Tax Audit Series 6 – S. Nos. 14-15

CA. PRAMOD JAIN
B. COM (H), FCA, FCS, FCMA, LL.B, DISA, MIMA

Namaste

In series - 6 we would discuss the Particulars of Form 3CD – Part B – S. Nos. 14 & 15.

<u>Serial no. 14</u>

<u>14 (a) - Method of valuation of closing stock employed in the previous year</u>

<u>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</u>

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

This clause requires reporting regarding method of valuation of inventory followed by the assesse and 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 with retrospective effect 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.
- Closing stock should be valued at lower of actual cost or 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 FMV, the same should also be stated. Accordingly the audit report in Form 3CB should be qualified for not complying with AS 2.
- Inventories 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)
- Cost of inventory includes
    - Cost of purchase includes purchase price including duties and taxes (except those recoverable from taxing authorities as per 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.
- Tax auditor has to ensure that method of valuation of stock is appropriate and complies with principles of 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.
- 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 (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):

S. No.	**Particulars**	**Increase in profit (Rs)**	**Decrease in profit (Rs)**

CA. PRAMOD JAIN
B. COM (H), FCA, FCS, FCMA, LL.B, DISA, MIMA

1	**Increase in Opening Stock on inclusion of VAT**		**30000**
2	**Increase in Purchases on inclusion of VAT**		**90000**
3	**Increase in Sales on inclusion of VAT**	**90000**	
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 assesse that 'Inventories are not inclusive of taxes and duties; however there is nil impact on profits due to the same as per the computation made'.

<u>Serial No. 15:</u>

Details of capital asset converted into stock in trade in 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 asset 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 assesse.

iv. Cost of Acquisition:

CA. PRAMOD JAIN
B. COM (H), FCA, FCS, FCMA, LL.B, DISA, MIMA

a. Verify cost of acquisition of capital asset (as per AS 10, if applicable), from purchase invoice and cash/bank account, Fixed asset register, etc.

v. Amount:

a. Verify the amount at which it is converted in to Stock-in Trade (as per AS 2).

b. 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.

Note: Conversion of capital asset in the form of Land & Building into stock in trade attracts provisions of Sec 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 *Ms. Diksha Plaha & Ms. Ria Agarwal* in assisting me to compile this part of the series. Your suggestions and comments would be highly appreciated

Best Regards

CA. Pramod Jain
pramodjain@lunawat.com
+91 9811073867