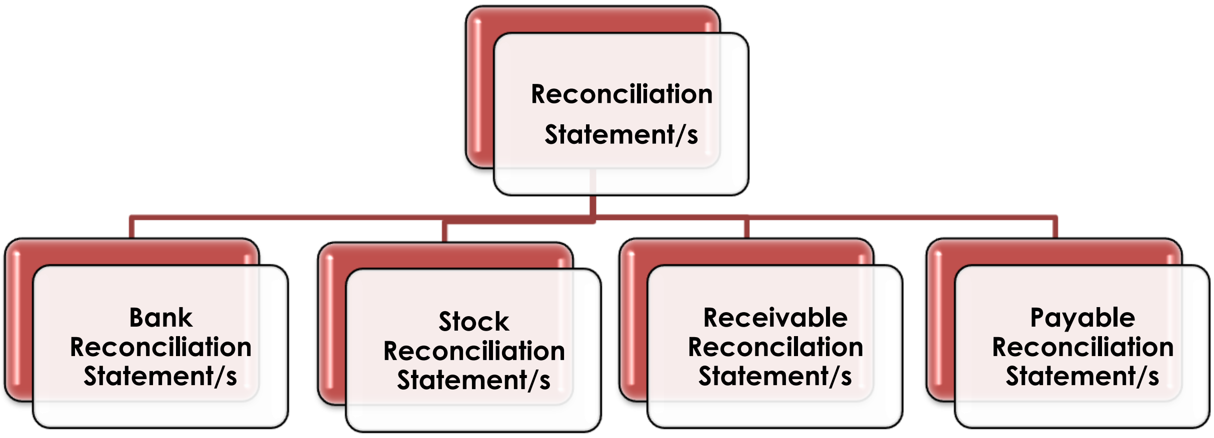
CMA Students Newsletter (For Intermediate Students)

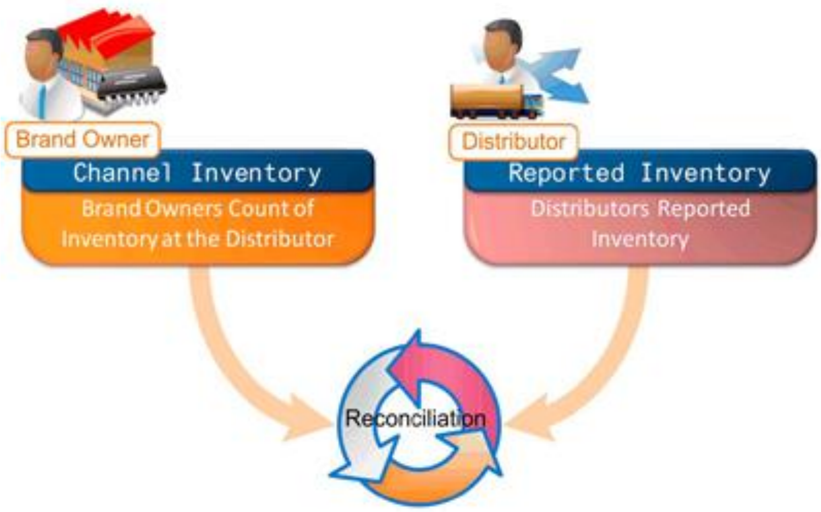
Vol.7B: April 15, 2015

RECONCILIATION STATEMENTS

We prepare 4 types of reconciliation statements:



Now we discuss about <u>Stock Reconciliation Statement</u>.



Another name of Stock Reconciliation Statement is Inventory Reconciliation Statement. Inventory Reconciliation is the vital aspect of accounting. Many medium and small businesses lack expertise and proficiency in inventory reconciliation, because it needs significant training and investment.

Reasons for preparing Stock Reconciliation Statement:

(i) Practice of all business houses to ascertain the balance of physical stock and book stock

(ii) to ascertain causes of difference, if any

Generally, stocks are valued at the closing date of the financial year. But sometimes it may so happen that the value of stock has been ascertained on a certain date instead of valuing the same on the closing date of the financial year which may either be the succeeding or preceding date of the financial year. As a result, reconciliation is to be made compulsory in order to ascertain the real position of stock.

In short, if stocks are valued at a certain date which is ***after*** the closing date of the financial year, the value of goods purchased, sold or returned are to be deducted in order to ascertain the value of the same between those two dates. On the contrary, if stocks are valued at a certain date which is ***before*** the closing date of the financial year, the above items will, however, be added.

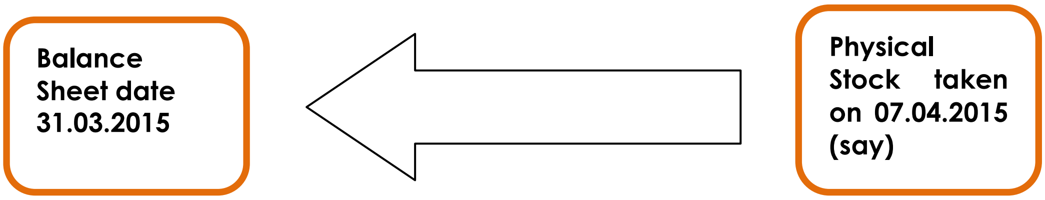
Principles to be followed

(i) Goods are purchased and invoices are passed through the books in the same accounting period, so that the liability is also taken into consideration in the same accounting period as appropriate asset.

(ii) Goods sold but not actually delivered should be included with sales for a particular accounting period but to be excluded from stock.

(iii) Goods belonging to the business, although not in its physical possession, must be included with stocks.

If Physical stock taken - after Balance Sheet date



The proforma will be

Value of Stock at the date of physical stock taking		XXX
Add: Sales [at cost] and Purchase Return between B/S Date and Stock taking date	XXX	
Stock with customers on Sale / Return [at cost]	XXX	
Stock with Consignee	XXX	

Stock with Branches	XXX	
		XXX
Less: Purchases and Sales Return [at cost] between B/S Date and stocking date	XXX	
Stock of goods received on Sale/Return and goods received as consignee	XXX	XXX
Value of Stock at the closing date of the financial year		XXX

Example

(i) Physical Stock taken on 7th April,2015 ₹90,000.

(ii) Goods received from consignor on 6th April ₹5,000. (in this case your organization is a consignee – an agent for the consignor)

(iii) Goods sent to consignee costing ₹7,000 at ₹10,000 (in this case you are the consignor and you have sent goods to the consignee) on 3rd April,2015

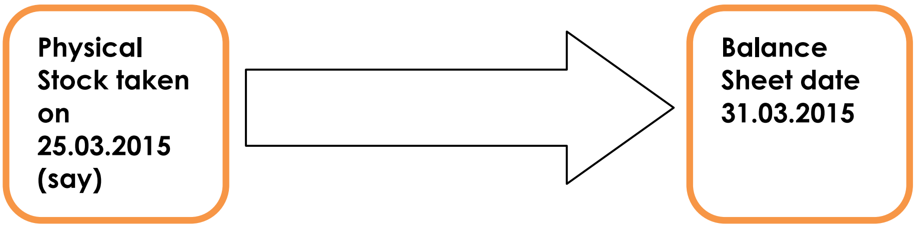
What is the value of stock for balance sheet purpose as on 31.03.2015?

Answer:

Stock Reconciliation Statement as at 31.03.2015

Particulars	**₹**
Value of Stock at the date of physical stock taking (07.04.2015)	90,000
Add: Goods sent to Consignee on 3rd April,2015 (added back as the ownership of the goods remains with the Consignor and not the consignee, hence forming part of book stock) – considered at cost price only	7,000
	97,000
Less: Goods received from Consignor on 6th April,2015 between B/S Date and stocking date (since not the owner of the goods, hence not forming part of book stock though is included in physical stock)	5,000
Value of Stock at the closing date of the financial year	92,000

If Physical Stock taken - Before Balance Sheet Date



The proforma will be:

Value of Stock at the date of physical stock taking		XXX
Less: Sales [at cost] and Purchase Return between B/S Date and Stock taking date	XXX	
Stock with customers on Sale / Return [at cost]	XXX	
Stock with Consignee	XXX	
Stock with Branches	XXX	
		XXX
Add: Purchases and Sales Return [at cost] between B/S Date and stocking date	XXX	
Stock of goods received on Sale/Return and goods received as consignee	XXX	XXX
Value of Stock at the closing date of the financial year		XXX

Example:

(i) Physical Stock taken on 25th March,2015 ₹63,000.

(ii) Goods returned to suppliers on 26th March,2015 ₹2,000

(iii) Goods returned by customers on 27th March,2015 ₹3,000 (at selling price on which profit made@ 20% on selling price)

What is the value of stock for balance sheet purpose as on 31.03.2015?

Answer:

Particulars	₹
Value of Stock at the date of physical stock taking (25.03.2015)	63,000
Add : Goods returned by customers on 27th March,2015 (to be considered at cost price after eliminating the profit element) = [₹3,000 less 20% of ₹3,000]	2,400
Less : Goods returned to suppliers on 26th March,2015 (these goods were not forming part of closing stock on the balance sheet date, hence deducted)	2,000
Value of Stock at the closing date of the financial year	63,400

CORPORATE GOVERNANCE

What is Corporate Governance?

In general the definitions of Corporate Governance found in the literature tend to share certain characteristics, one of which is the notion of accountability. Narrow definitions are oriented around corporate accountability to shareholders. Some narrower, shareholder-oriented definitions of Corporate Governance focus specifically on the ability of a country's legal system to protect minority shareholder rights. However, such definitions are mainly applicable to cross-country comparisons of Corporate Governance.

Broader definitions of Corporate Governance stress a broader level of accountability to shareholders and other stakeholders. We can see that Tricker's (1984) definition, encompassing accountability to a broader group of people than just the shareholders. This demonstrates an interest within the financial community in a broader, stakeholder- oriented approach to Corporate Governance. The broadest definitions consider that companies are accountable to the whole of society, future generations and the natural world. It is suggested that corporate governance should be a system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity.

Some definitions of Corporate Governance

Noble laureate Milton Friedman defined Corporate Governance as "the conduct of business in accordance with shareholders' desires, which generally is to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs."

"Corporate Governance is concerned with the way corporate entities are governed, as distinct from the way business within those companies is managed. Corporate governance addresses the issues facing Board of Directors, such as the interaction with top management and relationships with the owners and others interested in the affairs of the company." **Robert Ian (Bob) Tricker** (who introduced the words corporate governance for the first time in his book in 1984)

"Corporate Governance is about promoting corporate fairness, transparency and accountability". **James D. Wolfensohn**

Cadbury Committee, U.K says,
Corporate Governance is a system of structuring, operating and controlling a company with the following specific aims:—

(i) Fulfilling long-term strategic goals of owners;
(ii) Taking care of the interests of employees;
(iii) A consideration for the environment and local community;
(iv) Maintaining excellent relations with customers and suppliers;

Proper compliance with all the applicable legal and regulatory requirements.

"Corporate governance deals with laws, procedures, practices and implicit rules that determine a company's ability to take informed managerial decisions vis-á-vis its claimants - in particular, its shareholders, creditors, customers, the State and employees. There is a global consensus about the objective of 'good' corporate governance: maximising long-term shareholder value." **Confederation of Indian Industry (CII) -Desirable Corporate Governance Code (1998)**

"Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure." **Report of Kumar Mangalam Birla Committee on Corporate Governance constituted by SEBI(1999)**

NEED FOR CORPORATE GOVERNANCE

Corporate Governance is needed to create a Corporate culture of transparency, accountability and disclosure. It refers to compliance with all the moral & ethical values, legal framework and voluntary adopted practices. This enhances customer satisfaction, shareholder value and wealth. The main important points are discussed hereunder:

1. **Corporate Performance:** Improved governance structures and processes helps to ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance. This can be linked with improved corporate performance- either in terms of share price or profitability.

2. **Better Access to Global Market:** Good corporate governance systems attracts investment from global investors, which subsequently leads to greater efficiencies in the financial sector.

3. **Easy Finance from Institutions:** Several structural changes like increased role of financial intermediaries and institutional investors, size of the enterprises, investment choices available to investors, increased competition, and increased risk exposure have made monitoring the use of capital more complex thereby increasing the need of Good Corporate Governance. Evidence indicates that well-governed companies receive higher market valuations. The credit worthiness of a company can be trusted on the basis of corporate governance practiced in the company.

4. **Accountability:** Investor relations' is essential part of good corporate governance. Investors have directly/indirectly entrusted management of the company for creating enhanced value for their investment. The company is hence obliged to make timely disclosures on regular basis to all its shareholders in order to maintain good investor's relation. Good Corporate Governance practices create the environment where Boards cannot ignore their accountability to these stakeholders.

5. **Enhanced Investor Trust:** Investors consider Corporate Governance as important as financial performance when evaluating companies for investment. Investors who are provided with high levels of disclosure and transparency are likely to invest openly in those companies. Global institutional investors are prepared to pay a premium for shares in companies with superior corporate governance practices.

6. **Reduced Risk of Corporate Crisis and Scandals:** Effective Corporate Governance ensures efficient risk mitigation system in place. The transparent and accountable system of Corporate Governance makes the Board of a company aware of all the risks involved in particular strategy, thereby, placing various control systems to monitor the related issues.

7. **Combating Corruption:** Companies that are transparent, and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption will certainly fade out. Corporate Governance enables a corporation to compete more efficiently and prevent fraud and malpractices within the organization.

8. **Enhancing Enterprise Valuation:** Improved management accountability and operational transparency fulfill investors' expectations and confidence on management and return, increase the value of corporates.

OBJECTIVES OF CORPORATE GOVERNANCE

Good governance is integral to the very existence of a company. It inspires and strengthens investor's confidence by ensuring company's commitment to higher growth and profits. It seeks to achieve following objectives:

(i) A properly structured Board capable of taking independent and objective decisions is in place at the helm of affairs;

(ii) The Board is balanced as regards the representation of adequate number of non-executive and independent directors who will take care of the interests and well-being of all the stakeholders;

(iii) The Board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;

(iv) The Board has an effective machinery to sub serve the concerns of stakeholders;

(v) The Board keeps the shareholders informed of relevant developments impacting the company;

(vi) The Board effectively and regularly monitors the functioning of the management team; and

(vii) The Board remains in effective control of the affairs of the company at all times.

The overall endeavour of the Board should be to take the organisation forward, to maximise long-term value and shareholders' wealth.

FACTORS INFLUENCING QUALITY OF CORPORATE GOVERNANCE

Quality of governance primarily depends on following factors:

(i) Integrity of the management;

(ii) Ability of the Board;

(iii) Adequacy of the processes;

(iv) Commitment level of individual Board members;

(v) Quality of corporate reporting;

(vi) Participation of stakeholders in the management.

ELEMENTS OF GOOD CORPORATE GOVERNANCE

Some of the important elements of good corporate governance are discussed as under:

1. Role and powers of Board

Good governance is decisively the manifestation of personal beliefs and values which configure the organizational values, beliefs and actions of its Board. The Board as a main functionary is primary responsible to ensure value creation for its stakeholders. The absence of clearly designated role and powers of Board weakens accountability mechanism and threatens the achievement of organizational goals. Therefore, the foremost requirement of good governance is the clear identification of powers, roles, responsibilities and accountability of the Board, CEO, and the Chairman of the Board. The role of the Board should be clearly documented in a Board Charter.

2. Legislation

Clear and unambiguous legislation and regulations are fundamental to effective corporate governance. Legislation that requires continuing legal interpretation or is difficult to interpret on a day-to-day basis can be subject to deliberate manipulation or inadvertent misinterpretation.

3. Management environment

Management environment includes setting-up of clear objectives and appropriate ethical framework, establishing due processes, providing for transparency and clear enunciation of responsibility and accountability, implementing sound business planning, encouraging business risk assessment, having right people and right skill for the jobs, establishing clear boundaries for acceptable behaviour, establishing performance evaluation measures and evaluating performance and sufficiently recognizing individual and group contribution.

4. Board skills

To be able to undertake its functions efficiently and effectively, the Board must possess the necessary blend of qualities, skills, knowledge and experience. Each of the directors should make quality contribution. A Board should have a mix of the following skills, knowledge and experience:

— Operational or technical expertise, commitment to establish leadership;
— Financial skills;
— Legal skills; and
— Knowledge of Government and regulatory requirement.

5. Board appointments

To ensure that the most competent people are appointed in the Board, the Board positions should be filled through the process of extensive search. A well-defined and open procedure must be in place for reappointments as well as for appointment of new directors. Appointment mechanism should satisfy all statutory and administrative requirements. High on the priority should be an understanding of skill requirements of the Board particularly at the time of making a choice for appointing a new director. All new directors should be provided with a letter of appointment setting out in detail their duties and responsibilities.

6. Board induction and training

Directors must have a broad understanding of the area of operation of the company's business, corporate strategy and challenges being faced by the Board. Attendance at continuing education and professional development programmes is essential to ensure that directors remain abreast of all developments, which are or may impact on their corporate governance and other related duties.

7. Board independence

Independent Board is essential for sound corporate governance. This goal may be achieved by associating sufficient number of independent directors with the Board. Independence of directors would ensure that there are no actual or perceived conflicts of interest. It also ensures that the Board is effective in supervising and, where necessary, challenging the activities of management. The Board needs to be capable of assessing the performance of managers with an objective perspective. Accordingly, the majority of Board members should be independent of both the management team and any commercial dealings with the company.

8. Board meetings

Directors must devote sufficient time and give due attention to meet their obligations. Attending Board meetings regularly and preparing thoroughly before entering the Boardroom increases the quality of interaction at Board meetings. Board meetings are the forums for Board decision-making. These meetings enable directors to. discharge their responsibilities. The effectiveness of Board meetings is dependent on carefully planned agendas and providing relevant papers and materials to directors sufficiently prior to Board meetings.

9. Code of conduct

It is essential that the organization's explicitly prescribed norms of ethical practices and code of conduct are communicated to all stakeholders and are clearly understood and followed by each member of the organization. Systems should be in place to periodically measure, evaluate and if possible recognise the adherence to code of conduct.

10. Strategy setting

The objectives of the company must be clearly documented in a long-term corporate strategy including an annual business plan together with achievable and measurable performance targets and milestones.

11. Business and community obligations

Though basic activity of a business entity is inherently commercial yet it must also take care of community's obligations. Commercial objectives and community service obligations should be clearly documented after approval by the Board. The stakeholders must be informed about the proposed and on going initiatives taken to meet the community obligations.

12. Financial and operational reporting

The Board requires comprehensive, regular, reliable, timely, correct and relevant information in a form and of a quality that is appropriate to discharge its function of monitoring corporate performance. For this purpose, clearly defined performance measures - financial and non-financial should be prescribed which would add to the efficiency and effectiveness of the organisation.

The reports and information provided by the management must be comprehensive but not so extensive and detailed as to hamper comprehension of the key issues. The reports should be available to Board members well in advance to allow informed decision-making. Reporting should include status report about the state of implementation to facilitate the monitoring of the progress of all significant Board approved initiatives.

13. Monitoring the Board performance

The Board must monitor and evaluate its combined performance and also that of individual directors at periodic intervals, using key performance indicators besides peer review. The Board should establish an appropriate mechanism for reporting the results of Board's performance evaluation results.

14. Audit Committees

The Audit Committee is inter alia responsible for liaison with the management; internal and statutory auditors, reviewing the adequacy of internal control and compliance with significant policies and procedures, reporting to the Board on the key issues. The quality of Audit Committee significantly contributes to the governance of the company.

15. Risk management

Risk is an important element of corporate functioning and governance. There should be a clearly established process of identifying, analyzing and treating risks, which could prevent the company from effectively achieving its objectives. It also involves establishing a link between risk-return and resourcing priorities. Appropriate control procedures in the form of a risk management plan must be put in place to manage risk throughout the organization. The plan should cover activities as diverse as review of operating performance, effective use of information technology, contracting out and outsourcing.

RESPONSIBILITY OF THE BOARD

The Board has the ultimate responsibility for identifying major risks to the organization, setting acceptable levels of risk and ensuring that senior management takes steps to detect, monitor and control these risks. The Board must satisfy itself that appropriate risk management systems and procedure are in place to identify and manage risks. For this purpose the company should subject itself to periodic external and internal risk reviews. '

Factors which add greater value through Good Governance, may be summarized as follows:

— Adoption of good governance practices provides stability and growth to the enterprise.

— Good governance system, demonstrated by adoption of good corporate governance practices, builds confidence amongst stakeholders as well as prospective stakeholders. Investors are willing to pay higher price to the corporates demonstrating strict adherence to internationally accepted norms of corporate governance.

— Effective governance reduces perceived risks, consequently reduces cost of capital and enables Board of directors to take quick and better decisions which ultimately improves bottom line of the corporates.

— In today's knowledge driven economy, demonstrating excellence in skills has become the ultimate tool in the hands of Board of Directors to leverage competitive advantage.

— Adoption of good corporate governance practices provides long-term sustenance and strengthens stakeholders' relationship.

— A good corporate citizen becomes an icon and enjoys a position of respect.

— Potential stakeholders aspire to enter into relationships with enterprises whose governance credentials are exemplary.

FAQS ON TAX DEDUCTED AT SOURCE (TDS)

What is tax deducted at source?

For quick and efficient collection of taxes, the Income-tax Law has incorporated a system of deduction of tax at the point of generation of income. This system is called as **Tax Deducted at Source**, commonly known as TDS. Under this system tax is deducted at the origin of the income. Tax is deducted by the payer and the same is directly remitted to the Government by the payer on behalf of the payee.

The provisions of deduction of tax at source are applicable to several payments such as salary, interest, commission, brokerage, professional fees, royalty, contract payments, etc. In respect of payments to which the TDS provisions apply, the payer has to deduct tax at source on the payments made by him and he has to deposit the tax deducted by him to the credit of the Government. The following illustration will explain the TDS mechanism.

What are the payments covered under the TDS mechanism?

Sections 192 to 196D give various items in respect of which tax is to be deducted at source. Following is the list of items covered under the TDS mechanism:

Section reference	Nature of payment
192	Salary (to resident as well as non-resident)
193	Interest on securities
194	Dividends (dividends on which dividend distribution tax is levied under section 115-O are exempt from tax and hence are not liable to TDS)
194A	Interest other than interest on securities
194B	Winnings from lottery or crossword puzzle or card game or other game of any sort (to resident as well as non-resident)
194BB	Winnings from horse races (to resident as well as non-resident)
194C	Payment or credit to a resident contractor/sub-contractor
194D	Insurance commission
194E	Payment to non-resident sportsman or sports association
194EE	Payment in respect of deposits under National Savings Scheme, 1987
194F	Payment on account of repurchase of units of Mutual Fund or Unit Trust of India
194G	Commission on sale of lottery tickets
194H	Commission or brokerage
194I	Rent of land or building or furniture or fitting or plant or machinery
194IA	Payment/credit of consideration to a resident-transferor for transfer of any immovable property (other than rural agricultural land)

194J	Professional fees, technical fees, royalty or remuneration to a director
194LA	Payment of compensation on compulsory acquisition of certain immovable property
194LB	Payment/credit by way of interest by infrastructure debt fund to a non-resident
194LC	Payment/credit of interest by an Indian specified company on foreign currency approved loan/longterm infrastructure bonds from outside India
194LD	Interest on a rupee denominated bond of an Indian company or Government security (from June 1, 2013)
195	Payment/credit of other sum to a non-resident
196B	Payment/credit of income from units (including long-term capital gains on transfer of such units) to an offshore fund
196C	Payment/credit of interest of foreign currency bonds or GDR (including long-term capital gains on transfer of such bonds) (not being dividend referred to in section 115-O)
196D	Payment/credit of income from securities (not being dividend, short-term or long-term capital gain) to Foreign Institutional Investors

Is there any minimum amount upto which tax is not deducted?

In respect of various items liable to TDS, the Income-tax Law has prescribed a threshold limit. If the expenditure incurred/payment made during the year is below the threshold limit, then there is no requirement to deduct tax at source. Following list gives the threshold limit in respect of various items covered by TDS provisions:

Limit	Nature of payment
(*)	Salaries
₹ 5,000	Interest other than interest on securities (the limit is ₹ 10,000 for interest on time deposits with banks/ co-operative society engaged in banking business and Senior Citizen Saving Schemes, 2004 of post office)
₹ 10,000	Winnings from lottery or crossword puzzle or card game or other game of any sort
₹ 5,000	Winnings from horse races
₹ 30,000 per contract and ₹ 75,000 for aggregate amount during the year	Payment or credit to a resident contractor/sub-contractor
₹ 20,000	Insurance commission
₹ 1,000	Commission on sale of lottery tickets
₹ 2,500	Payment in respect of deposits under National Savings Scheme, 1987
₹ 5,000	Commission or brokerage

₹ 1,80,000	Rent of land or building or furniture or fitting or plant and machinery
₹ 50,00,000	Payment/credit of consideration to a resident transferor for transfer of any immovable property (other than rural agricultural land)
₹ 30,000	Professional fees, technical fees or royalty (no limit for remuneration to a director)
₹ 2,00,000	Payment of compensation on compulsory acquisition of certain immovable property

(*) No tax is to be deducted if the taxable salary (after allowing certain deductions under section 80C to section 80U) does not exceed the basic exemption limit applicable in case of an individual taxpayer (*i.e.*, ₹ 2,00,000 or ₹ 2,50,000 or ₹ 5,00,000, as the case may be).

What are the due dates for filing quarterly TDS Returns?

The due dates for filing quarterly TDS returns, both electronic and paper are as under:

Quarter	Due Date for Government Deductors	Due Date for Other deductor
April to June	31 July	15 July
4July to September	31 October	15 October
October to December	31 January	15 January
January to March	15 May	15 May

What is due date for remittance of TDS certificates? (Form-16 and Form-16A)

In this regard, your attention is invited to the CBDT circulars 04/2013 dated 17.04.2013, No. 03/2011 dated 13.05.2011 and No. 01/2012 dated 09.04.2012 on the **Issuance of certificate for Tax Deducted at Source** in Form 16/16A as per IT Rules 1962. It is now **mandatory for all deductors to issue TDS certificates after generating and downloading the same from "TDS Reconciliation Analysis and Correction Enabling System"** or http://www.tdscpc.gov.in (hereinafter called TRACES Portal).

In view of above circulars, it may kindly be noted that the TDS Certificates **downloaded only from TRACES Portal** will be valid. Certificates issued in any other form or manner will not comply to the requirements referred in the Income-tax Act 1961 read with relevant Rules and Circulars issued in this behalf from time to time.

Please be advised that under the provisions of section 203 of the Income Tax Act, 1961 read with rule 31A, Certificate of tax deducted at source is to be **furnished within fifteen (15) days from the due date for furnishing the statement** of tax deducted at source. Failure to comply with the provisions of the Act will attract **penalty under the provisions of section 272A of the Act, a sum of one hundred rupees for every day** during which the failure continues.

Difference between TDS and TCS?

TDS is Tax deducted at source and TCS is tax collected at source. The meaning can be understood from its definition itself. TDS is for expense and where as TCS is for revenue (Ex- scrap sale).

Whether any person is exempted from TDS deduction? Is there any such relaxation? If so what is the procedure that should be followed?

A) Yes, if the assessing officer is satisfied that the total income of the recipient is below the basic exemption limit or the tax liability of the person is NIL, he should, on an application in Form-13, may issue a certificate on a plain paper for deduction of tax at lower rate or no deduction of tax.

Difference between Form-15G and Form-15H?

Form-15G: It is declaration given by an individual or other person (not being a company or firm) to the person responsible for deducting tax at source not to deduct tax, since the total income including the current receipts will not exceed the maximum amount which is not chargeable to income tax.

Form-15H: It is declaration given by an individual who is the age of 60 years or more to the person responsible for deducting tax at source not to deduct tax, since the total income including the current receipts will not exceed the maximum amount which is not chargeable to income tax.

Whether conversion of out standing interest on loan into loan attracts TDS?

There are two situations generally we come across while dealing the above case-

(i) Interest payment to banks/financial institutions- Any interest paid or credited to the banks/financial institutions is not subject to tax deduction U/S 194(3)(iii), hence TDS is not required to be made on interest payments.

Even the interest payments does not attract TDS provisions, hence there is no question of TDS in case of capitalization of interest on loan as loan.

(ii) Interest payments to others (other than persons those who are covered under 194(3)(iii))- According to sec 194A, TDS is to be made at the time of credit or payment which ever earlier.

So the liability to deduct TDS arises at the time of credit or payment, where as the conversion of interest out standing into loan arises after a long period from the time interest liability becomes due for payment. This is due to inability of the borrower in making the interest payments.

There is a point of timing difference between the interest due and conversion of interest into loan.

Hence the liability to deduct TDS arises only at the time the interest becomes due but not at the time of conversion of interest outstanding into loan.

CONTRACT COSTING

Contract costing is the costing method applied to determine the cost of construction work performed as per a customer's specification. Contract costing is also called terminal costing as it terminates with the discharge of contract work. It applies where work each order is of long duration.

FEATURES OF CONTRACT COSTING:

- The contract terminates on its completion.
- Work is carried out at a site other than contractor's own premises.
- Most items of cost are directly chargeable.

TYPES OF CONTRACT:

- **Fixed Price Contracts:** under these contracts a fixed price of the contract is agreed upon between the contractor and the contractee.
- **Contracts with Escalation Clause:** In these cases the contract price is fixed with a provision that it will be increased with increase in the price of materials, wage rates and other major costs, and reduced with the decline in the costs
- **Cost plus Contract:** This method is adopted where the probable cost of the contract cannot be ascertained in advance with a reasonable accuracy. In case of these contracts no fixed price is pre-determined for the contract.

SOME BUSINESSES WHERE CONTRACT COSTING APPLIES:

- Buildings
- Dams
- Bridges
- Ship building
- Aircraft manufacturing
- And other constructional work.

SOME SPECIAL ITEMS UNDER CONTRACT ACCOUNTING:

- Sub-Contract
- Surveyor's Certificate and Retention Money
- Defective Work
- Escalation Clause
- Work-in-progress
- Profit on incomplete contracts

PROFIT ON INCOMPLETED CONTRACT:

- When work on contract has not reasonably advanced, no profit is taken into account. In practice, no profit is calculated when work certified is less than 1/4th but less than ½ of the contract price.

- When work certified is more than 1/4th but less than ½ of the contract price, following formula is used to determine the figures of profit to be credited to profit and loss account:

$$\text{Profit transferable to P \& L A/c} = \text{Notional Profit} \times \frac{1}{3} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

- When there is notional profit and the value of work certified is equal to or more than ½ of contract value but less than 90 percent:-

$$\text{Profit transferable to P \& L A/c} = \text{Notional Profit} \times \frac{2}{3} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

Or,

$$\text{Profit transferable to P \& L A/c} = \text{Notional Profit} \times \frac{\text{Value of work certified}}{\text{Contract price}} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

Or,

$$\text{Profit transferable to P \& L A/c} = \text{Notional Profit} \times \frac{\text{Cost of work to date}}{\text{Estimated total cost of work}} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

- When there is notional profit and the value of work certified is up to 90 percent or more than 90 percent i.e. it is nearing completion:-

  - $\text{Estimatd Profit} \times \frac{\text{Work certified}}{\text{Contract price}}$

- $\text{EstimatdProfit} \times \frac{\text{Work certified}}{\text{Contract price}} \times \frac{\text{Cash received}}{\text{Work certified}}$

- $\text{EstimatdProfit} \times \frac{\text{Cost of work to date}}{\text{Estimated total cost}}$

- $\text{EstimatdProfit} \times \frac{\text{Cost of work to date}}{\text{Estimated total cost}} \times \frac{\text{Cash received}}{\text{Work certified}}$

- $\text{Notional Profit} \times \frac{\text{Work certified}}{\text{Contract price}}$

With the help of an example can be clearly explained:

Example:

An amount of ₹19,80,000 was incurred on a contract work upto 31.03.2015. Certificates have been received to date to the value of ₹24,00,000 against which ₹21,60,000 has been received in cash. The cost of work done but not certified amounted to ₹45,000. It is estimated that by spending an additional amount of ₹1,20,000 (including provision for contingencies) the work can be completed in all respects in another two months. The agreed contract price of the work is ₹25 lakhs. Compute a conservative estimate of the profit to be taken to the profit & Loss Account. Illustrate four method of computing the profit.

Answer:

CALCULATION OF NOTIONAL PROFIT

Work Certified	₹24,00,000
Work Uncertified	₹45,000
	₹24,45,000
Less: Total expenditure upto date	₹19,80,000
	₹4,65,000

COMPUTATION OF ESTIMATED TOTAL PROFIT (N.P)

Expenditure incurred upto 31st March, 2014	₹19,80,000
Estimated additional expenditure (including provision for contingencies)	1,20,000
Estimated total cost (A)	21,00,000
Contract price (B)	25,00,000
Estimated total profit (B-A)	4,00,000

COMPUTATION OF CONSERVATIVE ESTIMATE OF THE PROFIT TO BE TAKEN TO PROFIT & LOSS ACCOUNT:

(i) $\text{Estimated Profit} \times \dfrac{\text{Value of work certified}}{\text{Contract price}} \times \dfrac{\text{Cash received}}{\text{Value Certified}}$

$= 4,00,000 \times \dfrac{24,00,000}{25,00,000} \times \dfrac{21,60,000}{24,00,000}$

=₹3,45,600

Or,

(ii) $\text{Estimated profit} \times \dfrac{\text{Cost of work to date}}{\text{Estimated Total Cost}} \times \dfrac{\text{Cash received}}{\text{Value Certified}}$

$= 4,00,000 \times \dfrac{19,80,000}{21,00,000} \times \dfrac{21,60,000}{24,00,000}$

=₹3,39,429 i.e., 3,39,430

Or,

(iii) $\text{Estimated profit} \times \dfrac{\text{Cash received}}{\text{Contract Price}}$

$= 4,00,000 \times \dfrac{21,60,000}{25,00,000}$

=₹3,45,600

(iv)

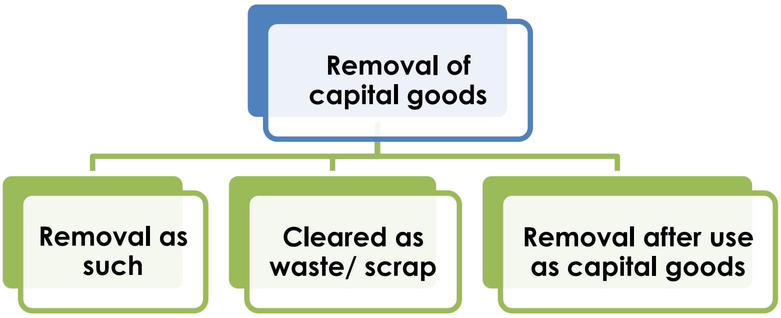
$= \dfrac{2}{3} \times \text{Notional Profit} \times \dfrac{\text{Cash received}}{\text{Work Certified}}$

$= 2/3 \times 4,65,000 \times \dfrac{21,60,000}{24,00,000}$

=₹2,79,000

EFFECT IN CENVAT CREDIT: REMOVAL OF CAPITAL GOODS

Cenvat credit scheme is devised to allow credit of duties of excise and additional duties on customs paid on inputs and capital goods and service tax paid on input services. The Cenvat credit can be reversed by way of removal of capital goods in the following manners.



(1) Removal as such i.e. without being used [Rule 3(5) of Cenvat Credit Rules, 2004]: When capital goods, on which CENVAT credit has been taken, are removed as such from the factory, or premises of the provider of output service, the manufacturer of the final products or provider of output service, as the case may be, shall pay an amount equal to the credit availed in respect of such inputs or capital goods. Such removal shall be made under the cover of an invoice referred to in rule 9.

Illustration 1.

A Ltd. purchased capital goods for ₹ 8,00,000 plus excise duty @12.36% on 01.04.2014. The Cenvat credit was taken accordingly. The said capital goods were removed without being used on 15.04.2014 at a transaction value of ₹ 5,00,000. Compute the amount of Cenvat credit to be reversed.

Answer:

In the above case, the provisions of Rule 3(5) shall be applicable. Since the capital goods are removed without use, the company will be required to pay an amount equal to Cenvat credit availed in respect of capital goods, i.e. ₹ 98,880.

(2) Removal after use as capital goods [Rule 3(5)(a) of Cenvat Credit Rules, 2004]: if the capital goods, on which CENVAT Credit has been taken, are removed after being used as capital goods, then amount required to be paid shall be the higher of the two:

(A) Limit based on straight line method percentage point credit:

Types of capital goods	Amount of Cenvat credit to be paid shall be:
Other than computers and computer peripherals	Amount of Cenvat credit taken thereon **Less:** 2.5% of such credit calculated by straight line method for each quarter of a year or part thereof from the date of taking the Cenvat credit [The life of the capital goods is assumed to be 10 years]
Computer & computer peripherals	Amount of Cenvat credit taken thereon **Less:** Percentage of credit taken in the following manner: • for each quarter in the first year @10% • for each quarter in the second year @8% • for each quarter in the third year @5% • for each quarter in the fourth & fifth year @1% [The life of the computer & computer peripherals is assumed to be 5 years]

(B) Transaction value × Rate of duty: Amount equal to duty leviable on transaction value.

Illustration 2.

A Ltd. purchased capital goods for ₹ 8,00,000 plus excise duty @12.36% on 01.04.2014. The Cenvat credit was taken accordingly. The said capital goods were removed after use on 10.04.2015 at a transaction value of ₹ 6,00,000 . Compute the amount of Cenvat credit to be reversed.

Answer:

In this case, the provisions of Rule 3(5A) will be applicable and the manufacturer shall be required to pay higher of the following amounts:

- Amount of Cenvat credit taken less 2.5% per quarter or part thereof of use, i.e. ₹ 98,880 – 2.5% × 5 quarter of ₹ 98,880 = ₹ 86,520.
- Excise duty payable on transaction value, i.e. ₹ 6,00,000 × 12.36% = ₹ 74,160.

Thus, the company will be required to pay ₹ 86,520.

(3) Capital goods cleared as waste/ scrap [Rule 3(5A)(b) of Cenvat Credit Rules, 2004]: If the capital goods are cleared as waste and scrap, the manufacturer shall pay an amount equal to the duty leviable on transaction value.

Illustration 3.

A Ltd. purchased capital goods for ₹ 8,00,000 plus excise duty @12.36% on 01.04.2012. The Cenvat credit was taken accordingly. The said capital goods were removed without being used on 15.10.2014 at a transaction value of ₹ 50,000. Compute the amount of Cenvat credit to be reversed.

Answer:

In this case, as the capital goods are cleared as waste and scrap, the manufacturer shall pay an amount equal to the duty leviable on transaction value, i.e. ₹ 50,000 × 12.36% = ₹ 6,180.

Timings of reversal: The amount payable under Rule 3(5), and 3(5A), unless specified otherwise, shall be paid by the manufacturer of goods or the provider of output services —

- by debiting the Cenvat credit or otherwise
- on or before 5th day of the following month except for the month of March, where such payment shall be made on or before the 31st March.

Removal of destroyed capital goods: If destroyed capital goods are removed, then —

- such removal shall not fall under 'removal as such' under Rule 3(5)
- but, on waste/ scrap, payment under Rule 3(5A) shall be required to be made.

However, if destroyed capital goods are never removed, no reversal can be sought.