

GUIDANCE NOTE ON TAX AUDIT UNDER SECTION 44AB OF THE INCOME-TAX ACT

1. Terms, abbreviations used in this Guidance Note.

In this Guidance Note the following terms and abbreviations occur often in the text. A brief explanation of such terms and abbreviations is given below. Further, reference to a section without reference to the relevant Act means that the section has reference to the Income-tax Act, 1961.

(a) Act

The Income-tax Act, 1961.

(b) AS

Accounting Standards issued, prescribed and made mandatory by the Institute of Chartered Accountants of India.

(c) AS(IT)

Accounting Standards notified by the Central Government under section 145(2).

(d) Assessee

As defined in section 2(7).

(e) Audit report

Any report submitted in Form No. 3CA/3CB along with the statement of particulars in Form No. 3CD.

(f) Board

The Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963.

(g) Circular

A circular or instructions issued by the Board under section 119(1).

(h) Form or Forms

Collectively refer to Forms 3CA, 3CB and 3CD.

(i) ICAI

The Institute of Chartered Accountants of India.

(j) Person

As defined in section 2(31).

(k) Previous year

As defined in section 3.

(l) Rules

The Income-tax Rules, 1962.

(m) Specified date

"Specified date", in relation to the accounts of the previous year relevant to an assessment year means, in the case of a company, the 30th day of November of the relevant assessment year and in any other case, the 31st day of October of the relevant assessment year.

(n) Tax audit

The audit carried out under the provisions of section 44AB.

(o) Tax auditor

Auditor appointed by an assessee to carry out tax audit.

2. Introduction

2.1 The Act provides for audit of accounts and/or report/certificate of a chartered accountant in the following cases :-

- (i) Public charitable or religious trusts or institutions under section 12A(b).

(Form No.10B)

- (ii) Assessee carrying on the business of growing and manufacturing tea claiming deduction under section 33AB.

(Form No.3AC)

- (iii) Assessee carrying on business consisting of the prospecting for, or extraction or production of, petroleum or natural gas or both in India and in relation to which the Central Government has entered into an agreement for the purpose of deposit in Site Restoration Account under section 33ABA.

(Form No.3AD)

- (iv) Assesseees other than companies or co-operative societies claiming amortisation of certain preliminary expenses under section 35D and deduction for expenditure on prospecting etc. for certain minerals under section 35E.

(Form No.3B)

- (v) Assesseees incurring any expenditure on or after 1.4.1999 wholly and exclusively in respect of a non-Y2K compliant computer system under section 36 (1)(xi).

(Form No.3BA)

- (vi) Assesseees carrying on business or profession whose sales, turnover or gross receipts exceed Rs.40 lakhs (Rs.10 lakhs in the case of profession), and assesseees who claim their income to be lower than the profits or gains deemed to be the profits and gains of their business under sections 44AD, 44AE or 44AF.

(Forms No.3CA/3CB/ and 3CD)

- (vii) Assesseees who have been ordered by the Assessing Officer with the previous approval of the Chief Commissioner or Commissioner under section 142(2A) to get their books of account audited having regard to the nature and complexity of the accounts of the assessee and the interests of the revenue.

(Form No. 6B)

- (viii) Assesseees other than companies or co-operative societies claiming deduction under section 80HH in respect of profits from newly established industrial undertakings or hotel business in backward areas.

(Form No.10C)

- (ix) Assesseees other than companies or co-operative societies claiming deduction under section 80HHA in respect of profits from newly established small scale industrial undertakings in rural areas.

(Form No.10C)

- (x) Assessee other than companies or co-operative societies claiming deduction under section 80HHB in respect of profits from projects outside India.
(Form No.10CCA)
- (xi) Assessee claiming deduction under section 80HHBA in respect of profits and gains from housing projects.
(Form No.10CCAA)
- (xii) Assessee being supporting manufacturers claiming deduction under section 80HHC in respect of profits on sale of goods and the merchandise to the recognised Export House/Trading House.
(Form No.10CCAB)
- (xiii) Assessee claiming deduction under section 80HHC in respect of export profits.
(Form No.10CCAC)
- (xiv) Assessee claiming deduction under section 80HHD in respect of profits from services provided to foreign tourists.
(Form No.10CCAD)
- (xv) Assessee claiming deduction under section 80HHE in respect of profits from the export of computer software.
(Form No.10CCAF)
- (xvi) Assessee being supporting software developers claiming deduction under section 80HHE in respect of profits on sale of computer software to exporting company.
(Form No.10CCAG)
- (xvii) Assessee being Indian companies, claiming deduction under section 80HHF in respect of profits derived from the business of export or transfer out of India of film software etc.
(Form No.10CCAI)
- (xviii) Assessee other than companies or co-operative societies claiming deduction under section 80-I in respect of profits and gains from newly established industrial undertakings, ships or hotel business set up after 31st March, 1981.
(Form No. 10CCB)

- (xix) Assesseees other than companies or co-operative societies claiming deduction under section 80-IA in respect of profits and gains derived from industrial undertakings etc.

(Form No. 10CCB)

- (xx) Assesseees claiming deduction under sub-section (7A) of section 80-IA in respect of profits and gains of business of housing or other activities which are an integral part of a highway project.

(Form No. 10CCC)

- (xxi) Assesseees, being Indian companies, claiming deduction under section 80JJAA, in respect of employment of new workers.

(Form No. 10DA)

- 2.2 The Guidance Note relating to the audit under section 44AB was first published in the year 1985 and revised in the years 1989 and 1998. The Government has substituted revised Rule 6G and Forms 3CA, 3CB and 3CD in the Official Gazette on June 4, 1999, vide Notification No. 10950/F.No. 153/74/98/TPL and omitted Forms No.3CC and 3CE. Hence, any tax audit report signed after 4th June, 1999 for any assessment year should be issued in the revised Form Nos. 3CA or 3CB along with the statement of particulars in Form No. 3CD, as the case may be. Since the requirements under the revised forms are quite different and enlarged as compared to the earlier forms, it has now become necessary to revise the Guidance Note. The revised Form No. 3CD is quite comprehensive and covers generally all the items included in Form No.6B prescribed for reporting under section 142(2A) and hence this Guidance Note would meet almost all the reporting requirements of audit under section 142(2A) also. However, if under section 142(2A), the Assessing Officer requires special information, the same has to be given separately along with Form No. 6B.
- 2.3 The Institute has published separate Guidance Notes for audit of Public Trusts under section 12A(b) and for audits required for claiming deduction under sections 80HBB/80HHC.
- 2.4 The tax audit was introduced by section 11 of the Finance Act, 1984, which inserted a new section 44AB with effect from 1st April, 1985 [Assessment Year 1985-86]. This section makes it obligatory for a person carrying on business to get his accounts audited by a chartered

accountant, and to furnish by the 'specified date', the report in the prescribed form of such audit, if the total sales, turnover or gross receipts in business in the relevant previous year exceed or exceeds Rs.40 lakhs. For a professional, the provisions of tax audit become applicable, if his gross receipts in profession exceed Rs.10 lakhs. As observed by the Finance Minister, while presenting the Union Budget for 1984-85, and as stated in the Memorandum explaining the provisions of the Finance Bill, 1984, the compulsory audit is intended to ensure proper maintenance of books of account and other records, in order to reflect the true income of the tax payer and to facilitate the administration of tax laws by a proper presentation of the accounts before the tax authorities. This would also save the time of the Assessing Officers considerably in carrying out the verification. The scope of section 44AB was enlarged by the Finance Act, 1997 to provide, w.e.f. Assessment Year 1998-99, that audit under the section would be required in case of a person carrying on the business of the nature referred to in section 44AD or 44AE or 44AF, if such person claims that his income is lower than the amount of income deemed under these sections as presumptive income.

- 2.5 The vires of section 44AB has been upheld by Hon'ble Supreme Court in *T.D. Venkata Rao v. Union of India* [1999] 237 ITR 315 (SC). The Apex Court has made the following significant observations:

"Chartered Accountants, by reason of their training have special aptitude in the matter of audits. It is reasonable that they, who form a class by themselves, should be required to audit the accounts of businesses whose income (sic: turnover) exceeds Rs.40 lakhs and professionals whose income (sic: gross receipts) exceeds Rs.10 lakhs in any given year. There is no material on record and indeed in our view, there cannot be that an income-tax practitioner has the same expertise as chartered accountants in the matter of accounts. For the same reasons the challenge under article 19 must fail, and it must be pointed out that these income-tax practitioners are still entitled to be authorised representatives of assesseees."

3. Provisions of section 44AB

3.1 Section 44AB reads as under :-

"Audit of accounts of certain persons carrying on business or profession.

44AB. Every person, --

- (a) *carrying on business shall, if his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds forty lakh rupees in any previous year; or*
- (b) *carrying on profession shall, if his gross receipts in profession exceed ten lakh rupees in any previous year; or*
- (c) *carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AD or section 44AE or section 44AF, as the case may be, and he has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, as the case may be, in any previous year,*

get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed:

Provided that this section shall not apply to the person, who derives income of the nature referred to in section 44B or section 44BB or section 44BBA or section 44BBB, on and from the 1st day of April, 1985 or, as the case may be, the date on which the relevant section came into force, whichever is later:

Provided further that in a case where such person is required by or under any other law to get his accounts audited, it shall be sufficient compliance with the provisions of this section if such person gets the accounts of such business or profession audited under such law before the specified date and furnishes by that date the report of the audit as required under such other law and a further report in the form prescribed under this section.

Explanation - For the purposes of this section, -

- (i) *"accountant" shall have the same meaning as in the Explanation below sub-section (2) of section 288;*
- (ii) *"specified date", in relation to the accounts of the previous year relevant to an assessment year means, -*
 - (a) *where the assessee is a company, the 30th day of November of the assessment year;*
 - (b) *in any other case, the 31st day of October of the assessment year."*

- 3.2. The above section stipulates that every person carrying on business or profession is required to get his accounts audited by a chartered accountant before the "specified date" and furnish by that date the report of such audit, if the total sales, turnover or gross receipts exceed Rs.40 lakhs in the case of business and gross receipts exceed Rs.10 lakhs in the case of profession - vide clauses (a) and (b) of section 44AB.
- 3.3. Clause (c) of section 44AB, inserted by the Finance Act 1997 w.e.f. assessment year 1998-99, provides that in the case of an assessee carrying on a business of the nature specified in sections 44AD, 44AE or 44AF, tax audit will be required, if he claims his income to be lower than the presumptive income deemed under the said sections. Therefore, an assessee will be required to get his accounts audited even if his turnover does not exceed Rs.40 lakhs.
- 3.4. Under the provisions of sections 44AD and 44AF, an assessee can opt to be assessed on presumptive basis, so long as the gross receipts/total turnover from any of the business(es) do not exceed Rs.40 lakhs. Once the total turnover/gross receipts from any such business(es) exceed Rs.40 lakhs, a tax audit will be required under clause (a) of section 44AB. The provisions of sections 44AA and 44AB shall not apply insofar as they relate to the business of civil construction, etc. as referred to in section 44AD(1), the business of plying, hiring or leasing goods carriages as referred to in section 44AE(1) and retail business as referred to in section 44AF(1). In computing the monetary limits under sections 44AA and 44AB, the turnover/gross receipts, or, as the case may be, the income from the said business shall be excluded.

- 3.5. If a person is carrying on business(es), coming within the scope of sections 44AD, 44AE or 44AF, but he exercises his option given under these sections to get his accounts audited under section 44AB, tax audit requirements would apply, in respect of such business(es) even if the turnover of such business(es) does not exceed Rs.40 lakhs. In the case of a person carrying on businesses covered by section 44AD, 44AE or 44AF and opting for presumptive taxation, tax audit requirement would not apply in respect of such businesses. If such person is carrying on other business(es) not covered by presumptive taxation, tax audit requirements would apply in respect thereof, if the turnover of such business(es), other than the business(es) covered by presumptive taxation thereof, exceed Rs.40 lakhs.
- 3.6. The first proviso to section 44AB stipulates that the provisions of that section will not be applicable to a person who derives income of the nature referred to in sections 44B, 44BB, 44BBA or 44BBB. Where the assessee is carrying on any one or more of the businesses specified in section 44B or section 44BB or section 44BBA or section 44BBB referred to in the first proviso to section 44AB, the sales/turnover/gross receipts from such businesses shall not be included in the total sales/turnover/gross receipts for determining the applicability of section 44AB.
- 3.7. The report of such audit, duly signed and verified by the chartered accountant is required to be given in such form and setting forth such particulars as prescribed by the Board. Rule 6G provides that such audit report and particulars should be given in Forms No. 3CA/3CB as may be applicable and the statement of particulars should be given in Form No.3CD.
- 3.8. A question may arise in the case of an assessee who is eligible to claim deductions under sections 80HH, 80HHA, 80HHC, 80HHD, 80HHE, 80HHF, 80-I or 80-IA etc., as to whether it will be necessary for him to get separate audit reports/certificates under these sections in addition to an audit report under section 44AB. The requirement of section 44AB is a general requirement covering the overall position of the accounts of the assessee. This applies to the consolidated accounts of the assessee for the relevant previous year covering the results of all the units owned by the assessee whether situated at one place or at different places. Therefore, when the turnover of all the units put

together exceed the prescribed limits, the assessee will have to get the audit report under section 44AB in the prescribed form and separate audit reports in the forms prescribed for different purposes like sections 80HH, 80HHA etc. will have to be further obtained by the assessee to meet the specific requirements of the relevant sections.

4. 'Profession' and 'business' explained

4.1. The term "business" is defined in section 2(13) of the Act, as under :-

"Business" includes any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

The word 'business' is one of wide import and it means activity carried on continuously and systematically by a person by the application of his labour or skill with a view to earning an income. The expression "business" does not necessarily mean trade or manufacture only - *Barendra Prasad Roy v ITO [1981] 129 ITR 295 (SC)*.

4.2 Section 2(36) of the Act defines profession to include vocation. Profession is a word of wide import and includes "vocation" which is only a way of living. - *CIT v. Ram Kripal Tripathi [1980] 125 ITR 408 (All)*.

4.3 Whether a particular activity can be classified as 'business' or 'profession' will depend on the facts and circumstances of each case. The expression "profession" involves the idea of an occupation requiring purely intellectual skill or manual skill controlled by the intellectual skill of the operator, as distinguished from an operation which is substantially the production or sale or arrangement for the production or sale, of commodities. - *CIT Vs. Manmohan Das (Deceased) [1966] 59 ITR 699 (SC)*.

The following have been listed out as professions in section 44AA and notified thereunder (Notifications No. SO-17(E) dated 12.1.77 and No. SO 2675 dated 25.9.1992):

- (i) Accountancy
- (ii) Architectural
- (iii) Authorised Representative
- (iv) Company Secretary

- (v) Engineering
- (vi) Film Artists/Actors, Cameraman, Director, Singer, Story-writer, etc.
- (vii) Interior Decoration
- (viii) Legal
- (ix) Medical
- (x) Technical Consultancy

4.4. The following activities have been held to be business :-

- (i) Advertising agent
- (ii) Clearing, forwarding and shipping agents - *CIT v. Jeevanlal Lallubhai & Co. [1994] 206 ITR 548 (Bom).*
- (iii) Couriers
- (iv) Insurance agent
- (v) Nursing home
- (vi) Stock and share broking and dealing in shares and securities - *CIT v. Lallubhai Nagardas & Sons [1993] 204 ITR 93 (Bom).*
- (vii) Travel agent.

5. Sales, turnover, gross receipts

- 5.1. It will be noted that the provision relating to tax audit applies to every person carrying on business, if his total sales, turnover or gross receipts in business exceed Rs.40 lakhs and to a person carrying on a profession, if his gross receipts from profession exceed Rs.10 lakhs in any previous year. However, the term "sales", "turnover" or "gross receipts" are not defined in the Act, and therefore the meaning of the aforesaid terms has to be considered for the applicability of the section.
- 5.2 In the "Guidance Note on Terms Used in Financial Statements" published by the Institute, the expression "Sales Turnover" (Item 15.01) has been defined as under :-

"The aggregate amount for which sales are effected or services rendered by an enterprise. The term 'gross turnover' and 'net turnover' (or 'gross sales' and 'net

sales') are sometimes used to distinguish the sales aggregate before and after deduction of returns and trade discounts".

- 5.3 The Guide to Company Audit issued by the Institute, while discussing "sales", states as follows : (Page 53 of 4th Edition, 1980)

"Total turnover, that is, the aggregate amount for which sales are effected by the company, giving the amount of sales in respect of each class of goods dealt with by the company and indicating the quantities of such sales for each class separately.

Note(i) The term 'turnover' would mean the total sales after deducting therefrom goods returned, price adjustments, trade discount and cancellation of bills for the period of audit, if any. Adjustments which do not relate to turnover should not be made e.g. writing off bad debts, royalty etc. Where excise duty is included in turnover, the corresponding amount should be distinctly shown as a debit item in the profit and loss account."

- 5.4 The "Statement on the Amendments to Schedule VI to the Companies Act, 1956" issued by the Institute, (Page 14, 1976 edition) while discussing the disclosure requirements relating to 'turnover' states as follows:-

"As regards the value of turnover, a question which may arise is with reference to various extra and ancillary charges. The invoices may involve various extra and ancillary charges such as those relating to packing, freight, forwarding, interest, commission, etc. It is suggested that ordinarily the value of turnover should be disclosed exclusive of such ancillary and extra charges, except in those cases where because of the accounting system followed by the company, separate demarcation of such charges is not possible from the accounts or where the company's billing procedure involves a composite charge inclusive of various services rather than a separate charge for each service.

In the case of invoices containing composite charges, it would not ordinarily be proper to attempt a demarcation of ancillary charges on a proportionate or estimated basis. For example, if a company makes a composite charge to its customer, inclusive of freight and despatch, the charge so made should accordingly be treated as part of the turnover for purpose of this section. It would not be proper to reduce the value of the turnover with reference to the approximate value of the service relating to freight and despatch. On the other hand, if the company makes a separate charge for freight and despatch and for other similar services, it would be quite proper to ignore such charges when computing the value of the turnover to be disclosed in the Profit and Loss Account. In other words, the disclosure may well be determined by reference to the company's invoicing and accounting policy and may thereby vary from company to company. For reasons of consistency as far as possible, a company should adhere to the same basic policy from year to year and if there is any change in the policy the effect of that change may need to be disclosed if it is material, so that a comparison of the turnover figures from year to year does not become misleading."

- 5.5. The Statement on the Manufacturing and Other Companies (Auditors' Report) Order, 1988 issued by the Institute in May 1989, while discussing the term 'turnover' in paragraph 41(c) states as follows:

"The term 'turnover' for the purposes of this clause may be interpreted to mean the aggregate amount for which sales are effected or services rendered by an enterprise. If sales tax and excise duty are included in the sale price, no adjustment in respect thereof should be made for considering the quantum of turnover. Trade discount can be deducted from sales but not the commission allowed to third parties. If however, the Excise duty and/or sales tax recovered are credited separately to Excise Duty or Sales Tax Account (being separate accounts) and payments to the authority are debited in the same account, they would

not be included in the turnover. However, sales of scrap shown separately under the heading 'miscellaneous income' will have to be included in turnover".

- 5.6. Considering that the words "Sales", "Turnover" and "Gross receipts" are commercial terms, they should be construed in accordance with the method of accounting regularly employed by the assessee. Section 145(1) provides that income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" should be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. The method of accounting followed by the assessee is also relevant for the determination of sales, turnover or gross receipts in the light of the above discussion.
- 5.7. Applying the above generally accepted accounting principles, a few typical cases may be considered:
 - (i) Discount allowed in the sales invoice will reduce the sale price and, therefore, the same can be deducted from the turnover.
 - (ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. The same should not be deducted from the figure of turnover.
 - (iii) Turnover discount is normally allowed to a customer if the sales made to him exceed a particular quantity. This being dependent on the turnover, as per trade practice, it is in the nature of trade discount and should be deducted from the figure of turnover even if the same is allowed at periodical intervals by separate credit notes.
 - (iv) Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount. If it is in the nature of commission on sales, the same cannot be deducted from the figure of turnover.
 - (v) Price of goods returned should be deducted from the figure of turnover even if the returns are from the sales made in the earlier year/s.

- (vi) Sale proceeds of fixed assets would not form part of turnover since these are not held for resale.
- (vii) Sale proceeds of property held as investment property will not form part of turnover.
- (viii) Sale proceeds of any shares, securities, debentures, etc., held as investment will not form part of turnover. However if the shares, securities, debentures etc., are held as stock-in-trade, the sale proceeds thereof will form part of turnover.

5.8. A question may also arise as to whether the sales by a commission agent or by a person on consignment basis forms part of the turnover of the commission agent and/or consignee as the case may be. In such cases, it will be necessary to find out, whether the property in the goods or all significant risks, reward of ownership of goods belongs to the commission agent or the consignee immediately before the transfer by him to third person. If the property in the goods or all significant risks and rewards of ownership of goods continue to belong to the principal, the relevant sale price shall not form part of the sales/turnover of the commission agent and/or the consignee as the case may be. If, however, the property in the goods, significant risks and reward of ownership belongs to the commission agent and/or the consignee, as the case may be, the sale price received/receivable by him shall form part of his sales/turnover.

In this context, it would be useful to refer to the CBDT Circular No.452 dated 17th March, 1986, where the Board has clarified the question of applicability of section 44AB in the cases of Commission Agents, Arhatias, etc. The Circular is published in Appendix I.

5.9. Share brokers, on purchasing securities on behalf of their customers, do not get them transferred in their names but deliver them to the customers who get them transferred in their names. The same is true in case of sales also. The share broker holds the delivery merely on behalf of his customer. The property in goods does not get transferred to the share brokers. Only brokerage which is being accounted for in the books of account of share brokers should be taken into account for considering the limits for the purpose of section 44AB. However, in case of transactions entered into by share broker on his personal account, the sale value should also be taken into account for

considering the limit for the purpose of section 44AB. The case of a sub-broker is not different from that of a share broker.

5.10. The term "gross receipts" is also not defined in the Act. It will include all receipts whether in cash or in kind arising from carrying on of the business which will normally be assessable as business income under the Act. Broadly speaking, the following items of income and/or receipts would be covered by the term "gross receipts in business":

- i) Profits on sale of a licence granted under the Imports (Control) Order, 1955 made under the Imports and Exports (Control) Act, 1947;
- ii) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India;
- iii) Any duty of customs or excise re-paid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1995;
- iv) The aggregate of gross income by way of interest received by the money lender;
- v) Commission, brokerage, service and other incidental charges received in the business of chit funds;
- vi) Reimbursement of expenses incurred (e.g. packing, forwarding, freight, insurance, travelling etc.) and if the same is credited to a separate account in the books, only the net surplus on this account should be added to the turnover for the purposes of Section 44AB;
- vii) The net exchange rate difference on export sales during the year on the basis of the guiding principle explained in (vi) above will have to be added.
- viii) Hire charges of cold storage;
- ix) Liquidated damages;
- x) Insurance claims - except for fixed assets;
- xi) Sale proceeds of scrap, wastage etc. unless treated as part of sale or turnover, whether or not credited to miscellaneous income account;

- xii) Gross receipts including lease rent in the business of operating lease;
- xiii) Lease rent or interest on financing in the business of finance lease ; and
- xiv) Hire charges and instalments received in the course of hire purchase.

5.11. The following items would not form part of "gross receipts in business" for purposes of section 44AB.

- i) Sale proceeds of fixed assets;
- ii) Sale proceeds of assets held as investments;
- iii) Rental income unless the same is assessable as business income;
- iv) Dividends on shares except in the case of an assessee dealing in shares;
- v) Income by way of interest unless assessable as business income;
- vi) Reimbursement of customs duty and other charges collected by a clearing agent;
- vii) In the case of a recruiting agent, the advertisement charges received by him by way of reimbursement of expenses incurred by him;
- viii) In the case of a travelling agent, the amount received from the clients for payment to the airlines, railways etc. where such amounts are received by way of reimbursement of expenses incurred on behalf of the client. If, however, the travel agent is conducting a package tour and charges a consolidated sum for transportation, boarding and lodging and other facilities, then the amount received from the members of group tour should form part of gross receipts, and
- ix) In the case of an advertising agent, the amount of advertising charges recovered by him from his clients provided these are by way of reimbursement. But if the advertising agent books the advertisement space in bulk and recovers the charges from

different clients, the amount received by him from the clients will not be the same as the charges paid by him and in such a case the amount recovered by him will form part of his gross receipts.

- 5.12. Thus the principle to be applied is that if the assessee is merely reimbursed for certain expenses incurred, the same will not form part of his gross receipts. But in the case of charges recovered, which are not by way of reimbursement of the actual expenses incurred, they will form part of his gross receipts.
- 5.13. In the case of a professional, the expression "gross receipts" in profession would include all receipts arising from carrying on of the profession. A question may, however, arise as to whether the out of pocket expenses received by him should form part of his gross receipts for purposes of this section. Normally, in the case of solicitors, advocates or chartered accountants, such out of pocket expenses received in advance are credited in a separate client's account and utilised for making payments for stamp duties, registration fees, counsel's fees, travelling expenses etc. on behalf of the clients. These amounts, if collected separately either in advance or otherwise, should not form part of the "gross receipts". If, however, such out of pocket expenses are not specifically collected but are included/collected by way of a consolidated fee, the whole of the amount so collected shall form part of gross receipts and no adjustment should be made in respect of actual expenses paid by the professional person for and/or on behalf of his clients out of the gross fees so collected. However, the amount received by way of advance for which services are yet to be rendered will not form part of the receipts, as such advances are the liabilities of the assessee and cannot be treated as his receipts till the services are rendered.
- 5.14. A question may arise in the case of an assessee carrying on business and at the same time engaged in a profession as to what are the limits applicable to him under section 44AB for getting the accounts audited. In such a case if his professional receipts are, say, rupees twelve lakhs but his total sales, turnover or gross receipts in business are, say, rupees twenty two lakhs, it will be necessary for him to get his accounts of the profession and also the accounts of the business audited because the gross receipts from the profession exceed the limit of rupees ten lakhs. If however, the

professional receipts are, say, rupees seven lakhs and total sales turnover or gross receipts from business are, say, rupees thirty four lakhs it will not be necessary for him to get his accounts audited under the above section, because his gross receipts from the profession as well as total sales, turnover or gross receipts from the business are below the prescribed limits.

- 5.15. It may, however, be noted that in cases where the assessee carries on more than one business activity, the results of all business activities should be clubbed together. In other words, the aggregate sales, turnover and/or gross receipts of all businesses carried on by an assessee would be taken into consideration in determining whether the limit of Rs.40 lakhs as laid down in this section has been exceeded or not. However, where the business is covered by section 44B or 44BB or 44BBA or 44BBB, turnover of such business shall be excluded. Similarly when the business is covered by sections 44AD, 44AE and 44AF and the assessee opts to be assessed under the respective sections on presumptive basis, the turnover thereof shall be excluded. So far as a partnership firm is concerned, each firm is an independent assessee for purposes of Income-tax Act. Therefore, the figures of sales of each firm will have to be considered separately for purposes of determining whether or not the accounts of such firm are required to be audited for purposes of section 44AB.
- 5.16. It must also be understood that the issue whether the turnover exceeds Rs.40 lakhs in the case of business or the gross receipts exceed Rs.10 lakhs in the case of profession is to be determined in each year independent of the results obtained in the preceding year or years. Further, this section applies only if the turnover exceeds the prescribed limit according to the accounts maintained by the assessee. If the Assessing Officer wants the assessee to get his accounts audited in cases where the figures of turnover as appearing in the books of account of the assessee do not exceed the prescribed limits, he has no option but to pass an order under section 142(2A) directing the assessee to get his accounts audited from a particular chartered accountant as may be nominated by the Commissioner of Income-tax or the Chief Commissioner of Income-tax.

6. Liability to tax audit - special cases

- 6.1. A question may arise in the case of an assessee whose income is not chargeable to income-tax by reason of a specific exemption contained

in the law or otherwise, as to whether he is required to get his accounts audited and to furnish such report under section 44AB. Such cases may cover those assesseees who are wholly outside the purview of income-tax law as well as those whose income is otherwise exempt under the Act. It is felt that neither section 44AB nor any other provisions of the Act stipulate exemption from the compulsory tax audit to any person whose income is exempt from tax. This section makes it mandatory for every person carrying on any business or profession to get his accounts audited where conditions laid down in the section are satisfied and to furnish the report of such audit in the prescribed form. A charitable trust carrying on business may enjoy exemption under sections 10(21), 10(23), 10(23B) or section 10(23BB) or section 10(23C) and a research association carrying on business may enjoy exemptions under section 10(21) and section 11. A co-operative society carrying on business may enjoy exemption under section 80P. Such institutions/ associations of persons will have to get their accounts audited and to furnish such audit report for purposes of section 44AB if their turnover in business exceeds Rs.40 lakhs. But an agriculturist, who does not have any income under the head "Profits and gains of business or profession" chargeable to tax under the Act and who is not required to file any return under the said Act, need not get his accounts audited for purposes of section 44AB even though his total sales of agricultural products may exceed Rs.40 lakhs. It may be appreciated that the object of audit under section 44AB is only to assist the Assessing Officer in computing the total income of an assessee in accordance with different provisions of the Act. Therefore, even if the income of a person is below the taxable limit laid down in the relevant Finance Act of a particular year, he will have to get his accounts audited and to furnish such report under section 44AB, if his turnover in business exceed Rs.40 lakhs.

- 6.2. The case of non-residents may be considered separately. Section 44AB does not make any distinction between a resident or non-resident. Therefore, a non-resident assessee is also required to get his accounts audited and to furnish such report under section 44AB if his turnover exceeds the prescribed limits. This audit, however, would be confined only to the Indian operations carried out by the non-resident assessee since he is not chargeable to income-tax in India in respect of income accruing or arising or received outside India.

7. Specified date and tax audit

A question may arise whether a tax auditor appointed under section 44AB can be held responsible if he does not complete the audit and give his audit report before the specified date. Answer to this question will depend on the facts and circumstances of the case. Normally, it is the professional duty of the chartered accountant to ensure that the audit accepted by him is completed before the due date. If there is any unreasonable delay on his part, he is answerable to the Institute if the complaint is made by the client. However, if the delay in the completion of audit is attributable to his client, the tax auditor cannot be held responsible. In view of the fact that section 44AB does not give any discretion to the tax authorities to extend the time limit for completion of audit, the audit has to be completed within the time limit provided in this section. It is, therefore, necessary that no chartered accountant should accept audit assignments which he cannot complete within the above time frame. In this regard, reference may also be made to paragraph 12 of this Guidance Note.

8. Penalty

- 8.1. In order to ensure proper compliance with section 44AB, section 271-B has been enacted which reads as under:-

"Failure to get accounts audited

271B. *If any person fails to get his accounts audited in respect of any previous year or years relevant to an assessment year or furnish a report of such audit as required under section 44AB, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum equal to one-half per cent of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years or a sum of one hundred thousand rupees, whichever is less."*

- 8.2. As such, the failure of a person, to get his accounts audited in respect of any previous year or furnish a copy of such report as required under section 44AB may attract a penalty equal to 0.5% of the total sales, turnover or gross receipts, or Rs.1 lakh whichever is less. However, in view of the specific provisions contained in section 273B, no penalty is

impossible under section 271B on the assessee for the above failure if he proves that there was reasonable cause for the said failure. The onus of proving reasonable cause is on the assessee.

8.3. Some of the instances where Tribunals/Courts have accepted as "reasonable cause" are as follows :-

- (a) Resignation of the tax auditor and consequent delay;
- (b) *Bona fide* interpretation of the term 'turnover' based on expert advice;
- (c) Death or physical inability of the partner in charge of the accounts;
- (d) Labour problems such as strike, lock out for a long period, etc.;
- (e) Loss of accounts because of fire, theft, etc. beyond the control of the assessee;
- (f) Non-availability of accounts on account of seizure;
- (g) Natural calamities, commotion, etc.

9. Tax auditor

9.1. The term "accountant" has been defined in sub-clause (i) of Explanation to section 44AB as under:-

"Explanation, - For the purposes of this section, -

- (i) "accountant" shall have the same meaning as in the Explanation below sub-section (2) of section 288".

The above-mentioned Explanation reads as under:

'Accountant' means a chartered accountant within the meaning of Chartered Accountants Act, 1949 (38 of 1949) and includes, in relation to any State, any person, who by virtue of the provisions of sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), is entitled to be appointed to act as an tax auditor of companies registered in that State."

The proviso to section 44AB also lays down that where the accounts of an assessee are required to be audited by or under any other law, it shall be sufficient compliance with the provisions of this section, if such person gets the accounts of such business or profession audited under

such other law before the specified date and furnishes by that date the report of the audit as required under section 44AB. It may be noted that with the deletion of the words "by an accountant" in the proviso to section 44AB by the Finance Act, 1985 with effect from 1st April, 1985, in the case of any assessee like a co-operative society where the accounts under the relevant law are allowed to be audited by a person other than a chartered accountant, the tax audit may also be conducted by the statutory auditor who may not be a chartered accountant.

- 9.2. Though the section refers to the accounts being audited by an accountant which means a chartered accountant as defined above, the audit can also be done by a firm of chartered accountants. This has been a recognised practice under the Act. In such a case, it would be necessary to state the name of the partner who has signed the audit report on behalf of the firm. The member signing the report as a partner of a firm or in his individual capacity should give his membership number below his name.
- 9.3. Section 44AB does not stipulate that only the statutory auditor appointed under the Companies Act or other similar statute should perform the tax audit. The tax audit can, therefore, be conducted either by the statutory auditor or by any other chartered accountant in practice.
- 9.4. A question may arise in the case of a public sector company or any other company where the statutory auditor has not been appointed by the authorities concerned as to whether the tax auditor appointed under section 44AB can complete his audit without waiting for statutory audit report on the accounts audited by the statutory auditors. It may be noted that Form No. 3CA requires the tax auditor to enclose a copy of the audit report conducted by the statutory auditor or the auditor of the financial statements as the case may be. Where a statutory auditor has not been appointed by the authorities concerned or where the report of the statutory auditor is not available for whatever reasons, it will be possible for the tax auditor to give his report in Form No. 3CB and to certify the relevant particulars in Form No. 3CD. This is particularly important in those cases where the assessee concerned has suffered losses in the relevant accounting year. It may, however, be noted that the tax auditor in such cases will have to conduct the financial audit as well in order to enable him to certify whether or not the accounts

reported upon by him give a true and fair view of the state of affairs of the assessee whose accounts are audited by him under section 44AB.

- 9.5 Tax audit under section 44AB being a recurring audit assignment, for expressing professional opinion on the financial statements and the particulars, the member accepting the assignment **should communicate** with the member who had done tax audit in the earlier year as provided in the Chartered Accountants Act. In the case of a person whose accounts of the business or profession have been audited under any other law (i.e. a company, a co-operative society, etc. which is required to get the accounts audited under a Statute) it is not necessary to communicate with the statutory auditor if he had not done tax audit in the earlier year. Attention of the members is invited to the detailed discussion in the publication of ICAI, "Code of Conduct" under clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 vide Appendix II.
- 9.6 The tax auditor should obtain from the assessee a letter of appointment for conducting the audit as mentioned in section 44AB. It is advisable that such an appointment letter should be signed by the person competent to sign the return of income in terms of the provisions of section 140. The tax auditor should get the statement of particulars, as required in the annexure to the audit report, authenticated by the assessee before he proceeds to verify the same.
- 9.7. The tax auditor is required to submit his report to the person appointing him viz. the assessee.
- 9.8. The appointment of the auditor for tax audit in the case of a company need not be made at the general meeting of the members. It can be made by the Board of Directors or even by any officer, if so authorised by the Board in this behalf. The appointment in the case of a firm or a proprietary concern can be made by a partner or the proprietor or a person authorised by the assessee. It is possible for the assessee to appoint two or more chartered accountants as joint auditors for carrying out the tax audit, in which case, the audit report will have to be signed by all the chartered accountants. In case of disagreement, they can give their reports separately. In this regard, attention is invited to paragraph 15 of the Statement on the Responsibility of Joint Auditors reproduced below:

“No problem arises if the joint auditors are able to arrive at an agreed report. But, where joint auditors are in disagreement with regard to the report, each one of them would be justified in expressing his own opinion through a separate report. Even where more than two joint auditors are appointed, there is no question of majority or minority with regard to the joint audit report. Each auditor is entitled to express his own separate opinion and, in fact, it is his duty to do so.”

The responsibility of joint tax auditors will be the same as in the case of other audits e.g. audit under the Companies Act. For details relating to such responsibility, in the case of joint tax audit, reference may be made to "Statement on the Responsibility of Joint Auditors" issued by ICAI. The same is reproduced in Appendix III.

- 9.9. The position of a tax auditor for conducting audit under section 44AB will be considered as an office of profit. Therefore, the provisions of section 314 of the Companies Act, 1956 will be attracted when a relative of a director is appointed as a tax auditor of the company, if the remuneration thereof exceeds the limits prescribed in the aforesaid section. The necessary formalities will be required to be complied with as required under section 314.
- 9.10. The Act does not prohibit a relative or an employee of the assessee being appointed as a tax auditor under section 44AB. It may, however, be noted that as per a decision of the Council (reported in the Code of Conduct under clause(4) of Part I of Second Schedule), a chartered accountant who is in employment of a concern or in any other concern under the same management cannot be appointed as tax auditor of that concern. Therefore, an employee of an assessee or an employee of a concern under the same management cannot audit the accounts of an assessee under section 44AB. It may also be noted that under the Second Schedule to the Chartered Accountants Act, if a member gives an audit report under section 44AB in the case of a concern in which he and/or his relatives have substantial interest, it will be necessary for him to disclose his interest in the audit report. Relevant extracts from the Code of Conduct published by ICAI relating to disclosure of substantial interest by a chartered accountant are given in Appendix IV.

- 9.11. A chartered accountant who is responsible for writing or the maintenance of the books of account of the assessee should not audit such accounts. This principle will apply to the partner of such a member as well as to the firm in which he is a partner. In view of this, a chartered accountant who is responsible for writing or the maintenance of the books of account or his partner or the firm in which he is a partner should not accept tax audit assignment under section 44AB in the case of such an assessee.
- 9.12. The audit of accounts of a professional firm of chartered accountants, under section 44AB cannot be conducted by any partner or employee of such firm.
- 9.13. A chartered accountant/firm of chartered accountants, who is appointed as tax consultant of the assessee, can conduct tax audit under section 44AB. But an internal auditor of the assessee cannot conduct tax audit if he is an employee of the assessee. If the internal auditor is working in a professional capacity (as an independent chartered accountant not being an employee of the assessee), he can conduct the tax audit.
- 9.14. A question may arise whether an assessee can remove a tax auditor appointed under section 44AB. The answer depends upon the facts and circumstances of the case. There is no specific procedure for removal of a tax auditor appointed under section 44AB. It is, however, possible for the management to remove a tax auditor where there are any valid grounds for such removal. This may arise where the tax auditor has delayed the submission of audit report under section 44AB for an unreasonable period and if it is found that there is no possibility of getting the audit report before the specified date. In such cases, the assessee may be justified in removing the tax auditor. However, the tax auditor cannot be removed on the ground that he has given an adverse audit report or the assessee has an apprehension that the tax auditor is likely to give an adverse audit report. If there is any unjustified removal of tax auditors, the concerned committee constituted by the Institute can intervene in such cases. No other chartered accountant should accept the audit assignment if the removal of his predecessor is not on valid grounds.
- 9.15. Before accepting a tax audit, the chartered accountant should take into consideration the ceiling on tax audit assignments fixed under the Notification dated 13th January, 1989, issued by the ICAI. A copy of this Notification is appended as Appendix V.

- 9.16. In view of the said Notification, a member of the Institute in practice, shall be deemed to be guilty of professional misconduct if he accepts in a financial year more than 30 tax audit assignments or such other limit as may be prescribed by ICAI from time to time under section 44AB, whether in respect of a person whose accounts have been audited under any other law or a person who carries on business or profession but who is not required by or under any other law to get his accounts audited. Further, as per a Council decision, audits of accounts of persons carrying on business covered by sections 44AD, 44AE or 44AF, is not included in the aforesaid limit. In case the member is a partner of a firm of chartered accountants in practice, the ceiling of 30 tax audit assignments shall be computed with reference to each of the partner in the said firm. Where any partner of the firm of chartered accountants in practice is also a partner of any other firm or firms of chartered accountants in practice, the ceiling limit of 30 shall apply with reference to all the firms together in relation to such partner. Similarly, where any partner accepts one or more tax audit assignments in his individual capacity, the total number of such assignments under section 44AB which may be accepted by him whether directly in his individual capacity or as partner of the firm of chartered accountants in practice shall not exceed 30 tax audit assignments. If two members or firms of chartered accountants are appointed as joint tax auditors, then the assignment will have to be included in the case of both the members or firms separately. It has, however, been clarified that the audit of the head office and branch offices concerned shall be regarded as one tax audit assignment. Similarly, the audit of one or more branches of the same concern by one chartered accountant in practice shall be construed as only one tax audit assignment. In computing the specified number of tax audit assignments each year's audit would be taken as a separate assignment. Every chartered accountant in practice shall maintain a record of the tax audit assignments accepted by him in each financial year in the format prescribed by the Council. This format is reproduced in Appendix VI.
- 9.17. No separate guidelines have been prescribed for tax audit fees under section 44AB. The Institute has recommended fees for professional services on the basis of time devoted by a chartered accountant and his assistants. The fees for tax audit assignment can be charged by a chartered accountant on the basis of the work involved in the

assignment. It will be appreciated that no uniform fees can be recommended on the basis of turnover because an assessee having turnover of Rs.1 crore in a trading activity may have less transactions as compared to an assessee having the same turnover in a manufacturing activity. Similarly the transactions in a wholesale business will be less than the transactions in a retail business. The scale of fees effective from 1.4.1995 recommended by the Institute for professional services is given in Appendix VII (published in 'The Chartered Accountant', April, 1995 p.1402). The Council has also clarified that the scale does not include fees chargeable in respect of non-qualified assistants and that the chartered accountants are free to negotiate the terms in respect of such assistants with the clients.

The chartered accountants should charge reasonable fees depending upon the responsibility involved under the revised forms and taking into consideration the work involved in tax audit assignment which has increased considerably consequent to the revision of the forms. It is necessary that members of the profession should also maintain reasonable standards of professional fees.

9.18. Attention is also invited to Notification No.1-CA/(7)/29/95 dated 1st March, 1995 of the Institute (published in 'The Chartered Accountant', April, 1995 p.1394) which prescribes minimum fees to be charged by certain specified categories of firms. The Notification is reproduced as Appendix - VIII. The notification does not apply to certification or audit under Income-tax Act by the statutory auditor. The limits specified in the notification will therefore apply only if tax audit is conducted by a firm other than that of statutory auditors. Also, where tax audit and statutory audit are done by the same firm, the total fee for both assignments shall be reckoned for the purpose.

9.19 As mentioned in Paragraph 9.16 above, the audit of the head office and branch offices of an assessee shall be regarded as one tax audit assignment.

10. Accounting Standards

10.1. Recognising the need to harmonise the diverse accounting policies and practices in use in India and keeping in view the International developments in the field of accounting, the Council of the Institute has issued AS.

- 10.2. AS are formulated by the Accounting Standards Board and issued by the Council of the Institute. Such Standards are issued for use in the presentation of general purpose financial statements which are issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members. The term 'General Purpose Financial Statements' includes balance sheet, statement of profit and loss and other statements and explanatory notes which form part thereof, issued for the use of shareholders/members, creditors, employees and public at large.
- 10.3. The Institute has so far issued fifteen definitive standards as follows:
- AS-1 Disclosure of Accounting Policies
 - AS-2 (Revised) Valuation of Inventories
 - AS-3 (Revised) Cash Flow Statements
 - AS-4 (Revised) Contingencies and Events Occurring After the Balance Sheet Date.
 - AS-5 (Revised) Net Profit or Loss for the period, Prior Period items and changes in Accounting policies
 - AS-6 (Revised) Depreciation Accounting
 - AS-7 Accounting for Construction Contracts
 - AS-8 Accounting for Research and Development
 - AS-9 Revenue Recognition
 - AS-10 Accounting for Fixed Assets
 - AS-11 (Revised) Accounting for the Effects of Changes in Foreign Exchange Rates
 - AS-12 Accounting for Government Grants
 - AS-13 Accounting for Investments
 - AS-14 Accounting for Amalgamations
 - AS-15 Accounting for Retirement Benefits in the Financial Statements of Employers

Out of the 15 Standards issued so far, 14 have been made mandatory except AS-3 Cash Flow Statements (Revised). It may be noted that AS-2 (Revised) Valuation of Inventories has been made mandatory from accounting year starting from 1.4.1999. The mandatory AS also apply in respect of financial statements audited under section 44AB of the Income-tax Act, 1961. Accordingly, members should examine compliance with the mandatory accounting standards when conducting such audit.

- 10.4. AS apply in respect of commercial, industrial or business activities of an enterprise. In the case of charitable or religious organisations, AS will not apply if all activities of such organisations are not of commercial, industrial or business nature (e.g. an activity of collecting donations and giving them to flood affected people). In other words, exclusion of an entity from the applicability of the AS would be permissible only if no part of the activity of such entity is commercial, industrial or business in nature. Even if a very small portion of the activities of an entity is considered to be commercial, industrial or business in nature, then it cannot claim exemption from the application of AS. The AS would apply to all its activities including those which are not commercial, industrial or business in nature.
- 10.5 The Companies Act, 1956, as well as many other statutes require that the financial statements of an enterprise should give a true and fair view of its financial position and working results. This requirement is implicit even in the absence of a specific statutory provision to this effect. However, what constitutes 'true and fair' view has not been defined either in the Companies Act, 1956, or in any other statute. The Accounting Standards (as well as other pronouncements of the Institute on accounting matters) seek to describe the accounting principles and the methods of applying these principles in preparation and presentation of financial statements so that they give a true and fair view.

In this connection, it may be noted that sub-section (3A) of section 211 of the Companies Act, 1956, newly inserted by the Companies (Amendment) Act, 1999 w.e.f. 31.10.1998 provides that every profit and loss account and balance sheet of a company shall comply with the accounting standards. Sub-section (3B) thereof, also newly inserted, provides that where the profit and loss account and the balance sheet of

the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and balance sheet, the following namely:-

- (i) the deviation from the accounting standards;
- (ii) the reasons for such deviation; and
- (iii) the financial effect, if any, arising due to such deviation.

Sub-section (3C) provides that for the purposes of section 211, the expression "accounting standards" means the standards of accounting recommended by the Institute of Chartered Accountants of India as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under sub-section (1) of section 210A. The proviso under sub-section (3C) provides that the standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the Accounting Standards until the accounting standards are prescribed by the Central Government under sub-section (3C).

Further, sub-clause (d) has been inserted in sub-section (3) of section 227 to provide that the auditors' report shall also state whether, in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in sub-section (3C) of section 211.

- 10.6. The 'Preface to the Statements of Accounting Standards', issued by the Institute, *inter alia*, states:

"While discharging their attest function, it will be the duty of the members of the Institute to ensure that the Accounting Standards are implemented in the presentation of financial statements covered by their audit reports. In the event of any deviation from the Standards, it will be also their duty to make adequate disclosures in their reports so that the users of such statements may be aware of such deviations."

- 10.7. While discharging their attest function, the members of the Institute may keep the following in mind with regard to the mandatory AS.

AS 1 Disclosure of Accounting Policies-AS 1.

In the case of a company, members should qualify their audit reports in case:

- (a) accounting policies required to be disclosed under Schedule VI or any other provisions of the Companies Act, 1956, have not been disclosed, or
- (b) accounts have not been prepared on accrual basis, or
- (c) the fundamental accounting assumptions of going concern and consistency have not been followed and this fact has not been disclosed in the financial statements, or
- (d) proper disclosures regarding changes in the accounting policies have not been made.
- (e) Accounting Standards referred to in section 211(3C) of the Companies Act, 1956 have not been followed.

Where a company has been given a specific exemption regarding any of the matters stated above, but the fact of such exemption has not been adequately disclosed in the accounts, the member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.

- 10.8 In the case of an enterprise other than a company, members should qualify their audit reports in case AS issued, prescribed and made mandatory by the ICAI have not been followed.

10.9 Financial Statements prepared on a basis other than accrual.

With regard to the fundamental accounting assumption of accrual, the Council has made a specific announcement that in respect of (a) Sole proprietary concerns/individuals, (b) Partnership firms, (c) Societies registered under the Societies Registration Act, (d) Trusts, (e) Hindu undivided families and (f) Association of persons, the auditor should examine whether the financial statements have been prepared on accrual basis. In case where the statute governing the enterprise requires the preparation and presentation of financial statements on accrual basis but the financial statements have not been so prepared, the auditor should qualify his report. On the other hand where there is no statutory requirement for preparation and presentation of financial

statements on accrual basis, and the financial statements have been prepared on a basis other than 'accrual', the auditor should describe in his audit report, the basis of accounting followed, without necessarily making it a subject matter of a qualification. In such a case the auditor should also examine whether those provisions of the AS which are applicable in the context of the basis of accounting followed by the enterprise have been complied with or not and consider making suitable qualifications in his audit report accordingly.

10.10. **Accounting Standards under Taxation Law:**

The Finance Act, 1995 substituted a new section 145 w.e.f. assessment year 1997-98. The section deals with method of accounting and is reproduced below :-

"145. (1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assesseees or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144."

10.11 **Standards notified by Government -AS(IT):**

In exercise of the powers conferred by section 145(2), the Central Government has by Notification No. S.O.69(E), dated 25th January, 1996 notified two AS(IT). This notification came into force with effect from 1st day of April, 1996, and is accordingly applicable from assessment year 1997-98 and subsequent assessment years.

These AS(IT) are given below:

Accounting Standards to be followed by all assesseees following mercantile system of accounting

A. Accounting Standard I relating to disclosure of accounting policies

1. All significant accounting policies adopted in the preparation and presentation of financial statements shall be disclosed.
2. The disclosure of the significant accounting policies shall form part of the financial statements and the significant accounting policies shall normally be disclosed in one place.
3. Any change in an accounting policy which has a material effect in the previous year or in the years subsequent to the previous years shall be disclosed. The impact of, and the adjustments resulting from such change, if material, shall be shown in the financial statements of the period in which such change is made to reflect the effect of such change. Where the effect of such change is not ascertainable, wholly or in part, the fact shall be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the previous year but which is reasonably expected to have a material effect in any year subsequent to the previous year, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted.
4. Accounting policies adopted by an assessee should be such so as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies. For this purpose, the major considerations governing the selection and application of accounting policies are the following, namely:
 - (i) Prudence - Provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information;

- (ii) Substance over form - The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form;
 - (iii) Materiality - Financial statements should disclose all material items, the knowledge of which might influence the decisions of the user of the financial statements.
5. If the fundamental accounting assumptions relating to going concern, Consistency and Accrual are followed in financial statements, specific disclosure in respect of such assumptions is not required. If a fundamental accounting assumption is not followed, such fact shall be disclosed.
6. For the purposes of paragraphs (1) to (5), the expressions, -
- (a) "Accounting policies" means the specific accounting principles and the methods of applying those principles adopted by the assessee in the preparation and presentation of financial statements;
 - (b) "Accrual" refers to the assumption that revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate;
 - (c) "Consistency" refers to the assumption that accounting policies are consistent from one period to another;
 - (d) "Financial statements" means any statement to provide information about the financial position, performance and changes in the financial position of an assessee and includes balance sheet, profit and loss account and other statements and explanatory notes forming part thereof;
 - (e) "Going concern" refers to the assumption that the assessee has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the business, profession or vocation and intends to continue his business, profession or vocation for the foreseeable future.

B. Accounting Standard II relating to disclosure of prior period and extraordinary items and changes in accounting policies:

7. Prior period items shall be separately disclosed in the profit and loss account in the previous year together with their nature and amount in a manner so that their impact on profit or loss in the previous year can be perceived.
8. Extraordinary items of the enterprise during the previous year shall be disclosed in the profit and loss account as part of income. The nature and amount of each such item shall be separately disclosed in a manner so that their relative significance and effect on the operating results of the previous year can be perceived.
9. A change in an accounting policy shall be made only if the adoption of a different accounting policy is required by statute or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements by an assessee.
10. Any change in an accounting policy which has a material effect shall be disclosed. The impact of, and the adjustments resulting from such change, if material, shall be shown in the financial statements of the period in which such change is made to reflect the effect of such change. Where the effect of such change is not ascertainable, wholly or in part, the fact shall be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the previous year but which is reasonably expected to have a material effect in years subsequent to the previous years, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted.
11. A change in an accounting estimate that has a material effect in the previous year shall be disclosed and quantified. Any change in an accounting estimate which is reasonably expected to have a material effect in years subsequent to the previous year shall also be disclosed.
12. If a question arises as to whether a change is a change in accounting policy or a change in an accounting estimate, such a question shall be referred to the Board for decision.

13. For the purposes of paragraphs (7) to (12), the expressions:

- (a) "Accounting estimate" means an estimate made for the purpose of preparation of financial statements which is based on the circumstances existing at the time when the financial statements are prepared;
- (b) "Accounting policies" means the specific accounting principles and the method of applying those principles adopted by the assessee in the preparation and presentation of financial statements;
- (c) "Extraordinary items" means gains or losses which arise from events or transactions which are distinct from the ordinary activities of the business and which are both material and expected not to recur frequently or regularly. Extraordinary items include material adjustments necessitated by circumstances which though related to the years preceding the previous years are determined in the previous year:

Provided that income or expenses arising from the ordinary activities of the business or profession or vocation of an assessee, though abnormal in amount or infrequent in occurrence, shall not qualify as extraordinary items;

- (d) "Financial statements" means any statement to provide information about the financial position, performance and changes in the financial position of an assessee and includes balance sheet, profit and loss account and other statements and explanatory notes forming part thereof;
- (e) "Prior period items" means material charges or credits which arise in the previous year as a result of errors or omissions in the preparation of the financial statements of one or more previous years:

Provided that the charge or credit arising on the outcome of a contingency, which at the time of occurrence could not be estimated accurately shall not constitute the correction of an error but a change in estimate and such an item shall not be treated as a prior period item.

The above Accounting Standards are to be followed by all assesseees following mercantile system of accounting. Therefore, it is clear that those assesseees who are following cash system of accounting need not follow the Accounting Standards notified above.

10.12. Implications of non-compliance with the AS and AS(IT)

As mentioned earlier, AS are applicable to tax audit also when the tax auditor performs the attest function, i.e., report on whether the accounts are true and fair. Therefore, in case of non-compliance with the AS, the chartered accountant should make appropriate qualifications/disclosures in the audit report. However, such qualifications/disclosures may or may not have any impact on the computation of total income for the purpose of the Act. Similarly, section 145 provides that the AS(IT) notified under that section should be followed by the assesseees to whom they are made applicable. It should be noted that the tax auditor auditing accounts under section 44AB is not computing the income but is - (a) reporting on accounts, and (b) reporting on the relevant information furnished in Form No. 3CD. Now, the revised Form No. 3CD *vide* clause 11(d) requires reporting of the details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under section 145 and the effect thereof on the profit or loss. Further, it may be noted that there is no material difference between AS(IT)-1 and AS(IT)-2 notified by the Government and the corresponding AS-1 and AS-5 of the ICAI respectively.

11. Audit procedures

- 11.1. In the case of an audit, the tax auditor is required to express his opinion as to whether the financial statements give a true and fair view of the state of affairs of the assessee in the case of the balance sheet and in the case of the profit and loss account/ income and expenditure account, of the profit/loss or income/expenditure. As regards the statement of particulars to be annexed to the audit report, he is required to give his opinion as to whether the particulars are true and correct. In giving his report the tax auditor will have to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require, considering the contents of the audit report. He will

have to conduct the audit by applying the generally accepted auditing procedures which are applicable for any other audit. He can apply the technique of test audit depending on the type of internal control procedures followed by the assessee. The tax auditor will also have to keep in mind the concept of materiality depending upon the circumstances of each case. He would be well advised to refer to the Statements on Standard Auditing Practices (SAPs) issued by ICAI, the "Statement on Auditing Practices" as well as the "Guidance Note on Audit Reports and Certificates for Special Purposes" while determining the extent of test checks and materiality in each particular case. If the statutory auditor of a person is also appointed to undertake tax audit, it is advisable to carry out both the audits concurrently.

- 11.2. Section 227 of the Companies Act gives certain powers to the auditors to call for the books of account, information, documents, explanations, etc. and to have access to all books and records. No such powers are given to the tax auditor appointed under Section 44AB. However, since the appointment of the tax auditor is made by assessee, it will be in the interest of the assessee to furnish all the information and explanations and produce books of account and records required by the tax auditor. If, however, the assessee refuses to produce any particular record or to give any specific information or explanation, the tax auditor will be required to report the same and qualify his report.
- 11.3. The audit report given under Section 44AB is to assist the income-tax department to assess the correct income of the assessee. In order that the tax auditor may be in a position to explain any question which may arise later on, it is necessary that he should keep detailed notes about the evidence on which he has relied upon while conducting the audit and also maintain all his working papers. Such working papers should include his notes on the following, amongst other matters:
 - (a) work done while conducting the audit and by whom;
 - (b) explanations and information given to him during the course of the audit and by whom;
 - (c) decision on the various points taken;
 - (d) the judicial pronouncements relied upon by him while making the audit report; and

- (e) certificates issued by the client/management letters.

Attention is also invited to the Statement on Standard Auditing Practices: Documentation (SAP-3) which provides that the tax auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

- 11.4. If the accounts of the business or profession of a person have been audited under any other law by the statutory auditor(s), it is not necessary for the tax auditor appointed under section 44AB to conduct the audit once again in the matter of expression of "true and fair view" of the state of affairs of the entity and of its profit/loss for the period covered by the audit. However, the said section envisages the certification of the particulars in the prescribed form on which the tax auditor has to express his opinion as to whether these are 'true and correct'. In other words, where an audit has already been conducted and the opinion of the auditor has been expressed on the accounts, it would not be necessary to repeat the entire exercise to express similar opinion all over again. The tax auditor has only to annex a copy of the audited accounts and the auditor's report and other documents forming part of these accounts to his report and verify the particulars in the prescribed form for expressing his opinion as to whether these are true and correct.
- 11.5. While test checks may suffice in the conduct of a statutory audit for the expression of the auditor's opinion as to whether the accounts depict a 'true and fair' view, the tax auditor may be required to apply reasonable tests on the total information to be prepared by the assessee in respect of certain items in the prescribed form, e.g., in verification of payments for purchases/expenses exceeding Rs.20,000/-in cash. While the entity may have to prepare the details for the entire year, the tax auditor may have to ensure that no items have been omitted in the information furnished and a reasonable test check would reveal whether or not the information furnished is correct. The extent of check undertaken would have to be indicated by the tax auditor in his working papers and audit notes. The tax auditor would be well advised to so design his tax audit programme as would reveal the extent of checking and to ensure adequate documentation in support of the information being certified.

- 11.6. The tax auditor may rely upon the audit conducted by an internal auditor or by an outside professional firm appointed as internal auditor, by using his own judgement as to the degree of reliance which he wishes to place on the work of the internal auditor relevant to tax audit. The degree of reliance would depend on the areas of work covered by the internal auditor and relevant for purposes of tax audit, particularly by reference to working papers/documents of the internal auditor and ensuring that reasonable checks/tests have been applied to transactions covered by the internal auditor, to satisfy himself about the authenticity of the ultimate information. It would be in the interest of the tax auditor to obtain and scrutinise the programme of work and procedures adopted and the relevant working papers and documents obtained by the internal auditor in evidence of the work carried out by him. Reference may be made to the Statement on Standard Auditing Practices: Relying upon the Work of an Internal Auditor (SAP-7) - vide Appendix IX. Primarily, however, it would, be necessary for the tax auditor to ensure that in expressing his opinion, he has adequately satisfied himself as to the authenticity of the information contained in the relevant form and that, his working papers and documents are adequate to enable him to certify the particulars. Reference may be made to Statement on Standard Auditing Practices: Study and Evaluation of the Accounting System and Related Internal Controls in Connection with an Audit (SAP-6) and Analytical Procedures (SAP-14).
- 11.7. Audit procedures applicable to a person whose accounts of the business or profession have been audited under any other law will apply as well to a person who carries on business or profession but who is not required by or under any other law to get his accounts audited. In order to express his opinion on the accounts of a person belonging to the latter category the tax auditor should apply the same tests and checks as he would have applied in the conduct of audit of the former category. In case the relevant vouchers for the expenditure and payments made by a non-corporate entity are not available, it will be necessary for the tax auditor to call for any other evidence in support of such expenditure and payments. The entity should be advised to maintain vouchers/records in evidence of transactions to avoid a qualification in the matter by the tax auditors. The qualification in respect of this matter would, in the normal course, be necessary in case the vouchers or other evidence required to be maintained are not produced in evidence of the

income/expenditure or assets/liabilities. The entity should be encouraged to maintain office vouchers with the recipient's signatures for the amounts reimbursed on account of expenditure like local conveyance etc., for which other supporting evidence is not possible to obtain. It would also be advisable to give appropriate notes on accounts in the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited. These may include disclosure regarding method of accounting and practices consistently and regularly followed, and whether a change in such matters or practice has been made during the year, notwithstanding the fact that such disclosures are required to be made in Form No.3CD.

12. Professional misconduct

It may be noted that when any question relating to professional misconduct in connection with tax audit arises, the tax auditor would be liable under the Chartered Accountants Act and the ICAI's disciplinary jurisdiction will prevail in this regard.

13. Audit report

13.1 Section 44AB requires the tax auditor to submit the audit report in the prescribed form and setting forth the prescribed particulars. Sub-rule 1 of rule 6G provides that the report of audit of accounts of a person required to be furnished under section 44AB shall -

- (a) in the case of a person who carries on business or profession and who is required by or under any other law to get his accounts audited, be in Form No. 3CA;
- (b) in the case of a person who carries on business or profession, but not being a person referred to in clause (a), in Form No. 3CB.

13.2 Sub-rule (2) of Rule 6G further provides that the particulars which are required to be furnished under section 44AB shall be in Form No. 3CD.

13.3 It may be noted that earlier there were three forms of audit report.

Form No. 3CA - Audit report under section 44AB of the Income-tax Act, 1961, in a case where the accounts of business of a person have been audited under any other law.

Form No. 3CB - Audit report under section 44AB of the Income-tax Act, 1961 in the case of a person carrying on business.

Form No. 3CC - Audit report under section 44AB of the Income-tax Act, 1961, in the case of a person carrying on profession.

The revised Form No. 3CA is applicable to a person whose accounts of the business or profession have been audited under any other law carrying on either business or profession while Form No. 3CB is applicable to a person who carries on business or profession but who is not required by or under any other law to get his accounts audited.

Earlier the required particulars in the case of a person carrying on profession were to be furnished in Form No. 3CE. However, the new Form No. 3CD is applicable in respect of persons carrying on business and/or profession.

- 13.4. It may thus be noted that the audit report is in two parts. The first part requires the tax auditor to give his opinion as to whether or not the accounts audited by him give a true and fair view:
- i. in the case of the balance sheet, of the state of affairs as at the last date of the accounting year.
 - ii. in the case of the profit and loss account, of the profit or loss of the assessee for the relevant accounting year.

The second part of the report states that the statement of particulars required to be furnished under section 44AB is annexed to the audit report in Form No. 3CD. The tax auditor is required to give his opinion whether the prescribed particulars furnished by the assessee are true and correct.

- 13.5 In paragraph 3 of Form No. 3CB the auditor has to report that the financial statements audited by him give a 'true and fair' view. The requirement in paragraph 3 of Form No.3CA and paragraph of Form No.3CB relating to particulars in Form No.3CD is that the auditor should report that these particulars in Form No.3CD are "true and correct". The terminology "true and fair" is widely understood though not defined even by the Companies Act, 1956. On the other hand, the words "true and correct" lay emphasis on factual accuracy of the information. In this context reference is invited to AS-1 and AS(IT)-I relating to disclosure of accounting policies. These standards recognise that the major considerations governing the selection and application of accounting

policies are (i) prudence, (ii) substance over form and (iii) materiality. Therefore, while giving particulars in Form No.3CD these aspects should be kept in view. In particular, considering the nature of particulars to be given in Form No.3CD, the aspect of materiality should be considered. In other words particulars should be given in the respect of material items and the auditors should ensure factual accuracy relating to these particulars.

- 13.6. In the case of a person whose accounts of the business or profession have been audited under any other law, it is not required for the tax auditor appointed under section 44AB to give his opinion, as to whether or not the accounts give a true and fair view as indicated herein above. It would only be necessary for him to annex a copy of the audited accounts as well as a copy of the audit report given by the statutory auditor with his report in Form No. 3CA along with Form No.3CD.
- 13.7 In the case of a person who carries on business and also renders professional services but who is not required by or under any other law to get his accounts audited, report should be given in Form No. 3CB. The statement of particulars should be given in Form No. 3CD. Even where separate sets of accounts are maintained in respect of business and professional activities Form No. 3CB and Form No. 3CD should be used.
- 13.8. In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, the expression "proper books of account" should mean, the books of original entry and other books of account required to be maintained to record all the transactions of the assessee in the same manner, as in the case of a person whose accounts of the business or profession have been audited under any other law. Although, proper books of account have not been prescribed generally for a person who carries on business or profession but who is not required by or under any other law to get his accounts audited (except under Section 44AA for certain categories of persons), the tax auditor should ensure that such books are maintained as would give the information required to prepare balance sheet and profit and loss account in the formats recommended in Appendices X and XI of this Guidance Note. Reference in this connection may also be made to the publication of the Institute entitled "Monograph on Compulsory Maintenance of Accounts", which provides the necessary guidance in the matter.

- 13.9. In case the accounts of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, are being audited for the first time, it is recommended that a disclosure be made to the effect that corresponding comparative figures of the previous year, if given, are not audited.
- 13.10. In certain cases, members are called upon to report on the accounts reopened and revised by the board of directors. The accounts of a company once adopted at its annual general meeting should not normally be re-opened and revised. The Institute and the Department of Company Affairs have affirmed this position. In case of revision, the audit report should be given in the manner suggested by the Institute. (Published in the Chartered Accountant, pp.655, February, 1985. Also refer to Revision/Rectification of Financial Statements, published in Compendium of Guidance Notes - Volume I). The Department of Company Affairs had also clarified that accounts can be revised to comply with technical requirements. It may be pointed out that report under section 44AB should not normally be revised. However, sometimes a member may be required to revise his tax audit report on grounds such as:
- (i) revision of accounts of a company after its adoption in annual general meeting.
 - (ii) change of law e.g., retrospective amendment.
 - (iii) change in interpretation, e.g. CBDT Circular, judgements, etc.

In case where a member is called upon to report on the revised accounts, then he must mention in the revised report that the said report is a revised report and a reference should be made to the earlier report also. In the revised report, reasons for revising the report should also be mentioned. [Reference may also be made to the Guidance Note on auditor's Report on Revised Accounts of Companies Before Circulation to shareholders, published in Compendium of Guidance Notes, Volume-I] - vide Appendix XII.

- 13.11. In the case of companies having their accounting year which is different from the financial year, accounts of the financial year are required to be prepared and audited. The audit report shall be in Form 3CB. The above position has also been clarified by the CBDT in its Circular No, 561 dated 22.5.1990. The Circular is reproduced in Appendix XIII.

14. Form No. 3CA

- 14.1. This form is to be used in a case where the accounts of the business or profession of a person have been audited under any other law. **The first part of the report refers to the fact that the statutory audit of the assessee was conducted by a chartered accountant or any other auditor in pursuance of the provisions of the relevant Act, and the copy of the audit report along with the audited profit and loss account and balance sheet and the documents declared by the relevant Act to be part of or annexed to the profit and loss account and balance sheet, are annexed to the report in Form No. 3CA.** In a case where the tax auditor carrying out the audit under section 44AB is different from the statutory auditor, a reference should be made to the name of such statutory auditor. In case the statutory auditor is carrying out the audit under section 44AB, the fact that he has carried out the statutory audit under the relevant Act should be stated.
- 14.2. The next paragraph states that the statement of particulars required to be furnished under section 44AB is annexed with the report in Form No. 3CD. The tax auditor has to state further that, in his opinion and to the best of his information and according to the explanations given to him, the particulars given in the said annexure are true and correct.
- 14.3. Where any of the requirements in this form is answered in negative or with qualification, the report shall state the reasons therefor. The tax auditor should state this qualification in the audit report so that the same becomes a comprehensive report and the user of the audited statement of particulars can realise the impact of such qualifications. In this regard the tax auditor should follow the "Statement on Qualifications in Auditors' Reports" - vide Appendix XV.
- 14.4. It is possible that in the case of a a person whose accounts of the business or profession have been audited under any other law, which has branches at various places, the branch accounts might have been audited by branch auditors under the statute. If the audit under section 44AB is also carried out by the same branch auditors or other chartered accountants, they should submit the report in Form No. 3CA to the management or the principal tax auditor appointed for the head office under Section 44AB. Attention in this regard is drawn to SAP-10 'Using the Work of Another Auditor' which discusses the procedures in this

regard as well as the principal tax auditor's responsibility in relation to his use of the work of the branch auditor. The principal tax auditor should submit his consolidated report on the registered office/head office and branch accounts and report in his tax audit report as under :

"I/We have taken into consideration the audit report and the audited statements of accounts, and particulars received from the auditors, duly appointed under the relevant law, of the branches not audited by me/us".

- 14.5 Item No. 4 of the notes to Form No. 3CA requires that the person, who signs this audit report, shall indicate reference of his membership No./certificate of practice number/authority under which he is entitled to sign this report. No separate certificate of practice number is allotted by ICAI. As such, where a chartered accountant acts as a tax auditor he should give his membership number with ICAI and the status such as proprietor or partner under which he has signed the report.
- 14.6 An assessee may have one or more branches outside India. The accounts of such branches are normally audited by the professional accountants overseas. The results of such branches are also incorporated in the consolidated accounts prepared in this country. In the case of foreign branches the relevant information in respect of such branches as is required by Form No. 3CD, may be obtained by the tax auditor in India from the assessee who should obtain the same from the overseas auditor who had audited the accounts of such foreign branches. The tax auditor in India while certifying the information in Form No. 3CD may rely upon the information obtained by him from the overseas auditor and while submitting his consolidated report in Form No.3CD he should specifically point out in his audit report as under:-

"I/We have taken into consideration the audit report and the audited statements of accounts, and particulars received from the auditors, appointed under the relevant law, of the overseas branches not audited by me/us".

If the assessee is unable to obtain relevant information in respect of the overseas branches duly certified by the overseas auditor, the relevant facts should be suitably disclosed and reported upon.

15. Form No. 3CB

- 15.1 In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited the audit report has to be given in Form No. 3CB. Form No. 3CB consists of four paragraphs.

The tax auditor has to state whether he has examined the balance sheet as at 31st March of the relevant previous year and the profit and loss account/income and expenditure account for the year ended on the date. **Further, such a balance sheet and the profit and loss account must be attached with the audit report.**

The tax auditor has to certify that the balance sheet and the profit and loss account/income and expenditure account are in agreement with the books of accounts maintained at the head office and branches. He has also to mention the total number of branches.

He has to report his observations, comments, discrepancies or inconsistencies, if any. Subject to the above observations, comments, discrepancies, inconsistencies he has to state whether:

- (a) he has obtained all the information and explanations which, to the best of his knowledge and belief, were necessary for the purposes of the audit;
- (b) in his opinion proper books of account have been kept by the head office and branches of the assessee so far as appears from his examination of the books;
- (c) in his opinion and to the best of his information and according to the explanations given to him the said accounts, read with notes thereon, if any, give a true and fair view;
 - (i) in the case of the balance sheet of the state of the affairs of the assessee as at 31st March, _____ and
 - (ii) in the case of the profit and loss account/income and expenditure account of the profit/loss or surplus/deficit of the assessee for the year ended on that date.

- 15.2 Under clause (a) of paragraph 3 of Form No.3CB, the tax auditor has to report his "observations/comments/ discrepancies/inconsistencies," if any. The expression "Subject to above" appearing in clause (b) makes

it clear that such observations/comments/ discrepancies/ inconsistencies which are of qualificatory nature relate to necessary information and explanations for the purposes of the audit or the keeping of proper books of accounts or the true and fair view of the financial statements, respectively to be reported on in paragraphs (A), (B) and (C) under clause (b) of paragraph 3. While reporting on clause (a) of paragraph 3 of Form No. 3CB the tax auditor should report only such of those observations/comments/ discrepancies/ inconsistencies which are of qualificatory nature which affect his reporting about obtaining all the information and explanations which were necessary for the purposes of the audit, about the keeping of proper books of account by the head office and branches of the assessee and about the true and fair view of the financial statements. Further, only such observations/comments/discrepancies/inconsistencies which are of a qualificatory nature should be mentioned under clause (a). Any other observations/comments/ discrepancies/inconsistencies, which do not affect the reporting on the matters specified above may form part of the notes to accounts forming part of the accounts. In case the tax auditor has no observations/comments/ discrepancies/inconsistencies to report which are of qualificatory nature, the following portion of paragraph 3 may be deleted:

"3(a) *I/We report the following observations/comments/discrepancies/ inconsistencies, if any:

Subject to above,-"

The tax auditor may then give his report as required by sub-paragraphs (A), (B), and (C) of paragraph 3 and paragraph 4.

- 15.3 Paragraph 4 of Form No.3CB provides that the prescribed particulars are furnished in Form No.3CD annexed to the report and whether in his opinion and to the best of his information and according to the explanations given to him, they are true and correct. The auditor may have a difference of opinion with regard to the particulars furnished by the assessee and he has to bring these differences under various clauses in Form No.3CD. The auditor should make a specific reference to those clauses in Form No.3CD in which he has expressed his reservations, difference of opinion, disclaimer etc. in this paragraph.

- 15.4. If a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, has branches and separate accounts are maintained at the branches, the assessee can request the tax auditor appointed under section 44AB to audit the head office and branch accounts. In the alternative, the assessee can appoint separate tax auditors for branches. The branch tax auditor in such a case will have to give an audit report in Form No. 3CB to the management or the tax auditor appointed for the audit of head office accounts. The tax auditor appointed for the audit of head office can rely on the report of branch tax auditors subject to such checks and verifications as he may choose to make and shall submit his consolidated report on the head office and branch accounts. He should make suitable reference to the audit conducted by separate branch tax auditors in the same manner as stated in para 14.6 above.
- 15.5 If the tax auditor is called upon to give his report only in respect of one or more businesses carried on by the assessee and the books of accounts of the other businesses are not produced as the same are not required to be audited under the Act, the tax auditor should mention the fact that audit has not been conducted of those businesses whose books of account had not been produced. However, if the financial statements include, *inter alia*, the results of such business for which books of account have not been produced, the auditor should qualify his report in Form No. 3CA/3CB.

16. Form No. 3CD

- 16.1 The statement of particulars given in Form No. 3CD as annexure to the audit report contains thirty two clauses. The tax auditor has to report whether the particulars are true and correct. This Form is a statement of particulars required to be furnished under section 44AB. The same is to be annexed to the reports in Forms No. 3CA and 3CB in respect of a person who carries on business or profession and whose accounts have been audited under any other law and in respect of person who carries on business or profession but who is not required by or under any other law to get his accounts audited respectively.
- 16.2. As stated earlier, the tax auditor should obtain from the assessee, the statement of particulars in Form No. 3CD duly authenticated by him. It would be advisable for the assessee to take into consideration the

following general principles while preparing the statement of particulars:

- (a) He can rely upon the judicial pronouncements while taking any particular view about inclusion or exclusion of any items in the particulars to be furnished under any of the clauses specified in Form No.3CD.
- (b) If there is a conflict of judicial opinion on any particular issue, he may refer to the view which has been followed while giving the particulars under any specified clause.
- (c) The Accounting Standards (AS), Guidance Notes, Statements of Auditing Practices (SAP) issued by the Institute from time to time should be followed.

16.3. While furnishing the particulars in Form No.3CD it would be advisable for the tax auditor to consider the following:

- (a) If a particular item of income/expenditure is covered in more than one of the specified clauses in the statement of particulars, care should be taken to make a suitable cross reference to such items at the appropriate places.
- (b) If there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD, the tax auditor should state both the view points and also the relevant information in order to enable the tax authority to take a decision in the matter.
- (c) If any particular clause in Form No.3CD is not applicable, he should state that the same is not applicable.
- (d) In computing the allowance or disallowance, he should keep in view the law applicable in the relevant year, even though the form of audit report may not have been amended to bring it in conformity with the amended law.
- (e) In case the prescribed particulars are given in part or piecemeal to the tax auditor or relevant form is incomplete and the assessee does not give the information against all or any of the clauses, the auditor should not withhold the entire audit report. In such a case, he can qualify his report on matters in respect of which information is not furnished to him. In the absence of

relevant information, the tax auditor would have no option but to state in his report that the relevant information has not been furnished by the assessee.

- (f) The information in Form No. 3CD should be based on the books of accounts, records, documents, information and explanations made available to the tax auditor for his examination.

17. Particulars to be furnished in Form No.3CD.

PART – A

1. **Name of the assessee** : _____
2. **Address** : _____
3. **Permanent Account Number** : _____
4. **Status** : _____
5. **Previous year ended** : **31st March** _____
6. **Assessment year** : _____

[Clauses 1 to 6]

The requirements of clauses 1 to 6 of Part-A are discussed as follows:

- 17.1 Under clause (1) the name of the assessee whose accounts are being audited under section 44AB should be given. However, if the tax audit is in respect of a branch, name of such branch should be mentioned along with the name of the assessee.
- 17.2 The address to be mentioned under clause (2) should be the same as has been communicated by the assessee to the Income-tax Department for assessment purposes as on the date of signing of the audit report. If the tax audit is in respect of a branch or a unit, the address of the branch or the unit should be given. In the case of a company, the address of the registered office should also be stated. In the case of a new assessee, the address should be that of the principal place of business.
- 17.3 Under clause (3) the permanent account number (PAN) allotted to the assessee should be indicated. If the assessee has not been allotted the permanent account number as on the date of signing of the report, that fact should be indicated. Where PAN is not known but the general index register number (GIR) is available, the same may be given.

- 17.4 Under clause (4) the status of the assessee is to be mentioned. Obviously this refers to the different classes of assessee included in the definition of "person" in section 2 (31) of the Act, namely, individual, Hindu undivided family, company, firm, an association of persons or a body of individuals whether incorporated or not, a local authority or artificial juridical person. In case of dispute regarding status the full facts should be mentioned.
- 17.5 Under clause (5), since the previous year under the Act uniformly ends on 31st March, the relevant previous year should be mentioned.
- 17.6 Under clause (6) the assessment year relevant to the previous year for which the accounts are being audited should be mentioned.

PART - B

18. (a) **If firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.**
- (b) **If there is any change in the partners/members or their profit sharing ratios, the particulars of such change.**

[Clause 7(a) and (b)]

- 18.1 Where the assessee is a firm or association of persons (AOP), the names of partners of the firm or members of the association of persons and their profit sharing ratios have to be stated. In case where the partner of a firm or the member of AOP acts in a representative capacity, the name of the beneficial partner/member should be stated. Thus, the details of partners or members during the entire previous year will have to be furnished. The term "profit sharing ratios" would include loss-sharing ratio also since loss is nothing but negative profits. This would not cover any specific ratio or understanding in relation to payment of remuneration or interest to partners or members. In this connection, reference may be made to Circular No.739 dated 25.9.1996 issued by the Board reproduced in Appendix XIV.
- 18.2 If there is any change in the partners of the firm or members of the association of persons or their profit or loss sharing ratio, the particulars of such change must be stated. All the changes occurring during the entire previous year must be stated.

18.3 The particulars in this clause should be verified from the instrument or agreement or any other document evidencing partnership or association of persons including any supplementary documents or other documents effecting such changes. For this purpose, the tax auditor may also verify:

- (i) whether the relevant documents, if required, have been filed with the concerned authorities,
- (ii) whether notice of changes, if required, has been given to the registrar of firms, and
- (iii) any minutes or any other understanding recording any changes in the partners/members or their profit sharing ratios.

18.4 The tax auditor should obtain certified copies of the deeds, documents, understanding, notice of changes etc. including certified copies of the acknowledgment, if any, evidencing filing of documents.

18.5 In certain cases of association of persons it may be possible that the shares of the members are not precisely ascertainable during the previous year resulting in a situation whereby the shares of the members are indeterminate or unknown. In such circumstances, the relevant fact should be stated.

19. (a) Nature of business or profession.

(b) If there is any change in the nature of business or profession, the particulars of such change.

[Clause 8 (a) and (b)]

19.1 In regard to the nature of business, the principal line of business such as manufacturing of electronic goods, trading in chemicals, wholesale trade in foodgrains or a retail trade in grocery should be stated. In the case of a person rendering services, the nature of services should be broadly stated. This information is similar to the information required in the return of income "Part IV, Information relevant to the business or profession", where an assessee is required to state the nature of business or profession.

19.2 Any material change in the nature of business should be precisely set out. The change will include change from manufacturer to trader as well as change in the principal line of business. For example, an assessee

switching over from wholesale business to retail business or an assessee switching over from manufacturing his own commodities to manufacturing goods on job basis for others. Likewise, any addition to or permanent discontinuance of, a particular line of business may also amount to change requiring reporting. However, temporary suspension of the business may not amount to change and therefore need not be reported.

- 19.3 A review of business report or the minutes of meetings would enable the tax auditor to note the changes, if any. Based thereon, he may make necessary enquiries and seek information and determine whether any change has occurred or not. If need be, the tax auditor should get a declaration from the assessee regarding change in the nature of business, if any.
- 19.4 In the case of amalgamation, if there is a similar line of activity, no reference need be made. However, if a new line of activity emerges because of amalgamation, the same may be stated. In the case of restructuring, if any line of activity is being hived off, the same may also be stated.
20. (a) **Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.**
- (b) **Books of account maintained.**
(In case books of account are maintained in a computer system, mention the books of account generated by such computer system.)
- (c) **List of books of account examined.**

[Clause 9 (a) to (c)]

- 20.1 The list of books of accounts prescribed, maintained and examined has to be stated under this clause. There may be difference between the 3 lists. For example, books of accounts may have been prescribed but all the prescribed books might not have been maintained or the entire books of accounts maintained might not have been produced for examination. The tax auditor should exercise his professional judgment and skill in order to arrive at the conclusion whether such a situation warrants any disclosure or qualifications while forming his opinion on the matters covered by reporting requirements in Form No.3CB.

20.2 Whereas the CBDT has prescribed the books of account and other documents to be kept and maintained by the specified professional persons in Rule 6F, it has not yet prescribed the books of account to be maintained by those falling under sub-section (2) of section 44AA. As such, every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist and whose total gross receipts exceed sixty thousand rupees (eighty thousand rupees in the case of a person who, in the course of his medical profession, dispenses drugs and medicines) in any one of the three years immediately preceding the previous year, or where the profession has been newly set up in the previous year, his total gross receipts in the profession for that year are likely to exceed the said amount, is required to maintain the following books of account:

1. Cash book.
2. Journal, if the accounts are maintained according to the mercantile system of accounting.
3. Ledger.

Apart from the aforesaid books of account, a person carrying on medical profession is required to keep the following:

- a) daily case register in Form No.3C showing data, patient's name, nature of professional services rendered, fees received and date of receipt; and
- b) an inventory under broad heads, as on the first and the last days of the previous year, of the stock of drugs, medicines and other consumable accessories used for the purpose of his profession.

No books of accounts have been prescribed so far in respect of any other class of persons.

20.3. If books of account have been prescribed under rule 6F, the list of books so prescribed have to be stated under clause 9(a). It may be noted that the daily case register and the inventory under broad heads do not constitute books of account and hence they need not be mentioned under clause 9(a). Sometimes an assessee may carry on a combination of activities. Books of account might have been prescribed for one of the activities. In that case, mention may be made of the activity for which books have been prescribed.

- 20.4. The tax auditor should obtain from the assessee a complete list of books of account and other documents maintained by him (both financial and non-financial records) and make appropriate marks of identification to ensure the identification of the books and records produced before him for audit. The list of books of account maintained by the assessee should be given under this clause.
- 20.5. Attention is invited to the Institute's publication titled "Monograph on Compulsory Maintenance of Accounts" dealing with the requirements of provisions of section 44AA relating to the books of account to be maintained by the tax payers falling within the said section. Section 44AA(2) provides that persons carrying on business or profession, other than those specified in sub-section (1), shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, if his income from business or profession exceeds the monetary limits prescribed under section 44AA(2) or his total sales, turnover or gross receipts in business or profession exceed the monetary limits prescribed under section 44AA(2) in any one of the three years immediately preceding the previous year. The tax auditor will have to verify that the assessee has maintained such books of accounts and documents as prescribed under sub-section (3).
- 20.6. For a person whose accounts of the business or profession have been audited under any other laws, the requirement for maintenance of books of account is contained in the relevant statutes. In the case of other assessees, normal books of account to be maintained will be cash book/bank book, sales/purchase journal or register and ledger. Assessee engaged in trading/manufacturing activities should also maintain quantitative details of principal items of stores, raw materials and finished goods. While giving his report in Form No. 3CB about maintenance of proper books of account, the tax auditor should ensure that they are maintained in accordance with the above requirements.
- 20.7. As to the requirement regarding the mentioning of the books of accounts generated by the computer system, only such books of account and other records which properly come within the scope of the expression "proper books of account" should be mentioned. The tax auditor should insist on proper print-outs of books of account being taken out.

20.8. Books of account examined would constitute the books of original entry and the other books of account. While the assessee is required to maintain proper evidence in the form of bills, vouchers, receipts, documents, etc., it may be noted that these are essential to support the entries in the books of account and no reference to such supporting evidence need be made under this clause.

21. Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant sections (44 AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB or any other relevant section).

[Clause 10]

21.1 Where the profits and gains of the business are assessable to tax under presumptive basis under any of the sections mentioned below, the amount of such profits and gains credited/debited to the profit and loss account should be indicated under this clause.

Sr. No.	Section	Business Covered
1	44AD	Civil construction business
2	44AE	Transport business
3	44AF	Retail trade
4	44B	Shipping business of a non-resident
5	44BB	Exploration etc. of mineral oil by a non-resident
6	44BBA	Operation of aircraft by non-resident
7	44BBB	Civil construction etc. in certain turnkey power project by non-residents.
8	Any other relevant section	This refers to the sections not listed above under which income may be assessable on presumptive basis like section 44D and will include any other section that may be enacted in future for presumptive taxation.

If the profit and loss account does not include profit assessable on presumptive basis, then, there is no requirement to furnish the particulars under this clause.

21.2 The amount to be mentioned under this clause means the amount included in the profit and loss account. The tax auditor is not required to indicate as to whether such amount corresponds to the amount assessable under the relevant section relating to presumptive taxation. As such, the reporting requirement gets satisfied if the amount as per profit and loss account is reported. However, the tax auditor may clarify by way of a note that the amount mentioned under this clause is not necessarily the actual amount of profits and gains chargeable to tax under the relevant section.

21.3 The tax auditor may come across three different situations as follows:

- a) Where the assessee, maintaining regular books of account has more than one business which include business of the nature assessable on presumptive basis under any of the said sections and the profit and loss account prepared from such books of account, *inter alia*, includes the income of the business assessable under the scheme of presumptive taxation.
- b) Where the assessee has more than one business including some business(es) falling under any of the aforesaid sections, but maintains separate sets of accounts for each such business and opts for getting the accounts of all such businesses audited under section 44AB.
- c) Where the assessee, having regular books of account for his main business, has some additional business of the nature described in any of the aforesaid sections and no books of account whatsoever is maintained for such additional business but the net income is credited to the main profit & loss account of the assessee.

Under each of the aforesaid three situations, the tax auditor may proceed as follows:

- a) This situation may give rise to the problem of apportionment of common expenditure in order to arrive at the correct amount of profit credited to profit and loss account and assessable on a

presumptive basis. In such a situation, the endeavour of the tax auditor should be to arrive at a fair and reasonable estimate of such expenditure on the basis of evidence in possession of the assessee or by asking the assessee to prepare such estimate which should be checked by him. It is also necessary to mention the basis of apportionment of common expenditure. However, if the tax auditor is not satisfied with the correctness of such apportionment, he should indicate such fact under this clause by a suitable note and the exact tenor and nature of such remarks has to be formulated on the basis of "Statement on Qualifications in Auditors' Report" issued by the ICAI - vide Appendix XV.

- b) In this case, since a separate set of accounts are maintained for respective businesses, it poses no problem for the tax auditor in ascertaining the amount of profit to be disclosed.
- c) Here, the tax auditor is unable to satisfy himself about the correctness of the net income from the presumptive business credited to the profit and loss account. He should, therefore, state the amount of income as appearing in the profit and loss account, with a suitable note expressing his inability to verify the said figure. In the absence of books of account, the tax auditor would be unable to form an opinion about the true and fair view of the profit and loss account or balance sheet of the assessee and therefore it would become necessary for him to qualify his report in Form No. 3CB.

- 21.4 In the case of an assessee opting against presumptive taxation, the provisions of section 44AB (c) requires such an assessee to get his accounts audited irrespective of the fact that his turnover has not exceeded Rs.40 lakhs. There may be another circumstance where an assessee has mixed nature of business amenable to taxation on presumptive basis and under normal provisions of law – turnover of which does not exceed 40 lakhs. In such a case, the tax auditor auditing the books of account etc. relating to business covered by the provisions relating to presumptive taxation should sufficiently indicate in his report that his audit report in Form No. 3CB and particulars in Form No.3 CD only relate to the business covered by the provisions relating to presumptive taxation and his audit report does not relate to business assessable under the normal provisions of the Act.

- 21.5 Even where the assessee opts for presumptive taxation, the tax auditor should impress upon the assessee that it would be advisable to maintain some basic records to support the turnover/gross receipts declared for presumptive taxation.
22. (a) **Method of accounting employed in the previous year.**
- (b) **Whether there has been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.**
- (c) **If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.**
- (d) **Details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under section 145 and the effect thereof on the profit or loss.**

[Clause 11 (a) to (d)]

- 22.1. The Finance Act, 1995 has amended section 145 with effect from assessment year 1997-98 to provide that the income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" must be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. It has also been provided that the Central Government may notify in the Official Gazette from time to time the accounting standards to be followed by any class of assessee or in respect of any class of income. The hybrid system of accounting viz. mixture of cash and mercantile hitherto allowed to be followed by the assessee is not permitted from assessment year 1997-98. However, the assessee may adopt cash system of accounting for one business and mercantile system of accounting for other business. Once the choice of method of accounting is decided, the assessee must follow consistently the method of accounting employed. If he employs different methods for different businesses regularly and consistently, the profits would have to be computed in accordance with the respective methods, provided the result is a proper determination of profits. As regards the accrual system of accounting the Institute has published a "Guidance Note on Accrual Basis of Accounting" which may be referred to.

- 22.2. It may be noted that in view of amendment made by the Companies (Amendment) Act, 1988 in section 209 of the Companies Act, every company is required to keep books of account on accrual basis. In other words, a company governed by the Companies Act, 1956 cannot follow cash system of accounting unless exempted under the Companies Act, 1956. The provisions of section 209 (3) of the Companies Act, 1956 are, however, not applicable to entities other than companies.

Under sub-clause (b), whether there has been any change in the method of accounting employed vis-à-vis the method employed in the immediately preceding previous year is to be stated. As already noted, an assessee can follow either cash or mercantile system of accounting.

- 22.3 If there is any change, the effect thereof has to be stated under this clause. Insofar as the question of effect of such change on the profit or loss is concerned, the concept of materiality is the basic governing factor. If it is not possible to quantify the effect of the change in the method of accounting, appropriate disclosure should be made under this clause.
- 22.4 An assessee can follow a number of accounting policies for the purpose of maintaining his books of account. As per AS-1 all significant accounting policies adopted in the preparation and presentation of financial statements shall be disclosed. The disclosure of the significant accounting policies shall form part of the financial statements and the significant accounting policies shall normally be disclosed in one place. Any change in an accounting policy which has a material effect in the previous year or in the years subsequent to the previous year shall be disclosed. The impact of, and the adjustments resulting from such change, if material, shall be shown in the financial statement of the period in which such change is made to reflect the effect of such change.
- 22.5 As per paragraph 9 under AS(IT) relating to disclosure of prior period and extraordinary items and changes in accounting policies, a change in an accounting policy can be made only if:
- a) adoption of different policy is required by the statute; or
 - b) the change would result in a more appropriate presentation of the financial statements.

- 22.6 The Calcutta High Court in *Snow White Food Products v CIT* [1983] 141 ITR 861, and Madras High Court in *CIT v Carborandum Universal Limited* [1966] 149 ITR 759 and several other decisions like *CIT v. Mopeds India Ltd.* [1998] 173 ITR 347, *Triveni Engg. Works Ltd. v. CIT* [1987] 167 ITR 742 (All), *CIT v. Ganga Trust Fund* [1986] 162 ITR 612 (Guj) have held that it is open to an assessee to change the method of accounting provided the changed method is the regular method of accounting and the assessee has not merely abandoned or changed it for a casual period to suit his own purposes. Any such change which is followed consistently has to be accepted by the Department, even if it results in reduction of tax liability
- 22.7 A change in an accounting policy will not amount to a change in the method of accounting and hence such change in the accounting policy need not be mentioned under sub-clause (b). This is due to the fact that as per the requirements of AS-1 and AS(IT)-1 such changes and the impact of such changes will be disclosed in the financial statements. It may be noted that a change in the method of valuation of stock will amount only to a change in an accounting policy and hence such a change need not be mentioned under sub-clause 11(b) but should be mentioned in the financial statements.
- 22.8. The tax auditor should apply reasonable checks to the earlier year's accounts to ascertain whether there is any change in the method of accounting as compared to that of the year under audit, after obtaining a written confirmation from the assessee as to the method of accounting followed.
- 22.9 It must also be ascertained as to whether the AS(IT) as may be applicable to the assessee or to the class of income, have been followed. Presently, only two AS(IT) have been prescribed. - AS(IT)-I relating to disclosure of accounting policies and AS(IT)-II relating to disclosure of prior period and extraordinary items and changes in profit and loss account. The tax auditor has to report the details of the deviations in the method of accounting in the previous year from the AS(IT) and the effect thereon on the profit or loss. The tax auditor, while reporting on prior period and extraordinary items should report only such items which fall within the meaning of prior period items and extraordinary items in the relevant AS(IT). Attention is invited to AS(IT)-II, paragraph 10, according to which any change in an accounting policy

which has a material effect is required to be disclosed. As stated above, a change in the method of valuation of closing stock would amount to a change in an accounting policy and has to be stated in the financial statements. The tax auditor should ensure that in case the same is not stated in the financial statements, the fact should suitably be stated under clause 11(d). He may rely on the various pronouncements and clarifications made by the ICAI.

- 23. (a) Method of valuation of closing stock employed in the previous year.**
- (b) Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss.**

[Clause 12 (a) and (b)]

- 23.1 The method of valuation of closing stock is to be stated under this clause. It is the normal practice to disclose the same as a part of disclosure of significant accounting policies. Accordingly, a reference may be invited to the same or the method of valuation may be again described in Form No.3CD.
- 23.2. The method of valuation followed by the assessee having regard to the articles or goods dealt in or manufactured by the assessee, should be clearly indicated. Some examples are given below:-
- (i) raw material at cost or net realisable value whichever is lower,
 - (ii) finished goods at cost or net realisable value whichever is lower.
- 23.3 In clause 3(i) of the old Form No. 3CD reference was to "opening and closing stock-in-trade". In sub-clause (a) of clause 12 of revised Form No.3CD, the reference is to "closing stock". The expression "stock-in-trade" means finished goods and raw materials. Since sub-clause (b) refers to section 145A where the term "inventories" is used, the term "closing stock" will include all items of inventories. AS-2 defines the term "inventories" to include finished goods, raw materials, work-in-progress, materials, maintenance supplies, consumables and loose tools. Therefore, method of valuation of items of inventories will have to be given under sub-clause (a).

- 23.4. The tax auditor should study the procedure followed by the assessee in taking the inventory of closing stock at the end of the year and the valuation thereof. He should obtain the inventory of closing stock, indicating the basis of valuation thereof, for reporting on the method of valuation of closing stock under this clause.
- 23.5. The method of stock valuation must be consistently followed from year to year and the method followed must be brought out clearly. The tax auditor should examine the basis adopted for ascertaining the cost and this basis should be consistently followed. It is necessary to ensure that the method followed for valuation of stock results in disclosure of correct profit and gains. The Hon'ble Supreme Court in case of *CIT v. British Paints Ltd. [1991] 188 ITR 44 (SC)* has held that the method of valuation of stock at actual cost of raw materials and not taking into account overhead charges was not the correct method of valuation even though the said method has been consistently followed. As per AS-2 - Valuation of inventories (Revised) (mandatory from accounting year starting from 1.4.1999), historical cost of manufactured inventories can be arrived at on the basis of absorption costing alone and the allocation of fixed costs of inventories should be based on the normal level of production only. It is further provided that overheads should be included as part of the inventory cost only to the extent that they clearly relate to putting the inventories in their present location and condition.
- 23.6 It is not necessary to indicate any change in the method of valuation of closing stock under this clause. However, as stated earlier in paragraph 23.7, any such change in the method of valuation of closing stock would amount to change in an accounting policy and needs to be disclosed in the financial statements as required by AS-1 and AS(IT).
- 23.7 The details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss have to be stated under clause 12(b).
- 23.8 Section 145A has been enacted by the Finance (No.2) Act, 1998 and has come into force from the accounting year 1.4.1998 to 31.3.1999 (assessment year 1999-2000). This section provides that the valuation of purchase and sale of goods and inventory for the purpose of computation of income from business or profession shall be made on the basis of the method of accounting regularly employed by the

assessee but this shall be subject to certain adjustments. Therefore, it is not necessary to change the method of valuation of purchase, sale and inventory regularly employed in the books of account. The adjustments provided in this section can be made while computing the income for the purpose of preparing the return of income. These adjustments are as follows:

- (a) Any tax, duty, cess or fee actually paid or incurred on inputs should be added to the cost of inputs (raw-materials, stores etc.); if not already added in the books of account.
- (b) Any tax, duty, cess or fee actually paid or incurred on sale of goods should be added to the sales, if not already added in the books of account.
- (c) Any tax, duty, cess or fee actually paid or incurred on the inventory (finished goods, work-in-progress, raw materials etc.) should be added to the inventories, if not already added while valuing the inventory in the accounts.

23.9 The statutory adjustments required under section 145A can be explained by the following example.

Particulars	Qty	Rate excluding excise duty	Rate of excise duty
Opening stock	10	10	2
Raw material purchased	90	10	2
Other manufacturing cost	80	10	-
Finished goods manufactured	80	-	-
Sales of finished goods	60	25	3
Closing stock of raw material	20	10	2
Closing stock of finished goods	20	20	3

The input output ratio of raw material to finished goods is 1: 1

23.10 It may be stated that the MODVAT is a procedure whereby manufacturer can utilise credit for input duty against duty payable on final products. Duty credit taken on input is of the nature of set off

available against the excise duty payable on the final products. For the accounting periods ending on or before 31st March, 1999, the following two alternative methods of treatment of MODVAT credit in the accounts are permissible.

- I. Duty paid on inputs may be debited to a separate account, e.g. MODVAT credit receivable account. As and when the MODVAT credit is actually utilised against payment of excise duty on final products appropriate accounting entries will be required to adjust the excise duty paid out of "MODVAT credit receivable account" to the account maintained for payment/provision for excise duty on final product. In this case, the purchase cost of the inputs would be net of input duty. Therefore, the inputs consumed and the inventory of inputs would be valued on the basis of purchase cost net of input duty. This method is hereinafter referred to as "exclusive method".
- II. In the second alternative, the cost of inputs may be recorded at the total amount paid to the supplier inclusive of input duty. To the extent the MODVAT credit is utilised for payment of excise duty on final products, the amount could be credited to a separate account, i.e. MODVAT credit availed account. Out of the MODVAT credit availed account, the amount of MODVAT credit availed in respect of consumption of inputs would be reduced from the total cost of inputs consumed. This method is hereinafter referred to as "inclusive method".

The effect of section 145A is to reflect the figures on "inclusive method".

Following two illustrations explain the above propositions.

The profit & loss account on “exclusive method” would be as under:

Item	Particulars	Unit	Rate	Amount	Amount	Item	Particulars	Unit	Rate	Amount
(a)	Opening Stock	10	10	100		(h)	By sales	60	25	1,500
(b)	Purchase of raw material	90	10	900		(i)	By closing stock of finished goods	20	20	400
	Total	100	10	1000						
(c)	Less closing stock of raw material	20	10	200						
(d)	Raw material consumed	80	10		800					
(e)	To manufacturing cost	80	10		800					
(f)	To excise duty on finished goods sold				0					
(g)	To gross profit				300					
	TOTAL				1900		TOTAL			1900

The profit & loss account on “inclusive method” which is also in accordance with the provisions of section 145A would be as under:

Item	Particulars	Unit	Rate	Amount	Amount	Item	Particulars	Unit	Rate	Amount
(j)	Opening stock	10	12	120						
(k)	Purchase of raw material	90	12	1080		(s)	By sales	60	28	1680
	Total	100	12	1200		(t)	By closing stock of finished goods	20	23	460
(l)	Less closing stock	20	12	240						
(m)	Less MODVAT credit	80	2	160						
(n)	Raw material consumed	80	10		800					
(o)	To manufacturing cost	80	10		800					
(p)	To excise duty on finished goods	60	3		180					
(q)	To excise duty on closing stock of finished goods	20	3		60					
(r)	To gross profit				300					
	TOTAL				2140		TOTAL			2140

23.11 It may be pointed out that the "inclusive method" is not permitted by AS2 which is made mandatory from accounting year beginning on or after 01.04.1999. Further, in the Guidance Note on Accounting for MODVAT the second method (inclusive method) has been withdrawn with effect from accounting year commencing from 1.4.1999. In view of the above, the adjustments under section 145A will have to be made in all cases where 'exclusive method' is followed.

23.12 In this connection, it is worthwhile to note that the Memorandum explaining the provisions of section 145A inserted by the Finance (No.2)

Bill, 1998 states as follows:

“Computation of value of inventory.

The issue relating to whether the value of closing stock of the inputs, work-in-progress and finished goods must necessarily include the element for which MODVAT credit is available has been the matter of considerable litigation.

*In order to ensure that the value of **opening and closing stock (bold for emphasis)** reflect the correct value, it is proposed to insert a new section to clarify that while computing the value of the inventory as per the method of accounting regularly employed by the assessee, the same shall include the amount of any tax, duty, cess or fees paid or liability incurred for the same under any law in force.*

The proposed amendment which is clarificatory in nature shall take effect retrospectively from the 1st day of April, 1986 and will accordingly apply in relation to assessment year 1986-87 and subsequent years.

[Clause 45]”

(Section 145A was initially proposed to be applicable in relation to assessment year 1986-87 and subsequent years. However, later on, when the Finance (No.2) Bill, 1998 was enacted into law the provision was made applicable from 1.4.1999 i.e. assessment year 1999-2000)

- 23.13 It may be noted that when the adjustments are made in the valuation of inventories, this will affect both the opening as well as closing stock. Whatever adjustment is made in the valuation of closing stock, the same will be reflected in the opening stock also. Question for consideration is whether the opening stock as on 1.4.1998 should be adjusted as required under section 145A. It is now well settled that if any adjustment is required to be made by a statute, effect to the same should be given irrespective of any consequences on the computation

of income for tax purposes. Section 145A starts with the non obstante clause "Notwithstanding anything to the contrary contained in section 145". Therefore, to give effect to section 145A, the opening stock as on 1.4.98 will have to be increased by any tax, duty, cess or fee actually paid or incurred with reference to such stock if the same has not been added for the purpose of valuation in the accounts.

23.14 It may be noted that while making the adjustments stated in Para 23.8 and 23.13 above, the tax auditor should ensure that if any deduction is claimed for any tax, duty, cess or fee on the items covered by these two paragraphs by way of debit in the profit and loss account, either in the earlier year or in the year under report, adjustment for the same should be made in such a manner that no double deduction is claimed for the same expenditure. Similarly, adjustment should be made for any item of income to ensure that the same item is not treated as income twice.

23.15 When the exclusive method is followed in the accounts, the adjustments to be made under section 145A can be explained by the following illustrations which is required to be reported under clause 12(b).

Sl. No.	Particulars	(Rupees) Increase in Profit	(Rupees) Decrease in Profit
1.	Increase in cost of opening stock on inclusion of excise duty on which MODVAT credit is available/availed (j - a)		20
2.	Increase in purchase cost of raw material on inclusion of excise duty on which MODVAT credit is available/availed (k - b)		180
3.	Increase in sales of finished goods on inclusion of excise duty (s - h)	180	
4.	Excise duty paid on sale of finished goods as a result of its inclusion in sales (p-f)	-	180
5.	Increase in closing stock of raw material on inclusion of excise duty (l - c)	40	-
6.	Increase in closing stock of finished goods on inclusion of excise duty (t - i)	60	-
7.	Increase in excise duty on closing stock of finished goods as a result of its inclusion in closing stock of finished goods (q)	-	60
8.	Accounting of MODVAT credit availed and utilised on raw materials consumed in	160	-

	payment of excise duty on finished goods accounted on the basis of raw material consumed (m)		
	TOTAL	440	440

It may be noted that the net impact on the profit or loss will be nil.

- Note 1: The reference in brackets is to items in the illustration given in paragraphs 23.11 above.
- Note 2: The MODVAT credit in the "inclusive method" has been worked out on the basis of quantity of raw material consumed multiplied by excise duty paid on purchase of such raw material (Rs.160) (item m), though the MODVAT credit set off availed and utilised by the assessee against payment of excise duty on finished goods is Rs.180. This is so because the raw material consumed during the year under both the methods is Rs.800. The MODVAT credit in the inclusive method would have to be deducted from purchase of raw material on the basis of consumption of raw material and not on the basis of set off availed in excise law to arrive at correct cost of consumption. In the illustration if MODVAT credit of Rs.180 is accounted, then the raw material consumed would be Rs.780. This figure would not be the correct figure of consumption, since 80 units have been consumed and the net cost of each raw material is Rs.10 (12-2). In other words, the consumption of raw material to be debited during the year should be Rs.800 i.e. 80 units multiplied by 10. So also the figure of excise duty on finished goods sold of Rs.180 is correctly debited because the same represents excise duty on finished goods sold and the same cannot be changed on account of MODVAT credit set off availed.
- In the inclusive method the cost of the finished goods have been taken at Rs.20 plus Rs.3 excise duty. The raw material component included in the finished goods has been taken at Rs.10 since MODVAT credit have been accounted at the rate of Rs.2 in arriving at consumption of raw material.
- Note 3: Similar treatment should be given for other tax, duty, cess, or fee paid by the assessee i.e. sales tax etc.
- Note 4: It may be noted that liability for sales tax arises on sale as against liability for excise duty which arises on manufacture. As

such the liability for sales tax need not be adjusted in the closing stock of finished goods before the same are sold.

- 23.16 It may be noted that after making the above addition to the closing stock under section 145A, it will be possible to claim a separate deduction for excise duty actually paid after the year end but before the due date for filing the return of income on production of evidence as provided under section 43B. Therefore, in the above illustration if the assessee has paid Rs.60 added in the valuation of closing stock of finished goods before the due date for filing the return, deduction for the same can be separately claimed in the computation of income under section 43B, if other conditions of that sections are satisfied.

- 23.17 The computation of total income would appear as under :

	Rs.	Rs.	Rs.
Profit as per Profit and Loss account			
On the basis of exclusive method			
(see paragraph 23.10)			300
Add: Adjustments required			
under section 145A:			
1) Excise duty on sales			
(Rs.3/ per unit for			
60 units)	180		
2) Excise duty on closing			
stock of raw materials			
(Rs. 2/- per unit for			
20 units)	40		
3) Excise duty on closing			
stock of finished goods			
(Rs.3/ per unit for 20 units)	60		
4) MODVAT credit utilised			
on consumption of raw			
materials			
(Rs.2/- per unit for 80 units)	160		440

Less: 1) Excise duty on opening stock of raw material (Rs.2/- per unit for 10 units)	20		
2) Excise duty on purchase of raw materials (Rs.2/- per unit on 90 units)	180		
3) Excise duty on sales (paid or incurred as per section 145A)	180	380	60
	-----	-----	-----
			360
* Less: Deduction under section 43B on the assumption that the amount is paid on or before due date of filing return of income in respect of excise duty payable on finished goods			
			60

Profit			300

24. Amounts not credited to the profit and loss account, being,-

- (a) the items falling within the scope of section 28;
- (b) the pro forma credits, drawbacks, refunds of duty of customs or excise, or refunds of sales tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;
- (c) escalation claims accepted during the previous year;
- (d) any other item of income;
- (e) capital receipt, if any.

[Clause 13 (a) to (e)]

- 24.1 Under this clause various incomes falling within the scope of section 28 which are not credited to the profit and loss account are to be stated. The information under sub-clauses (a), (d) and (e) of clause (13) is to be given with reference to the entries in the books of account and records made available to the tax auditor for the purpose of tax audit under section 44AB. Section 28 refers to (a) profits and gains of business or profession, (b) compensation received on termination of employment, agency etc (c) income of trade or professional or similar

association from specific services to members, (d) export incentives, (e) perquisite received during the course of business or profession, (f) interest, salary, bonus, remuneration, etc. received by a partner of a firm which is allowable under section 40(b) and (g) amount received under Keyman Insurance policy. It will now be necessary to ascertain from the assessee about any receipts under these heads which have not been credited to profit and loss account and state such amounts in this clause. Clause 13 (b), (c) ,& (d) require information in respect of items which may also be covered under section 28 and as such will also fall in clause 13 (a). However, those items which are reported in clauses 13(b), (c) and (d) need not be reported in clause 13 (a). The tax auditor may obtain a management representation in writing from the assessee in respect of all items falling under this clause.

24.2. The details of the following claims, if admitted as due by the concerned authorities but not credited to the profit and loss account, are to be stated under sub-clause (b).

- a) Pro forma credits
- b) Drawback
- c) Refund of duty of custom
- d) Refund of excise duty
- e) Refund of sales tax

In respect of items falling under sub-clause (b) the tax auditor should examine all relevant correspondence, records and evidence in order to determine whether any particular refund/claim has been admitted as due and accepted during the relevant financial year.

There may be practical difficulties in verifying the information in regard to such refunds and credits. It may, therefore, be necessary for the tax auditor to scrutinise the relevant files or subsequent records relating to such refunds while verifying the particulars and also obtain an appropriate management representation.

The words 'admitted by the concerned authorities' would mean 'admitted by the authorities within the relevant previous year'.

The system of accounting followed in respect of these particular items may also be brought out in appropriate cases. If the assessee is

following cash basis of accounting, it should be clearly brought out, since the admittance of claims during the relevant previous year without actual receipt has no significance in cases where cash method of accounting is followed. Credits/claims which have been admitted as due after the relevant previous year need not be reported here.

Where such amounts have not been credited in the profit and loss account but netted against the relevant expenditure/income heads, such fact should be clearly brought out.

- 24.3 Under sub-clause (c), the escalation claims accepted during the previous year but not credited to the profit and loss account are to be stated. The escalation claims accepted during the year would normally mean "accepted during the relevant previous year". If such amount has not been credited to the profit and loss account the fact should be brought out. The system of accounting followed in respect of this particular item may also be brought out in appropriate cases. If the assessee is following cash basis of accounting with reference to this item, it should be clearly brought out since acceptance of claims during the relevant previous year without actual receipt has no significance in cases where cash method of accounting is followed.

Escalation claims would normally arise pursuant to a contract (including contracts entered into in earlier years), if so permitted by the contract. Only those claims to which the other party has signified unconditional acceptance could constitute accepted claims. Mere making of claims by the assessee or claims under negotiations or claims which are sub-judice *CIT v. Hindustan Housing & Land Development Trust Ltd.*[1986] 161 ITR 524 (SC) cannot constitute claims accepted.

- 24.4 Sub-clause (d) covers any other items which the tax auditor considers as an income of the assessee based on his verification of records and other documents and information gathered, but which has not been credited to the profit and loss account. In giving the details under sub-clauses (c) and (d), due regard should be had to AS-9 - Revenue Recognition.

The tax auditor should scrutinise all the items including casual and non-recurring items appearing in the books of account, particularly the credit items, and ensure himself whether any such credit which is in the nature of income has been credited to the profit and loss account or not.

- 24.5 Under sub-clause (e), capital receipt, if any, which has not been credited to the profit and loss account has to be stated. The tax auditor should use his professional expertise and judgement in determining whether the receipt is capital or revenue. The tax auditor may also indicate various judicial pronouncements on which he has relied.

The following is an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under this sub-clause.

- a) Capital subsidy received in the form of Government grants which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g., Capital Investment Subsidy Scheme.
- b) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.
- c) Compensation for surrendering certain rights.
- d) Compensation received for agreeing not to compete.
- e) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

- 24.6 Loans and borrowings are not required to be stated under this sub-clause.

25. Particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form:-

- (a) **Description of asset/block of assets.**
- (b) **Rate of depreciation.**
- (c) **Actual cost or written down value, as the case may be.**
- (d) **Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of -**
 - (i) **Modified Value Added Tax credit claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March, 1994,**

- (ii) **change in rate of exchange of currency, and**
- (iii) **subsidy or grant or reimbursement, by whatever name called.**
- (e) **Depreciation allowable.**
- (f) **Written down value at the end of the year.**

[Clause 14 (a) to (f)]

- 25.1 Having regard to the nature of requirements prescribed, it may be necessary for the tax auditor to examine:
- a) Classification of the asset
 - b) Classification thereof to a block
 - c) The working of actual cost or written down value
 - d) The date of acquisition and the date on which it is put to use.
 - e) The applicable rate of depreciation
 - f) The additions / deductions and dates thereof.
 - g) Adjustments required – specified as well as on account of sale, etc.
- 25.2 The word “allowable” implies that depreciation should be permissible as a deduction, as per the provisions of the Act and the Rules. This would require exercise of judgement having regard to the facts and circumstances of the case, developments in law from time to time, etc.
- 25.3 For the purpose of determining the rate of depreciation, the tax auditor has to examine the classification of the assets into various blocks. For example, a particular asset may be classified as plant or machinery from the view point of one class of assessee, yet it may not be plant or machinery from the view point of another class of assessee. The purpose for which the asset is used is also very material in this regard. Hence, the tax auditor should ensure that the classification as made by the assessee is in consonance with legal principles. In this connection, he should traverse through judicial pronouncements as well as through the past assessment history of the assessee, and upon an analysis thereof, if he comes to the conclusion that the matter is not free from doubt or controversy, he has to indicate the fact in his report by way of

suitable qualification. It may also be necessary to rely upon technical data for determining the proper classification of the block. Since the tax auditor is not a technical expert, he has to obtain suitable certificate from concerned experts

- 25.4 Once the classification has been ascertained and checked properly, the rates applicable as per the Income-tax Rules, 1962 follow as a natural corollary. The tax auditor must have due regard to the Income-tax Rules, 1962, relevant clarifications from the Department and judicial decisions.

Under sub-clauses (a) to (b), information in respect of description of assets, block of assets under which the concerned asset is classifiable and the rate of depreciation are to be stated. This will include information about the existing assets. In respect of the existing assets, the computation of depreciation would involve stating the opening written down value of the block of assets which should be taken from the relevant income-tax records. The tax auditor will be conducting the audit in the current year only. As such the tax auditor can rely upon the classification of assets and written down value stated in the income tax records available with the assessee. The tax auditor should mention the fact that he has relied upon the income tax records of the assessee in respect of the information regarding the classification of assets and written down value of the existing assets.

If there is any dispute with regard to the classification of an asset in a particular block or the rate of depreciation applied, the tax auditor must give his working with suitable reasons.. Further, there may be disputes in the earlier years between the assessee and the Department regarding classification, rate of depreciation etc. and the tax auditor should give suitable disclosure depending upon the facts and circumstances of the case. Alternatively, where the tax auditor adopts a system of classification different from the one adopted by the assessee, suitable disclosure should be made regarding the effect thereof.

It will, therefore, be advisable to put a suitable note with regard to those items in respect of which disputes for the earlier years are not resolved upto the date of giving the audit report and it should be clarified that the amount of depreciation allowable may change as a result of any decision which may be received after the audit report is given. This note can be in the following manner:

“NOTE: Certain disputes about (a) the rate of depreciation on _____ (b) determination of WDV of block of assets relating to _____ and (c) ownership of _____ have arisen in the assessment years _____ for which assessments are pending/appeals are pending. The figures of WDV and/or rate of depreciation mentioned in the above statement may require modification when these disputes are resolved. Therefore, the amount of depreciation allowable as stated in the above statement will have to be accordingly modified.”

- 25.5 For the purpose of determination of actual cost, the tax auditor has to be guided by the relevant legal provisions. Since determination of actual cost has got accounting implications, he can rely on the relevant publications of the ICAI such as AS, Guidance Notes, Statement on Expenditure during Construction Period etc. Due to the amendments made by the Finance (No.2) Act, 1998, depreciation is allowable on intangible assets like know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature. There may be intangible assets like patents invented by the company, brand names, etc. for which the assessee might have incurred costs. The tax auditor should examine the basis on which the cost of such intangible assets has been arrived at.
- 25.6 The additions/deductions during the year have to be reported, with dates. The tax auditor is advised to get the details of each asset or block of asset added during the year or disposed of during the year with the dates of acquisition/disposal. Where any addition was made, the date on which the asset was put to use is to be reported. In respect of deductions, the sale value of the assets disposed of along with dates should be mentioned. As per Explanation 8 to section 43(1) of the Act, so much of interest as is relateable to any period after such asset is first put to use shall not form part of actual cost. The tax auditor should check the working regarding the calculation of depreciation allowable under the Act. To ascertain when the asset has been put to use, the tax auditor could call for basic records like production records/installation details/excise records/records relating to power connection for operating

the machine and any other relevant evidence. In the absence of any specific documentation with regard to the effective date from which the asset is put to use, he could get a representation letter from the management, in respect of the assets acquired. He should examine whether the apportionment of depreciation in cases like succession, amalgamation, demerger etc. has been properly made.

- 25.7 Details have to be given in respect of adjustments on account of three factors.

The first adjustment relates to Modified Value Added Tax credit claimed and allowed under the Central Excise Rules, 1944 in respect of assets acquired on or after 1st March, 1994. Explanation 9 to section 43(1) of the Act provides that where an asset is or has been acquired on or after the 1st day of March, 1994 by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1974 (51 of 1975) in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944. It is necessary, therefore, for the tax auditor to examine the details of assets acquired on or after 1st March, 1994 and the details of MODVAT credit claimed and allowed in respect of those assets.

- 25.8 Under the Central Excise rule relating to MODVAT credit on capital goods, the assessee is entitled to avail MODVAT and utilise the same in payment of duty of excise leviable on final products, but subject to the condition that the assessee shall not claim depreciation under the Income-tax Act on an amount equivalent to the amount of MODVAT credit and therefore, it is necessary for the tax auditor to check the amount of MODVAT credit which has been claimed by the assessee. It is very relevant to note here that only that portion of MODVAT credit is to be deducted from the cost of fixed assets which has been claimed and allowed. If in a given case, the claim of MODVAT credit has not been allowed by the Central Excise Department or the same is under any dispute pending adjudication, the adjustment may not be made till the final decision and depreciation may be claimed on the amount of actual cost. However, if in the succeeding year the claim is settled and allowed by the Department, the same has to be adjusted from the written down value of the related asset/block of assets in that year. The tax auditor may also rely on the excise records for the purpose of verifying the details regarding MODVAT credit

- 25.9 The second adjustment relates to the change in the rate of exchange of currency. Section 43A deals with the adjustment on account of change in the rate of exchange of currency. AS-11 (Revised) issued by the ICAI deals with accounting for effects of changes in foreign exchange rates. Therefore, the tax auditor should refer to them and arrive at a judgement as to whether the adjustment as contemplated in the said provisions of law and AS-11 has been made properly.
- 25.10 The third adjustment relates to the subsidy or grant or reimbursement, by whatever name called. Explanation 10 to section 43(1) provides that where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relateable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee. As per the proviso to the above Explanation, where such subsidy or grant or reimbursement is of such nature that it cannot be directly relateable to the asset acquired, such of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee. Subsidy coming within the scope of Explanation 10 to section 43(1) in respect of asset acquired in any earlier year(s) and received during the year has to be deducted from the written down value of such assets in the year of receipt.
- 25.11 Finally, the amount of depreciation allowable and the WDV at the year end have to be stated. Wherever a claim for depreciation involves any reliance on any judgement or opinion or other contentions (as to its classification, rate applicable, cost, date on which put to use etc.), it may be advisable for tax auditor to disclose full particulars thereof and the basis on which the depreciation allowable has been determined and vouched by him.
- 25.12 There are judicial pronouncements to the affect that depreciation which is not claimed by the assessee should not be thrust on him. *Shri Sahakari Sakhar Karkhana Ltd. 177 ITR 443 (Bom.)*, *Beco Engineering Co. Ltd. 148 ITR 478 (P & H)* , *Premier Automobiles Ltd. 206 ITR 1*

(Bom.) *Machine Tools Corp. of India Ltd.* 201 ITR 101 (Kar), and *Andhra Cotton Mills Ltd.* 209 ITR 404 (A.P.) However, there are certain other judicial pronouncements to the effect that allowance of depreciation is mandatory whether the assessee has claimed the same or not. *Allahabad Glass Works* [1961] 42 ITR 439 (All), *Dasaprakash Bottling Company v. CIT* [1980] 122 ITR 9 (Mad) *CIT v. Southern Petro Chemical Industries Corporation Limited (No.2)* [1998] 233 ITR 400 (Mad).

25.13 However, if other relevant details are made available by the assessee, they would have to be mentioned under the relevant sub-clauses.

26. Amounts admissible under section 33AB, 33ABA, 33AC, 35, 35ABB, 35AC, 35CCA, 35CCB, 35D, 35E:-

- (a) debited to the profit & loss account (showing the amount debited and deduction allowable under each section separately);
- (b) not debited to the profit and loss account.

[Clause 15 (a) and (b)]

26.1 The assessee can claim deduction under the following sections subject to the terms and conditions mentioned in these sections.

- i) Section 33AB: Tea Development Account
- ii) Section 33ABA: Site Restoration Fund
- iii) Section 33AC: Reserve for Shipping Business
- iv) Section 35 : Expenditure on Scientific Research
- v) Section 35ABB: Expenditure for obtaining licence to operate telecom services
- vi) Section 35AC: Expenditure on eligible projects/schemes
- vii) Section 35CCA: Expenditure by way of payments to associations and institutions for carrying out rural development programmes.
- viii) Section 35CCB: Expenditure by way of payments to associations and institutions for carrying out programmes of conservation of natural resources.
- ix) Section 35D: Amortisation of certain preliminary expenses

- x) Section 35E: Deduction for expenditure on prospecting etc. for certain minerals

In case the assessee has obtained a separate audit report for claiming deductions under any of these sections, he must make a reference to that report while giving the details under this clause.

- 26.2 The tax auditor should indicate the amount debited in the profit and loss account and the amount actually admissible in accordance with the concerned provisions of law.
- 26.3 The amount not debited to the profit and loss account but admissible under any of the sections mentioned in the clause have to be stated. Sections 33AB and 33ABA allow deduction in respect of amount deposited in designated account for specified purposes which, as per accounting principles, are not to be debited to the profit and loss account. In this connection, the tax auditor has to work out, on the basis of the conditions prescribed in the concerned section, the amount admissible thereunder and report the same.
- 26.4 Where the assessee is eligible for deduction under one or more of the above sections, the tax auditor has to state the deduction allowable under each section separately.
- 26.5 In many cases, capital expenditure may have been incurred which is allowable as deduction while computing the profits and gains of the assessee under these heads and such expenditure may have been capitalised and shown as fixed assets in the books. The tax auditor should ascertain such expenditure and state the same under sub-clause (b).
27. (a) **Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36(1)(ii)].**
- (b) **Any sum received from employees towards contributions to any provident fund or superannuation fund or any other fund mentioned in section 2(24)(x); and due date for payment and the actual date of payment to the concerned authorities under section 36(1)(va).**

[Clause 16 (a) and (b)]

- 27.1. Section 36(1)(ii) provides for deduction of any sum paid to an employee as bonus or commission for services rendered where such sum would not have been payable to him as profit or dividend, if it had not been paid as bonus or commission. In other words, if bonus or commission is in the nature of profit or dividend, it may not be normally allowable as a deduction unless such payment is wholly and exclusively made to the employee. [*Shahzada Nana & Sons v. CIT* [1977] 108 ITR 358 (SC)]. In the case of *Loyal Motor Service Company Ltd. v. CIT* [1946] 14 ITR 647, (Bom) the assessee company paid bonus at the rate of 2 months' salary to its employees who were also shareholders in the company. The tax authorities contended that the bonus paid was not allowable as it would have been payable to the employees as profit or dividend. It was held by the court that it was not in the nature of profit or dividend and accordingly it was held to be allowable.
- 27.2 The requirement is only in respect of the disclosure of the amount and the tax auditor is not expected to express his opinion about its allowability or otherwise. The tax auditor should verify the contract with the employees so as to ascertain the nature of payments.
- 27.3 Section 2(24)(x) includes within the scope of income any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or ESI Fund or any other Fund for employees' welfare (hereafter referred to as "Welfare Fund").
- 27.4 Section 36(i)(va) of the Act permits deduction of such sum if it is credited by the assessee to the account of the employees in the relevant statutory fund on or before the due date, i.e., the date by which it is required to be credited as per the provisions of the applicable law etc. It may be noted that Employees' P.F Act provides for 5 days of grace period for payment of contribution. This can be taken into consideration for determining the due date of payment. Similar grace period is available under ESI fund and other funds and the same treatment can be given.
- 27.5 Section 36(1)(va) read with section 2(24)(x) does not give much latitude about the due date of payment. However, the Appellate Tribunal has held that this provision should be liberally construed - vide *Madras Radiators Pressing Ltd, v. DCIT* – 59 ITD 515 (Mad), *Fluid Air (India) Ltd. v. DCIT* [1997] 63 ITD 182 (Bom.).

- 27.6 The tax auditor should get a list of various contributions recovered from the employees which come within the scope of this clause. He should also verify the documents relating to provident funds and other welfare funds. He should verify the agreement under which employees have to make contributions to provident fund and other welfare funds. The ledger account of contributions from employees should be reviewed, the due dates of payments and the actual dates of payment should be verified with the evidence available. In view of the voluminous nature of the information, the tax auditor can apply test checks and compliance tests to satisfy himself that the system of recovery and remittance is proper. Under this clause, details of the amount deducted, due date for payment and actual date of payment in respect of provident fund, ESI fund or other staff welfare fund have to be stated. However, in case of big assesseees such as public sector undertakings, banks etc. where information to be stated is voluminous, the tax auditor may exercise his professional judgement and state only those cases under this clause where actual date of payment to the concerned authorities is beyond the due date of payment and state this fact by way of a suitable note.

Amounts debited to the profit and loss account, being:-

28. (a) expenditure of capital nature;
[Clause 17(a)]
29. (b) expenditure of personal nature;
[Clause 17 (b)]
30. (c) expenditure on advertisement in any souvenir, brochure, tract, pamphlet or the like, published by a political party;
[Clause 17(c)]
31. (d) expenditure incurred at clubs,—
(i) as entrance fees and subscription;
(ii) as cost for club services and facilities used;
[Clause 17(d)]
32. (e) (i) expenditure by way of penalty or fine for violation of any law for the time being in force;

- (ii) any other penalty or fine;
- (iii) expenditure incurred for any purpose which is an offence or which is prohibited by law;

[Clause 17 (e)]

33. (f) amounts inadmissible under section 40(a);

[Clause 17 (f)]

34. (g) interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof;

[Clause 17(g)]

35. (h) amount inadmissible under section 40A(3) read with rule 6DD and computation thereof;

[Clause 17(h)]

36. (i) provision for payment of gratuity not allowable under section 40A(7);

[Clause 17 (i)]

37. (j) any sum paid by the assessee as an employer not allowable under section 40A(9);

[Clause 17 (j)]

38. (k) particulars of any liability of a contingent nature;

[Clause 17 (k)]

28. Clause 17(a)

- 28.1 This clause requires the tax auditor to state the amount of expenditure incurred by the assessee in respect of various items listed therein. These expenses may be allowable or may not be allowable or may be allowable subject to certain limits. It is important to note that the amount of expenditure in respect of each of the items is required to be stated. Accordingly, tax auditor will have to obtain the information and make necessary enquiries in that behalf. It may necessitate review of books of account, basis of classification, groups under which such expenses have been debited, and so on.

28.2 Capital expenditure is not allowable in computing business income unless specifically provided in any sections of the Act. The words “capital expenditure” are not defined in the Act and no conclusive test or rules can be laid down to determine whether a particular expenditure is capital or revenue in the nature. Different tests have been applied by the courts in different cases depending upon the facts and circumstances of each case and the case law on the subject, as evolved over a period of years, gives guidance for determining the nature of expenditure.

28.3. Some tests which, however, are generally applied to determine whether a particular item of expenditure is of capital nature, are set out hereunder:

- (i) Whether it brings into existence an asset or advantage of enduring benefit. The question whether a particular benefit is of an enduring or permanent nature will depend upon the facts and circumstances of each case, the concept of permanency being relative.
- (ii) Whether it is referable to fixed capital or fixed assets in contrast to circulating capital or current assets.
- (iii) Whether it relates to the very framework of the assessee's business.
- (iv) Whether it is an initial expenditure or an expenditure incurred in setting the profit earning machinery into motion.
- (v) Whether it is an expenditure to acquire a concern or goodwill.

The nature of receipt in the hands of the recipient is not a determining factor to determine the nature of payment in the hands of payer. If the amount is in the nature of capital receipt in the hands of the payee, it does not necessarily imply that it is a capital expenditure for the payer and vice versa. The case of the payer has to be considered independently based on the facts concerning him.

28.4. Under the Act, capital expenditure of certain types e.g., on scientific research referred to in section 35, is deductible in computing the income. Similarly depreciation at 100% is allowed in respect of capital expenditure on certain assets like energy saving devices. Similarly, capital expenditure on preliminary expenses, etc. is deductible over a period of years.

It is, however, suggested that those items of capital expenditure which are otherwise fully deductible in computing the total income of the assessee under the Act should be separately indicated under this clause so that the assessee can claim proper deduction in the computation of his total income.

- 28.5. The capital expenditure, if any, debited to the profit and loss account should be disclosed in a classified manner stating the amount on various heads separately. Since part of this capital expenditure may be allowable as deduction in the computation of total income, it is necessary to specify the nature of expenditure, the amount of expenditure incurred, and the relevant provision under which the expenditure is admissible, so that proper deduction can be allowed in the computation of total income.

29. Clause 17(b)

- 29.1. Personal expenses debited to the profit and loss account are to be specified under this sub-clause as they are not deductible in the computation of total income under section 37. It may be noted that the word “personal” is confined to and attached with the “assessee” and not necessarily to and with persons other than the assessee.
- 29.2. Section 227(1A) and the Manufacturing and Other Companies (Auditor’s Report) Order, 1988 issued by the Central Government in terms of section 227 (4A) of the Companies Act require the auditor to state in his report whether personal expenses have been charged to revenue account.

In this context, a reference may be made to paragraph 45(b) of the Statement on the Manufacturing and Other Companies (Auditors’ Report) Order, 1988, which states as follows:

“Whether an item of expenditure is of the nature of personal expenses or is a legitimate business expenditure depends upon the facts and circumstances of each case. The practice of meeting certain types of personal expenses (such as provision of rent-free accommodation, conveyance for private use, medical expenses, leave travel concession, maternity benefits, canteen facilities, etc.) of the employees and/or directors is normal and is recognised by the Department of Company Affairs and

other authorities. The charging of such expenses to the revenue account either on the basis of contractual obligations or in accordance with the generally accepted business practice is normal and does not call for any comment by the tax auditor. Where, however, such expenses are not covered by contractual obligations or by generally accepted business practice and are charged to revenue account, the tax auditor should report thereon”.

Similar views have been expressed in para 2.28 of the ‘Statement on Qualifications in Auditors’ Reports’ (Edition 1985) vide Appendix

Thus, in the case of a person whose accounts of the business or profession have been audited under any other law, the tax auditor will have to report in respect of personal expenses debited in the profit and loss account. In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, the tax auditor will have to verify the personal expenses if debited in the expenses account while conducting the audit and verify the amount of expenses mentioned under this clause.

29.3 The particulars may be furnished in the following form:

Sl.No.	Nature and particulars of expenditure	Account head under which debited	Amount of expenditure	Remarks

30. Clause 17(c)

- 30.1. Section 37(2B) provides that no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. Therefore, the expenditure of this nature should be segregated and reported under this clause.
- 30.2. The tax auditor may come across advertising expenditure incurred on advertising in a souvenir, brochure, tract, pamphlet or journal

published by a trade union or a labour union formed by a political party. The trade union or labour union though promoted or formed by a political party may have a distinct legal entity. In that event, expenditure incurred by the assessee by way of advertisement given in the souvenir, brochure, tract, pamphlet or journal published by the trade union or the labour union is not required to be indicated against clause 17(c) in Form No. 3CD. If the trade union or labour union formed by the political party does not have a separate and distinct legal entity, then the expenditure incurred on such an advertisement will have to be indicated against this clause.

31. Clause 17(d)

- 31.1. The amount of payments made to clubs by the assessee during the year should be indicated under this clause. The payments may be for entrance fees as well as membership subscription and for catering and other services by the club, both in respect of directors and other employees in case of companies and for partners or proprietors in other cases. The fact whether such expenses are incurred in the course of business or whether they are of personal nature should be ascertained. If they are personal in nature, they are to be shown separately under Clause 17(b) referred to earlier.
- 31.2. Details of payments made to clubs are also required by tax authorities for the purpose of determining whether any portion of club expenses could be treated as perquisite in the hands of the person concerned. All payments made to credit card agencies should be carefully scrutinised. Credit card agency is nothing but credit/collecting agency. In order to determine whether the payments have been made to a club, one has to look into the substantive activity of the institution concerned. Likewise, payments made to service organisations such as Rotary, Lions, Jaycees, Giants etc., would not necessarily be covered by this clause.

31.3 The particulars may be stated in the following form:

Sr. No.	Name of the club	Nature of amount paid			Remarks
		Entrance fees	Subscri-ption	Cost of club services	
(1)	(2)	(3)	(4)	(5)	(6)

32. Clause 17(e)

- 32.1 In this clause, sub-clause (i) covers only penalty or fine for violation of any law for the time being in force, while sub-clause (ii) covers any other penalty or fine. The tax auditor should obtain in writing from the assessee the details of all payments by way of penalty or fine for violation of any law as have been made and paid or incurred during the relevant previous year and how such amounts have been dealt with in the books of account produced for audit. The tax auditor may not be aware of the intricacies of all the laws of the land. It must be borne in mind that the tax auditor while reporting under this clause is not required to express any opinion as to the allowability or otherwise of the amount of penalty or fine for violation of law. He is only to give the details of such items as have been charged in the account. This clause covers only penalty or fine and not the payment for contractual breach or for redressal of contractual wrongs. While stating the particulars under this clause, the tax auditor should take into consideration the concept of materiality.
- 32.2 In order to ascertain the facts whether the sum debited in the profit and loss account is by way of penalty or fine for any violation of law, the tax auditor will have to refer to the relevant law under which the amount has been paid or incurred and ascertain whether such amount is in the nature of penalty or fine. He should also ascertain all the facts by having recourse to the order of the jurisdictional authority which has levied the penalty or fine. Even if the assessee is contesting against

such order before higher authorities, the same will not be relevant and the mere point for ascertaining is whether such sum is debited to the profit and loss account, if yes, the same has to be disclosed.

- 32.3 The courts have laid down that any penalty or fine for violation of law is not admissible as expenditure. It is in this context the requirement stipulated by clause 17 (e)(i) is to be answered.
- 32.4 Any expenditure in consequence of violation of law like penalty or fine levied for evading provisions of the Act, FERA, Excise and Customs law etc., cannot be claimed as deduction under the Act. A penalty imposed for violation of any law during the course of trade cannot be described as a commercial loss. Even if the need for making payments has arisen out of trading operations, the payments are not wholly and exclusively for the purpose of the trade. Violation of law is not a normal incidence of business. This principle was laid down by Hon'ble Supreme Court in case of *CIT v. Maddi Venkataratnam & Co. (P) Ltd* [1998] 96 Taxman 643 and in the case of *Hazi Aziz Shekooor Bros v. CIT* [1961] 41 ITR 350. In both the cases it was held that one can carry business or his trade without violating the law. Some of the other cases where it has been held that penalty for violation of law is not an allowable expenditure are cited below:

Penalty paid in lieu of confiscation of goods by customs authorities

[CIT v. Mihir Textiles Ltd. [1976] 104 ITR 167 (Guj)]

Penalty paid for delayed payment of cess tax and purchase tax -

[CIT v. Upper Doad Sugar Mills Ltd [1972] 85 ITR 489 (Del)]

Penalty payable under section 3(5) of Sugarcane Cess Act

[Upper Doad Sugar Mills Ltd v. [CIT [1979] 116 ITR 928 (All)]

- 32.5 In *Prakash Cotton Mills (P) Ltd. v CIT* [1993] 201 ITR 684 (SC) it has been held that whenever any statutory impost paid by an assessee by way of damages or penalty or interest is claimed as a allowable expenditure under section 37(1) of the Act, the assessing authority is required to examine the scheme of the provisions of the relevant statute providing for payment of such impost notwithstanding the nomenclature of the impost as given by the statute, to find whether it is compensatory or penal in nature. The authority has to allow deduction under section

37(1) wherever such examination reveals the concerned impost to be purely compensatory in nature. Wherever such impost is found to be of a composite nature, that is, partly of compensatory nature and partly of penal nature, the authority would have to bifurcate the two components of the impost and give deduction of that component which is compensatory in nature and refuse to give deduction of that component which is penal in nature.

Further, in *CIT v Ahmedabad Cotton Mfg. Co. Ltd.* [1993] 205 ITR 163 (SC), the Supreme Court held that what needs to be done by an Assessing Authority under the Act, in examining the claim of an assessee that the payment made by such assessee was a deductible expenditure under section 37 although called a penalty, is to see whether the law or scheme under which the amount was paid, required such payment to be made, as penalty or as something akin to penalty, that is, imposed by way of punishment for breach for infraction of the law or the statutory scheme. If the amount so paid is found to be not a penalty or something akin to penalty due to the fact that the amount paid by the assessee was in exercise of the option conferred upon him under the levy, law or scheme concerned, then one has to regard such payment as business expenditure of the assessee, allowable under section 37 as incidental to business laid out and expended wholly and exclusively for the purposes of the business.

In case of *Malwa Vanaspati & Chemical Co. v. CIT* [1997] 225 ITR 383 (SC), it was held that where the assessee is required to pay an amount comprising both the elements of compensation and penalty, the compensation is allowable as business expenditure, but not the penalty.

- 32.6 Where the penalty or fine is in the nature of penalty or fine only, the entire amount thereof will have to be stated. As discussed above, with reference to certain penalty/penal interest courts have held that it is partially compensatory payment and partially in the nature of penalty. In such a case, on the basis of appropriate criteria, the amount charged will have to be bifurcated and only the amount relating to penalty may be stated.
- 32.7 If in an illegal business, income arises, expenses/losses incurred in earning such income are deductible. However, fine or penalty imposed thereon is not deductible while computing taxable income-*Mam vs. Nash* [1932] 1 KB 752.

- 32.8 The following Explanation to section 37(1) of the Act has been inserted by Finance Act (No.2) Act, 1998 with effect from assessment year. 1962-63.

"For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure".

The above said Explanation appears to have been enacted in order to nullify the effect of the decisions, such as *Pranav Construction Co v. Asst. CIT [1998] 61 TTJ (ITAT, Mumbai) 145*, where a sum of Rs.20 lakhs paid as protection money to certain persons by the assessee, a builder, engaged in the construction activities in areas which were vulnerable to such dangers as extortion, haftas etc. has been held as an allowable expenditure. Hence, any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law is to be stated under this sub-clause.

33. Clause 17(f)

- 33.1 Section 40(a) specifies certain amounts which shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession". They are as follows:
- i) Any interest, royalty, fees for technical services or other sum chargeable under the Income-tax Act on which tax has not been paid or deducted under Chapter XVII-B.
 - ii) Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.
 - iii) Any sum paid on account of wealth tax.
 - iv) Any payment which is chargeable under the head "salaries", if it is payable outside India and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

- v) Any payment to a provident or other fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangement to secure that tax shall be deducted at source from any payment made from the fund which are chargeable to tax under the had "Salaries".

33.2 In respect of items (i) and (iv) the tax auditor should obtain in writing from the assessee the details of all payments of the nature referred to in paragraph 33.1 and debited to the profit and loss account. Where an actual remittance overseas has been made by the assessee during the relevant previous year without deducting any tax at source, the tax auditor may rely upon the legal opinion and/or certificates from chartered accountants based upon which remittances have been made without deduction of tax at source. The tax auditor needs to report under this clause only if he has a different opinion on the issue. Where no remittances have been made during the relevant year, the tax auditor may examine the relevant provisions vis-vis the agreement or correspondence in pursuant to which the liability is provided by the assessee in his books of account in order to determine whether any amount so provided is at all chargeable to tax under the Act. The tax auditor may use his professional judgement in these matters based upon decided cases and he may rely upon a legal opinion obtained by the assessee where no tax is required to be deducted in respect of the amount so provided. In case he disagrees with the stand taken by the assessee, he should give both the views in his report.

34. Clause 17(g)

34.1 As per earlier Form No.3CD, only particulars of interest and remuneration paid to a partner were required to be furnished. The scope of information has been enlarged and now the tax auditor is required to state the inadmissible amount and such information is also required to be given in respect of interest/remuneration paid to a member of an Association of persons (AOP)/Body of individuals (BOI). The word "inadmissible" implies that the tax auditor will have to examine the facts, apply the conditions for allowance or disallowance and accordingly determine the *prima facie* inadmissibility of the deduction and also quantify the same.

- 34.2 Salary, bonus, commission or remuneration or interest are not admissible, unless the following conditions are satisfied:
- (a) Remuneration is paid to working partner(s).
 - (b) Remuneration or interest is authorised by the partnership deed and is in accordance with the partnership deed
 - (c) Remuneration or interest does not pertain to a period prior to the date of partnership deed
- 34.3 The inadmissible remuneration, salary, bonus or commission under section 40(b) has to be determined on the basis of the provisions of sub-clause (v) thereof read with the limits laid down therein. Such limits are laid down as a percentage of book profits. Explanation 3 to section 40(b) provides that “book profits” means the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit. The inadmissible amount of salary, bonus, commission or remuneration is to be worked out after deducting interest allowable to partners as per the provisions of section 40(b). According to Explanation 4, “working partner” means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner. It is advisable for the auditor to obtain from the assessee a detailed working of the inadmissible remuneration, salary, bonus or commission under section 40(b). He has to verify the computation from the instrument or agreement or any other document evidencing partnership including any supplementary documents or other documents effecting changes which would affect the computation of the inadmissible amounts under section 40(b).
- 34.4 Under section 40(b)(iv), any payment of interest to any partner which is authorised by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed in so far as such amount exceeds the amount calculated at the rate of eighteen per cent simple interest per annum will not be admissible as a deduction.
- 34.5 Section 40(ba) lays down that any interest or remuneration paid by an AOP to its member shall not be allowed as a deduction to the AOP. It may also be noted that in computing such disallowance:

- (a) where interest is paid by AOP / BOI to a member who has also paid interest to AOP/ BOI, only net amount of interest, if any, shall be disallowed;
- (b) where a member is in a representative capacity, the disallowance of net interest paid by AOP/BOI shall be the amount of net interest received by the member in a representative capacity or by the person who is so represented by the member;
- (c) where a person who is a member in his individual capacity receives the interest for the benefit of or on behalf of any other person, then, interest so paid by AOP/ BOI shall not be disallowed;

34.6 In order to determine the amounts inadmissible under section 40(b), the tax auditor should obtain the computation of total income from the assessee.

34.7 In working out the inadmissible amount the tax auditor must have due regard to the Circular No.739 dated 25.3.1996 issued by the Board reproduced in Appendix XIV.

35. Clause 17(h)

35.1 Section 40A(3) provides that where the assessee incurs any expenditure in respect of which payment is made in a sum exceeding Rs.20,000 (present limit) otherwise than by a crossed cheque or a crossed bank draft, 20% of such expenditure shall not be allowed as deduction except in certain cases and circumstances. The cases and circumstances in which payment of a sum exceeding Rs.20,000/- in cash or otherwise than by crossed cheque or draft is allowable are specified in Rule 6DD. The details regarding the payments made in cash or otherwise than by crossed cheque or bank draft are to be stated under this clause.

35.2 The particulars may be furnished in the following form:

<i>Sl. No</i>	<i>Nature and particulars of expenditure</i>	<i>Date of Payment</i>	<i>Amount paid otherwise than by account payee cheque/ draft</i>	<i>20% of such expenditure</i>	<i>Remarks</i>

35.3. There may be practical difficulties in verifying of payments made through crossed cheques or bank drafts. If no proper evidence for verification of the payment by crossed cheque or draft is available, such a fact could be brought out by appropriate comments in the following manner:-

“It is not possible for me/us to verify whether the payments in excess of Rs.20,000 have been made otherwise than by crossed cheque or bank draft, as the necessary evidence is not in the possession of the assessee”.

35.4. For the purpose of furnishing the above particulars, the tax auditor should obtain a list of all cash payments in respect of expenditure exceeding Rs.20,000 made by the assessee during the relevant year which should include the list of payments exempted in terms of Rule 6DD with reasons. This list should be verified by the tax auditor with the books of account in order to ascertain whether the conditions for specific exemption granted under clauses (a) to (l) of Rule 6DD are satisfied. Details of payments which do not satisfy the above conditions should be stated under this clause.

35.5 Items of expenditure in respect of which specific exemption has been given under Clauses (a) to (l) of Rule 6DD are not required to be stated under this clause.

36. Clause 17(i)

36.1. As per Section 40A(7), the deduction of any provision for gratuity made after 1.4.1976 is allowable only if an approved gratuity fund is created

and the provision is made for contribution due to such fund.

- 36.2. The tax auditor should call for the order of the Commissioner of Income-tax granting approval to the gratuity fund, verify the date from which it is effective and also verify whether the provision has been made as provided in the trust deed.
- 36.3. In case the provision made for payment of gratuity is not allowable under section 40A(7), the same is to be stated under this sub-clause.

37. Clause 17(j)

- 37.1. Under section 40A(9) any payment made by an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860, or other institutions (other than contributions to recognised provident fund) is not allowable. The tax auditor should furnish the details of payments which are not allowable under this section.

38. Clause 17(k)

- 38.1. The assessee is required to furnish particulars of any liability of a contingent nature debited to the profit and loss account. The tax auditor may not be able to immediately ascertain the details of contingent liabilities debited to the profit and loss account without a detailed scrutiny of various account heads e.g. outstanding liabilities, provision etc. Accounting policy followed and disclosed would be helpful in ascertaining and verifying details. The expenses relating to disputed claims will be revealed only on the basis of the scrutiny of records relating to contingent liabilities. The tax auditor may look into particular items of contingent liabilities of the earlier year in order to determine whether or not any items has been charged to the profit and loss account of the current year and if so, whether the liability continues to be contingent in nature. Wherever necessary, a suitable note should be given by the tax auditor as to the non-availability of such particulars relating to the contingent liabilities.
- 38.2. Reference may be made to AS-4, 'Contingencies and Events occurring after the Balance Sheet Date' to determine what should normally be

treated as a contingent liability.

39. Particulars of payments made to persons specified under section 40A(2)(b).

[Clause 18]

- 39.1. Section 40(A)(2) provides that expenditure for which payment has been or is to be made to certain specified persons listed in the section (Refer Appendix XVI) may be disallowed if, in the opinion of the Assessing Officer, such expenditure is excessive or unreasonable having regard to:
- (i) the fair market value of the goods, services or facilities for which the payment is made; or
 - (ii) for the legitimate needs of business or profession of the assessee; or
 - (iii) the benefit derived by or accruing to the assessee from such expenditure.
- 39.2. The section enjoins on the Assessing Officer the power to fix the quantum of disallowance. Under this clause, the particulars of payments coming under this sub-section are to be stated. The following steps may be taken by the tax auditor in this connection:
- a) Obtain full list of specified persons as contemplated in this section.
 - b) Obtain details of expenditure/payments made to the specified persons.
 - c) Scrutinise all items of expenditure/payments to the above persons.
 - d) It may be difficult to locate all such payments and it may also involve a time consuming effort. It is, however, possible to localise the area of enquiry by ascertaining the following:-
 - (i) Call for all contracts or agreements entered into by the assessee and list out the contracts or agreements entered into with the specified persons and segregate the items of payments made to them under these

agreements.

- (ii) In case of payments for purchases and expenses on credit basis, the appropriate ledger accounts can be scrutinised to identify the dealings with the specified persons
- (iii) In case of cash purchases and expenses, the purchase or expense account should be scrutinised. It may be difficult to identify such payments in each and every case where the volume of transactions is rather huge and voluminous. Therefore, it may be necessary to restrict the scrutiny only to such payments in excess of certain monetary limits depending upon the size of the concern and the volume of business of the assessee.
- (iv) In case of a large company, it may not be possible to verify the list of all persons covered by this section and, therefore, the information supplied by the assessee can be relied upon. In this context, a reference may be made to Circular No.143 dated 20.8.1974, issued by the Board, in which it is clarified that a tax auditor can rely upon the list of persons covered under Section 13(3) as given by the managing trustee of a Public Trust. (Refer Appendix 'B' of "A Guide to Audit of Public Trusts under the Income-tax Act" published by the Institute). Where the tax auditor relies upon the information in this regard furnished to him by the assessee it would be advisable to make an appropriate disclosure.

40. Amounts deemed to be profits and gains under section 33AB or 33ABA or 33AC.

[Clause 19]

- 40.1 Sections 33AB and 33ABA lay down the circumstances under which amount withdrawn from such deposit account covered thereby for purposes other than specified purposes is to be deemed income chargeable as profit and gains of business. The tax auditor is required to report such amounts. Likewise, section 33AC allows deduction in respect of reserve created out of the profit of the assessee engaged in shipping business to be utilised in accordance with the provision of sub

section (2) of section 33AC. Sub section (3) thereof lays down the circumstances in which the amount of reserve account shall be deemed to be the profit and gains chargeable to tax. The tax auditor should verify the amount withdrawn from the deposit account for purposes other than specified purposes. Similarly, he should verify whether the reserve created under section 33AC and utilised not in accordance with the provisions of sub-section (2) of section 33AC has been properly disclosed.

41. Any amount of profit chargeable to tax under section 41 and computation thereof.

[Clause 20]

- 41.1 Section 41(1) provides that where any allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year the assessee obtains any amount, whether in cash or in any other manner whatsoever, in respect of such loss or expenditure or some benefits in respect of trading liability by way of remission or cessation thereof, the amount obtained by him or the value of benefit accruing to him is chargeable to tax as business income.

Where the assessee to whom the trading liability may have been allowed is succeeded in his business either because of amalgamation of two companies or on account of the constitution of new firm or the business is continued by some other person when the assessee ceases to carry on the business, then the person succeeding will be chargeable to tax on any amount received in relation to which deduction or allowance has been made.

Explanation (1) to section 41(1) provides to tax the remission or cessation of liability in the hands of the taxpayer and for this purpose the expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof" shall include the remission or cessation of any liability by a unilateral act of the assessee by way of writing off such liability in his accounts.

- 41.2 Section 41(2) provides for chargeability to income-tax as income of the business of the previous year in which the moneys payable for the building, machinery, plant or furniture of an undertaking engaged in generation or generation and distribution of power is sold, discarded,

demolished or destroyed. Where the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together with the amount of scrap value, if any, exceeds the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value shall be chargeable to income-tax as income of the business of the previous year in which the moneys payable for the building, machinery, plant or furniture become due. Where the moneys payable in respect of the building, machinery, plant or furniture become due in a previous year in which the business, for the purpose of which the building, machinery, plant or furniture was being used, is no longer in existence, the above provision shall apply as if the business is in existence in that previous year.

- 41.3 Section 41(3) provides that where any capital asset used in scientific research is sold without having been used for other purposes and the sale proceeds together with the amount of deduction allowed under section 35 exceeds the amount of capital expenditure, such surplus or the amount of deduction allowed, whichever is less, is chargeable to tax as business income in the year in which the sale took place.
- 41.4 It may be noted that section 41(3) is applicable only if an asset is sold without having been used for other purposes. In other words, if an asset which is initially purchased for the purpose of scientific research is utilised for business purposes on completion of scientific research and later on is sold or transferred, then section 41(3) is not applicable but in such case section 41(1) would apply.
- 41.5 Section 41(4) provides where any bad debt has been allowed as deduction under section 36(1) (vii) and the amount subsequently recovered on such debt is greater than the difference between the debt and the deduction so allowed, the excess realisation is chargeable to tax as business income of the year in which debt is recovered. For this purpose, it is immaterial whether the business of the assessee is in existence during the previous year in which recovery is made.

From the assessment year 1998-99, section 41(4A) has been inserted which provides that if any amount is withdrawn from the special reserve created under section 36(1)(viii), then it will be chargeable to tax in the year in which the amount is withdrawn, regardless of the fact whether

the business is in existence in that year or not.

- 41.6 Section 41(5) provides that where the business or profession referred to in section 41 is no longer in existence and there is income chargeable to tax under sub-section (1), sub-section (3), sub-section (4) or sub-section (4A) in respect of that business or profession, any loss, not being a loss sustained in speculation business which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall, so far as may be, be set off against the income chargeable to tax under the sub-sections aforesaid.
- 41.7 The tax auditor should obtain a list containing all the amounts chargeable under section 41 with the accompanying evidence, correspondence, etc. He should in all relevant cases examine the past records to satisfy himself about the correctness of the information provided by the assessee. The tax auditor has to state the profit chargeable to tax under this section. This information has to be given irrespective of the fact whether the relevant amount has been credited to the profit and loss account or not. However, if the amount has already been credited to the profit and loss account, the tax auditor should mention the fact. The computation of the profit chargeable under this clause is also to be stated.
- 42. * (i) In respect of any sum referred to in clause (a), (c), (d) or (e) of section 43B, the liability for which:-**
- (A) pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was**
- (a) paid during the previous year;**
- (b) not paid during the previous year;**
- (B) was incurred in the previous year and was**
- (a) paid on or before the due date for furnishing the return of income of the previous year under section 139(1);**
- (b) not paid on or before the aforesaid date.**
- (ii) In respect of any sum referred to in clause (b) of section**

43B, the liability for which-

- (A) pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year:**
 - (a) nature of liability;**
 - (b) due date of payment under second proviso to section 43B;**
 - (c) actual date of payment;**
 - (d) if paid otherwise than in cash, whether the sum has been realised within fifteen days of the aforesaid due date;**
- (B) was incurred in the previous year:**
 - (a) nature of liability;**
 - (b) due date of payment under second proviso to section 43B;**
 - (c) actual date of payment;**
 - (d) if paid otherwise than in cash, whether the sum has been realised within fifteen days of the aforesaid due date.**

*** State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost etc. is passed through the profit and loss account.**

[Clause 21]

42.1 Section 43B provides that notwithstanding anything contained in any other provisions of the Act, the following amounts shall be allowed as deduction in computing the business income of an assessee in the previous year in which such amounts are actually paid:

- i) Any tax, duty (sales tax, excise duty, municipal tax, etc.), cess or fee payable by the assessee under any law for the time being in force.**
- ii) Employer's contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of**

employees.

- iii) Any bonus or commission payable by the assessee to its employees.
- iv) Interest on any loan or borrowing from any public financial institution, a state financial corporation or a state industrial investment corporation payable in accordance with the terms and conditions of the agreement governing such loan or borrowing.
- v) Any sum payable by the assessee as interest on any term loan from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan.

- 42.2 In the case of an assessee maintaining its accounts on the mercantile system, the tax auditor should verify the aforesaid particulars, referred to in clause (i), (iii) (iv) and (v) from the books of account for the year under audit as well as from the books of account, vouchers and documents of the immediately succeeding assessment year so that the information about the aforesaid payments made in the subsequent year can be furnished.
- 42.3 In case of contribution to provident fund, superannuation fund, gratuity fund or any other fund for the welfare of employees, the restriction for allowance contained in second proviso should be noted. The said proviso, *inter alia*, states that no deduction shall be allowed unless such sum has actually been paid on or before due date as defined in the Explanation below section 36(1)(va) and where such payment has been made otherwise than in cash, the sum has been realised within 15 days from due date. Regarding grace period and lenient treatment of reasonable delays in payment, reference may also be made to paragraphs 27.4 and 27.5 of this Guidance Note.
- 42.4 If the assessee is following the cash basis of accounting, sums referred to in clause (a), (c), (d) and (e) of section 43B which are debited to the profit and loss account will be allowable as they would have been actually paid during the year.
- 42.5 Under the first proviso to section 43B, deduction is available in respect of any sum referred to in clause (a), (c), (d) or (e) which is actually paid by the assessee on or before the due date applicable in his case for furnishing the

return of income under sub-section (1) of section 139. Since the due date of filing of the return would usually be subsequent to the signing of the tax audit report the tax auditor would be able to give information in respect of matters only upto the date of signing of the tax audit report. This fact should be stated under this clause by way of note as follows:

NOTE: Information given under clause 21(i) (B) is only up to and does not include any payment which the assessee may make subsequently before the due date of filing of the return of income under section 139(1).

The payment made subsequent to that date but before the date of filing of the return, will still be eligible for deduction under section 43B. Hence the tax auditor should advise the assessee to include necessary evidence of payments made after the signing of the tax audit report but before the due date of filing. This evidence may also be in the form of a certificate from a chartered accountant obtained specifically for this purpose - Circular No.601 dated 4.6.1991 vide Appendix XVII.

- 42.6 The provision made in the accounts for excise duty payable on finished goods in the bonded warehouse will also have to be disclosed under this clause. For enabling the assessee to claim this amount as a deduction the tax auditor may have to verify that the said goods have been cleared and that excise duty thereon has been paid or adjusted against MODVAT credits before the due date applicable in his case for furnishing the return of income under section 139 (1).
- 42.7 The information required under clause 21(i)(B) is for the purpose of allowing the deduction of such sum as per the first proviso to section 43B in respect of payments made after the end of the previous year but before the due date of filing return of income. As such, reporting under clause 21(i)(B) is required only in respect of the amounts referred to in clauses (a), (c), (d) or (e) of section 43B which were incurred in the previous year but were outstanding as at the end of the relevant previous year.
- 42.8 The above particulars are required irrespective of the fact whether they have been debited to profit and loss account or not and such a fact should be stated under this clause.
- 42.9 The tax auditor is not required to determine any admissible or inadmissible amount(s).

42.10 Under section 43B(a), sales-tax when paid is allowed as a deduction. Although under clause (a) of section 43B items that have been debited to the profit and loss account but not paid during the previous year, are to be specified, where it is the practice of the company to maintain a separate sales-tax/excise duty account and treat the sales tax/excise duty collected as a liability, it would be necessary to show by way of note under this clause, the amount of sales tax/excise duty collected but not paid. In case, any sum has been paid before the due date of filing the return the fact of payment along with the amount paid should also be disclosed.

42.11 In respect of the expenditure covered by clauses (a), (c), (d) and (e) of section 43B, the particulars may be furnished in the following form:

(A) Liability pre-existing on the first day of the previous year :

Sl. No.	Nature of liability	Outstanding opening balance not allowed in any earlier previous year(s)	Amount paid/set off during the year against column 3
(1)	(2)	(3)	(4)

Amount written back to the profit and loss account	Amount remaining unpaid as at the end of the year	Whether passed through profit & loss account	Remarks
(5)	(3-4-5)=(6)	(7)	(8)

(B) Liability incurred during the previous year :

Sl No.	Nature of liability	Amount incurred during the previous year but remaining outstanding as on the last day of the previous year	Amount paid/set off before the due date of filing return/date upto which reported in the tax audit report, whichever is earlier against column (3)
(1)	(2)	(3)	(4)
			Date Amount

Amount unpaid on the due date of filing the return/date upto which reported in the tax audit report whichever is earlier	Whether passed through the profit & loss account	Remarks
(5)	(6)	(7)

42.12 In respect of contributions covered by clause (b) of section 43B, the particulars may be furnished in the following form:

(A) Liability pre-existing on the first day of the previous year:

Sl No.	Nature of liability	Outstanding opening balance not allowed in any earlier previous year(s)	Due date for payment
(1)	(2)	(3)	(4)

Amount paid during the previous year		If not paid in cash, whether realised within 15 days	Outstanding balance as at the end of the year	Remarks
(5)		(6)	(3 - 5) = (7)	(8)
Date	Amount			

(B) Liability incurred during the previous year :

Sl No.	Nature of liability	Due date of Payment	Amount incurred during the previous year
(1)	(2)	(3)	(4)

Amount paid before the due date		If not paid in cash, whether realised within 15 days	Closing balance as at the end of the year	Remarks
Date	Amount			
(5)		(6)	(4-5) = (7)	(8)

- 42.13 As suggested under clause 16(b), given herein before, here also, in view of the voluminous nature of the information the tax auditor can apply test checks and compliance tests to satisfy himself. It may be mentioned that under clause 21(ii), complete details of amounts due, amounts paid, due date of payment and actual date of payment are to be given. In the case of big assessees such as public sector undertakings, banks etc., where information to be stated is voluminous, the tax auditor may exercise his professional judgement and state only those cases under this clause where actual date of payment to the concerned authorities is beyond the due date of payment and indicate this fact by way of a suitable note.
- 42.14 In some cases the tax auditor may find amounts of the nature referred to in section 43B being credited to the profit and loss account although the relevant provisions for such liability had not been allowed as a deduction in any previous year in view of the specific provisions of section 43B requiring actual payment as a condition precedent to allowance. The amounts so credited to the profit and loss account are not chargeable to tax since the conditions referred to in section 41(1) have not been satisfied. The tax auditor should identify such items in his report so that the assessee, while preparing his return of income may exclude such items.
43. (a) **Amount of Modified Value Added Tax credits availed of or utilized during the previous year and its treatment in the profit and loss account and treatment of outstanding Modified Value Added Tax credits in the accounts.**
44. (b) **Particulars of income or expenditure of prior period credited or debited to the profit and loss account.**

[Clause 22 (a) and (b)]

43. Clause 22(a)

- 43.1 This clause requires the factual reporting about the amount of MODVAT credit availed of and utilised during the year as well as its treatment in profit and loss account and treatment of outstanding MODVAT credits in the accounts. Accordingly the tax auditor should check relevant statutory records viz. RG-23 (both parts) maintained under the Central Excise Rules 1944 and ascertain therefrom the amount of credit on inputs availed and utilised during the previous year. The tax auditor should verify that there is a proper reconciliation between balance of MODVAT credit in the accounts and RG-23. The tax auditor should report the amount of MODVAT availed and utilised under this sub-clause. In a given case MODVAT availed may be lesser than the MODVAT credit utilised during the year on account of opening balance in MODVAT account or vice-versa and as such it would be advisable, in order to avoid any misleading conclusion and inferences, to report the opening and closing balances of MODVAT also.
- 43.2 In so far as the reporting of accounting treatment of MODVAT credit is concerned the clause requires that its treatment in profit and loss account and the treatment of outstanding MODVAT credit in the account have to be reported upon.

The tax auditor may consider reporting under this clause in the following manner:

	Capital Goods	Others
Balance representing MODVAT credits as at the beginning of the year		
MODVAT credit available during the year		
Less amount of MODVAT credit utilised during the year		
Balance representing outstanding amount as at the end of the year		

Where the assessee follows exclusive method by accounting the excise duty paid on purchase of raw material to the MODVAT credit receivable account and not as part of the purchase cost of raw material and adjusts the excise paid against the MODVAT receivable account, the tax auditor should state the facts under this clause.

- 43.3 The reporting requirement under clause 12(b) of Form No.3CD is a requirement distinct and separate from the reporting requirement under this clause. The tax auditor should verify that information furnished under this sub-clause is compatible with the information furnished under clause 12(b).

44. Clause 22(b)

- 44.1. It may be noted that information under this clause would be relevant only in those cases where the assessee follows mercantile system of accounting. Under cash system of accounting, expenses debited/income credited to the profit and loss account would be current year's expenses/income even though they may relate to earlier years. The tax auditor should obtain the particulars of expenditure or income of any earlier year debited or credited to the profit and loss account of the relevant previous year when mercantile system of accounting is followed. In the case of a person whose accounts of the business or profession have been audited under any other law, the information may be readily available from annual accounts. In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, however, a close scrutiny of the ledger in regard to the period for which expenditure or income is entered in the account books may be necessary.
- 44.2 It may be noted that there is a difference between expenditure of any earlier year debited to the profit and loss account and the expenditure relating to any earlier year which has crystallised during the relevant year. Material adjustments necessitated by circumstances which thought related to previous periods but determined in the current period, will not be considered as prior period items. In such cases, though the expenditure may related to the earlier year, it can be considered as arising during the year on the basis that the liability materialised or crystallised during the year and such cases will not be reported under this clause. Similar consideration will apply in relation to income also.

44.3. In AS –5 as also in AS (IT) – II notified by the Government under section 145, it has been explained that material charges (expenses) or credits (income) which arise in the current year as a result of errors or omissions in the accounts of the earlier years will be considered as prior period items. In view of this, the statutory auditor would normally take into consideration all items of prior period income and expenditure while giving his report on the financial statements. It would, therefore, be advisable for the tax auditor to ascertain the circumstances under which a particular expenditure has not been considered as a prior period expenditure. If, on making the enquiries he comes to the conclusion that a particular item has to be treated as prior period expenditure, he should disclose the same against this sub-clause.

45. Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque. [Section 69D].

[Clause 23]

45.1. Details of the amount borrowed on hundi (including interest on such amount borrowed) and details of repayment otherwise than by an account payee cheque, are required to be indicated under this clause. In this context, a reference may also be made to Circular No.208 dated 15th November, 1976 issued by Board explaining the provisions of section 69D - vide Appendix XVIII.

45.2. For this purpose, the tax auditor should obtain a complete list of borrowings and repayments of hundi loans otherwise than by account payee cheques and verify the same with the books of account.

45.3. There will be practical difficulties in verifying the loan taken or repaid on hundi by account payee cheque. In such cases, the tax auditor should verify the borrowing/repayments with reference to such evidence which may be available and in the absence of conclusive or satisfactory evidence, he should make a suitable comment in his report as suggested below which is exactly similar to the one suggested in respect of expenditure paid otherwise than through an account payee cheque [Section 40A(3)].

“It is not possible for me/us to verify whether the amounts borrowed on hundi or any amount due thereon (including interest on the amount borrowed) were repaid

otherwise than by crossed cheque or bank draft, as the necessary evidence is not in the possession of the assessee”.

46. (a)* **Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year :-**
- (i) name, address and permanent account number (if available with the assessee) of the lender or depositor;
 - (ii) amount of loan or deposit taken or accepted;
 - (iii) whether the loan or deposit was squared up during the previous year;
 - (iv) maximum amount outstanding in the account at any time during the previous year;
 - (v) whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or an account payee bank draft.

*(These particulars need not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act.)

47. (b) **Particulars of each repayment of loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year:-**
- (i) name, address and permanent account number (if available with the assessee) of the payee;
 - (ii) amount of the repayment;
 - (iii) maximum amount outstanding in the account at any time during the previous year;
 - (iv) whether the repayment was made otherwise than by account payee cheque or account payee bank draft.

[Clause 24 (a) and (b)]

46. Clause 24(a)

46.1 Section 269SS prescribes the mode of taking or accepting certain loans and deposits. As per this section, no person shall take or accept from any other person any loan or deposit otherwise than by an account payee cheque or account payee bank draft if,-

- (a) the amount of such loan or deposit or the aggregate amount of such loan and deposit; or
- (b) on the date of taking or accepting such loan or deposit, any loan or deposit taken or accepted earlier by such person from the depositor is remaining unpaid (whether repayment has fallen due or not), the amount or the aggregate amount remaining unpaid; or
- (c) the amount or the aggregate amount referred to in clause (a) together with the amount or the aggregate amount referred to in clause (b),

is twenty thousand rupees or more.

46.2 For the purposes of section 269SS "loan or deposit" means loan or deposit of money.

46.3 Particulars of each loan or deposit falling within the scope of this section as mentioned above taken or accepted during the previous year have to be stated under this sub-clause. This sub-clause requires five specific particulars in respect of each loan or deposit including the permanent account number of the lender, if available.

46.4 The tax auditor should obtain the above details from the assessee in respect of each loan or deposit and verify the same from the records maintained by him.

46.5 If the total of all loans/deposits in a year exceed Rs.20,000/- but each individual item is less than Rs.20,000/-, the information will still be required to be given in respect of all such entries starting from the entry when the balance reaches Rs.20,000/- or more and until the balance goes down below Rs.20,000/. As such the tax auditor should verify all loans/deposits taken or accepted where balance has reached Rs.20,000 or more during the year for the purpose of reporting under this clause.

- 46.6 There will be practical difficulties in verifying the loan or deposit taken or accepted by account payee cheque or an account payee bank draft. In such cases, the tax auditor should verify the transactions with reference to such evidence which may be available and in the absence of conclusive or satisfactory evidence, he should make a suitable comment in his report as suggested below.

“It is not possible for me/us to verify whether loans or deposits have been taken or accepted otherwise than by an account payee cheque or account payee bank draft, as the necessary evidence is not in the possession of the assessee”.

- 46.7 For the purposes of this clause, the tax auditor may keep in mind the following typical situations:
- (i) Sale proceeds collected by the selling agent will not be considered as loan or deposit.
 - (ii) A current account is not excluded from the definition of the deposit'. Therefore, if the transactions in a current account exceed the amount of Rs.20,000/-, it will be necessary to give the information against this sub-clause. This is the position even if no interest is paid on current account.
 - (iii) When there is a mixed account, the transactions relating to loans and deposits (temporary advances) should be segregated from other accounts and the transactions relating to loans / deposits only should be stated under this clause.
 - (iv) Advance received against agreement of sale of goods is not a loan or deposit.
 - (v) Opening credit balance of loan taken in earlier years is not specifically required to be disclosed. However, while giving figures of maximum amount outstanding at any time during the year or while giving information about repayment of loan/deposit, the opening balances in the loan accounts will have to be taken into consideration.
 - (vi) Even if the loans are taken free of interest the information will still have to be given.

- (vii) Security deposits against contracts, etc. will be covered by the definition of 'deposit' and therefore, such information will have to be given.
- (viii) Loans and deposits taken or accepted by means of transfer entries constitute acceptance of deposits or loans otherwise than by account payee cheques. Hence, such entries have to be reported under this clause. The entries that relate to transactions with a supplier and customer will not be treated as loans or deposits accepted.

46.8 As per the proviso to section 269SS, the provisions of section 269SS shall not apply to any loan or deposit taken or accepted from, or any loan or deposit taken or accepted by,-

- (a) Government;
- (b) any banking company, post office savings bank or co-operative bank;
- (c) any corporation established by a Central, State or Provincial Act;
- (d) any Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956);
- (e) such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette.

The footnote in clause 24(a) states that the particulars required under this sub-clause need not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act. This is in accordance with the proviso to section 269SS mentioned above. As such, information about loans or deposits taken or accepted from or any loan or deposit taken or accepted by Government, banking company, etc. need not be reported under this sub-clause.

47. Clause 24(b)

47.1 This sub-clause requires particulars of each repayment of loan or deposit in an amount exceeding the limits specified in section 269T made during the previous year. Section 269T is attracted where

repayment of the deposit is made to a person, where the aggregate amount of deposits held by such person either in his own name or jointly with any other person on the date of such repayment together with interest, if any, payable on such deposit is Rs.20,000 or more. Section 269T does not cover repayment of loans. Explanation (ii) contains a definition of the term 'deposit' for the purposes of section 269T. Accordingly, "deposit" means any deposit of money which is repayable after notice or repayable after a period and, in the case of a person other than a company, includes deposit of any nature. As such, all repayments made to any person where the deposit along with interest is Rs.20,000 or more are to be reported under this sub-clause, even though the amount of repayment may be less than Rs.20,000. The tax auditor should verify such repayments and report accordingly.

- 47.2 Clause 24(b) does not exclude Government companies, banking companies from the scope of its applicability. As such, details of repayment are to be shown in the case of these entities also. But considering the voluminous nature of information to be provided in the case of these entities, only those cases may be reported where such repayments have been made otherwise than by way of account payee cheque or account payee bank draft and the auditor should indicate this fact by way of a suitable note.
- 47.3 In the case of company assessee deposit is defined to mean deposit repayable after notice or deposit repayable after a period. Therefore, deposit repayable on demand will not be considered as deposit. However, in the case of non-company assessee deposit is defined to mean deposit of any nature. This distinction will have to be kept in mind while giving information under this sub-clause.
- 47.4 Deposits discharged by means of transfer entries constitute repayment of deposits otherwise than by account payee cheques or account payee bank drafts. Hence, such entries have to be reported under this clause. The entries that relate to transactions with a supplier and customer will not be treated as loans or deposits repaid.
- 47.5 As pointed out in paragraph 47.1, section 269T prescribes the mode of repayment only in respect of deposits. However, this sub-clause requires the relevant particulars in respect of each "loan or deposit". Hence the particulars required under this sub-clause are to be given in

respect of both loan and deposit but in view of applicability of section 269T to deposits only, the particulars of loan and deposit may be given separately.

- 47.6 Clause 24(b) does not exclude repayment of deposits to Government company, banking company etc. from its scope. Hence, details of repayments of deposits falling within the scope of section 269T as mentioned in clause 47.1 have to be stated. Section 269T also does not exclude Government company, banking company or a corporation established by a Central, State or Provincial Act. As such, repayment of deposits by banking companies falling within the scope of section 269T are also to be stated. However, both in the case of repayment to banking companies etc. and repayment by banking companies etc. considering the voluminous nature of information to be provided, the tax auditor can exercise his professional judgment and state only those cases of repayment of deposits which are made otherwise than by account payee cheque or account payee bank draft and should state this fact by way of a suitable note.

48. Details of brought forward loss or depreciation allowance, in the following manner, to the extent available:

Serial Number	Assessment Year	Nature of loss / allowance (in rupees)	Amount as returned (in rupees)	Amount as assessed (give reference to relevant order)	Remarks

[Clause 25]

- 48.1 The amount is required to be quantified as per return and assessment orders.
- 48.2 A format has been given which could be used for reporting. To the extent necessary, modification can be made provided basic information is furnished. For example in the 5th column two requirements have been clubbed, namely, amount assessed and reference to relevant order. These two requirements may be split up into two columns and the reference to the relevant order may be given opposite to the amount assessed. In a given case, appeal(s) may have been decided; but effect might not have been given. While giving particulars, appropriate

adjustment may be made, with suitable disclosure. Where the relevant particulars are not available, the necessary disclosure may be made in that behalf.

- 48.3 While giving information under this head it will be necessary to ascertain whether the figures of unabsorbed loss or depreciation are likely to be modified as a result of any assessment or appellate proceedings which are pending for the earlier years. If that is the position, the fact relating to the pending assessment or appellate proceedings should be clearly stated and it should be mentioned that the figures of unabsorbed loss or depreciation are likely to be modified as a result of the assessment or appellate proceedings.
- 48.4 Brought forward losses may relate to different heads of income such as property income, profits and gains of business or profession, speculation business or capital gains. Different provisions are contained in sections 32 and 70 to 78 of the Income-tax Act with regard to loss/depreciation under different heads. Therefore, the information should be separately given under each head of income under which the loss/ depreciation has remained unabsorbed. In the remarks column information about the pending assessment or appellate proceedings or about delay in filing loss returns should be given. For giving the above information, the auditors should study the assessment records i.e. income-tax returns filed, assessment orders, appellate orders and rectification/revisonal orders for the earlier years and ascertain if the figures given in the above clause are correct.

49. Section-wise details of deductions, if any, admissible under Chapter VIA.

[Clause 26]

- 49.1 Chapter VIA of the Act deals with various deductions which have to be given effect to by way of allowance from gross total Income of the assessee and they have been categorised under the Act as follows:
- A. Deduction in respect of certain payments.
 - B. Deduction in respect of certain incomes.
 - C. Other Deductions.
- 49.2 As stated earlier, the tax audit report in Form No.3CA/3CB relates to

business or professional activity of the assessee covered by section 44AB. Form No.3CD is an annexure to this Form giving particulars relating to the business/profession covered by the tax audit report. Therefore, the requirement under clause 26 relating to the deductions admissible under Chapter VIA will have to be restricted to the items appearing in the books of accounts audited by the tax auditor. If the tax auditor is giving tax audit report in respect of the accounts of a particular branch or a particular unit he will have to examine the particulars relating to deduction admissible under Chapter VIA with reference to the books of account of that branch or that unit which is audited by him. Similarly when the tax auditor is giving report on tax audit of the head office he will have to take into consideration the tax audit reports of the branches as well as other units of the assessee which may have been audited by the other tax auditors. He will have to consider the particulars of deductions admissible under Chapter VIA with reference to the particulars given by the tax auditor of other branches/units and also particulars of such deductions from books of the head office.

- 49.3 In the case of a sole proprietor being an individual or HUF it may so happen that the tax auditor is auditing the accounts of the business/profession and the sole proprietor is having other activities and other sources of income in respect of which tax audit is not mandatory. In such cases the particulars of deductions admissible under Chapter VIA will have to be given only with reference to the items appearing in the books of accounts of the business/profession which is subject to audit under section 44AB.
- 49.4 Section 80A(2) provides that the aggregate amount of deductions under Chapter VIA shall not, in any case exceed the gross total income of the assessee. It is possible that the tax auditor may not be aware about the gross income of the assessee because the income-tax return has not been prepared before the tax audit report is given or because the tax auditor is auditing only the particular branch or a unit. In such circumstances the tax auditor should put a note while giving the above particulars under clause 26 that the figure of deductions mentioned under clause 26 is subject to the determination of the gross total income of the assessee.
- 49.5 The admissibility of the aforesaid deductions is dependent upon

various conditions precedent laid down in the section under which deduction is admissible. It is, therefore, advised that while working out the amount of admissible deduction the tax auditor has to ascertain that those condition stand fulfilled or not. For ascertaining this, the tax auditor has to obtain all necessary evidence on his record which would enable him to express the opinion on the admissibility of deductions. For example, under section 80IA one of the conditions is that the new Industrial undertaking which qualifies for deduction thereunder should not have been formed by splitting up or by the reconstitution of a business already in existence or by transfer to a new business of machinery or plant previously used for any purpose. In order to ascertain the fulfillment of this condition the tax auditor may have to check all documentary evidence in respect of plant and machinery installed in the industrial undertaking to arrive at the conclusion that plant and machinery is new and has not been used previously for any other purpose. Likewise if there is any condition which qualifies the admissibility of the amount of deduction, the tax auditor has to see and ascertain that those qualifying conditions are fulfilled on the basis of documentary evidence available with the assessee. For example under section 80HHC the quantum of deduction in respect of export profit is on the basis of convertible foreign exchange having been received within a period of 6 months from the end of accounting year or extended period. In this context tax auditor has to verify that all export proceeds have been received by the assessee by 30th September and for this he has to ask the client to produce necessary bank certificate etc. There may be cases where there is difference between the amount claimed by the assessee and the amount worked out by the tax auditor. In such cases it is quite possible that the client's claim is based on some judicial pronouncement on the subject. In such case it may be advisable for the tax auditor to report the amount admissible and the amount claimed and the background behind and the basis of the claim of the assessee. If the claim of the assessee is well-founded and settled by judicial pronouncement the tax auditor may accept the claim but he has to clarify that admissible amount has been reported on the basis of judicial pronouncement.

- 49.6 It may be noted that there are certain sections under Chapter VIA where separate audit report or certificate is required to be given. Under section 80-HH, 80-HHA, 80I, 80IA, 80IB a non-corporate assessee who has income from industrial undertaking covered under the above sections has to obtain audit report with reference to the accounts of these undertakings. Section 80HHB, 80HHC, 80HHD, 80HHE, 80HHF and 80O while relate to profits of foreign projects, profit from export of goods as well as foreign export earning etc. require separate audit report. While giving information with regard to the deduction allowable under these section the tax auditor should refer to separate audit reports/certificates obtained by the assessee. These audit reports/certificates may have been given by the tax auditor or by any other auditor. The figures given in this separate audit reports/certificates should be taken into consideration while giving information with regard to income covered by these sections.
- 49.7 Some sections in Chapter VIA such as section 80G (donations), section 80JJAA (wages of new workmen) etc. which relate to the expenditure incurred by a assessee. There are other sections such as 80HHBA (specified housing project), section 80P (income of co-operative societies), 80JJA (certain specified business relating treatment of biodegradable waste) etc. which relate to income of the assessee. In respect of all these sections the tax auditor should ascertain whether there is any expenditure or income covered by the above sections recorded in the books of accounts audited by him. Information with regard to such expenditure/income in respect of deduction allowable under Chapter VIA should be given on the basis of the examination of the books of account and other records under clause 26.
50. (a) **Whether the assessee has deducted tax at source and paid the amount so deducted to the credit of the Central Government in accordance with the provisions of Chapter XVII-B.**

- (b) If the answer to (a) above is in the negative, then give the following details:

Serial Number.	Particulars of head under which tax is deducted at source	Amount of tax deducted at source (in rupees)	Due date for remittance to Government	Details of Payment: Date Amount (in rupees)	Remarks

[Clause 27 (a) and (b)]

- 50.1. Under this clause, the tax auditor is expected to verify from the records whether the tax deducted at source has been paid to the credit of the Central Government in accordance with the time stipulated under Chapter XVII-B of the Act. The details about the delay in payment of tax deducted at source may be given under this clause in the form prescribed.
- 50.2. Normally the tax auditor should clarify in the report whether there is a delay in payment of tax deducted at source. It is not expected under this clause from a tax auditor to verify whether the tax deductible has been properly deducted or not. There is no requirement of giving information under this clause about the delay in filing the return relating to tax deducted at source.
- 50.3. The tax auditor should obtain the details of tax deducted at source and paid to the credit of the Central Government from the assessee. A copy of the tax deducted at source account and the certified details of evidence relating to payment should be retained by the tax auditor.
51. (a) **In the case of a trading concern, give quantitative details of the principal items of goods traded :**
- (i) **Opening stock;**
 - (ii) **Purchases during the previous year;**
 - (iii) **Sales during the previous year;**

- (iv) Closing stock;
 - (v) shortage/excess, if any.
52. (b) In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products :
- A. Raw materials:
 - (i) opening stock;
 - (ii) purchases during the previous year;
 - (iii) consumption during the previous year;
 - (iv) sales during the previous year;
 - (v) closing stock;
 - (vi)* yield of finished products;
 - (vii)* percentage of yield;
 - (viii)* shortage/excess, if any.
 - B. Finished products/By-products:
 - (i) opening stock;
 - (ii) purchases during the previous year;
 - (iii) quantity manufactured during the previous year;
 - (iv) sales during the previous year;
 - (v) closing stock;
 - (vi) shortage/excess, if any.

* Information may be given to the extent available.

[Clause 28 (a) and (b)]

51. Clause 28(a)

- 51.1 This information was required by old Form 3CD, pursuant to a Note inserted below Clause 3 and the information requirement more or less corresponds to information to be submitted in case of a manufacturing concern.

51.2 Accordingly, a reference may be made to the subsequent paragraph - paragraph 52, for compliance, etc.

51.3 The tax auditor should obtain certificates from the assessee in respect of the principal items of goods traded, the balance of the opening stock, purchases, sales and closing stock and the extent of shortage/excess/damage and the reasons thereof.

52. Clause 28(b)

52.1. This information should be given only in respect of those items where it is practicable to do so, having regard to the records maintained by the assessee. In other cases, the tax auditor may indicate in his report that the relevant records were either not maintained or were inadequate for the purpose of furnishing the requisite information.

52.2. In a large concern it may be difficult for tax auditor to verify each and every item of purchase, consumption and production. In such cases, he may verify the figures on a sampling method and satisfy himself as to the correctness of the figures furnished. This clause requires that quantitative details of "principal items" of raw materials and finished goods should be given. Therefore, information about petty items need not be given. What would constitute principal items will depend on the facts of each case. Normally, items which constitute more than 10% of the aggregate value of purchases, consumption or turnover may be classified as principal items. In this connection a reference may be made to the ICAI's 'Statement on Amendments to Schedule VI to the Companies Act, 1956.'

52.3. The information about 'yield', 'percentage of yield', and 'shortages/excess' is required to be given only to the extent such information is available in the records of the business.

52.4 In respect of assesseees other than companies and those whose accounts have not been audited under any other law, the tax auditor should obtain the following certified documents for the principal items of raw materials, finished goods and by-products:

- a) Certificate from the assessee certifying the balance of the opening stock, purchases, sales and closing stock.
- b) Certificate to the extent of shortage/excess/damage and the reasons thereof.

- 52.5 By-products represent products whose manufacture results incidentally from the manufacture of the main product or where the waste arising in the manufacture of main product is further processed to create a by-product. Where the by product so produced or is continuously generated it should be treated for the purpose of sale and disposal at par with at any other product produced by the company and similar records should be maintained.

The quantitative details on the above lines are to be given in respect of by-product also.

53. In the case of a domestic company, details of tax on distributed profits under section 115-O in the following form:-

- (a) total amount of distributed profits;**
- (b) total tax paid thereon;**
- (c) dates of payment with amounts.**

[Clause 29]

- 53.1 Section 115-O provides for a special levy to the extent of 10% plus surcharge, if any, on the amount of dividend declared, distributed or paid by such company whether such dividend is out of current profit or accumulated profits. Vide this clause the tax auditor has to report on profit distributed during the financial year. and therefore, the amount of tax worked @ 10% on such distributed profit has to be reported against this clause.
- 53.2 It may be noted that for the purposes of chapter XII-D containing special provisions relating to tax on distributed profits of domestic companies the expression “dividends” shall have the same meaning as is given to “dividend” in clause (22) of section 2 but shall not include sub-clause (e) thereof. However, the the tax auditor need not go into the question of how the total amount of distributed profits has been arrived at.
- 53.3 The next requirement is to report the tax paid thereon and the date of payment. The date of payment of tax can be ascertained by the tax auditor from the duly received challan and books of account etc.
- 53.4 In this clause, the total amount of profits distributed in the previous year , tax paid thereon and the date of payment is required to be given. Information about the date of declaration/distribution of dividend or

payment of dividend is not required to be given. However, it will be advisable to give the above information of distribution because the company is required to deposit the tax due under section 115-O within 14 days of the date of declaration/distribution or payment whichever is earlier.

54. Whether any cost audit was carried out, if yes, enclose a copy of the report of such audit [See section 139(9)].

[Clause 30]

- 54.1 The tax auditor should ascertain from the management whether cost audit was carried out and if yes enclose the copy of the report of such audit. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of any material observation made in such cost audit report which may have relevance to the tax audit conducted by him. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out.
- 54.2 In cases where cost audit which might have been ordered is not completed by the time the tax auditor gives his report, he has to state the same in this report.
- 54.3 The tax auditor should examine the time period for which the cost audit if any has been required to be carried out. Information is required to be given only in respect of such cost audit report the time period of which falls within the relevant previous year.

55. Whether any audit was conducted under the Central Excise Act, 1944, if yes, enclose a copy of the report of such audit.

[Clause 31]

- 55.1 The tax auditor should ascertain from the management whether any audit was conducted under the Central Excise Act, 1944 and if such audit was carried out, obtain the report, if available and enclose the copy of the report of such audit. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of any material observation made in such excise audit report which may have relevance to the tax audit conducted by him. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out.

- 55.2 In cases where excise audit which might have been ordered is not completed by the time the tax auditor gives his report, he has to state the same in this report.
- 55.3 The tax auditor should examine the time period for which the excise audit, if any, has been required to be carried out. Information is required to be given only in respect of such excise audit report the time period of which falls within the relevant previous year.
56. **Accounting ratios with calculations as follows:-**
- (a) **Gross profit /Turnover;**
 - (b) **Net profit/Turnover;**
 - (c) **Stock-in-trade /Turnover;**
 - (d) **Material consumed /Finished goods produced.**

[Clause 32]

- 56.1 These ratios have to be calculated only for assesseees who are engaged in manufacturing or trading activities. This clause is not applicable to assesseees carrying on profession. Moreover, the ratios have to be given for the business as a whole and need not be given product wise. Further, the ratio mentioned in sub-clause (d) need not be given for trading concern.
- 56.2 While calculating these ratios, the tax auditor should assign a meaning to the terms used in the above ratios having due regard to the generally accepted accounting principles. All the ratios mentioned in the this clause are to be calculated in terms of value only.
- 56.3 The following definitions given by the ICAI in its Guidance Note on the Terms Used in Financial Statements may be noted.
- (a) **Gross Profit:** The excess of the proceeds of goods sold and services rendered during a period over their *cost*, before taking into account administration, selling, distribution and financing expenses. When the result of this computation is negative it is referred to as **gross loss**.
 - (b) **Turnover:** The aggregate amount for which sales are effected or services rendered by an enterprise. The terms **gross turnover** and **net turnover** (or *gross sales* and *net sales*) are sometimes used to distinguish the sales aggregate *before* and after deduction of returns and trade discounts.

(c) **Net Profit:** The excess of *revenue* over *expenses* during a particular accounting period. When the result of this computation is negative, it is referred to as **net loss**. The net profit may be shown before or after tax.

56.4 For the purpose of calculating the ratio mentioned in sub-clause (c), only closing stock is to be considered. The term 'stock-in-trade' used therein does not include stores and spare parts or loose tools. The term 'stock-in-trade' would include only finished goods and would not include the stock of raw material and work-in-progress since the objective here is to compute the stock-turnover ratio.

56.5 Material consumed would, apart from raw material consumed, include stores, spare parts and loose tools.

56.6 The value of finished goods produced may be arrived at by using the following formula :

(a)	Raw material consumption	-
(b)	Stores and spare parts consumption	-
(c)	Wages	-
(d)	Other manufacturing expenses excluding depreciation.	-

Sub total -

Add : Opening stock in process -

Deduct : Closing stocks in process -

Value of finished goods produced -

56.7 Under this clause, calculation of the ratios are also to be stated. As such, computation of various components based upon which these ratios have been worked out is required to be stated under this clause. However, if any of the above component is stated in the financial statements themselves, a reference to the same may be made.

56.8 There should be consistency between the numerator and the denominator while calculating the above ratios. Any significant deviation thereof should be pointed out.

57. **Signature :**

Form 3CD has to be signed by the person competent to sign Form No. 3CA or Form No.3CB as the case may be. He has also to give his full name, address, membership number, place and date. It may be noted

that in the earlier Form No. 3CD there was no requirement of signature by the person competent to sign the audit report.

58. Code of Conduct and other matters

58.1 Some of the issues which are commonly raised in regard to different aspects of tax audit vis à vis the liability/obligations of the tax auditor are considered hereunder.

58.2 The liability of the tax auditor in respect of tax audit will be the same as in any other audit assignment. It may be noted that when any question relating to the audit conducted by a tax auditor arises, he is answerable to the Council of the Institute under the Chartered Accountants Act. In all matters concerning tax audit, ICAI's disciplinary jurisdiction will prevail.

In case the assessee is found guilty of having concealed the particulars of his income it would not *ipso facto* mean that the tax auditor is also responsible. If the Assessing Officer comes to the conclusion that the tax auditor was grossly negligent in the performance of his duties, he can refer the matter to the ICAI so that appropriate action can be taken against the tax auditor under the Chartered Accountants Act.

The Assessing Officer or any other authority who is authorised to issue summons and to call for evidence or documents, can call upon the tax auditor who has audited the accounts to give any evidence or produce documents. For this purpose notice under section 131 can be issued by the Assessing Officer or other tax authority mentioned in the said section.

58.3 If the actual work relating to examination of books and records is done by a qualified assistant in a firm of chartered accountants and the partner of the firm signing the audit report has relied upon this work, action, if any, for professional negligence can be initiated against the member who has signed the report and in such an event, it would be open for the member concerned to prove that he has taken due care and diligence in the performance of his duties and is not aware of any reason to believe that he should not have so relied.

If the qualified assistant (whether or not holding the certificate of practice) is found to be grossly negligent in the performance of his duties, the Council of the Institute can take disciplinary action against him.

- 58.4 A tax auditor can accept the assignment of tax representation.
- 58.5 Under the Code of Conduct, no tax auditor can charge professional fees by way of percentage of turnover or percentage of profits. In this connection, reference is invited to Clause (10) of Part I of the First Schedule to the Chartered Accountants Act and the commentary on the subject at page 43 of the Code of Conduct (1988 Edition). Certain exceptions are made in Regulation 168, but these exceptions do not apply for charging of fees for tax audit.
- 58.6 Since the figures in Form No. 3CD are duly verified by a chartered accountant, they should normally be accepted by tax authorities. If, however, there is a specific reason for differing from the view taken by tax auditor, the Assessing Officer may compute the income of the assessee by adopting different figures.
- 58.7 The opinion expressed by the tax auditor is not binding on the assessee. If the tax auditor has qualified his report and expressed an opinion on a particular item, the assessee may take a different view while preparing his return of income. In such cases, it is advisable for the assessee to state his viewpoint and support the same by any judicial pronouncements on which he wants to rely.

59. Format of Financial Statements

- 59.1 The tax auditor of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited has to give his report in Forms No. 3CB/3CD and will have to ensure that the financial statements i.e. balance sheet and profit and loss account/ income and expenditure statement, are prepared in such a manner that adequate information which is necessary to convey a true and fair view of the state of affairs of the assessee is given. So far as a person whose accounts of the business or profession have been audited under any other law is concerned, the information to be given in the financial statements is normally provided in the particular statute by which the assessee is governed. Since there is no such legislation in respect of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, it is necessary to achieve some uniformity in respect of information to be provided in the financial statements.

- 59.2 It should be noted that the responsibility for maintenance of books and records and that for preparation of financial statements is that of the assessee. It is, therefore, desirable that guidance is given to a person who carries on business or profession but who is not required by or under any other law to get his accounts audited about the maintenance of books of accounts and records as well as about the requirements of auditing. Similarly, guidance is also required to be given about the preparation of financial statements and the information to be provided in such statements. (See 'Monograph on Compulsory Maintenance of Accounts' published by ICAI.)
- 59.3 Two separate sets of forms of balance sheet and profit and loss account have, therefore, been prepared and given as Appendices to this Guidance Note. Appendix XI gives the recommended format of the balance sheet and also the information to be provided in the profit and loss account, in case of an assessee engaged in trading business. This format can be used in the case of an assessee, who is engaged in profession and other service activities, by making such changes as may be considered to suit the circumstances. Appendix X gives the recommended format of the balance sheet and the requirements of the profit & loss account in the case of an assessee engaged in the manufacturing activities. . It is suggested that the balance sheet and the profit and loss account can be prepared either in the vertical or in the horizontal form according to the circumstances of each case. If the information required to be given in any item or sub-item of the financial statements cannot conveniently be given on the face of the financial statements, the same may be given by way of footnotes/ annexures to and forming part of such financial statements. Since the formats are designed also for accounts of non-corporate borrowers from banks, they may be modified so as to exclude the information, which may not be relevant for accounts for tax audit. For presentation and disclosure requirements, applicable AS and AS(IT) should be kept in mind.