



AUDIT MANUAL
UNDER
VALUE ADDED TAX LAW

COMMISSIONERATE OF TAXES
GOVERNMENT OF MEGHALAYA

AUDIT MANUAL

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Preface

This manual is a guide for Officers conducting audits of dealers. It outlines the policy, general rules and procedures to be followed. It provides a framework for planning, preparation, carrying out an audit and making reports. It is particularly important in that it sets out a different and more professional approach to audit. It describes many of the standard techniques used to check or assess the correctness of a dealer's liability to VAT. This manual seeks to be comprehensive and it covers most of the recognized means of detecting errors and underreported VAT. Techniques used can often vary but the results are usually very similar.

Audit Officers need a sound understanding of VAT Law and audits should be seen as routine activity. In order to be effective communicators, accurate gatherers and interpreters of relevant information, auditors must be courteous but firm in their approach without being rude or arrogant. These skills can help prevent a hostile environment. Most dealers will accept a professional approach and will often voluntarily explain how their business operates. Many dealers will also accept that they make errors that must be corrected. Audit officers must nevertheless be alert to the possibility of evasion. However, it is extremely important not to treat all taxpayers as if they are trying to evade tax.

A countrywide VAT is new to India and many will see it as replacement for Sales Tax. This is simply not the case. VAT differs from the Sales Tax in that it is designed to remove cascading in supply chains. The strengths that remove distortions to trade and bring neutrality result in its single greatest weakness i.e. the VAT refund mechanism. Thus effective control of the tax is paramount if revenue receipts are to be maximized. Continuing the practice of 'assessment' is not an option for a well managed VAT. The counter to the weakness of a VAT is effective audit carried out at the taxpayer's premises.

The manual is a reference book that officers who are conducting audits of dealers should use selectively. It is not a rulebook that has to be followed slavishly. Not everything in the manual will be applicable to all dealers. In fact it is doubtful if everything included in the manual will be applicable to any one dealer. Officers are encouraged to use their own judgement.

The tax officers may give their valuable suggestions based on their experience which will help to make further improvement of this manual.

Dated Shillong
The _____ March, 2009

(L.Kharkongor)
Commissioner of Taxes, etc.,
Meghalaya, Shillong.

CHAPTER – 1

Introduction to Audit

Like most modern taxation systems, Value Added Tax is based upon a register of taxable dealers (usually computerized) and the information concerning their tax affairs. By design VAT is a self-assessed tax and it is the responsibility of registered dealer to ensure that they account for the correct amount of tax time. Taxable dealers make periodic declarations, (returns), of their tax liability. These returns may be audited (verified) by officers from the VAT department. If no such audit checks were made on dealers' declared or assessed tax liabilities; tax evasion would increase and the tax yield would progressively decline. To protect the tax yield, dealers, their records, and their activities are subject to a regular programme of audit visits. During these audit visits, various techniques are used to determine the accuracy of the returns. This manual describes a number of such techniques and their application in the audit of VAT.

The responsibility of the VAT department is to the tax paying public at large to ensure that the amount of tax properly due is accounted for rather than to individual dealers to safeguard them against their own errors. That said, there is an education element in every audit visit and time should be set aside to deal with dealer queries and problems.

In view of the number of VAT dealers and limited resources, audit visits cannot be considered to be full or financial audits, neither is it a function of the officer on such visit to undertake a physical stock take, unless the need is unavoidable in cases of suspected evasion of criminal fraud.

It will be seen from the techniques that are used to ensure the veracity of the returns a full audit will, rarely, if ever be necessary and will serve little useful purpose.

A financial audit may show that the financial records agree with the basic documents. This does not necessarily mean that the VAT return is correct. Various factors may be the cause of an incorrect return e.g.:

- taxable sales may not have been recorded;
- purchase invoices may have been forged;
- input tax may have been paid and deducted but the deduction may not be allowable
- discounts may have been allowed to related companies that may reduce the taxable value incorrectly; or
- goods may have been taken from stock for non-business reasons and not recorded in the accounts resulting in an evasion of the tax.

These examples are not comprehensive but indicative why, only, the carrying out of a financial audit is not sufficient for the verification of a VAT return.

A stock take is the responsibility of the dealer and the officer's action should be restricted to the extent necessary to be satisfied that the stock records are correct. If they are considered to be suspect then best judgement based upon all available documentary evidence, (e.g. central excise records), is to be used to assess the true stocks. A full official stock take would only be necessary in conjunction with an investigation when evasion or criminal fraud is suspected.

1.1 Aims and Objectives of Audit

The aims are to:

- i) protect the expected yield from the tax;
- ii) identify the true amount of tax, and bring errors to account;
- iii) seek value for money in the deployment of audit resources; and
- iv) maintain social acceptance of the tax.

There are practical limitations to these aims but the over-riding aim must be to provide a credible deterrent which protects the tax yield.

The objectives of audit are:

- (a) To make visits to registered dealers and to test the credibility of the declared or assessed tax. The dealers' expectation of such a visit has preventive and deterrent effects. The preventive effect is the extent to which audit visits prevent dealers from continuing to under-declare their liability. The deterrent effect is the extent to which dealers decide not to avoid or evade because they are aware of control activity and fear detection. Tax avoidance, although legal, may need to be reported.
- (b) To direct activities within the audit to the areas of the greatest revenue or potential revenue risk. For very large dealers it is not expected that all aspects of their activities will be covered on every visit. Consequently officers controlling the largest taxpayers (in Dealer Group I) should plan checks across the totality of the business within a one or two year period, (i.e. a control cycle).
- (c) To allocate the available audit officers to the selective audit of dealers. The basis for selection is the apparent revenue risk of the individual dealer, and the frequency and duration of the visits are determined by the degree of difficulty and risk perceived. Selection is explained in more detail in Annex I.
- (d) To conduct audits that are seen, generally, as fair and reasonable.

1.2 Statutory provision relating to Audit

In terms of Section 52 of the Meghalaya Value Added Tax Act, 2003 (as amended) read with Rule 35 of the Meghalaya Value Added Tax Rules, 2005 the Commissioner shall select on the basis of any criteria or on random basis from amongst the registered dealers a certain number of dealers for audit assessment under Section 55 of the Meghalaya Value Added Tax Act, 2003 (Act No.2 of 2005). Which dealers will be selected and what shall be the number is given in sub-rule (3A) of Rule 35 of the Meghalaya Value Added Tax Rules, 2005 (as amended).

1.3 Selection for Audit

The Commissioner shall select 10-20 % dealers for audit by the 31st January every year. The selection shall be made on random basis District wise. Audit assessment may be made for a particular period or for the aggregate of periods. No audit assessment under Section 55 or 56 shall be made after the expiry of 5(five) years from the end of the tax period to which the assessment relates except in the case of offence under the Meghalaya Value Added Tax Act for which proceeding for prosecution has been initiated, the time limit as specified shall not apply.

Upon selection of registered dealers for audit assessment the Commissioner shall send the list of registered dealers so selected to the appropriate audit authority for conducting audit assessment.

1.4 Issue of Notice to a dealer.

The audit authority heading the team of audit shall issue a notice in Form 21 to the dealer and such dealer shall be required to produce or cause to be produced the books of accounts and all evidence on which the dealer relies as may be specified before him on the date and time specified in the said Notice. While specifying the date it needs to be seen that the date is fixed not earlier than fifteen days from the date of issue of such Notice.

If the dealer fails to comply with the Notice

Where the dealer does not comply with the requirements of the Notice the appropriate audit authority shall proceed to assess the dealer to the best of his judgement the amount of tax due from him. The appropriate audit authority shall issue a notice to the dealer in Form 22 and the same will contain one or more reasons mentioned in sub-section (1) of Section 55 for proceeding for completion of the best judgement assessment.

1.5 Information required before commencement of audit

Before commencement of the audit assessment certain information shall be furnished by the dealer as and when required and asked for by the appropriate audit authority.

1.6 On completion of Audit

The audit team on completion of audit shall send a copy of the audit report to the concerned dealer and also a copy to the Commissioner of Taxes. The appropriate audit authority shall see whether there is any adverse finding in respect of the dealer in the audit report. If yes, he shall issue a notice to the dealer in form 22 and the same will contain one or more reasons mentioned in sub-section (1) of Section 55 for proceeding for completion of the best judgement assessment in accordance with Rule 36 of the MVAT Rules, 2005. While assessing the dealer the appropriate audit authority shall arrive at his own independent decision on the discrepancies, anomalies or evasion or any other matter as stated in the audit report. Assessing a dealer simply on the basis of an audit report is a nullity. It is, therefore, advisable that the appropriate audit authority should use the audit report and apply his own judgement to the facts of the cases after allowing the dealer an opportunity of being heard. Under no circumstances the appropriate audit authority should state or give any hint in the assessment order where from it can be understood that the dealer has been assessed on the basis of the audit report.

Commissioner of Taxes may review atleast 10% of the audit reports submitted by the audit authority and give his views/comments thereon, if necessary.

Time frame:

An audit is to be completed within six months from the date on which the Commissioner has made the selection. The commissioner may allow further extension of six

months in accordance with the provisions of the first and second proviso to sub-section (7) of Section 55.

1.7 Maintenance of accounts, records, etc.

In terms of Rule 45 of the Meghalaya Value Added Tax Rules, 2005 every registered dealer is required to maintain the following –

1. Purchase and stock register of raw material for manufacturing and/or processing of goods.
2. Manufacturing accounts.
3. Fuel purchase and consumption accounts.
4. Purchase register for resale of goods and stock register thereof.
5. Sales register.
6. Input – tax paid or payable register.
7. Output tax paid or payable register.
8. Delivery note receipt and issue register.
9. Credit note and debit note issue and receipt register.
10. Goods liable to be taxed at the last point of purchases within the state shall maintain purchase register and dispatch register.
11. Any other document or register as may be directed by the Commissioner from time to time.
12. Every register dealer shall maintain all records in support of any entry in his accounts/register.

A registered dealer who intends to claim input tax credit under sub-section (1), shall for the purpose of determining the amount of input tax credit, maintain accounts, evidence and such other records as may be prescribed in respect of the purchases and sales made by him in Meghalaya.

In terms of Rule 13 of the Meghalaya Value Added Tax Rules, 2005 for availing of the input tax credit a registered dealer is required to maintain the following registers and documents:-

- (i) true and up-to-date account of sales of goods made in Output register in Form 7;
- (ii) true and up-to-date account of all purchases of goods made in Input register in Form 8;
- (iii) delivery Notes received and utilization record thereof;
- (iv) sale and purchase documents, vouchers, bills or cash memos, counterfoils of delivery notes issued, copies of tax invoice issued and received, documents and certificated relating to exports;
- (v) inventory of raw materials used for manufacturing of goods and up to date account of manufactured goods;
- (vi) dispatch register of goods for sale outside the State;
- (vii) VAT Account register in Form 9.

A dealer making payment of composite tax shall maintain the following books of accounts –

- (i) Sales and purchase invoices;
- (ii) Sales register and purchase register;
- (iii) Cash book and ledger;

- (iv) Stock register.

The return will be filed quarterly by such dealers on Form 5 along with the proof of payment of tax. An annual return will be filed in Form 6.

Powers of Officer under Section 82

- (1) In order to enforce provisions of this Act, the Commissioner or any officer authorized by the Commissioner-
 - (a) shall have, at all time during normal working hours and at all reasonable times without any prior notice to any person full and free access to any premises, place, goods, books, records, computer or any electronically stored data;
 - (b) may make an extract or copy from any book, record or computer-stored information to which access is obtained under clause (a);
 - (c) may seize and confiscate any goods not accounted for and seize any books or records that, in his option, affords evidence that may be material in determining the liability of any person under this Act;
 - (d) may retain any such book or record for a period of one month for determining a person's liability or for any proceeding under this Act; in the event this period needs to be extended the permission of the next higher authority must be obtained for each additional month the book or record is retained; and
 - (e) may, where a hard copy or computer disk of informations stored on a computer is not provided, seize and retain the computer for a period of one month to copy the information required; in the event this period needs to be extended the permission of the next higher authority must be obtained for each additional month such record is retained.
- (2) No officer shall exercise the power under sub-section (1) of this Section of this Act in respect of residential premises without authorization in writing from the Deputy Commissioner.
- (3) The owner, manager, or any other person on the premises or at the place entered or proposed to be entered under this Section shall provide all reasonable facilities and assistance for the effective exercise by the Commissioner or any Officer of the powers under this Section of this Act.
- (4) A person whose books, records, or computer have been removed and retained under sub-section (1) of this Section of this Act may examine them and make copies or extracts from them during regular office hours under such supervision as the Commissioner or authorized officer may determine.
- (5) The Commissioner or any officer authorized by the Commissioner may, by notice in writing require any person, whether or not liable to pay tax under this Act –
 - (a) to furnish any information that may be required by the notice; or
 - (b) to attend at the time and place designated in the notice for the purpose of being examined on oath by the Commissioner or by any officer authorized by the Commissioner, concerning the tax affairs of that person or any other person, and for that purpose the Commissioner or any authorized officer may required the person examined to produce any book, record, or computer-stored information in the control of the person.
- (6) Where the notice requires the production of a book of record, it is sufficient if that book or record is described in the notice with reasonable certainty.

- (7) A notice duly signed and issued under this Section shall be sent to the person to whom it is directed, or left at the person's last and usual place of business or abode.

Period of preservation of books of accounts, etc by a dealer

All books of account and documents referred to in sub-section (1) and all declaration and other relevant documents shall be preserved by the dealer for a period of not less than eight years from the end of the year to which they relate:

Provided that where an assessment, reassessment, appeal, revision for any period is pending at the end of the aforesaid period of eight years such books of account, documents and declarations shall be preserved till such pending proceedings are finally disposed of.

1.8 Statement to be furnished by dealer, transporter, owner or lessee of warehouse, etc.

If, in the opinion of the State Government, there is appreciable evasion of tax in respect of any goods, the State Government may, by notification, specify such goods and thereupon every person dealing in transporting, carrying, shipping or clearing, forwarding or warehousing, whether as owner or lessee of warehouses of such goods, shall furnish a statement or declaration in such form, within such time, in such manner, and for such period, as may be specified in the notification.

1.9 Information to be furnished by dealers regarding changes of business – If any dealer: -

- (a) sells or otherwise disposes of his business or any part of his business or effect or comes to know of any change in the ownership of his business of his business, or discontinues his business or changes his place of business or opens a new place of business; or
- (b) discontinues or changes his warehouses or open new warehouses, or changes the name or nature of his business or effects any change in the class or classes of goods in which he carries on his business and which is or are specified in his certificate of registration; or
- (c) in the case of a company, effect any change in the constitution of its board of directors he shall, within the prescribed time and in the prescribed manner, inform the prescribed authority accordingly and if any such dealer dies, his legal representative shall, in the like manner, inform the said authority.

1.10 Statements, accounts or declarations to be furnished by dealers

1. Every registered dealer shall, in the manner as may be prescribed, submit before the prescribed authority such statements, accounts or declarations within such time as may be prescribed and shall verify that such statements, accounts or declarations are true to the best of his knowledge and belief.
2. If a registered dealer fails to submit statements, accounts or declarations referred to in sub-section (1), he shall be liable to pay a penalty not exceeding Rupees twenty five thousand for each time of default, in the manner as may be prescribed.

1.11 Types of Audit

Audit can be carried out in different ways as given under:-

1. Partial audit
2. Full audit.
3. Investigation.

PARTIAL AUDIT

When it is necessary to verify certain transactions of a particular dealer, a partial audit may be done. These audits are meant to ensure, primarily, that the statutory provisions of VAT are being complied with, that records of purchases and sales are correctly compiled from original documents, that the return for selected periods correspond with the totals in the records of purchases and sales and that the totals under the different columns in the return are correct and the records accurately reflect the business operations. If the auditing authority detects what he thinks may be an evidence of fraud, he may report, so that a full audit may be made. Partial audit may be ordered under several circumstances such as –

- i. to find out the veracity of certain information or allegations received about an assessee;
- ii. if volume and value of imports does not commensurate with the sales;
- iii. where the monthly tax paid by the dealer shows an unusual decline;
- iv. excessive stock transfer to other States compared to the earlier trends;
- v. Inter-state sales shows a rising trend;
- vi. Export sales to neighbouring countries like Nepal, Bhutan, etc shows a rising trend;
- vii. Excessive claims of zero-rated sales like high-sea sales and other sales within the meaning of sub-section (2) of Section 5 of the Central Sales Tax Act.

Basically, any deviation from his normal pattern of business should invite partial audit.

FULL AUDIT

The Commissioner will select certain percentage of dealers for full audit. All business activities of the dealer should be evaluated under full audit. This type of audit is most extensive and therefore time consuming.

INVESTIGATION

It is not audit in a routine manner. Investigation is carried out in case of fraud, evasion and misuse of credit facilities. In these cases penal action may normally be taken. This will be generally taken up by investigating agencies like Central Section, Range Offices and Bureau of Investigation.

1.12 Amendments

The manual does not contain the answers to all the problems that may arise in the day-to-day audit work. In such cases, the auditor has to apply his mind, keeping in view the

spirit of the principles and policies outlined in the manual. If needed, he may seek guidance from the supervisory officer.

Future changes in the Value Added Tax Act and the Rules framed thereunder, administrative policies and procedures may require changes to this Manual. Further, the experience gained during the conduct of audit would also necessitate its periodic updating to maintain its utility.

The officers to the Directorate are welcome to provide suggestions for the improvement of this Manual and to make its scheme and contents more useful. Suggestions may be forwarded to the Commissioner through the respective head of offices.

CHAPTER – 2

Audit Programme

2.1 Period of Audit

In the first eighteen months audit will be done for the return period since full year's reports will not be available. After that audit will be generally done for entire year only. The officers to whom powers will be delegated should chalk out the audit programme. The audit schedule is to be allocated to each audit team by the Administrative Deputy Commissioner of the concerned circle.

The selected dealers should be informed in advance so that they can make their records and books of account available for audit. If a dealer has a genuine reason for adjournment, the officer would fix an alternative date.

2.2 Place of Audit

It should be normally done in the office and only exceptionally in the dealer's place of business.

2.3 Preparation for Audit

Preparation for audit is vital, no matter what kind of audit is going to take place. The officers should study the information available in the concerned dealer's records and also the information available from other sources. They should make themselves familiar with the type of business, form of accounting and other points relevant to audit by retrieving the data relating to dealers from the computer. In this regard the auditing authority may call for the records from the Charge offices, etc. He must keep a record of all relevant information relating to such dealer and accordingly plan the manner in which he wants the audit to be done in consultation with the other officers.

The computer in the office should contain the profile of all dealers and it should be updated, if possible, every quarter. Needless to say that if the updated is not done regularly then the whole exercise will become fruitless. The profile, in respect of the period under audit, should contain the following information:

ASSESSEE PROFILE

| | | | | |
|---|---|--|---|--|
| 1. (a) Name and address of the dealer | | | | |
| (b) Name of the contact person | | | | |
| (c) Contact number | | | | |
| 2. Registration Certificate No. | | | | |
| 3. Nature of business | | | | |
| 4. Principal items dealt in | 1 | | 4 | |
| | 2 | | 5 | |
| | 3 | | 6 | |
| 5. (a) Factory address, if any | | | | |
| (b) Address of the godown, warehouse etc | | | | |
| 6. Details of bank account, if any | | | | |
| 7. For importers, details of figures | | | | |
| 8. Adverse report, if any in possession | | | | |
| 9. Mode of accounting | | | | |
| 10. Basis of valuation of stock | | | | |
| 11. Reliability of returns submitted in earlier periods (information to be obtained from the respective charge) | | | | |

Note: Although it is not possible to prescribe fixed criteria to judge the reliability of return, some indicative factors are enumerated below:

- *Any sudden change in the nature of business.*
- *Growths in turnover of sales and tax payable during the period.*
- *Growths in turnover of sales but fall in tax payable during the period.*
- *Significant rise in non-revenue yielding transactions likes stock transfer, export, high-sea sales etc.*
- *Inconsistency in import and tax payment.*
- *Noticeable change in the composition of total purchases i.e. imports & local purchase and vice versa (registered & unregistered).*
- *Increase in inter-State sales.*
- *Showing huge stock in hand and still effecting purchase and claiming input tax credit.*

From the profile of the assessee the audit team should form an idea about the following aspects before it starts the actual audit.

- *Credibility of the dealer's return – Do they appear reasonable? If not, which area needs attention – purchase, sales, etc.?*
- *The volumes of export, branch or stock transfer to other States or high-sea sales. Does the same appear realistic?*
- *Whether input tax credit as claimed commensurate with the local purchases?*
- *The volume of zero-rated and inter-State sales. Does the same appear realistic?*

- In respect of dealers enjoying any form of incentive under Section 118, whether the sales as stated by the dealer commensurate with the production capacity (i.e. installed capacity of the Plant and machinery)
- Outstanding problems from previous visits. Have those been resolved?

2.4 Approach

Effective audit requires intelligent observation, sound knowledge of accounts and law, an alert enquiring mind, good judgement, a keen revenue sense and a positive approach. A right attitude is the key to success. If the officers act with a complacent or negative attitude it is likely to result in loss of substantial amount of tax, as he shall be unable to correct errors and detect evasion and fraud, if any.

As a matter of fact most dealers generally try to meet their obligations. Irregularities, if any, will often be not more than misunderstanding or misinterpretation of legal requirements. But officers should always be alert for signs of deliberate evasion or fraud. All significant information gathered or given must be recorded.

2.5 Official documents

The official books and papers should not be left at the dealers' premises or elsewhere, nor should the dealers be given opportunity to read departmental papers, official files, references etc.

2.6 Closing of audit

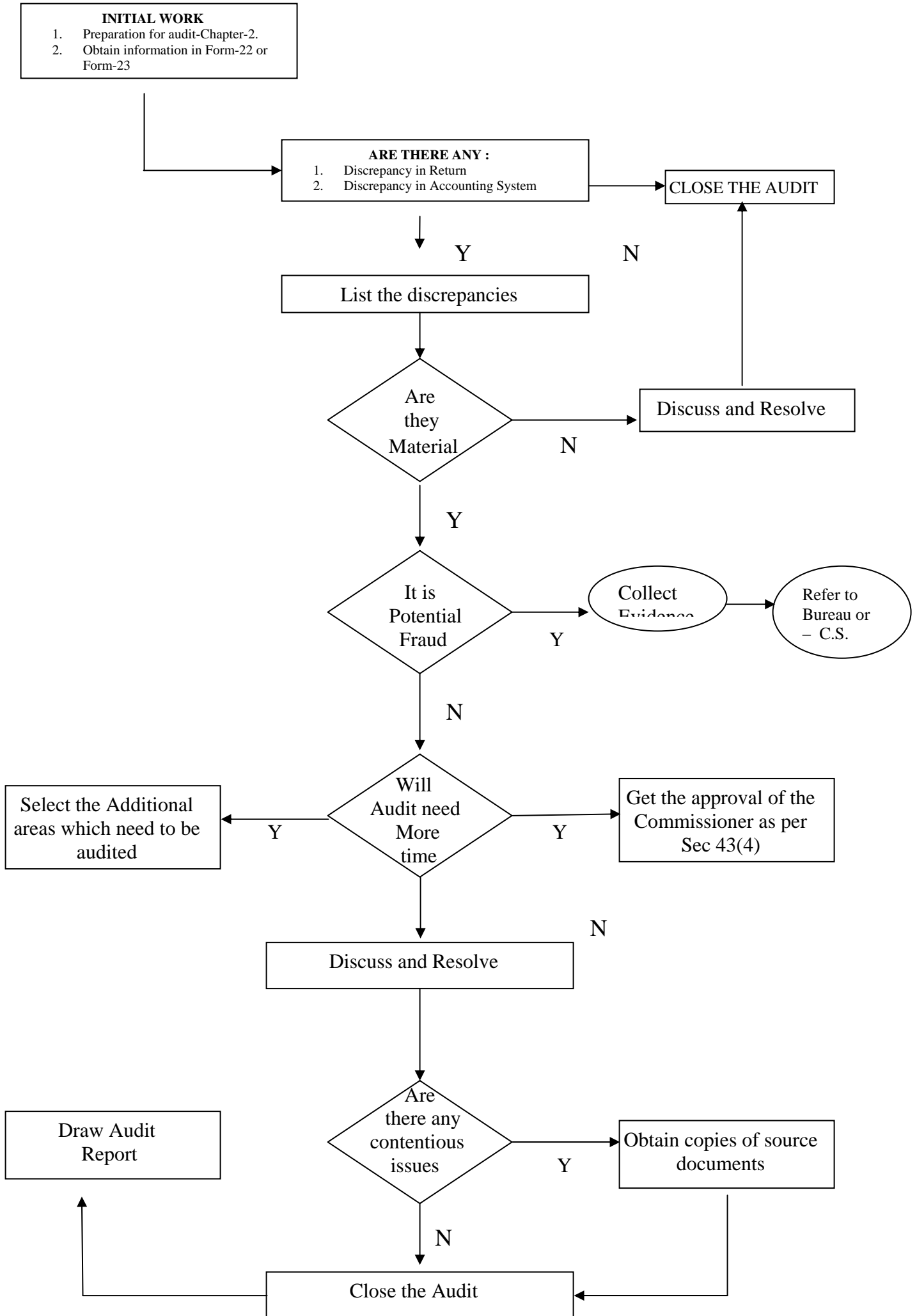
Factors to be considered in closing the audit-

- (i) Suspicion of fraud:
 - Obtain and document evidence and note down the reason, which has given rise to such a suspicion.
 - Refer the case of Bureau of Investigation or Central section for thorough investigation. However, where it is felt that the dealer may tamper with records etc., the auditing authority in consultation with his immediate superior arrange for seizure of such records as per the provisions of Section 67.
- (ii) Tax under – declared, but not suspicion of fraud:
 - If full facts and information are available and un-declared tax can be computed, the auditing authority should try to obtain the dealer's assent to such a differential.
 - If full facts and information are not available, the dealer should be asked to explain the findings as made within a specified time or, cross verification, where ever felt necessary, should be made.
- (iii) No tax under-declared, but some discrepancies found:
 - Make a note of the discrepancies as found and seek explanation from the dealer and resolve them.
- (iv) No discrepancies found:

Audit report to be prepared accordingly.

The diagram given in the next page shows the overall procedures to be followed.

Closing of Audit



Y = Yes
N = No

CHAPTER – 3

Evaluation of Internal control

The auditor should acquire an understanding of the accounting system and related internal control and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. Where an auditor finds that the internal control system is reliable, his substantive procedures (i.e. obtaining evidence from the data produced by the accounting system) would generally be less extensive than would otherwise be required. It may be stated that every business organization follows some sort of an internal control, good or bad. Where after evaluation it transpires that the system is not good it shall throw light on areas which need special attention and which may ultimately lead to detection of evasion.

Different techniques are used to record information relating to internal control system. One such technique is QUESTIONNAIRES. The following questionnaire is not exhaustive but only illustrative. Further it may be said that it is not at all necessary to obtain answers to all the queries as discussed below. Depending upon the case the auditing authority will decide which question is relevant and answer to which is essential. Generally in such cases one should obtain a written answer from the dealer to avoid any future hassles.

3.1 Questionnaire regarding sales.

(I) *Order Booking.*

1. What record is kept of sales orders received by post or otherwise?
2. In deciding upon the acceptance of orders, are the stock position and production programme considered? If yes, how the same is evidenced?
3. How is the credit limit of a customer fixed before credit is given?
4. Who authorizes discount and on what basis?
5. Is there any procedure discount for accepting an order on unusual terms? If yes, state the procedure.

(II) *Despatch and billing.*

6. What records are kept for goods despatched to customers?
7. Are acknowledgements of the receipt of goods obtained from customers? If yes, where and how these records are kept?
8. Are sales invoices compared with:
 - (a) Orders as received?
 - (b) goods despatch records?
 - (c) Acknowledgements as received?
 - (d) Specification including quantity of goods mentioned in the order?
9. (a) How many copies of tax invoices, invoices etc. are prepared?
 - (b) How are they disturbed?
 - (c) Are they pre-numbered?
 - (d) Are the copies of invoices of different colours?

10. Who signs the invoices? Give their status?

(III) *Return of goods and Credit notes.*

11. What records are kept when customers return goods?

12. From what sources of information credit notes are prepared?

13. Are all credit notes authorized by a responsible person? If yes, give his status?

(IV) Debtors ledger.

14. How many independent accounts does it contain?

15. Are year-end confirmations of balances obtained from the customers?

16. Are receipts issued where payments are received in cash or bearer cheques? How are the receipts kept?

17. What is the procedure for following up outstanding debts?

18. Are special discount or allowances given to customers? If yes, what is the basis?

3.2 Questionnaire regarding Purchases.

1. How purchase orders are placed upon suppliers?

2. What records are kept for this purpose?

3. How is it ensured that all purchases have been made as per order?

4. Who acknowledges the receipt of goods at the time of delivery?

5. Where and how such acknowledgements are kept?

6. Are Goods Inward Book maintained at the place where goods are kept?

7. Are purchase bills checked with acknowledgements & Goods Inward Book?

8. How Input tax paid is recorded in books?

9. Have Input Tax Credit been claimed on original tax invoices only? If no, give reasons.

10. How goods returned are recorded and verified?

11. When goods are returned whether Input Tax Credit is reversed or not? If yes, when?

12. Whether credit notes are obtained from suppliers or not?

13. How many suppliers are there in the Creditors ledger?

14. What is the percentage of outside purchase (i.e. purchase from outside Meghalaya) to total purchase?

15. Where payments are made in cash, are acknowledgments obtained from suppliers or not?

16. Are payments in excess of rupees twenty thousand in a day made by cheque or not?

17. Where the dealer is an importer of goods from outside the country, the name and address of the Customs House agents engaged by him?

3.3 Questionnaire regarding Wages:

There are various ways to obtain information about production of a unit e.g. analysis of ratios of various manufacturing expenses, etc. One such means is evaluation of internal control relating to wages.

1. Does any Wage Board cover the industry or is it subject to any provision of any law as regards any aspect of wages?

2. Is there any wage agreement with the workers in force?

3. How many workers are employed in the factory?

4. Are records maintained to show:
 - (i) Terms of engagement?
 - (ii) Basis of Wage Payment?
5. What is the normal working hour?
6. On what basis is overtime paid?
7. Are time clocks used? If not, how is attendance recorded?
8. (i) In respect of employees paid on HOURLY BASIS, are job cards maintained in addition to clock cards?
 - (ii) If yes, are the two records tallied?
9. (i) In respect of employees paid on PIECE BASIS, state the method of recording work done?
 - (ii) How are 'piecework' qualities and quantities checked?
 - (iii) Are records maintained for rejections?
10. Describe the way in which payroll is prepared from clock cards, job cards and piece work cards?
11. Is any incentive payment in force? If so, briefly explain the scheme.
12. (i) Are the wages paid weekly or monthly?
 - (ii) To which day of the week are wages made up, if wages are paid weekly?
 - (iii) On which day are the wages paid?
13. What is the procedure laid down for building up the composition of wages?
14. Do employees signify receipt of pay packets?
15. (i) How is the deduction from gross wages accounted for?
 - (ii) What is the system of payments to outside authorities to whom deductions along with employer's contribution, if any, are payable? (Example – E-S-I., Professional tax etc.)
 - (iii) Are these paid in time?
16. Are there any special features of the wages sheet? Please enclose a specimen of wages sheet.

3.4 Questionnaire for evaluating Internal Control regarding Stock & Stores

(Store here means – Raw materials, Consumable stores, Spares & Finished Products.)

1. Whether any stocks register is maintained?
2. If yes, who maintains it and where?
3. Is the principle of valuation at cost or net realizable value, whichever is lower, has been applied on a consistent basis?
4. Has there been any change in the basis of ascertainment of the cost of stocks, for example, *LIFO basis to *FIFO basis or vice versa?
5. Have physical stocks been properly adjusted for items like goods sold but not yet dispatched, goods sent to customers on approval basis, goods sent on consignment and sold out, goods received on consignment etc?
6. Are stocks physically verified? If yes, when & how?
7. Give the code no. of each items of stores, if any?

8. Are Bin Card and Store Ledger maintained?

Remember:

- A Bin Card is used to keep physical record of each item of stores. It generally contains three columns viz. receipt, issue and balance. It is kept at a place where the items are stores. The storekeeper maintains the Bin Card.
- The office maintains the Store ledger. Here values are also recorded in addition to quantities.

9. Are issues made only on receipt of requisitions by the Using Departments?

10. How is shortage accounted for?

-
- For LIFO and FIFO see Chapter on valuation of stock.

3.5 Questionnaire regarding power consumption.

1. What are the source of power in the factory?
2. How many electric meters does the firm own?
3. Are there separate meters for the factory where machines are installed? If yes, give details.
4. How many machines are used in the manufacturing process? Give details as per the following format.

| Sl. No. | Types of machine | No of machines | Items manufactured | Unit capacity | Source of power | Power consumption per hour | No. of hrs in use during the period |
|---------|------------------|----------------|--------------------|---------------|-----------------|----------------------------|-------------------------------------|
| | | | | | | | |
| | | | | | | | |

5. If coal, diesel, petrol, any other natural gas, etc are used as source of power give details as per format below.

| Sl. No. | Item | Opening Stock | Purchase during the period | Closing Stock | Quantity consumed |
|---------|------|---------------|----------------------------|---------------|-----------------------|
| (1) | (2) | (3) | (4) | (5) | (6) = (3) + (4) – (5) |
| | | | | | |
| | | | | | |

CHAPTER – 4

Method of Conducting Audit

4.1 Introduction

It is not expected that an officer will be able to cover every details of a dealer's account in course of only one visit. Audit is an on-going activity, which is built up over days. By recording what is found in one visit, the next visit can pick up from where the last one left off. Over a period a full picture of the business will emerge and to achieve this objective it is essential that a full report of the work performed be properly recorded. The officer is required to prepare a record of the checks made by him. For example, the checks require examination of a proportion of sales invoices. If this check establishes a high error rate, in-depth checks can extend this examination to further examination of additional transaction invoices and scrutiny of sales orders and sales accounts.

An effective audit depends largely on the conduct and attitude of the officers conducting the audit. The officer should not automatically assume that the tax payer is either honest or dishonest.

They should not try to force answers from the dealers but must at all times, obtain answers to the question asked. However, all answers should be doubly checked. The officers should not interfere with the running of the business anymore than is necessary. In particular, there must be no action on the part of the officers that may frighten the customers who may be at the place of business. The officer may inspect the business premises to obtain a general idea of the business if necessary. It is to be ensured that all activities are consistent with the accounts and records.

4.2 Basic checks:

This check is required to ensure –

- that the information we have about the dealer is accurate and up to date; and
- that the dealers are kept informed about VAT matters.

The successful operation of VAT collection and enforced collection procedures, the effectiveness of audit procedures and the reliability of statistics are dependent on these purposes being achieved. It follows that basic checks should be carried out on every visit. In carrying out these checks the officer gathers knowledge about the nature of business, type of accounting and about the nature of the dealer.

The basic checks to be undertaken:-

1. Check on registered particulars:

- (a) To enquire whether there have been any changes in the business that affect the VAT registration and for which amendment may be required.
- (b) In case of any change the dealer should be asked to immediately apply for amendment in certificate of registration as per the provisions of Section 31;

(c) For accuracy and security purpose it is important that the following confirmation is obtained in writing from the dealer:-

- (i) the name of the commodities that the dealer does business in;
- (ii) bank account no. ; and
- (iii) his telephone and mobile number, if any.

2. *Adequacy of the dealer records:*

Confirm whether the dealer's accounts ensure (or will ensure):

- (i) that tax is properly accounted for all business activities including sale of scrap, sale of any machinery etc.;
- (ii) that tax paid at the time of purchase of taxable goods has been properly recorded;
- (iii) that input tax credit have been claimed strictly in accordance with provisions of section 22;
- (iv) that where the dealer manufactures both taxable and non-taxable goods, such outputs are clearly distinguishable;
- (v) that where the dealer manufactures both taxable and non-taxable goods, input tax credit is not claimed in respect of inputs involved in manufacturing non-taxable goods;

3. *Check on business activities:*

- (a) Enquire whether the dealer carries on any other business activity;
- (b) If separate business are being carried out to ensure that the tax is being paid in respect of all taxable sales;
- (c) Check, whether desegregation of business is for sound commercial or legal reasons or have been done to avoid payment of tax. (Desegregation is the artificial fragmentation of business into separate units to avoid VAT registration).

4. *Check on non-business activities:*

- (a) Ascertain whether the dealer has any non-business activity/other sources of income or not;
- (b) Ascertain that no input tax credit has been claimed on purchases meant for such activities;

5. *Principal inputs and outputs :*

Ascertain as far as possible the main inputs and outputs:

- (a) What are the main inputs/outputs at each positive rate?
- (b) What are the main inputs/outputs that are exempt from tax?
- (c) What are the main input/outputs at a zero rate?
- (d) What other inputs/outputs, if any, are there?

4.3 Guidance for audit:

- I. *Relationship to Income Tax Audit* – Recent Income Tax Audit reports, if any, should be asked for and studied.
- II. Matters outstanding from a previous audit – Any issue outstanding from the previous audit should be dealt with.

III. VAT Audit Trail – One of the biggest advantages of multi-stage VAT, compared to a single stage consumption sales tax, is believed to be the VAT audit trail, which would make cross checking of documents possible. Using the audit trail the department should be able to uncover undue VAT benefits due to, say, falsification of tax invoices.

- The Act provides that no input tax credit may be allowed if the assessee is not in possession of a tax invoice. Since tax invoice is a crucial document, audit should exercise the check on this tax invoice strictly (and not superficially).
- A tax invoice driven VAT should enable the department to perform comprehensive desk audit. The main idea of audit is to link suppliers and recipients and uncover all underlying transactions. So cross checking of invoice is the key to such audit of VAT.

***For format for verification of transactions
see the Annexure at the end of this Chapter.***

IV. *Annual Report* – It is a published document of limited companies. It contains Directors report, Auditors report, Profit and Loss account. Balance sheet, Schedules to accounts, notes, annual report of subsidiary companies etc. It should be thoroughly examined and, if possible, compared with the figures of earlier years.

V. *Partially exempt taxpayers* – The officer should select a few sales invoices and check whether proper VAT rate has been charged, if they come across any invoice for sale of tax-free goods then they should make a note of the details of the invoices for future checking with reference to stock. It is to be checked whether the dealer is using the approved method of calculating his input tax.

VI. *Cash sales* – The officer should check whether these sales are included in the VAT return and verify the following –

- (a) the sales register, if any, or the sales account with the counterfoils of the cash memos;
- (b) the summary of daily cash sales;
- (c) the summary tallies with receipts of cash recorded in cash book;
- (d) that the dates of the cash memos and the date of receipts in the cash book tallies.

VII. *Bank accounts* – The bank transactions should be test-checked with reference to cash book and bank statements and it should be seen whether the bank reconciliation statement is upto date. There is a possibility that to claim input tax credit or input tax rebate the dealer may produce fake tax invoices or invoices, etc. and to cover up the same show the payment through bank. In such cases payments will be made generally through bearer cheques and on enquiry it may be found that the amount was actually withdrawn by the dealer. The books of accounts and the bank statements will however show it as a genuine transaction.

VIII. *Stock Statement to Bank* – Dealers obtain overdraft facilities against hypothecation of stock. And for this purpose they are required to submit a stock statement at the end of every month or period as may be agreed upon. The stock register or accounts as maintained by the dealer showing true and up-to-date account of the quantity and value of such stock under sub-section (1) of Section 63 need to be verified and compared with such statements. Any discrepancy should be noted and VAT implications studied.

IX. *Production* – The officer should examine the types of goods produced and check whether that agrees with the invoices. A rough assessment of the volume of production may be made. It should agree with the Excise record as in Daily Stock Register (Previously known as RGI). It is to be checked whether the production is commensurate with the VAT paid.

- X. *Basis of value* – A number of sale invoices may be selected and the same may be compared with the invoices of other dealers for the same goods. The price list and the brochures may also be examined.
- XI. *Return of goods* – Some goods are sold on the understanding that they may be returned to the seller if they are returned in good condition within a specified period. The tax-point for these goods is the time they are made available to the purchaser and VAT must be charged at that point. If the goods are subsequently returned, a sale credit note must be raised and the goods have to be brought back into the stock.
- XII. *Appropriation and gifts* – Generally big companies allow the employees to purchase the company products at a discounted price or on occasions the products may be given to them as gifts. If the goods are provided free, input tax credit or input tax rebate in respect of such goods have to be reversed. If the goods are provided at a discounted price, then output tax must be accounted for on the discounted price.
- XIII. *Consignment transfer or branch transfer* – Input credit is available in case of consignment transfer or branch transfer, outside the State, subject to restriction given in sub-section (9) of Section 11. So the audit team should check this very carefully so that there is no loss of revenue. The auditor should verify the goods sent to the consignee with reference to the copies of Proforma invoice and transport documents. The expenses and commission of the consignee from time to time. One should be very cautious while checking such transfers as sometimes the dealers disguise actual sales as stock transfer.

Remember:

1. In case of goods sent on consignment basis the ownership of the goods remains with the consignor (i.e. the principal) and the stock lying with the consignee (i.e. the agent) at the end of a period is regarded as the stock of the consignor only.
2. Sales effected by the consignee will be recorded as sales in the books of the consignor and not consignee's.

- XIV. *Inter- State sales* – Since the dealer can carry forward their unutilized input tax credit under the Value Added Tax as rebate to the Central Sales Tax Act and set-off the same from his tax liability under that Act, the dealers may resort to passing off their local sales as sales to registered dealers outside the State (more likely in cases where the local VAT rate is 12.5%). In all such cases where there may be reason to suspect, apart from the other checks, the officer should send it for inter-state verification.
- XV. *Exports out of the territory of India* – Like inter-State sales, exports should be considered a vulnerable area. They provide a major field for evasion of tax and fraudulent refund claims. Apart from the other checks, the auditing authority should-
- (i) cross verify the export documents from Customs, Bank or any other appropriate agency, when ever there is any doubt about the validity of the documents; and
 - (ii) where exports are substantial and in currency other than freely convertible currency, check whether the volume of exports commensurate with the dealer's capacity of business or not.
- XVI. *Challenge of selected purchases and importation* –
- (a) The officer should ask the dealer to produce a small selection of taxed goods identified as having been purchased against tax invoices or imported from outside the State;
 - (b) A dealer, who claims goods have been lost destroyed or stolen, should be asked to produce evidence of claims on insurance companies, etc.
 - (c) If the dealer is unable to account satisfactorily for the goods, the officer should quantify the amount of tax involved;

- (d) Failure to account for goods challenged will automatically make the dealer suspect and, apart from the action indicated above, may suggest need for an urgent investigation involving a full stock taking;
- (e) The possibility that stock have been ‘borrowed’ from other dealers in order to conceal a deficiency should not be overlooked;
- (f) False exports can conceal stock deficiencies/sales of goods ‘off records’ in the State.

XVII. Works Contract – It is always mistaken that till the bill is raised by the contractor on the contractee no deemed sale has taken place. In this connection the Hon’ble Supreme Court in the **Builders Association case [1989] 73 STC 370-page 401**, clarified the legal position as below –

“The contractor becomes liable to pay the sales tax ordinarily when the goods or materials are so used in the construction of the building and it is not necessary to wait till the final bill is prepared for the entire work”.

It may be stated that many contractors adopt ‘payment basis’ as the deciding factor for declaring his contractual transfer price. It means that the work is executed, resulting in the transfer of property in such goods only if the outstanding payments have been cleared. This is basically against the provision of law. The deemed sale is complete the moment there is any transfer of property in goods in the execution of works contract.

4.4 Checks on risks:

A. Checking of tax invoices:

1. The tax invoices should be scrutinized to check that:
 - they have been issued by a registered dealer;
 - they are consecutively numbered;
 - if such invoices are being issued of different series, then reason for doing so should be looked into;
 - they show the tax amount separately.
 - they contain all the requisite particulars as asked for in the rules;
 - tax is being calculated at proper rate and is being charged on proper value;
2. If the invoices are not consecutively numbered then the omissions must be recorded and the dealer asked to explain. Even in cases where the invoices have been cancelled or spoiled the original and the other copies should be retained.
3. If there are omissions in the sequence of invoices issued, the dealer should be asked to account for the missing numbers.
4. Where a dealer is unable to substantiate his claim of input tax credit with original tax invoice the claim should be disallowed. In case of loss of original tax invoice the claim should be allowed only on the strength of Commissioner’s order passed under sub-section (7) of Section 11.
5. Where a dealer is claiming credit on the strength of any original tax invoice the officer should check that they relate to goods consistent with the purpose of the business and input tax credit is available to them as per the provisions of Section 11.

Remember:

1. As per the provision of Section 11, input tax credit shall not be claimed by the purchasing registered dealer unless –
 - he is in possession of an original tax invoice as referred to in sub-section (6) of Section 11 evidencing the amount of tax;
 - he is in possession of an original invoice, cash memo or bill, as referred to in sub-section (1) or sub-section (2) of Section 88, as the case may be, issued by the selling unregistered dealer.
2. As per the provision of sub-section (1) of Section 11, input tax credit is available to the purchasing registered dealer who has purchased goods from a registered dealer holding a valid certificate of registration.
3. As per the provision of sub-section (7) of Section 11, where a registered dealer fails to produce the original tax invoice input tax credit can be claimed by the purchasing registered dealer only on the strength of the order passed by the Commissioner of Taxes under the said provision.

B. Checking Input tax credit Account for:-

1. Input tax credit claimed on invoice other than original tax invoice;
2. Input tax credit claimed on purchase of goods made in the course of inter State trade or commerce;
3. Input tax credit claimed by a registered dealer on purchase of goods specified in the negative list;
4. Input tax credit claimed on the strength of tax invoice which does not contain all the requisite particulars as given in Rule 46;
5. Input tax credit claimed on purchase tax payable under Section 6 of the VAT Act even where the purchasing registered dealer is not in possession of any invoice, etc;
6. Input tax credit claimed on purchase tax payable under Section 6 where such purchases were made from a person other than a dealer;
7. Input tax credit claimed on purchase tax payable under Section 6 of the VAT Act on the strength of an invoice, etc. which does not contain all the requisite particulars as given in Rule 46;
8. Input tax credit claimed by a registered dealer acting as an agent of another registered dealer where the latter has through book entry transferred input tax credit to the former;
9. Input tax credit claimed on goods not meant for direct use in business, e.g. stationery, computer, furniture, etc. by a registered dealer other than a dealer of those goods;
10. Input tax credit claimed on goods purchased for direct use in business but subsequently used for other purpose;
11. Input tax credit claimed by a newly registered dealer under the VAT Act on stock held by such dealer on the date of incurring liability where such dealer had not applied for registration within thirty days from the date of incurring liability to pay tax under the VAT Act;
12. Input tax credit claimed on goods stock transferred to another State;
13. Input tax credit claimed on capital goods not capitalized in the books ;

14. Input tax credit claimed on goods which remain unsold at the time of closure of business.

C. Reverse credit :

Input tax already enjoyed during a tax period have to be reversed, i.e. returned, in the tax period in which any event takes place for which the dealer is not entitled to claim such credit. As a matter of fact input tax credit is available to a registered dealer immediately on purchase (i.e. the dealer can take input tax credit on the very date of purchase), it is not linked to sales or use in manufacturing process etc. As such, where a registered dealer has claimed input tax credit, as per the provision of Section 11, but subsequently it is found that such credit has not been lawfully claimed then the registered dealer has to reverse the input tax credit so claimed in his books immediately on the happening of the event for which he became disentitled to such credit as laid down in Rule

D. Some other points relating to input tax credit:

1. Where a supplier issues a credit note to a registered dealer, the effect should reduce the dealer's entitlement to input tax credit for the period in which the credit note is issued;
2. There is obvious risk in these circumstances as the dealer may neglect, either accidentally or deliberately, to reverse the input tax credit;
3. Where there is a conspiracy between dealers, they deliberately overcharge tax and issued credit notes which are deducted from output tax, but which the customers suppresses from input tax records;
4. The risk is enhanced when buyer and the seller are related;
5. To confirm whether input tax credits have been correctly and fully posted and whether the input tax credit has properly adjusted with the output tax. The credit notes received should be examined and compared with the Purchase A/C and other records kept for the purpose.
6. Purchase ledger accounts, suppliers' statements, and the general ledger should be examined to ensure as far as possible that all credit notes received have been accounted for;
7. Correspondence with suppliers and other parties may provide an indication that all credit notes received are accounted for.

4.5 Study of Debit notes & Credit notes

Debit Note is a statement prepared by a business organization informing another person that his account has been debited for the reasons given in the debt note. It is prepared in duplicate, the original sent to the person whose account has been debited and the duplicate is used for passing an accounting entry. The financial impact of a Debit Note is that the addressee is liable to pay the amount mentioned in the said statement to be business organization that has issued the same. In other words, the person issuing a debit note is eligible to receive the amount from the addressee.

Reasons for issue of Debit Note:

In case of purchase of goods:

- (i) Return of goods to supplier;
- (ii) Short receipt of goods;

- (iii) Price reduction claimed by buyer for defective goods or higher price charged by a supplier;
- (iv) To claim deduction for discount.

In case of sale of goods:

- (v) Increase in rate/quantity;
- (vi) Increase in excise duty, sales, VAT;
- (vii) Recovery of packing charges, transportation charges, handing charges, warranty charges or after sales service charges from a customer in relation to the sale of good.

Other reasons:

- (viii) Extra charges billed by service provider, say transporters charged Rs.7000 per lorry instead of Rs.6000;
- (ix) Debiting insurance company while lodging claim;
- (x) Recovery of charges like advertisement expenses, sales promotion activity charges from customers.

Study of Debit Notes

Study of debit notes is one of the most important areas of work of an auditor. In fact financial impact of issue of Debit Notes is to increase income or reduce expenditure and both have its direct impact on output tax liability. It is therefore, necessary that all the debit notes issued by a company should be examined very carefully. Generally, the units maintain a Debit Note Register and it may also show reasons for issue of debit note in brief. If the number of debit notes is large, a study of the said register may help an auditor in selecting the relevant ones for detailed scrutiny.

Study of Credit Notes

Credit Notes is a statement prepared by a business organization informing another person that his account has been credited for the reasons given in the Credit Note. Generally, a Credit Note is prepared by a supplier of goods on receipt of goods returned by a customer. In other words, when a customer returns the goods he sends a Debit Note and on receipt of goods, the supplier prepares a Credit Note in favour of the customer. The financial impact of the Credit Note is that the addressee is eligible to receive the amount. In other words, persons issuing Credit Note is liable to pay the amount mentioned in the Credit Note.

The Credit Note is issued in the following cases:

- (i) When buyer returns goods;
- (ii) When an allowance for damaged, defective or short quantity is given;
- (iii) When buyer returns an empty container;
- (iv) Issue of debit notes by another person, say a customer or supplier or job worker.

Remember:

1. As per the proviso to sub-section (3) of Section 44, where goods purchased or sold in a year is returned or rejected in the subsequent year, within six months from the date of purchase or sale, the credit note issued by the seller or the debit note issued by the purchaser shall be adjusted with the turnover of sales or turnover of purchases, as the case may be, of the year in which such goods were returned or rejected.
2. Any adjustment in respect of tax undercharged or overcharged by a dealer entitled to issue tax invoice must be backed by the debit note or credit note, as the case may be.

4.6 Other irregularities to look for:-

- (1) Incorrect computation.
- (2) Failure of account for VAT on all purchases and sales.
- (3) Wrongful claim of input tax credit is to be verified by cross verification of invoices.
- (4) If prices reflect normal market values or is deflated.
- (5) Invoices not genuine to be found out by cross verification of documents. In some countries, like France, there is a Directorate of Verification for verifying invoices of very high value. That may not be necessary in Meghalaya. But such systems underline the importance of cross verification. In South Africa, South America and even in Europe, there has been a menace of false invoice. So the thrust of audit should be to prevent such misuse by cross-verification. However, cross-verification should not be done of all invoices but selectively.
- (6) In one of the studies on MODVAT by NIPFP in 1995-97 the nature of offences detected are given below. This may help in understanding the type of irregularities take place in a VAT system.

Procedural / Technical –

- (i) Improper documents;
- (ii) Misuse of credit on capital goods;
- (iii) In-admissible inputs;
- (iv) Prior to commencement of registration;
- (v) Undeclared inputs;
- (vi) Wrong interpretation of notifications;
- (vii) Unregistered dealers' invoice;
- (viii) Credit on duplicate invoice;
- (ix) Invoice not on factory address;
- (x) Invoice not in the name of unit;
- (xi) Credit on delivery Challan instead of invoices;

Substantial –

- (i) Irregular utilization of declared credit;
- (ii) Credit on exempted final products;
- (iii) Rejected inputs sent back without reversal of credit;
- (iv) Credit on basic customs duty;
- (v) Misuse of facility of job work;

- (vi) Excess credit availed;
- (vii) S.S.I. Unit availing MODVAT after opting out of it.

Fraudulent –

- (i) Credit without producing document;
- (ii) Credit on invoice without physical movement;
- (iii) Credit on extra / Xerox copy of invoice;
- (iv) Credit availed twice on same invoice;
- (v) Credit availed without payment of duty;
- (vi) Fraud/fake documents etc.

4.7 Discussion with assessee –

Before finalizing the objections, the audit party should discuss with the assessee about the nature of the objections being raised.

Meghalaya Value Added Tax Act, 2003
Verification of transactions

To,

.....
..... (Office)

| | |
|----------------|--|
| Action Rating: | |
| Urgent: | |
| Routine: | |

| | | |
|---------------|------|--|
| Office Number | Memo | |
| Date | | |

| Dealer under audit. | | | | | | | | | |
|---------------------|--|--|--|--|--|--|--|--|--|
| | | | | | | | | | |
| Name: | | | | | | | | | |
| Address: | | | | | | | | | |

| Dealer under audit. | | | | | | | | | |
|---------------------|--|--|--|--|--|--|--|--|--|
| | | | | | | | | | |
| Name: | | | | | | | | | |
| Address: | | | | | | | | | |

This reference is for cross checking of *purchase/sales transactions as noted below:

| Srl. No. | Date | Tax Invoice Number | Description of goods in brief | Amount (Rs) |
|----------|------|--------------------|-------------------------------|-------------|
| | | | | |
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| | | |
|--|--------------------------------------|--|
| *Office telephone number/Fax number / Email Number | Signature of the Officer | |
| | Name of the Officer with designation | |

*Strike out whichever is not applicable.

Scrutiny of Other Incomes & Scrutiny of Expenditures

5.1 Scrutiny of incomes

This is one of the most important areas, which an auditor is required to analyse very carefully. It may include income under following heads:

- (i) Sale of scraps and by-products;
- (ii) Insurance claims;
- (iii) Profit on sale of fixed assets;
- (iv) Interest/Dividend;
- (v) Commission received;
- (vi) Royalty;
- (vii) Tech know-how or tech consultancy charges;
- (viii) Erection and commissioning charges;
- (ix) Miscellaneous Income like labour charges etc;
- (x) Freight/Insurance recovered.

Sometimes a detailed break-up of various items of other income may not be available in the Schedule of Other Income in the Profit and Loss Account. In that case ledger account grouping should be obtained from the assessee. Study of Trial Balance also shows different heads of other income. Exact nature of each income account should be ascertained from the company. This should be verified with the study of the ledger account. The ledger accounts should be scrutinized with reference to documents like invoices or debit notes or journal vouchers used for passing entries in the ledger accounts. It may happen that exact nature of these incomes may be different than what has been declared.

Some of the above-mentioned items of other income are discussed below:

(a) *Sale of scrap:* An auditor should ascertain the series of sales invoice used for sale of scrap. Other documents like debit notes or journal voucher may also be used for recording sale of scrap. This fact can be found out from the study of the ledger account. Scrap sale Account or like in the ledger should be scrutinized along with vouchers to confirm whether output tax has been paid or not.

(b) *Insurance claim:* Insurance claim may be lodged, for damage or destruction of raw material, work in progress, finished goods or capital goods. An auditor should examine exact details of such claims. Following type of insurance claim cases should be examined in detail.

- (i) damage of raw material before receipt in the factory;
- (ii) damage of raw material in the factory;
- (iii) damage of work in progress or finished goods in the factory;
- (iv) damage of capital goods in the factory.

It is important to note that the auditor should not only examine the cases where insurance claims have been received by the assessee but he should examine all cases where claims have been lodged even though the claims have not been finally sanctioned by the insurance company. Insurance claim applications should be studied to find out details of

quantity claimed to have been damaged, value and input tax claimed in the insurance claim. This will help us in verifying the reversal of Input tax credit in such cases.

- (c) *Profit / loss on sale of fixed assets:* This income shows profit or loss earned on sale of fixed assets. An auditor to find out the details of fixed assets sold during the year should scrutinize the ledger account. The vouchers should be studied to find out full details, such as, year of purchase, and profit or loss on sale. It should be seen whether, appropriate output tax has been paid or not on such sale.
- (d) *Development / Design Charges:* Sometimes a manufacturer is required to use a particular mould or die for manufacture of an item for a customer. The said mould or dies can be made by him or can be purchased from other person. The cost of such die or mould made may be charged separately from the customer and it is shown as income of the company. The said income has direct relation to the goods manufactured by the assessee. Therefore, an auditor should examine the exact nature of such charges and find out whether it shall form a part of the sale price of the goods sold or whether it constitute a separate sale.
- (e) *Interest/ Commission received:* Generally interest income arises from investment made by the company. Commission may be on account of sale of certain products of other company. But if interest or commission is received from customers of the company, such transaction of interest/commission should be examined in detail to find out whether additional consideration is being received in the guise of interest or commission from same customer.

5.2 Cases Studies on Other Incomes

- (a) **Insurance Claim on Damaged Raw Material:** An assessee was engaged in the manufacture of decorative laminates. One of the major raw materials was paper, which was imported or purchases locally. On going through the grouping of other income, in the Profit and Loss Account, one of the income accounts was found to be Insurance Claim Received Account. On a study of ledger account and relevant documents, it was noticed that the assessee had insured the purchase of papers including for transit damage. If the paper was received in damaged condition, they were claiming the value of damaged paper from the insurance company. It was one of the conditions of the insurance policy that for every bale of paper loss, up to 10kg. of paper was to be borne by the assessee and for the balance quantity insurance company was required to pay the insurance claim. It was noticed that every month a sizable quantity of paper received by them was found to be damaged and they were claiming the money from insurance company. Assessee was availing modvat credit (under Central Excise) of entire quantity of paper covered by purchase invoice. In fact they were not eligible to avail credit on quantity of paper up to 10kg. per bale for which insurance claim was not lodged.
- (b) **Commission Income:** In the case of a unit manufacturing steel products such as S.S.Flats, the profit and Loss Account showed receipt of commission/service charges to the extent of about Rs.30 crores in 5 years. On scrutiny of ledger

account it was found that company had received commissions from well-known companies for providing services of obtaining export orders and for arranging purchase of certain machineries. Since the business of the company was totally different than the areas where commission was charged, further investigations were made with companies who were supposed to have paid commission and it revealed that these companies did not pay any commission charges. In fact, said amount pertained to sale proceeds of S.S.Flats. The amount were recovered from assessee by demand drafts and credited to the income account showing receipts from fictitious companies. The value of the said commission also tallied with the value of finished goods manufactured out of excess consumption of raw materials.

(c) Recovery of Advertisement Charges, Crate Hiring Charges and Delivery Charges: An assessee was engaged in the manufacture of aerated water. On going through the Schedule for 'Other Incomes' forming part of Profit and Loss Account it was noticed that they have shown following three items under the heading 'Other Income':

- (i) Advertisement and management service charges.
- (ii) Crate Hiring Charges.
- (iii) Net delivery charges on re-sale of goods. On going through the ledger accounts of these incomes and supporting vouchers it was noticed that the company was recovering additional charges from their customer for sale of aerated water in the guise of above referred three charges. Advertisement and management service charges were recovered at a fixed rate for each crate of aerated water. Further they were recovering crate hiring charges for an amount much more than the actual cost of the crates (about 15 times of the actual cost of crates). Delivery charges were supposed to be recovered for actual expenses on transportation of goods, from depots to dealers. On going through the details, it was noticed that such charges accounted to about 45% of the sale value of the goods. Hence, these charges were also recovered in much excess of actual charges. The study of groupings also showed that the amount shown in Profit and Loss Account was after deducting actual expenses on transportation and therefore the word "net" was used. In fact, the manufacturer had created another company who was collecting these charges on behalf of them and paying to them.

5.3 Scrutiny of Expenditures

Initially an auditor may glance through the particulars of Profit and Loss Account to find out which are the major expenditures of the company and what is their share in total expenses. In case of any unusual expenditure the auditor may like to examine the case in detail. For example, in pharmaceutical industries or other consumer goods industries, the marketing and sales promotion expenditure contributes towards a major portion of the expenditure. Hence, if the expenditure on such item is very small, the case needs further investigation. In the case of one company manufacturing cosmetics, study of the Profit and

Loss Account revealed that the company was incurring a very small amount on marketing expenditure. The scrutiny of ledger account for expenses revealed that the company was recovering marketing expenses from their customers separately and only net expenses (i.e. the marketing expenses incurred by the company minus the amount realized from the customers on account of marketing expenses) were shown in the Profit and Loss Account. Expenses incurred under the head “Selling and Distribution” forms a part of the cost. This cost should form a part of the sale-price.

Another analysis, which should be done by a tax auditor on reading the details of Profit and Loss Account, is comparison with figures of the previous year. If increase or reduction in expenditure is not commensurate with variation in goods produced sold, further inquiries should be made.

Expenditure Accounts having Credit Entries: Even though study of details of expenditure of Profit and Loss Account may not show the accounts having credit entries but some of the expenditure accounts where recoveries are possible from customers like packing expenses, freight expenses, advertisement expenses etc. The expenditure account where any credit entry may have been passed should be scrutinized carefully to rule out the possibility of any evasion of tax.

CASE STUDY:

At the time of assessment, one particular exporter had submitted that during the year under assessment he had not obtained any REP licence, etc, nor made any sale of them. Accordingly, the Profit and Loss account did not reflect the same. The officer concerned sensing something fishy went through the Profit and Loss account of the earlier periods. To his surprise he found that in the Profit and Loss account of last four years there was one entry in the credit side which showed income from sale of Rep licence, Exim Scrips etc. On scrutiny of the ledger he found that sale of such goods during the year was credited to one expenditure account – as a result of which the said expenditure was showing a much lesser amount when compared to earlier years. It can be said that this was done with the sole intention to suppress sale and evade tax.

Valuation of Inventories

Inventories are assets:

- Held for sale in the ordinary course of business;
- In the production of such sale; or
- In the form of materials or supplies to be consumed in the production process or in the rendering of services.

The generally accepted accounting principle for valuation of inventory is that it should be valued at cost or net realizable value whichever is lower. The meaning of cost as per the accounting standard issued by the Institute of Chartered Accountants of India are as follows:-

Cost of Inventories: The cost of inventories should comprise all cost of purchase, cost of conversion and other cost incurred in bringing the inventories to their present location and condition.

Cost of Purchase: The cost of purchase consists of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition.

Cost of conversion:

1. The costs of conversion of inventories include costs directly related to the unit of production, such as direct labour. They also include systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.
 - ❖ **Fixed overheads** are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and the cost of factory management administration.
 - ❖ **Variable production overheads** are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as consumable stores, other indirect materials and indirect labour.
2. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed production overheads allocated to each unit of production is not increased as a consequence of low production or idle plant. unallocated overheads are recognized as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that the inventories are not measured above cost. Variable production overheads are assigned to each unit of production on the basis of the actual use of the production facilities.

3. A production process may result in more than one product being procured simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Exclusions from costs of inventories: In determining the cost of inventories it is appropriate to exclude certain costs and recognize them as expenses in period in which they are incurred. Examples of such costs are –

- ❖ abnormal amount of wasted materials;
- ❖ storage costs, unless those costs are necessary in the production process prior to a further production stage;
- ❖ administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- ❖ selling and distribution costs.

4. **Net realizable value (NRV):** It is the estimated selling price in the ordinary course of business less estimated costs of completion and the estimated cost necessary to make the sale. The practice of writing down inventories below cost to NRV is done with the view that assets should not be carried in excess of amounts expected to be realized from their sale or use. Inventories are usually written down to NRV on item to item basis. In some circumstances it may be appropriate to group similar or related items.

Methods

There are different methods of valuing stock. The most commonly used method is FIFO i.e. First In First Out. There are other methods too. We shall try to learn them through an example.

A trader has the following record of purchases of an item say (A):

| Date | Quantity Units | Price per unit (Rs.) |
|--------------|-------------------|-------------------------|
| April. 2 | 1,000 | 50.00 |
| 8 | 500 | 52.00 |
| 9 | 400 | 56.00 |
| 17 | 300 | 58.00 |
| 26 | 900 | 55.00 |
| Total | | 3,100 |

Issues were made as follows:

| Date | Quantity Units |
|------|-------------------|
|------|-------------------|

| | |
|--------------------|-----|
| April. 3 | 700 |
| 10 | 500 |
| 21 | 400 |
| Total 1,600 | |

The different basis for valuation of closing stock in the question concerned can be the following:

- (i) FIFO (first in first out) basis: The actual issue of goods is usually the first lot on hand. The stock of goods on hand, therefore, consists of the current purchases.

In the question under discussion the closing stock is 1500 units and would consist of
900 units received on 26th April; and
300 units received on 17th April; and
300 units received on 9th April

| | | |
|--------------------------|----------------------|-------------------------|
| The value therefore is - | 900 units @ Rs.55.00 | 49,500.00 |
| | 300 units @ Rs.58.00 | 17,400.00 |
| | 300 units @ Rs.56.00 | <u>16,800.00</u> |
| | Total | <u>83,700.00</u> |

- (ii) LIFO (Last in first out) basis: Though actual issues are made out of the earliest lot on hand (to prevent unnecessary deterioration in quantity), the issues are valued according to the price paid for the latest consignment on hand. The closing stock then is assumed to consist of earlier consignments and its value is then calculated according to such consignments. This method of valuing stock is known as LIFO basis.

In the question given above the price of the earliest consignment (1000 units) is Rs50 per unit and that of the next consignment (500 units) is Rs.52.00 per unit. The value of 1,500 units of closing stock on this basis would be:

| | |
|-----------------------|-------------------------|
| 1000 units @ Rs.50.00 | Rs.50,000 |
| 500 units @ Rs.52.00 | <u>Rs.26,000</u> |
| Total | <u>Rs.76,000</u> |

The value shall be Rs.76,000/-, if we do not have the details of the issues made by the dealer. In case where such details are available (as in the example under consideration) the valuation under LIFO basis would be Rs.80,000.00 (see chart)

| Date | Receipts | | | Issues | | | Balance (i.e. in stock) | | |
|-------|----------|-------|----------|--------|------|--------|-------------------------|-------|----------|
| | Qty | Rate | Amount | Qty | Rate | Amount | Qty | Rate | Amount |
| Apr.2 | 1000 | 50.00 | 50000.00 | | | | 1000 | 50.00 | 50000.00 |

| | | | | | | | | | |
|--------|-----|-------|----------|------------|----------------|---------------------|--|-------------------------|---|
| Apr.3 | | | | 700 | 50.00 | 35000.00 | 300 | 50.00 | 15000.00 |
| Apr.8 | 500 | 52.00 | 26000.00 | | | | 300 500 | 50.00 52.00 | 15000.00 26000.00 |
| Apr.9 | 400 | 56.00 | 22400.00 | | | | 300 500 400 | 50.00 52.00 56.00 | 15000.00 26000.00 22400.00 |
| Apr.10 | | | | 400 100 | 56.00 52.00 | 22400.00 5200.00 | 300 400 | 50.00 52.00 | 15000.00 20800.00 |
| Apr.17 | 300 | 58.00 | 17400.00 | | | | 300 400 300 | 50.00 52.00 58.00 | 15000.00 20800.00 17400.00 |
| Apr.21 | | | | 300 100 | 58.00 52.00 | 17400.00 5200.00 | 300 300 | 50.00 52.00 | 15000.00 15600.00 |
| Apr.26 | 900 | 55.00 | 49500.00 | | | | 300 300 900 | 50.00 52.00 55.00 | 15000.00 15600.00 49500.00 |

Here aggregate value of the closing stock comes to **Rs.80,100/-**

- (iii) Average Price: Average price may be simple i.e. all the prices taken together and then dividing the total by the number of prices. The closing stock will be valued according to the price ascertained.

The simple average in this example is $(50.00 + 52.00 + 56.00 + 58.00 + 55.00) / 5$
= Rs.54.20.

Thus, the value of 1500 units will be Rs.81,300/- (1500 units x Rs.54.20/unit)

However, the most appropriate method for calculating average is the one, which also takes quantities into account i.e. Weighed Average Method. Valuation under this method is worked out below:-

| Date | Receipts | | | Issues | | | Balance (i.e. in stock) | | | Remarks |
|--------|----------|-------|----------|--------|-------|----------|-------------------------|-------|-----------------|--------------------------|
| | Qty | Rate | Amount | Qty | Rate | Amount | Qty | Rate | Amount | |
| Apr.2 | 1000 | 50.00 | 50000.00 | | | | 1000 | 50.00 | 50000.00 | |
| Apr.3 | | | | 700 | 50.00 | 35000.00 | 300 | 50.00 | 15000.00 | |
| Apr.8 | 500 | 52.00 | 26000.00 | | | | 800 | 51.25 | 41000.00 | 41000/800 = 51.25 |
| Apr.9 | 400 | 56.00 | 22400.00 | | | | 1200 | 52.83 | 63400.00 | 41000 + 22400 = 63400 |
| Apr.10 | | | | 500 | 52.83 | 26415.00 | 700 | 52.83 | 36985.00 | |
| Apr.17 | 300 | 58.00 | 17400.00 | | | | 1000 | 54.39 | 54385.00 | |
| Apr.21 | | | | 400 | 54.39 | 21756.00 | 600 | 54.39 | 32629.00 | |
| Apr.26 | 900 | 55.00 | 49500.00 | | | | 1500 | 54.75 | 82129.00 | |

In a particular case, the dealer claimed that closing stock has been valued at FIFO basis and submitted the following details of closing stock.

| Item No. | Quantity | Rate per Ft. | Total Value |
|----------|----------|--------------|--------------|
| 1 | 200 Ft. | Rs.36.00 | Rs.7,200.00 |
| 2 | 1000 Ft. | Rs.15.00 | Rs.15,000.00 |
| 3 | 100 Ft. | Rs.125.00 | Rs.12,500.00 |
| 4 | 50 Ft. | Rs.305.00 | Rs.15,250.00 |

The assessing authority checked the particular bills. Since, the dealer had adopted FIFO basis, the goods which remain in stock at the end of the year are generally the one which are purchased towards the end of the year.

The last purchases of the goods, as evident from the purchase bills showed the following cost price:

| Item Number | Cost price |
|-------------|-------------------|
| 1 | Rs.32.95 per ft. |
| 2 | Rs.13.74 per ft. |
| 3 | Rs.90.00 per ft. |
| 4 | Rs.290.00 per ft. |

Evidently, there was overvaluation of stock as follows:

| Item No. | Quantity | Valued at | Should have been valued at | Overvaluation |
|--------------|----------|--------------|----------------------------|-------------------|
| 1 | 200 Ft. | Rs.7,200.00 | Rs.6,590.00 | Rs.610.00 |
| 2 | 1000 Ft. | Rs.15,000.00 | Rs.13,740.00 | Rs.1,260.00 |
| 3 | 100 Ft. | Rs.12,500.00 | Rs.9,000.00 | Rs.3,500.00 |
| 4 | 50 Ft. | Rs.15,250.00 | Rs.14,500.00 | Rs.750.00 |
| Total | | | | Rs.6120.00 |

Percentage of overvaluation to the value of stock disclosed by the dealer:

$$= \frac{\text{Rs. 6,120}}{\text{Rs. 49.95}} \times 100 = 12.25\%$$

Qualities of an Auditor

The Meghalaya Value Added Tax Act has given vast powers to the Auditor. Although, to use the words of Shakespeare, law has given the auditor giant's strength, it would be tyrannical to use it like a giant. This chapter discusses the qualities expected of an auditor.

Firstly, an auditor should be free from any bias or pre-conceived notion about the assessee and should exercise his independent judgement. Previous auditors may have given a clean chit to a dealer or recorded adverse findings against him. But such findings should not prejudice an auditor. He should analyse all data and come to his own findings. He is to obtain evidence through the performance of compliance and substantive procedures to enable him to draw the dealer and checking the internal control system. Substantive procedure means obtaining evidence from the data produced by the accounting system.

Secondly, the VAT system has dispensed with mandatory assessment of all dealers and relies on audit to check evasion of tax. So, it is imperative for an auditor to have a thorough understanding of various legal and accounting principles and their practical application. Knowledge is power and good command of such principles and their application will stand the auditor in good stead.

Thirdly, unearthing vital clues is the most important work of an audit officer. An audit officer has to develop himself so that he is properly equipped with to pick up clues, which may even be lying on the surface.

- (i) *Observations and deductions* – An audit officer should be on the alert for finding out fraud and also the methods of proving fraud. For example, a printer's bill may be an innocuous document but it may give information regarding an invoice book, which has been produced before the audit officer.
- (ii) *Imagination* – The audit officer should be able to visualize the nature of primary records a dealer should maintain. The officer should also think of the methods of frauds that may be adopted. For instance, a rent receipt of some obscure premises may be of no interest in itself but it may give some food for thought and the audit officer may find out a place where goods are stored and have been kept out of the stock sheets.
- (iii) *Tenacity* – An audit officer should have the tenacity in the face of reverse and disappointment. This will help him to get clues in his work.
- (iv) *Intuition* – An audit officer should cultivate this virtue. In investigation, the danger of seeing the wood for the trees cannot be ruled out. It is not possible to exhaust every possibility because in that event investigation will continue for an indefinite period. It is intuition that helps an investigating officer or an audit officer to lay hands on the clues that work.

AUDIT REPORT & RESULT OF AUDIT

8.1 Audit Report

On completion of the audit, the officers should proceed to finalise the audit report.

The essential elements of post audit action should be to:

- (a) Update the summary of dealer's activities in **FORMAT I**;
- (b) Summarise all the irregularities found;
- (c) Inform senior officers of the business of the findings;
- (d) Factor to be considered in closing the audit visit are:
 - Suspicion of fraud,
 - Tax under-declared, but no suspicion of fraud,
 - No discrepancies.
- (e) In case of under declaration, issue a proposition notice to the dealer. On the basis of the reply furnished by the dealer or if he does not respond, further action shall be taken;
- (f) Submit the audit report, which, inter alia, may contain the following:
 - (i) the period(s) audited,
 - (ii) taxable turnover,
 - (iii) tax liability,
 - (iv) export,
 - (v) exempted sales,
 - (vi) taxable purchases/import,
 - (vii) tax exempt purchases,
 - (viii) Cross checking of inter-state sale/stock transfer with other sales, cross-checking of export-documents used to prove export,
 - (ix) Suggestion if the firm needs to be audited more frequently in future than the normal requirement,
 - (x) Finally, the audit team should enter the summary of audit objections in the computer in the Assessee Profile File as per the following proforma –
 - I. Dealer's name,
 - II. R.C. No.,
 - III. Period(s) of Audit,
 - IV. Previous objections not settled so far,
 - V. Present objections raised (important ones),
 - VI. Date on which it has been forwarded to dealer/Commissioner of Taxes..

The report to be submitted can be in **FORMAT II**, with suitable adjustment of particulars.

The officer should review the work on completion of the visit and ensure that all the appropriate action has been taken.

8.2 How to measure the result of Audit.

To ensure an effective operation of the audit programme to the greatest possible extent, it is necessary to monitor the results. The measurement of the result should consist of the following elements: -

- (a) Number of completed audits;
- (b) Number of case where discrepancies have been detected in audit;
- (c) Number of cases and the amount of tax payable, where the audit has detected that such amount payable by the dealer on account of VAT, has not been paid by him.
- (d) Amount of tax payable as an outcome of the Audit.

These measurements should be made for each and every group of auditor. However, the indicators should be interpreted with caution.

8.3 Monitoring of Audit

Every month on a particular date the officer-in-charge of Audit should hold a meeting of all the members of audit team so as to assess the nature of objections being raised and the progress of the work.

FORMAT – I
SUMMARY OF DEALER’S ACTIVITIES

| | |
|-------------------------|-------------|
| Name of VAT dealer..... | TIN |
| | CST No..... |

1. Authorized Person to contact (and status)_____
2. Telephone Number(s)_____
- Location of premises _____
3. Effective date of Registration_____
4. Accountant (if any)_____
- Address_____
- Telephone Number_____
5. Financial Year ends_____
6. Address of Principal place of business_____
7. Other business address_____
8. Main business activity_____
9. Subsidiary business activities_____
- (provide approximate % of turnover of each activity)_____
10. Manufacturer YES/NO_____ Enjoying exemption/ remission YES/NO_____
- Eligibility Certificate from Industry Department obtained YES/NO_____
- Authorization Certificate or Certificate of Entitlement obtained YES/NO_____
- Entitlement of (a) Period of Exemption _____ (b) Monetary Ceiling_____
- Exemption availed (a) Period_____ (b) Amount_____
- Time left of availment _____ Unexpired amount of exemption _____
- Input/output ratio_____
- Licensed capacity _____ Installed capacity_____ Actual production_____
- Brief description of manufacturing process:_____
- _____
11. Importer (International) YES/NO_____ % OF INPUTS_____
- Brief description of imports_____
12. Purchases from other states YES/NO_____ % OF INPUTS_____
- Brief description of purchases_____
13. Receipts from other states on stock transfer basis
- YES/NO_____ % INPUTS_____
- Brief description of receipts_____
14. Purchased within the states YES/NO_____ % OF INPUTS_____
- Brief description of purchase_____
15. Exporter YES/NO _____ % OF OUTPUT_____
- Brief description of export_____
16. Sales to other states YES/NO_____ % OF OUTPUT_____

Brief description of inter-state sales _____

17. Branch transfer/consignment sales to other states

YES/NO _____ % OF OUTPUT _____

Brief description of branch transfer/consignment sales _____

18. Sales within the states YES/NO _____ % OF OUTPUT _____

Brief description of intra-state sale _____

19. Description of principal outputs _____

1% Rate _____

4% Rate _____

12.5 % Rate _____

Zero- Rated- International Exports _____

Zero Rated – Inter State Sale _____

Exempted goods/ transactions _____

Fourth Scheduled goods _____

20. Principal inputs _____

1% Rate _____

4% Rate _____

12.5 % Rate _____

Exempt goods _____

Fourth Scheduled goods _____

21. Accounting Method CASH/ MERCANTILE

If there is any change in the method of Accounting from previous year.

22. Method of Valuation of Opening stock and closing stock FIFO/ LIFO

If there is any change in the method of Valuation from previous year YES/NO

23. Current Accounting Records – Describe overleaf the books and records used by business.

Highlight those used for accounting for VAT. Identify records where the VAT account or VAT calculation are maintained.

24. Audit Report from a Chartered Accountant / Cost Accountant, if any, filed by the dealer

YES/NO _____

25. Information from third parties, if any _____

26. Cross reference requests, if any _____

27. Matters outstanding from a previous audit, if any _____

28. Adverse report, if any _____

| | |
|-------------------------------|--------------------------------|
| Date..... | Recorded by: Officer Name..... |
| Signature..... | |
| Checked by: Officer Name..... | Signature..... |
| Updated..... | Officer Name..... |
| Signature..... | |

FORMAT – II
REPORT ON AUDIT VISIT TO DEALER

1. Name of the VAT Dealer_____
2. Tin _____
3. Period of Audit_____
4. Address(es) visited_____
5. Person (s) interviewed_____
6. Date and time of visit: Date from_____ to _____
Date from_____ to _____
Date from_____ to _____
7. Summary of dealer's trading activities and Record – Updated and signed_____
8. BASIC CHECKS, whether completed, Yes/No_____
9. GENERAL REVIEW, whether completed Yes/ No _____
10. CREDIBILITY_____
11. IN-DEPTH CHECKS, whether completed Yes/ No _____
12. AUDITING OF SPECIAL FOCUS AREAS Yes/No_____
13. PHYSICAL VERIFICATION Yes/No_____
14. Conclusion and credibility of returns_____
15. Previous objection not settled so far,_____
16. Matters for consideration on next visit._____
17. Irregularities found, particulars of assessment_____
18. Turnover of sales, stock transfer, turnover of purchases and other details [As per separate annexure (i)]
19. Liability of tax, interest etc. for the period under audit, [As per separate annexure (ii)]

Turnover and other details for the period under audit:

| | Particulars | As disclosed by dealer(Rs.) | As found upon audit (Rs.) |
|----|---|-----------------------------|---------------------------|
| 1. | A. Sales, stock transfer etc. | | |
| | Local sales under the MVAT Act | | |
| | (i) Exempted goods (First Sch.) | | |
| | (ii) @4% goods (Second Sch.) | | |
| | (iii) @2% goods (Third Sch.) | | |
| | (iv) @1% goods (Third Sch.) | | |
| | (v) @12.5% goods (Fifth Sch.) | | |
| | (vi) @___% goods (Forth Sch.) | | |
| | (vii) @___% goods (Fourth Sch.) | | |
| | (viii) @_____% tax paid goods (Fourth Sch.) | | |
| | (ix) @_____% tax paid goods (Fourth Sch.) | | |
| | (x) @_____% (other, if any) | | |
| 2. | Inter-state Sales under the CST Act | | |
| | (i) to Registered dealers | | |
| | (ii) to Un registered dealers | | |
| 3. | Second/Transit Sales under the CST Act | | |
| 4. | Sales in the course of Export out of India | | |
| 5. | Sales in the course Import into India | | |
| 6. | Inter-state stock transfer under the CST | | |
| | | | |
| | B. Purchases/ Receipts etc. | | |
| 1. | Purchases from other states | | |
| 2. | Receipt from outside State | | |
| 3. | Purchases within the State: | | |
| | (i) from registered dealers | | |
| | (ii) from un-registered dealers | | |

Liability of tax, interest etc. for the period under audit:-

| Particulars | - | As disclosed by the dealer in tax returns (Rs.) | As per Audit(Rs.) |
|-----------------------------------|---|---|-------------------|
| (i) Output tax | - | | |
| (ii) Input tax credit | - | | |
| (iii) Net tax credit | - | | |
| (iv) ITC adjusted with CST | - | | |
| (v) Output tax remitted/ exempted | - | | |
| (vi) Net tax payable | - | | |
| (vii) Net tax paid | - | | |
| (viii) Interest payable | | | |
| (ix) Interest paid | - | | |

Observation of audit:

(a) Short payment by the dealer-

(i) Tax :

(ii) Interest :

(iii) Total :

(b) Other Observations-

Reasons for the observations;