

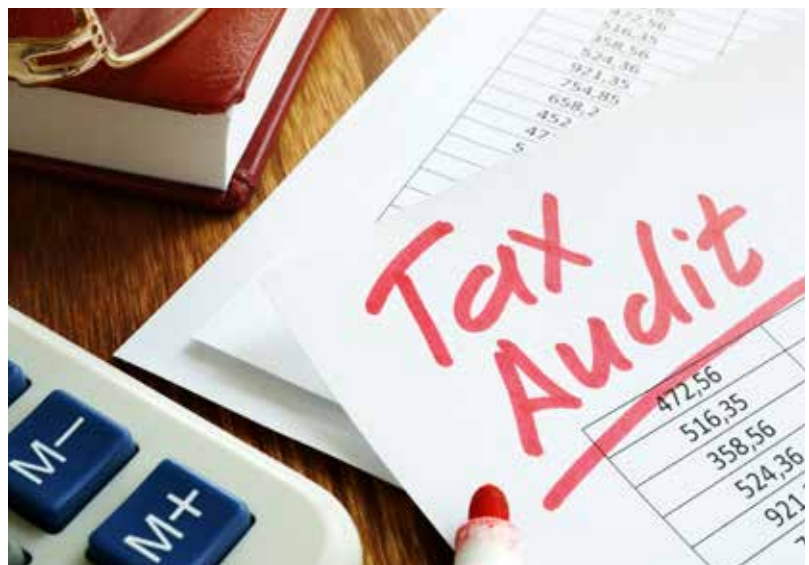
Strengthening Tax Audit - Enhancing Reporting Quality

Tax Audit under section 44AB of the Income tax Act, 1961 is one of the core areas of practice for Chartered Accountants. Considering the expertise and domain knowledge of Chartered Accountants, the onerous responsibility of Tax Audit was casted on Chartered Accountants through the Finance Act, 1984 to support the tax department in correct assessment of income. The dynamic nature of taxation laws, time and again, led to changes in the reporting requirements of tax audit report. The reporting has been effectively used by the Income-tax Department to make correct assessment of income of an assessee.

ICAI has from time to time provided guidance on tax audit matters to its members through Guidance Notes and Technical guides through its Direct Taxes Committee. Apart from providing guidance, ICAI also has a regulatory role to play. Continuing with its commitment to serve the nation and in order to improve the reporting of compliances under various taxation laws (both Direct as well as Indirect), the Council of the Institute constituted the Taxation Audits Quality Review Board (TAQRB) in the year 2018. It was envisaged that the reviews carried out by the Board will help the members to exercise greater diligence while certifying various reports prescribed under the taxation

laws and in long run would improve the overall reporting and certification done by them. There is a three tier review conducted by the Board. During this process of review of tax audit reports, the Taxation Audits Quality Review Board of ICAI has come across certain commonly found irregularities/non-compliances.

Some of them, which need specific attention of members, have been mentioned in this article. While some important have been detailed, others have been just listed down for reference purposes. It is important for our members to take a note of these non-compliances or commonly found irregularities so as to ensure qualitative reporting.



Contributed by Secretariat, Taxation Audits Quality Review Board (TAQRB) of ICAI. They can be reached at taqrb@icai.in and eboard@icai.in.

I. FORM NO. 3CA / FORM NO. 3CB

1. Form to be filed

As per Rule 6G of the Income Tax Rules, 1962 the report of audit of the 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.

Accordingly, the assessee who are required to get their accounts audited under Companies Act, 2013 are required to furnish the report under section 44AB in Form No. 3CA. In the case of entities including companies having their accounting year which is different from the financial year (as per Income Tax Act), accounts of the financial year are required to be prepared and audited and in such case the audit report shall be in Form No. 3CB.

Non-compliances or commonly found irregularity:

Tax audit reports for some corporates having accounting year same as financial year also have filed reports in Form No. 3CB which is contrary to the provisions of law.

2. Revised SA 700, Forming an Opinion and Reporting on Financial Statements

Para 11.9 of the Guidance Note on Tax Audit under Section 44AB of the Income-Tax Act, 1961- ICAI had pursuant to the issuance of the Revised SA 700, Forming an Opinion and Reporting on Financial Statements, prescribed a revised format of the auditor's report on financial statement. Since Form No. 3CA and Form No. 3CB are required to be filed online in a preset form and the same are not in line with the requirements of SA 700, there is no specifically allocated field for providing information relating to the respective responsibilities of the assessee and the tax auditor as required in terms of the principles laid out in SA 700. However, having regard to the importance of these respective responsibility paragraphs from the perspective of the readers of the tax audit report, it is suggested that these respective responsibility paragraphs relating can be provided in the space provided for giving observations, etc., Para 3 of Form No. 3CA or Para 5 of Form No. 3CB as the case may be.

The illustrative Assessee's responsibility paragraph and Tax Auditor's responsibility paragraphs in respect of Form No.3CB has been given in the Guidance Note. The same are to be suitably reworded to meet the situation envisaged in Form No.3CA.

Non-compliances or commonly found irregularities:

- a) *Many of the Tax Audit reports do not have the paragraphs relating to Assessee's responsibility and Tax Auditor's responsibility as required by the Guidance Note in respect of SA 700.*
- b) *Some of the tax audit reports contained a reference about the attached physically signed tax audit reports which mention these Paragraphs thereby complying with the requirement of SA 700. However, as per the Guidance Note on Tax Audit the same are specifically required to be mentioned / reported under clause (3) of Form No.3CA or Clause (5) of Form No.3CB, as the case may be.*

3. Observations/Comments/ Discrepancies/ Inconsistencies by Auditor

Para 14.5 of the Guidance Note on Tax Audit under section 44AB of the Income-tax Act, 1961- "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 realize the impact of such qualifications."

Also as per Para 15.5 of the Guidance Note on Tax Audit under section 44AB of the Income-tax Act, 1961:

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, “NIL” should be reported in this part of paragraph 3. The tax auditor may then give his report as required by sub-paragraphs (A), (B), and (C) of paragraph 3 and paragraph 4.

Non-compliances or commonly found irregularities:

In certain tax audit reports that were examined, it has been observed that the qualification paragraph i.e. Para 3 of Form No.3CA or Para 5 of Form No.3CB, as the case may be, contained a reference to Notes to Form No. 3CD. These notes did not mainly contain the qualifications but also contain general additional information.

As per the Guidance Note (paragraphs mentioned above) only qualifications/ observations should be reported in the space provided in the Form No. 3CA/3CB itself while the additional information which are not in the nature of qualification could be attached as notes.

II. FORM NO. 3CD

a) Clause 2: As per the Guidance Note, the tax audit report should contain the address as has been communicated by the assessee to the Income-tax Department for assessment purposes as on the date of signing of the audit report. In certain tax audit reports ‘address’ reported under this clause, is different from

the one mentioned in Annual report or as registered under MCA which is expected to be the address with the Income tax Department.

b) Clause 4: This clause requires reporting of registrations under indirect tax law. In certain tax Audit reports, registrations under all the other Indirect Tax Laws which have been mentioned in CARO have not been reported under this clause. Also, in some cases, Registration no. based on PAN did not match with the PAN as reported under clause 3.

c) Clause 8: As per the provisions of the third proviso to section 44AB 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.

It was observed that in respect of the majority of tax audit report of companies (which are required to get their accounts audited under Companies Act, 2013) option (a) was selected [*Clause 44AB(a)-Total sales/ turnover/gross receipts in business exceeding specified limits*] instead of option “*Third Proviso to section 44AB: Audited under any other law*”.

d) Clause 10a: In few tax audit reports, codes for business or profession for principle line of each of the businesses have not been reported.

e) Clause 11a: Under section 44AA No Books of accounts are prescribed for a company. Also, the Companies Act, 2013 does not specifically prescribes books of accounts for a Company. However, in certain cases 'Yes' was reported under this clause which is not correct.

Clause 11b: The location of maintenance of Books of Accounts or records has not been specified in some tax audit reports. Location of server also has not been reported in case of maintenance of records in ERP based computer system. Also, the fact that the Books of Accounts are maintained in computer system is not mentioned in some cases.

Clause -11c: As per para 14.3 of GN, the auditor is required to examine not only the books of account but also the above stated documents directly related to transactions reflected in the books of account. The underlying documents would differ from assessee to assessee depending on the nature of activity carried on by them. Reference to such supporting evidence/ relevant documents is also required to be made under this clause.

It has been observed that all the relevant documents examined are not mentioned like Invoices, receipts, vouchers, bills, secretarial, confirmation, certificates, internal & external.

In many cases the term "etc." is used without the mention of detailed documents examined.

f) Clause 13e: Adjustments required to be reported under this sub-clause are not fully disclosed. While reporting is done in respect of some of the ICDS, others are just left blank. In order to ensure clarity, if no adjustments are there to be reported, "0" or "Nil" should be mentioned.

Clause 13f: This clause requires reporting of information pertaining to each ICDS notified (disclosures) and not only where any deviation from the notified ICDS is encountered. However, in few tax audit reports, reporting was done only where deviation from the notified ICDS was encountered and reported under clause 13e, which is not appropriate.

g) Clause 14a: The method of valuation of closing stock is to be stated under this clause. The method of valuation has not been mentioned separately for each item of stock. Also, in some cases reference was given in respect of annexure which was not attached.

Clause 14b: Inclusive method for valuation of inventory is prescribed under the taxation laws and thus effects of inclusion of duties & taxes are to be properly reported under this clause. It was observed that deviations from 145A remained to be reported while following exclusive method especially in case of corporates.

h) Clause 17: Reporting under this clause is required where any land or building or both is transferred during the previous year for a consideration *less than value* adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C. However, in some cases reporting under this clause was done when consideration received on transfer of land, or building, or both & the value adopted u/s 43CA or 50C *were same*, which was not required.

i) Clause 18d: In some cases the Amount of adjustment on account of Exchange Fluctuation (due to change of rate of exchange if any) for which a separate column is provided under Additions has not been shown in the TAR uploaded on the Income Tax department website while the same has been reported in the annexure attached to physically signed TAR.

j) Clause 21a: Penalty charged under various acts is to be shown separately for each Act which was not found in many tax audit reports.

Clause 21b: This clause requires reporting of Amounts inadmissible under section 40(a). The following discrepancies/ common errors were noticed.

- In certain cases the reporting has been done in respect of provision for various expenses of *sundry parties* under a random date. Since the amount is yet to be paid



Inclusive method for valuation of inventory is prescribed under the taxation laws and thus effects of inclusion of duties & taxes are to be properly reported

the date of crediting the amount of provision in the books of account should have been mentioned.

- Reporting under this clause is required separately for each of the individual payee. Consolidated reporting for the heads under which Tax has not been deducted has been done in certain cases which should not be done.
- Taxes deducted for resident and non-resident payee are to be reported appropriately under respective sub-clauses, which was not done in few cases.

Clause 21g: Particulars of contingent liabilities are to be reported and not provision created in the Books of accounts, which has been done in certain cases.

k) Clause 22: It was observed in many cases that interest paid to MSME mentioned in Annual Report was not reported in TAR.

l) Clause 23: This clause requires payments made to all the persons as specified u/s 40A(2)(b). In certain cases, the following common irregularities were observed:

- Name and PAN of related persons were not reported.
- The amount reported under this clause did not match with the amount as mentioned in Annual Report.
- Consolidated figures were reported instead of respective transaction with respective related party.

m) Clause 25: Details of all the amounts chargeable under section 41 is to be reported here, whether the same have been credited to the profit and loss account or not. In some cases it was evident from the annual report but not reported in tax audit report.

n) Clause 26: If excise duty is passed through profit & loss account, it has to be reported appropriately under this clause and clause 27a which was not done in many reports.

o) Clause 27a: This clause requires reporting of amount of Central 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 Central Value Added Tax credits in the account. In few Tax Audit reports computation shown under this clause was incorrect. Some reports did not

mention the CENVAT utilized while some missed reporting treatment of the same in Profit and Loss Account.

p) Clause 31a: Consolidated figures were reported under this clause instead of respective transaction with various parties.

Clause 31c: As per the Guidance Note on Tax Audit in case of company, *“loan or deposit” means any deposit of money which is repayable after notice or repayable after a period* and, for persons other than company, *includes loan or deposit of any nature*. In certain cases repayment of fixed deposits and term loans reflecting in Annual report were not reported.

q) Clause 32a: Section under which Assessment Order is passed, date of order and Demand Identification No. (DIN) is required to be reported under this clause. However, complete details were missing in many audit reports.

Clause 32b: Only *“Yes/No”* can be reported under this clause in respect of companies. However some tax audit reports of companies reported *“Not Applicable”*.

r) Clause 34a: The total of expenses as reported under this clause in TAR for specific heads like salary, rent etc. were not matching with the relevant figures in financial statements. A reconciliation of amount as per books of accounts and amount on which TDS/TCS is required to be deducted/collected could have been attached as notes.

Clause 34c: In certain cases, the date of payment with respective amount has not been mentioned under the relevant columns of this sub-clause.

s) Clause 35a: The following common irregularities were noticed:

- i) Details to be reported under this clause if “Trading” is one of the natures of business of the assessee as reported under clause 10a. The same has not been done in some reports.
- ii) Even if the closing stock of goods acquired for trading is “NIL” the quantitative details of opening, purchases & sales made during the year are required to be reported under this clause, which has not been done in certain cases.

Clause 35b: In certain cases where assessee is engaged in manufacturing, neither percentage of yield has been reported nor any qualification has been given in the Audit report.

t) Clause -40: The following was observed :

- i) As per the Guidance Note on tax audit “Sale proceeds of scrap, wastage etc. is to be included in the turnover unless treated as part of sale or turnover, whether or not credited to miscellaneous income account”. In certain

cases scrap sale was not considered while arriving at the turnover for TAR.

- ii) As per GN, *Net profit to be shown is net profit before tax*. However, in certain cases net profit after tax was reported under this clause.
- iii) In case of manufacturing units, reporting under sub-clause (e) – ratio of material consumed/ finished goods produced is required, which was missing in many reports.

III. OTHER GENERAL OBSERVATIONS

The following is to be considered in respect of reporting under clause 21d and 31a to 31e, as per GN- *Where the reporting has been done on the basis of the certificate of the assessee, the same shall be reported as an observation in Para 3 of Form No. 3CA and Para 5 of Form No.3CB, as the case may be.*

- a) In respect of sub clauses where no information is to be given, instead of leaving the same as blank, “Nil” “0” or “NA” could be mentioned for better reporting.
- b) If answer to any of the clause is reported in uploaded TAR it has to be reported same in physically signed TAR (if any).

“Sale proceeds of scrap, wastage etc. is to be included in the turnover unless treated as part of sale or turnover, whether or not credited to miscellaneous income account”.

CONCLUSION

The Taxation Audits Quality Review Board wherever finds any material/serious non-compliance, it may refer the case to the Director (Discipline) of the Institute of Chartered Accountants of India for initiating appropriate action against the tax auditor under the Chartered Accountants Act, 1949.

In cases where no material non-compliances are observed by the Board and only immaterial non-compliances are observed, the Board may not refer the case to the Director (Discipline) of ICAI, but appropriately bring the non-compliance to the attention of the tax auditor by way of an advisory.

The instances/discrepancies noticed by the Board which have been reported above have been appropriately dealt with. As per the Terms of reference of the Board, with a view to apprise the members of the Institute and others concerned about the major non-compliances observed during the review, the Board has compiled such non-compliances or commonly found irregularities in this article. In the interest of the profession and also the nation, the members may keep the above pointers in mind while reporting under section 44AB of the Income tax Act, 1961. ■■■



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ABOUT ICAI

The Institute of Chartered Accountants of India (ICAI) was established by an Act of Parliament in 1949 and since inception has proven its mark as an elite institution devoted to uphold the values of transparency, accountability and integrity. It has indeed come a long way, be it in terms of numbers, skills & utilities, recognition from society, or its role in nation building.

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