

(ANNEXURE – ST-III)

DOCUMENTS REQUIRED FOR DESK REVIEW

I. Documents required during Desk Review -

1. Annual report and Director's report
2. Profit and Loss Account
3. Balance Sheet
4. Notes to the Accounts
5. Trial Balance
6. Cost Audit Report
7. VAT returns
8. Tax Audit Report
9. TDS

Sr.No.	Name of the Record/Document	Relevance of the documents and checks to be done
<b>1.</b>	<b>Annual Report &amp; Director's Report</b>	
		<p>The Annual Report prepared by a company <i>inter alia</i> contains the following:</p> <p>i) Director's Report (ii) Statutory Auditor's Report (iii) Balance sheet and Profit &amp; Loss Account (iv) Financial statements of subsidiary companies, if any.</p> <p><u>Director's Report:</u> Director's report may, inter alia, contain information about-</p> <p>a) Foreign Exchange earned during the year.</p> <p>b) Foreign Exchange paid during the year, e.g. - may be on account of taxable services availed by the Assessee/Taxpayer where he is liable to pay service tax under reverse charge mechanism.</p> <p>c) Information on the operations carried out by the Assessee/Taxpayer during the year under report. This may help in finding the exact nature of services provided by the Assessee/Taxpayer.</p> <p>d) The facts stated in Director's Report should be reconciled with the ST-3 Returns.</p> <p><u>Auditor's Report:</u> It is the most important report contained in the Annual Accounts of a Company. The statutory auditor certifies as to whether the books of account of the company are properly maintained or not and also whether internal control mechanism is commensurate with the size and extent of business of the company. Any adverse noting of the Statutory Auditor has to be replied by the management of the Company</p> <p><u>Nature of verification:</u> (i) The Auditor's Report should be studied to find out any qualified/adverse opinion given by the auditors which may have impact on Service Tax liability.</p> <p>ii) CARO Report may be studied to find out whether the fixed assets records have been maintained properly or whether physical verification of capital goods was undertaken and whether any discrepancies were noticed on such verification or whether the company has maintained proper records for unserviceable or damaged capital goods or not.</p> <p>iii) CARO Report also shows disputed tax liabilities separately for Sales Tax, Customs, Central Excise and Income Tax. Cases booked under Sales Tax or Income Tax may be examined to find out any implication on the Service Tax.</p> <p>iv) In the case of Public Sector unit, C &amp; AG report and comment of the company available in the Annual Report should be examined.</p>
<b>2.</b>	<b>Profit &amp; Loss Account</b>	
		<p><u>Nature of the Account:</u> The Profit and Loss Account shows major items of expenditure and income. This is one of the important documents used during desk review to find out the overall working of the unit. In the main body of the Profit &amp; Loss Account, only major heads of expenditure and income are given and the constituents of these headings are given in a separate annexure. The said annexure should be studied in detail. The expenditure or income of the major heads should be compared with the previous year's amount in order to find out cases of major variations.</p>

	<p>Nature of Verification: The auditor is required to examine income and expenditure accounts in the Profit and Loss Account:</p> <p>Auditor should analyse both debit and credit side of the profit &amp; loss a/c, trial balance, ledgers etc. because it is a myth that while ascertaining the service tax liability of the Assessee/Taxpayer, one has to look only at the credit side of P&amp;L A/c. Debit side is equally important or rather more prone to frauds and errors. Therefore, the auditor needs to pay attention towards debit side also. Debit side is important because of–</p> <ol style="list-style-type: none"> <li>i. Reverse charge mechanism- under this mechanism, the recipient of services is liable to pay service tax (e.g. GTA Services, services received from abroad, Services notified in terms of Section 68(2) of Finance Act, 1994 etc.). Therefore nothing appears on the credit side of the P&amp;L a/c. However, service tax has to be calculated on the amount paid towards taxable services received.</li> </ol> <p>Reimbursement- unless the concept of 'pure agent' is applicable, reimbursements are includible in the value of Taxable Service. Reconciliation should cover all receivables including reimbursements, sale of goods etc</p> <p><b>a) Income Accounts:</b> Normally, the Profit and Loss Account would show a consolidated entry for business income from all sources. According to accounting standards, non-business income such as interest income or dividend income is required to be shown separately.</p> <p>To begin with, auditors should call for the groupings of business income shown in the Profit and Loss Account. The said groupings would show the different heads under which the incomes have been accounted for. They should carefully study the nature of business income – some of which may have accrued from the sale of taxable services and the balance from the sale of non-taxable services. The exact nature of these services may be determined from the supporting documents such as vouchers, bills or contracts. In doing so, auditors need to be guided by the nomenclature (used for each of these services) in the Trial Balance or Annexures to the Profit and Loss Account. It is possible that the true nature of the service may be obscured or disguised by using a nomenclature that is either non-taxable or exempted.</p> <p>Other incomes like insurance claims receipt, sale of capital goods, commission received, erection and commissioning income, freight and insurance recovered etc. may be examined in detail to find out the exact nature of such incomes and whether these are liable for Service tax and have any bearing on cenvat credit utilisation.</p> <p><b>b) Expense Accounts:</b> Scrutiny of expense accounts would enable the Auditor to identify major expenditure heads. In specific terms, such scrutiny may be useful in the following manner:</p> <ol style="list-style-type: none"> <li>➤ Useful for verification of out of pocket expenses where deductions for these have been claimed from the value of taxable services.</li> <li>ii. Correlation between expenditure head and value of taxable service e.g. fuel expenses and the value of taxable service in the case of tour operators.</li> </ol>
<b>3.</b>	<b>Balance Sheet</b>
	<p><u>Nature of document :</u></p> <p>Balance sheet is a statement of assets and liabilities of a unit on a particular day. The overall financial health of a company can be determined from the study of a Balance sheet.</p> <p><u>Types of verification</u></p> <ol style="list-style-type: none"> <li>(i) Study of schedule of Share Capital may reveal if the company is subsidiary company and in case the company is holding company, in that case, the name of subsidiary company will be disclosed in the Schedule of Investment. If there are sale/purchase transactions with the holding/subsidiary company, in that case, the valuation of such products needs to be examined in the light of Valuation Rules.</li> <li>(ii) Study of fixed assets schedule may show additions and deductions to the fixed assets during the year. For the deductions made during the year, verification may be made as to whether appropriate excise duty have</li> </ol>

	bee paid, if the Cenvat credit was availed in the past.
<b>4.</b>	<b>Notes to the Accounts</b>
	<p>These notes are part of the Profit &amp; Loss Account and Balance Sheet. These notes may be inserted by the company as per the requirement of the Companies Act or may be added at the instance of Statutory auditor. These notes are very important to a Tax auditor as these reveal important transactions or the important accounting policies followed by the unit.</p> <p><u>Nature of verification:</u></p> <p>In case of debtors, notes indicate debtors which are outstanding for a period exceeding 6 months. Foreign Exchange related transactions are also given in the notes on accounts. Management can use these figures to show book profit to suit their requirements. Netting of amounts of revenue or expenditure can also be resorted to by the management although as per accounting standards it is mandatory to specify the figures separately.</p> <p>Scrutiny of Notes will also reveal as to whether there was any change in the system of accounting. For example- an Assessee/Taxpayer changes from cash system of accounting to mercantile system. The notes also indicate the impact of accounting policies on various liabilities including the tax liability of the Assessee/Taxpayer. Therefore, the auditor must read the notes carefully</p>
<b>5.</b>	<b>Trial Balance</b>
	<p><u>Nature of Document</u> :-</p> <p>Trial Balance is a statement showing balances of all accounts in the ledgers as on a particular date. In other words, it is a summary of the ledger account maintained by an assessee. The final accounts, namely, Profit &amp; Loss account and Balance Sheet are prepared from the Trial Balance only. From the Trial Balance, similar accounts are grouped together and these are transferred to the Profit &amp; Loss Account and Balance Sheet.</p> <p>The perusal of the Trial Balance could achieve the following:</p> <ol style="list-style-type: none"> <li>Familiarization with chart of accounts/account code and understand as to what extent the information is detailed and integrated with other subsystems; few sample Journal Vouchers may also be seen to understand the information mentioned therein.</li> <li>Understand the grouping of sub accounts under main accounts for the purposes of summarization into Profit and Loss account and the Balance Sheet.</li> <li>Identification of accounts, which have a prima facie relevance for service tax payment (may be direct or indirect). These accounts may have to be seen in detail at later stage of audit depending upon the result of subsequent audit processes;</li> <li>Understand the tax accounting system in so far as it pertains to Service Tax payment and treatment of credit of service tax on input services;</li> </ol> <p>During the study of the Trial Balance/ Profit and Loss Account all income accounts should be studied in detail The most important use of Gross Trial Balance is that it contains balances of individual accounts whereas in Balance Sheet and P&amp;L A/c many accounts are grouped together, e.g.,</p> <ol style="list-style-type: none"> <li>In the P&amp;L A/c, all the incomes are clubbed together under the head 'Gross Receipts', 'Sales' as the case may be. However, Trial Balance shows income earned under each category of revenue separately.</li> <li>Not only the Trial Balance is important in relation to income side, but it is very important in relation to expenditure side also. For instance, Payment made towards <b>Sponsorship services</b> may be clubbed in the category of Advertisement and Sales Promotion Expenses which can be identified only from the Trial Balance.</li> <li>Similarly, <b>freight paid</b> may be clubbed with Purchases or Fixed Assets.</li> </ol>
<b>6.</b>	<b>Cost Audit Report</b>

	<p>Cost Audit Report provides quantitative and financial details regarding related party transaction, valuation of services rendered as per service tax return.</p> <p>The auditor may examine the following aspects from the Cost Audit report.</p> <table border="1"> <thead> <tr> <th>S. No. in Annexure to the Cost Audit Report and subject</th> <th>What is to be seen</th> </tr> </thead> <tbody> <tr> <td>1 &amp; 3 - General Information</td> <td>Auditors may use this information at time of Desk Review.</td> </tr> <tr> <td>5 - Royalty &amp; Technical Know-how Charges</td> <td>As the information contain is product wise, the auditor may find it useful in determining the tax liability of the assessee under reverse charge mechanism if any in case the same was paid to foreign entities. Moreover, auditor may go through the source documents about the scope of work and terms of payment to assess the tax-compliance aspect of service tax on Royalty &amp; Technical Know-how.</td> </tr> <tr> <td>10 - Related party transactions.</td> <td>Auditors may use this information with regard to valuation of related party transactions.</td> </tr> </tbody> </table>	S. No. in Annexure to the Cost Audit Report and subject	What is to be seen	1 & 3 - General Information	Auditors may use this information at time of Desk Review.	5 - Royalty & Technical Know-how Charges	As the information contain is product wise, the auditor may find it useful in determining the tax liability of the assessee under reverse charge mechanism if any in case the same was paid to foreign entities. Moreover, auditor may go through the source documents about the scope of work and terms of payment to assess the tax-compliance aspect of service tax on Royalty & Technical Know-how.	10 - Related party transactions.	Auditors may use this information with regard to valuation of related party transactions.
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<b>7.</b>	<b>Scrutiny of VAT Returns</b>								
	<p>The VAT Returns should be scrutinized for ensuring that the value of services which attract both service tax &amp; VAT are consistently reported. Some of such services which attract both Service Tax &amp; VAT are:-</p> <ol style="list-style-type: none"> <li>i. Commercial or Industrial Construction Services</li> <li>ii. Complex Construction Services</li> <li>iii. Works Contract Services</li> <li>iv. Annual Maintenance Services</li> <li>v. Outdoor Caterer Services</li> <li>vi. Mandap Keeper Services</li> <li>vii. Pandal or Shamiana Contractor Services</li> <li>viii. Rent – a - Cab Services</li> </ol>								
<b>8</b>	<b>Scrutiny of the Tax Audit Report</b>								
	<ol style="list-style-type: none"> <li>i. Clause 18 of the Tax Audit Report provides information about amount of depreciation under Section 32 of the Income Tax Act, 1961 and that of CENVAT credit availed by the service providers on capital goods.</li> <li>ii. Clause 27(a) of the Tax Audit report gives the details of CENVAT Credit claimed by the service provider. It also provides the details of credit available and carried forward to the next year. Hence, the Auditor can authenticate the amount of credit carried forward in the service tax returns with the information provided in terms of this clause.</li> <li>iii. Clause 21(b) of the Tax Audit Report also gives information regarding prior period incomes and expenses booked in the year under Tax audit. The Auditor shall ensure that service tax is paid on these amounts in case they are subject to service tax.</li> <li>iv. Clause 39 of the Tax Audit Report provides the information relating to Cost Audit. If such an audit has been carried out, the Auditor should examine the Cost Audit Report.</li> <li>v. Clause 40 of the Tax Audit Report provides the important accounting ratios.</li> </ol>								
<b>9</b>	<b>Scrutiny of Tax Deducted at Source (TDS) Certificates</b>								
	<p>The total receipts for services can be verified from TDS certificates in the following manner: -</p> <ol style="list-style-type: none"> <li>i. By deducting the amount of service tax from the value on which tax has been deducted at source,</li> </ol>								

	<p>the receipts appearing in the books of accounts can be reconciled.</p> <ul style="list-style-type: none"><li>ii. The nature of services can also be confirmed from these certificates and in case of any discrepancy in the categorization of services under proper head, elaborate checks need to be carried out by the Auditor.</li><li>iii. Details of TDS credit claimed in the Income Tax Return may also be examined.</li></ul>
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