

# Tax Audit Series - Version 4.0

## Chapter 7 – Clauses 14 - 15



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Namaste

In Chapter - 7 we would discuss the Particulars of Form 3CD – Part B – Clauses 14 and 15.

### Clause 14

#### 14 (a) - Method of valuation of closing stock employed in the previous year

- Closing stock should be valued at lower of actual cost and net realisable value (NRV), where costs are ascertained on the basis of Specific Identification Method, FIFO or weighted average cost method.
- In case of conversion of capital asset into stock is valued at fair market value (FMV), the same should also be stated. Accordingly, the audit report in Form 3CB should be qualified for not complying with AS 2 / Ind AS 2.
- Inventories (Closing Stock) include:
  - Finished goods being held for sale in course of ordinary business
  - Stock-in-trade being Goods held for resale
  - Raw material
  - Work in progress
  - Maintenance supplies
  - Consumables
  - Loose tools (not including machine spares forming part of Property Plant & Equipment)
- Method of valuation should be given for each class of inventory.
- Cost of inventory includes
  - Cost of purchase includes purchase price including duties and taxes (except those recoverable from taxing authorities as per AS 2 / Ind AS 2), freight inwards etc. trade discounts, rebates etc. are deducted from cost.
  - Cost of conversion includes directly attributable costs such as labour cost
  - Other costs incurred in bringing the inventory to present location.
- It should be ensured that method of valuation of stock is appropriate and complies with principles of AS 2 / Ind AS 2 and the same method is used consistently. If the method is inappropriate, then suitable qualification in Tax audit report is required in Form 3CB.
- Where assessee has other than raw material and finished goods too as closing stock a disclosure may be mentioned in Para 5 of Form 3CB or Para 3 of 3CA as under:  
*Though the Form 3CD requires disclosure of method of valuation of closing stock (for all types of stocks), yet the online schema contains disclosure only for raw material and finished goods. For complete method of valuation of closing stock, refer to disclosure given in ICDS II at Clause 13(f) of Form 3CD*

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**14(b) - In case of deviation from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss, please furnish**

S. No	Particulars	Increase in Profit (in Rs.)	Decrease in Profit (in Rs.)

This clause requires reporting of details of deviation, if any, from the method of valuation prescribed u/s 145A and its impact on profit and loss account. It is pertinent to note that section 145A has been amended from AY 2017-18 to give effect to ICDS.

- The amended section 145A w.e.f. AY 2017-18 covers not only goods but services and securities too.
- Section 145A allows change in method of valuation in following conditions
  - Adoption of different policy is required by statute, or
  - Change would result in better presentation of financial statements of the enterprise
- As the enterprise follows exclusive method of accounting as per AS 2 / Ind AS 2 (which is different from section 145A, which requires inclusive system to be followed), hence the following adjustments are required:
  - Any tax, duty or fee paid on purchase or inventory should be added to the cost of purchase or cost of inventory respectively.
  - Any tax, duty or fee paid on sale of goods or services should be added to sales.
- It is pertinent to note that as per ICAI Tax Audit Guidance Note (Revised 2014) Para 28, the impact of following exclusive method or inclusive method would not impact profits of the entity.
- Disclosure in S. No. 14(b) may be made as under (as suggested by ICAI Guidance Note of the example taken therein) shown below for VAT (to be replaced by GST):

<u>S. No.</u>	<u>Particulars</u>	<u>Increase in profit (Rs)</u>	<u>Decrease in profit (Rs)</u>
1	<b>Increase in Opening Stock on inclusion of VAT</b>		30000
2	<b>Increase in Purchases on inclusion of VAT</b>		90000
3	<b>Increase in Sales on inclusion of VAT</b>	90000	

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4	Increase in Closing Stock on inclusion of VAT	60000	
5	VAT paid on sales		90000
6	VAT credit availed on cost of goods sold	60000	
		210000	210000

- Depending on the case, a note may be given by the assessee that 'Inventories are not inclusive of taxes and duties; however, there is nil impact on taxable profits and also stated in Para 26.16 of the Guidance Note on Tax Audit u/s 44AB of the Income Tax Act, 1961 (Revised 2023) issued by ICAI'.

### Clause 15

#### Details of capital asset converted into stock in trade in the prescribed format

- i. Reporting requirement:
  - a. Arises in the previous year in which such conversion takes place and the same should not be postponed till the year of sale.
- ii. Description of Capital Asset:
  - a. Provide the detail of Capital assets such as shares, securities, land, building, plant, machinery, etc. along with section 32 (if depreciable asset) that deals with depreciation and classifies the different assets based on their nature.
- iii. Date of Acquisition:
  - a. Verify the period of holding of asset to ensure whether it is long-term or short-term asset and for this purpose verify the date of purchase of assets from assessee.
- iv. Cost of Acquisition:
  - a. Verify cost of acquisition of capital asset (as per AS 10 / Ind AS 16, if applicable), from purchase invoice and cash/bank account, fixed asset register, etc.
  - b. Even in case, where capital asset is acquired prior to 1<sup>st</sup> April 2021, original cost should be stated in this sub-clause.

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- v. Amount:
- Verify the amount at which it is converted into Stock-in Trade (as per AS 2 / Ind AS 2).
  - In case the conversion is not done at cost but at FMV, appropriate disclosure is to be made at clause 14 (a) of Form 3CD that inventories on conversion of capital asset into stock is valued at FMV. Accordingly, the audit report in Form 3CB should be qualified for not complying with AS 2 / Ind AS 2.

**Note:** Conversion of capital asset in the form of Land & Building into stock in trade attracts provisions of Section 50C of the Act by virtue of s. 45(2) read with s. 2(47)(iv). Hence, reporting requirement is also required under clause 17 of Form 3CD.

I hope this document is of use to you. I thank CA. Shreya Jain in assisting me to compile this part of the series. Your suggestions and comments would be highly appreciated

Best Regards

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### EARLIER CHAPTERS

Chapter No.	Title	Link
1	Applicability	<a href="http://lunawat.com/Uploaded_Files/Attachments/F_20303.pdf">http://lunawat.com/Uploaded_Files/Attachments/F_20303.pdf</a>
2	Turnover	<a href="http://lunawat.com/Uploaded_Files/Attachments/F_20304.pdf">http://lunawat.com/Uploaded_Files/Attachments/F_20304.pdf</a>
3	Audit Report Format	<a href="http://lunawat.com/Uploaded_Files/Attachments/F_20305.pdf">http://lunawat.com/Uploaded_Files/Attachments/F_20305.pdf</a>
4	Clauses 1 to 8A	<a href="http://lunawat.com/Uploaded_Files/Attachments/F_20307.pdf">http://lunawat.com/Uploaded_Files/Attachments/F_20307.pdf</a>
5	Clauses 9 to 12	<a href="http://lunawat.com/Uploaded_Files/Attachments/F_20309.pdf">http://lunawat.com/Uploaded_Files/Attachments/F_20309.pdf</a>
6	Clause 13	<a href="http://lunawat.com/Uploaded_Files/Attachments/F_20321.pdf">http://lunawat.com/Uploaded_Files/Attachments/F_20321.pdf</a>

(Disclaimer: Though full efforts have been made to state the interpretations correctly, yet the author is not responsible / liable for any loss or damage caused to anyone due to any mistake / error / omissions)

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### ABOUT CA. PRAMOD JAIN

He is a commerce graduate [B. Com (H)] from Shri Ram College of Commerce (SRCC). He is a fellow member of the Institute of Chartered Accountants of India (FCA). He is a fellow member of the Institute of Companies Secretaries of India (FCS). He is a fellow member of the Institute of Cost Accountants of India (FCMA). He is a Bachelor of Law (LL. B). He is qualified as an Information System Auditor [DISA (ICAI)]. He is also a member of All India Management Association (MIMA). He is also an Insolvency Professional (IP). He has also passed the Certificate Course on CSR of ICAI. He has also passed the Proficiency Self-Assessment Test for Independent Director's Databank. He has passed certification course NCFM of National Stock Exchange of India (NSE). He has also done certification course CAAT and post qualification certificate course on Valuation of ICAI.

He is elected as Central Council Member of ICAI for 2 consecutive terms from 2019 to 2025. Apart from being member in more than 25 committees / groups / directorates of ICAI, and other Bodies he is / was:

- Chairman of Accounting Standards Board (ASB) of ICAI for 3 years from 2022 to 2025
- Deputy Convenor of Centre for Audit Quality Directorate (CAQD) for 2024-25
- Convenor - Members & Students (Grievances Handling & e-Sahayata) Directorate for 2023-24
- Chairman of Accounting & Finance Services Sectional Committee SSD-12 under the Services Sector Division Council (SSDC) of Bureau of Indian Standards (BIS) for 2023-24
- Chairman of Expert Advisory Committee (EAC) of ICAI for Year 2022-23
- Co-Chairman of Corporate Affairs Committee of PHDCCI for the year 2022-23
- Chairman of Committee on International Taxation (CITAX) of ICAI for 2021-22
- Chairman of Taxation Audit Quality Review Board (TAQRB) of ICAI for 2021-22.
- Member of Quality Review Board (QRB) for 2 terms from 2020 to 2026.
- Member of the SME Implementation Group (SMEIG) of IFRS Foundation, UK for 3 years from 2023 to 2026.
- Chairman of Valuation Standards Board (VSB) of ICAI for the year 2020-21.
- Chairman of CSR Committee of ICAI for year 2020-21.
- Vice-Chairman of Committee on MSME & Start-up of ICAI for the year 2021-22.
- Vice-Chairman of Women Members Empowerment Committee (WMEC) of ICAI for 2021-22.
- Vice-Chairman of Direct Tax Committee (DTC) of ICAI for 2 years from 2019 to 2021.
- Vice-Chairman of Committee on International Taxation (CITAX) of ICAI for 2019-20.
- Member of ICAI Disciplinary Committee for the year 2020-21.

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He is the conceptualizer of the portal [www.expertspanel.in](http://www.expertspanel.in) which is a one stop solution for all professional queries which has given more than 36500 answers since its launch in mid of year 2018.

He has delivered more than 1700 lectures and articles on various topics of Income Tax, Corporate Laws, LLP, Audits, Peer Review, Quality Review, etc. at more than 200 forums throughout the country. Most of his presentations and articles since 2013 are available for free download from [www.lunawat.com](http://www.lunawat.com) and from 2018 at [www.expertspanel.in](http://www.expertspanel.in) also.

He is Senior Partner of **M/s LUNAWAT & CO.**, Chartered Accountants. He is president, founder convener and member of various Boards, Directorate, Committees, Study Circles, etc. of ICAI, ICSI and other prestigious bodies and associations. He has been a Technical Reviewer with Financial Reporting Review Board (FRRB) and Quality Review Board (QRB) and Peer Reviewer with Peer Review Board (PRB).

He has authored books on “*Chartered Accountant’s Documentation and Compliance for Audits and Reviews*”, “*Limited liability Partnership – A Complete Resource Book*”, “*Chartered Accountant’s Documentation and Compliance for Audits and Reviews*”, “*Importance of LLP after Companies Act, 2013*”, “*Chartered Accountant’s Documentation and compliance under Companies Act 2013, Peer Review and Quality Review*”, “*Limited Liability Partnership – Law, Procedures and Taxation*”, “*Documentation for Chartered Accountants*”, “*Limited Liability Partnership – Law and Procedures with Ready Reckoner*”, “*Fringe Benefit Tax & Banking Cash Transaction Tax*”, “*Documentation for Audits*” and “*Accounting Standards and CARO*”.

He has written various articles on taxation, company law and audit in various journals. He has vast practical experience in income tax, audit, corporate laws and LLP.