

# Analysis of the Scope of Audit and Auditors' Responsibility under GST Law



*This article concentrates on the extent of scope and responsibilities of Auditors under GST law. In this regard, the article analyses the definition of audit provided under GST law and refers to the role and responsibilities of an auditor as per various judicial pronouncements. Further, the article scrutinises the scope as laid down in the GST law and explained the meaning of the phrase “verify the correctness of” to understand the extent of liability of auditors. There are several inherent limitations which do not allow an auditor to prove/verify the accuracy/correctness of the information to be certified. Therefore, the article suggests measures to mitigate auditor’s liability arising from carrying out GST Audit and appropriate disclosures to be made by the auditor, which would help the auditor to lessen the burden cast by the onerous definition of audit under GST Act.*

As per Section 35 (5) of the Central Goods and Services Tax Act, 2017 (hereinafter referred to as “the CGST Act”), and the *pari materia* provisions under the respective State GST Laws and Integrated Goods and Services Tax Act, 2017

(hereinafter referred to as “the IGST Act”), every registered person whose turnover during the financial year exceeds the prescribed limit shall get his accounts audited by a chartered accountant or a cost accountant.

Further, as per Section 44 of the CGST Act, every registered person is liable to furnish an annual return for every financial year, electronically along with copy of audited annual accounts and reconciliation statement, reconciling the value of supplies declared in the return furnished for the financial year along with the audited financial statement.



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In a nutshell, following are the requirements in relation to annual audit and annual return under GST Law:-

1. Preparation of annual return in form GSTR - 9/9A/9B
2. Preparation of reconciliation statements in Form 9-C
3. Audit of annual accounts
4. Submissions of copy of audited annual accounts with the annual return.
5. Submissions of duly certified reconciliation statements in Form 9-C

This article concentrates on the scope of audit and auditors' responsibility under the GST Law.

### Definition of Audit under GST

At the outset, let's refer to the definition of audit as contained in Section 2 (13) of the CGST Act, which reads as under:-

#### *Section 2: Definitions*

*In this Act, unless the context otherwise requires. -*

13. "audit" means the examination of records, returns and other documents maintained or furnished by the registered person under this Act or the rules made thereunder or under any other law for the time being in force to verify the correctness of turnover declared, taxes paid, refund claimed and input tax credit availed, and to assess his compliance with the provisions of this Act or the rules made thereunder.

This definition of audit can be conveniently segregated into two parts-

1. "audit" means the examination of records, returns and other documents maintained or furnished by the registered person under this Act or the rules made thereunder or under any other law for the time being in force, and
2. to verify the correctness of turnover declared, taxes paid, refund claimed and input tax credit availed, and to assess his compliance with the provisions of this Act or the rules made thereunder.

The first part represents the process of audit and the second part represents the scope of audit. As is evident, the process of audit is as ordinarily expected from an auditor to follow. However, in authors' views, the expectation in the second part is far more than what an auditor could be ordinarily expected to perform in an audit. To further elaborate, the scope of audit is -

**to verify the correctness of turnover declared, taxes paid, refund claim and inputs tax availed, and to assess the compliance of the registered person with the provisions of the GST Act or the rules made thereunder.**

Before we proceed to further scrutinise the scope as laid down by the above referred definition, we first refer to the role and responsibilities of an auditor as per the various judicial pronouncements.

- An auditor is expected to discharge his duties with reasonable caution and care.<sup>1</sup>
- The test is the standard of ordinary skilled man exercising and professing to have the special skills.<sup>2</sup>
- While performing his duties, an auditor is to act as a "watchdog" and not as a "bloodhound".<sup>3</sup>
- Performance of duty by an auditor is not to be judged with the hindsight, and one has to bear in mind the facts available at the time when the auditor performed his duty.<sup>4</sup>
- While performing his duties, an auditor is perfectly justified in acting on the opinion of an expert where special knowledge is required.<sup>5</sup>

Since the expression used in definition of "audit" is "to verify the correctness of", it is important to ascertain the true scope of this expression. This expression is not defined under the GST Act. Therefore, the meaning of the said expression is to be derived from the normal dictionary meaning. For this purpose, we refer to the meaning of the terms "verify" and "correct" as appearing in English dictionaries.

<sup>1</sup> *Tri-sure India Ltd.* [1987] 61 Comp Cas 548 Bom; *London and General Bank, In re* (No. 2) [1895] 2 Ch 673

<sup>2</sup> *Supra*

<sup>3</sup> *Kingston Cotton Mill Co., In re* (No. 2) [1896] 2 Ch 279

<sup>4</sup> *City Equitable Fire Insurance Co. Ltd. In re* [1925] 1 Ch 407

<sup>5</sup> *Fomento (Sterling Area) Ltd.* [1958] 1 WLR 45 (HL)

Sl. No.	Name of the Dictionary	Verify	Correct
1.	<i>Webster's Encyclopedic Unabridged Dictionary</i>	<ol style="list-style-type: none"> <li>To prove the truth of, as by evidence or testimony; confirm; substantiate.</li> <li>To ascertain the truth or correctness of, as by examination, research, or comparison.</li> </ol>	<ol style="list-style-type: none"> <li>to set or make true, accurate, or right; remove the errors or faults from: The native guide corrected, our pronunciation. The new glasses corrected his eyesight.</li> <li>to point out or mark the errors in: The teacher corrected the examination papers.</li> </ol>
2.	<i>The New International Webster's Comprehensive Dictionary</i>	<ol style="list-style-type: none"> <li>To prove to be true or accurate; substantiate; confirm</li> <li>To test or ascertain the accuracy or truth of</li> </ol>	<ol style="list-style-type: none"> <li>To rectify or remove error from; make right.</li> <li>To point out the errors; set right.</li> </ol>

From the bare reading of the dictionary meanings, it can be seen that verify means to prove something, or to show something to be true.

The expression "correct" also refers to being accurate, or right. Reading these terms together in the phrase "to verify the correctness of" would mean to prove the accuracy of the turnover declared, taxes paid, refund claimed and input tax credit availed. However, we need to remind ourselves that we are dealing with one of the most complex legislations i.e. GST Law, and therefore, it is rather easy to say that an auditor is required to prove the accuracy/correctness of the four most important and integral constituents of GST Law, but practically it is very difficult because there are several inherent limitations which cannot allow an auditor to prove/verify the accuracy/correctness of the said attributes. Few of the limitations are as follows: -

- GST Law involves several interpretational issues. Even an assessing authority cannot vouch for the correctness of the assessment made by him and some other authority/court may take a different view on the very same facts.
- While audit is performed on the basis of financial statement containing financial data/ transactions, GST is also imposed on non monetary transactions. Reference in this regard may be made to transactions between distinct persons, which are without consideration, and therefore, are not recorded in the financial statements. In respect of such transactions, an auditor can only provide his judgement/

opinion, but cannot verify the correctness thereof.

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- Financial statements are prepared at entity level, whereas GST is administered on a State-wise registration basis. While auditing from the perspective of a particular registration, which would be for a particular state, the financial data prepared at entity level would be subjected to fragmentation for that state on some logical basis. However, the accuracy of audit findings would have the inherent limitation of correctness with respect to which the data have been fragmented.
- An auditor would be performing the audit on a date which may be much later than the period for which the audit is being conducted. For example, for the period ending on 31.03.2018, the form for filing of the reconciliation statement/audit report was not available on the common portal till April 2019. Thus, it can be seen that the auditors would be appointed only after that, and the audit would be done further later. Thus, much time would have elapsed

from the period under audit, and the actual date of audit. This may lead to loss/corruption/manipulation of data, which itself would be the limitation of audit. The auditor can only give his opinion as regards the financial data being presented, and cannot verify the completeness/correctness of the same.

5. Even otherwise, an auditor is a professional who applies his professional education and practical experience to form his views/opinion on the financial statements/data. He cannot be expected to guarantee that his opinion regarding the state of affairs or regarding the existence of certain facts would be correct.
6. The auditing standards prescribed by the ICAI are considered to be auditing standards under the Companies Act, 2013. In this regard, reference is made to the following:

*Section 2(7) – auditing standards means the standards of auditing or any addendum thereto for companies or class of companies referred to in sub-section (10) of section 143;*

*Section 143*

*(9) Every auditor shall comply with the auditing standards.*

*(10) The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority: Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.*

7. The auditor is neither expected to nor is capable of reducing the audit risk to zero. Reference in this regard is invited to Para A-45 of SA-200 issued by the ICAI.

*A45 The auditor is not expected to, and cannot, reduce audit risk to zero and*

*cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:*

- *The nature of financial reporting;*
- *The nature of audit procedures; and*
- *The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.*

Amidst the above limitations, it may be observed that the definition of audit provided for by the legislature under GST is too demanding, and is far from being realistic. **An auditor cannot be expected to provide absolute assurance, which the definition seems to expect from him.**

**Amidst the limitations explained in this article, one may observe that the definition of audit provided for by the legislature under GST is too demanding. An auditor cannot be expected to provide absolute assurance, which the definition seems to expect from him.**

In authors' view, if at all the requirement is to "verify the correctness", it can only be regarding the *arithmetical accuracy*. To substantiate it further, we refer to the Companies Act, 1956, wherein the expression "true and fair" was inserted in place of the phrase "true and correct". In this regard, the Ld. Author *A. Ramaiya*, in his celebrated book - *Guide to the Companies Act - 18<sup>th</sup> Edition*, has stated that the expression true and correct would be interpreted as implying that the auditor had to merely examine whether the financial statements were arithmetically correct and corresponded to the figures in the books of account and that he was not required to examine whether the financial statements represented a fair state of affairs and working results.

However, since the definition is appearing in a taxing statute, and nowadays public authorities are considering a very high degree of responsibility on the part of the auditors, it is needed that the

issue is followed up with the Government and the definition is amended.

### Measures for Mitigating Auditor's liability

It is suggested that it is important for the individual auditors to mitigate their liability arising from carrying out the GST Audit. It is quite necessary that appropriate disclosures are made by the auditor, which would help the auditor lessen the burden cast by the onerous definition. The disclosures can be divided into following categories:-

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1. **Disclosure by the Client:** The initial days of GST had seen lots of errors in the returns. Since the GSTN does not allow rectification of erroneous return filed in form GSTR-3B, the error, if any, is required to be corrected by adjustment in the subsequent return when the error comes to the knowledge of the assessee. This way, there are numerous differences in the monthly figures appearing in returns compared with those appearing in the books of account.

Since the GST audit is for whole financial year, it is advisable that a self certified reconciliation statement between the books of account and the GSTR-3B return be obtained from the client, explaining these differences. In case of short payment for the period of audit, the said explanation may be given by the client along with payment of tax short paid and interest. This would help the client mitigate issuance of show cause-cum-demand notice, and would help the auditor to use the explanation given by the client in his audit. Even in the audit report, the auditor may mention this fact of furnishing the reasons for difference by the client.

2. **Disclosure regarding legal issues:** While performing the GST audit, an auditor may find that on a particular issue there are different views possible. The auditor may disclose the said issues in his audit report itself along with the basis on which the client / assessee is

taking a particular position. Further, in cases where the auditor feels the need, he may also seek opinion of experts to check the tenability of position taken by the client.

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3. **Disclosure regarding facts:** In the course of audit, if the auditor comes across any peculiar facts, which in his opinion are material and should be disclosed for better appreciation, the auditor may disclose the same in the audit report.
4. **Disclosure of scope/ limitation:** As elaborated above, there are several limitations of audit. It is advisable that the auditor discloses these limitations in his audit report.
5. **Disclosure of Method of Doing Audit:** Ordinarily, an auditor performs the audit on test check basis, which is universally accepted and is also prescribed by the governing body of chartered accountants namely ICAI. The auditor should also disclose the methods/ basis of auditing followed by him and the inherent risks associated with the method.
6. **Obtaining Engagement Letter:** It is also recommended that the auditor should obtain the proper engagement letter from the client setting forth clearly, the scope of services to be performed by the auditor *inter alia* specifying the scope of limitation and the methods which the auditor would employ in performance of his responsibility. ■

#### References :

1. *Tri-sure India Ltd. [1987] 61 Comp Cas 548 Bom*
2. *London and General Bank, In re (No. 2) [1895] 2 Ch 673*
3. *Kingston Cotton Mill Co., In re (No. 2) [1896] 2 Ch 279*
4. *City Equitable Fire Insurance Co. Ltd. In re [1925] 1 Ch 407*
5. *Fomento (Sterling Area) Ltd. [1958] 1 WLR 45 (HL)*
6. *Guide to the Companies Act - 18<sup>th</sup> Edition by A. Ramaiya*