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Audit under Fiscal Laws

15.1 Introduction

For ensuring compliance sometimes audit becomes a necessity. Therefore, various statutes, including legislations governing direct and indirect tax provisions have incorporated audit provisions in some or the other form. Under direct taxes, the Central Board of Direct taxes has posed onerous responsibility on the auditor via Income-tax Act, 1961 which has various provisions requiring compulsory audit. However, with the growing importance of the indirect taxes in the economy, the Government is realizing the need of audit byindependent bodies especially equipped to do the same. Introduction of audit provisions in the newly introduced Value Added Tax (VAT) legislations is a step towards this direction. Various state Governments have incorporated compulsory audit provisions in their respective State VAT legislations. Various provisions relating tax audit are discussed in this Chapter.

15.2 Audit(S) Under the Income-Tax Act, 1961

The Income-tax Act, 1961 (hereinafter referred to as the Act) contains several provisions for audit of accounts of public charitable trusts, non-corporate assesses and other assesses to meet the specific objectives of the Act. Under the Act, several sections such as 12A, 35D, 35E, 44AB, 80IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 142(2A), etc., require audit of accounts for tax purposes. We shall discuss the requirements of some of these provisions from the audit angle.

Who can audit the Accounts under the Income-tax Act -Normally, in all the sections referred to above, subject to the exceptions specifically provided, the audit is to be conducted by an 'accountant', as defined in the Explanation below Section 288(2) of the Act. The Explanation to Section 288(2) defines 'accountant' as a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 and any other person who is entitled to be appointed as an auditor of a company under Section 226(2) of the Companies Act, 1956. It is clear that any chartered accountant, whether in practice or not, is also covered by the definition of the term Accountant. It may, therefore, *prima facie* appear that even a non-practising member of the Institute may be covered by the definition of 'accountant'. However, Section 7 of the Chartered Accountants Act, 1949 requires every member who practices as a Chartered Accountant to hold a certificate of practice and hence a member, if he wishes to render services which amount to "practice" must hold a certificate of practice. Further, it may be noted that by the virtue of a resolution of the Council, with effect from 1st April 2005, a member in part-time practice (namely holding a certificate of practice and also engaging himself in any other business/ and or occupation) is not entitled to perform attest functions including tax audit. Therefore, although it is not directly inherent in the definition of "accountant" given by Section

288, it is nevertheless a necessary requirement that the member concerned must hold a certificate of practice.

15.2.1 Audit of Public Trusts: Section 12A of the Act deals with the conditions as to registration of trust etc. According to this section, exemption from Income tax would be available under sections 11 and 12 of the Income tax Act in relation to the income of any trust or institution provided the following conditions are satisfied:

(A) Clause (a) of section 12A requires a charitable or religious trust or institution to make an application for registration within one year from the date of creation of the trust or establishment of the institution. The Commissioner is empowered to condone the delay in making the application for registration if he is satisfied that there were sufficient reasons for such delay. In such cases, the exemption provisions of section 11 and 12 would apply from the date of creation of the trust or establishment of the institution.

This requirement of filing an application for registration under section 12A within one year of creation of the religious or charitable trust or institution has been removed. The application can be filed at any time now. This has been provided by insertion of new clause (aa) in section 12A(1). Further, a proviso has been inserted in clause (a) to restrict the applicability of that clause to applications made prior to 1.6.2007.

Also, the power of the Commissioner to grant registration for past years, by condoning the delay in filing such application, has been removed.

Accordingly, in respect of applications filed on or after 1st June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year.

(B) Where the total income of the trust or institution as computed under this Act, without giving effect to the provisions of Sections 11 and 12 exceeds the maximum amount which is not chargeable to income tax in any previous year i.e. *₹ 2,00,000* for the A.Y. *2013-14*, the accounts of the trust or institution for that year have been audited by an accountant as defined in the explanation below sub-section (2) of Section 288 and the person in receipt of the income furnishes alongwith the return of Income for the relevant assessment year, the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed. Rule 17B of the Income tax Rules, 1962 provides that the report of audit of accounts of a trust or institution which is required to be furnished under Clause (b) of Section 12A should be in Form No. 10B. The audit programme is outlined in the following paragraphs:

(a) Preliminary:

(i) Obtain a resolution from the trust specifying the appointment as also indicating the scope of audit. In particular, the resolution should specify the duties of the auditor in relation to the items specified in the annexure to the prescribed Form No. 10B.

(ii) Obtain a letter of appointment from the trust. Although the audit may have

been conducted in the past by a person appointed as an auditor for the purpose of Section 12A, having regard to the spirit of the requirement contained in clause (8) of Part-I of Schedule I to the Chartered Accountants Act, 1949, it is suggested that the auditor appointed for the purpose of Section 12A, should, before accepting the audit, communicate with such previous auditor.

(iii) Obtain a certificate

as to the opening balances of assets and liabilities and the fund.

(iv) Obtain a list of books of accounts which are maintained by the trust.

(v) Obtain a certificate from the trust as to the system of accounting and internal control.

(vi) Obtain from the trust a list of the institutions/ activities run/carried out by the trust.

(vii) Obtain from the trust a certified true copy of the Deed of Trust or any other scheme containing the objects and conditions of the trust as operative from time to time.

(b) Routine Checking:

(i) Check the books of account and other records having regard to the system of accounting and internal control.

(ii) Vouch the transactions of the trust to satisfy that:

(a) the transaction falls within the ambit of the trust;

(b) the transaction is properly authorised by the trustees or other delegated authority as may be permissible in law;

(c) all incomes due to the trust have been properly accounted for on the basis of the system of accounting followed by the trust;

(d) all expenses and outgoings appertaining to the trust have been recorded on the basis of the system of accounting followed by the trust; and

(e) amounts shown as applied towards the object of the trust are covered by the objects of the trust as specified in the document governing the trust.

(iii) Obtain a trial balance on the closing date certified by the trustees.

(iv) Obtain the Balance Sheet and Profit & Loss Account of the trust authenticated by the trustees and check the same with the trial balance with which they should agree.

(c) Accounting Principles: The auditor should follow, i.e., generally accepted accounting principles and ascertain the accuracy, truth and fairness of the Balance Sheet and Profit & Loss Account.

In particular, the auditor will scrutinise that:

(i) all assets of the trust are verified;

(ii) the assets of the trust have been properly valued and depreciation duly provided for;

(iii) all liabilities of the trust are properly accounted for;

(iv) the investments of the trust are properly classified and indicated and market values shown; and

(v) outstanding due to the trust are properly accounted for and their recoverability examined and provision made for irrecoverable.

(d) Annexure to the Audit Report:

(i) Obtain from the trustees, a certified list of persons covered by Section 13(3).

(ii) Obtain from the trustees, a statement enlisting the various items specified in the Annexure to Form No. 10B and giving the information against each item together with explanatory or supporting schedules.

(iii) Verify the information supplied by the trustees in the statements specified above in the light of available material. Where a list of persons specified in Section 13(3) is not available, indicate against Sections II and III of the items specified in the annexure the appropriate qualifying remarks.

The audit report is required to be furnished to the relevant year. Failure to furnish the report will disentitle the trust or institution to the benefit of Sections 11 and 12. The Auditor can accept as correct the list of persons covered by Section 13(3) as given by the managing trustees.

15.2.2 Audit of accounts in connection with the claim for deduction under Sections 35D and 35E : The conditions under which certain specified preliminary expenditure incurred before the commencement of business and once the business is commenced on expanding an industrial undertaking or in connection with setting up a new industrial unit can be amortised are stated in Section 35D of the Act. The manner in which deductions are allowed in respect of expenditure on any prospecting operations relating to certain specified minerals listed in the Seventh Schedule to the Act are stated in Section 35E of the Act. In respect of assessees other than a company or a co-operative society, these deductions are admissible only if the accounts for, the year or years in which the above specified expenditure is incurred are audited by an "accountant" as defined in explanation below sub-section (2) of section 288 of the Income-tax Act,1961 and the report of such audit is furnished by the assessee along with the return of income. Rule 6AB of the Income-tax Rules 1962 provides that the report of audit required to be furnished by the above-mentioned assessees under section 35D and 35E should be in Form No.3AE. While doing the audit the auditor is expected to follow general principles of auditing as mentioned in Standards on Auditing.

15.3 Tax Audit under Section 44AB

Section 44AB provides for the compulsory audit of accounts of certain persons carrying on business or profession. Section 44AB reads as under:

Audit of accounts of certain persons carrying on business or profession.

Every person -

(a) carrying on business shall, if his total sales turnover or gross receipts, as the case may be, in business exceed or exceeds one crore rupees in any previous year.

(b) carrying on profession shall, if his gross receipts, in profession exceed *twenty five lakhs* rupees in any previous year,

(c) carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AE or section 44BB or section 44BBB as the case may be, and he has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, as the case may be, in any previous year,

(d) carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person *under section 44AD, and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year*

get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed:

Provided that this section shall not apply to the person, who derives income of the nature referred to in section 44B or section 44BBA on and from the lst day of April, 1985 or, as the case may be, the date on which the relevant section came into force, whichever is later:

Provided further that in a case where such person is required by or under any other law to get his accounts audited, it shall be sufficient compliance with the provisions of this section if such person gets the accounts of such business or profession audited under such law before the specified date and furnishes by that date the report of the audit as required under such other law and a further report by an accountant in the form prescribed under this section.

Explanation: For the purposes of this section,

(i) "accountant" shall have the same meaning as in the explanation below sub-section (2) of Section 288;

(ii) "specified date", in relation to the accounts of the assessee of the previous year relevant to an assessment year, means the 30th day of September of the assessment year.

The above section stipulates that every person carrying on business is required to get his accounts audited before the "specified date" by a chartered accountant, if the total sales turnover or gross receipts in the business in any previous year exceed ₹ one crore rupees. A

person carrying on a profession will also have to get his accounts audited before the "specified date" by a chartered accountant if his gross receipts in profession in any previous year exceed *₹ 25 lakhs.*

Clause (c) of Section 44AB, provides that in the case of an assessee carrying on a business of the nature specified in sections 44AE, 44BB or 44BBB, tax audit will be required if he claims his income to be lower than the presumptive income deemed under those sections. Therefore, such assessees will be required to have a tax audit even if their sales, turnover or gross receipts do not exceed ₹ *100 lakhs (one crore rupees).*

If a person is carrying on business(es), coming within the scope of sections 44AE, 44BB or 44BBB but he exercises his option given under these sections to get his accounts audited under Section 44AB, tax audit requirements would apply, in respect of such business(es) even if the turnover of such business(es) does not exceed *₹ 100 lakhs (one crore rupees).*

In the case of a person carrying on businesses covered by sections 44AE, 44BB or 44BBB and opting for presumptive taxation, tax audit requirement would not apply in respect of such businesses, If such person is carrying on other business(es) not covered by presumptive taxation, tax audit requirements would apply in respect thereof if the turnover of such business(es), other than the business covered by presumptive taxation thereof, exceed *₹ 100 lakhs (one crore rupees).*

The first proviso to section 44AB stipulates that the provisions of that section will not be applicable to a person who derives income of the nature referred to in sections 44B, or 44BBA. Where the assessee is carrying on any one or more of the businesses specified in section 44B or 44BBA referred to in the first proviso to section 44AB, the sales/turnover/gross receipts from such businesses shall not be included in the total sales/turnover/gross receipts for determining the applicability of section 44AB.

The report of such audit, duly signed and verified by the chartered accountant is required to be given in such form and setting forth such particulars as prescribed by the Board. Rule 6G provides that such audit report and particulars should be given in Form No. 3CA/3CB as may be applicable and the statement of particulars should be given in Form No.3CD.

A question may arise in the case of an assessee who is eligible to claim deductions under sections 80-IA, 80-IB etc., as to whether, it will be necessary for him to get separate audit reports/certificates under these sections in addition to an audit report under Section 44AB. The requirement of section 44AB is a general requirement covering the overall position of the accounts of the assessee. This applies to the consolidated accounts of the assessee for the relevant previous year covering the results of all the units owned by the assessee whether situated at one place or at different places. If turnover of all the units put together exceeds prescribed limits, the assessee would be required to get a separate audit report/certificate under above said sections he wants to avail deduction under the respective sections. Therefore it will be necessary for an assessee to get separate audit reports/certificates under above said sections in addition to an audit report, if any, required under section 44AB.

15.3.1 Tax Auditor : The term "accountant" has been defined in sub-clause (i) of Explanation to Section 44AB as under:

Explanation: For the purposes of this section,

(i) "accountant" shall have the same meaning as in the Explanation below sub-section (2) of Section 288".

The above-mentioned Explanation reads as under:

1. Accountant means a chartered accountant within the meaning of Chartered Accountants Act, 1949 (38 of 1949) and includes, in relation to any State, any person, who by virtue of the provisions of sub-section (2) of Section 226 of the Companies Act, 1956 (I of 1956), is entitled to be appointed to act as an auditor of companies registered in that State." In this context it may be noted that from April 1, 2005, any member in part-time practice (namely, holding a certificate of practice and also engaging himself in any other business and/or occupation) is not entitled to perform attest functions including tax audit.
2. The proviso to Section 44AB also lays down that where the accounts of an assessee are required to be audited by or under any other law, it shall be sufficient compliance with the provisions of this section, if such person gets the accounts of such business or profession audited under such other law before the specified date and furnishes by that date the report of the audit as required under such other law and a further report by an accountant in the form prescribed under this section. It may be noted that with the deletion of the words "by an accountant" in the former part of the proviso to section 44AB by the Finance Act, 1985 with effect from 1st April, 1985, in the case of any assessee like a co-operative society where the accounts under the relevant law are allowed to be audited by a person other than a chartered accountant, the statutory auditor need not be a chartered accountant. Further in the latter part of proviso the words 'by the accountant' has been inserted by Finance Act, 2001 w.e.f. 1-4-2001 which indicates that tax auditor has to be a chartered accountant even if statutory audit has been conducted by a person other than a chartered accountant.
3. Though the section refers to the accounts being audited by an accountant, which means a chartered accountant as defined above, the statement of audit can also be done by a firm of chartered accountants. This has been a recognised practice under the Act. In such a case, it would be necessary to state the name of the partner who has signed the audit report on behalf of the firm. The member signing the report as a partner of a firm or in his individual capacity should give his membership number below his name. Section 44AB does not stipulate that only the statutory auditor appointed under the Companies Act or other similar statute should perform the tax audit. The tax audit can, therefore, be conducted either by the statutory auditor or by any other chartered accountant in full-time practice. It should be noted that from April 1, 2005, any member in part-time practice is not entitled to perform attest functions including tax audit.
4. Tax audit under section 44AB being a recurring audit assignment, for expressing professional opinion on the financial statements and the statement of particulars, the member accepting the assignment should communicate with the member who had done

tax audit in the earlier year as provided in the Chartered Accountants Act. While making an enquiry from the retiring auditor, the member accepting the assignment should find out whether there is any professional or other reasons why he should not accept the appointment. While accepting any assignment the tax auditor has to keep in mind the 'Code of Ethics' of the ICAI also.

5. The tax auditor should obtain from the assessee a letter of appointment for conducting the audit as mentioned in section 44AB. It is advisable that such an appointment letter should be signed by the person competent to sign the return of income in terms of the provisions of section 140. SA 210- Agreeing the Terms of Audit Engagements has to be followed by an auditor while accepting any new audit engagement.

6. The tax auditor should get the statement of particulars, as required in the annexure to the audit report, authenticated by the assessee before he proceeds to verify the same. The tax auditor is required to submit his report to the person appointing him viz. the assessee.

7. The Act does not prohibit a relative or an employee of an assessee to be appointed as a tax auditor under section 44AB. However as per the decision of the Council a chartered accountant who is in employment of a concern or in any other concern under the same management cannot be appointed as a tax auditor of the concern. Further, as per another decision of the Council, a member who is not in full-time practice cannot carry out attest functions on or after April 1, 2005. Therefore, an employee of an assessee or an employee of a concern under the same management cannot audit the accounts of an assessee under section 44AB. It may also be noted that under the Second Schedule to the Chartered Accountants Act, if a member gives an audit report under section 44AB in the case of a concern in which he and/or his relatives have substantial interest, it will be necessary for him to disclose his interest in the audit report.

8. A chartered accountant who is responsible for writing or the maintenance of the books of account of the assessee should not audit such accounts. This principle will apply to the partner of such a member as well as to the firm in which he is a partner. In view of this, a chartered accountant who is responsible for writing or the maintenance of the books of account or his partner or the firm in which he is a partner should not accept tax audit assignment under section 44AB in the case of such an assessee.

9. The audit of accounts of a professional firm of chartered accountants, under section 44AB cannot be conducted by any partner or employee of such firm.

10. A chartered accountant / firm of chartered accountants, who is appointed as tax consultant of the assessee, can conduct tax audit under section 44AB. But an internal auditor of the assessee cannot conduct tax audit if he is an employee of the assessee. If the internal auditor is working in a professional capacity (as an independent chartered accountant not being an employee of the assessee), he can conduct the tax audit.

11. A question may arise whether an assessee can remove a tax auditor appointed under section 44AB. The answer depends upon the facts and circumstances of the case. There is no specific procedure for removal of a tax auditor appointed under section 44AB. It is, however, possible for the management to remove a tax auditor where there are any valid

grounds for such removal. This may arise where the tax auditor has delayed the submission of audit report under section 44AB for an unreasonable period and if it is found that there is no possibility of getting the audit report before the specified date. In such cases, the assessee may be justified in removing the tax auditor.

12. Before accepting a tax audit, the chartered accountant should take into consideration the ceiling on tax audit assignments fixed under the Notification dated 13th January, 1989, issued by the ICAI. In view of the said Notification, a member of the Institute in practice, shall be deemed to be guilty of professional misconduct if he accepts in a financial year more than *45* tax audit assignments or such other limit as may be prescribed by ICAI from time to time under section 44AB, whether in respect of a person whose accounts have been audited under any other law or a person who carries on business or profession but who is not required by or under any other law to get his accounts audited. Further, as per a Council decision, audits of accounts of persons carrying on business covered by sections 44AE, 44BB or 44BBB is not included in the aforesaid limit.

13. The audit of head office and branch offices of the assessee shall be regarded as one tax audit assignment.

15.3.2 Accounting Standards (AS): Accounting Standards are basically issued for use in the presentation of general purpose financial statements which are issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time. AS also apply in respect of financial statements audited under section 44AB of the Income-tax Act, 1961. Accordingly, members should examine compliance with the mandatory accounting standards when conducting such audit.

AS apply in respect of commercial, industrial or business activities of an enterprise. In the case of charitable or religious organisations, AS will not apply if all activities of such organisations are not of commercial, industrial or business nature (e.g. an activity of collecting donations and giving them to flood affected people). In other words, exclusion of an entity from the applicability of the AS would be permissible only if no part of the activity of such entity is commercial, industrial or business in nature. Even if a very small portion of the activities of an entity is considered to be commercial, industrial or business in nature, then it cannot, claim exemption from the application of AS. The AS would apply to all its activities including those, which are not commercial, industrial or business in nature.

Financial Statements prepared on a basis other than accrual - With regard to the fundamental accounting assumption of accrual, the Council has made a specific announcement that in respect of (a) Sole proprietary concerns/individuals, (b) Partnership firms, (c) Societies registered under the Societies Registration Act, (d) Trusts, (e) Hindu undivided families and (f) Association of persons, the auditor should examine whether the financial statements have been prepared on accrual basis. In case where the statute governing the enterprise requires the preparation and presentation of financial statements on accrual basis but the financial statements have not been so prepared, the auditor should qualify his report. On the other hand where there is no statutory requirement for preparation and presentation of financial statements on accrual basis, and the financial statements have been prepared on a basis other than 'accrual', the auditor should describe in his audit report, the basis of accounting followed, without necessarily making it a

subject matter of a qualification. In such a case the auditor should also examine whether those provisions of the AS which are applicable in the context of the basis of accounting followed by the enterprise have been complied with or not and consider making suitable qualifications in his audit report accordingly.

Accounting Standards under Taxation Law - The Finance Act, 1995 substituted a new section 145 w.e.f. assessment year 1997-98. The section deals with method of accounting and is reproduced below:

"145.(1) Income chargeable under the head 'Profits and gains of business or profession' or "Income from other sources' shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessees or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in Section 144."

Standards notified by Government -AS(IT) - In exercise of the powers conferred by section 145(2), the Central Government has by Notification No. S.O.69(E), dated 25th January, 1996 notified two AS(IT). This notification came into force with effect from 1st day of April, 1996, and is accordingly applicable from assessment year 1997-98 and subsequent assessment years.

These AS (IT) are given below :

Accounting Standards to be followed by all assessees following mercantile system of accounting.

A. Accounting Standard I relating to disclosure of accounting policies.

B. Accounting Standard II relating to disclosure of prior period and extraordinary items and changes in accounting policies.

The above Accounting Standards are to be followed by all assessees following mercantile system of accounting. Therefore, it is clear that those assessees who are following cash system of accounting need not follow the Accounting Standards notified above.

Implications of non-compliance with the AS and AS (IT) - As mentioned earlier, AS are applicable to tax audit also when the tax auditor performs the attest function, i.e., report on whether the accounts are true and fair. Therefore, in case of non-compliance with the AS, the chartered accountant should make appropriate qualifications/disclosures in the audit report. However, such qualifications/disclosures may or may not have any impact on the computation

of total income for the purpose of the Act. Similarly, Section 145 provides that the AS(IT) notified under that section should be followed by the assessees to whom they are made applicable. It should be noted that the tax auditor auditing accounts under section 44AB is not computing the income but is - (a) reporting on accounts, and (b) reporting on the relevant information furnished in Form No. 3CD. Now, the revised Form No. 3CD *vide clause* 11(d) requires reporting of the details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under section 145 and the effect thereof on the profit or loss. Further, it may be noted that there is no material difference between AS(IT)-l and AS(IT)-2 notified by the Government and the corresponding AS-1 and AS-5 of the ICAI respectively.

15.3.3 Audit procedures*:* In the case of tax audit the tax auditor is required to express his opinion as to whether the financial statements gives a true and fair view of the state of affairs of the assessee in the case of the balance sheet and in the case of the profit and loss account or income and expenditure account, of the profit and loss or income/expenditure. As regards the statement of particulars to be annexed to the audit report, he is required to give his opinion as to whether the particulars are true and correct. In giving his report the tax auditor will have to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require, considering the contents of the audit report. He will have to conduct the audit by applying the generally accepted auditing procedures which are applicable for any other audit. He can apply the technique of test check depending on the type of internal control procedures followed by the assessee. The tax auditor will also have to keep in mind the concept of materiality depending upon the circumstances of each case. He would be well advised to refer to the Standards on Auditing (SAs) issued by ICAI, as well as the 'Guidance Note on Audit Reports and Certificates for Special Purposes" while determining the extent of test checks and materiality in each particular case. If the statutory auditor is also appointed to undertake tax audit, it is advisable to carry out both the audits concurrently.

Section 227 of the Companies Act gives certain powers to the auditors to call for the books of accounts, information, documents, explanations, etc. and to have access to all books and records. No such powers are given to the tax auditor appointed under Section 44AB. However, since the appointment of the tax auditor is made by assessee, it will be in the interest of the assessee to furnish all the information and explanations and produce books of account and records required by the tax auditor. If, however, the assessee refuses to produce any particular record or to give any specific information or explanation, the tax auditor will be required to report the same and qualify his report.

The audit report given under section 44AB is to assist the income-tax department to assess the correct income of the assessee. In order that the tax auditor may be in a position to explain any question which may arise later on, it is necessary that he should keep detailed notes about the evidence on which he has relied upon while conducting the audit and also maintain all his working papers. Such working papers should include his notes on the following, amongst other matters:

(a) work done while conducting the audit and by whom;

(b) explanations and information given to him during the course of the audit and by whom;

(c) decision on the various points taken;

(d) the judicial pronouncements relied upon by him while making the audit report; and

(e) certificates issued by the client/management letters.

If the accounts of the business or profession of a person have been audited under any other law by the statutory auditor(s), it is not necessary for the tax auditor appointed under section 44AB to conduct the audit once again in the matter of expression of "true and fair view" of the state of affairs of the entity and of its profit and loss for the period covered by the audit. However, the said section envisages the certification of the particulars in the prescribed form on which the tax auditor has to express his opinion as to whether these are 'true and correct'. In other words, where an audit has already been conducted and the opinion of the auditor has been expressed on the accounts, it would not be necessary to repeat the entire exercise to express similar opinion all over again. The tax auditor has only to annex a copy of the audited accounts and the auditor's report and other documents forming part of these accounts to his report and verify the particulars in the prescribed form for expressing his opinion as to whether these are true and correct.

While test checks may suffice in the conduct of a statutory audit for the expression of the auditor's opinion as to whether the accounts depict a true and fair view, the tax auditor may be required to apply reasonable tests on the total information to be prepared by the assessee in respect of certain items in the prescribed form, e.g., in verification of expenditure in respect of which a payments or aggregate of payment for purchases/expenses etc made to a person in a day, otherwise than by account payee cheque drawn on bank or account payee draft exceeds ₹ 20,000/- (₹ 35,000 for payments to transport operators) in cash. While the entity may have to prepare the details for the entire year, the tax auditor may have to ensure that no items have been omitted in the information furnished and a reasonable test check would reveal whether or not the information furnished is correct. The extent of check undertaken would have to be indicated by the tax auditor in his working papers and audit notes. The tax auditor would be well advised to so design his tax audit programme as would reveal the extent of checking and to ensure adequate documentation in support of the information being certified.

15.3.4 Audit report*:* Section 44AB requires the tax auditor to submit the audit report in the prescribed form and setting forth the prescribed particulars. Sub-rule 1 of rule 6G provides that the report of audit of accounts of a person required to be furnished under Section 44AB shall -

(a) in the case of a person who carries on business or profession and who is required by or under any other law to get his accounts audited, be in Form No. 3CA;

(b) in the case of a person who carries on business or profession, but not being a person referred to in clause (a), be in Form No. 3CB.

Sub-rule (2) of Rule 6G further provides that the particulars which are required to be furnished under Section 44AB shall be in Form No. 3CD.

It may thus be noted that the audit report is in two parts, The first part requires the tax auditor

to give his opinion as to whether or not the accounts audited by him give a true and fair view:

i. in the case of the balance sheet, of the state of affairs as at the last date of the accounting year.

ii. in the case of the profit and loss account, of the profit or loss of the assessee for the relevant accounting year.

The second part of the report states that the statement of particulars required to be furnished under Section 44AB is annexed to the audit report in Form No. 3CD. The tax auditor is required to give his opinion whether the prescribed particulars furnished by the assessee are true and correct.

In paragraph 3 of Form No. 3CB the auditor has to report that the financial statements audited by him give a 'true and fair' view. The requirement in paragraph 3 of Form No.3CA and paragraph 4 of Form No.3CB relating to particulars in Form No.3CD is that the auditor should report that these particulars in Form No.3CD are "true and correct". The terminology "true and fair" is widely understood though not defined even by the Companies Act, 1956. On the other hand, the words "true and correct" lay emphasis on factual accuracy of the information. In this context reference is invited to AS-1 and AS(IT)-I relating to disclosure of accounting policies. These standards recognize that the major considerations governing the selection and application of accounting policies are (i) prudence, (ii) substance over form and (iii) materiality. Therefore, while giving particulars in Form No.3CD these aspects should be kept in view. In particular, considering the nature of particulars to be given in Form No.3CD, the aspect of materiality should be considered. In other words particulars should be given in the respect of material items and the auditors should ensure factual accuracy relating to these particulars. Even in case of immaterial items, particulars are required to be given by auditor for e.g., delay in TDS deposit, untimely payment of PF/ESI dues.

In the case of a person whose accounts of the business or profession have been audited under any other law, it is not required for the tax auditor appointed under section 44AB to give his opinion, as to whether or not the accounts give a true and fair view as indicated herein above. It would only be necessary for him to annex a copy of the audited accounts as well as a copy of the audit report given by the statutory auditor with his report in Form No. 3CA along with Form No.3CD.

In the case of a person who carries on business and also renders professional services but who is not required by or under any other law to get his accounts audited, report should be given in Form No, 3CB. The statement of particulars should be given in Form No. 3CD. Even where separate sets of accounts are maintained in respect of business and professional activities Form No. 3CB and Form No. 3CD should be used.

In the case of "person" having their accounting year which is different from the financial year, accounts of the financial year are required to be prepared and audited. The audit report shall be in Form 3CB.

Form No. 3CA

1. This form is to be used in a case where the accounts of the business or profession of a

person have been audited under any other law. The first part of the report refers to the fact that the statutory audit of the assessee was conducted by a chartered accountant or any other auditor in pursuance of the provisions of the relevant Act, and the copy of the audit report along with the audited profit and loss account and balance sheet and the documents declared by the relevant Act to be part of or annexed to the profit and loss account and balance sheet, are annexed to the report in Form No. 3CA. In a case where the tax auditor carrying out the audit under Section 44AB is different from the statutory auditor, a reference should be made to the name of such statutory auditor. In case the statutory auditor is carrying out the audit under section 44AB, the fact that he has carried out the statutory audit under the relevant Act should be stated.

2. The next paragraph states that the statement of particulars required to be furnished under section 44AB is annexed with the report in Form No. 3CD. The tax auditor has to state further that, in his opinion and to the best of his information and according to the explanations given to him, the particulars given in the said Form No. 3CD and annexure therefore true and correct.

3. Where any of the requirements in this form is answered in negative or with qualification, the report shall state the reasons thereof. The tax auditor should state this qualification in the audit report so that the same becomes a comprehensive report and the user of the audited statement of particulars can realise the impact of such qualifications.

4. It is possible that in the case of a person whose accounts of the business or profession have been audited under any other law, which has branches at various places, the branch accounts might have been audited by branch auditors under the statute. If the audit under section 44AB is also carried out by the same branch auditors or other chartered accountants, they should submit the report in Form. No. 3CA to the management or the principal tax auditor appointed for the head office under Section 44AB. Attention in this regard is drawn to SA-600, "Using the Work of Another Auditor" which discusses the procedures in this regard as well as the principal tax auditor's responsibility in relation to his use of the work of the branch auditor. The principal tax auditor should submit his consolidated report on the registered office/head office and branch accounts and report in his tax audit report as under:

   "I/We have taken into consideration the audit report and the audited statements of accounts, and particulars received from the auditors, duly appointed under the relevant law, of the branches not audited by me/us".

If the assessee is unable to obtain relevant information in respect of the overseas branches duly certified by the overseas auditor, the relevant facts should be suitably disclosed and reported upon.

Item No.4 of the notes to Form No. 3CA requires that the person, who signs this audit report, shall indicate reference of his membership No./certificate of practice number/authority under which he is entitled to sign this report. Further, the auditor is required to indicate registration number of the firm as allotted by ICAI compulsorily. No separate certificate of practice number is allotted by ICAI. As such, where a chartered accountant acts as a tax auditor he should give his membership number with ICAI and the status such as proprietor or partner under which he has signed the report.

Form No. 3CB

In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited the audit report has to be given in Form No. 3CB. Form No. 3CB consists of four paragraphs.

The tax auditor has to state whether he has examined the balance sheet as at 31st March of the relevant previous year and the profit and loss account/income and expenditure account for the year ended on the date. Further, such a balance sheet and the profit and loss account must be attached with the audit report.

The tax auditor has to certify that the balance sheet and the profit and loss account income and expenditure account are in agreement with the books of accounts maintained at the head office and branches. He has also to mention the total number of branches.

He has to report his observations, comments, discrepancies or inconsistencies, if any. Subject to the above observations, comments, discrepancies, inconsistencies he has to state whether:

(a) he has obtained all the information and explanations which, to the best of his knowledge and belief, were necessary for the purposes of the audit;

(b) in his opinion proper books of account have been kept by the head office and branches of the assessee so far as appears from his examination of the books;

(c) in his opinion and to the best of his information and according to the explanations given to him the said accounts, read with notes thereon, if any, give a true and fair view;

  (i) in the case of the balance sheet of the state of the affairs of the assessee as at 31st March, _____ and

  (ii) in the case of the profit and loss account / income and expenditure account of the profit / loss or surplus/deficit of the assessee for the year ended on that date.

Under clause (a) of paragraph 3 of Form No.3CB, the tax auditor has to report his "observations /comments/ discrepancies /inconsistencies," if any. The expression 'Subject to above' appearing in clause (b) makes it clear that such observations/comments/ discrepancies/inconsistencies which are of qualificatory nature relate to necessary information and explanations for the purposes of the audit or the keeping of proper books of accounts or the true and fair view of the financial statements, respectively to be reported on in paragraphs (A), (B) and (C) under clause (b) of paragraph 3. While reporting on clause (a) of paragraph 3 of Form No. 3CB the tax auditor should report only such of those observations/ comments/discrepancies/ inconsistencies which are of qualificatory nature which affect his reporting about obtaining all the information and explanations which were necessary for the purposes of the audit, about the keeping of proper books of account by the head office and branches of the assessee and about the true and fair view of the financial statements. Further, only such observations/ comments/ discrepancies/ inconsistencies, which are of a qualificatory nature, should be mentioned under clause (a). Any other observations/ comments/ discrepancies/inconsistencies, which do not affect the reporting on the matters specified above may form part of the notes to accounts forming part of the accounts. In case the tax auditor has no observations/comments/ discrepancies/inconsistencies to report, which are of qualificatory nature, the following portion of paragraph 3 may be deleted:

"3(a) *I/We report the following observations/comments/discrepancies/ inconsistencies, if any: Subject to above,"

The tax auditor may then give his report as required by sub-paragraphs (A), (B), and (C) of paragraphs 3 and 4.

Paragraph 4 of Form No.3CB provides that the prescribed particulars are furnished in Form No.3CD annexed to the report and Para 5 of Form No.3CB requires the auditor to report whether in his opinion and to the best of his information and according to the explanations given to him, the particulars given in Form No.3CD and annexure thereto are true and correct. The auditor may have a difference of opinion with regard to the particulars furnished by the assessee and he has to bring these differences under various clauses in Form No.3CD. The auditor should make a specific reference to those clauses in Form No.3CD in which he has expressed his reservations, difference of opinion, disclaimer etc. in this paragraph.

If a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, has branches and separate accounts are maintained at the branches, the assessee can request the tax auditor appointed under Section 44AB to audit the head office and branch accounts. In the alternative, the assessee can appoint separate tax auditors for branches. The branch tax auditor in such a case will have to give an audit report in Form No. 3CB to the management or the tax auditor appointed for the audit of head office accounts. The tax auditor appointed for the audit of head office can rely on the report of branch tax auditors subject to such checks and verifications as he may choose to make and shall submit his consolidated report on the head office and branch accounts. He should make suitable reference to the audit conducted by separate branch tax auditors in the same manner as stated above.

If the tax auditor is called upon to give his report only in respect of one or more businesses carried on by the assessee and the books of accounts of the other businesses are not produced as the same are not required to be audited under the Act. the tax auditor should mention the fact that audit has not been conducted of those businesses whose books of account had not been produced. However, if the financial statements include, *inter alia,* the results of such business for which books of account have not been produced, the auditor should qualify his report in Form No. 3CA/3CB.

Form No. 3CD

The statement of particulars given in Form No. 3CD as annexure to the audit report contains thirty two clauses and two annexure. The tax auditor has to report whether the particulars are true and correct. This Form is a statement of particulars required to be furnished under section 44AB. The same is to be annexed to the reports in Forms No. 3CA and 3CB in respect of a person who carries on business or profession and whose accounts have been audited under any other law and in respect of person who carries on business or profession but who is not required by or under any other law to get his accounts audited respectively.

As stated earlier, the tax auditor should obtain from the assessee, the statement of particulars in Form No.3CD duly authenticated by him. It would be advisable for the assessee to take into consideration the following general principles while preparing the statement of particulars:

(a) He can rely upon the judicial pronouncements while taking any particular view about inclusion or exclusion of any items in the particulars to be furnished under any of the clauses specified in Form No.3CD.

(b) If there is a conflict of judicial opinion on any particular issue, he may refer to the view which has been followed while giving the particulars under any specified clause.

(c) The Accounting Standards (AS), Guidance Notes, Standards on Auditing (SAs) issued by the Institute from time to time should be followed.

While furnishing the particulars in Form No.3CD it would be advisable for the tax auditor to consider the following:

(a) If a particular item of income/expenditure is covered in more than one of the specified clauses in the statement of particulars, care should be taken to make a suitable cross reference to such items at the appropriate places.

(b) If there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD, the tax auditor should state both the view points and also the relevant information in order to enable the tax authority to take a decision in the matter.

(c) If any particular clause in Form No.3CD is not applicable, he should state that the same is not applicable.

(d) In computing the allowance or disallowance, he should keep in view the law applicable in the relevant year, even though the form of audit report may not have been amended to bring it in conformity with the amended law.

(e) In case the prescribed particulars are given in part or piecemeal to the tax auditor or relevant form is incomplete and the assessee does not give the information against all or any of the clauses, the auditor should not withhold the entire audit report. In such a case, he can qualify his report on matters in respect of which information is not furnished to him. In the absence of relevant information, the tax auditor would have no option but to state in his report that the relevant information has not been furnished by the assessee.

(f) The information in Form No. 3CD should be based on the books of accounts, records, documents, information and explanations made available to the tax auditor for his examination.

PART A

1.	Name of the assessee	:	
2.	Address	:	
3.	Permanent Account Number	:	
4.	Status	:	
5.	Previous year ended	:	31st March

6. Assessment year :

If the tax audit is in respect of a branch then the name of the branch should be mentioned along with the name of the assessee. Similarly, in such a case the address of the branch or unit should be given.

PART B

7. (a) If firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.

(b) *"If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change.*"

In case where the partner of a firm or the member of AOP acts in a representative capacity, the name of the beneficial partner/member should be stated.

The details of partners or members during the entire previous year will have to be furnished.

The term "profit sharing ratios" would include loss-sharing ratio also since loss is nothing but negative profits.

If there is any change in the partners of the firm or members of the association of persons or their profit or loss sharing ratio, since the last date of preceding year, the particulars of such change must be stated. All the changes occurring during the entire previous year must be stated.

The particulars in this clause should be verified from the instrument or agreement or any other document evidencing partnership or association of persons including any supplementary documents or other documents effecting such changes. For this purpose, the tax auditor may also verify:

(i) whether the relevant documents, if required, have been filed with the concerned authorities,

(ii) whether notice of changes, if required, has been given to the registrar of firms, and any minutes or any other understanding recording any changes in the partners/members or their profit sharing ratios.

The tax auditor should obtain certified copies of the deeds, documents, understanding, notice of changes etc. including certified copies of the acknowledgment, if any, evidencing filing of documents

8. (a) Nature of business or profession (if more than one business or profession is carried on during the previous year, nature of every business or profession).

(b) If there is any change in the nature of business or profession, the particulars of such change.

In regard to the nature of business, the principal line of each business such as manufacturing of electronic goods, trading in chemicals, wholesale trade in food grains or a retail trade in grocery should be stated.

In the case of a person rendering services, the nature of services should be broadly stated. Any material change in the nature of business should be precisely set out. The change will include change from manufacturer to trader as well as change in the principal line of business.

A review of business report or the minutes of meetings would enable the tax auditor to note the changes, if any. If need be the tax auditor should get a declaration form the assessee regarding change in the nature of business, if any.

9. (a) Whether the books of account are prescribed under Section 44AA, if yes, list of books so prescribed.

(b) Books of account maintained.

(In case books of account are maintained in a computer system, mention the books of account generated by such computer system.)

(c) List of books of account examined.

The list of books of account prescribed, maintained and examined has to be stated under this clause. There may be difference between the three lists. For example, books of account may have been prescribed but all the prescribed books might not have been maintained or the entire books of account maintained might not have been produced for examination. The tax auditor should exercise his professional judgment and skill in order to arrive at the conclusion whether such a situation warrants any disclosure or qualifications while forming his opinion on the matters covered by reporting requirements in Form No.3CB.2. The tax auditor should obtain from the assessee a complete list of books of account and other documents maintained by him (both financial and non-financial records) and make appropriate marks of identification to ensure the identification of the books and records produced before him for audit. The list of books of account maintained by the assessee should be given under this clause.As to the requirement regarding the mentioning of the books of account generated by the computer system, only such books of account and other records which properly come within the scope of the expression “proper books of account” should be mentioned. The tax auditor should insist on proper print-outs of books of account being taken out.

For a person whose accounts of the business or profession have been audited under any other laws the requirement for maintenance of books of account is contained in the relevant statutes. In the case of other assessees, normal books of accounts to be maintained will be cash book/ bank book, sale/ purchase journal or register and ledger. Assessees engaged in trading/manufacturing activities should also maintain quantitative details of principal items of stores, raw materials and finished goods. While giving his report in Form No. 3CB about maintenance of proper books of account, the tax auditor should ensure that they are maintained in accordance with the above requirements.

Books of account examined would constitute the books of original entry and the other books of account. While the assessee is required to maintain proper evidence

in the form of bills, vouchers, receipts, documents, etc., it may be noted that these are essential to support the entries in the books of account and no reference to such supporting evidence need be made under this clause.

10. Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant Sections (44 AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB or any other relevant section).

Where the profits and gains of the business are assessable to tax under presumptive basis under any of the sections mentioned below, the amount of such profits and gains credited/debited to the profit and loss account should be indicated under this clause.

S. No.	*Section*	*Business Covered*
1	44AD	Civil construction business
2	44AE	Transport business
3	44AF	Retail trade
4	44B	Shipping business of a non-resident
5	44BB	Exploration etc. of mineral oil by a non-resident
6	44BBA	Operation of aircraft by non-resident
7	44BBB	Civil construction etc. in certain turnkey power project by non-residents.
8	Any other relevant section	This refers to the sections not listed above under which income may be assessable on presumptive basis like Section 44D and will include any other section that may be enacted in future for presumptive taxation.

If the profit and loss account does not include profit assessable on presumptive basis, then, there is no requirement to furnish the particulars under this clause.

The amount to be mentioned under this clause means the amount included in the profit and loss account. The tax auditor is not required to indicate as to whether such amount corresponds to the amount assessable under the relevant section relating to presumptive taxation. As such, the reporting requirement gets satisfied if the amount as per profit and loss account is reported. However, the tax auditor may clarify by way of a note that the amount mentioned under this clause is not necessarily the actual amount of profits and gains chargeable to tax under the relevant section.

11. (a) Method of accounting employed in the previous year.

(b) Whether there has been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.

(c) If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.

(d) Details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under Section 145 and the effect thereof on the profit or loss.

The Finance Act, 1995 has amended Section 145 with effect from assessment year 1997-98 to provide that the income chargeable under the head "Profits and gains of business or profession" or 'Income from other sources" must be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. It has also been provided that the Central Government may notify in the Official Gazette from time to time the accounting standards to be followed by any class of assessees or in respect of any class of income. The hybrid system of accounting viz. mixture of cash and mercantile hitherto allowed to be followed by the assessee is not permitted from assessment year 1997-98. However, the assessee may adopt cash system of accounting for one business and mercantile system of accounting for other business. Once the choice of method of accounting is decided, the assessee must follow consistently the method of accounting employed. If he employs different methods for different businesses regularly and consistently, the profits would have to be computed in accordance with the respective methods, provided the result is a proper determination of profits.

It may be noted that section 209 of the Companies Act,1956 requires every company to maintain books of account on accrual basis. However, this section is not applicable to entities other than companies.

If there is any change the effect thereof has to be stated under this clause. In so far as the question of effect of such change on the profit or loss is concerned, the concept of materiality is the basic governing factor. If it is not possible to quantify the effect of the change in the method of accounting, appropriate disclosure should be made under this clause.

An assessee can follow a number of accounting policies for the purpose of maintaining his books of account. As per AS-1 all significant accounting policies adopted in the preparation and presentation of financial statements shall be disclosed. The disclosure of the significant accounting policies shall form part of the financial statements and the significant accounting policies shall normally be disclosed in one place. Any change in an accounting policy which has a material effect in the previous year or in the years subsequent to the previous year shall be disclosed. The impact of, and the adjustments resulting from such change, if material, shall be shown in the financial statement of the period in which such change is made to reflect the effect of such change.

The Calcutta High Court in *Snow White Food Products v CIT 11983] 141 ITR 861,* and Madras High Court in *CIT v Carborandum Universal Limited [1966] 149 ITR 759* and several other decisions like *CIT v. Mopeds India Ltd. [1998] 173 ITR 347, Triveni Engg, Works Ltd. v. CIT [1987] 167 ITR 742 (All), CIT v. Ganga Trust Fund [1986] 162 ITR 612 (Guj)* have held that it is open to an assessee to change the method of accounting provided the changed method is the regular method of accounting and the assessee has not merely abandoned or changed it for a casual period to suit his own purposes. Any such change which is followed consistently has to be accepted by the department, even if it results in reduction of tax liability.

A change in an accounting policy will not amount to a change in the method of accounting and hence such change in the accounting policy need not be mentioned under sub-clause (b). This is due to the fact that as per the requirements of AS-1 and AS(IT)-l such changes and the impact of such changes will be disclosed in the financial statements. It may be noted that a change in the method of valuation of stock will amount only to a change in an accounting policy and hence such a change need not be mentioned under sub-clause 11(b) but should be mentioned in the financial statements.

The tax auditor should apply reasonable checks to the earlier year's accounts to ascertain whether there is any change in the method of accounting in the year under audit, after obtaining a written confirmation from the assessee as to the method of accounting followed.

It must also be ascertained whether the AS (IT) as may be applicable, have been followed. The tax auditor has to report the details of deviations in the method of accounting in the previous year from the AS (IT) and the effect thereof on the profit or loss.

12. (a) Method of valuation of closing stock employed in the previous year.

(b) Details of deviation, if any, from the method of valuation prescribed under Section 145A, and the effect thereof on the profit or loss.

The method of valuation of closing stock is to be stated under this clause. It is the normal practice to disclose the same as a part of disclosure of significant accounting policies. Accordingly, a reference may be invited to the same or the method of valuation may be again described in Form No.3CD.

The method of valuation followed by the assessee having regard to the articles or goods dealt in or manufactured by the assessee, should be clearly indicated. Some examples are given below:

(i) raw material at cost or net realisable value whichever is lower,

(ii) finished goods at cost or net realisable value whichever is lower,

In clause 3(i) of the old Form No. 3CD reference was to "opening and closing stock-in-trade". In sub-clause (a) of clause 12 of revised Form No.3CD, the reference is to "closing stock". The expression "stock-in-trade" means finished goods and raw materials. Since sub-clause (b) refers to section 145A where the term "inventories" is used, the term "closing stock" will include all items of inventories. AS-2 defines the term "inventories" to include finished goods, raw materials, work-in progress, materials, maintenance supplies, consumables and loose tools. Therefore, method of valuation of items of inventories will have to be given under sub-clause (a).

The tax auditor should study the procedure followed by the assessee in taking the inventory of closing stock at the end of the year and the valuation thereof. He should obtain the inventory of closing stock, indicating the basis of valuation thereof, for reporting on the method of valuation of closing stock under this clause.

The method of stock valuation must be consistently followed from year to year and the method followed must be brought out clearly. The tax auditor should examine the basis adopted for ascertaining the cost and this basis should be consistently followed. It is necessary to ensure that the method followed for valuation of stock results in disclosure of correct profit and gains.

The details of deviation, if any, from the method of valuation prescribed under Section 145A, and the effect thereof on the profit or loss have to be stated under clause 12(b). Section 145A has been enacted by the Finance (No.2) Act, 1998 and has came into force from the accounting year 1.4.1998 to 31.3.1999 (assessment year 1999-2000). This section provides that the valuation of purchase and sale of goods and inventory for the purpose of computation of income from business or profession shall be made on the basis of the method of accounting regularly employed by the assessee but this shall be subject to certain adjustments. Therefore, it is not necessary to change the method of valuation of purchase, sale and inventory regularly employed in the books of account. The adjustments provided in this section can be made while computing the income for the purpose of preparing the return of income. These adjustments are as follows:

(a) Any tax, duty, cess or fee actually paid or incurred on inputs should be added to the cost of inputs (raw-materials, stores etc.); if not already added in the books of account.

(b) Any tax, duty, cess or fee actually paid or incurred on sale of goods should be added to the sales, if not already added in the books of accounts.

(c) Any tax, duty, cess or fee actually paid or incurred on the inventory (finished goods, work-in-progress, raw materials etc.) should be added to the inventories, if not already added while valuing the inventory in the accounts.

12A. Give the following particulars of the capital asset converted into stock-in-trade:

(a) Description of capital asset;

(b) Date of acquisition;

(c) Cost of acquisition;

(d) Amount at which the asset is converted into stock-in-trade.

This is a new clause that has been inserted by the Notification 208/2006 dated 10th August, 2006. For furnishing particulars required under this clause, the provisions of section 2(47), 45(2),47(iv),(v) and 47A have to be kept in mind.

The particulars to be stated under new clause 12A should be furnished with respect to the previous year in which the asset has been converted into stock-in-trade. The clause does not require details regarding the taxability of capital gains or business income arising from such deemed transfer.

Under clause (a) description of the capital asset is required to be mentioned for example, shares, security, land, building, plant, machinery, etc.

Under Clause (b) the date of acquisition is to be reported. For ascertaining the

correct date the tax auditor will have to refer the accounts of the financial year in which such capital assets is acquired. The date assumes importance for the purpose of determining whether the asset is long term or short-term in nature.

Under clause(c) the cost of acquisition is required to be reported. Here the cost of acquisition as per the books of account is to be mentioned. In case of depreciable assets, the carrying cost appearing in the books will be the written down value. But the value to be reported will be the original cost of acquisition. Even in case of an asset acquired prior to the 1st day of April 1981 the value to be reported will be the original cost of acquisition. The assessee may exercise the option of considering the fair market value of the asset as on 1st April, 1981 for assets acquired prior to that date for the purpose of computation of capital gains as provided under Section 55(2)(b)(i).

Under clause (d) the amount at which the asset converted into stock-in-trade should be stated. Such an amount may not be the fair market value as on the date of conversion or treatment as stock in-trade. If a value other than carrying cost is recorded then the auditor has to examine the basis of arriving at such a value. The valuation of stock-in-trade is to be examined with reference to AS 2 Valuation of Inventories. Non-compliance with AS 2 is to be suitably qualified in the main audit report.

13. Amounts not credited to the profit and loss account, being

(a) the items falling within the scope of Section 28;

(b) the pro forma credits, drawbacks, *refund of duty of customs or excise or service tax, or refund of sales tax or value added tax* , where such credits, drawbacks or refunds are admitted as due by the authorities concerned;

(c) escalation claims accepted during the previous year;

(d) any other item of income;

(e) capital receipt, if any.

Under this clause various incomes falling within the scope of Section 28, which are not credited to the profit and loss account are to be stated. The information under sub-clauses (a), (d) and (e) of clause (13) is to be given with reference to the entries in the books of account and records made available to the tax auditor for the purpose of tax audit under Section 44AB. Section 28 refers to (a) profits and gains of business or profession, (b) compensation received on termination of employment, agency etc (c) income of trade or professional or similar association from specific services to members, (d) export incentives, (e) perquisite received during the course of business or profession, (f) interest, salary, bonus, remuneration, etc. received by a partner of a firm which is allowable under section 40(b) (g) sum received for not carrying out any activity in relation to business or not shares any know-how, patent, etc. and (h) amount received under Keyman Insurance policy. It will now be necessary to ascertain from the assessee about any receipts under these heads, which have not been credited to profit and loss account

and state such amounts in this clause. Clauses 13 (b), (c) & (d) require information in respect of items which may also be covered under Section 28 and as such will also fall in clause 13 (a) However, those items which are reported in clauses 13(b), (c) and (d) need not be reported in clause 13 (a). The tax auditor may have to obtain a management representation in writing from the assessee in respect of all items falling under this clause.

The details of the following claims, if admitted as due by the concerned authorities but not credited to the profit and loss account, are to be stated under sub-clause (b)

(a) Proforma credits

(b) Drawback

(c) Refund of duty of custom

(d) Refund of excise duty

(e) Refund of sales tax

In respect of items failing under sub-clause (b) the tax auditor should examine all relevant correspondence, records and evidence in order to determine whether any particular refund/claim has been admitted as due and accepted during the relevant financial year.

There may be practical difficulties in verifying the information in regard to such refunds and credits. It may, therefore, be necessary for the tax auditor to scrutinise the relevant files or subsequent records relating to such refunds while verifying the particulars and also obtain an appropriate management representation.

The words 'admitted by the concerned authorities' would mean 'admitted by the authorities within the relevant previous year'.

The system of accounting followed in respect of these particular items may also be brought out in appropriate cases. If the assessee is following cash basis of accounting, it should be clearly brought out, since the admittance of claims during the relevant previous year without actual receipt has no significance in cases where cash method of accounting is followed. Credits/claims which have been admitted as due after the relevant previous year need not be reported here.

Where such amounts have not been credited in the profit and loss account but netted against the relevant expenditure/income heads, such fact should be clearly brought out.

Under sub-clause (c), the escalation claims accepted during the previous year but not credited to the profit and loss account dare to be stated. The escalation claims accepted during the year would normally mean "accepted during the relevant previous year". If such amount has not been credited to the profit and loss account the fact should be brought out. The system of accounting followed in respect of this particular item may also be brought out in appropriate cases. If the assessee is following cash basis of accounting with reference to this item, it should be clearly brought out since acceptance of claims during the relevant previous year without actual receipt has no significance in cases

where cash method of accounting is followed.

Escalation claims would normally arise pursuant to a contract (including contracts entered into in earlier years), if so permitted by the contract. Only those claims to which the other party has signified unconditional acceptance could constitute accepted claims. Mere making of claims by the assessee or claims under negotiations or claims which are sub-judice *CIT v. Hindustan Housing & Development Trust Ltd. (1986) 161 ITR 524* (SC) cannot constitute claims accepted.

Sub-clause (d) covers any other items which the tax auditor considers as an income of the assessee based on his verification of records and other documents and information gathered, but which has not been credited to the profit and loss account. In giving the details under sub-clauses (c) and (d), due regard should be had to AS-9 - Revenue Recognition.

The tax auditor should scrutinise all the items including casual and non-recurring items appearing in the books of account, particularly the credit items, and ensure himself whether any such credit which is the nature of income has been credited to the profit and loss account or not.

Under sub-clause (e), capital receipt, if any, which has not been credited to the profit and loss account has to be stated. The tax auditor should use his professional expertise and judgement in determining whether the receipt is capital or revenue. The tax auditor may also indicate various judicial pronouncements on which he has relied.

The following is an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under this sub-clause.

(a) Capital subsidy received in the form of Government grants, which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g., Capital Investment Subsidy Scheme.

(b) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.

(c) Compensation for surrendering certain rights.

(d) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

14. Particulars of depreciation allowable as per the Income tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form :

(a) Description of asset/block of assets.

(b) Rate of depreciation.

(c) Actual cost or written down value, as the case may be.

(d) Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use ; including adjustments on account of -

(i) Modified Value Added Tax credit* claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March, 1994,

(ii) change in rate of exchange of currency, and

(iii) subsidy or grant or reimbursement, by whatever name called.

(e) Depreciation allowable.

(f) Written down value at the end of the year.

Having regard to the nature of requirements prescribed, it may be necessary for the tax auditor to examine:

(a) Classification of the asset.

(b) Classification thereof to a block.

(c) The working of actual cost or written down value.

(d) The date of acquisition and the date on which it is put to use.

(e) The applicable rate of depreciation.

(f) The additions / deductions and dates thereof.

(g) Adjustments required - specified as well as on account of sale, etc.

For the purpose of determining the rate of depreciation, the tax auditor has to examine the classification of assets into various blocks. Once the classification has been ascertained and checked properly, the rates applicable as per the Income tax Rules, 1962 follow as a natural corollary. The tax auditor must have due regard to the Income tax Rules, 1962, relevant clarifications from the Department and judicial decisions. If there is any dispute with regard to the classification, or the rate of depreciation applied, the tax auditor must give his working with suitable reasons.

The additions/deductions during the year have to be reported with dates. The tax auditor is advised to get the details of each asset or block of asset added during the year or disposed of during the year with the dates of acquisition/disposal. Where any addition was made, the date on which the asset was put to use is to be reported. In respect of deductions, the sale value of the assets disposed of along with dates should be mentioned. From assessment year 2002-03 the depreciation shall be allowed mandatorily whether it is claimed or not. This principle applies to additional depreciation also.

15. Amounts admissible under sections 33AB, 33ABA, 33AC*(wherever applicable), 35, 35ABB, 35AC, 35CCA, 35CCB**, 35D,*35DD, 35DDA* and 35E:

(a) debited to the profit & loss account (showing the amount debited and deduction allowable under each section separately);

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* No deduction shall be allowed under this section for any assessment year commencing on or after 1st day of April, 2005.

** No deduction shall be allowed in respect of any expenditure incurred after 31st day of March, 2002.

(b) not debited to the profit and loss account.

[Clause 15 (a) and (b)]

The tax auditor should indicate the amount debited in the profit and loss account and the amount actually admissible in accordance with the concerned provisions of law. The amount not debited to the profit and loss account but admissible under any of the sections mentioned in the clause have to be stated. Sections 33AB and 33ABA allow deduction in respect of amount deposited in designated account for specified purposes which, as per accounting principles, are not to be debited to the profit and loss account. In this connection, the tax auditor has to work out, on the basis of the conditions prescribed in the concerned section, the amount admissible there under and report the same. Where the assessee is eligible for deduction under one or more of the above sections, the tax auditor has to state the deduction allowable under each section separately.

16. (a) Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36(l)(ii)].

(b) Any sum received from employees towards contributions to any provident fund or superannuation fund or any other fund mentioned in Section 2(24)(x); and due date for payment and the actual date of payment to the concerned authorities under Section 36(l) (va).

The requirement is only in respect of the disclosure of the amount and the tax auditor is not expected to express his opinion about its allowability or otherwise. The tax auditor should verify, the contract with the employees so as to ascertain the nature of payments.

The tax auditor should get a list of various contributions recovered from the employees which come within the scope of this clause. He should also verify the documents relating to provident funds and other welfare funds. He should verify the agreement under which employees have to make contributions to provident fund and other welfare funds. The ledger account of contributions from employees should be reviewed, the due dates of payments and the actual dates of payment should be verified with the evidence available. In view of the voluminous nature of the information, the tax auditor can apply test checks and compliance tests to satisfy himself that the system of recovery and remittance is proper. Under this clause, details of the amount deducted, due date for payment and actual date of payment in respect of provident fund, ESI fund or other staff welfare fund have to be stated. However, in case of big assessees such as public sector undertakings, banks etc. where information to be stated is voluminous, the tax auditor may exercise his professional judgement and state only those cases under this clause where actual date of payment to the concerned authorities is beyond the due date of payment and state this fact by way of a suitable note.

17. Amounts debited to the profit and loss account, being:

(a) expenditure of capital nature;

(b) expenditure of personal nature;

(c) expenditure on advertisement in any souvenir, brochure tract, pamphlet or the

like, published by a political party;

(d) expenditure incurred at clubs,-

(i) as entrance fees and subscription

(ii) as cost for club services and facilities used;

(e) (i) expenditure by way of penalty or fine for violation of any law for the time being in force;

(ii) any other penalty or fine;

(iii) expenditure incurred for any purpose which is an offence or which is prohibited by law;

(f) amounts inadmissible under section 40(a);

(g) interest, salary, bonus, commission or remuneration inadmissible under Section 40(b)/40(ba) and computation thereof;

(h) (A) whether a certificate has been obtained from the assessee regarding payments relating to any expenditure covered under Section 40A(3) that the payments were made by account payee cheques drawn on a bank or account payee bank draft, as the case may be; [Yes/No]

(B) amount inadmissible under Section 40A(3), read with rule 6DD [with break-up of inadmissible amounts];

(i) provision for payment of gratuity not allowable under Section 40A(7);

(j) any sum paid by the assessee as an employer not allowable under Section 40A(9);

(k) particulars of any liability of a contingent nature;

(l) amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income.

(m) amount inadmissible under the proviso to section 36(1)(iii)

Clause 17(a): This clause requires the tax auditor to state the amount of expenditure incurred by the assessee in respect of various items listed therein. These expenses may be allowable or may not be allowable or maybe allowable subject to certain limits. It is important to note that the amount of expenditure in respect of each of the items is required to be stated. Accordingly, tax auditor will have to obtain the information and make necessary enquiries in that behalf. It may necessitate review of books of account, basis of classification, groups under which such expenses have been debited, and so on.

Clause 17(b): Personal expenses debited to the profit and loss account are to be specified under this sub-clause as they are not deductible in the computation of total income under Section 37.

Clause 17(c): Section 37(2B) provides that no allowance shall be made in respect of

expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. Therefore, the expenditure of this nature should be segregated and reported under this clause.

Clause 17(d): The amount of payments made to clubs by the assessee during the year should be indicated under this clause. The payments may be for entrance fees as well as membership subscription and for catering and other services by the club, both in respect of directors and other employees in case of companies and for partners or proprietors in other cases. The fact whether such expenses are incurred in the course of business or whether they are of personal nature should be ascertained. If they are personal in nature, they are to be shown separately under Clause 17(b) referred to earlier.

Clause 17(e): In this clause, sub-clause (i) covers only penalty or fine for violation of any law for the time being in force, while sub-clause (ii) covers any other penalty or fine. The tax auditor should obtain in writing from the assessee the details of all payments by way of penalty or fine for violation of any law as have been made and paid or incurred during the relevant previous year and how such amounts have been dealt with in the books of account produced for audit. The tax auditor may not be aware of the intricacies of all the laws of the land. It must be borne in mind that the tax auditor while reporting under this clause is not required to express any opinion as to the allowability or otherwise of the amount of penalty or fine for violation of law. He is only to give the details of such items as have been charged in the account. This clause covers only penalty or fine and not the payment for contractual breach or for redressal of contractual wrongs. While stating the particulars under this clause, the tax auditor should take into consideration the concept of materiality.

Clause 17(f): Section 40(a) specifies certain amounts which shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession". They are as follows:

(i) Any interest, royalty, fees for technical services or other sum chargeable under the Income tax Act, which is payable outside India or in India to a non resident, not being a company or to a foreign company on which tax has not been deducted or after deduction has not been paid before the expiry of the time prescribes under section 200(1) and in accordance with other provisions of Chapter XVII B.

(ii) Any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident or amounts payable to a contractor or sub-contractor, being resident for carrying out any work (including supply or labour for carrying out any work) on which tax is deductible under Chapter XVII-B and such tax has not been deducted or, after deduction has not been paid on or before the due date specified in sub-section (1) of section 139.

(iii) Any sum paid on account of securities transaction tax.

(Iv) Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.

(v) Any sum paid on account of wealth tax.

(vi) Any payment which is chargeable under the head "salaries", if it is payable outside India or to a non resident and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

(vii) Any payment to a provident or other fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangement to secure that tax shall be deducted at source from any payment made from the fund which are chargeable to tax under the head "Salaries".

(viii) Any tax actually paid by an employer referred to in Clause (10CC) of section 10.

Clause 17(g): *The tax auditor has to verify whether the assessee has complied with the provisions.The tax auditor is required to state the inadmissible amount and such information is also required to be given in respect of interest/ remuneration paid to a member of an Association of persons (AOP) / Body of individuals (BOI). The word "inadmissible' implies that the tax auditor will have to examine the facts, apply the conditions for allowance or disallowance and accordingly determine the prima facie inadmissibility of the deduction and also quantify the same.*

Clause 17(h): This is an amendment to the existing sub-clause (h) of clause 17. The Taxation Laws (Amendment) Act, 2006 has amended Section 40A(3) w.e.f 13th July, 2006 to provide that the payment for expenditure is made only by account payee cheque or account payee bank draft. The present provision of allowing the expenditure in case the payment has been made by crossed cheque/bank draft has been discontinued. It should be noted that the reporting requirements under this clause arise only after 13th July 2006.

There may be practical difficulties in verifying the payments made through crossed/account payee cheque or bank drafts. If no proper evidence for the verification of the payment by the crossed/ account payee cheque or draft is available, such a fact could be brought out by appropriate comments as suggested in the Supplementary Guidance Note.

The earlier sub-clause (h) required furnishing of the amount inadmissible under Section 40A(3) read with rule 6DD along with computation. The amended sub-clause requires disclosure of amount inadmissible under Section 40A(3) read with rule 6DD with the break-up of inadmissible amount.

Wherever possible individual items of inadmissible expenses may be given. However where, in view of the large volume of transactions, it is not possible to give individual items of inadmissible amounts, the tax auditor may furnish such details under broad heads of accounts.

Clause 17(i): The tax auditor should call for the order of the Commissioner of Income-tax granting approval to the gratuity fund, verify the date from which it is effective and also verify whether the provision has been made as provided in the trust deed.

In case the provision made for payment of gratuity is not allowable under Section 40A(7), the same is to be stated under this sub-clause.

Clause 17(j): Under Section 40A(9) any payment made by an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of

individuals, society registered under the Societies Registration Act, 1860, or other institutions (other than contributions to recognised provident fund) is not allowable. The tax auditor should furnish the details of payments which are not allowable under this section.

Clause 17(k): The tax auditor may look into particular items of contingent liabilities of the earlier year in order to determine whether or not any items has been charged to the profit and loss account of the current year and if so, whether the liability continues to be contingent in nature. Wherever necessary, a suitable note should be given by the tax auditor as to the non-availability of such particulars relating to the contingent liabilities.

Clause 17(l):This is a new clause inserted by notification No. 208/2006. It is primarily the responsibility of the assessee to furnish the details of amounts of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income, which does not form part of the total income. The method of ascertaining the inadmissible expenditure as and when prescribed should be followed. The tax auditor has to verify the details furnished by the assessee and should satisfy himself that the inadmissible amounts have been worked out correctly. Where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under the Act and does not furnish the necessary particulars for the purpose of ascertaining the inadmissible expenditure under Section 14A, the tax auditor has to make a proper disclaimer qualification. Attention is invited to SA 580, Written Representations which is as under.

"During the course of an audit, management makes many representations to the auditor, either unsolicited or in response to specific enquiries. When such representations relate to matters which are material to the financial Information, the auditor should;

a) seek corroborative audit evidence from sources inside or outside the entity;

b) valuate whether the representations made by management appear reasonable and consistent with other audit evidence obtained, including other representations; and

c) consider whether the individuals making the representation can be expected to be well informed on the matter."

Clause 17(m): This is a new clause inserted by notification No.208/2006. The requirements of sub-clause (m) are applicable in respect of capital borrowed for acquisition of an asset for extension of the existing business or profession. The assessee has to furnish the details of amount inadmissible under the proviso to Section 36(1) (iii). The tax auditor has to verify the correctness of the particulars furnished by the assessee with the documentary evidence.

Clause 17A- Amount inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006: This is a new clause inserted by the Central Board of Direct Taxes through its Notification No. 36/2009 dated 13-4-2009, in the Form No.3CD in Appendix II of theIncome-tax Rules, 1962.

The tax auditor is required to state the amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006. The Micro, Small and Medium Enterprises Development Act, 2006 (MSME Act) is an Act to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto.

Section 23 of the MSME Act lays down that an interest payable or paid by the buyer, under or in accordance with the provisions of this Act, shall not for the purposes of the computation of income under the Income-tax Act,1961 be allowed as a deduction.

The inadmissible interest has to be determined on the basis of the provisions of the MSME Act. Section 16 of the MSME Act provides for the date from which and the rate at which the interest is payable. Accordingly, where a buyer fails to make payment of the amount to the supplier, as required under section 15, the buyer shall , notwithstanding anything contained in any agreement between the buyer and the supplier or any law for the time being in force, be liable to pay compound interest with monthly rests to the supplier on that amount from the appointed date or, as the case may be, from the date immediately following the date agreed upon, at three times of the bank rate notified by the Reserve Bank.

The tax auditor while reporting in respect of clause 17A should take the following steps:

(a) The auditor should seek information regarding status of the enterprise i.e. whether the same is covered under the Micro, Small and Medium Enterprises Development Act, 2006. Where the information is available and has been disclosed the same should be reported as such in Form No. 3CD. Where the information is not available the auditor should also mention the same in the Form No.3CD.

(b) Since Revised Schedule VI and Section 22 of the Micro, Small and Medium Enterprises Development Act, 2006 requires disclosure of information, the tax auditor should cross check the disclosure made in the financial statements.

(c) Obtain a full list of suppliers of the assessee which fall within the purview of the definition of "Supplier" under section 2(n) of the Micro, Small and Medium Enterprises Development Act, 2006. It is the responsibility of the auditee to classify and identify those suppliers who are covered by this Act.

(d) Review the list so obtained.

(e) Verify from the books of account whether any interest payable or paid to the buyer in terms of section 16 of the MSME Act has been debited or provided for in the books of account.

(f) Verify the interest payable or paid as mentioned above on test check basis.

(g) Verify the additional information provided by the auditee relating to interest under section 16 in his financial statement.

(h) If on test check basis, the auditor is satisfied, then the amount so debited to the profit and loss account should be reported under clause 17A.

Where the tax auditor, upon due verification, finds that the auditee has neither provided for nor paid any interest payable under the MSME Act, the no amount is inadmissible under section 23 of MSME Act. In such a case 'Nil' can be reported against clause 17A.

18. Particulars of payments made to persons specified under Section 40A(2)(b): Section 40(A)(2) provides that expenditure for which payment has been or is to be made to certain specified persons listed in the section may be disallowed if, in the opinion of the Assessing Officer, such expenditure is excessive or unreasonable having regard to:

(i) the fair market value of the goods, services or facilities for which the payment is made; or

(ii) for the legitimate needs of business or profession of the assessee; or

(iii) the benefit derived by or accruing to the assessee from such expenditure.

19. Amounts deemed to be profits and gains under Sections 33AB or 33ABA or 33AC: Sections 33AB and 33ABA lay down the circumstances under which amount withdrawn from such deposit account covered thereby for the purpose other than specified purposes is to be deemed income chargeable as profit and gains of business. The tax auditor is required to report such amounts. Likewise, Section 33AC allows deduction in respect of reserve created out of the profit of the assessee engaged in shipping business to be utilised in accordance with the provision of sub section (2) of Section 33AC. Sub section (3) thereof lays down the circumstances in which the amount of reserve account shall be deemed to be the profit and gains chargeable to tax. The tax auditor should verify the amount withdrawn from the deposit account for purposes other than specified purposes. Similarly, he should verify whether the reserve created under Section 33AC and utilised not in accordance with the provisions of Sub-section (2) of Section 33AC has been properly disclosed. However, consequent to the amendment made by the Finance (No.2) Act, 2004, no deduction shall be allowed under section 33AC for any assessment year commencing on or after 1stday of April, 2005.

20. Any amount of profit chargeable to tax under Section 41 and computation thereof: The tax auditor should obtain a list containing all the amounts chargeable under Section 41 with the accompanying evidence, correspondence, etc. He should in all relevant cases examine the past records to satisfy himself about the correctness of the information provided by the assessee. The tax auditor has to state the profit chargeable to tax under this section. This information has to be given irrespective of the fact whether the relevant amount has been credited to the profit and loss account or not. However, if the amount has already been credited to the profit and loss account, the tax auditor should mention the fact. The computation of the profit chargeable under this clause is also to be stated.

21. (i)* In respect of any sum referred to in clause (a), (b),(c), (d), (e) or (f) of section 43B, the liability for which:

   (A) pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was

      (a) paid during the previous year;

      (b) not paid during the previous year;

   (B) was incurred in the previous year and was

      (a) paid on or before the due date for furnishing the return of income of the previous year under Section 139(1);

      (b) not paid on or before the aforesaid date.

* State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost etc. is passed through the profit and loss account.

Section 43B has been significantly amended by the Finance Act, 2001 and Finance Act, 2003. Consequent to the above amendments an uniform treatment is being given in respect of all sums specified in clauses (a) to (f) of section 43B including clauses (b). Therefore, the duty of the tax auditor is restricted to reporting under clause 21(i) (A) and (B).

Section 43B provides that notwithstanding anything contained in any other provisions of the Act, the following amounts shall be allowed as deduction in computing the business income of an assessee in the previous year in which such amounts are actually paid:

(a) Any tax, duty (sales tax, excise duty, municipal tax, etc.), cess or fee payable by the assessee under any law for the time being in force.

(b) Employer's contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.

(c) Any bonus or commission payable by the assessee to its employees.

(d) Interest on any loan or borrowing from any public financial institution, a state financial corporation or a state industrial investment corporation payable in accordance with the terms and conditions of the agreement governing such loan or borrowing.

(e) Any sum payable by the assessee as interest on any loan or advances from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan or advances.

(f) Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee.

First proviso to section 43B provides that nothing contained in this section shall apply in relation to any sum which is actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income under section 139(1) in respect of previous year in which the liability to pay such sum was incurred as aforesaid and the evidence of such payment is furnished by the assessee along with such return.

In the case of an assessee maintaining its accounts on the mercantile system, the tax auditor should verify the aforesaid particulars, from the books of account for the year under audit as well as from the books of account, vouchers and documents of the immediately succeeding assessment year so that the information about the aforesaid payments made in the subsequent year can be furnished.

The above particulars are required irrespective of the fact whether they have been debited to profit and loss account or not and such a fact should be stated under this clause. The tax auditor is not required to determine any admissible or inadmissible amount(s).

22. (a) Amount of Modified Value Added Tax* credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Modified Value Added Tax credits in the accounts.

(b) Particulars of income or expenditure of prior period credited or debited to the profit and loss account.

* Now CENVAT

Clause 22 (a): The tax auditor should check relevant statutory records viz. RG-23 (both reports) maintained under the Central Excise Rules and ascertain the amount of credit on inputs availed and utilised during the previous year. He should verify that there is proper reconciliation between balance of MODVAT credits in the accounts and RG-23. In so far as the reporting of accounting treatment of MODVAT credit is concerned the clause requires that its treatment in profit and loss account and the treatment of outstanding MODVAT credit in the account have to be reported upon.

The tax auditor may consider reporting under this clause in the following manner :

	Capital Goods	*Others*
Balance representing CENVAT credits as at the beginning of the year		
CENVAT credit available during the year		
Less amount of CENVAT credit utilised during the year		
Balance representing outstanding amount as at the end of the year.		

Clause 22(b): It may be noted that information under this clause would be relevant only in those cases where the assessee follows mercantile system of accounting. Under cash system of accounting, expenses debited/income credited to the profit and loss account would be current year's expenses/income even though they may relate to earlier years. The tax auditor should obtain the particulars of expenditure or income of any earlier year debited or credited to the profit and loss account of the relevant previous year when mercantile system of accounting is followed. In the case of a person whose accounts of the business or profession have been audited under any other law, the information may be readily available from annual accounts. In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, however, a close scrutiny of the ledger in regard to the period for which expenditure or income is entered in the account books may be necessary.

23. Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque. [Section 69D]

For this purpose, the tax auditor should obtain a complete list of borrowings and repayments of hundi loans otherwise than by account payee cheques and verify the same with the books of account.

There will be practical difficulties in verifying the loan taken or repaid on hundi by account payee cheque. In such cases, the tax auditor should verify the borrowing/repayments with reference to such evidence which may be available and in the absence of conclusive or satisfactory evidence, he should make a suitable comment in his report as suggested below which is exactly similar to the one suggested in respect of expenditure paid otherwise than through an account payee cheque [Section 40A(3)].

"It is not possible for me / us to verify whether the amounts borrowed on hundi or any amount

due thereon (including interest on the amount borrowed) were repaid otherwise than by crossed cheque or bank draft, as the necessary evidence is not in the possession of the assessee".

24 (a)* Particulars of each loan or deposit in an amount exceeding the limit specified in Section 269SS taken or accepted during the previous year

(i) name, address and permanent account number (if available with the assessee) of the lender or depositor;

(ii) amount of loan or deposit taken or accepted;

(iii) whether the loan or deposit was squared up during the previous year;

(iv) maximum amount outstanding in the account at any time during the previous year;

(v) whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or an account payee bank draft.

(b) Particulars of each repayment of loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year:

(i) name, address and permanent account number (if available with the assessee) of the payee;

(ii) amount of the repayment;

(iii) maximum amount outstanding in the account at any time during the previous year;

(iv) whether the repayment was made otherwise than by account payee cheque or account payee bank draft.

(c) Whether a certificate has been obtained from the assessee regarding taking or accepting loan or deposit, or repayment of the same through an account payee cheque or an account payee bank draft. [Yes/No]

The particulars (i) to (iv) at (b) and the Certificate at (c) above need not be given in the case of a repayment of any loan or deposit taken or accepted from Government, Government company, banking company or a corporation established by a Central, State or Provincial Act.

[Clause 24 (a), (b) & (c)]

Clause 24(a): Particulars of each loan or deposit falling within the scope of this section as mentioned above taken or accepted during the previous year have to be stated under this sub-clause. This sub-clause requires five specific particulars in respect of each loan or deposit including the permanent account number of the lender, if available.

* (These particulars need not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act.)

The tax auditor should obtain the above details from the assessee in respect of each loan or deposit and verify the same from the records maintained by him.

Clause 24(b): This sub-clause requires particulars of each repayment of loan or deposit in an amount exceeding the limits specified in section 269T. Section 269T is attracted where repayment of the loan or deposit is made to a person, where the aggregate amount of deposits held by such person either in his own name or jointly with any other person on the date of such repayment together with interest, if any, payable on such deposits is ₹ 20,000 or more. As such, all repayments made to any person where the loan or deposit along with interest is ₹ 20,000 or more are to be reported under this sub-clause, even though the amount of repayment may be less than ₹ 20,000. The tax auditor should verify such repayments and report accordingly. The second proviso to section 269T inserted by the Finance Act, 2003 w.e.f. 1.6.2002 excluded repayments of loans taken from Government, Government company, Banking company, corporation established by a Central , State or Provincial Act, etc. from the scope of the above section and therefore the tax auditor need not report such repayments in his reports. However, section 269T does not exclude Government companies, banking companies from the scope of its applicability. As such, details of repayment are to be shown in the case of these entities also.

Clause 24(c): The tax auditor has to state whether a certificate has been obtained from the assessee regarding taking or accepting loan or deposit , or repayment of the same through an account payee cheque or an account payee bank draft. The mere obtaining of such certificate does not reduce the responsibility of the tax auditor to verify the compliance with the provisions of section 269SS and 269T. The auditor should verify the information obtained from the assessee with the bank statements and other relevant records and if such verification is not possible then such fact should be reported.

25. (a) Details of brought forward loss or depreciation allowance, in the following manner, to the extent available.

Serial Number	Assessment Year	Nature of loss/ allowance (in rupees)	Amount as returned (in rupees)	Amount as assessed (given reference to relevant order)	Remarks

(b) whether a change in shareholding of the company has taken place in the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of Section 79.

For giving the above information, the auditors should study the assessment records i.e. income tax returns filed, assessment orders, appellate orders and rectification/revisional orders for the earlier years and ascertain if the figures given in the above clause are correct.

The Comparison of the composition of the shareholding is to be given with refernce to the last day of the current previous year and the last day of every previous year in which the loss was

incurred. The carry forward of the loss incurred in respect of different previous years is to be determined with respect to the individual previous years. This comparison can be done by referring to the Register of members and also the relevant records available to the tax auditor.

26. Section-wise details of deductions, if any, admissible under Chapter VIA

Chapter VIA of the Income Tax Act deals with various deductions which have to be given effect to by way of allowance from gross total income of the assessee and they have been categorised under the Act as follows:

A.. Deduction in respect of certain payments.

B. Deduction in respect of certain incomes.

C. Other Deductions.

As stated earlier, the tax audit report in Form No.3CA/3CB relates to business or professional activity of the assessee covered by Section 44AB. Form No.3CD is an annexure to this Form giving particulars relating to the, business/profession covered by the tax audit report. Therefore, the requirement under clause 26 relating to the deductions admissible under Chapter VIA will have to be restricted to the items appearing in the books of accounts audited by the tax auditor, If the tax auditor is giving tax audit report in respect of the accounts of a particular branch or a particular unit he will have to examine the particulars relating to deduction admissible under Chapter VIA with reference to the books of account of that branch or that unit which is audited by him. Similarly when the tax auditor is giving report on tax audit of the head office he will have to take into consideration the tax audit reports of the branches as well as other units of the assessee which may have been audited by the other tax auditors, He will have to consider the particulars of deductions admissible under Chapter VIA with reference to the particulars given by the tax auditor of other branches/units and also particulars of such deductions from books of the head office.

27. (a) Whether the assessee has complied with the provisions of Chapter XVII-B regarding deduction of tax at source and regarding the payment thereof to the credit of the Central Government Yes/No]

(b) If the provisions of Chapter XVII-B have not been complied with please give the following details*, namely:

		Amount
(i)	Tax deductible and not deducted at all	.....
(ii)	Shortfall on account of lesser deduction than required to be deducted	.....
(iii)	Tax deducted late	.....
(iv)	tax deducted but not paid to the credit of the Central Government	.....

Clause 27 (a): The newly inserted clause 27 is different from the earlier clause. In the earlier clause the requirement was with reference to the tax deducted at source but not paid to the

credit of the Central Government in accordance with the provisions of Chapter XVII-B. The new clause requires reporting on the compliance with the provisions of Chapter XVII-B regarding deduction of tax at source and payment thereof to the credit of the Central Government; Thus, the scope of reporting under the new clause is much wider. This reporting requirement is to be read with the specific non-compliances stated under clause (b).

While reporting under this clause the tax auditor may exercise his judgment in the light of the applicable laws and report accordingly about the compliance of this provision. The tax auditor may rely upon the judicial pronouncements while taking any particular view. In case of difference of opinion between the tax auditor and the assessee, the tax auditor should state both the viewpoints. Further, in view of the voluminous nature of the transactions, the tax auditor can apply tests checks and compliance tests for verifying the information required to be provided under this clause.

Clause 27(b): Under clause (i),(ii) and (iii) of clause 27(b) the tax auditor has to verify the particulars regarding tax deductible and not deducted at all. It is extremely difficult for the tax auditor to verify each and every transaction in this regard. Therefore, while verifying such transactions, the tax auditor can apply the concepts of materiality and test checks. The reporting requirement in clause (b) arises where the tax auditor is not satisfied as to the compliance by the auditee with the provisions of the Chapter XVII-B regarding deduction of tax at source and the payment thereof to the credit of the Central Government. Such non-compliance is required to be reported under sub-clause (i), (ii), (iii) and (iv).

28. (a) In the case of a trading concern, give quantitative details of the principal items of goods traded :
    - (i) Opening stock;
    - (ii) Purchases during the previous year;
    - (iii) Sales during the previous year;
    - (iv) Closing stock;
    - (v) shortage/excess, if any.

    (b) In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products:

    A. Raw materials:
    - (i) opening stock;
    - (ii) purchases during the previous year;
    - (iii) consumption during the previous year;
    - (iv) sales during the previous year;
    - (v) closing stock;

(vi)* yield of finished products;

(vii)* percentage of yield;

(viii)* shortage/excess, if any.

B. Finished products/By-products:

(i) opening stock;

(ii) purchases during the previous year;

(iii) quantity manufactured during the previous year;

(iv) sales during the previous year;

(v) closing stock;

(vi) shortage/excess, if any.

Clause 28(a): The tax auditor should obtain certificates from the assessee in respect of the principal items of goods traded, the balance of the opening stock, purchases, sales and closing stock and the extent of shortage/excess/damage and the reasons thereof.

Clause 28(b): This information should be given only in respect of those items where it is practicable to do so, having regard to the records maintained by the assessee. In other cases, the tax auditor may indicate in his report that the relevant records were either not maintained or were inadequate for the purpose of furnishing the requisite information.

29. In the case of a domestic company, details of tax on distributed profits under Section 115O in the following form:

(a) total amount of distributed profits;

(b) total tax paid thereon;

(c) dates of payment with amounts.

Section 115O provides for a special levy to the extent of 12.5% plus surcharge, if any, on the amount of dividend declared, distributed or paid by domestic company whether such dividend is out of current profit or accumulated profits. Vide this clause the tax auditor has to report on profit distributed during the financial year, and therefore, the amount of tax paid on such distributed profit and the dates and amount of payment against this clause.

30. Whether any cost audit was carried out, if yes, enclose a copy of the report of such audit [See Section 139(9)]

The tax auditor should ascertain from the management whether cost audit was carried out and if yes enclose the copy of the report of such audit. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of any material observation made in such cost audit report which may have relevance to the tax audit conducted by him. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out.

* Information may be given to the extent available.

31. Whether any audit was conducted under the Central Excise Act, 1944, if yes, enclose a copy of the report of such audit.

The tax auditor should ascertain from the management whether any audit was conducted under the Central Excise Act, 1944 and if such audit was carried out, obtain the report, if available and enclose the copy of the report of such audit. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of any material observation made in such excise audit report which may have relevance to the tax audit conducted by him. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out.

32. Accounting ratios with calculations as follows:

    (a) Gross profit/Turnover;

    (b) Net profit/Turnover;

    (c) Stock-in-trade / Turnover;

    (d) Material consumed/Finished goods produced.

These ratios have to be calculated only for assessees who are engaged in manufacturing or trading activities. This clause is not applicable to assessees carrying on profession. Moreover, the ratios have to be given for the business as a whole and need not be given product wise. Further, the ratio mentioned in sub-clause (d) need not be given for trading concern.

While calculating these ratios, the tax auditor should assign a meaning to the terms used in the above ratios having due regard to the generally accepted accounting principles. All the ratios mentioned in this clause are to be calculated in terms of value only

Audit approach and reporting responsibilities

1. In formulating the audit approach towards reporting on truth and correctness of the particulars contained Form No.3CD, it is necessary to understand the rationale behind the introduction of the provisions

2. In carrying out an audit the tax auditor is primarily concerned with verifying that the transactions of the business, as entered in the books of account, are recorded in a manner such that the financial statements drawn up there-from reflect a true and fair view of the state of affairs of the enterprise on a given date.

3. In carrying out the verification, an issue would arise in determination of the head of expenditure which could be a matter of a subjective view. Thus certain items of expenditure could be looked at from different perspectives and the appropriate head of expenditure would be determined in accordance with the approach and policy adopted in this regard.

   For example, expenditure on providing helmets or certain uniforms or umbrellas to employees may be intended to provide an amenity to the employees. Another possibility of the same expenditure is that the expenditure is incurred primarily with the objective of reducing potential expenditure/loss arising from injury or illness. The accounting head to

be debited for recording such expenditure could be staff welfare or kit expenses. This decision would depend primarily on the approach adopted.

It would be difficult to categorically say that any one of these approaches is incorrect. As per generally accepted accounting principles and practices, whichever is the policy adopted, so long as it reflects the substance of transaction, the same should be accepted for the purposes of determining the appropriate head of expenditure for forming an opinion.

4. Adoption of this approach would mean that the underlying objective of the expenditure should be considered and not merely the apparent objective. In determining whether or not certain expenditure falls within the specific clauses of heads mentioned, this aspect would be important.

5. In formulating the audit approach towards reporting on true and correctness of the particulars contained in Form No.3CD, it is necessary to understand that the tax auditor would need to apply reasonable tests on the information prepared by the auditee.

6. The expression "true and fair" is widely understood though not defined even by the Companies Act, 1956. On the other hand, the words "true and correct" lay emphasis on factual accuracy of the information. In this context reference is invited to AS-1 and AS(IT) – I relating to disclosure of accounting policies. These standards recognize that the major considerations governing the selection and application of accounting policies are (i) prudence, (ii) substance over form and (iii) materiality. Therefore, while giving the particulars, considering the nature of expenditure to be given in the Annexure to Form No.3CD, the aspect of materiality should be considered.

7. In giving his report the tax auditor will have to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require, considering the contents of the audit report. He will have to conduct the audit by applying the generally accepted auditing procedures, which are applicable for any other audit. He can apply the test checks depending on the type of internal control procedures followed by the assessee/employer. The tax auditor will also have to keep in mind the concept of materiality depending upon the circumstances of each case. He would be well advised to refer to (SA-320) "Audit Materiality" issued by the ICAI. If the statutory tax auditor of an auditee is also appointed to undertake tax audit, it is advisable to carry out both the audits concurrently.

8. The audit report given under this section is to assist the income-tax department to work out the correct value. In order that the tax auditor may be in a position to explain any question which may arise later on, it is necessary that he should keep detailed notes about the evidence on which he has relied upon while conducting the audit and also maintain all his working papers. Such working papers should include his notes on the following, amongst other matters:

   (a) work done while conducting the audit and by whom;

   (b) explanation and information given to him during the course of the audit and by whom;

(c) decision on the various points taken;

(d) the judicial pronouncements relied upon by him while drafting the audit report; and

(e) certificates issued by the client / management letters.

The requirements of documentation and peer review concepts are applicable in respect of tax audit conducted by chartered accountants. For this purpose attention is also invited to SA 230 – Audit Documentation, which provides that the tax auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

9. It is important that the audit working papers prepared and / or obtained by the tax auditor provide evidence that:

(i) the opinion expressed by the tax auditor in respect of the particulars given in is based on the examination made by him;

(ii) in arriving at his opinion, the tax auditor has given due cognizance to the information and explanations given by the assessee and that his opinion is not arbitrary;

(iii) the information and explanations obtained were full and complete that is, the tax auditor has called for all the information and explanations which were necessary to be considered before arriving at his opinion; and

(iv) the tax auditor did not merely rely upon the information or explanations given by the auditee/assessee but that he subjected such information and explanations to reasonable tests to verify their accuracy and completeness.

10. The tax auditor is required to report whether the particulars contained are "true and correct". It is essential to note that it is the primary responsibility of the assessee to prepare the information in such manner so that the tax auditor can verify the compliance thereof. The tax auditor is required to verify that no items have been omitted in the information furnished to him and reasonable tests checks would reveal whether or not the information furnished is correct. The extent of check undertaken would have to be indicated by the tax auditor in his working papers and audit notes. The tax auditor would be well advised to so design his tax audit programme as would reveal the extent of checking and to ensure adequate documentation in support of the information being certified.

11. The tax auditor in terms of the requirements of audit under section 44AB of the Act is required to report whether in his opinion the particulars in respect of Form No.3CD, are true and correct.

12. The audit procedures help the tax auditor in forming his opinion; and the audit report is the culmination of the tax auditor's audit exercise and conclusions reached by him. The audit report is a medium through which the tax auditor communicates the results of his findings to the users. It is, therefore, essential that the audit report contains a clear expression of the tax auditor's opinion on the subject matter under audit. The attention of the members in this regard is invited to (SA) 700 - "Forming an Opinion and Reporting on Financial Statements" issued by the ICAI contain the basic principles to be followed by

the tax auditor while giving his audit report, including the basic elements of an audit report. However, the tax auditor, pursuant to tax audit under section 44AB of the Act, is required to submit his report in Form No.3CA or 3CB, as the case may be. These forms have been prescribed under the Rules. Nevertheless, paragraph 6 of SA-700 clearly states that where the regulator prescribes the form in which the tax auditor should issue his report, the tax auditor should report in the form prescribed by the regulator in addition to the requirements of SA-700. Thus, while reporting in the Form Nos. 3CA and 3CB, the tax auditor should enquire that the report among other things complies with the requirements of SA-700. For example, those relating to the basic elements of the tax auditor's report, such as title, addressee, introductory paragraph, scope paragraph, opinion paragraph, date of report, place of signature, membership number and tax auditor's signature.

13. Form Nos. 3CA and 3CB require the tax auditor to report whether in his opinion and to the best of his information and according to the explanations given to him, are true and correct. As a result of his audit procedures, the tax auditor may reach a conclusion that the particulars have been correctly identified and reported In such a situation, the tax auditor would give an unqualified opinion stating as under:

    "In my opinion and to the best of my information and according to the explanations given to me and considering the materiality the particulars given Form No.3CD are true and correct".

14. In terms of the principles laid down in SA-700, a qualified opinion should be expressed when an auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with the management is not so material and pervasive as to require an adverse opinion, or a limitation on scope is not so material and pervasive as to require a disclaimer of opinion. In other words, the tax auditor should express an adverse opinion when the effect of a disagreement is so material and pervasive that the tax auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the information contained in Annexure II. A disclaimer of opinion should be expressed when the possible effect of limitation on scope is so material and pervasive that the tax auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion. Thus, the decision as to the kind of modified report to be issued would depend upon the materiality of the item/amount in question.

15. The tax auditor, while issuing a modified report, should give full information about the subject matter of his qualification and not merely create grounds for suspicion or inquiry and leave it to the readers to ascertain facts by diligent inquiry. Thus, the tax auditor's report should contain a clear description of all the substantive reasons and unless impracticable, a quantification of the items under qualification.

15.4 Audit Provisions under VAT Law

Some of the major States who have introduced VAT on 1.4.2005 and some other States which are in waiting to implement VAT have incorporated audit provisions in their VAT Legislations.

Some of the important features of these provisions along with the eligibility of the professionals to undertake the audit function and their supportive role for the successful implementation of the VAT system are dealt with in following paragraphs.

15.4.1 Necessity of audit : Like majority of the developing economies our country is also facing the problem of lack of education and awareness about tax laws, more particularly amongst the trading community. Further, the VAT System of taxation is new to them. Since the trading community is not educated enough and equipped to understand the implications of the VAT system of taxation immediately, there is every possibility that they may not be in a position to arrange their business affairs to fall in line with the requirements of the State Level VAT, calculate and discharge their exact tax liability under the VAT Law. On the other hand, the tax administrator i.e. the authorities in the taxation department also find themselves devoid of sufficient resources to educate the tax payers and inform them about the procedural and accounting changes that are necessitated by the implementation of VAT system.

Another reason for prescribing an audit under the VAT law by a Chartered Accountant, is that under the VAT system a major thrust is to be laid on the 'self assessment' meaning thereby that the tax liability calculated and paid by the tax payers through their periodical returns will be accepted by and large and the tax payers will not be called to substantiate the tax liability shown by them in the returns by producing books of account and other relevant material. The assessments with books of account will be an exception. Therefore there is a strong need to see that the tax payers discharge their tax liability properly while filing the returns. This can be ensured only where the particulars furnished by the tax payers are verified by an independent auditor in minute details by going not only through the books of account but also by analysing and interpreting the provisions of the State-Level VAT Laws and reporting, whether any under-assessment was made by the dealer requiring additional payment or whether there was any excess payment of tax warranting refund to the tax payer. In most of the countries tax evasion is rampant under the existing tax systems. In India too evasion of excise and sales-tax is estimated to be very high. If no audit is prescribed under VAT law, the chances of evasion of VAT tax will increase causing revenue leakage for the Government. It is, therefore, essential that the audit of the proposed VAT system is attempted on a regular basis. However, it is not possible to conduct the audit of all the VAT dealers. Therefore, the criteria for audit can be the amount of turnover or the class of dealer dealing in specified commodities.

The concept of audit is popular even in foreign countries where the system of VAT is in practice since long in the field of indirect taxation. In countries like France and Korea the audit has proved to be an effective tool to check the evasion of tax, which was mostly done by producing fake invoices etc.

Since VAT is a new concept, some of the States want to keep the procedural formalities to the minimum. Hence at the initial stage their law makers refrain from keeping any audit provisions in their Act and rules. Perhaps, this may be due to the initial stage of introduction of VAT. But most of the States, keeping in mind the importance of audit, have incorporated the audit provisions since inception.

15.4.2 The role of the tax auditor *:* The role of tax auditor in the initial years of

implementation of VAT would be that of an adviser to the taxpayers. This role will cast upon him the responsibility to educate and guide the auditee regarding the maintenance of proper records and in assisting the auditees in maintaining accounting records in such a manner as to get the information needed for filing of return without delay and extra efforts. In playing the advisory role the auditor will have to help in devising a proper accounting system as will generate the required information regarding the output tax, input tax credit etc. While doing so the auditor may take the guidance from the guidance notes issued by the Institute of Chartered Accountants of India, New Delhi.

The role of tax auditor vis-a-vis the tax administrators is that the auditor while discharging his function finds out whether the turnover of sales/purchases is shown correctly in the returns and is backed up by the accounts and other relevant documents; the deductions claimed by the tax payer from the turnover of sales are genuine and are supported by valid documents; the claim of input tax credit has been properly made i.e. it has not been claimed on the higher side or on such purchases, which are not eligible for grant of input tax credit. There may be certain instances wherein at the time of purchases the goods might have been eligible for set-off and accordingly the same was claimed in the returns but subsequent events might have rendered the input tax credit in admissible. In such circumstances, it should be the responsibility of the VAT auditor to state whether the inadmissible input tax credit has been reversed or not and if not, he has to point it out in his report. Thus to a certain degree the VAT auditor is expected to assist the VAT administrators in the proper quantification of tax liability of the tax payer and see that State exchequer gets its revenue which is legally due.

15.4.3 Preparation for tax audit under VAT*:* A tax auditor has to make certain preliminary preparations before the actual execution of tax audit under the VAT law. The major steps required to be undertaken for the preparation are as under:

(i) Knowledge of business - After accepting the audit assignment the auditor should familiarize himself with the business of the auditee. In this regard, the auditor should refer to the SA 315- "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment" issued by the Council of the Institute of Chartered Accountants of India. Before starting the audit, the auditor should have a preliminary knowledge of the industry/ business and of the nature of ownership, management etc. More detailed information should be obtained and should be assessed and updated during the course of audit. For this purpose the various sources of information may be tapped. The knowledge of business is important not only to the auditor but also to his staff engaged in the audit. The auditor has to ensure that the audit staff assigned to an audit engagement obtains sufficient knowledge of the business to carry out the audit work delegated to them and further they should make effective use of the knowledge about the business and should consider how it affects the tax liability reported in the return. The facts and figures in the returns should be consistent with the auditor's knowledge of the business. The auditor should also make himself familiar with the process of production and the distribution chain. The auditor should also obtain information about whether the auditee is a manufacturer/ importer/ retailer, the details of major customers to whom the sales are effected and the details of sales which are

outside the scope of VAT law. Similarly the sources of purchase and the items sold should be listed out. Further it should be ascertained whether the auditee has opted for the composition scheme or not.

(ii) Obtaining a list of all the accounting records maintained by the auditee - The auditor should obtain a complete list of all the accounting records relating to sale/purchase of goods, stocks, the various registers, the ledgers etc. maintained, in which the transactions are recorded, the various source documents in which the entries are recorded in the books of account and the process of their generation.

(iii) Ascertaining the major accounting policies adopted by the auditee - The auditor should know the major accounting polices based on which books of account have been recorded. The accounting policy regarding recording of sales, purchases and valuation of inventory must be made known and the auditor should also find out whether there has been any change in those policies during the year covered by audit. If there is any significant change in the accounting policy giving rise to some material effect on the tax liability, the same should be invariably reported.

(iv) Evaluation of internal control etc. - Before determining the extent of audit checks to be applied i.e. whether to go in- depth or to do only test check, the auditor should ascertain whether there is an internal check system in operation in the entity. He should particularly find out how the purchases and sales gets initiated and ocused ized. For example, in case of purchase, receipt of indent by the purchase department, determining the need for purchases, initiation of purchase order, receipt of material, preparation of MRN, entries made in the books of accounts etc. should be verified. For sales, receipt of inquiry, acceptance of sales order, execution of sales, preparation of sale invoice and realization of transaction. If the internal control is reliable, the extent of audit may be reduced and should be focused only on those areas where the auditor feels that greater degree of audit risk is involved.

(v) Knowledge about the VAT law and allied laws - The auditor and his staff should obtain a thorough knowledge of the State VAT law under which the audit is to be conducted. The auditor should study the VAT law starting from the definition of various terms, the procedure to be adopted, the provisions regarding issue of invoices, claiming of input tax credit, composition schedule in the VAT law, the manner in which the output tax is to be calculated the provisions of audit, the contents of the audit report, the periodicity of the return to be filed, the format of the forms of returns, and the various notifications issued. Further the auditor should know the Central Sales-tax law as he has to comment on the liability under that law also. The auditor should also have some knowledge about the judicial pronouncements made by the Tribunals and the Courts on the various facets of these laws.

15.4.4 Approach to tax audit under VAT: The audit approach of the tax auditor under the value added tax system will be more or less similar to the approach, which is adopted by the auditor while conducting the tax audit under the provisions of section 44AB of the Income-tax Act, 1961. However, the reporting requirements vary to a considerable extent.

While the auditor has to apply the basic principles of audit he has to keep in mind that the requirements of VAT audit are different and accordingly he should design his audit programme.

While designing the audit program the auditor has to ensure that the program includes the performance of such audit checks as would generate the information which would enable him to ensure the following and also to draw his audit reports.

(i) The turnover of sales /purchases of goods has been properly determined keeping in view not only the generally accepted accounting policies but the definition of turnover of sales in the relevant VAT law. The sales turnover arrived at by applying the generally accepted accounting policies may not be the same as required under the VAT law. To take an example, the sale proceeds of a fixed asset will not form a part of turnover or sales as per the generally accepted accounting policies but will form a part of turnover or sales for the purpose of VAT law. Similarly the price of goods returned is deducted from the turnover or sales even if the returns are from the sales effected in the previous years, while under VAT law, the goods returned are to be deducted only if they are made within the prescribed time, say six months from the date of sale. Thus, the results of the audit procedure adopted by the auditor should be such as will give him a reasonable assurance regarding the figures of sales reported in the returns. Not only that, he should also be able to get the exact quantum of the sales under reported or over reported duly classified for different tax rates and its impact on overall tax liability. The sales as per the financial statements may include the turnover or sales effected by all the branches, but for the purposes of VAT law the turnover or sales of only those branches will be included which are included in one registration certificate.

(ii) The turnover of purchases should be tested by applying audit checks as will enable the auditor to get the purchases eligible for grant of input tax credit segregated from other purchases. Further, the purchases on which the input tax credit is available in full and the purchases on which it is available partially should also be ascertained correctly. Thereafter, the auditor should get the exact amount of input tax credit available, compare the same with the credit claimed in the returns and report on the excess/short claim of the credit in the returns filed.

(iii) The auditor is also required to comment on the timely filing of the returns under the VAT law. For this purpose the auditor is expected to list out the due dates of filing of returns and find out the reasons for delay in filing the returns if any.

(iv) The auditor is also required to give his report on the composition scheme. He should apply such compliance tests as will be enable him to ascertain that the auditee is eligible for composition, it has paid the requisite composition fee and all the procedural formalities in relation thereto have been complied with.

(v) The auditor has to give his report on the TDS. Therefore, such tests are to be applied as will enable him to report on the applicability of TDS provisions, the accuracy of the amount deducted and paid, timely issue of TDS certificate and filing of TDS returns.

(vi) The auditor is also expected to check the consolidation of the returns filed for all the periods covered in the year under audit, both under the State-Level VAT law and the Central Sales-

tax Act, 1956. These returns are to be compared with the books of account and the documentary evidences available. The auditor is expected to apply such substantive steps as would enable him to judge whether all the transactions relating to sale and purchase are entered in the books of account and have been taken into consideration while filing the returns. In case of any inconsistency a proper reconciliation of book figures and the returned figures should be made and also the correct quantification of tax liability is to be done.

The above are only the major areas which are to be tested by the auditor while conducting the tax audit under VAT laws. The auditor has to take a judgement of his own regarding the adequacy and appropriateness of the audit checks to be applied and the areas where the tests are to be applied, so as to give him all the information needed to form a view not only on the authenticity of the books of account, correctness of the returns filed but also in the quantification of tax liability.

15.4.5 Audit report under the VAT law : All State-Level VAT laws have been framed by following a common VAT law Module suggested by the Central Government. Further the Empowered Committee which pioneered the concept of model VAT law based on certain common principles also insisted that the basic framework of all the VAT laws in the various States should be common. It is felt that there should be a common design for VAT Audit Report also so that the auditor should not find it difficult to conduct the audit and the reports can be made more meaningful and comprehensible to all. The Institute of Chartered Accountants of India has already taken a major initiative in this direction and has already developed a standard format of the audit report. The standard format of audit report was also submitted to the Empowered Committee. States can take the benefit of the same and incorporate the format of the audit report suggested by the ICAI in their VAT laws.

At the end of the audit the auditor has to arrive at his conclusion on the matters to be reported in the audit report. The format of the audit report is generally prescribed under the relevant VAT law and the auditor has to fill in all the columns of the audit report that are applicable. While performing the audit under VAT law the auditor is expected to conduct the audit presuming himself to be the tax assessor. His audit report will therefore have to be comprehensive commenting on each and every aspect which goes to the root of quantification of tax liability. The auditor is expected to give his opinion on the adequacy of accounting records, correctness and completeness and arithmetical consistency of returns filed. Further he has to State the basis of his opinion on the accounts, financial statements and the documents verified by him to arrive at the above conclusion. The auditor is also expected to give the summary of additional tax liability/additional refund arising on his verification of the returns together with the books of account. While the auditor is giving a general opinion on the truth and fairness of books and account he can make a qualified opinion or an unqualified opinion. He can also report to disclaimer where he finds that the accounting records were insufficient to enable him to frame either a unqualified opinion or a qualified opinion.

So far as the comment on the variation of tax liability is concerned the auditor has to quantify exactly the amount by which the liability increases or decreases. He has also to State the transactions against which there is variation in tax liability. Therefore, either he has to State that the

tax liability shown in the return is correct or is incorrect and to what extent. Thus, an amount of certification of tax liability is involved therein which casts greater responsibility on the auditor.

Several State VAT Legislations have provided for audit of accounts by chartered accountants. Such audit becomes necessary whenever the turnover of the assessee exceeds the prescribed limit under the relevant State VAT Legislations. In this context the ICAI has developed a model State VAT Audit report. Maharashtra VAT legislation has also prescribed a form of audit report and also the details to be furnished along with the audit report. The audit report and the prescribed details are largely similar to the Model VAT Audit report developed by the ICAI. The objective of furnishing such details is to help the VAT authorities to determine the correct turnover and also to satisfy themselves whether the VAT has been remitted properly to the credit of the State *Government. Wherever applicable such particulars have* to be verified by the Chartered accountants. Such verification ensures that the input VAT credit has been claimed by the assessee in a proper manner.

Annexure I

By virtue of Notification No.280, dated November 16, 2004 issued by CBDT the tax auditor is now required to annex to Form No.3CD a "Statement of Particulars" in the prescribed form The said Statement has two parts, viz. Part A and Part B.

Part A contains general particulars and Part B requires following particulars to given:

- Paid-up share capital/ capital of partner/ proprietor
- Share application money/ Current account of Partner or Proprietor,
- Reserves and surplus/ Profit and Loss Account
- Secured loans
- Unsecured loans
- Current liabilities and provisions
- Total of balance sheet
- Gross turnover/ Gross receipts
- Gross profit
- Commission received
- Commission paid
- Interest received
- Interest paid
- Depreciation as per boos of account
- Net profit (or loss) before tax as per the Profit and Loss account
- Taxes on income paid/provided for the books.

Format of Financial Statements: The tax auditor of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited has to give

his report in Forms No. 3CB/3CD and will have to ensure that the financial statements i.e. balance sheet and profit and loss account/ income and expenditure statement, are prepared in such a manner that adequate information which is necessary to convey a true and fair view of the state of affairs of the assessee is given. So far as a person whose accounts of the business or profession have been audited under any other law is concerned, the information to be given in the financial statements is normally provided in the particular statute by which the assessee is governed, since there is no such legislation in respect of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, it is necessary to achieve some uniformity in respect of information to be provided in the financial statements.

Annexure II

Notification No.208/2006 dated 10th August, 2006 has also inserted an Annexure II to Form No.3CD which requires the tax auditor to report the value of fringe benefits in the terms of section 115WC read with section 115WB for the relevant Assessment year.

This annexure II is still to be updated by CBDT as provisions relating to FBT are abolished by the Finance Act 2009.