Desk Review: An Emerging Challenge And Opportunity For Chartered Accountants

The Central value added tax (CENVAT) is a tax administered by the Central Government. It is an indirect tax, which is levied on the manufacture or production of goods in India. CENVAT is collected at the time of removal of goods from the factory. CENVAT is mainly governed by the Central Excise Act, 1944 and the rules, notifications and circulars issued from time to time by the Central Board of Excise and Customs (CBEC).

Presently, a system of self-assessment of the value of goods removed prevails which requires the assessee to quantify the duty to be paid on the basis of approved classification list and price list. The goods are allowed to be removed on payment of the determined duty. As the duty is calculated by the assessee himself, the department may conduct certain audits to ascertain the correctness or otherwise of the duty paid. Such an audit is known as Excise Audit-2000.

The annual financial statements along with the supporting documents constitute an important component in the process of verifying whether proper excise duty has been remitted by the assessee. A professional review of the financial statements from the angle of central excise will certainly point out the areas of deficiency. Such a review by qualified accounting professionals would certainly contribute to plugging leakages of revenue. Recently, the central government has taken a significant initiative of associating Chartered Accountants in the process of desk-review which in other words means a critical review of the financial statements to find out whether the assessee has properly complied with the provisions of excise laws while computing and paying the excise duty. The object of this article is to give a general view of Excise audit-2000 and desk review.

Excise Audit-2000

The central excise department frequently undertakes verification of records and other documents of excise assessees. The Excise Audit- 2000 is based on a Canadian audit model. This new system was initiated from 1st December 1999 when it was implemented in case of all assessees paying cash duty of over Rs.5 crore per annum. Thereafter the Central Board of Excise and Customs made this audit applicable in case of the following assessees.

Contributed by the Secretariat of the Fiscal Laws Committee

Desk review is one of the stages of EA-2000. It is conducted without communicating with the assessee. The information received through desk review is analysed further to find out vulnerable areas before conducting the actual audit. The basic purpose of the desk review is that the auditor gets himself familiar with issues, which he may face in the course of conducting an audit of a particular assessee.

Excise Audit-2000 is a modern, transparent and interactive method of audit, which involves the following steps.

Annual PLA duty	Duration
below Rs.10 lakhs	at least once in 5 years
Rs. 10 lakhs to Rs.1 crore	at least once in 2 years
Rs. 1 crore and above and all export oriented units	once a year

1. Selection of assessees and risk assessment: Scientific method of selection of assessee based on the results of risk assessment.
2. Desk review: Available information reviewed
3. Documentation of information: Information specifically sought for review and analysis.
4. Touring and discussion: Getting to know the business of the assessee.
5. Review the internal control: No audit is now done on 100 per cent verification and therefore the extent of reliance placed on the internal controls existing is important.
6. Preparation of the audit plan: This is generally based on the results of 1 to 5 above.
7. Conduct of the audit: At present the vouching on test check basis is done and in areas of error the same is extended to the entire year or previous years.
8. Audit objections and para: The response of the assessee is invited and if amounts voluntarily reversed the same is noted.
9. Audit report: The resolved and unresolved issues are reported.

The auditor should be equipped with the knowledge of the business of the assessee and can call for and scrutinise any record of the assessee. The assessee has to maintain proper records, as the reliance is placed not on the statutory records but the business records of the company. This is a systematic form of audit wherein the auditor has to gather basic information about the assessee through desk review phase of EA-2000 before actually conducting the audit.

Desk Review: Introduction

As mentioned above, desk review is one of the stages of EA-2000. Desk review is to be conducted without communicating with the assessee. The information received through desk review is analysed further to find out the vulnerable areas before conducting the actual audit. The basic purpose of the desk review is that the auditor gets himself familiar with issues, which he may face in course of conducting an audit of a particular assessee. The Central Board of Excise and Customs has started associating Chartered Accountants with the desk review work. Such assistance is particularly required for interpreting the information contained in ER-4 returns filed by the assessee.

Form ER-4 – Annual Financial Information Statement for the Financial year……

As per Rule 12(2)(a) of the Central Excise Rules, 2002 every assessee has to submit to the Superintendent of Central Excise, an annual financial information statement for the preceding financial year to which the statement relates in the form specified by notification by the Board by 30th day of November of the succeeding year. The Central Board of Excise and Customs have notified Form No. E.R.- 4 in this regard.

Form No. E.R.-4 broadly contains the information relating to the following:

a) Details of the assessee along with the registration number.
b) Details of expenditure:
   - details of inputs including packing material and components used for manufacture
   - value and quantity of each major raw material consumed in the manufacture of goods.
   - details of other expenditure like total inward freight, total outward freight, advertisement, commission etc.
   - details of goods manufactured by the assessee through job workers
c) Details of income:
   - total sales value (gross) as per profit and loss account
   - value and quantity of each major manufactured finished goods sold
   - details of trading activity
   - sales value of non-excisable and fully exempted goods (excluding the goods exported) cleared during the financial year.
   - value of goods exported under bond
   - value of goods exported under claim rebate
   - total value of sale of waste and scrap
   - total value of inputs on which CENVAT credit has been availed and cleared as such

- total sales tax paid
- details of other income like warranty charges from buyer, advertisement/ marketing expenditure recovered from customers etc
- total " Other income" as per Profit and loss account
- details of other job work undertaken by the assessee for others.

d) CENVAT Credit details
- on inputs
- on capital goods
- on taxable input service

e) Declaration

The above information is provided annually by assessees and the Chartered Accountants are being called upon to assist the department in interpreting such information. To accomplish this task effectively and efficiently a Chartered accountant must have detailed knowledge about financial bookkeeping, accountancy and proficiency in understanding commonly used commercial books and documents. In the modern business context a good knowledge of information technology will help the chartered accountant to add value in the progress of the desk review.

Maintenance of documents

The Budget 2000 has dispensed with the requirement of maintaining the prescribed statutory records in case of assessees paying an excise duty of less than Rs. 5 crore. However, even such assessees should maintain proper records so as to enable the existing officers to effect a proper assessment.

Examination of relevant records/ returns

Examination of relevant records/returns is essential for an effective audit. It is not feasible to generalise the list of documents that may be necessary for carrying out 'desk review' and consequential audit. However, the following documents may be useful.

(1) Latest annual report in case of corporate assessees and balance sheet and profit and loss account in case of non-corporate assessees.
(2) Cost audit report, if available
(3) Tax audit report, with its complete annexures.
(4) BOM File, if available i.e. Bill of materials (It is required since it contains technical details such as raw materials, or components/ ingredients used and requirement of such materials per unit of production/stage/process. Thus it helps in determining the input-output ratio)
(5) Input-output norms fixed by Director General of Foreign Trade (DGFT), if it is available in respect of certain products and such information can be detailed in the format given in Annexure – II hereinafter.
(6) List of all records prepared and maintained by the assessee for accounting of transactions in regard to receipt, purchase, manufacture, storage, sales or delivery of the goods including inputs and capital goods (Rule 22(2) of Central Excise Rules 2002)
(7) Daily stock account (prepared and maintained under Rule 10 of the Central Excise Rules 2002)
(8) Detailed flow-chart of the manufacturing process.
(9) Detailed break-up of the contingent liabilities to get an idea of the issues on which showcause notices have been issued and its relevance in the audit period.
(10) Statement of accounts of the creditors/suppliers
(11) Bank statements containing details of the cheques issued to various suppliers against the payment to be made for inputs supplied.
(12) Cash/bank book
(13) Machine log book
(14) Value added statement
(15) Central excise returns
(16) Documents, based on which credits have been availed such as Invoices, Supplementary Invoices including Bill of entry for imports (These records have been specified under Rule 9(1) of the Cenvat Credit Rules 2004)
(17) RG-23 A Part I & II and RG-23 C Part I & II or any other records maintained by the assessee for recording the benefit and utilisation of the CENVAT credit.

In addition auditors may also find the following information significantly useful to them:-

(1) Types of the products manufactured, by the assessee & turnover and duty paid during the audit period.
(2) Types of discounts offered by an assessee.
(3) Trends of increase or decrease in duty paid in respect of each product manufactured by the assessee.
(4) Details of provisional assessment, if any against the assessee (Rule 7 of Central Excise Rules 2002)

Analysis of accounting records

In relation to the examination of records the auditors may find the following information useful

1. Annual report

- In profit and loss account - purchases, material consumed, sales, captive consumption and storage and clearance of the goods should be verified.
- In balance sheet- un-utilised balances of Cenvat credit of both inputs and capital goods and PLA shown under the heading current assets.
- Annexure showing depreciation – To examine that Cenvat credit has not been taken in respect of that part of value of capital goods which represents the amount of duty on such goods, which the manufacturer claims as depreciation under section 32 of the Income-tax Act, 1961. It should be noted that Explanation 9 to Section 43(1) of the Income-tax Act, 1961 also prohibits an assessee to claim depreciation on the amount of excise duty which is recoverable i.e. Cenvat credit.
- Director's report and notes to the accounts – information relating to writing off of inventories, any major addition to the capital goods, clarification on abnormal situation, statutory auditor's qualification, contingent duties having bearing on excise duty payable and Cenvat credit.

2. Cost audit report

It is submitted under section 233 B of the Companies Act, 1956 and hence for non-corporate assessees, this report is not available. As for the corporate assessees also, the availability is limited since all companies of the notified industries are presently not covered under the cost audit.

Following information is useful in conducting desk review.

- Process of manufacture
- Quantitative details
- Major inputs/components consumed
- Standard consumption of major input materials per unit
- Actual consumption of major input materials per unit
- Non moving stock
- Written-off stock
- Value addition
- Excise duty reconciliation

3. Tax audit report

It is submitted by all assessees having turnover of Rs. 40 lacs and above and hence being less than exemption limit of Rs. 1 crore of Excise, it is furnished by all the assessees. The auditor should examine the Quantitative details about production, stock, Cenvat credit availed, utilised and closing balance as reported. It also addresses availment of dual benefit of Cenvat credit and depreciation under central excise laws and income tax respectively. It may serve a useful document especially for the audit of non-corporate assessees.

4. Input output norms by DGFT

The auditor may examine the Input output norms fixed by the Directorate General of Foreign Trade. They are generally available for certain products like chemicals and allied products, electronic products, engineering products, food products, leather products, plastic products, textile, ready made garments, hosiery, knit wears, gem jewellery products, etc.

5. Supplier or creditor's ledger

This ledger contains entries of all the transactions relating to procurement of Inputs or capital goods, journal vouchers which have been raised for rejection or short supply of materials and payments made. The details of these entries are to be examined by auditor bank statement and bank/cash book may also be examined for verification of payment made against the supplies.

6. Machine log- book

It contains details about machine in operation, hours run, inputs deployed, output produced, scrap generated etc. This record is very useful in respect of iron and steel products

7. Value added statement

Business performance is also measured by determining the value added by it. It is defined as sales value less cost of bought in goods and services used in producing such sales.

Ideally, percentage of value addition should be equal to the percentage of payment of duty through PLA upon total duty paid

i.e. per cent of value addition =

$$\frac{\text{Duty from PLA}}{\text{Total duty paid}} \times 100$$

However, due to certain reasons, this ideal ratio may not be achieved. Broadly, the reasons are disproportionate procurement of inputs, accumulation of Cenvat credit, inputs stock in hand etc.

It is necessary to look into reasons for low percentage of PLA/total duty paid in comparison to the percentage of value addition

Cenvat credit is an important aspect for consideration by the audit team in desk review. It sig-

nificantly affects the amount of duty paid/payable by the assessee. Hence attention of auditors is hereby invited

Possible areas of value addition by Chartered Accountants

The Chartered accountants by virtue of their expert knowledge in accounting and finance can zero in on the vulnerable areas contributing to leakage of the tax revenue. The following areas are generally prone to malpractices by assessees.

1. Non-maintenance of proper records: One of the announcements made during Budget 2000 as a measure of simplification of procedures, was the dispensation of all statutory records under the central excise law. The assessee is no longer required to record the receipt of raw material, production and clearance/sale of finished goods etc. in registers/documents prescribed by the central excise department. As a result, the assessees are now allowed to maintain all their records in whichever form they like (including maintenance of the entire records in electronic form) provided the essential information required for calculation of central excise duty liability can be obtained from such records. Under these circumstances it becomes necessary for the auditors to look into the assessees own (private) records to verify whether the assessee is paying central excise duty correctly and following the laid down procedures.
2. Wrong availment of credit:
   Areas of concern
   a) availment of double credit on the same document.
   b) availment of credit on ineligible goods like high-speed diesel oil, light diesel oil etc.
   c) non-reversal of CENVAT credit on inputs/ stocks written off.
   d) non-reversal of CENVAT credit on rejection or return
   e) availment of value of goods as credit
   f) availment of credit in excess of prescribed limits
   g) availment of credit without purchase/ receipt of inputs
   h) availment of credit without payment of duty on the finished goods.
3. Role of Chartered Accountants: Chartered Accountants with their specialised training in auditing and accounting can easily verify the records of the assessee. They can also contribute to the building up of a sound system of maintaining excise records, which can be standardised throughout the country. So far as the possible misuse of CENVAT credit is concerned the Chartered Accountants can devise suitable checklist, which can be used to methodically verify the entire process of availment of credit.

Process of Desk review

The desk review generally comprises the following components

1. Knowledge of business/industry as a whole is important as it indicates the inherent risk involved in the industry as a whole. This is dependent on the type of final/intermediate product, type of customers, suppliers, exports or not, competitive or not, global prices etc.
2. The problems peculiar to the industry and the normal litigation common to the industry.
3. Available information of a competitor provides a point of comparison between the two.
4. Information collection prior to the audit wherein the historical data with regard to the manufacturer is collected requires some modification to ensure that the manufacturer can easily provide it.
5. The returns (ER-1, ER-2, ER-3) provide some of the basic information as to the monthly sales whether on payment of duty or without, details of credits availed, utilised and payment in cash, etc.
6. The special returns, which are applicable for those assessees whose value of clearances results in payment of excise duty in case exceeding Rs. 100 lakhs. These are;
   ER-4: Annual Financial Information of the value of purchases, sales, break up, job work sent and received and the credits availed.
   ER-5: Annual information on the principal inputs and their usage per quantity of finished goods.
   ER-6: The same information as ER-5 monthly with additional information on scrap and wastages.
7. The analysis of the financial statements (past 3/ 4 years) provide the information as to the working of the company. The notes to account contain a lot of information which sometimes has a significant impact on the profits disclosed by the entity. For example, ascertained liabilities may be passed off as contingent liabilities to indicate the same (such as contingent liability.)

8. The director's report provides an idea of the operations of the company and the industry.
9. The auditors report gives a clue as to the state of internal controls and whether they can be relied upon or not.
10. The past few years' movement of credit as a percentage of purchases as well as the credit utilisation as a percentage of the total duty payment indicates the possibility of error. (This however should be adjusted for the removals without payment of duty, trading transactions, etc).
11. The list of litigations and the resolution is also an indicator.
12. The issues raised in the previous audit reports and the resolution of the same is useful indicator of the state of affairs as regards compliance.
13. For industries like cement, sugar, textiles etc., some exclusive provisions of central excise are applicable. Since these provisions are not common for other industries, a review of such provisions may better equip the auditor.
14. Review of the weekly reports submitted by the major assessees (those who are paying more than one crore through P.L.A) provide better insights to the progress of the transactions and the status of the business of the assessees.
15. Review of the major decided case laws on the industry or on the type of activities of the assessees equips the auditor with additional knowledge.
16. Review of the latest circulars provides the departmental view of the grey areas, if any, which may be encountered in relation to the industry/ product.

Review of the pronouncements of ICAI/ ICWAI/ ICSI such as Accounting Standards, Guidance Notes on the accounting of indirect taxes may assist the auditor in understanding and better appraising the diversified financial statements.

Vulnerable areas in Desk Review

There are certain vulnerable areas that require significant planning by the desk reviewers. Some of them can be highlighted as under: -

1. Scrutinisation of various items of income appearing in the profit and loss account to detect extra consideration or flow back received by the assessee, which is to be included in the transaction value.
2. Discrepancies, if any, found on reconciliation of the finished goods stock as per RGI register with the quantity shown in the balance sheet

schedule, shall attract differential central excise duty payment.

3. On reconciliation of the value of clearance as per RT12 / ER1 returns with the value of sales as shown in the profit and loss account or the sales tax return discrepancies are to be noticed.
4. On reconciliation, the quantity of raw materials or finished goods as shown in balance sheet and the statement furnished to the banks for enhancing credit limit or hypothecation or shown to insurance companies for insurance purposes should tally.
5. Scrutiny of the miscellaneous income head under the profit and loss account, to locate under-invoicing of the value of the goods at the time of clearance and recovery of differential amount through debit notes without payment of differential duty.
6. Different charges recovered from the buyers of the assessee like rental charges, forwarding charges, delivery charges, material handling charges, after sale service, warranty charges and special packing charges etc. as shown in the Balance Sheet of the assessee, are deliberately claimed separately as part of commercial price not forming part of transaction value as shown in the invoice involving duty thereon.
7. Examination of the depreciation schedule of the capital goods may reveal whether the depreciation on excise duty element of the cost of capital goods has been claimed for income tax purposes under section 4 (4) of CENVAT Credit Rules, 2002.
8. Scrutinisation of the details of power consumed may reveal that the same is disproportionately higher than the production shown in the RGI register leading to suppression of production.
9. In case of certain large units, disbursement of productivity-linked bonus as shown in the balance sheet without commensurate growth in the production as per the Excise records thereby underpayment of the excise duty.
10. In the capital goods account some of the Capital Goods may be shown as sold or scrapped whereas due duty of excise is not discharged thereon.
11. Examination of packing material or containers stock account may reveal that the quantity therein shown as consumed is much higher than the commensurate production / clearance of finished goods.
12. Generation and clearance of scrap as shown in the financial statements of the assessee may not be reflected in the excise records thereby hurting revenue.
13. Job-work charges may be shown as recovered in the balance sheet without due accountal or the discharge of duty payment/service tax payment.
14. Receipts of service charges or free replacement charges shown in balance sheet but not accounted for central excise duty payment purposes.
15. Discounts on sales as reflected in the financial statements might not have been made prior to removal nor actually passed on to the customers thereby becoming ineligible for deduction from the price to arrive at the assessable value.
16. Expenses on account of advertisement shown in the balance sheet, part of which is otherwise shared by their buyers, amounts to accrual of extra consideration from buyers attracting central excise duty thereon.
17. Scrutiny of freight outward and inward/transit insurance paid and recovered may lead to discrepancies.
18. Payment of royalty or consultancy fee attracting service tax.

Similarly, the auditors while looking into the ledger accounts and the transactions recorded therein on comparison with the supporting documents like vouchers, purchase orders, amended purchase orders, invoices, bills, challans, general entries and sundry debtor ledgers can detect discrepancies involving central excise duty.

In the same way examination of the facts declared by the assessee in his tax audit report and cost audit report and their reconciliation with the related figures as shown in excise returns can also be profitably used by the audit parties

Conclusion

The government's decision to associate Chartered Accountants in the process of desk review under the overall scheme of Excise Audit-2000 is an important landmark in the onward march of the accounting profession. The member of the Institute can make substantial contribution in checking unauthorised revenue-leakage. By this process they would be not only contributing to the health of the national exchequer but also paving the way for one more grand opportunity for the profession. ❐