorithms and input variables, the probability of deriving the private key from the public key is extremely remote. The private key must be stored in encrypted text and protected with a password or PIN to avoid compromise or disclosure. The private key is used to create an electronic identifier called a digital signature that uniquely identifies the holder of the private key and can only be authenticated with the corresponding public key.

5. **Firewalls:** A firewall is a collection of components (computers, routers, and software) that mediate access between different security domains. All traffic between the security domains must pass through the firewall, regardless of the direction of the flow. Since the firewall serves as an access control point for traffic between security domains, they are ideally situated to inspect and block traffic and coordinate activities with network intrusion detection systems (IDSs).

The four primary firewall types are given as follows:

- i. **Packet Filter Firewalls:** Packet filter firewalls evaluate the headers of each incoming and outgoing packet to ensure it has a valid internal address, originates from a permitted external address, connects to an authorized protocol or service, and contains valid basic header instructions. If the packet does not match the pre-defined policy for allowed traffic, then the firewall drops the packet. Packet filters generally do not analyze the packet contents beyond the header information. Many routers contain access control lists (ACLs) that allow for packet-filtering capabilities.
- ii. **Stateful Inspection Firewalls:** Stateful inspection firewalls are packet filters that monitor the state of the TCP connection. Each TCP session starts with an initial "handshake" communicated through TCP flags in the header information. When a connection is established the firewall adds the connection information to a table. The firewall can then compare future packets to the connection or state table. This essentially verifies that inbound traffic is in response to requests initiated from inside the firewall.
- iii. **Proxy Server Firewalls:** Proxy servers act as an intermediary between internal and external IP addresses and block direct access to the internal network. Essentially, they rewrite packet headers to substitute the IP of the proxy server for the IP of the internal machine and forward packets to and from the internal and external machines. Due to that limited capability, proxy servers are commonly employed behind other firewall devices. The primary firewall receives all traffic, determines which application is being targeted, and hands off the traffic to the appropriate proxy server. Common proxy servers are the domain name server (DNS), Web server (HTTP), and mail (SMTP) server. Proxy servers frequently cache requests and responses, providing potential performance benefits.

Additionally, proxy servers provide another layer of access control by segregating the flow of Internet traffic to support additional authentication and logging capability, as well as content filtering. Web and e-mail proxy servers,

for example, are capable of filtering for potential malicious code and application-specific commands (see “Malicious Code”). They may implement anti-virus and anti-spam filtering, disallow connections to potentially malicious servers, and disallow the downloading of files in accordance with the Institution’s security policy.

- iv. Application-Level Firewalls: Application-level firewalls perform application level screening, typically including the filtering capabilities of packet filter firewalls with additional validation of the packet content based on the application. Application-level firewalls capture and compare packets to state information in the connection tables. Unlike a packet filter firewall, an application-level firewall continues to examine each packet after the initial connection is established for specific application or services such as telnet, FTP, HTTP, SMTP, etc. The application-level firewall can provide additional screening of the packet payload for commands, protocols, packet length, authorization, content, or invalid headers. Application level firewalls provide the strongest level of security, but are slower and require greater expertise to administer properly.

6. Every system is built to meet some set of needs, for example, the need of the organisation for lower operational costs, better information for managers, smooth operations for users or better levels of service to customers. To assess these needs, the analysts often interact extensively with the people, who will be benefited from the system, in order to determine what their actual requirements are. Various fact-finding techniques, which are used by the system analyst for determining these needs / requirements, are:-

- i. Documents : Document means manuals, input forms, output forms, diagrams of how the current system works, organisation charts showing hierarchy of users and manager responsibilities, job descriptions for the people who work with the current system, procedure manuals, program codes for the applications associated with the current system, etc. They are a good source of information about user needs and the current system.
- ii. Questionnaires: Users and managers are asked to complete questionnaire about the information system when the traditional system development approach is chosen. The main strength of questionnaires is that a large amount of data can be collected through a variety of users quickly. Also, if the questionnaire is skilfully drafted, responses can be analysed rapidly with the help of a computer.
- iii. Interviews: Users and managers may also be interviewed to extract information in depth. The data gathered through interviews often provide systems developer with a complete picture of the problems and opportunities. Interviews also give analyst the opportunity to note user reaction first-hand and to probe for further information.
- iv. Observation: In prototyping approaches, observation plays a central role in requirement analysis. Only by observing how users react to prototypes of a new system, the system can be successfully developed. In the traditional approach, observation is not always mandatory. But it is desirable in most instances. The analyst should visit the user site to watch how the work was taking place. The value of observational visits by analyst is effective.

**PRIME ACADEMY**  
**32ND SESSION PROGRESS TEST – DIRECT TAX LAWS**

**No. of Pages: 6**

**Total Marks: 75**  
**Time Allowed: 2Hrs**

**PART-A**

1. The residential status is determined for a minor child based on
  - a. His parents residential status
  - b. The residential status of his guardian
  - c. The residential status of the HUF in whose family he is a member
  - d. His stay in India
  
2. Residential status is dependent on the
  - a. The number of days of stay
  - b. The income of a person
  - c. The citizen ship
  - d. All of the above
  
3. Mr Kumar, working in London, for the last 15 years, comes to India on 1-1- 2011 to India and leaves on 25-12-2011,his intention is to perform a pilgrimage , then for the assessment year 2011-2012 he is
  - a. Resident and ordinarily resident
  - b. Resident but not ordinarily resident
  - c. Non resident
  - d. None of the above
  
4. Dr.A had two motor cars one for personal use and another for professional use. On sale of motor car for personal use,the gain is
  - a. Taxable as short term capital gain
  - b. Taxable as long term capital gain
  - c. Taxable as professional income
  - d. Not taxable since it is a movable property held for personal use
  
5. Maximum Investment towards 54 EC specified bonds is limited to
  - a. 40 lacs
  - b. 50lacs
  - c. 60 lacs
  - d. 10 lacs
  
6. Any improvement done before 1-4-1981 is
  - a. Taken as improvement is done after 1-4-1981
  - b. Ignored
  - c. Given as a choice to the assessee to be taken into consideration
  - d. Indexed at 100

7. Advance money received and forfeited is
  - a. An expense on transfer
  - b. Added to cost of acquisition of the holder in due course
  - c. Deducted from the cost of acquisition
  - d. To be ignored
  
8. A new business was set up on 15-11-2010 and it commenced its business from 1-12-2010. The first previous year in this case shall be:
  - a. 15-11-2010 to 31-3-2011
  - b. 1-12-2010 to 31-3-2011
  - c. 2010-2011
  - d. 1-4-2010 to 31-3-2011
  
9. A person leaves India permanently on 15-11-2010. The assessment year for income earned till 15-11-2010 in this case shall be:
  - a. 2009-10
  - b. 2010-11
  - c. 2011-12
  - d. none of the above
  
10. Conversion of capital asset into stock in trade will result into capital gain of the previous year:
  - a. In which such conversion took place
  - b. In which such converted asset is sold or otherwise transferred
  - c. In which the business commenced
  - d. At the option of the assessee
  
11. Where a partner transfers any capital asset into the business of firm, the sale consideration of such asset to the partner shall be:
  - a. Market value of such asset on the date of such transfer
  - b. Price at which it was recorded in the books of the firm
  - c. Cost of such asset to the partner
  - d. Stamp duty value on the date of transfer
  
12. Where the entire block of the depreciable asset is transferred after 36 months, there will be:
  - a. Short-term capital gain
  - b. Long-term capital gain
  - c. Short-term capital gain or loss
  - d. Long-term capital gain or loss

13. In the case of compulsory acquisition, the indexation of cost of acquisition or improvement shall be done till the :
- Previous year of compulsory acquisition
  - Year in which the full compensation received
  - Year in which part or full consideration is received
  - Option is exercised by the assessee
14. If good will of a profession which is self generated is transferred, there will:
- Be long term or short term capital gain depending on the period of holding.
  - Not be any capital gain
  - Be a short-term capital gain
  - none of the above
15. Exemption under section 54 is available to:
- All assesses
  - Individuals only
  - Individual + HUF
  - only company assessee
16. Agent of a non resident is
- not subject to any tax
  - an assessee in default
  - exempt
  - Representative assessee
17. In the case of a demerger
- The resulting company issues shares to the shareholders of the demerged company on a proportionate basis
  - The demerged company issues shares to the shareholders of the resulting company on a proportionate basis
  - The resulting company issues 75% of its shares to the shareholders of the demerged company
  - The demerged company issues 75% of its shares to the shareholders of the resulting company.
18. When the members of the HUF carry on business in the premises belonging to the HUF
- The annual value is exempt
  - The annual value is taxable as house property income
  - The annual value is taxable as business income
  - Self occupied allowance is available for one house property

19. Municipal taxes paid outside India
- Is allowed as a deduction under section 24
  - Is allowed as a deduction from Gross annual value
  - Is not allowed
  - Can be claimed as a deduction only if TDS is made
20. Capital assets exclude personal effects being movable property(excluding jewellery) owned by the
- Assessee along with his family members not dependant on him
  - Assessee along with his family members dependant on him
  - Only assessee
  - Only assessee and his spouse
21. When a capital asset is converted into stock in trade ,the Fair market value is taken as
- Cost of acquisition of the asset
  - Cost of improvement
  - Cost of transfer
  - Sale consideration
22. The benefit of indexation is not available for the following except
- When shares are transferred by a non resident
  - Bonds
  - Conversion of capital asset into stock in trade
  - Slump sale
23. For the purposes of calculating net worth ,.....is ignored.
- Any change in the value of an asset on revaluation
  - Book value of assets
  - Written down value of the block
  - Book value of liabilities
24. If the Capital gains Deposit is not utilized within the time allowed ,it is taxable
- In the year in which exemption was claimed
  - In the year of transfer of asset
  - In the year in which the 3 year period expired
  - In the year in which tax was paid
25. The amount received by the retiring partner from the firm towards his share in the firm is
- Proportionately taxable
  - Proportionately exempt
  - Fully taxable
  - Fully exempt

**(25x1=25 Marks)**

## PART B

### Answer all Questions

1. Mr. Rajiv, an employee of the Central Government, on deputation since the last two years, received salary of Rs.8Lakh for the P.Y.2010-11 for services rendered in USA. In addition, he was also paid Rs.4.50 lakh in USA by the government towards allowances and perquisites. He came to India for one month vacation in June, 2010 during the said year. Discuss the taxability of the above income during the P.Y.2010-11 in the hands of Mr. Rajiv.
2. Mr. Albert has two houses one is occupied by him for his residence in Delhi and the other is in Noida, occupied by his parents. The particulars of the houses for the P.Y.2010-11 are as under

Particulars	House 1 (Delhi)	House 2 (Noida)
Municipal valuation p.a.	1,25,000	2,75,000
Fair rent	1,10,000	3,00,000
Standard rent	1,00,000	2,50,000
Municipal taxes paid during the year	10%	6%
Interest on money borrowed for repair of property during the current year	-	40,000

Compute Mr. Albert's income from house property and also suggest which house should be opted by him to be assessed as self occupied so that his tax liability is minimum.

3. Mr. Ashok subscribed to 1000 shares of X Ltd. (Face value of Rs.100 each) by paying the application money of Rs.10,000 (Rs 10 per share). He was allotted 800 shares against the 1000 shares applied for however thereafter he failed to pay the allotment money of Rs.50 per share. The company therefore cancelled the allotment and forfeited the share application money. Can Mr. Ashok treat the loss on forfeiture as a loss under the head "capital gains"? Discuss with the aid of a recent case law. Would the forfeited share application money be subject to tax in the hands of X Ltd.?
4. Mr. Anand converted the capital asset acquired by him in the year 2001, into stock in trade on 3<sup>rd</sup> February, 2010. He sold the stock in trade so converted on 12<sup>th</sup> March, 2011. What are the tax implications of the transactions of conversion and subsequent sale under the Income Tax Act, 1961? Discuss.

5. Ranjith, an individual resident in India bought 1,000 equity shares of Rs10 each of A Ltd at Rs.50 per share on 30.05.2010. He sold 700 equity shares at Rs.35 per share on 30.09.2010 and the remaining 300 shares at Rs.25 per share on 20.01.2011. A Ltd declared a dividend of 50%, the record date being 10.08.2010. R sold on 01.02.2011 a house from which he derived a long term capital gain of Rs.75,000. Compute the capital gain arising to R for the assessment year 2011-2012.
6. Vimla sold a residential building at Jodhpur for Rs 15,00,000 on 1.7.2010. The building was acquired for Rs 1,50,000 On 1.6.2003. She paid brokerage at 2% at the time of sale of the building. She invested Rs.7 Lakhs in purchase of a residential building in December 2010 and deposited Rs.2Lakhs NHA capital gains bond in March 2011. Compute her taxable capital gains.
7. Arvind commenced construction of a residential house intended exclusively for his residence on 1.11.2009. He raised a loan of Rs 5Lakhs @ 16% interest for purpose of construction on 1.11.2009. Finding that there was an overrun in the cost of construction he raised a further loan of Rs 8 Lakh at the same rate of interest on 1.10.2010. What is the interest allowable u/s 24 assuming that the construction was completed on 31.3.2011?
8.
  - i. Aniruth is the owner of the property on which there is an annual charge of Rs 24,000 payable to his brother permanently residing in Dubai. He remits the money to his brother permanently in full and claims as a deduction in computing the income from property. Examine the tax consequence of this transaction
  - ii. Discuss the validity of the following claim: Raju in terms of a will executed by his father, became the owner of a house property on 1.06.2005. The will inter alia created a charge on the property for payment of maintenance of Rs 750 per month payable by Raju to his mother. The property was let out at Rs 2,000 per month from 1.8.2005. Raju wanted to claim the maintenance as deduction from the property income in the assessment year 2011-12.
9. Discuss whether the following is diversion of income or application of income. Certain partners of the assessee firm of chartered accountants retired and the firm was under legal obligation to pay outstanding fees to retiring partners in terms of the deed of the retirement.
10. What is Electoral Trust?

**(10x5=50 Marks)**

**PRIME ACADEMY**  
**32<sup>ND</sup> SESSION PROGRESS TEST – DIRECT TAX LAWS**  
**SUGGESTED ANSWERS**

**PART A**

1	d
2	a
3	c
4	d
5	b
6	b
7	c
8	b
9	b
10	b
11	b
12	c
13	a
14	b
15	c
16	d
17	a
18	b
19	b
20	b
21	d
22	c
23	a
24	c
25	d

## PART B

1. Mr. Rajiv is a non-resident for the P.Y.2010-11 since his stay in India is only for 30 days during the P.Y.2010-11 as per section 5(2) the scope of total income in the case of a non-resident would include the following:

- i. Income received or deemed to be received in India in the previous year and
- ii. Income which accrues or arises or is deemed to accrue or arise in India during the previous year.

As per section 9(1)(3), income chargeable under the head 'salaries' which is payable by the government to a citizen of India for services rendered outside India is deemed to accrue or arise in India. Therefore salary of ₹.8Lakh would be taxable in the hands of Mr. Rajiv even if he is a non-resident assuming that he is a citizen of India.

However allowances and perquisites paid outside India by the government to a citizen of India for rendering service outside India is exempt under section 10(7).

2. Computation of income from house property of Mr. Albert for A.Y.2011-12

Let us first calculate the income from each house property assuming that they are deemed to be let out.

Particulars	Amount in ₹ House 1 (Delhi)	Amount in ₹ House 2 (Noida)
Gross Annual Value (GAV) Annual Letting Value (ALV) is the GAV of house property ALV=higher of municipal value and fair rent, but restricted to standard rent	1,00,000	2,50,000
Less: Municipal taxes (paid by the owner during the previous year)	12,500	16,500
Net Annual Value (NAV)	87,500	2,33,500
Less: Deductions under section 24		
(a) 30% of NAV	26,250	70,050
(b) Interest on borrowed capital	-	40,000
Income from house property	61,250	1,23,450

Option 1 (House 1- self occupied and House 2- deemed to be let out)

If house 1 is opted to be self-occupied the income from house property shall be-

<b>Particulars</b>	<b>Amount in ₹</b>
House 1 (self-occupied)	Nil
House 2 (Deemed to be let out)	1,23,450
Income from house property	1,23,450

Option 2 (House 1 deemed to be let out and House 2 self occupied)  
If house 2 is opted to be self occupied the income from house property shall be-

<b>Particulars</b>	<b>Amount in ₹</b>
House 1 (Deemed to be let out)	61,250
House 2 (self occupied) (interest deduction restricted to Rs.30,000)	-30,000
Income from house property	31,250

Since option 2 is more beneficial Mr. Albert should opt to treat house 2 (House at Noida) as self occupied and house 1 (House at Delhi) as deemed to be let out. His income from house property would be ₹31,250 for the A.Y.2011-12.

3. This issue was considered by the Karnataka high court in DCIT v. BPL Sanyo Finance Ltd. (2009) 312 ITR 63. The high court held that when an assessee commits a default in payment of allotment money and consequently the share application money is forfeited by the company, it would be extinguishment of a right and consequently, result in short term capital loss.

Consequent to Mr. Ashok's default on not paying the allotment money, his right in the shares stood extinguished on forfeiture by the company. The loss suffered by Mr. Ashok, i.e., the non recovery of share application money was consequent to the forfeiture of his right in the shares and has to be understood to be within the scope and ambit of transfer.

Therefore the loss on forfeiture would be treated as a capital loss in the hands of Mr. Ashok.

Further the share application money forfeited and credited to capital reserve shall not be taxable in the hands of X Ltd.

4. Conversion of a capital asset into stock in trade falls within the definition of transfer under section 2(47). Therefore in this case transfer has taken place during the previous year 2009-10 however as per section 45(2) the capital gains liability arises only in the year in which the stock in trade is sold i.e., previous year 2010-11 in this case it is a long term capital gain since the asset was acquired in 2001. The fair market value (FMV) on the date of conversion i.e., on 3.2.2010 is deemed to be the full value of consideration accruing as a result of transfer of the capital asset.

Therefore in the year of sale of stock in trade (i.e. P.Y.2010-11), both business income and capital gains would raise

Business income = Sale consideration of stock in trade – FMV on the date of conversion

Capital gains = FMV on the date of conversion – Indexed cost of acquisition / improvement.

#### 5. Computation of taxable capital gains

Particulars	₹	₹
Date of transfer	30.09.10	20.12.10
No. of shares	700	300
Sale price/ share	35	50
Consideration for transfer	24,500	7,500
Less: Cost of Acquisition	(35,000)	(15,000)
Short term capital loss	(10,500)	(7,500)
Add: Dividend (700 shares of face value Rs 10 per share @50%) [Transferred within 3 months from record date]	3,500	Nil
Short term capital loss[after considering section 94(7)]- Note	(7,000)	(7,500)
Total short term capital loss		(14,500)
Long term capital gains(given)		75,000
Taxable LTCG(after set off u/s 71)		60,500

#### 6. Assessee: Ms. Vimla previous year:2010-2011 assessment year:2011-2011

Computation of long term capital gains on sale of residential building

Particulars	₹
Sale consideration	15,00,000
Less: Expenses on transfer (2% of ₹15Lakhs)	(30,000)
Net consideration	14,70,000
Less: indexed cost of acquisition = cost of Acqn. * CII of year of transfer / CII of year of Acqn. = ₹1,50,000 * 711/463	(2,30,346)
Long term capital gain	12,39,654
Less: Exemption u/s 54- = for purchase of new house	(7,00,000)
Taxable Long Term Capital Gains	5,39,654

Note: Investment in NHAI Bonds is not entitled for exemption U/S 54EC , because the amount was not invested within six months from the date of transfer.

7. ASSESSEE: Arvind Previous year: 2010-2011 Assessment Year: 2011-2012

Computation of interest u/s 24

Particulars	₹	₹
Prior period 1.11.2009 to 31.3.2010		
Prior period interest calculation: Loan-1; ₹5,00,000 * 5/12 * 16%	33,333	
1/5 <sup>th</sup> of prior period interest: (1/5 * 33,333)		6,667
Interest current year: Loan-1: ₹ 5,00,000 * 16%	80,000	
Loan-2: Rs8,00,000 * 16% * 6/12	64,000	1,44,000
Total Interest (3+4)		1,50,667
Deduction allowable u/s 24 in respect of interest on borrowed capital (see note below)		1,50,000

Note: In case of self occupied property, the maximum permissible interest deduction is ₹1,50,000.

8.

- i. The sum of ₹24,000 remitted by Aniruth to his brother is not an allowable deduction from "Income from house property".
- ii. The sum of ₹750 paid per month by Raju to his mother as per the will executed by his father will not be allowed as a deduction against the annual value of the property.

9. The court held that such fee could not be treated as the assessee firm's income. In this case as per the deed of retirement outstanding fees falling to the share retiring partners until the payment was made in full to them cannot be considered to be the income of the firm this was held to be an instance of the source being subject to an obligation the mere collection of the income where obligation is attached to the source of such income cannot be taxed as it can never be income.

10. Electoral trust means a trust approved by CBDT in accordance with the scheme made by central govt. Voluntary contributions received by an electoral trust shall be exempt. The income would be exempt if 95% of the aggregate donations received during the previous year along with the surplus brought forward from earlier previous year is distributed to any political party registered u/s 29A of the Representation of the People Act, 1951. Electoral trust should function in accordance with the rules made by the central govt.

**PRIME ACADEMY  
32ND SESSION PROGRESS TEST – INDIRECT TAXES**

**No. of Pages: 3**

**Total Marks: 75  
Time Allowed: 2Hrs**

**PART A**

1. Whether finished goods can be despatched directly from the job worker's end?
2. How valuation of capital goods, on which credit has been taken, is to be done when they are sold?
3. What is the procedure to be followed for movement of inputs/raw materials for job work to another premises? Whether 10% profit is to be added to arrive at the assessable value for payment of duty when inputs/capital goods are cleared "as such"?
4. Whether value of equalized freight is includible in assessable value or not for the purpose of Central Excise duty?
5. What is transaction value? If two invoices are issued to two different buyers at different rates, whether both the values can be treated as assessable values for payment of duty?
6. An assessee is selling 90% goods to a firm, owned by his brother and 10% to independent buyers. Are the sales to be assessed to duty at the price at which his brother's firm sells the goods or at the price at which the assessee sells the goods to the independent buyers?
7.
  - a. Whether additional duty charged @ 4% in respect of imported IT products is eligible for CENVAT credit?
  - b. Whether Assessee is entitled for credit of duty debited from DEPB?
  - c. Whether duty paid under DFRC is eligible for CENVAT credit?
8. Explain: Specific duty and Ad valorem duty
9. In CETA, state the
  - a. Number of schedules
  - b. Number of chapters
  - c. Number of sections
10. Explain: Rule 3 b and Rule 5 of General Interpretative rules.

**(10x2.5=25 Marks)**

## PART B

### Answer any 5 Questions

1. Explain:

a. Accounting Treatment of Inputs received &  
Accounting of Duty paid on Capital goods received.

**(5 Marks)**

b. Documents required for availing CENVAT Credit

**(5 Marks)**

2.

a. A Limited takes CENVAT credit based on the invoices issued by the dealers. In these invoices the dealer mentioned A Limited as consignee and Buyer, as some other person, an unregistered party. In this case the Audit Party has taken objection that in any dealer's invoices consignee and the Buyer should be the same.

Whether A limited can take the credit on the basis of invoices issued by Dealer mentioning A Limited as consignee and Buyer as a different person – comment.

**(5 Marks)**

b. What are the provisions relating to the payment of Excise Duty on used capital goods cleared by an assessee on which Cenvat credit has been availed?

**(5 Marks)**

3. Following transactions took place in the factory of KFJ Ltd:

- i. an imported consignment of raw materials was received vide bill of entry dated 2.12.07 showing the following customs duty payments: Basic customs duty ₹25,000; Additional duty (CVD) ₹20,000; Special additional duty ₹5,800.
- ii. A consignment of 1,000 kg of inputs was received. The excise duty paid as per the invoice was ₹10,000. While the input was being unloaded, 50 kg were damaged and were found to be not usable.
- iii. A vehicle containing machinery was received. The machinery was purchased through a dealer and not from the manufacturer. The dealer's invoice no. 925 dated 3.4.07 marked 'original for buyer' certified that the excise duty paid by the manufacturer of machinery was ₹24,000. The dealer is registered with the Central Excise Authorities.
- iv. Some inputs for final product were received. These were accompanied by a certified Xerox copy (photo copy) of invoice no. 286 dated 15.1.09 indicating that excise duty of ₹6,400 had been paid on inputs. The original or duplicate copy of invoice was not traceable. Indicate the eligibility of

CENVAT credit, in each case, under the CENVAT Credit Rules, 2004 with explanations where necessary

**(10 Marks)**

4.

- a. How will the assessable value under the subject transaction be determined under section 4 of the Central Excise Act, 1944? Give reasons with suitable assumptions wherever necessary. Contracted sale price for delivery at buyer's premises - ₹9, 00,000. The contracted sale price includes the following elements of cost –
- Cost of drawings and designs ₹4,000
  - Cost of primary packing ₹3,000
  - Cost of packing at buyer's request for safety during transport ₹7,000
  - Excise duty ₹1,11,200
  - VAT (Sales tax) ₹37,000
  - Octroi ₹9,500
  - Freight and insurance charges paid from factory to 'place of removal' ₹20,000
  - Actual freight and insurance from place of removal' to buyer's premises ₹42,300

**(8 Marks)**

- b. Central Excise - Eligibility of CENVAT credit of SAD debited under DFCE/DEPB and Target Plus Schemes

**(2 Marks)**

5.

- a. Classification of goods and determination of Tariff headings.

**(5 Marks)**

- b. B Limited Manufactures and clearance of sub-assemblies, parts, components etc against common purchased orders by classifying them as turbo generator sets, steam/gas turbines, oil drilling equipments. Department demands differential duty on piece-meal clearance. Whether it is tenable?

**(5 Marks)**

6.

- a. M/s A Limited sends goods to its job worker. The job worker pays full duty on processed goods returned and M/S A limited avails CENVAT credit of the same. Is there a dual benefit?

**(5 Marks)**

- b. Dealers of M/s M S Limited collects pre-delivery inspection charges and after sale service charges. Discuss the treatment in light of Valuation Rules, 2000.

**(5 Marks)**

PRIME ACADEMY  
32ND SESSION PROGRESS TEST – INDIRECT TAXES  
SUGGESTED ANSWERS

PART A

1. Yes, as per Rule 4(6) of CENVAT credit rules , it can be done after making an application to that effect and after obtaining permission from the Assistant Commissioner of Central Excise.
2. In terms of CENVAT credit rules, 2004, if the capital goods are cleared as such, an amount equal to the credit allowed should be paid. If the capital goods are cleared as “Waste and Scrap”, duty is to be paid on Transaction value.
3. The procedure to be followed for movement of inputs/raw materials for job work to another premises is prescribed under Notification Nos 83/94-CE dated 11/4/94 and 214/86 CE dated 25.3.86. the former deals with the procedure to be followed by the principal manufacturer and the later deals with the procedure to be followed by the Job worker. The principal manufacturer has to intimate the Central Excise Officer having jurisdiction over the factory of Job worker and give an undertaking with regard to Job work process , liability of duty, details about job worker, details of waste and scrap/ Process Loss / and the time required for the Job work process to complete. 10% profit is not required to be added to arrive at the assessable value for payment of duty when inputs/Capital goods are cleared as such. The Unit is only required to debit the credit availed on such inputs/capital goods.
4. The cost of transportation from place of removal upto the place of delivery is excluded even in the case where freight is averaged and the cost of transportation is calculated in accordance with the generally accepted principles of costing.
5. Section 4(3)(d) of the Central Excise Act,1944 defines Transaction Value Different rates for different buyers can be treated as assessable value if the assessee and the buyer of the goods are not related and price is the sole consideration for the same.
6. As per the Companies Act, 1956, the brother is deemed to be a related person. The related persons and independent persons are two different classes of buyers. The transaction value in respect of independent buyer is acceptable in terms of Section 4(1)(a) of the Central Excise Act,1944. The goods removed to the brother’s firm shall be assessed to duty at the price which the brother’s firm (related person) sells the goods to the buyers (not being related persons) in terms of Rule 9 of the Central Excise (Valuation) Rules,2000.

7. Yes, the Additional duty leviable under section 3(5) of the Customs Tariff Act is listed as an eligible duty for taking credit under Rule 3(1)(vii a) of CENVAT Credit Rules, 2004.  
 Yes, CVD debited in the DEPB on the goods imported under the licence issued on or after 1.9.2004 is available as CENVAT credit under the New Foreign Trade Policy (2004). In this connection, CBEC Circular NO 59/2004 Cus dated 21.10.2004.  
 Yes, under notification no 90/2004 Cus dated 10.9.2004, only Basic Customs Duty is exempt from payment of duty and CVD is payable. Therefore, Additional Duty of Customs (CVD) in terms of Section 3 of the Customs Tariff Act, 1975 paid under DFRC is eligible for CENVAT credit.
8. Specific Duty is payable on basis of certain units like volume, height, length, weight, thickness etc.  
**Specific Duty**  
 It is a duty payable on the basis of certain unit like weight, length, volume, thickness, etc. Calculation of duty payable is comparatively easy. In view of simplicity, many goods were covered under "specific duty".  
 However, the disadvantage is that even if selling price of the product increases, the revenue earned by Govt. does not increase correspondingly. Hence, most goods are covered under "*Ad valorem*" duty.  
 Presently, specific rates have been announced for -
- Cigarettes (length basis)
  - Matches (per 100 boxes / packs)
  - Sugar (per quintal basis)
  - Marble slabs and tiles (square meter basis)
  - Color TV when MRP is not marked on package or when MRP is not the sole consideration (based on screen size in cm)
  - Cement clinkers (per ton basis)
  - Molasses resulting from extraction of sugar (per ton basis)
9. The Central Excise Tariff Act, 1985 classifies all the goods under 91 chapters (actually 96 chapters out of which 5 are blank - 1, 6, 10, 12 and 77) and specific code is assigned to each item. There are over 1,000 tariff headings and 2,000 sub-headings. CETA has two schedules. It is divided into 20 sections.
10. **Rule 3(b):** Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets, which cannot be classified by reference to rule 3(a), shall be classified as if they consisted of the material or component which gives them their essential character, insofar as this criterion is applicable.

**Rule 5:** For legal purposes, the classification of goods in the sub-headings of a heading shall be determined according to the terms of those sub-headings and any related Sub-heading notes and, mutatis mutandis, to the above rules, on the understanding that only sub-headings at the same level are comparable. For the purpose of this rule, the relative Chapter and Section Notes also apply, unless the context otherwise requires.

## PART B

1.
  - a. **Accounting Treatment of Inputs received** - When inputs are purchased, Purchase price (net of Excise) should be debited to Purchase Account and excise on inputs should be debited to 'Cenvat Credit Receivable (Inputs) account'. Total Invoice amount (i.e. net purchase price plus excise) will be credited to Supplier's Account (as the supplier has paid Excise and his Invoice is inclusive of excise paid by him on the material supplied). When duty is debited in Input Cenvat Credit Account towards payment of duty on final product, 'Excise Duty Paid on Final Products' account should be debited and 'Cenvat Credit Receivable (Input) account' should be credited. [ *suggestion : This entry could be on monthly basis as duty is payable or once at the end of the month*]. Balance in 'Cenvat Credit Receivable (Input) account' in General Ledger and credit in 'Input Cenvat Credit Account' as per excise records (that time 'RG23 A Part II') should tally, or reconciled.  
If there is debit balance at the end of year in 'Cenvat' account, it means that credit is not fully utilised and should be shown under Current Assets under 'Loans and Advances'. Closing stock of inputs should be valued 'Net of Excise Duty'. However, since Cenvat on stock which has not been used is also utilised for payment of duty, purchases are understated to that extent. ***If balance in credit of Cenvat cannot be utilised for any reason, the same must be written off.***
  - b. **Accounting of Duty paid on Capital Goods purchased** - It has to be remembered that if Cenvat credit on capital goods is availed, depreciation under section 32 of Income Tax is not available. Moreover, Cenvat credit on capital goods is available in two stages i.e. 50% in current year and balance 50% in subsequent year.  
'Capital Goods' for Cenvat purposes include tools, spare parts etc., which are treated as consumables and normally not capitalised in financial accounts. Hence, question of claiming depreciation on these does not arise. When credit is availed of duty paid on machinery or equipment which is capitalised, it will be necessary to reduce cost of asset by the amount of duty claimed as credit.

If the assessee follows the accounting system as suggested by Guidance Note of Institute of Chartered Accountants of India, the condition gets satisfied.

Documents and accounts.- (1) The CENVAT credit shall be taken by the manufacturer or the provider of output service or input service distributor, as the case may be, on the basis of any of the following documents, namely :-

- a. An invoice issued by –
  1. a manufacturer for clearance of –
    - i. Inputs or capital goods from his factory or depot or from the premises of the consignment agent of the said manufacturer or from any other premises from where the goods are sold by or on behalf of the said manufacturer;
    - ii. Inputs or capital goods as such;
    - iii. an importer;
    - iv. an importer from his depot or from the premises of the consignment agent of the said importer if the said depot or the premises, as the case may be, is registered in terms of the provisions of Central Excise Rules, 2002;
    - v. a first stage dealer or a second stage dealer, as the case may be, in terms of the provisions of Central Excise Rules, 2002; or
  - b. a supplementary invoice, issued by a manufacturer or importer of inputs or capital goods in terms of the provisions of Central Excise Rules, 2002 from his factory or depot or from the premises of the consignment agent of the said manufacturer or importer or from any other premises from where the goods are sold by, or on behalf of, the said manufacturer or importer, in case additional amount of excise duties or additional duty leviable under section 3 of the Customs Tariff Act, has been paid, except where the additional amount of duty became recoverable from the manufacturer or importer of inputs or capital goods on account of any non-levy or short –levy by reason of fraud, collusion or any wilful misstatement or suppression of facts or contravention of any provisions of the Excise Act, or of the Customs Act, 1962 (52 of 1962) or the rules made there under with intent to evade payment of duty.  
**Explanation.-** For removal of doubts, it is clarified that supplementary invoice shall also include challan or any other similar document evidencing payment of additional amount of additional duty leviable under section 3 of the Customs Tariff Act; or
  - (c) a bill of entry; or
  - (d) a certificate issued by an appraiser of customs in respect of goods imported through a Foreign Post Office; or
  - (e) a challan evidencing payment of service tax by the person liable to pay service tax under subclauses

(iii) and (iv) of clause (d) of sub-rule (1) of rule (2) of the Service Tax Rules, 1994; or

(f) an invoice, a bill or challan issued by a provider of input service on or after the 10th day of, September, 2004; or

(g) an invoice, bill or challan issued by an input service distributor under rule 4A of the Service Tax Rules, 1994.

2. The CENVAT credit shall not be denied on the grounds that any of the documents mentioned in sub-rule (1) does not contain all the particulars required to be contained therein under these rules, if such document contains details of payment of duty or service tax, description of the goods or taxable service, assessable value, name and address of the factory or warehouse or provider of input service: Provided that the Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise, as the case may be, having jurisdiction over the factory of a manufacturer or provider of output service intending to take CENVAT credit, or the input service distributor distributing CENVAT credit on input service, is satisfied that the duty of excise or service tax due on the input or input service has been paid and such input or input service has actually been used or is to be used in the manufacture of final products or in providing output service, then, such Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise, as the case may be, shall record the reasons for not denying the credit in each case.
3. The manufacturer or producer of excisable goods or provider of output service taking CENVAT credit on input or capital goods or input service, or the input service distributor distributing CENVAT credit on input service shall take all reasonable steps to ensure that the input or capital goods or input service in respect of which he has taken the CENVAT credit are goods or services on which the appropriate duty of excise or service tax as indicated in the documents accompanying the goods or relating to input service, has been paid.

2.

- a. CENVAT credit is admissible only if the goods are received, duty is paid and such goods are used in manufacture of dutiable final products. If the documents covering goods reveal some other person as buyer, it means the other person is receiving the goods and therefore, Audit objection is correct. It is not known why some other person is mentioned as buyer when consignee is using the goods and availing CENVAT credit. The dealer may be diverting the goods to some other unregistered buyer and consignee may be availing CENVAT credit without receiving goods. Even if the goods have been received by the consignee, since invoices show different persons as buyers, the goods will be treated as diverted with the

intention to avail ineligible credit. This practice contravenes rules consignee is not only liable to credit reversal but also penalty for availing credit without receiving goods.

If the dealer is mentioning some other buyer's name out of clerical or inadvertent mistake, then consignee may ask the dealer to rectify the mistake. If the consignee is a trader and if he is not using goods received from dealer for manufacturing dutiable goods, then consignee cannot avail and utilize CENVAT credit.

- b. When used Capital Goods are cleared by the assessee, which is treated as Second Hand Capital Goods and the assessee as well can sell the same. The machinery may be in working condition or could be brought in working condition after some expenditure. In such cases, where goods are removed after use, the manufacturer shall pay an amount (not excise duty) equal to Cenvat Credit taken by them on the said capital goods reduced by 2.5% for each quarter of a year or a part thereof from the date of taking of Cenvat Credit (second proviso to rule 3(5) of Cenvat Credit Rules, inserted w.e.f.13.11.2007).

For example, if capital goods are received in July 2007 (duty paid ₹1,00,000) 50% i.e, ₹50,000 was taken in Nov.2007 and balance 50% Rs.50,000 was taken on Apr. 2008, capital goods were installed in Jan.2008 and were sold after use in July 2009, the quarter involved are 8 (2007 – 1, 2008 – 4, 2009 – 3) for first 50% and 6 (2008 – 3, 2009 – 3) for balance 50%.

Thus, assessee can get deduction of 20% (2.5% X 8) of first ₹50,000 (₹10,000) and 15% (2.5% X 6) of balance Rs.50,000 (Rs.7,500). He has to pay an 'amount' of ₹82,500 and (₹1,00,000 – Rs.10,000 – ₹7,500).

The buyer can avail Cenvat Credit of the 'amount' as made clear in rule 3(6) of Cenvat Credit Rules. Hence, seller should clear second hand capital goods under 'invoice' charging 'amount' in invoice (and not excise duty).

3.

- a. Though the Sale Price is Rs.9,00,000, the Assessable Value under Sec.4 of Central Excise Act, 1944 will be as under :-

Sec.4(3)(d) of CEA, 1944 defines 'Transaction Value' as under :

"Transaction Value" means price actually paid or payable for the goods, and includes in addition to the amount charged as price, any amount that the buyer is liable to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising, or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any actually paid or payable on such goods.

Hence, the applicability of Transaction Value in the following elements of cost is given as under:-

- i. Cost of Drawings & Designs – ₹4,000 – includible since it is part of price and price is including the cost of the drawing and designs.
- ii. Cost of Primary Packing – ₹3000 – includible. Under old law there is a distinction between primary and special packing and even under old law, primary packing is includible and hence, it has to be included
- iii. Cost of packing at buyer's request for safety during transport ₹7,000 – It is also includible under new law since the Transaction Value shall include the cost of additional packing also.
- iv. Excise duty Rs.1,11,200 – not includible since TV excludes all excise duty
- v. VAT (Sales tax) ₹37,000 – not includible since TV Rules excludes all sales tax
- vi. Octroi ₹9,500 – not includible since TV Rules excludes all other taxes
- vii. Freight and insurance charges paid from factory to 'place of removal' Rs. 20,000 – This is includible as it is the transportation cost incurred upto the place of removal satisfying all other conditions of Sec.4(1)(a).
- viii. Actual freight and insurance from 'place of removal' to buyer's premises ₹42,300 – not includible. Where excisable goods are sold satisfying all the conditions to Sec.4(1)(a), except the condition of delivering at the place of removal and the goods are delivered at a place other than the place of removal, then the value shall be transaction value minus (-) cost of transportation from the places of removal to place of delivery. In view of the above, the Assessable Value shall be (₹9,00,000 – ₹1,11,200 – ₹37,000 – ₹9,500 – ₹42,300 = ₹8,00,000)

b. Cenvat Credit eligibility under Cenvat Credit Rules, 2004:

- i. ₹25,800 is eligible Cenvat Credit (₹20,000 – Additional CVD and ₹5,800 Special Additional Duty (SAD – which is 4%) and both can be availed. However, ₹25,000 – BCD is not Cenvatable since it is import duty.
- ii. ₹9,500 can only be availed as Input Credit since 50 kg of input is not usable and credit eligibility comes only when inputs is used in or in relation to manufacture of final product and 50 kg which is not used in manufacturing activity, credit entitlement does not arise and hence, the value is calculated like this –  $₹10,000 * 50/1000 = ₹500$  &  $₹10,000 - ₹500 = ₹9,500$
- iii. The purchase from First and Stage Dealer is eligible for Cenvat Credit provided the dealer is registered with CE Authorities under Rule 9 of CE Rules since all the purchases cannot be made directly from the manufacturer. In this case, as the original invoice is also available and the dealer is also registered with Central Excise Authorities and hence, ₹24,000 – machinery purchases can be availed as Cenvat Credit.
- iv. Cenvat Credit can be availed based on any copy original, duplicate or triplicate and there is no specific provision if all the copies of duty paying documents are lost and only photo copy is available. Hence, ₹6,400 which is not backed up by any duty paying document, whether original or duplicate or

triplicate copy is not eligible credit. If atleast triplicate copy could be provided, credit can be availed, but not based on photo copy of the document.

4.

a. **Classification of Goods**

There are thousands of varieties of manufactured goods and all goods cannot carry the same rate or amount of duty. It is also not possible to identify all products individually. It is therefore necessary to identify the numerous products through groups and sub-groups and then to decide the rate of duty. This is called "Classification" of products, which means determining of heading or sub-heading under which the particular product will be covered.

- The Central Excise Tariff Act, 1985 classifies all the goods under 91 chapters (actually 96 chapters out of which 5 are blank - 1, 6, 10, 12 and 77) and specific code is assigned to each item. There are over 1,000 tariff headings and 2,000 sub-headings.
- India adopted the International convention of Harmonized System of Nomenclature (HSN), called Harmonized Commodity Description and Coding System developed by World Customs Organization w.e.f. 28.2.1986
- CETA contains two schedules - the first schedule gives basic excise duties (i.e. CENVAT duty) leviable on various products, while the second schedule gives list of items on which special excise duty is payable. Second schedule contains only a few items.
- Central Excise Tariff is divided into 20 sections. A "section" is a grouping of a number of Chapters which codify a particular class of goods. **E.g.** *Section XI is "Textile and Textile Articles" and within that section, Chapter 50 is Silk, Chapter 51 is Wool, Chapter 52 is Cotton and so on*
- Each chapter is further divided into various headings depending on different types of goods belonging to the same class of products. **E.g.** *Chapter 50 relating to Silk is further divided into 5 headings - 50.01 relates to silkworm cocoons, 50.02 relates to raw silk, 50.03 relates to silk waste, 50.04 relates to silk yarn and 50.05 relates to woven fabric of silk. The headings are sometimes divided into further sub-headings. **E.g.** 5004.11 means silk yarn containing 85% or more by weight of silk or silk waste while 5004.19 means containing less than 85% by weight of silk or silk waste.*
- All excisable goods are classified using 4 digit system and 2 more digits are added for further sub-classification whenever required. In above example, first two digits i.e. 50 indicates the Chapter number, next 2 digits i.e. 01 or 02 relate to heading of goods in that Chapter and the last 2 digits indicate sub-heading.

- b. **M/s Tecumseh Products India Pvt Ltd Vs CCE, Hyderabad (Dated: January 21, 2010)**  
Central Excise - Eligibility of CENVAT credit of SAD debited under DFCE/DEPB and Target Plus Schemes - Duty demand for any short payment of customs duty by debiting DEPB/DFCE license to be raised by Customs authorities - In the absence of such demand, payment of SAD through DFCE/DEPB licenses to be treated as duty paid under Section 3 of Customs Tariff Act, eligible as CENVAT Credit - Impugned orders liable to be set aside: **BANGALORE CESTAT;**
- c. **M/s Bharat Heavy Electricals Limited Vs CCE, Hyderabad (Dated: December 23, 2009)**  
Central Excise - Manufacture & clearance of sub-assemblies, parts, components etc against common purchased orders by classifying them as turbo generator sets, steam/gas turbines, oil drilling equipments - Though there is piece-meal clearance, finished products to be classified as machinery and not as parts of machinery - Impugned orders demanding differential duty after finalization of provisional assessment, liable to be set aside: **BANGALORE CESTAT;**
- 5.
- a. **M/s Aries Dychem Industries Vs CCE, Ahmedabad (Dated: January 7, 2010)**  
Central Excise - CENVAT Credit on the inputs sent to job worker under rule 4(5) of the CENVAT Credit Rules, 2004 - the job worker paid full duty on the processed goods returned and the appellants availed CENVAT Credit of the same - Revenue alleges dual benefit - There is no double benefit of CENVAT Credit as alleged by the revenue - rules do not bar the job worker from paying duty and the job worker 4) been diverted or not received back: **AHMEDABAD CESTAT;**
- b. **M/s Maruti Suzuki India Ltd Vs CCE, Delhi (Dated: August 13, 2010)**  
Central Excise - Valuation - Transaction Value - Pre-delivery Inspection and after-sale-service charges collected by dealers to be included; The manufacturing of a product and the marketability thereof are inbuilt elements of the scheme of assessable value under Section 4: The expression 'transaction value' is the guiding principle in the process of ascertaining the assessable value of a product. The sale price, being paid or payable as the sole consideration, forms the base for the transaction value. Depending upon the fact situation relating to all the factors mentioned in said section 4 of the said Act, including the agreement and the arrangement arrived at between the manufacturer and the dealer or the agent in respect of sale of the product to the buyers, and the terms and the conditions thereof, the transaction value arrived at would lead to the quantification of the assessable value of the product, which in turn will determine the duty liability of the manufacturer. In the scheme of the

said Act, therefore, the concept of transaction value relates to the manufacturing cost inclusive of any other amount received or receivable directly or indirectly to make the product marketable. The manufacturing of a product and the marketability thereof are inbuilt elements of the scheme of assessable value under Section 4 of the said Act. : **DELHI CESTAT (LARGER BENCH);**