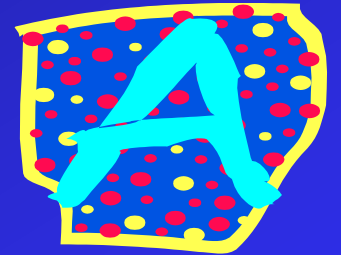


How to **handle** Departmental Audit under GST

22nd May, 2021



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**WIRC - VIRTUAL REFRESHER COURSE ON
INDIRECT TAX**

How to handle Departmental Audit

SCOPE

- Basic legal Provisions of department's audit
- Areas which the Department may check
- Preparatory measures
- On ground Handling

N.B. *Lecture not on the legal issues which the department may take up in scrutinising annual return, reconciliation statements, etc. but how you can prepare and handle the audit*

At this stage of the evolution of the law both the taxpayer and tax-gatherer are in the dark !!

The Faculty

Basic Legal Provisions

Basic Legal Provisions

Audit of entity

- Department authorised to Audit u/s. 65 of the CGST Act, 2017 read with rule 101 of the CGST Rules, 2017 **(Audit by Tax Authorities)**
- Department may direct an entity to get its accounts audited by a CA / CWA nominated by the Commissioner u/s. 66 r.w.r. 102 [Where the AC (or above) during a scrutiny, inquiry or investigation, etc. is of opinion that the value is not correctly declared, or ITC availed is not within normal limits he may with prior approval of the Commissioner direct the entity to get its records including books of accounts examined and audited by a CA / CMA nominated by the Commissioner **(Special Audit)**]

The focus of this lecture - only on s. 65 audit

Basic Legal Provisions

- Audit is examination of records, books, returns and statements to determine correctness of -
 - Turnover declared [incl. exemptions, deductions claimed]
 - Taxes paid (including rates)
 - Refund claimed
 - Input Tax Credit availed and utilised
 - Assess Compliances with Act & Rules made [e.g. filing of periodical GST returns alongwith payment of taxes etc.]
 - Other relevant issues
- [s. 2(13) of CGST Act r.w.r.101(3)]

Basic Legal Provisions (Contd...)

- Basically, done for a financial year [though part thereof or multiple thereof allowed]. [r.101(1)]
- Would be done at place of business or at department's office [s.65(2)].
- Department to give 15 working days notice period before commencement of audit [FORM GST ADT-01]. [s.65(3) r.w.r.101(2)]
- To be completed within a period of 3 months from the date when records are made available or **actual institution** of audit at place of business whichever is later [Commissioner may extend by a further period not exceeding 6 months if audit cannot be completed within 3 months] [s.65 (4)].
- Tax payer to **provide necessary facilities** for verification of books and records and furnish required information and **render assistance** for timely completion of audit [s. 65(5)]

Basic Legal Provisions (Contd...)

- Audit Findings to be finalized after consideration of replies made by Taxpayer to the discrepancies noticed by auditor. [r. 101(4)]
- Audit Report would be furnished within 30 days of completion containing his findings with reasons and Taxpayer's **RIGHTS** and obligations [FORM GST ADT-02]. [s.65(6) r.w.r.101(5)]
- If tax is not paid / short paid or incorrect credit taken etc. proceedings for SCN would be taken/initiated u/s 73/74. [s. 65(7)].

Basic Legal Provisions (Contd...)

Access to registered premises [s. 71]

Proper officer authorised by JC or above, shall have access to any place of business to inspect the following:

- **Books of accounts**, - Some Challenges - SHARED SERVICES
- Documents,
- Computers,
- Computer programmes / software whether installed **or otherwise**
- Other required things available at that place

for audit, scrutiny, verification and checks, as maybe necessary, to safeguard the Revenue's interest [s.71(1)].

Basic Legal Provisions (Contd...)

Access to registered premises [s. 71] contd...

Person in charge of that place shall on demand make available -

- Records prepared and maintained by him;
- Trial balance or its equivalent;
- Annual financial statements, duly audited, where required;
- Cost-audit report u/s. 148 of the Companies Act, 2013;
- Tax Audit Report u/s. 44AB of the Income Tax Act, 1961
- Any other relevant record,

for scrutiny of the proper officer / audit party / [CA or CWA nominated by the Commissioner in case of audit u/s. 66], within 15 days or such further period as maybe allowed. [s.71(2)]

Areas which the department may check

Areas which the department may check

- Nature of business and the revenue streams
- Books of accounts, records & Audited Financial statements
(entity level and GSTIN level)
- Annual return (FORM GSTR-9)
- Reconciliation Statement (FORM GSTR-9C)
- Incomes
 - Types of supplies – intra-state supply; inter-state supply; exports; nil rated supply; non-GST Supply; no Supply, deductions; exemptions.
 - Rate of tax applicable

Areas which the department may check (Contd...)

- Expenses

- Reverse Charge

- Input Tax Credit – GSTR 2A;
GSTR 3B; Reversal under Rule 36(4);
blocked credit; apportionment u/r. 42 & u/r. 43 of CGST
Rules, 2017

- Tax paid – Cash + Credit

- Refunds claimed



Preparatory measures

Preparatory measures



- Prepare a note on nature of business and revenue streams.
- Prepare an organisation structure and also persons responsible for interface with auditors and give their co-ordinates.
- Prepare a process flow / note on how the trial balance and financial statements at the GSTIN level is arrived at from the entity level Audited Financial statement.

Issues in case of multi-locational entities:



- Cost Allocations and apportionment criteria
- Inter-branch transfers
- HO-Branch transactions
- Overseas branches income & expense
- **ISSUES OF SHARED SERVICES - HANDLING MULTI ENTITY Accounts & records**



Preparatory measures

- Check whether the books of accounts and records are at the place of business. Failure to keep the books of accounts and records at that place would be presumed that you are not in possession of books and records.

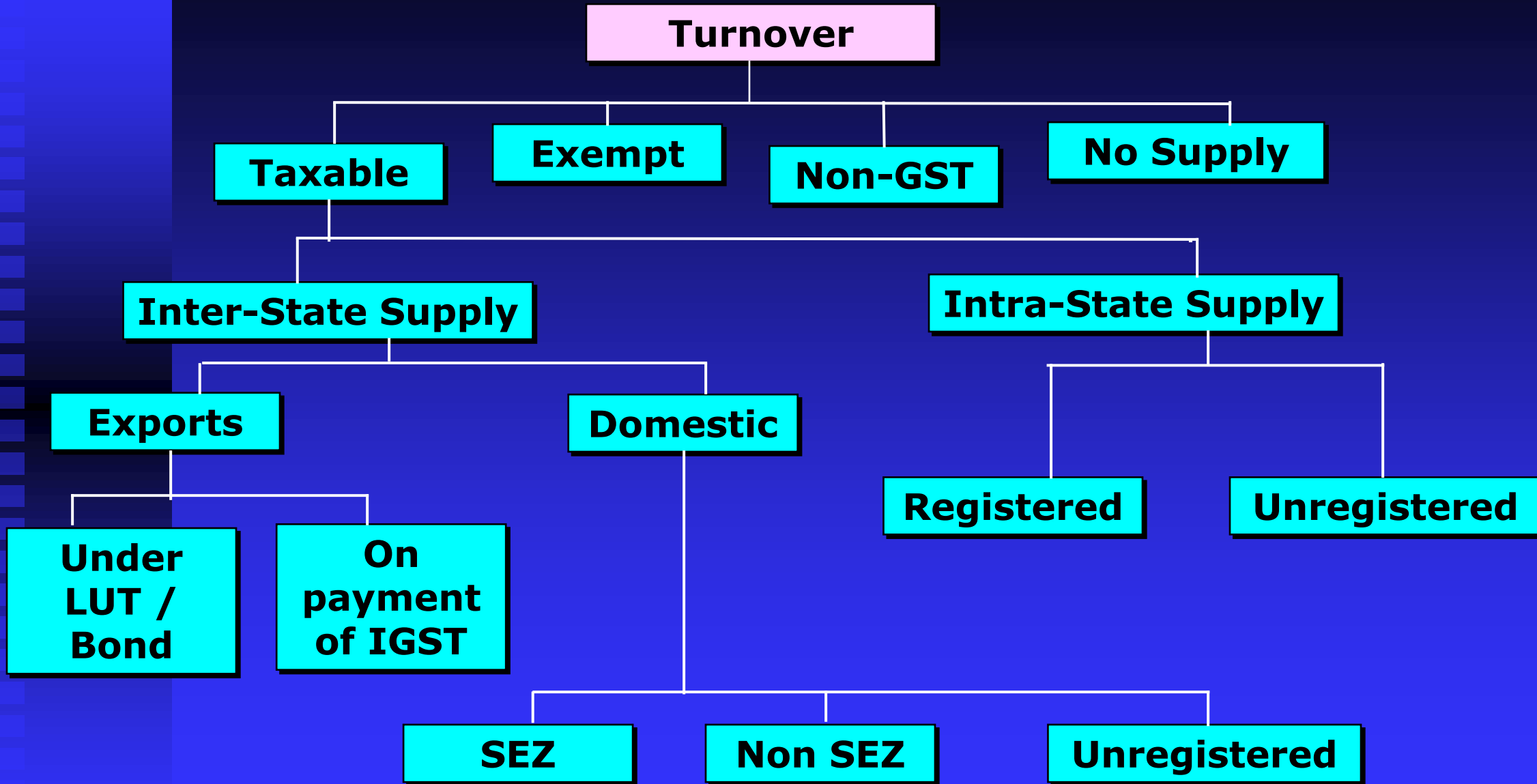


- Place – if auditor wants to do the audit at his office – should be **OK.**

- Although Annual return and Reconciliation Statement have already been filed when the auditor arrives, check them once again before submission. If there are discrepancies it may still be explainable to the auditors or necessary remedial steps can be taken before audit commences.



Preparatory measures



Preparatory measures

Income in the Financial Statements

- Divide income into the above categories (Illustrative)
- Make a list of Schedule I supplies, if any, and quantify the same. Be prepared with a justification for valuation method adopted.
- Identify and quantify Nil rated and exempt supplies. Document reasons for exemptions where the exemptions are conditional and document how the conditions are fulfilled and keep proofs ready.
- REIMBURSEMENTS – keep separate account and explanation why not taxable and complies with all conditions under rule 33 of CGST Rules [Pure agent] with documentary proof.

Preparatory measures

Income in the Financial Statements (Contd...)

- Some important items in Form GSTR-9C [reconciliation statement]
 - **Unbilled revenue**
 - Note on nature of unbilled revenue in your business [No right to bill only income accrued for accounting purpose];
 - Details of unbilled revenue at the beginning of the year, amount reduced during the year; amount added during the year and unbilled revenue at the end of the year.
 - Details of **unadjusted advances** at the beginning, advances received during the year, amount adjusted during the year, and unadjusted advances at the end of the year.

Preparatory measures

Income in the Financial Statements (Contd...)

- Details of **trade discount** accounted in audited financial statement but not reduced from turnover under GST law.
- Details of **credit notes** (commercial credit notes) accounted in audited financial statement but not reduced under GST law.
- (Residuary item in reconciliation of turnover): Adjustments in turnover due to 'other reasons': Keep details (should not be merely a balancing figure).
- Details of supplies on which tax is to be paid by the recipient on reverse charge basis.

Preparatory measures

Expenses in the Financial Statements

Reverse Charge payments

- Keep details of all RCM payments declared in the Annual Return.
- Prepare reconciliation in all the cases where RCM applicable with financial statements

Input Tax Credit

- Keep details of ITC availed in GSTR 3B giving complete details of vendor, GSTIN details, invoice no. date, value, tax (CT, ST,IT), etc.

Preparatory measures

Expenses in the Financial Statements (Contd...)

Input Tax Credit (Contd...)

- Details of amount reversed in GSTR 3B:
 - Under Rule 36(4) [amount in excess of 10% of ITC reflected in GSTR 2A] – **Portal is immortal !!**
 - For Non-payment of consideration within 180 days [r.37]
 - ISD [r.39]
 - Apportionment under Rule 42 and 43. It is advisable to keep a process note on how the apportionment is done.
- Details of ITC reclaimed

Preparatory measures

Expenses in the Financial Statements (Contd...)

Input Tax Credit (Contd...)

- Keep details of amount of ITC utilised for tax payment.
- Balance amount of Credit should be tallied with the Current Asset balance in the Financial Statements.
- Refund of ITC claimed must not be debited to expenses [though debited to Cenvat Credit Electronic Ledger]. [Circular no. 125 dated 18.11.2019 – Q 43 (c)]. It must appear as current asset.

Preparatory measures

- **Most of the details in Form GSTR-9 [Annual Return] flows from:**

- GSTR-1 [Details of outward supplies of goods or services]
- GSTR-3B [details of outward and inward supplies, ITC, tax paid etc.]
- GSTR-2A [Auto-populated ITC based on suppliers' GSTR 1]

Check if the details in GSTR 9 and these forms and statements match and if there are differences keep a reconciliation of the differences.

On Ground Handling

On Ground Handling

- Keep the auditor always in good cheer! Avoid confrontation on any point.
- Give all the process notes and reconciliations and explain how the figures in the Annual return (GSTR 9) and the Reconciliation statement (GSTR 9C) for the financial year under audit have been arrived at from the audited financial statements. This will give comfort to the auditor.

On Ground Handling

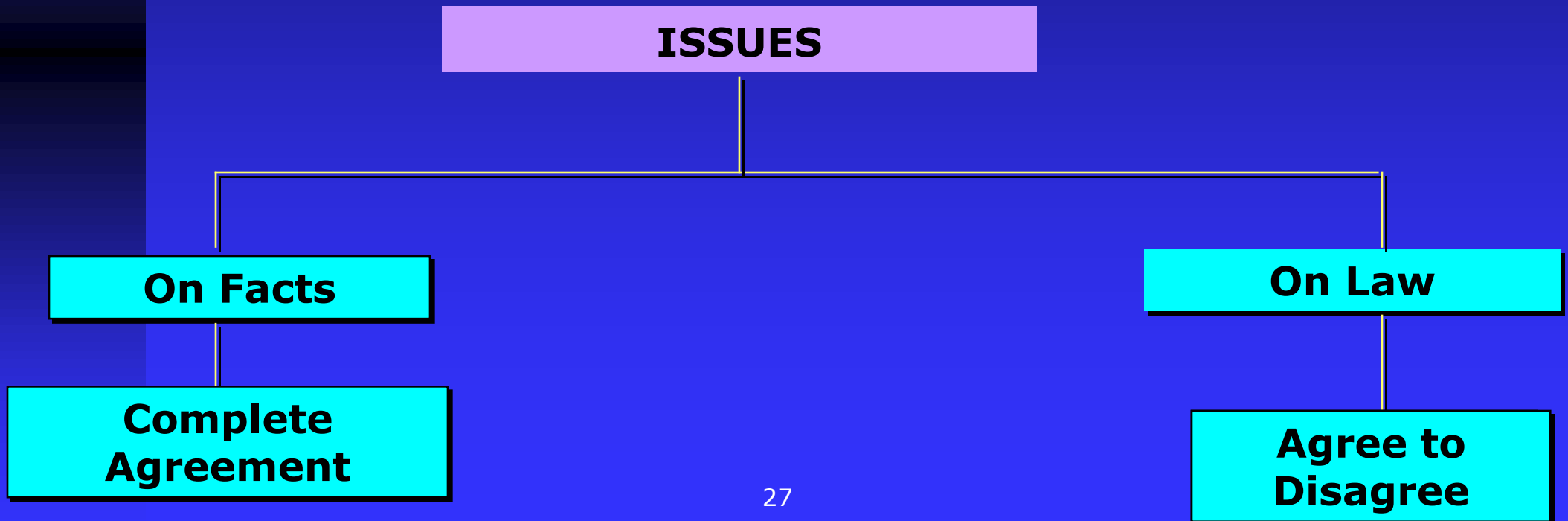


- Evidence of audit to claim limitation subsequently:
 - ◆ Record of visit by audit party – Log book to be maintained
 - ◆ Insist to give audit objections / information required in writing.
 - ◆ Information/ details / replies to be furnished to the audit party under a covering letter.
 - ◆ Insist to give audit report in writing

[Audit objections & Audit report to be in '**writing**' not '**verbal**'- Section 65(6), Rule 101(4) & 101 (5)- words are 'inform'. For Final Audit report the law itself provides for a Form ADT – 2. For audit objections – CBIC's GST Audit Manual 2019 (Directorate of Audit) para 5.14 – page 46 states audit objections must be in 'writing'].

On Ground Handling

- *Verify facts and figures* before submitting to the audit party – Basic Investigation
- In case auditor wants to issue an SCN on any point try and restrict it only to law and clear all differences in facts and figures.....





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2 (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;

Audit by tax authorities.

65. (1) The Commissioner or any officer authorised by him, by way of a general or a specific order, may undertake audit of any registered person for such period, at such frequency and in such manner as may be prescribed.

(2) The officers referred to in sub-section (1) may conduct audit at the place of business of the registered person or in their office.

(3) The registered person shall be informed by way of a notice not less than fifteen working days prior to the conduct of audit in such manner as may be prescribed.

(4) The audit under sub-section (1) shall be completed within a period of three months from the date of commencement of the audit:

Provided that where the Commissioner is satisfied that audit in respect of such registered person cannot be completed within three months, he may, for the reasons to be recorded in writing, extend the period by a further period not exceeding six months.

Explanation.—For the purposes of this sub-section, the expression "commencement of audit" shall mean the date on which the records and other documents, called for by the tax authorities, are made available by the registered person or the actual institution of audit at the place of business, whichever is later.

(5) During the course of audit, the authorised officer may require the registered person,—

(i) to afford him the necessary facility to verify the books of account or other documents as he may require;

(ii) to furnish such information as he may require and render assistance for timely completion of the audit.

(6) On conclusion of audit, the proper officer shall, within thirty days, inform the registered person, whose records are audited, about the findings, his rights and obligations and the reasons for such findings.

(7) Where the audit conducted under sub-section (1) results in detection of tax not paid or short paid or erroneously refunded, or input tax credit wrongly availed or utilised, the proper officer may initiate action under section 73 or section 74.

Special audit

66. (1) If at any stage of scrutiny, inquiry, investigation or any other proceedings before him, any officer not below the rank of Assistant Commissioner, having regard to the nature and complexity of the case and the interest of revenue, is of the opinion that the value has not been correctly declared or the credit availed is not within the normal limits, he may, with the prior approval of the Commissioner, direct such registered person by a communication in writing to get his records including books of account examined and audited by a chartered accountant or a cost accountant as may be nominated by the Commissioner.

(2) The chartered accountant or cost accountant so nominated shall, within the period of ninety days, submit a report of such audit duly signed and

certified by him to the said Assistant Commissioner mentioning therein such other particulars as may be specified:

Provided that the Assistant Commissioner may, on an application made to him in this behalf by the registered person or the chartered accountant or cost accountant or for any material and sufficient reason, extend the said period by a further period of ninety days.

(3) The provisions of sub-section (1) shall have effect notwithstanding that the accounts of the registered person have been audited under any other provisions of this Act or any other law for the time being in force.

(4) The registered person shall be given an opportunity of being heard in respect of any material gathered on the basis of special audit under sub-section (1) which is proposed to be used in any proceedings against him under this Act or the rules made thereunder.

(5) The expenses of the examination and audit of records under sub-section (1), including the remuneration of such chartered accountant or cost accountant, shall be determined and paid by the Commissioner and such determination shall be final.

(6) Where the special audit conducted under sub-section (1) results in detection of tax not paid or short paid or erroneously refunded, or input tax credit wrongly availed or utilised, the proper officer may initiate action under section 73 or section 74.

Audit

101. (1) The period of audit to be conducted under sub-section (1) of section 65 shall be a financial year ^{56a}[or part thereof] or multiples thereof.

(2) Where it is decided to undertake the audit of a registered person in accordance with the provisions of section 65, the proper officer shall issue a notice in FORM GST ADT-01 in accordance with the provisions of sub-section (3) of the said section.

(3) The proper officer authorised to conduct audit of the records and the books of account of the registered person shall, with the assistance of the team of officers and officials accompanying him, verify the documents on the basis of which the books of account are maintained and the returns

and statements furnished under the provisions of the Act and the rules made thereunder, the correctness of the turnover, exemptions and deductions claimed, the rate of tax applied in respect of the supply of goods or services or both, the input tax credit availed and utilised, refund claimed, and other relevant issues and record the observations in his audit notes.

(4) The proper officer may inform the registered person of the discrepancies noticed, if any, as observed in the audit and the said person may file his reply and the proper officer shall finalise the findings of the audit after due consideration of the reply furnished.

(5) On conclusion of the audit, the proper officer shall inform the findings of audit to the registered person in accordance with the provisions of sub-section (6) of section 65 in FORM GST ADT-02.