GN(A) 25 (Revised 2000)

Guidance Note on Accounting Treatment for MODVAT/CENVAT

(*The following is the text of the Guidance Note on Accounting Treatment for MODVAT/CENVAT, issued by the Council of the Institute of Chartered Accountants of India.*)

Introduction

1. The Guidance Note on Accounting Treatment for MODVAT was first issued in March 1988. The Guidance Note was revised in July 1995 in view of extension of MODVAT Credit Scheme to capital goods. The Guidance Note is revised again with the issuance of revised Accounting Standard (AS) 2 on 'Valuation of Inventories', which has come into effect in respect of accounting periods commencing on or after 1.4.1999 and is mandatory in nature. This revised Guidance Note is issued in supersession of the earlier Guidance Note issued in July 1995, and is effective in respect of accounting for MODVAT for accounting periods beginning on or after April 1, 1999. With the substitution of the MODVAT Credit Scheme with CENVAT Credit Scheme w.e.f. 1.4.2000, this revised Guidance Note also deals with accounting treatment in respect of the latter Scheme.

Objective

2. The objective of this Guidance Note is to provide guidance in respect of accounting for MODVAT/CENVAT credit. Salient features of MODVAT and CENVAT credit schemes are briefly set out hereinafter. Reference may be made to Central Excise Act, 1944, Central Excise Rules, 1944, Notifications and Circulars issued from time to time for details of the provisions of MODVAT/ CENVAT Schemes. Guidance for accounting for excise duty is provided in the Guidance Note on Accounting Treatment for Excise Duty, which has been revised and issued separately.

MODVAT Credit Scheme (Upto 31.3.2000) – Salient Features

3. Modified Value Added Tax (MODVAT) Scheme allows instant credit of specified duties paid on specified inputs used in or in relation to manufacture of specified final excisable goods to be utilised for payment of excise duties in respect of such goods. The Scheme covers imported goods as also those acquired indigenously. Specified duty in relation to imported goods is countervailing duty and in case of indigenous goods is excise duty, additional excise duty under Additional Duties of Excise (Textile and Textile Articles) Act, 1978 as also additional excise duty under Additional Duties of Excise (Goods of Special Importance) Act, 1957.

4. MODVAT Scheme was introduced in 1986, effective from 1.3.86, with a view to reduce the cascading effect of duties. Initially, the Scheme was restrictive in its application in that

(i) it applied only to limited categories of inputs and final goods; and

(ii) use of inputs in or in relation to manufacture of final goods was essential for utilisation of duty credit for payment of excise duties on clearance of such final goods. In other words, correlation of inputs and final goods was essential though one to one correlation of inputs was not essential.

5. Significant amendments have since been made to the MODVAT Scheme and the scope of the Scheme has been expanded considerably. Salient features of the Scheme are summarised hereinafter.

6. The Scheme applies to inputs ('Input Duty Credit Scheme') and capital goods ('Capital Goods Duty Credit Scheme').

Input Duty Credit Scheme

7. Provisions in relation to this Scheme are contained in Rules 57A to 57J of the Central Excise Rules, 1944. The Scheme covers inputs and final products classifiable under any of the headings of the Chapters of the Central Excise Tariff Act, 1985. The salient features of the Input Duty Credit Scheme are as follows:

(i) The Scheme is operative only when excise duty is payable on final goods. Thus, MODVAT credit cannot be availed of if the final goods are exempted from duty or are chargeable to nil rate of duty. However, the Scheme is operative in case the final goods enjoy partial exemption from duty.

(ii) Correlation between inputs and final goods is not required, i.e., duty credit in respect of any input brought into the factory can be utilised for payment of duty on any final product manufactured in that factory even if that input is not used in or in relation to manufacture of that final product.

(iii) A manufacturer is required to debit RG 23A or account current with an amount equal to 10% of the value of inputs or partially processed inputs removed from his factory for jobwork. The said amount is available as credit on return of processed/final goods to his factory from jobworkers' premises or on clearance of such processed/final goods from jobworkers' premises, if so permitted by the Commissioner, within specified time period. The debited amount is also available for adjustment against duty payable on such inputs or partially processed inputs not received back within specified time.

(iv) If common inputs are used in manufacture of final products which do not attract duty liability as also those which are chargeable to duty, manufacturer (except in specified cases) is required to pay an amount equal to 8% of the price of products not chargeable to duty at the time of clearance of such products.

8. Supreme Court in a recent judgement in the case of *CCE, Pune vs. Dai Ichi Karkaria Ltd*. [1999 (112) ELT 353; decided on 11.8.99] had occasion to summarise the Scheme. Relevant extract from the decision is reproduced below:

> *"It is clear from these Rules, as we read them, that a manufacturer obtains credit for the excise duty paid on raw material to be used by him in the production of an excisable product immediately it makes the requisite declaration and obtains an acknowledgement thereof. It is entitled to use the credit at any time thereafter when making payment of excise duty on the excisable product. There is no provision in the Rules which provides for a reversal of the credit by the excise authorities except where it has been illegally or irregularly taken, in which event it stands cancelled or, if utilised, has to be paid for. We are here really concerned*

with credit that has been validly taken, and its benefit is available to the manufacturer without any limitation in time or otherwise unless the manufacturer itself chooses not to use the raw material in its excisable product. The credit is, therefore, indefeasible. It should also be noted there is no co-relation of the raw material and the final product; that is to say, it is not as if credit can be taken only on a final product that is manufactured out of the particular raw material to which the credit is related. The credit may be taken against the excise duty on a final product manufactured on the very day that it becomes available."

Capital Goods Duty Credit Scheme

9. Provisions in relation to this Scheme are contained in Rules 57Q to 57U of the Central Excise Rules, 1944. The salient features of the Capital Goods Duty Credit Scheme are as follows:

(i) The Scheme covers specified capital goods used in the factory of the manufacturer in relation to the production of specified final products;

(ii) A manufacturer would not be entitled to the MODVAT credit on capital goods until the capital goods are installed or, as the case may be, used for manufacture of excisable goods, in the factory of the manufacturer;

(iii) A manufacturer has option to:

(a) avail MODVAT credit in respect of duty paid on capital goods as per the Rules;

or

(b) claim depreciation on duty element under Section 32 of the Income-tax Act, 1961 or claim deduction of duty element by way of revenue expenditure under any section of the Income-tax Act, 1961, as the case may be;

(iv) A manufacturer can claim MODVAT credit of the duty element of capital goods even if capital goods are acquired on lease, hire-purchase or loan agreement if specified duty is paid by manufacturer either directly to capital goods supplier or to the finance company before payment of first lease/hire-purchase or loan installment, as the case may be.

General

10. The general salient features relevant to Input Duty Credit Scheme and Capital Goods Duty Credit Scheme are as below:

(i) A manufacturer is required to comply with various procedural requirements, in particular, filing of declaration, and maintenance of register of receipts, issues and balance of inputs and capital goods in Form RG-23A Part I and RG-23C Part I, respectively. It is also required to maintain registers related to MODVAT credit in respect of inputs and capital goods in Form RG-23A Part II and RG-23C Part II, respectively.

(ii) There is no time limit for utilisation of MODVAT credit. Government is, however, empowered to provide for lapsing of unutilised credit balances for specific products.

(iii) Cash refund of duty credit is not allowable except in case of export of goods if the manufacturer is unable to utilise duty credit towards payment of excise duty on clearance of final goods from his factory.

CENVAT Scheme (Effective from 1.4.2000) – Salient Features

11. Modified Value Added Tax (MODVAT) scheme has been replaced by Central Value Added Tax (CENVAT) Scheme with effect from 1.4.2000. The same is contained in newly inserted Rules 57AA to 57AK. CENVAT Scheme, in essence, is the same as MODVAT Scheme except that it is simpler in that, the erstwhile separate schemes for inputs and capital goods are merged into one under CENVAT Scheme. The scope of the Scheme is also expanded in that all inputs (except High Speed Diesel Oil and Petrol) and specified capital goods (except equipments or appliances used in office) are covered in the Scheme.

12. Procedural simplifications have been introduced and requirement of filing declarations has been dispensed with.

13. The major difference between MODVAT and CENVAT Schemes is in relation to capital goods. The CENVAT credit in respect of capital goods received in a factory at any point of time in a given financial year is allowed to be taken only for an amount not exceeding fifty percent of the duty paid on such capital

goods in the same financial year. The balance of CENVAT credit can be taken in any financial year(s) subsequent to the financial year in which the capital goods were received in the factory of the manufacturer provided capital goods are still in the possession and use of the manufacturer of final products in such subsequent year(s). The condition of possession and use is not applicable to components, spares and accessories, refactories and refractory materials and goods falling under Tariff Heading 68.02 and sub-heading 6801.10 of first Schedule of the Central Excise Tariff Act, 1985, if they are not removed without use.

14. Outstanding balances in MODVAT Credit accounts are allowed to be transferred to the CENVAT Credit accounts and utilized as per the CENVAT Scheme.

Accounting Treatment in Case of Inputs Used in or in Relation to Manufacture of Final Products

15. In the light of the basic features of 'MODVAT/CENVAT' discussed above, it may be stated that MODVAT/CENVAT is a procedure whereby the manufacturer can utilise credit for specified duty on inputs against duty payable on final products. Duty credit taken on inputs is of the nature of set-off available against the payment of excise duty on the final products.

16. Specified duty paid on inputs may be debited to a separate account, e.g., MODVAT/CENVAT Credit Receivable (Inputs) Account. As and when MODVAT/CENVAT credit is actually utilised against payment of excise duty on final products, appropriate accounting entries will be required to adjust the excise duty paid out of MODVAT/CENVAT Credit Receivable (Inputs) Account to the account maintained for payment/provision for excise duty on final product. In this case, the purchase cost of the inputs would be net of the specified duty on inputs. Therefore, the inputs consumed and the inventory of inputs would be valued on the basis of purchase cost net of the specified duty on inputs. The debit balance in MODVAT/CENVAT Credit Receivable (Inputs) Account should be shown on the assets side under the head 'advances'.

An illustration of the above method is given in Annexure 'A'.

17. It may be appropriate to quote the following paragraphs nos. 6 and 7, dealing with 'cost of inventories' and 'costs of purchase', of Accounting

Standard (AS) 2 (Revised) on 'Valuation of Inventories', issued by the Institute of Chartered Accountants of India.

> ***"6. The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.***
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> 7. The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase."

Particular attention is invited to the paragraph related to 'costs of purchase', according to which, only those duties have to be included as costs of purchase which are not subsequently recoverable by the enterprise from the taxing authorities. Since the specified duty on inputs is available for set-off against the excise duty on final products, it is considered of the nature of duty recoverable from taxing authorities.

18. A question may arise as to when the 'MODVAT/CENVAT' credit should be taken if documents evidencing payment of specified duty on inputs are received later than the physical receipt of the goods. According to the accrual concept of accounting, one may account for such credit, provided one is reasonably certain of getting the said documents at a later date.

Change in Accounting Policy

19. In cases, where enterprises were accounting for MODVAT credit on inputs in accordance with the erstwhile inclusive method, i.e., the second alternative[1]

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[1] Para 6.1(b) of erstwhile Guidance Note has been withdrawn. This para recommended as below: "(b) in the second alternative, the cost of inputs may be recorded at the total amount paid to the supplier inclusive of the specified duty on inputs. To the extent the MODVAT credit is utilised for payment of excise duty on final products, the amount could be credited to a separate account, e.g., MODVAT Credit Availed Account. Out of the MODVAT Credit Availed Account, the amount of MODVAT credit availed in respect of consumption of inputs would be reduced from the total cost of inputs consumed. The balance amount standing to the credit of MODVAT Credit Availed Account representing MODVAT credit in respect of input not consumed but lying in stock could be shown in the balance sheet as deduction from the value of inventory. It will have to be ensured that the set-off for MODVAT credit on input not yet consumed is carried forward and there is no accounting of double income, firstly, as set-off adjusted as reduction in the cost of input and secondly, as credit taken in the profit and loss account by inclusion of the specified duty on input as part of value of inventory of the input."

recommended in the earlier edition (1995) of the Guidance Note on Accounting Treatment for MODVAT, they will have to change the method of accounting in accordance with paragraph 16 of this Guidance Note. Accordingly, such an enterprise will have to adjust the amount of opening stock in respect of the accounting periods commencing on or after April 1, 1999, in such a way so that the opening stock should appear at the amount which would have been arrived at had the method suggested in paragraph 16 of this Guidance Note been followed. This could be done by adjusting the amount of opening stock in respect of the accounting periods commencing on or after April 1, 1999, by the amount of the balance lying in the MODVAT credit availed account. Further, an amount equal to the balance of RG23A register, representing the MODVAT credit receivable in respect of the inputs purchased in the earlier years should be transferred to MODVAT Credit Receivable Account[2] with a corresponding adjustment in the amount of opening stock. After the aforesaid adjustments, the MODVAT Credit Receivable Account should also appear at the amount which would have been arrived at had the method suggested in paragraph 16 of this Guidance Note been followed. An example illustrating the change in accounting policy has been given as Annexure B.

Appropriate disclosures as per Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, are also required to be made in the financial statements for change in accounting policy.

Accounting Treatment – Job-work

Accounting treatment in case of inputs and/or partially processed inputs sent outside the factory to job-worker for further processing

[2] At the time of transfer to the MODVAT Credit Receivable Account, the MODVAT credit receivable should be reviewed and if it is found that the MODVAT credit is not likely to be used in the normal course of business within a reasonable time or it is revealed that the terms and conditions subject to which the benefit of MODVAT credit is available, have not been complied with or are not being capable of compliance, then such credit should not be transferred to MODVAT Credit Receivable Account.

20. In a case where an enterprise removes inputs as such or in a partially processed form to a place outside the factory for the purpose of testing, repairing, refining, reconditioning or carrying out any other operations necessary for manufacture of final products, the enterprise is required to debit MODVAT Credit Register (RG 23A) or account current with an amount equal to 10% of the value of inputs or partially processed inputs, as the case may be. The said debit is in the nature of deposit and is available for credit at the time of return of duly processed goods to the factory within the prescribed time. The said deposit is also available for adjustment against duty payment if the goods are not received back in the factory within the prescribed time limit. If this amount is debited to MODVAT Credit Register (RG 23A), the same should be accounted for as a deposit and should be debited to a separate account with appropriate nomenclature say, 'MODVAT Credit Deposit (Jobwork) Account' and credited to 'MODVAT Credit Receivable Account'. This deposit amount should be credited and 'MODVAT Credit Receivable Account' should be debited at the time of receipt of duly processed goods in the factory within the prescribed time limit or for adjustment of duty if the goods are not received back in the factory within the prescribed time limit. *This requirement of debit has been dispensed with under CENVAT Scheme.*

Accounting treatment in case of inputs received by enterprise for further processing on job-work basis

21. An enterprise may receive inputs from a principal for processing and/or converting to final products on job work basis and may be required to avail MODVAT/CENVAT credit on such inputs and discharge duty liability on clearance of final products on behalf of the principal; the ownership of the inputs and final products continuing to be of the principal. In such cases, the enterprise should, at the time of taking MOVDAT/CENVAT credit, debit an appropriate account say, 'MODVAT/CENVAT Credit Receivable Account' and the account to be credited would depend upon the terms of jobwork with the principal. If the enterprise is required to bear excise duty burden, 'Excise Duty Account' should be credited. If, on the other hand, excise duty is to be paid on the principal's account, 'Principal Account' should be credited. Similarly, in former case, excise duty paid on clearance of final products should be debited to 'Excise Duty Account' and in latter case to 'Principal Account' and credited to 'MODVAT/CENVAT Credit Receivable Account'.

Accounting Treatment for MODVAT Credit in Case of Capital Goods Used for Manufacture of Specified Goods

22. In case an enterprise does not avail MODVAT credit on capital goods obviously no accounting treatment would be necessary. The following paragraphs apply only to those situations where an enterprise avails of MODVAT credit on capital goods.

23. Accounting Standard (AS) 10 on 'Accounting for Fixed Assets', issued by the Institute of Chartered Accountants of India, states, *inter-alia*, in para 9.1, as follows:

"The cost of an item of fixed asset comprises its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price."

MODVAT credit can be considered is of the nature of a refundable tax. Therefore, MODVAT credit should be reduced from the purchase cost of capital goods concerned.

24. In view of the above, the specified duty on capital goods should be debited to separate account, e.g., MODVAT Credit Receivable (Capital Goods) Account. On actual utilisation, the account will be adjusted against excise duty on final products. Accordingly, the purchase cost of the capital goods would be net of the specified duty on capital goods. The unadjusted balance standing in the MODVAT Credit Receivable (Capital Goods) Account, if any, should be shown on the assets side under the head 'advances'.

25. MODVAT credit in respect of capital goods should be recognised in the books of account when the following conditions are satisfied: (i) The enterprise is entitled to the MODVAT credit as per the Rules, and (ii) there is a reasonable certainty that the MODVAT credit would be utilised.

Accounting Treatment for CENVAT Credit in Case of Capital Goods

26. The nature of the CENVAT Credit in respect of capital goods is the same as that of MODVAT Credit. However, the CENVAT Credit in respect of capital goods is allowed for an amount not exceeding fifty percent of the duty paid on such capital goods in the financial year in which the goods are received in factory and the balance will be allowed in the subsequent year(s). In case the conditions specified in para 25 above are met and the enterprise decides to take CENVAT credit, the entire amount of CENVAT Credit should be deducted from the cost of capital goods. The amount of CENVAT credit taken in the financial year, in which goods are received, should be debited to an appropriate account, say, 'CENVAT Credit Receivable (Capital Goods) Account' and balance may be debited to another appropriate account, say, 'CENVAT Credit Deferred Account'. In the subsequent financial year(s), when balance CENVAT credit is availed of, the appropriate adjustment for the same should be made, i.e., amount of CENVAT credit availed of should be credited to 'CENVAT Credit Deferred Account' with a corresponding debit to 'CENVAT Credit Receivable (Capital Goods) Account'.

Accounting Treatment where Capital Goods are Acquired on Lease or Hire Purchase

27. MODVAT/CENVAT credit is available to the lessee or hirer where the capital goods have been acquired on lease or hire purchase. The accounting treatment in this regard is described hereinafter.

28. In the books of the lessor, where the financing arrangement also covers the specified duty on capital goods, the asset given on lease should be shown at purchase cost net of the specified duty on the capital goods. The specified duty on capital goods, which would be availed of as MODVAT/CENVAT credit by the lessee, should be recorded and disclosed separately as the duty recoverable from the lessee. This will not form part of 'Minimum Lease Payments' in view of the definition of the aforesaid term reproduced below from the Guidance Note on Accounting for Leases, issued by the Institute of Chartered Accountants of India:

> "*Minimum Lease Payments:* The payments over the lease term that the lessee is or can be required to make (excluding costs for services and

> taxes to be paid by and be reimbursable to the lessor) together with the residual value."

Where the specified duty on capital goods does not form part of the financing arrangement and the lessee pays the duty directly to the supplier, obviously the same need not be recorded in the books of the lessor.

In the books of the lessee, MODVAT/CENVAT credit receivable on the capital assets acquired on lease should be treated in the same manner as recommended in paras 24 and 26 above, except that the cost of the relevant leased capital asset and depreciation is not accounted in the books of the lessee.

29. Capital asset acquired on hire purchase should be recorded and disclosed[3] at net cash value, i.e., cash value net of MODVAT/CENVAT credit receivable in the books of the hirer. The other accounting treatment in relation to MODVAT/CENVAT in the books of the hirer should be the same as if the asset has been acquired on outright purchase basis. The aforesaid accounting treatment, in the books of the hirer, should be made whether or not the specified duty on the capital goods forms part of the financing arrangement. In the books of the vendor, in case the specified duty on capital goods forms part of the hire purchase arrangement and the benefit of MODVAT/CENVAT credit is available to the hirer, the vendor should book the sale in the normal course inclusive of the specified duty on the capital goods. However, where the specified duty on the capital goods does not form part of the financing arrangement and the hirer directly assumes the liability in respect thereof, the same need not be recorded in the books of the vendor.

Review of Balances in MODVAT/CENVAT Credit Receivable Accounts

30. Balances in MODVAT/CENVAT Credit Receivable Accounts, pertaining to both inputs and capital goods, should be reviewed at the end of the year and if it is found that the balances of the MODVAT/CENVAT credit are not likely to be used in the normal course of business within a reasonable time, then, notwithstanding the right to carry forward such excess credit in the Excise Rules, the non-useable excess credit should be adjusted in the accounts. The

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[3] Disclosure should be "with an appropriate narration to indicate that the enterprise does not have full ownership thereof" [Accounting Standard (AS) 10, 'Accounting for Fixed Assets'].

consequence would be that the balances of the MODVAT/CENVAT Credit Receivable Accounts in the financial accounts may be lower than the credit available as per the MODVAT/CENVAT Credit registers. In such a case, a reconciliation statement would have to be prepared indicating the amounts adjusted so that a track is kept for the difference between the balances and the difference between the financial accounts and the credit available as per the excise registers can be explained in subsequent years also.

31. (a) The above adjustment related to input credit should be made to the raw material or input purchase account. The effect of this would be to increase the cost of purchase and thereby to increase the cost of inputs for the purpose of accounting for consumption and valuation of closing stocks. Where it is not possible to debit or identify this excess credit to a particular lot or lots of materials purchased, such excess credit may be apportioned over the entire purchases of raw materials, components etc., entitled to MODVAT/CENVAT credit during the year on pro-rata basis.

(b) The adjustment of excess credit related to capital goods should be made to the concerned Capital Goods Account. The excess MODVAT/CENVAT credit, either availed or deferred, which relates to fixed assets acquired, should be added to the cost of the relevant fixed asset. For accounting purposes, depreciation on the revised unamortised depreciable amount should be provided prospectively over the residual useful life of the asset. In case the fixed asset no longer exists, the relevant amount should be written-off in the profit and loss account. To facilitate aforesaid treatment, MODVAT/CENVAT credit record should be maintained fixed asset-wise in the relevant RG Register. In relation to capital goods other than fixed assets, the accounting treatment for the excess MODVAT/CENVAT credit would be the same as stated in para 31(a) above. It is, therefore, advisable that MODVAT/CENVAT Credit Receivable (Capital Goods) Account is maintained separately for fixed assets and other capital goods.

(c) For capital goods acquired on lease, the amount of excess MODVAT/CENVAT credit should be written-off on a pro-rata basis along with the lease rentals.

32. Where, at any time during the year, it is revealed that the terms and conditions subject to which the benefit of MODVAT/CENVAT credit is available, have not been complied with or are not being capable of compliance, e.g., where the inputs are destroyed prior to the manufacture of final product or the relevant

plant and machinery cannot be put to use for the manufacture of final product, appropriate adjustments should be made in the accounts to reverse such credit which cannot be availed of, as recommended in para 31 (a) for inputs and 31 (b) and (c) for capital goods.

Accounting Treatment for Duty Demands paid by Debit to MODVAT/CENVAT Credit Balance – Inputs and/or Capital Goods

33. An enterprise may choose to discharge excise duty demands made by Central Excise Department from time to time by way of debit to MODVAT/ CENVAT credit balance pertaining either to inputs or to capital goods. In that case, the duty demand so paid out of the MODVAT/CENVAT credit balance should be debited to appropriate account, depending upon the nature of demand and credit should be given to MODVAT/CENVAT Credit Receivable Account. For example, if the duty demand pertains to excise duty on finished goods, the same should be debited to excise duty account. If, on the other hand, it pertains to disallowance of MODVAT/CENVAT credit taken on purchase of raw materials during the year, the same should be added to the cost of inputs. Appropriate adjustment in that case would have to be made while valuing inventory of inputs. If the duty demand pertains to disallowance of MODVAT/CENVAT credit in respect of purchases effected in earlier years, the accounting treatment would depend on whether the said inputs are consumed or are available in stock. If they are consumed, the disallowance should be debited to excise duty account and treated as expense of the current year. If raw materials are still lying in stock, duty demand should be added to the cost of stock of inputs.

Valuation of Inventories of Inputs

34. The inventory of inputs should be valued at net of input duty. In other words, the specified duty paid on inputs will not form part of the cost of inventories. Balance in MODVAT/CENVAT Credit Receivable (Inputs) Account should be shown in the Balance Sheet under the head ‘advances’ on the assets side.

35. In some cases ‘inputs’ may be exempted from excise duty in the hands of the supplier, e.g., job charges are exempt from excise duty provided the prescribed procedures are observed. Small-scale suppliers who are in the

exempted category may also supply the inputs free from the levy of excise duty. In such circumstances normal valuation rules in determining the cost of inventories are to be applied as these are not subject to the specified duty on inputs relief. Where purchases are made from the dealers who are not eligible under the Central Excise Rules to pass MODVAT/CENVAT credit and, therefore, cannot issue an invoice in accordance with the aforesaid Rules, the valuation should be made at the actual cost inclusive of excise duty.

36. In some cases, the same item of input can be obtained from different sources, some of them may be able to provide the required documents evidencing payment of duty while others may not be able to provide the required documents. In such cases where it is not possible for the buyer to take advantage of the MODVAT/CENVAT credit, the closing stock of inputs of such items should be valued inclusive of the specified duty on inputs.

37. If any input is used for the production of more than one final product, some of which are excisable while others are either not chargeable to excise duty or chargeable at nil rate of duty, and separate inventory of the input is not maintained, the entire inventory of inputs should be valued at net of input duty. However, if separate inventory is being maintained, the inventory of inputs useable for final products chargeable to excise duty should be valued at net of input duty and the inventory of inputs useable for final products not chargeable to duty should be valued at the actual cost inclusive of excise duty.

38. While valuing inventories of final products[4], the value of inputs should be net of the duty on inputs, that is, the purchase cost as reduced by the MODVAT/CENVAT credit.

Valuation of Inventory of Capital Goods

39. Inventories of capital goods should be valued net of MODVAT/CENVAT credit taken on capital goods. In other words, specified duties paid on such capital goods will not form part of their cost.

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[4] For accounting treatment of excise duty with regard to valuation of inventories, reference may be made to the Guidance Note on Accounting Treatment for Excise Duty, issued by the Institute of Chartered Accountants of India (Published in 'The Chartered Accountant', July 2000).

ANNEXURE A

Illustration of Accounting for MODVAT/CENVAT Credit on Inputs

The illustration is based on the following assumptions:

(i) There is an opening stock of 10 units purchased at Rs. 10/- per unit (Excise duty paid on these units was @ Rs. 2/- per unit).

(ii) 100 units of raw materials are purchased at Rs. 10/- per unit, plus Rs. 2/-for excise duty, aggregating to Rs. 12/-.

(iii) 70 units of raw material are consumed in a process involving manufacture of a component. All the 70 units are sold in the year. The balance 40 units are manufactured and sold in the subsequent year.

(iv) The manufactured components are sold at a price of Rs. 15/- per unit (including excise duty Rs.3/- per unit).

(v) MODVAT/CENVAT credit is available on the raw material purchased and can be set-off against the excise duty payable on the final product.

(vi) Conversion costs are ignored.

The accounting treatment as per paragraph 16 is illustrated on the next page

Profit & Loss Account

Particulars	*Units*	*Rate*	*Amount*		*Particulars*	*Units*	*Rate*	*Amount*
To Opening Stock of Raw Materials	10	10	100		By Sales	70	15	1,050
To Purchases of Raw Materials	100	10	1,000					
	110	10	1,100					
Less: Stock of Raw Materials	40	10	400	700				
To Excise Duty	70	3		210				
To Gross Profit				140				
				1,050				1,050

Note

1. Opening balance of the MODVAT/CENVAT Credit Receivable Account is Rs. 20/-.

2. Besides showing stock of raw materials at Rs. 400/-, the Balance Sheet would also reflect, 'MODVAT/CENVAT Credit Receivable Account' at Rs. 10/-, arising out of the following entries:

(a)	Purchase A/c	Dr.	1,000	
	MODVAT/CENVAT Credit Receivable A/c	Dr.	200	
	To Sundry Creditors			1,200

(Being the purchase of 100 units at Rs. 10/- plus Rs. 2/- for excise duty in respect of which the company is eligible to claim MODVAT/CENVAT credit)

(b)	Excise Duty A/c	Dr.	210	
	To MODVAT/CENVAT Credit Receivable A/c			210

(Being the payment of excise duty out of MODVAT/CENVAT credit available to the company)

Balance Sheet

Liabilities	Amount	Assets	Amount
		Current Assets, Loans and Advances	
		(A) *Current Assets*	
		Inventory of raw materials	400
		(B) *Loans and Advances*	
		MODVAT/CENVAT Credit Receivable A/c	10

The opening balances of inventories of raw materials and MODVAT/CENVAT Receivable Account, for the next year, would be Rs. 400/- and Rs. 10/-, respectively.

ANNEXURE 'B'

Illustration of Change in Accounting Policy

(See paragraph 19 of the Guidance Note)

Continuing the illustration given in Annexure 'A' and supposing that an enterprise followed the erstwhile inclusive method for accounting for MODVAT credit, the accounting treatment as per this method would be as follows:

Profit & Loss Account

Particulars	*Units*	*Rate*	*Amount*	*Particulars*	*Units*	*Rate*	*Amount*
To Opening Stock of Raw Materials	10	12	120	By Sales	70	15	1,050
To Purchases of							
Raw Materials	100	12	1,200				
	110	12	1,320				
Less: Stock of Raw							
Materials	40	12	480				
Raw Material consumed	70	12	840				
Less: MODVAT Credit	70	2	140				
	70	10	700				
To Excise Duty	70	3	210				
To Gross Profit			140				
			1,050				1,050

Note:

(1) Opening Balance of MODVAT Credit Availed A/C was Nil.

(2) Besides showing stock of raw material at Rs.480, the balance of 'MODVAT Credit Availed Account' would be Rs.70, arising out of the following entries:

(a) At the time when credit is availed of and adjusted against the excise duty which becomes payable:

Excise Duty A/c	Dr.	Rs. 210	
To MODVAT Credit Availed A/c			Rs. 210

(Being the payment of excise duty from the MODVAT Credit available to the company)

(b) At the year end, to the extent raw material items have been consumed in the production:

MODVAT Credit Availed A/c	Dr.	Rs. 140	
To Material Consumed			Rs. 140

(Being the set off the MODVAT credit availed against materials consumed)

Balance Sheet

Liabilities	Amount	Assets		Amount
		Current Assets, Loans and Advances		
		(A) Current Assets		
		Inventory of Raw Material	480	
		Less: MODVAT Credit Availed A/c	70	410

In the above example, the RG 23A register would show a balance of Rs.10 representing the MODVAT credit receivable in respect of inputs purchased.

Now the enterprise changes the accounting policy to that recommended in paragraph 16 the Guidance Note. In that case, the following journal entries will be passed (See paragraph 19):

I. MODVAT Credit Availed A/c	Dr.	Rs. 70	
To Opening Stock			Rs. 70

(Being the opening stock adjusted by the balance of MODVAT Credit Availed Account).

II. MODVAT Credit Receivable A/c	Dr.	Rs. 10	
To Opening Stock			Rs. 10

(Being an amount equal to the balance of RG 23A register, representing the MODVAT credit receivable in respect of inputs purchased transferred to MODVAT Credit Receivable Account)

As a result of above entries, the figures of opening stock and MODVAT Credit Receivable A/c would appear at Rs. 400 (i.e. Rs.480-70-10) and Rs.10 respectively. It may be noted that these figures are the same had the method suggested in paragraph 16 of the Guidance Note been followed.

(See note to the balance sheet in the illustration given in Annexure A of the Guidance Note).