

आयकर अपीलिय अधीकरण, न्यायपीठ – “B” कोलकाता,  
**IN THE INCOME TAX APPELLATE TRIBUNAL  
KOLKATA BENCH “B” KOLKATA**

Before **Shri N.V.Vasudevan, Judicial Member** and  
**Shri Waseem Ahmed, Accountant Member**

**ITA No.994/Kol/2015**  
Assessment Year :2004-05

DCIT, Circle-1(2), Aayakar Bhawan, Room 14, 7 <sup>th</sup> Floor, P-7, Chowringhee Square, Kol-700 09	<b>V/s.</b>	M/s The Braithwaite Burn & Jessop Construction Co. Ltd. 27, R.N. Mukherjee Road, Kolkata-700 001 <b>[PAN No.AAACT 9760 B]</b>
अपीलार्थी /Appellant	..	प्रत्यर्थी/Respondent

अपीलार्थी की ओर से/By Appellant	Md. Usman, CIT-DR
प्रत्यर्थी की ओर से/By Respondent	Shri Ravi Tulsian, FCA
सुनवाई की तारीख/Date of Hearing	18-01-2018
घोषणा की तारीख/Date of Pronouncement	04-04-2018

**आदेश /O R D E R**

**PER Waseem Ahmed, Accountant Member:-**

This appeal by the Revenue is directed against the order of Commissioner of Income Tax (Appeals)-1, Kolkata dated 20.03.2015. Assessment was framed by ACIT, Circle-1, Kolkata u/s 143(3) of the Income Tax Act, 1961 (hereinafter referred to as ‘the Act’) vide his order dated 31.08.2006 for assessment year 2004-05. The Revenue has raised the following grounds:-

- “1. That on the facts and in the circumstances of the case, the Ld. CIT(A) is not justified in law in deleting the addition of Rs.15,74,43,000/- made by the AO on account of prior period expenses in respect of closing stock of raw materials and work in progress.*
- 2. That the appellant craves leave to add, alter, amend or modify the grounds of appeal during the course of hearing proceedings of this case.”*

Md. Usman, Ld. Departmental Representative appeared on behalf of Revenue and Shri Ravi Tulsiyan, Ld. Authorized Representative appeared on behalf of assessee.

2. Sole issue raised by Revenue in this appeal is that Ld. CIT(A) erred in deleting the addition of ₹15,74,43,000/- on account of prior period expenses in respect of closing stock of raw materials and work-in-progress.

3. The brief facts of the case appealed before us are that the assessee is a public sector undertaking and engaged in the business of Erection/Fabrication of railway bridges. The assessee has debited its profit & loss account on account of adjustments in the closing stock and work in progress for Rs. 345.77 lacs and Rs. 1228.66 lacs respectively. During the examination of the Audited Financial Statement AO found that the adjustment in Closing Stock & work in progress pertains to the earlier years. Therefore he was of the view that the same cannot be allowed in the year under consideration being prior period items. On confrontation, the assessee submitted that on the basis of Chartered Accountant firm's report, it was revealed that stock of raw material and stock work in progress were overvalued in earlier years. Accordingly in the year under consideration the assessee has made the adjustment with regard to the overvaluation as pointed out by the Chartered Accountants Firm in its report.

Further assessee claimed that overvaluation of stock in earlier year has resulted to excessive profit which was offered to tax in earlier year. Accordingly there is no escapement of income which was not offered to tax.

However, the AO objected to accept the explanations given by the assessee on the following grounds :

1. Expenses claims do not relate to the year under consideration.
2. The assessee should have filed the revised return of those years in which stock was overvalued.
3. There is no proper identification of stock and WIP which was overvalued. The claim made by the assessee is merely an estimation /provisional in nature hence not allowable.

In view of above the AO disallowed the amount charged in the profit & loss account by the assessee on account of over valuation of stock and WIP and accordingly added to the total income of the assessee.

4. Aggrieved, assessee preferred an appeal before Ld. CIT(A). The assessee before Id. CIT(A) submitted that the AO wrongly assumed revaluation of stock and WIP as is based on estimate. Rather the same is supported by the report of the chartered accountants and Audited financial statements and CAG audit report. Accordingly the accounts were corrected to represent the true and fair view of Financial Statements of the assessee in the year under consideration. There was no time available to file the revised return under the provisions of law as suggested by the AO to rectify the mistake.

The AO failed to consider the Chartered Accountants report wherein the shortage/ valuation of Current Assets were reported. The AO has not pointed out any defect in the report of the chartered accountants. No further opportunity was given by the AO to produce the documentary evidence with regard to the valuation of stock and WIP.

The Chartered Accountants report clearly highlighted that the overvaluation of stocks and WIP pertains to the prior period. Thus it is clear that the profit of prior period was overstated and the same has already suffered the tax in respective years of earlier period. Hence on the basis of C.A. report it was not justifiable to disclose such incorrect and untrue value and add to the value of inventory and thereby leading to double taxation. However, the Id. CIT(A) after due consideration of submission placed by the assessee and remand report has deleted the addition made by the AO by observing as under:-

*“6.1.1 In view of the above submissions, the matter had been remanded to the Assessing Officer in his remand report dt. 25-1-2007 submitted as under:-*

‘If there was overvaluation of stock and work-in-progress, the assessee could have filed revised return by making appropriate adjustment because of such over-valuation in the AY 2003-04. But that has not been done.

Apart from not filing of revised return, the assessee could have raised the issue/made the claim towards adjustment of

overvaluation of work-in-progress and stock even in the assessment order stage. But this has not also been done. If the assessee makes any mistake in the matter of computation of total income, this mistake may be regularized by filing a revised return or by making a submission before the Assessing Officer during the course of scrutiny assessment order proceeding. But the assessee is not allowed to compensate the mistake of one year by rectifying the same in the next year.'

*In the rejoinder and in the submissions of the appellant to the above report of the AO, it was submitted that the adjustment made by the AO was not justified and the disclosure made in the Audit Report and in the case of the appellant the quantification of over-valuation of inventory and work-in-progress was discovered in AY 2004-05, although the amount relating to prior year. However the adjustment cannot be disallowed on the ground that it was a prior period item, as the term prior period item does not include adjustment necessitated by circumstances which though related to prior period are determined in the current period. It is claimed that the exact quantum of shortage was not quantified before the report of the Chartered Accountant and hence the amount could not be claimed earlier. It is also claimed that Rs.345.08 lakhs (wrongly mentioned by the AO as 345.77 lakh) was disclosed as prior period expenses and Rs.1228.66 lakhs disclosed as extra-ordinary expenses which was on account of adjustment of stock and work-in-progress in earlier years respectively. In addition, it has been submitted in appeal that –*

'The management of the company is liable to carry out physical verification of inventory at year end. The company carries out physical verification of stock at the time of closing of a particular site/contract. Thereafter, suitable adjustments are made in the books. This practice has been followed by the company year after year consistently.

During the previous year 2002-03 a committee of senior officials of the company gave a report indicating substantial variation in the air value of stock and the value appearing in the books. However, the exact quantum could not be ascertained.

Attention is invited to Accounting Standard II relating to disclosure of prior period and Extraordinary items and changes in accounting policies as notified by Central Government in exercise of the powers conferred by sub-section (2), of section 145 of the Income-tax Act,1961 to be followed by all assessee following mercantile system of accounting.

Relevant extract from the standard are made as under:

- "Accounting estimate" means an estimate made for the purpose of preparation of financial statements which is

based on the circumstances existing at the time when the financial statements are prepared;

- A change in an accounting estimate that has a material effect in previous year shall be disclosed and quantified. Any change in an accounting estimate which is reasonably expected to have a material effect in year subsequent to previous year shall also be disclosed.
- “Prior period items” means material charges or credits which arise in the previous year as a result of errors or omissions in the preparation of the financial statements of one or more previous years:

Provided that the charge or credit arising on the outcome of a contingency, which at the time of occurrence could not be estimated accurately shall not constitute the correction of an error but a change in estimate and such an item shall not be treated as a prior period item.

*The value of inventory at the year-end needs to be estimated to arrive at the correct profit for the year. Using the above definitions of Accounting Estimate and prior period items it is clear that the value of inventory is an accounting estimate and the value of which cannot be precisely determined rather it can only be reasonably estimated. A change in the value of inventory having a material impact on the financial statements should be quantified and disclosed. If however, the quantification is not possible then the fact of change is required to be given in notes to accounts. Further, any charge due to change in estimate is not a prior period item i.e a charge to the profit & loss account pursuant to change in the value of inventory is a change in estimate.*

*From the above analysis, it is clear that the Appellant company followed the above accounting standard as required u/s. 145(2) of the Act and disclosed the fact of change in the previous year 2002-03. Then in the previous year 2003-04 when the exact value of inventory was ascertained the effect of the same was given in books of accounts.*

*Further, it should be borne in mind that diminution in the value of stock-in-trade/work-in-progress is always a revenue loss. The loss is in valuation of current asset and hence is not a provision but a real loss.*

*Thus, there is no occasion for disallowance of adjustment made for inventory and work-in-progress for earlier years pursuant to the estimation of value made by the firm of Chartered Accountants on the ground that it a prior period item. Further, since it is not a prior period item. Further, since it is not a prior period item, there arose no need for thee Appellant to have filed a revised return. The charge of Rs.345.08 lakhs on account of adjustment of stock for earlier years disclosed as prior period expenses and Rs.1228.66 lakhs on account of adjustment*

*of work-in-progress for earlier years disclosed as extra-ordinary expenses is allowable in its entirety.*

*Attention is also invited to the decision of the Hon'ble Supreme Court in the case of Kedarnath Jute Mfg. Co. Ltd. v. Commissioner of Income-tax 82 ITR 362 wherein it was held that:*

*'Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter.'*

*The appellant has also relied on the decision of ITAT Cuttack Bench in the case of National Aluminium Co. Ltd. vs. DCIT, Bhubneswar in ITAT No. dt. 30-11-20005. The Appellant also relied on the Notification of CBDT dt. 25-1-1996. Further in support of the above claim, the Appellant submitted copies of Auditor's report, extract of Meeting of Board of Directors on 12-3-2004 and copy of Report submitted by Chartered Accountant on the stock of steel and work-in-progress.*

*6.2 The submissions of the Appellant and the rejoinder to the remand report have been considered. It is seen that the issue is regarding disallowance of Rs.345.08 lakhs and Rs.1228.66 lakhs on the grounds that these amounts were prior period expenses and hence not allowable. In this regard, the copy of the Auditor's report of FY ending 31-3-2003 has been considered and it is seen that in the same in notes on accounts, Note No.14 refers as under:-*

*'in order to ascertain true and fair value of inventories (Sch.6), Debtors (Sch.7), other current assets (Sch.9) and Deposit/Advances (Sch.10), the committee comprising three senior officials was constituted and it gave a report indicating substantial variation between fair value and value appearing in books of account on these items. On a preliminary review, the committee was of view that errors were committed over past several year in proper accounting of inventories, debtors, etc which shows over-reporting of these items whose values may aggregate to around Rs.30 crores. Accordingly, the job to ascertain true position has been entrusted on present internal Auditors, being established Chartered Accountants Firm. After receiving their report suitable adjustments will be carried out in the books which may result in short reporting of loss by like amount in current year and over reporting of current assets by equivalent amounts.*

*It is further seen from the extracts of the Minutes of the Board Meeting that there is reference to un-realized WIP and the relevant part is re-produced as under:-*

'Thereafter referring to the submissions made to the Board on the position of work in progress and raw materials, stood at 1879.816 MT of steel as on 31-3-03 and was sought to be provided for in the accounts for 2003-04, the Board maintained that the reasons for accumulation of such huge inventory of raw materials and WIP as shown being not clear, the Board advised the company to get the same reconciled with reference to actual and for the purpose on outside firm of Chartered Accountants or the internal Auditors would be engaged to find out inter-alia in greater details the reasons of such accumulations, actual quantity of accumulation and recommend with justification the quantity required to be provided for in the accounts.'

*It is also seen that the Chartered Accountant appointed for the above purpose had submitted their report in respect of the steel stock and WIP, a copy of which was submitted in appeal. The CBDT Notification 69(E) supra, which refers to the definition of prior period expenses as under:-*

'(7) prior period items shall be separately disclosed in the profit and loss account in the previous year together with their nature and amount in a manner so that their impact on profit or loss in the previous year can be perceived.

(8) Extraordinary items of the enterprise during the previous year shall be disclosed in the profit and loss account as part of income. The nature and amount of each such item shall be separately disclosed in a manner so that their relative significance and effect on the operating results of the previous year can be perceived.'

*Therefore considering the above facts and the decisions of ITAT, Cuttack Bench wherein the issue of prior period expenses have been considered. The Tribunal has held as under:-*

'The Commissioner (Appeals) had confirmed an amount under '**other manufacturing expenses**'. The assessee had issued 18.675 kg. of nitric acid for consumption during the FY 1992-93. However by mistake, the issue voucher was prepared at 1867.5 kg. said difference was found out during the inventory verification in the FYs. 1993-94 and the amount short charged during the FYr 1992-93 was debited to the profit and loss account during the FYr 1993-94 as prior period expenses. This was the only way in which the assessee could rectify that mistake by debiting the prior period expenses. Accordingly, the Assessing Officer was directed to delete the above addition.'

*In view of the same, it is held that the AO was not justified in considering these items as disallowable and all the grounds on which the disallowances had been made have been account for a above. The*

*appellant has claimed that the AO was not justified in disallowing the claim despite the fact it was based on the CS Report and the accounts were audited by Statutory Auditors as well as Comptroller & Auditor General of India. It is further claimed that the AO has ignored the facts disclosed in para-14 of the Notes of Accounts for AY 2003-04. It has also claimed that the AO had wrongly assumed that there was opportunity to file revised return not realizing that the exact quantum of stock write off was ascertained only in current year and there was no scope of re-computation of income of earlier year. In support of its contention, the appellant filed details of the Stock of steel and work-in-progress. Tax audit report, etc., Accordingly, the disallowance made by the AO as above of Rs.15,74,43,000/- is held to be not justified and the same is deleted.”*

Being aggrieved by the order of Id. CIT(A) the Revenue is in appeal before us.

5. The Id. DR vehemently supported the order of the Assessing Officer whereas Id. AR for the assessee filed a paper book comprising pages from 1 to 68 and drew our attention on the chartered accountants report which is placed on pages 50 to 60 of the paper where the over value of the stock and WIP was recorded. The assessee on the basis of the report debited the profit & loss account for the amount representing the over value of stocks & WIP as evident from the schedule no. 23 & 24 attached to the audited financial statement which is placed on pages 33 of the paper book. The Id. AR also drew our attention on page 42 of the paper book where notes to accounts were placed where the discrepancy in the stock & WIP was duly observed as per note no. 14 of the financial statement for the year ended 31-03-2003. The relevant extract of the note no. 14 for the financial year ending as on 31.3.2003 is reproduced below :

*“14. In order to ascertain true and fair value of inventories (Sch.6) Debtors (Sch.7). Other Current Assets (Sch.9) and Deposit Advances (Sch.10) the Committee comprising three senior officials was constituted and it gave a report indicating substantial variation between fir value and value appearing in Books of Accounts on these items. On a preliminary review, the Committee was of view that errors were committed over past several years in proper accounting of Inventories. Debtors, etc., which shows over-reporting of these items whose value may aggregate to around Rs.30 crores. Accordingly, the job to ascertain true position has been entrusted on present Internal Auditors, being established Chartered Accountants Firm. After receiving their report suitable adjustment will be carried out in the Books which may result in short-*

*reporting of loss busy like amount in current year and over-reporting of Current Assets by equivalent amounts.”*

Ld. AR for the assessee relied on the order of Id. CIT(A).

6. We have heard the rival contentions and perused the materials available on record. The assessee during the year has debited its profit and loss account on account of over valuation of closing stock and work-in-progress. As per the assessee the amount of excessive closing stock and work-in-progress was crystallized during the year. Therefore, it was written off in the profit and loss account of the current year. However, the AO disregarded the contention of the assessee and made the addition for the amount charged in the profit and loss account of the assessee on the ground that it is prior period items. Subsequently, the view taken by the AO was reversed by the Ld CIT(A) by observing that it was crystallized during the year. The undisputed facts are that the over valuation of stock and WIP was revealed on the basis of physical verification carried out by the firm of chartered accountants. The amount of over valuation of stock & WIP was duly debited in the profit and loss account of the assessee. As per the AO the over valuation of stocks & WIP represents the prior period items, therefore the same have been debited in the profit and loss account of the respective years to which it pertains. In our considered view, the fact of over valuation of closing stock was crystallized in the year under consideration therefore the same has to be written off in the current year only. In holding so, we find support and guidance from the order of ITAT Cuttack Bench in the case of *National Aluminium Co Ltd* (supra), wherein the relevant extract of the order is reproduced below

*“From reading of the notes on account of the public sector undertakings, it was clear that the diminution in value because of obsolescence at 20 per cent of historical cost could not be said to be without any basis. Neither this could be said to be improper. Although the stores and spares related to past years, the assessee had made the revaluation during the current year and subsequent years on the basis of audit objections by the C & AG when they pointed out that the profit had been overstated. Accordingly, the bona fideness of such change also should not be doubted. The change effected by the assessee was bona fide and aimed at obtaining correct business profit as*

*such obsolete stocks/non-moving spare parts went on losing their values thereby distorting the true profits of the assessee.*

*Considering the totality of the facts of the case, the order of the Commissioner (Appeals) was set aside on this ground and the Assessing Officer was directed to allow the claim of loss on account of value of non-moving stores and spares."*

The principles laid down by the Hon'ble ITAT Cuttack Bench are squarely applicable to the case on hand, therefore respectfully following the same we are of the view that the loss on account of over valuation of closing stock/WIP is liable for deduction under section 37(1) of the Act.

In addition to the above we also observe that there is neutral effect of writing off the closing stock & WIP on the profitability of the assessee as it has consequential effect. Indeed the profit of the current year shall come down by the amount written off during the year on account of over valuation of closing stock. But the same closing stock of the current year shall become the opening stock of the next year and the profit of the next year shall enhance.

In view of above, we uphold the order of Ld. CIT(A). Hence the ground of appeal of the Revenue is dismissed.

**7. In the result, appeal filed by Revenue stands dismissed.**

Order pronounced in the open court 04/04/2018

(न्यायिक सदस्य)  
(N.V.Vasudevan)  
(Judicial Member)  
Kolkata,  
\*Dkp, Sr.P.S

(लेखा सदस्य)  
(Waseem Ahmed)  
(Accountant Member)

दिनांक:- /03/2018 कोलकाता ।

**आदेश की प्रतिलिपि अग्रेषित / Copy of Order Forwarded to:-**

1. अपीलार्थी/Appellant-DCIT, Circle-1(2), Rom No.14, 7<sup>th</sup> Fl, P-7, Chowringhee Sq. Kol-69
2. प्रत्यर्थी/Respondent-M/s The Braithwaite Burn & Jessop Construction Co. Ltd, 27, R.N. Mukherjee Road, Kolkata-700001
3. संबंधित आयकर आयुक्त / Concerned CIT Kolkata
4. आयकर आयुक्त- अपील / CIT (A) Kolkata
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, कोलकाता / DR, ITAT, Kolkata
6. गार्ड फाइल / Guard file.

By order/आदेश से,

Sr. Private Secretary, Head of Office/DDO  
आयकर अपीलीय अधिकरण, कोलकाता ।