CMA Students Newsletter(For Intermediate Students)

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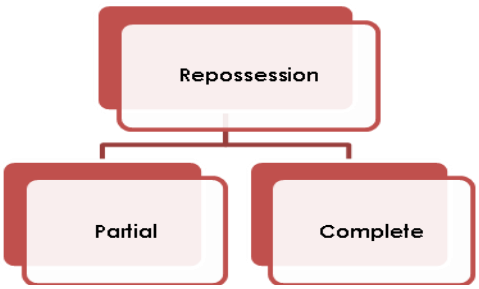
FINANCIAL ACCOUNTING

Surrender of Asset / Repossession under Hire Purchase Method

Under hire purchase agreement, the property or ownership of the asset purchased does not pass to the buyer until he pays the last installment.

If the buyer fails to pay any installment, the hire vendor can take back the goods. The latter does not have to pay any compensation to the defaulting buyer. If the vendor has sold more than one item to the same buyer, he (the vendor) can take back all the items or any portion thereof **[Partial Repossession]**. This recovery of possession is called **Repossession** from the vendor's point of view. From the buyer's standpoint this may be termed as **Surrender of Asset.**

Repossession can be classified:



Here we will discuss about the Partial Repossession:

(i) Neither the Buyer nor the Hire vendor should close the other's Account.

(ii) Usually the portion repossessed is separately valued as per agreement. If the agreed basis is not given, the depreciated value of repossessed goods as on the date of repossession should be taken as the agreed value.

(iii) In the Buyer's book the entries will be –

Hire Vendor A/c ..... Dr

To Hire Purchase Asset A/c

[With the amount of the agreed value of goods repossessed]

The Balance of the Asset Account should be the depreciated value of the assets not repossessed.

The Balance of the Hire Vendor Account will show the amount due to him for not repossessed goods.

Any difference in the Asset Account will show the profit / loss on surrender and shall be transferred to Profit & Loss Account.

(iv) In the Hire Vendor's Book the entry should be –

H.P. Goods Repossessed Asset A/c .....

Dr. To Hire Purchase Debtors A/c

[With the amount of the agreed value of the repossessed goods]

The Balance of the Buyer Account will represent the amount due from him for goods not repossessed.

Example:

3 machines purchased on Hire Purchase costing ₹2,00,000 each. Down Payment - ₹1,50,000. Instalment - @₹2,00,000 p.a. for 3 years. Interest @10% p.a. Depreciation @15% p.a. SLM. 2nd instalment could not be paid for which there is a repossession of 2 machines at a depreciation @25% WDV. The vendor spent ₹ 15,000 for repairs of plant and sold it ₹ 2,50,000

Ascertain Profit/Loss on surrender.

Statement showing Profit/Loss on surrender:

	As per Hire Purchaser	As per Hire Vendor
	@ 15% of SLM	@ 25% WDV
Cost Price of 2 Machines	₹4,00,000	₹4,00,000
(-) Depreciation for 1st yr	₹60,000	₹1,00,000
	₹3,40,000	₹3,00,000
(-) Depreciation for 2nd Yr	₹60,000	₹75,000
	₹2,80,000	₹2,25,000
Loss on Surrender = ₹2,80,000 - ₹2,25,000 = ₹55,000		

In the books of Hire Purchaser

Dr Machinery Account Cr.

Particulars	(₹)	Particulars	(₹)
To, Hire Vendor A/c	6,00,000	By, Dep A/c	90,000
		By, Balance c/d	5,10,000
	6,00,000		**6,00,000**
To, Balance b/d	5,10,000	By, Dep A/c	90,000
		By, Hire Vendor A/c	2,25,000
		By, P/L A/c **[Loss on default]**	55,000
		By, Balance c/d	1,40,000
	5,10,000		**5,10,000**

Dr Hire Vendor Account Cr

Particulars	(₹)	Particulars	(₹)
To, Bank A/c **[Down Payment]**	1,50,000	By, Mach. A/c	6,00,000
		By, Interest A/c	45,000
To, Bank A/c **[Instalment]**	2,00,000		
To, Balance c/d	2,95,000		
	6,45,000		**6,45,000**
To, Mach A/c	2,25,000	By, Balance b/d	2,95,000
To, Balance c/d	99,500	By, Interest A/c	29,500
	3,24,500		**3,24,500**
		By, Balance b/d	99,500

In the books of Hire Vendor

Dr. Hire Purchase Debtors Account Cr.

Particulars	(₹)	Particulars	(₹)
To, Hire Purchase Sales A/c	6,00,000	By, Bank A/c **[Down Payment]**	1,50,000
To, Interest A/c	45,000	By, Bank A/c **[Instalment]**	2,00,000
		By, Balance c/d	2,95,000
	6,45,000		**6,45,000**
To, Balance b/d	2,95,000	By, Goods Repossessed A/c	2,25,000
To, Interest A/c	29,500	By, Balance c/d	99,500
	3,24,500		**3,24,500**
To, Balance b/d	99,500		

Dr. H.P. Goods Repossessed Account Cr.

Particulars	(₹)	Particulars	(₹)
To, Hire Purchase Debtors A/c	2,25,000	By, Bank A/c - Sale	2,50,000
To, Bank A/c - Repairs	15,000		
To, P/L A/c Profit on sale of repossessed goods	10,000		
	2,50,000		**2,50,000**

DIRECT TAXATION

1. Amendment in the meaning of land in definition of agricultural income [Section 2 (1A)] [W.e.f. A.Y. 2014-15]

The provision contained in clause (1A) of the section 2 defines the term "agricultural income". Sub-clause (c) of the said clause (1A) includes any income derived from any building on, or in the immediate vicinity of the land, and is used as a dwelling house, store house or other out-building as required by the receiver of the rent or revenue or the cultivator, in connection with such land, within the definition of "agricultural income". Clause (ii) of proviso to sub-clause (c) provides that where the land is not assessed by land revenue or subject to a local rate, it should not be situated within the areas as specified in item (A) or item (B) of clause (ii) of the proviso, to qualify income derived from any such building as agricultural income.

The Act has amended item (B) of clause (ii) of the proviso to sub-clause (c) of clause (1A) of section 2 so as to provide that if the land is situated in any area within the distance, measured aerially,—

(i) not being more than 2 kilometers, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than 10,000 but not exceeding 1,00,000; or

(ii) not being more than 6 kilometers, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than 1,00,000 but not exceeding 10,00,000; or

(iii) not being more than 8 kilometers, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than 10,00,000,

the income derived from such building on, or in the immediate vicinity of such land will not be agricultural income.

[Note - For the purposes of clause (ii) of the proviso to sub-clause (c), "population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year. [Explanation 4 to section 2(1A)].]

2. Amendment in the definition of Capital Asset [Section 2(1A) and section 2(14)] [W.e.f. A.Y. 2014-15]

The existing provisions contained section 2(14) of the Income-tax Act define the term "capital asset" as property of any kind held by an assessee, whether or not connected with his business or profession. Certain categories of properties including agricultural land have been excluded from this definition. Section 2(14) (iii) provides that—

(a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand according to the last preceding census of which relevant figures have been published before the 1st day of the previous year, or

(b) agricultural land situated in any area within such distance not exceeding eight kilometers from the local limits of any municipality or cantonment board, as notified by the Central Government having regard to the extent and scope of urbanization and other relevant factors,

forms part of capital asset.

The Act has amended the above item (a) as under:

The words "according to the last preceding census of which relevant figures have been published before the 1st day of the previous year" shall be omitted. Instead of this, the expression "population" has been defined by inserting an *Explanation* to this clause.

The Act has also amended the above item (b) of section 2(14)(iii) so as to provide that the following land situated in any area within the distance, measured aerially (shortest aerial distance) shall form part of capital asset,—

(I) any land situated not being more than two kilometers, from the local limits of any municipality or cantonment board referred to in item *(a)* and which has a population of more than 10,000 but not exceeding 1,00,000; or

(II) any land situated not being more than six kilometers, from the local limits of any municipality or cantonment board referred to in item *(a)* and which has a population of more than 1,00,000 but not exceeding 10,00,000; or

(III) any land situated not being more than eight kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than 10,00,000.

Further, the Act has also defined the expression "population" both for items (a) and (b) above to mean population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

[Note - Similar amendments have also been made in section 2(1A) of the Income-tax Act, 1961 relating to the definition of "agricultural income" and in respect of the definition of "urban land" in the Wealth-tax Act, 1957.]

Wealth Tax

1. Change in the definition of Urban land [Explanation 1 to section 2(ea)] [W.e.f. A.Y 2014-15]

The existing definition of urban land has been substituted by a new definition. The new definition provides as under:

"Urban land" means land situate—

(i) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than 10,000; or

(ii) in any area within the distance, measured aerially,—

(I) not being more than two kilometers, from the local limits of any municipality or cantonment board referred to in sub-clause (i) and which has a population of more than 10,000 but not exceeding 1,00,000; or

(II) not being more than six kilometers, from the local limits of any municipality or cantonment board referred to in sub-clause (i) and which has a population of more than 1,00,000 but not exceeding 10,00,000; or

(III) not being more than eight kilometers, from the local limits of any municipality or cantonment board referred to in sub-clause (i) and which has a population of more than 10,00,000,

but does not include

(a) land classified as agricultural land in the records of the Government and used for agricultural purposes. **[Inserted by the Finance Act, 2013, w.r.e.f. A.Y. 1993-94]**; or

(b) land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated, or

(c) the land occupied by any building which has been constructed with the approval of the appropriate authority, or

(d) any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him, or

(e) any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him.

[Note - For the purposes of clause *(b)* of *Explanation 1,* "population" means the population according to the last preceding census of which the relevant figures have been published before the date of valuation.]

Financial Management

Time Value of Money

Concept of Time Value of Money

Let's start a discussion on Time Value of Money by taking a very simple scenario. If you are offered the choice between having ₹40,000 today and having ₹40,000 at a future date, you will usually prefer to have `40,000 now. Similarly, if the choice is between paying ₹40,000 now or paying the same ₹40,000 at a future date, you will usually prefer to pay ₹40,000 later. It is simple common sense. In the first case by accepting ₹40,000 early, you can simply put the money in the bank and earn some interest. Similarly in the second case by deferring the payment, you can earn interest by keeping the money in the bank.

Therefore the time gap allowed helps us to make some money. This incremental gain is time value of money. Now let me ask a question, if the bank interest was zero (which is generally not the case), what would be the time value of money? As you rightly guessed it would also be zero. As we understood above, the interest plays an important role in determining the time value of money. Interest rate is the cost of borrowing money as a yearly percentage. For investors, interest rate is the rate earned on an investment as a yearly percentage.

Reasons Why Money in the Future is Worth Less Than Similar Money Today

There are three reasons why money can be more valuable today than in the future. Let's discuss them:

(i) Preference for Present Consumption: Individuals have a preference for current consumption in comparison to future consumption. In order to forego the present consumption for a future one, they need a strong incentive. Say for example, if the Individual's present preference is very strong then he has to be offered a very high incentive to forego it like a higher rate of interest and vice versa.

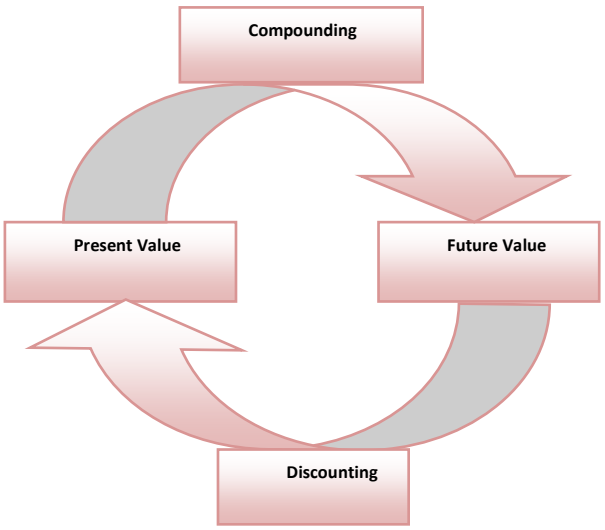
(ii) Inflation: Inflation means when prices of things rise faster than they actually should. When there is inflation, the value of currency decreases over time. If the inflation is more, then the gap between the value of money today to the value of money in future is more. So, greater the inflation, greater is the gap and vice versa.

(iii) Risk: Risk of uncertainty in the future lowers the value of money. Say for example, non-receipt of payment, uncertainty of investor's life or any other contingency which may result in non-payment or reduction in payment. Time value of money results from the concept of interest. So it is now time to discuss Interest.

Present Value and Future Value

Let's first define Present Value. Simple definition is "Present Value" is the current value of a "Future Amount". It can also be defined as the amount to be invested today (Present Value) at a given rate over specified period to equal the "Future Amount".

If we reverse the flow by saying that we expect a fixed amount after n number of years, and we also know the current prevailing interest rate, then by discounting the future amount, at the given interest rate, we will get the present value of investment to be made.



Discounting future amount converts it into present value amount. Similarly, compounding converts present value amount into future value amount. Therefore, we can say that the present value of a sum of money to be received at a future date is determined by discounting the future value at the interest rate that the money could earn over the period.

This process is known as Discounting.

The present value interest rate or the future value interest rate is known as the discount rate. This discount rate is the rate with which the present value or the future value is traded off. A higher discount rate will result in a lower value for the amount in the future. This rate also represents the opportunity cost as it captures the returns that an individual would have made on the next best opportunity.

Present Value = Future Value * Discount Factor

Where Discount Factor : 1/(1+r)^t
r: interest rate per period
t: time in period

Future Value= Present Value* Compounding Factor

Where Compounding Factor: (1+r)^t
r: interest rate per period
t: time in period

JUST-IN TIME (JIT): Emerging Concept in Cost Management

JIT is considered to be one of the modern techniques used for management of costs associated with inventories. The JIT approach involves a continuous commitment to the pursuit of excellence in all phases of manufacturing systems, designs and operations. It refers to a system in which materials arrive exactly as they are needed.

It is claimed that the implementation of JIT production method has been one of the major factors contributing to the success of Japanese firms in international market. *Many companies like AT&T, Honda Motors and Siemens, started to believe that inventory was a waste that can be minimized through careful planning.*

To meet JIT objectives, the process relies on signals or Kanban between different points, which are involved in the process, which tell production when to make the next part. Defective materials and late deliveries may disrupt the operation. So companies adopting JIT must select their suppliers very carefully and pay attention to developing long-run relationship with them.

Example: Toyota

Toyota is considered by many to be the poster child for JIT success. The Toyota production strategy is highlighted by the fact that raw materials are not brought to the production floor until an order is received and this product is ready to be built. No parts are allowed at a node unless they are required for the next node, or they are part of an assembly for the next node. This philosophy has allowed Toyota to keep a minimum amount of inventory which means lower costs. This also means that Toyota can adapt quickly to changes in demand without having to worry about disposing of expensive inventory.

Important Factors to Toyota Success:

- Small amounts of raw material inventory must be kept at each node in production, so that production can take place for any product. These parts are then replenished when they are used.
- Accuracy of forecasting is important so the correct amount of raw materials can be stocked.

Example: Dell

Dell has also leveraged JIT principles to make its manufacturing process a success. Dell's approach to JIT is different in that they leverage their suppliers to achieve the JIT goal. They are also unique in that Dell is able to provide exceptionally short lead times to their customers, by forcing their suppliers to carry inventory instead of carrying it themselves and then demanding (and receiving) short lead times on components so that products can be simply assembled by Dell quickly and then shipped to the customer.

Important Factors to Dell Success:

- Dependable suppliers with the ability to meet Dell are demanding lead time requirements.
- A seamless system that allows Dell to transmit its component requirements so that they will arrive at Dell in time to fulfill its lead times.
- A willingness of suppliers to keep inventory on hand allowing Dell to be free of this responsibility.

The JIT philosophy seeks to achieve the following goals:

- JIT reduces the inventory carrying costs, e.g. cost of spoilage and obsolescence, material handling and breakage, warehousing, tax, insurance and opportunity cost of capital.
- Due to frequent purchase of materials or goods, the issue price is likely to be closer to the replacement price. This facilitates pricing decision.
- It helps to develop a long run relationship with the suppliers. This will reduce the cost of quality and stock-out costs.
- JIT system is dedicated to elimination of waste which does not add value to the product. Identification and elimination of non-value added activities improve the quality or function of a product or service.

Despite the magnitude of the preceding advantages, there are also some disadvantages associated with JIT:

- There is a high reliance on suppliers, whose performance is generally outside the purview of the manufacturer.
- Transaction costs would be relatively high as frequent transactions would be made.
- A natural disaster could interfere with the flow of goods to the company from suppliers, which could halt production almost at once.
- A company may not be able to immediately meet the requirements of a massive and unexpected order, since it has few or no stocks of finished goods.

INDIRECT TAXATION

Mandatory e-payment for assessees

Notification No. 16/2013-ST dated 22.11.2013 has amended Rule 6(2) of Service Tax Rules, 1994, to provide that:

1. The assessee shall deposit the service tax liable to be paid by him with the bank designated, by CBEC for this purpose in Form TR-6, or in any other form prescribed by CBEC.
2. Where an assessee has **paid a total service tax of ₹ 1 lakh or more, including the amount paid by utilization of Cenvat Credit, in the preceding financial year**, he shall deposit the **service tax liable to be paid by him electronically, through internet banking**.

PERIODICITY AND DUE DATE OF PAYMENT OF SERVICE TAX