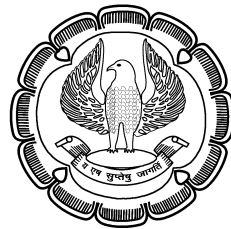


# BACKGROUND MATERIAL ON

*TRAINING PROGRAMME*

*FOR*

*CBEC OFFICIALS*



**The Institute of Chartered Accountants of India**

*(Set up by an Act of Parliament)*

New Delhi

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## MESSAGE FROM PRESIDENT

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The Indian Taxation system particularly under indirect tax structure has evolved tremendously on account of major developments and effective implementation. All the services were brought under the ambit of service tax by way of Finance Act, 2012 barring few services. We are all now set to witness the major taxation reform with introduction of GST. The introduction of GST will bring in sweeps of changes in the taxation system which would be required to be dealt with ingeniously.

Government's revenue has increased on account of the rapid expansion of service tax law. But this increase in revenue comes with additional responsibilities on Officials of CBEC to assess the tax liability accurately and implement the provisions of law in order to prevent revenue leakage. Therefore, it is highly important for the officers to be abreast with topical and intriguing concepts of accounting, auditing and taxation.

It gives me immense pleasure that the Indirect Taxes Committee of ICAI is organizing a ***Training Programme*** for the Officials of the Central Board of Excise and Customs. This study material covers a large number of relevant topics which would prove to be a value addition to Department Officials and enable them to understand the accounting and auditing aspects involved in the indirect taxes which will, in turn, help them in verifying the tax credits, exemptions, abatement etc. as per the requirements of the law.

I wish you a great learning experience.

Place: New Delhi  
Date: 24<sup>th</sup> August, 2016

**CA. M. Devaraja Reddy**  
**President, ICAI**



## MESSAGE FROM CHAIRMAN

---

The onus of fair collection of revenue rests upon the officers of the Department of Revenue for which basic understanding of accounting and auditing concepts play a very important role. Considering the fast pace of developments in the field of indirect taxes it has become imperative for the officials of the department to be updated with the changes in the indirect tax laws which would enable them to perform their duties efficiently. Knowledge and understanding of the financial statements become all the more essential for verifying the tax credits, exemptions, abatements etc. as prescribed under the law.

I am happy to mention that the Indirect Taxes Committee of ICAI has undertaken an initiative of training the CBEC officials which will certainly help in effectively implementing fiscal legislation at the assessment and appellate levels. These programmes have been finely designed to deliberate on the accounting and auditing aspects involved in the indirect taxes. This study material has been thoroughly revised to aptly match the contents of the training programmes and elucidates topics like CENVAT Credit, Service Tax – Accounting Standards, Accounting Issues & reconciliation, Desk Review, Basic Accounting Concepts, Ratio Analysis etc. This material will pertinently complement the training programme.

I am confident that this training initiative would be handy and the officials will certainly be benefited by the deliberations of eminent experts chosen for this training programme.

I wish the program all success.

Date: 24<sup>th</sup> August, 2016  
Place: New Delhi

**CA. Madhukar N Hiregange**  
Chairman  
Indirect Taxes Committee



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# 1

## BASIC CONCEPTS

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### INTRODUCTION

1.1 Every individual performs some kind of economic activity. A salaried person gets salary and spends to buy provisions and clothing, for children's education, construction of house, etc. A sports club formed by a group of individuals, a business run by an individual or a group of individuals, a local authority like Kolkata Municipal Corporation, Delhi Development Authority, Governments, either Central or State, all are carrying some kind of economic activities. It is not necessary that all the economic activities are run for any individual benefit, some economic activities may benefit a group of people or the public, at large. Any way such economic activities are performed through '*transactions and events*'. **Transaction** is used to mean 'a business, performance of an act, an agreement' while **Event** is used to mean a happening, as a consequence of transaction(s), a result.

1.2 Businesses wish to keep a record of all transactions and events and to have adequate information about the economic activity as an aid to decision making. Accounting discipline has been developed to serve this purpose. Accounting has universal application for recording transactions and events and presenting suitable accurate information. We concentrate only on business activities and their accounting. We hope that it would provide adequate knowledge to understand accounting as a field of study for universal application.

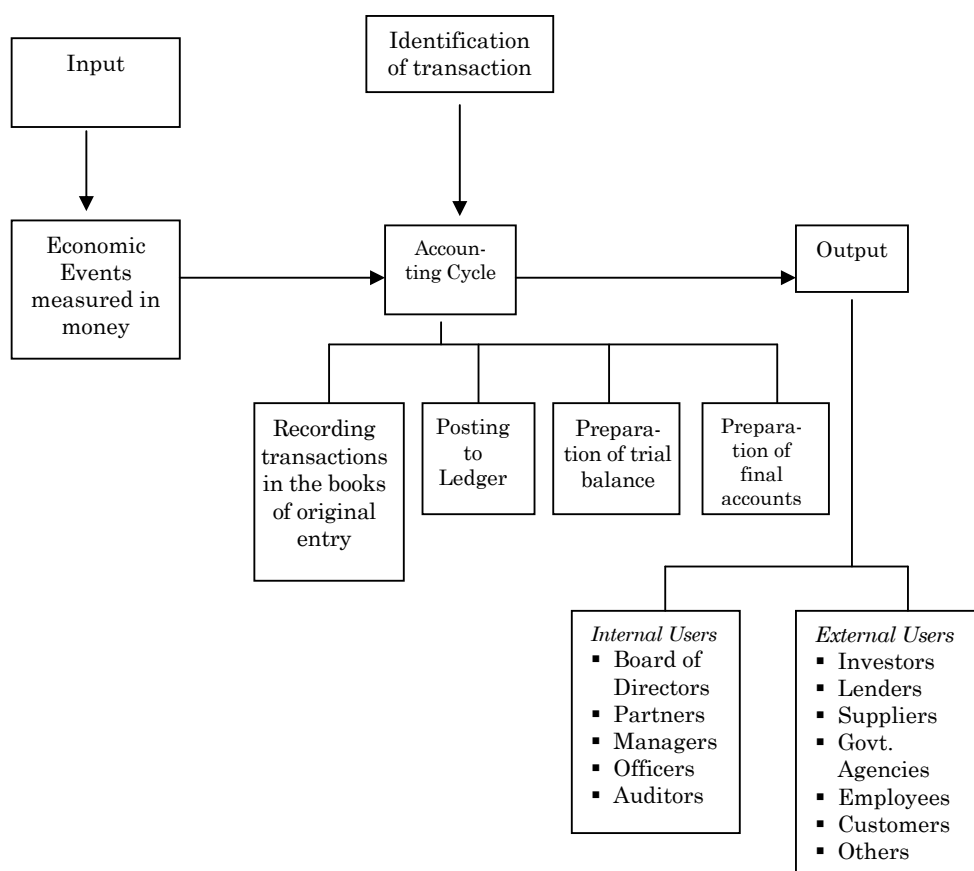
### *Nature of accounting*

#### 1.3 *Accounting*

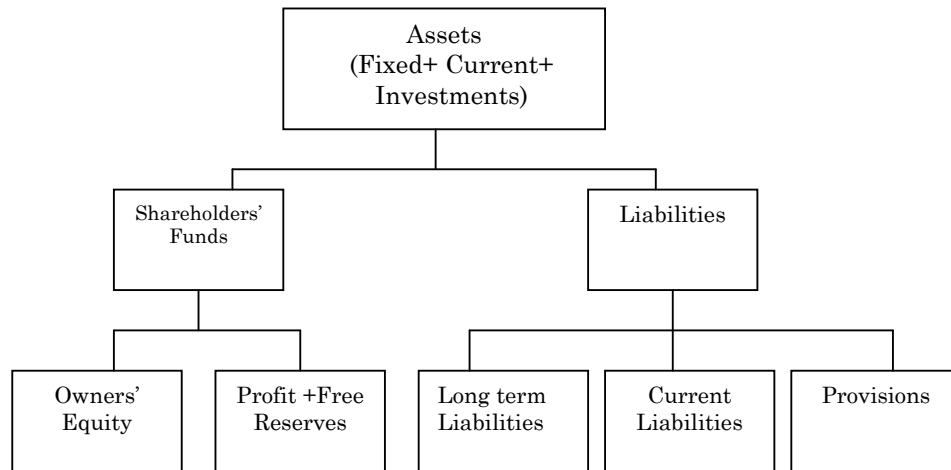
- (i) is man-made
- (ii) has evolved over a period of time

- (iii) is practiced in a social system
- (iv) is a systematic exercise
- (v) is judgmental in many circumstances
- (vi) is essentially the language of business
- (vii) records only financial information

### ACCOUNTING PROCESS-A FLOWCHART



## THE ACCOUNTING EQUATION



## BASIC CONCEPTS IN ACCOUNTING

1.4 A systematic record of the daily events of a business leading to presentation of a complete financial picture is known as *Accounting*. Accounting communicates the state of affairs of a business entity to the outside world. To ensure that the same meaning is conveyed to all the users, certain basic concepts are to be followed while preparing the accounts of an organization. The world over uniformity is sought to be achieved by way of application of Standards. IFRS and Ind AS are example of exercises to achieve uniformity in reporting. These accounting concepts are discussed briefly below:

### (i) *Business Entity Concept*

To bring out the true picture of the affairs of any business entity, the business is treated as distinct from the persons who own it. This concept has been further extended to different business units of the same entity so as to ascertain the results of every unit.

### (ii) *Money Measurement Concept*

Accounting records only those transactions which can be measured in monetary terms. Events, which do not have monetary value, are not recorded in the books of account even though they are very important like strike of the workers.

**(iii) Cost Concept**

Cost concept requires the recording the transactions at the amount actually involved. For example, if the land has been purchased for ₹1.5 crores but its actual worth is ₹ 2.5 crores, it will be recorded at a value of ₹1.5 crore and not ₹ 2.5 crores. The reporting based on market value is being tested as in some cases the assets like land may have appreciated many times.

**(iv) Going Concern Concept**

It is assumed that the business is not likely to be closed in the near future and the transactions are recorded from that point of view. If it is certain that the entity will exist only for a limited period then the records may reflect the realizable value. When this aspect is qualified by the CA, the stakeholders whether the tax administrators or suppliers need to be careful. An example is the case of Kingfisher Airlines where from 2009 onwards the going concern concept was qualified by the auditors. The service tax overdue was reported Rs. 20 lakhs. By 2012-13 the going concern qualification continued and the ST overdue had reached Rs.703 crores!! This was available in the balance sheet filed with the ROC year after year. If known the dues of service tax could have been collected.

**(v) Dual Aspect Concept**

Each transaction that is recorded in the books of account has two aspects. For example, if a business has acquired an asset, it must result in one of the following:

- (a) Giving up of some other asset; or
- (b) An obligation to pay has arisen; or
- (c) Profit has arisen; or
- (d) The proprietor has contributed money for acquisition of such asset

At any time the following equation will hold true:

$$\boxed{Assets = Liabilities + Capital}$$

**(vi) Realisation Concept:**

Accounting can be defined as a historical record of the transactions. Transactions which have already taken place are recorded. Unless money

has been realized or a legal obligation to pay has arisen, no sale is recorded in the books of account.

***(vii) Accrual Concept***

The transactions are recorded not only on cash basis but are also recorded if the amount has accrued. This is due to the matching of revenue to the expenses.

***(viii) Consistency***

The accounting practice followed by the assessee should be consistent from one year to another. If a change becomes necessary, the change and its effect must be stated clearly. Many times the changes are made on account of statutory needs such as compliance of Ind AS or IFRS.

***(ix) Disclosure***

All significant information should be properly disclosed irrespective of the legal requirements. Whether an item is to be disclosed or not would depend on its materiality. [example - 1 % of the expense sample]

***(x) Prudence***

In view of the uncertainty attached to future events, profits are not anticipated but recognized only when realized though not necessarily in cash. Refunds from statutory authorities are at times not recognised as they can take a few years. This at times leads to the same being questioned under unjust enrichment!!

Provision is 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

***(xi) 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. An example could be a works contract agreement being broken into 2 parts one for supply of goods and one for labour which are fully co terminus. Under VAT they would be held to be WCT and consequently under service tax too.

***(xii) Materiality***

Financial Statements should disclose all material items i.e. items the knowledge of which might influence the decision of the user of the financial statements. Materiality could mean depicting a different picture also. Example if an amount converts a loss into a profit that amount could be said to be material. Otherwise in the group a 1% + could be considered material. Material amounts may be hidden in miscellaneous expenses or in capital work in progress which may have some liability under service tax.

**METHODS OF ACCOUNTING – CASH AND MERCANTILE BASIS OF ACCOUNTING (ACCRUAL)**

***Cash System***

1.5 In this method of accounting, entries are recorded only when the impact of a transaction results in either a cash receipt or cash payment.

***Mercantile System***

1.6 Under this basis, the effects of transactions and other events are recognized on mercantile (accrual) basis i.e. when they occur (and not as cash or a cash equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past events involving the payment and receipt of cash, but also of obligations to pay cash in the future and represent cash to be received in the future.

1.7 To understand accrual assumption, knowledge of revenues and expenses is required. Revenue is the gross inflow of cash, receivables and other consideration arising in the course of the ordinary activities of an enterprise from sale of goods, from rendering services and from the use by others of enterprise's resources yielding interest, royalties and dividends.

*For example*, Mr. X started a cloth merchandising business. He invested ₹50,000, bought merchandise worth ₹50,000. He sold such merchandise for ₹60,000. Customers paid him ₹50,000 cash and assured him to pay ₹10,000 shortly. His revenue is ₹60,000. It arose in the ordinary course of cloth business; Mr. X received ₹50,000 in cash and ₹10,000 by way of receivables.



*Take another example,* an electricity supply undertaking supplies electricity expending ₹16,00,000 for fuel and wages and collects electricity bill in one month ₹20,00,000 by way of electricity charges. This is also revenue which arose from rendering services.

*Lastly,* Mr. A invested ₹1,00,000 in a business. He purchased a machine paying ₹1,00,000. He hired it out for ₹20,000 annually to Mr. B. ₹20,000 is the revenue of Mr. A, it arose from the use by others of the enterprise's resources.

1.8 Expense is a cost relating to the operations of an accounting period or to the revenue earned during the period or the benefits of which do not extend beyond that period.

*In the first example,* Mr. X spent ₹50,000 to buy the merchandise. It is the expense of generating revenue of ₹60,000. In the *second instance* ₹16,00,000 are the expenses. Also whenever any asset is used it has a finite life to generate benefit. Suppose, the machine purchased by Mr. A in the *third example* will last for 10 years only. Then ₹10,000 is the expense he met. For the time being, ignore the idea of accounting period.

1.9 Accrual means recognition of revenue and costs as they are earned or incurred and not as money is received or paid. The accrual concept relates to measurement of income, identifying assets and liabilities.

*Example:* Mr. JD buys clothing of ₹50,000 paying cash ₹20,000 and sells at ₹60,000 of which customers paid only ₹50,000.

His revenue is ₹60,000, not only ₹50,000 which is cash received. Expense (i.e. cost incurred for earning the revenue) is ₹50,000 and not ₹20,000 which is cash paid. So the accrual concept based profit is ₹10,000 (Revenue – Expenses).

1.10 As per Accrual Concept:

Revenue – Expenses = Profit

Alternative as per Cash basis

Cash received in ordinary    –    Cash paid in ordinary    = profit.  
course of business                      course of business

Revenue may not be realised in cash. Cash may be received simultaneously, or

- (i) before revenue is created (A.1)
- (ii) after revenue is created (A.2)

Expenses may not be paid in cash. Cash may be paid simultaneously or (i) before expense is made (B.1) (ii) after expense is made (B.2)

A.1 creates a liability when cash is received in advance.

A.2 creates an asset called Receivables or Trade Debtors.

B.1 creates an asset called Trade Advance when cash is paid in advance.

B.2 creates a liability called payables or Trade Creditors or Outstanding Liabilities. If the expenses remain unpaid in respect of goods, it is called *Trade Creditors*, if it remains unpaid for other expenses, it is called Outstanding Expenses.

1.11 Accrual Concept provides the foundation on which the structure of present day accounting has been developed.

1.12 If any fundamental accounting assumption is not followed in the financial statements, the fact should be disclosed.

## **DOUBLE ENTRY SYSTEM**

1.13 Every transaction has two aspects and according to this system, both the aspects are recorded. For example, if a business acquires something then either it must have been given by someone or it must have been acquired by giving up something. On purchase of furniture either the cash balance will be reduced or a liability to the supplier will arise. This has been made clear already. The Double Entry System is so named since it records both the aspects. We may define the *Double Entry System as the system, which recognizes and records both the aspects of transactions*. This system has proved to be systematic and has been found of great use for recording the financial affairs for all institutions requiring use of money.

1.14 This system affords the under-mentioned advantages:

- (i) By the use of this system the accuracy of the accounting work can be established, through the device of the Trial Balance.

- (ii) The profit earned or loss suffered during a period can be ascertained together with details.
- (iii) The financial position of the firm or the institution concerned can be ascertained at the end of each period, through preparation of the Balance Sheet.
- (iv) The system permits accounts to be kept in as much detail as necessary and, therefore affords significant information for the purposes of control etc.
- (v) Result of one year may be compared with those of previous years and reasons for the change may be ascertained.

It is because of these advantages that the system has been used extensively in all countries.

## DEBIT AND CREDIT

1.15 Under Double entry book keeping, if there is any change on one side of the equation, there is bound to be similar change on the other side of the equation or amongst items covered by it. Hence, there is an equation, which is the basis of whole accounting under double entry book keeping.

$\begin{aligned} \text{Assets} &= \text{Liabilities} + \text{Capital or} \\ \text{Assets} - \text{Liabilities} &= \text{Capital} \end{aligned}$
---

We have seen that by deducting the total of liabilities from the total of assets the amount of capital is ascertained, as is indicated by the accounting equation.

1.16 It is a tradition that:

- (i) an increase in assets is recorded on the left-hand side and a decrease in them on the right-hand side; and
- (ii) in the case of liabilities and capital, an increase is recorded on the right-hand side and a decrease on the left-hand side.

1.17 When two sides are put together in T form, the left-hand side is called the 'debit side' the right hand side is 'credit side'. When in an account a record is made on the debit or left-hand side, one says that one has debited that account: similarly to record an amount on the right-hand side is to credit it.

1.18 From the above, the following rules can be obtained:

- (i) When there is an increase in the amount of an asset, its account is debited; the account will be credited if there is a reduction in the amount of the asset concerned:

Suppose, a firm purchases furniture for ₹800, the furniture account will be debited by ₹800 since the asset has increased by this amount. If later, the firm sells furniture to the extent of ₹300, the reduction will be recorded by crediting the furniture account by ₹300.

- (ii) *If the amount of a liability increases, the increase will be entered on the credit side of the liability account, i.e., the account will be credited.*

A liability account will be debited if there is a reduction in the amount of the liability. Suppose a firm borrows ₹500 from Mohan. In this case, Mohan's account will be credited since ₹500 is now payable to him. If later, the loan is repaid, Mohan's account will be debited since the liability no longer exists.

- (iii) *An increase in the owner's capital is recorded by crediting the capital account.*

Suppose the proprietor introduces additional capital the capital account will be credited. If the owner withdraws some money, i.e., makes a drawing, the capital account will be debited.

- (iv) *Profit leads to an increase in capital and a loss to reduction in capital.*

According to the rule mentioned in (iii) above, profit may be directly credited to the capital account and losses may be similarly debited.

However, it is more useful to record all incomes, gains, expenses and losses separately. By doing so, very useful information will be available regarding the factors which have contributed to the year's profits and losses. Later the net result of all these is ascertained and adjusted in the capital account.

- (v) *Expenses are debited and Incomes are credited*

Since incomes and gains increase capital, the rule is to credit all gains and incomes in the accounts concerned and since expenses and losses decrease capital, the rule is to debit all expenses and

losses. Of course, if there is a reduction in any income or gain, the account concerned will be debited: similarly, for any reduction in an expenses or loss the concerned account will be credited.

The rules given above are summarized below:

- (i) Increases in assets are debits; decreases are credits;
- (ii) Increases in liabilities are credits; decreases are debits;
- (iii) Increases in owner's capital are credits; decreases are debits;
- (iv) Increases in expenses are debits; decreases are credits; and
- (v) Increases in revenue or incomes are credits; decreases are debits.

The terms debit and credit should not be taken to mean, respectively, favourable and unfavourable things. They merely describe the two sides of accounts.

### ***Account***

1.19 We have seen how the accounting equation becomes true in all cases. A person starts his business with say, cash of ₹10,000, in such case capital and cash accounts both will be effected by ₹10,000. Transactions entered into by the firm will alter the cash balance in two ways, one will increase the cash balance and other will reduce it. Payment for goods purchased, for salaries and rent, etc., will reduce the cash balance whereas sale of goods for cash and collection from customers will increase it.

We can change the cash balance with every transaction but this will be cumbersome. Instead it would be better if all the transactions that lead to an increase are recorded in one column and those that reduce the cash balance in another column, then the net result can be ascertained. If we add all increases to the opening balance of cash and then deduct the total of all decreases, we shall know the Closing Balance. In this manner, significant information will be available relating to cash.

The two columns of which we talked of above are put usually in the form of an account, called the 'T' form. This is illustrated below by taking imaginary figures:

**Cash**

	Increase ₹	Decrease ₹
Opening Balance	10,000	1,000
	2,500	300
	2,000	200
	50	500
	1,350	
	400	Total 2,000
New or Closing Balance		14,300
	16,300	16,300

What we have done is to put the increase of cash on the left hand side and the decrease on the right hand side. The closing balance has been ascertained by deducting the total of payments, ₹2,000 from the total of the left-hand side. Such a treatment of receipts and payment of cash is very convenient.

The proper form of an account is as follows:

**Account**

Dr.				Cr.			
Date	Particulars	Ref.	Amount	Date	Particulars	Ref	Amount
			₹				₹

The columns are self-explanatory except that the column for reference (Ref.) is meant to indicate the sources where information about the entry is available.

**JOURNAL AND LEDGER**

1.20 Though accounts can be written up directly, it is common to use two books for the purpose. These are:

- (i) **Journal:** Transactions are first entered in this book to show which accounts should be debited and which credited. Journal is also called *subsidiary book*.

- (ii) **Ledger:** On the basis of entries made in the Journal, accounts are prepared; the book which contains the accounts is called 'ledger'. Ledger is also called *principal book*.

**Journalising Process:** All transactions are first recorded in the Journal as and when they occur. The record chronological recorded, otherwise it would be difficult to maintain in an orderly manner. The form of the Journal is given below:

**Journal**

			<i>Dr</i>	<i>Cr</i>
<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount</i> ₹	<i>Amount</i> ₹
(1)	(2)	(3)	(4)	(5)

The columns have been numbered only to make clear the following but otherwise they are not numbered. The following points should be noted:

- (i) In the first column the date of the transaction is entered-the year is written at the top, then the month and in the narrow part of the column the particular date is entered.
- (ii) In the second column, the names of the accounts involved are written; first the account to be debited, with the word "Dr" written towards the end of the column. In the next line, after leaving a little space, the name of the account to be credited is written preceded by the word "To" (the modern practice shows inclination towards omitting "Dr." and "To"). Then in the next line the explanation for the entry together with necessary details is given-this is called narration.
- (iii) In the third column, the page number of the ledger where posting has been made from the Journal is entered.
- (iv) In the fourth column, the amounts to be debited to the various accounts concerned are entered.
- (v) In the fifth column, the amount to be credited to various accounts is entered.

**STEPS IN JOURNALISING**

1.21 Before one can journalize transactions, one must think, on the basis of the rules given above, the effect of the transaction on assets, liabilities, expenses, gains etc. of the firm. In accordance with the effects, the accounts to be debited or credited will be determined. Then the entry will be made in the Journal, as indicated above.

1.22 It should be noted that the papers or documents supporting transaction and establishing its veracity are known as ***vouchers***. These should be filed in proper order, together with necessary references, so that in times of need these can be referred to.

An entry in the Journal may appear as follows:

May 5	Cash Account Dr. To Mohan (Being the amount received from Mohan in payment of the amount due from him)		₹ 450	₹ 450
-------	---	--	----------	----------

We will now consider some individual transactions.

- (i) Mohan commences business with ₹5000 cash According to the rules given above, the increase in an asset has to be debited to it. The firm also now owes ₹5000 to the proprietor, Mohan as capital. The rule given above also shows that the increase in capital should be credited to it. Therefore, the Journal Entry will be:

Cash Account	Dr. ₹5,000	
To Capital Account		₹5,000
(Being capital introduced by Sh. Mohan)		

- (ii) Out of the above, ₹500 is deposited in the bank. By this transaction the cash balance is reduced by ₹500 and another asset, bank account, comes into existence. Since increase in assets is debited and decrease is credited, the Journal Entry will be:

Bank Account	Dr. ₹500	
To Cash Account		₹500
(Being cash deposited to Bank)		



- (iii) Furniture is purchased for cash ₹200. Applying the same reasoning as above the entry will be:

Furniture Account	Dr. ₹200	
To Cash Account		₹200
(Being Furniture purchased vide CM No....)		

- (iv) Purchased goods for cash ₹400. The required entry will be:

Purchase Account	Dr. ₹400	
To Cash Account		₹400
(Being goods purchased vide CM No....)		

- (v) Purchased goods for ₹1,000 credit from M/s. Ram Narain Bros. Purchase of merchandise is an expense item so it is to be debited. ₹1,000 is now owed to the supplier; his account should therefore be credited, since the amount of liabilities has increased. The entry will be:

Purchases Account	Dr. ₹1,000	
To M/s Ram Narain Bros.		₹1,000
(Being goods purchased vide Bill No....)		

- (vi) Sold goods to M/s Ram & Co. for cash ₹600. The amount of cash increases and therefore, the cash amount should be debited. Sale of merchandise is revenue item so it is to be credited. The entry will be.

Cash Account	Dr. ₹600	
To Sales Account		₹600
(Being goods sold vide CM No....)		

- (vii) Sold goods to Ramesh on credit for ₹300. The stock of goods has decreased and therefore, the goods account has to be credited. Ramesh now owes ₹300, that is an asset and therefore. Ramesh should be debited. The entry is:

Ramesh	Dr. ₹300	
To Sales Account		₹300
(Being goods sold vide Bill No....)		

- (viii) Received cash from Ramesh ₹300. The amount of cash increased therefore the cash account has to be debited. Ramesh no longer owes any amount to the firm, i.e., this particular form of assets has disappeared, therefore, the account of Ramesh should be credited. The entry is.

Cash Account	Dr. ₹300	
To Ramesh		₹300

(Being cash received against Bill No....)

- (ix) Paid to M/s Ram Narain Bros. ₹1000. The liability to M/s Ram Narain Bros. has been discharged, therefore this account should be debited. The cash balance has decreased and, therefore, the cash account has to be credited. The entry is:

M/s Ram Narian Bros.	Dr. ₹1,000	
To Cash Account		₹1,000

(Being cash paid against Bill No....)

- (x) Paid rent ₹100. The cash balance has decreased and therefore, the cash account should be credited. No asset has come into existence because of the payment. The payment is for services enjoyed and is an expense. Expenses are debited. Therefore, the entry should be :

Rent Account.	Dr. ₹100	
To Cash Account		₹100

(Being rent paid for the month of .....)

- (xi) Paid ₹200 to the clerk as salary. Applying the reasons given in (x) above, the required entry is:

Salary Account	Dr. ₹200	
To Cash Account		₹200

(Being salary paid to Mr..... for the month of .....)

- (xii) Received ₹20 interest. The cash account should be debited since there is an increase in the cash balance. There is no increase in any liability. Since the amount is not returnable to any one, the amount is an income, incomes are credited. The entry is:

Cash Account	Dr. ₹20	
Interest Account		₹20
(Being interest received from..... for the period .....)		

When transactions of similar nature take place on the same date, they may be combined while they are journalised. For example, entries (x) and (xi) may be combined as follows:

Rent Account	Dr. ₹100	
Salary Account	Dr. ₹200	
To Cash Account		₹300
(Being expenses done as per detail attached)		

When Journal entry for two or more transactions is combined, it is called composite Journal entry.

Usually, the transactions in a firm are so numerous that to record the transactions for a month will require many pages in the journal. At the bottom of one page the totals of the two columns are written together with the words “Carried forward” in the particulars column. The next page is started with the respective totals in the two columns with the words “Brought forward” in the particulars column.

## CLASSIFICATION OF ACCOUNTS

1.23 The accounting equation tells us that in broad categories the account is as follows:

- (i) Assets, indicating the resources, which the firm is enjoying. They may be in the form of cash, stock of goods, amounts owing from customers, land, buildings etc.
- (ii) Liabilities, indicating the amounts, which the firm owes to outsiders.
- (iii) Capital, indicating the amounts, which the proprietor has invested in the firm, the accretion to it or a reduction in it.

Since capital is affected by expenses and gains, net results from the operation of the entity i.e, profit and loss is the part of the capital.

1.24 Accounts may be classified in another manner;

- (i) *Personal Accounts:* Personal accounts related to persons, debtors or creditors. Example-,the account of Ram & Co., a credit customer or the account of Jhaveri & Co., a supplier of goods. The capital account is the account of the proprietor and, therefore, it is also personal but adjustment on account of profits and losses are made in it.
- (ii) *Impersonal Accounts:* Accounts, which are not personal such as machinery account, cash account, rent account etc. These can be further sub-divided as follows:
  - (a) *Real Accounts:* Accounts, which relate to assets of the firm but not debt. For example, accounts regarding land, building, investment, fixed deposits etc., are real accounts. Cash in hand and the bank accounts are also real.
  - (b) *Nominal Accounts:* Accounts, which relate to expenses, losses, gains, revenue, etc. like salary account, interest paid account, commission received account. The net result of all the nominal accounts is reflected as profit or loss, which is transferred to the capital account. Nominal accounts are, therefore, temporary.

### LEDGER POSTING

1.25 The Journal tells us the accounts to be debited and credited and also the amounts involved. The amount is written on the left-hand side of the account to be debited. In the particulars column, the name of the account is written, preceded by the word. "To" The amount is written on the right-hand side of the account to be credited. In the particulars column the name of the other account concerned is written preceded by the word "By". Consider the following entry.

March 6	Furniture Account	Dr.	₹1,120	
	To Modern Furniture			₹1,120

The amount of ₹1,120 is debited to the Furniture Account and credited to Modern Furniture. In the Furniture Account in the particulars column we write: "To Modern Furniture". In the account of Modern Furniture is written: "By Furniture Account." The two accounts appear as under:

***Furniture Account***

Dr.				Cr.			
Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
			₹				₹
March 6	To Modern Furniture	57	1,120				

***Modern Furniture***

Dr.				Cr.			
Date	Particulars	JF	Amount	Date	Particulars	JF	Amount
			₹				₹
				March 6	By Furniture Account	57	1,120

“57” is the assumed number of the page on which the entry was made in the Journal. While preparing one account in the ledger, page no. of the corresponding account is also given along with the page no. of Journal. The concept of page number (F.) is highly relevant in manual accounting. But in computerized accounting environment the page number (F.) is not used.

Sometimes in the Journal there may be two or more accounts to be debited and only one to be credited or vice versa. The entry given below shows that the debt of ₹500 due from Satish has been discharged by receipt of only ₹485 cash and by ₹15 allowed as discount:

		₹	₹
Cash Account	Dr.	485	
Discount Account	Dr.	15	
To Satish			500

In the Cash Account we write “To Satish ₹485”; in the Discount Account we write “To Satish ₹15”; in the account of Satish we write as follows (On credit side).

Cash Account	₹485
Discount Account	₹15
But we may also write, By Sundries	₹500

The transactions which have been journalized earlier are posted below:

**Ledger**  
**Cash Account**

Dr.			Cr.		
Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
April 1	To Capital A/c	10,000	April 2	By Bank A/c	7,000
4	To Bank A/c	100	3	By Purchases A/c	500
24	To Krishna A/c	145	30	By Shyam A/c	215
30	To Sales A/c	800	30	By Rent A/c	50
				By Salary A/c	100
				By Balance c/d	3,180
		11,045			11,045
May 1	To Balance b/d	3,180			

**Capital Account**

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
			April 1	By Cash A/c	10,000

**Bank Account**

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
April 12	To Cash A/c	7,000	April 4	By Cash A/c	100
			April 30	By Balance c/d	6,900
		7,000			7,000
May 1		6,900			6,900

**Purchase Account**

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
April 3	To Cash A/c	500			
April 20	To Shyam	225			

***Sales Account***

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
			April 13	By Krishna	150
			April 30	By Cash A/c	800

***Krishna***

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
April 13	To Sales A/c	150	April 20	By Cash A/c	145
			April 30	By Discount A/c	5
		150			150

***Shyam***

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
April 13	To Cash A/c	215	April 20	By Purchases A/c	2
	To Discount A/c	10	April 30	By Discount A/c	5
		225			150

***Discount Account***

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
April 24	To Krishna	5	April 28	By Shyam	10

***Rent Account***

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
April 30	To Cash A/c	50			

***Salaries Account***

Date 2015	Particulars	Amount ₹	Date 2015	Particulars	Amount ₹
April 30	To Cash A/c	100			

*Balancing an account:* At the end of the each month or year or any particular day it may be necessary to ascertain the balance in an account. This is not a too difficult thing to do; suppose a person has bought goods worth ₹1,000 and has paid only ₹850; he owes ₹150 and that is balance in his account. To ascertain the balance in any account, what is done is to total the sides and ascertain the difference; the difference is the balance. *If the credit side is bigger than the debit side, it is a credit balance. In the other case it is a debit balance.* The credit balance is written on the debit side as, “To Balance c/d”; c/d means “carried down”. By doing this two sides will be equal. The totals are written on the two sides opposite one another.

Then the credit balance is written on the credit side as “By balance b/d (i.e., brought down)”. This is the opening balance for the new period. The debit balance similarly is written on the credit side as “By Balance c/d”, the totals then are written on the two sides as shown above as then the debit balance written on the debit side as, “To Balance b/d”, as the opening balance of the new period.

It should be noted that nominal accounts are not balanced; the balance in the end are transferred to the profit and loss account. Only personal and real accounts ultimately show balances. In the illustration given above, one will have noticed that the capital account, the purchases account, sales account the discount account, the rent account and the salary account have not been balanced. The capital account will have to be adjusted for profit or loss and that is why it has not been balanced yet.

## **BALANCING AN ACCOUNT**

1.26 Once the posting in ledger is completed the accounts are to be balanced. For balancing an account, first the total of two sides is ascertained. If the total of debit side is higher than the total of credit side, the difference is known as “Debit Balance” and if the total of credit side is higher than the total of debit side, the difference is known as “Credit Balance” Such a difference is placed on the shorter side saying “To/By balance carried down (c/d)”. After placing the difference on the shorter side the two sides become equal.



In the beginning of next year the difference that was placed on the shorter side of the ledger is carried forward and written on its opposite side, saying “To/By Balance Brought forward (b/f)”.

The accounts, which are to be balanced, are those, which relate to some property like building, vehicle etc. Certain other accounts are not balanced at the year-end as they are to be transferred to some other accounts in order to ascertain the profit or loss of the business.

The balancing process has been shown in the illustration showing ledger posting above.

### **SUBSIDIARY BOOKS AND THEIR ADVANTAGES**

1.27 In a Business most of the transactions generally relate to receipts and payments of cash, sale of goods and their purchase. It is convenient to keep a separate register for each such class of transactions one for receipts and payments of cash, one for purchase of goods and one for sale of goods. A register of this type is called a Book of Original Entry or of Prime Entry. For transactions recorded in such books there will be no Journal Entry. The system by which transactions of a class are first recorded in the book, specially meant for it and on the basis of which ledger accounts are then prepared is known as the Practical System of Book keeping or even the English System. It should be noted that in this system, there is no departure from the rules of the double entry system.

These books of original or prime entry are also called Subsidiary Books since ledger accounts are prepared on their basis and, without the further process of ledger posting, a trial balance cannot be taken out. Normally, the following subsidiary books are used in a business:

- (i) *Cash Book* to record receipts and payments of cash, including receipts into and payments out of the bank.
- (ii) *Purchases Book* to record credit purchases of goods dealt in or of the materials and stores required in the factory.
- (iii) *Purchases Returns Books* to record the returns of goods and materials previously purchased.
- (iv) *Sales Book* to record the credit sales of the goods dealt in by the firm.

- (v) *Sales Returns Book* to record the returns made by the customers.
- (vi) *Bills receivable books* to record the receipts of promissory notes or hundies from various parties.
- (vii) *Bills Payable Book* to record the issue of the promissory notes or hundies to other parties.
- (viii) *Journal* (proper) to record the transactions, which cannot be recorded in any of the seven books, mentioned above.

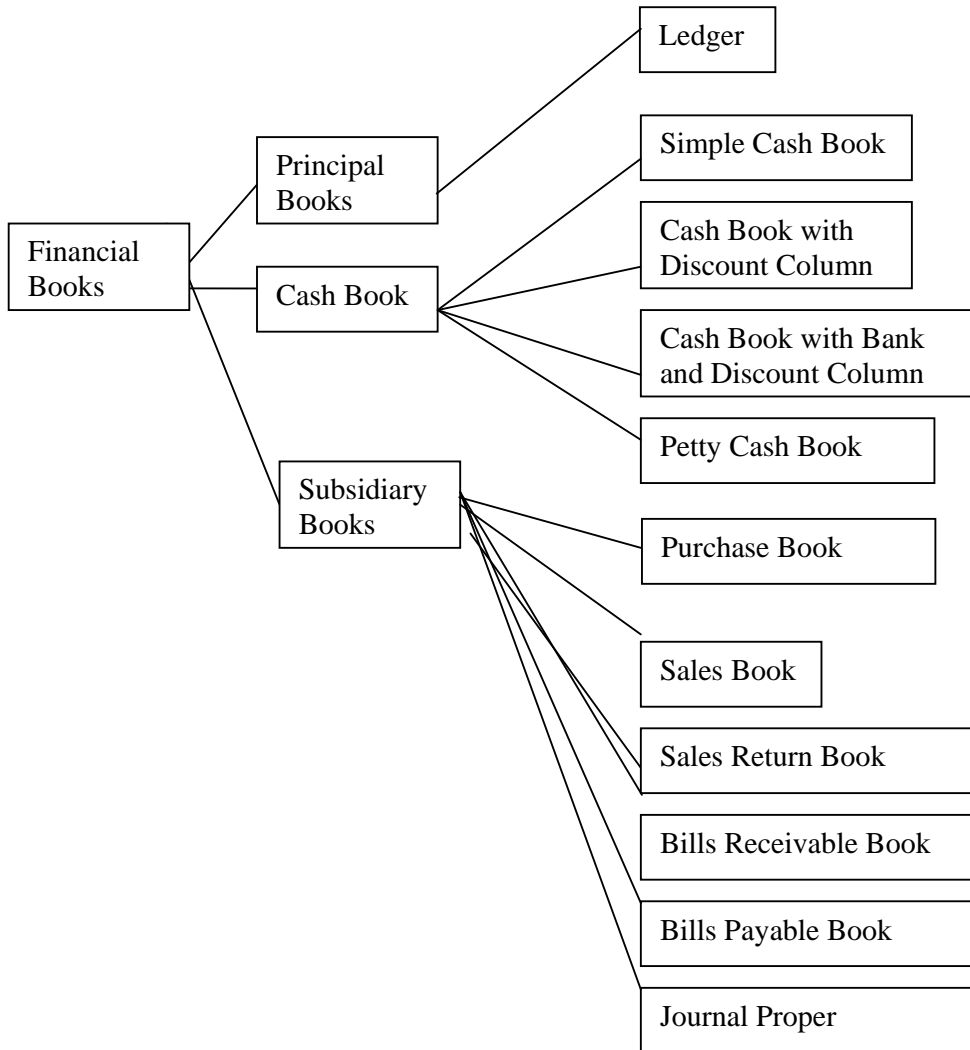
It may be noted that in all the above cases the word “Journal” may be used for the word “book”.

In today’s world most of the medium and large companies are working on ERPs wherein only the basic entry is made with due care. Postings to all the subsidiary ledgers is automatic. Common ERPS today are Tally ERP , JD Edwards, Oracle, SAP, BAAN, etc.

### ***Advantages of Subsidiary Books***

1.28 The use of subsidiary books affords the under mentioned advantages:

- (i) *Division of work:* Since in the place of one Journal there will be so many subsidiary books, the accounting work may be divided amongst a number of clerks.
- (ii) *Specialization and efficiency:* When the same work is allotted to a particular person over a period of time, he acquires full knowledge of it and becomes efficient in handling it. Thus the accounting work will be done efficiently.
- (iii) *Saving of the time:* Various accounting processes can be undertaken simultaneously because of the use of a number of books. This will lead to the work being completed quickly.
- (iv) *Availability of information:* Since a separate register or book is kept for each class of transactions, the information relating to each transactions will be available at one place.
- (v) *Facility in checking:* When the trial balance does not agree, the location of the error or errors is facilitated by the existence of separate books. Even the commission of errors and frauds will be checked by the use of various subsidiary books.



### ***Purchases Book***

1.29 To record the *credit purchases* of goods dealt in or materials and stores used in the factory, a separate register called the Purchases Book or the Purchases Journal, is usually maintained by firms. The ruling is given below:

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Details</i>	<i>Amount</i>
			₹	₹

It should be remembered that:

- (i) Cash purchases are not entered in this book since these will be entered in the cash book; and
- (ii) Credit purchases of things other than goods or materials, such as office furniture or typewriters are journalised-they also are not entered in the Purchases Book.

The particulars column is meant to record the name of the supplier and name of the articles purchased and the respective quantities. The amount in respect of each article is entered in the details column. After totaling the various amounts included in a single purchase, the amount for packing, or other charges is added and the amount for trade discount is deducted. The net amount is entered in the extreme right-hand column. The total in this column shows the total purchase made in a period.

### **Posting the Purchase Book**

1.30 The Purchases Book shows the names of the parties from whom goods have been purchased on credit. These parties are now creditors. Their accounts have to be credited for the respective amounts shown in the purchase book. The total of the amounts column shows the total purchases made in a period. The amount is debited to the Purchase Account to indicate receipt of goods. In illustration 11, the Purchases Account is debited by ₹502.12, M/s Brown & Co. is credited by ₹304.12, the Paper Company by ₹180 and M/s Verma Bros. by ₹18. The total of the amounts put on the credit side equals the debit. Thus the double entry is completed.

### **Sales Book**

1.31 The Sales Book is a register specially kept to record *credit sales* of goods dealt in by the firm, cash sales are entered in the Cash Book and not in the Sales Book. Credit sales of things of other than the goods dealt in by the firm are not entered in the Sales Book, they are journalized. The ruling is the same as for the Purchases Book.

Entries in the sales book are also made in the same manner as in the Purchase Book. The particulars column will record the name of the customers concerned together with particulars and quantities of the goods sold. For each item, the amount is entered in the details column; after

totaling the amounts for one sale, charges for packing etc, are added and the trade discount, if any is deducted. The net amount is put in the outer column. The total of this column will show the total credit sales for a period.

### **Posting the Sales Book**

1.32 The names appearing in the Sales Book are of those parties, which have received the goods. The accounts of the parties have to be debited with the respective amounts. The total of the Sales Book shows the credit sales made during the period concerned, the amount is credited to the Sales Account. In the illustration 12, ₹1,921 is credited to the Sales Account; ₹396 is debited to M/s Gupta and Verma ₹400 to M/s Jain and Sons and ₹1,125 to M/s Mathur & Jain. The amount put on the credit side is equal to the total of the amount put on the debit side. Thus, the double entry principle is followed correctly.

### **Sales Book with Sales Tax column**

1.33 Sales Tax is one levied at the point of sales. Sales Tax is collected by the seller from the customers on sales of goods and deposited with the state government. Sales Tax is charged at a fixed percentage on the net price of the goods. It is calculated after giving trade discount, if any. Generally a separate column is provided in the Sales Book for sales tax so that a proper record is maintained regarding sales tax collected. Rates of sales tax vary from item to item and also on local sales and interstate sales (or say central sales). A separate column in sales book for each rate of sales tax helps the dealer in calculating sales tax liability accurately.

At the end of a certain period, generally quarterly or monthly, the total of sales tax column is credited to the Sales Tax Account. When sales tax is deposited with the sales tax department, the Sales Tax Account is debited and Cash/Bank Account is credited. When there is any credit balance in Sales Tax Account, it shows the amount payable as sales tax and hence be shown in the Balance Sheet as a liability.

### **Sales Returns Book or Returns Inward Book**

1.34 If customers frequently return the goods sold to them, it would be convenient to record the returns in a separate book, which is named as the Sales Returns Book or the Returns Inward Book. The ruling of the

book is similar to the Purchases or the Sales Book and entries are also made in the same manner. The following, assumed figures, will illustrate this:

**Returns Inward Book**

<i>Date</i>	<i>Particulars</i>	<i>Details</i>	<i>L.F.</i>	<i>Amount</i>
2015				₹
June 7	Sunil Bank & Co. 6 Copies–Double Entry Book keeping by T.S. Grewal @ ₹7 Less: Trade Discount 10% (returns as per debit note no.....) Kailash & Co. 1 Copy–Business Methods by R.K. Gupta (returns as per debit note no.....)	42.00 4.20      Total		37.80     3.50 41.30

**Purchase Returns or Returns Outward Book**

1.35 Such a book conveniently records return of purchased goods or materials back to the suppliers. If however, the returns are infrequent, it may be sufficient to record the transaction in the Journal. The ruling of the Purchase Returns or Returns Outward Book is similar to that of the Purchase Book; entries are also similarly made, as the illustration given below shows:

**Returns Outward Book**

<i>Date</i>	<i>Particulars</i>		<i>Amount</i>
2015		₹	₹
June 2	Premier Electric Co. One 36" Usha Ceiling Fan		175.00
June 28	Mohan Electric Co. Ten Iron Heaters Less : Discount Total	150.00 15.00	135.00 310.00

**Posting of the Return Books**

1.36 The Sales Return Book will show the total of the returns made by customers. Really, the total of the returns is in reduction of the sales. Therefore, the amount may be debited to the Sales Account. But usually, a separate account called Returns Inward Account is opened and the total of the sales returns is debited to this accounts. The customers who have returned the goods are credited with the respective amounts.

1.37 It should be noted that on goods being received and accepted back from the customers, a credit note is issued to the customers concerned. This shows the amount to be credited to the customer's account.

1.38 Similarly, when goods are returned to suppliers they will issue the necessary credit note; also the firm returning the goods will issue a debit note to the supplier, indicating the amount for which the supplier is liable on account of the return.

1.39 The total of Returns Outwards Book shows the total returns made. The amount can be credited to the purchase Account, but in practice, is credited to a separate account called Purchase Returns or Returns Outward Account.

**Bills Receivable Books and Bills Payable Books**

1.40 If the firm usually receives a number of promissory notes or hundies, it would be convenient to record the transaction in a separate book called the Bills Receivable Book. Similarly, if promissory notes or hundies are frequently issued, the Bills Payable Book will be convenient.

**BANK RECONCILIATION STATEMENT**

1.41 Strictly speaking, there should be no difference between the balance shown by the passbook and the cash-book. This is so, if all the entries are recorded in both. However, on a particular date it is possible that balances of both the books do not tally i.e., some entries may or may not have been recorded in the cash-book or the pass-book. Efforts are made for their reconciliation. This reconciliation is prepared and presented in the form of a statement commonly known as *Bank Reconciliation Statement*.

**Procedure for reconciling the cash-book balance with the Pass-book balance**

1.42 Before proceeding further, one must understand the meaning of the term “Dr. Balance as per cash book”. This means deposits in the bank or cash at bank or Cr. balance as per pass book. Similarly, ‘Cr-balance as per cash book’ means excess amount over deposits, withdrawn by the account holder or overdraft balance or Dr. Balance as per pass-book.

Bank reconciliation can be started from any of the following four balances:

1. Dr. Balance as per cash book
2. Cr. Balance as per cash book
3. Dr. balance as per pass book
4. Cr. balance as per pass book

When causes of differences are known, one can start the reconciliation by taking any of the balances stated above and proceed further with the causes. If the balance of the other book is more on account of the said causes then add the amount. If the balance of the other book is less on account of the said causes then subtract the amount.

The main causes of differences are:

- i. Cheques received and accounted not deposited
- ii. Cheques deposited not credited
- iii. Cheques issued not handed over
- iv. Cheques issued not banked by creditors
- v. Cash In Transit
- vi. Bank charges debited not accounted
- vii. ,, , few more.

But if the causes of differences are not known then one has to compare the debit entries of cash book with the credit entries of the pass-book and *vice-versa*. The entries, which do not tally in the course, are the causes of difference in the balances of both the books. Once the causes are located, their effects on both the books are analyzed and then the reconciliation statement is prepared to arrive at the actual bank balance.



## **CAPITAL AND REVENUE RECEIPTS AND EXPENDITURE**

1.43 Accounting aims at ascertaining and presenting the results of the business for an accounting period. For ascertaining the periodical business results, the nature of transactions should be analyzed whether they are of capital or revenue nature. Revenue Expenses relate to the operations of the business of an accounting period or the items of expenditure, benefits of which do not extend beyond that period. Revenue Receipts relates to the revenue earned during the period. Capital Expenditure, on the other hand, generates enduring benefits and helps in revenue generation over more than one accounting period. Revenue Expenses must be associated with the operations of the entity. Therefore, whereas production and sales generate revenue in the earning process, use of goods and services in support of those functions causes expenses to occur. Expenses are recognized in the Profit & Loss Account through matching principal which tells us when and how much of the expenses is to be charged against revenue. A part of the expenditure can be capitalized only when these can be traced directly to definable streams of future benefits.

1.44 The distinction of transaction into revenue and capital is done for the purpose of placing them in Profit and Loss Account or in the Balance Sheet. For example, revenue expenditures are shown in the profit and loss account as their benefits are for one accounting period i.e., in which they are incurred while capital expenditures are placed on the asset side of the balance sheet as they will generate benefits for more than one accounting period and will be transferred to profit and loss account of the year on the basis of utilization of that benefit in particular accounting year. Hence, both capital and revenue expenditures are ultimately transferred to profit and loss account.

1.45 Revenue expenditures are transferred to profit and loss account in the year of spending while capital expenditures are transferred to profit and loss account over the period during which their benefits are utilized. Therefore, we can conclude that it is the time factor, which is the main determinant for transferring the expenditure to profit and loss account. Also expenses are recognized in profit and loss account through matching concept which tells us when and how much of the expenses to be charged against revenue. However, distinction between capital and revenue

creates a considerable difficulty. In many cases borderline between the two is very thin.

***Considerations in determining Capital and Revenue Expenditure***

1.46 Following are the basic considerations for determining whether an expenditure is capital or revenue in nature:

If an expenditure meets the definition of Asset given in the *Framework for the Preparation and Presentation of Financial Statements*, issued by the Institute of Chartered Accountants of India, the same should be capitalized. Otherwise, it should be treated as revenue expense and should be charged to Profit and Loss Account.

***Asset:*** *An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.*

If an expenditure does not meet above definition, the same should be charged to profit and loss account as expense.

**Capital Receipts and Revenue Receipts**

1.47 Just as a clear distinction between Capital and Revenue expenditure is necessary, in the same manner capital receipts must be distinguished from revenue receipts.

Receipts which are obtained in course of normal business activities are revenue receipts (e.g. receipts from sale of goods or services, interest income etc.). On the other hand, receipts which are not revenue in nature are capital receipts (e.g. receipts from sale of fixed assets or investments, secured or unsecured loans, owner's contributions etc.). Revenue and capital receipts are recognised on accrual basis as soon as the right of receipt is established. Revenue receipts should not be equated with the actual cash receipts. Revenue receipts are credited to the Profit and Loss Account.

On the other hand, Capital receipts are not directly credited to Profit and Loss Account. For example, when a fixed asset is sold for ₹92,000 (cost ₹90,000), the capital receipts ₹92,000 is not credited to Profit and Loss Account. Profit/Loss on sale of fixed assets is calculated and credited to Profit and Loss Account as follows:

Sale Proceeds	₹92,000
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Cost	(₹90,000)
Profit	₹2,000

For more clarity on Capital and Revenue Receipts and Expenditures, relevant Accounting Standards may be referred.

### CASE STUDY

1.48 Journalise the following transactions in the books of a trader

*Debit Balance on January 1, 2015*

Cash in Hand ₹8,000, Cash at Bank ₹25,000, Stock of Goods ₹20,000, Furniture ₹2,000, Building ₹10,000. Sundry Debtors: Vijay ₹2,000, Anil ₹1,000 and Madhu ₹2,000.

*Credit Balances on January 1, 2015:*

Sundry Creditors: Anand ₹5,000, Loan from Bablu ₹10,000.

Following were further transactions in the month of January, 2015:

Jan. 1	Purchased goods worth ₹5,000 for cash less 20% trade discount and 5% cash discount.
Jan. 4	Received ₹1,980 from Vijay and allowed him ₹20 as discount.
Jan. 6	Purchased goods from Bharat ₹5,000.
Jan. 8	Purchased plant from Mukesh for ₹5,000 and paid ₹100 as cartage for bringing the plant to the factory and another ₹200 as installation charges.
Jan. 12	Sold goods to Rahim on credit ₹600.
Jan. 15	Rahim became insolvent and could pay only 50 paise in a rupee.
Jan. 18	Sold goods to Ram for cash ₹1,000.
Jan. 20	Paid salary to Ratan ₹2,000.
Jan. 21	Paid Anand ₹4,800 in full settlement.
Jan. 26	Interest received from Madhu ₹200.
Jan. 28	Paid to Bablu interest on loan ₹500.
Jan. 31	Sold goods for cash ₹500.
Jan. 31	Withdrew goods from business for personal use ₹200.

**Solution:*****Cash Account***

<i>Dr.</i>				<i>Cr.</i>			
<i>Date</i>	<i>Particulars</i>	<i>LF.</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>₹</i>
2015				2015			
Jan. 1	To Balance b/d		8,000	Jan. 1	By Purchases A/c		3,800
Jan. 4	To Vijay		1,980	Jan. 8	By Plant A/c		300
Jan. 15	To Rahim		300	Jan. 20	By Salary A/c		2,000
Jan. 18	To Sales A/c		1,000	Jan. 21	By Anand		4,800
Jan. 26	To Interest A/c		200	Jan. 28	By Interest of Loan A/c		500
Jan. 31	To Sales A/c		<u>500</u>	Jan. 31	By Balance c/d		<u>580</u>
			<u>11,980</u>				<u>11,980</u>
Feb. 1	To Balance b/d		580				

***Interest Account***

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
Jan. 31	To Balance b/d	<u>200</u>	Jan. 26	By Cash A/c	<u>200</u>
		<u>200</u>			<u>200</u>
			Feb. 1	By Balance b/d	200

***Bank Account***

<i>Dr.</i>				<i>Cr.</i>			
<i>Date</i>	<i>Particulars</i>		<i>₹.</i>	<i>Date</i>	<i>Particulars</i>		<i>₹</i>
Jan. 1	To	Balance b/d	<u>25,000</u>	Jan. 31	By	Balance c/d	<u>25,000</u>
			<u>25,000</u>				<u>25,000</u>
Feb. 1	To	Balance b/d	25,000				

**Stock Account**

<i>Dr.</i>				<i>Cr.</i>			
<i>Date</i>	<i>Particulars</i>		₹	<i>Date</i>	<i>Particulars</i>		₹
Jan. 1	To	Balance b/d	<u>20,000</u>	Jan. 31	By	Balance c/d	<u>20,000</u>
			<u>20,000</u>				<u>20,000</u>
Feb. 1	To	Balance b/d	<u>20,000</u>				

**Furniture Account**

<i>Dr.</i>				<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹	
Jan. 1	To Balance b/d	<u>2,000</u>	Jan. 31	By Balance c/d	<u>2,000</u>	
		<u>2,000</u>			<u>2,000</u>	
Feb. 1	To Balance b/d	<u>2,000</u>				

**Building Account**

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 1	To    Balance b/d	<u>10,000</u>	Jan. 31	By    Balance c/d	<u>10,000</u>
		<u>10,000</u>			<u>10,000</u>
Feb. 1	To    Balance b/d	<u>10,000</u>			

**Vijay**

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 1	To    Balance b/d	2,000	Jan. 4	By    Cash A/c	1,980
		<hr/>		By    Discount A/c	<u>20</u>
		2,000			2,000

**Anil**

<i>Dr.</i>				<i>Cr.</i>	
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 1	To Balance b/d	<u>1,000</u>	Jan. 31	By Balance c/d	<u>1,000</u>
		<u>1,000</u>			<u>1,000</u>
Feb. 1	To Balance b/d	1,000			

**Madhu**

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 1	To Balance b/d	<u>2,000</u>	Jan. 31	By Balance c/d	<u>2,000</u>
		<u>2,000</u>			<u>2,000</u>
Feb. 1	To Balance b/d	<u>2,000</u>			

**Anand**

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 21	To Cash A/c	4,800	Jan. 1	By Balance b/d	5,000
Jan. 21	To Discount A/c	<u>200</u>			—
		<u>5,000</u>			<u>5,000</u>

**Capital Account**

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 31	To Balance c/d	<u>55,000</u>	Jan. 1	By Balance b/d	<u>55,000</u>
		<u>55,000</u>			<u>55,000</u>
			Feb. 1	By Balance b/d	55,000

**Babu's Loan Account**

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 31	To Balance c/d	<u>10,000</u>	Jan. 1	By Balance b/d	<u>10,000</u>
		<u>10,000</u>			<u>10,000</u>
			Feb. 1	By Balance b/d	10,000

***Purchases Account***

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 1	To Cash	3,800	Jan. 31	By Drawings A/c	200
Jan. 1	To Discount	200	Jan. 31	By Balance c/d	8,800
Jan. 6	To Bharat	<u>5,000</u>			
		<u>9,000</u>			<u>9,000</u>
Feb. 1	To Balance b/d	8,800			

***Discount Account***

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 4	To Vijay	20	Jan. 1	By Purchases A/c	200
Jan. 31	To Balance c/d	<u>380</u>	Jan. 21	By Anand	<u>200</u>
		<u>400</u>			<u>400</u>
			Feb. 1	By Balance b/d	380

***Bharat***

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 31	To Balance c/d	<u>5,000</u>	Jan. 6	By Purchases A/c	<u>5,000</u>
		<u>5,000</u>			<u>5,000</u>
			Feb. 1	By Balance b/d	5,000

***Plant Account***

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>	₹
Jan. 8	To Mukesh	5,000	Jan. 31	By Balance c/d	5,300
Jan. 8	To Cash A/c	<u>300</u>			
		<u>5,300</u>			<u>5,300</u>
Feb. 1	To Balance b/d	5,300			

**Interest on Loan Account**

<i>Dr.</i>				<i>Cr.</i>			
<i>Date</i>		<i>Particulars</i>	₹	<i>Date</i>		<i>Particulars</i>	₹
Jan. 28	To	Cash A/c	<u>500</u>	Jan. 31	By	Balance c/d	<u>500</u>
			<u>500</u>				<u>500</u>
Feb. 1	To	Balance b/d	500				

**Mukesh**

<i>Dr.</i>			<i>Cr.</i>		
<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
Jan. 31	To    Balance c/d	<u>5,000</u>	Jan. 8	By   Plant A/c	<u>5,000</u>
		<u>5,000</u>			<u>5,000</u>
			Feb. 1	By   Balance b/d	5,000

**Sales Account**

<i>Dr.</i>				<i>Cr.</i>	
<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
Jan. 31	To    Balance c/d	2,100	Jan. 21	By    Rahim	600
			Jan. 18	By    Cash A/c	1,000
		_____	Jan. 31	By    Cash A/c	<u>500</u>
		<u>2,100</u>	Feb. 1	By    Balance b/d	<u>2,100</u>

**Rahim**

<i>Dr.</i>				<i>Cr.</i>	
<i>Date</i>	<i>Particulars</i>	<i>₹</i>	<i>Date</i>	<i>Particulars</i>	<i>₹</i>
Jan. 12	To Sales A/c	600	Jan. 15	By Cash A/c	300
		—	Jan. 15	By Bad Debts A/c	<u>300</u>
		600			600

**Bad Debts Account**

<i>Dr.</i>				<i>Cr.</i>			
<i>Date</i>	<i>Particulars</i>		<i>₹</i>	<i>Date</i>	<i>Particulars</i>		<i>₹</i>
Jan. 15	To	Rahim	<u>300</u>	Jan. 31	By	Balance c/d	<u>300</u>
			<u>300</u>				<u>300</u>
Feb.1	To	Balance b/d	300				



***Salary Account***

<i>Dr.</i>			<i>Cr.</i>			
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>		₹
Jan. 20	To Cash A/c	<u>2,000</u>	Jan. 31	By Balance b/d		<u>2,000</u>
		<u>2,000</u>				<u>2,000</u>
Feb. 1	To Balance b/d	2,000				

***Drawings Account***

<i>Dr.</i>			<i>Cr.</i>			
<i>Date</i>	<i>Particulars</i>	₹	<i>Date</i>	<i>Particulars</i>		₹
Jan. 31	To Purchases A/c	<u>200</u>	Jan. 31	By Balance c/d		<u>200</u>
		<u>200</u>				<u>200</u>
Feb. 1	To Balance b/d	200				

## UNDERSTANDING THE TRIAL BALANCE

---

2.1 After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the Trial Balance. It may also be prepared by listing each and every account and entering in separate columns the totals of the debit and credit sides. Whichever way is prepared, the totals of the two columns should agree. An agreement indicates reasonable accuracy of the accounting work. If the two sides do not agree, then this is simply an arithmetic error(s).

This follows from the fact that under the Double Entry System, the amount written on the debit sides of various accounts is always equal to the amounts entered on the credit sides of other accounts and *vice versa*. Hence, the totals of the Debit Balance (debit sides) must be equal to the totals of the Credit Balance (credit sides). Once this agreement is established, there is reasonable confidence that the accounting work is free from clerical errors, though is not proof of cent percent accuracy, because some errors of principle and compensating errors may still remain.

### OBJECTIVES OF PREPARING THE TRIAL BALANCE

2.2 The preparation of trial balance has the following objectives:

- (i) This trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish arithmetical accuracy of the books.
- (ii) Financial statements are normally prepared on the basis of agreed trial balance, otherwise the work may be cumbersome. Preparation of financial statements, therefore, is the second objective.

- (iii) The trial balance serves as a summary of what is contained in the ledger. The ledger may have to be seen only when details are required in respect of an account.

### EXTRACTING BALANCES AND PREPARATION

2.3 Once the Journal entries are posted to the respective accounts there would be debit or credit balances in each account. Arriving at such debit or credit balances is called the process of extracting balances. These balances will constitute the trial balance. There are three methods of preparation of trial balance. These are explained below:

#### (i) Total Amount method

Under this method, every ledger account is totaled and that total amount (both of debit side and credit side) is transferred to trial balance. In this method, trial balance can be prepared as soon as ledger account is totaled. Time taken to balance the ledger accounts is saved under this method as balance can be found out in the trial balance itself. The difference of totals of each ledger account is the balance of that particular account. ***This method is not commonly used as it cannot help in the preparation of the financial statements***

#### (ii) Balance method

Under this method, every ledger account is balanced and those balances only are carry forward to the trial balance. This method is used commonly by the accountants and helps in the preparation of the financial statements. Financial statements are prepared on the basis of the balances of the ledger accounts.

#### (iii) Total Amount and Balance method

Under this method, the above two explained methods are combined. Under this method statement of trial balance contains seven columns instead of five columns. This has been explained with the help of the following example:

**Trial Balance of X as at 31.3.2016**

<i>Sl. No.</i>	<i>Heads of Account</i>	<i>L.F.</i>	<i>Debit Balance</i>	<i>Credit Balance</i>	<i>Debit Total</i>	<i>Credit Total</i>
			(₹ )	(₹ )	(₹ )	
1.	Cash Account		7,500		35,500	28,000
2.	Furniture Account		3,000		3,000	
3.	Salaries Account		2,500		2,500	
4.	Shyam's Account			3,500	21,500	25,000
5.	Purchases Account		26,000		26,000	
6.	Purchase Returns Account			500		500
7.	Ram's Account		4,900		30,000	25,100
8.	Sales Account			30,500		30,500
9.	Sale Returns Account		100		100	
10.	Capital Account			9,500	500	10,000
	Total		44,000	44,000	1,19,100	1,19,100

**OPENING TRIAL BALANCE AND CLOSING TRIAL BALANCE**

2.4 Opening trial balance is nothing but the closing trial balance of the previous financial year. After entering the transactions that have taken place during the year, into the respective accounts in the ledger, the balances are extracted. After this entries are passed in the Journal for rectifying errors, for providing for outstanding liabilities, for providing accrued income etc., and these entries are posted in the respective ledger accounts. Then the final balances are extracted which will form the base for the preparation of the closing trial balance.

**COMPARISON OF OPENING LEDGER BALANCES WITH THE CLOSING TRIAL BALANCE OF THE PREVIOUS YEAR**

2.5 One of the important responsibilities of an auditor is to compare the opening balances in the ledger with the closing trial balance of the previous year. This will ensure that the outstanding expenses, accrued

income and other provisions relating to the last year are correctly reflected in the current year's ledger.

### GROSS TRIAL BALANCE AND NET TRIAL BALANCE

2.6 Please refer to para no. 2.3 where reference has been made to total and net balances method for preparing the trial balance. Even though this method is more detailed, it will provide a better insight into the nature and extend of operations in an account.

### QUARTERLY TRIAL BALANCE BY LISTED COMPANIES

2.7 Nowadays listed companies are required to publish quarterly results in respect of their operations. A detailed comparison is also made between the current quarterly figures and the corresponding quarterly figure of the previous financial year. This information would be quite useful to the auditor.

### CASE STUDY- 1-BALANCE METHOD

2.8 Given below is a ledger extract relating to the business of X and Co. as on March, 31, 2016. You are required to prepare the Trial Balance by the Balance Amount Method.

#### Cash Account Ledger

<i>Dr</i>		<i>Cr.</i>	
<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Capital A/c	10,000	By Furniture A/c	3,000
To Ram's A/c	25,000	By Salaries A/c)	2,500
To Cash Sales	500	By Shyam's A/c	21,000
		By Cash Purchases	1,000
		By Capital A/c	500
		By Balance c/d	<u>7,500</u>
	<u>35,500</u>		<u>35,500</u>

***Furniture Account***

<i>Dr</i>		<i>Cr.</i>	
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Cash A/c	<u>3,000</u>	By Balance c/d	<u>3,000</u>
	<u>3,000</u>		<u>3,000</u>

***Salaries Account***

<i>Dr</i>		<i>Cr.</i>	
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Cash A/c	<u>2,500</u>	By Balance c/d	<u>2,500</u>
	<u>2,500</u>		<u>2,500</u>

***Shyam's Account***

<i>Dr</i>			<i>Cr.</i>	
<i>Particulars</i>		₹	<i>Particulars</i>	₹
To Cash A/c		21,000	By Purchases A/c (Credit Purchases)	25,000
To Purchase Returns A/c		500		
To Balance c/d		<u>3,500</u>		
		<u>25,000</u>		<u>25,000</u>

***Purchases Account***

<i>Dr</i>			<i>Cr.</i>	
<i>Particulars</i>		₹	<i>Particulars</i>	₹
To Cash A/c (Cash Purchases)		1,000	By Balance c/d	26,000
To Sundries as per Purchases Book (Credit Purchases)		<u>25,000</u>		
		<u>26,000</u>		<u>26,000</u>

***Purchases Returns Account***

<i>Dr</i>		<i>Cr.</i>	
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Balance c/d	500	By Sundries as per	
—		Purchases Return Book	<u>500</u>
	<u>500</u>		<u>500</u>

***Ram's Account***

<i>Dr.</i>		<i>Cr.</i>	
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Sales A/c (Credit Sales)	30,000	By Sales Returns A/c	100
		By Cash A/c	25,000
	_____	By Balance c/d	<u>4,900</u>
	<u>30,000</u>		<u>30,000</u>

***Sales Account***

<i>Dr.</i>		<i>Cr.</i>	
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To    Balance c/d	30,500	By    Cash A/c (Cash Sales)	500
		By    Sundries as per Sales Book (Credit sales)	<u>30,000</u>
	<u>30,500</u>		<u>30,500</u>

***Sales Returns Account***

<i>Dr.</i>		<i>Cr.</i>	
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To    Sundries as per Sales Returns Book	<u>100</u> 100	By    Balance c/d	100 — <u>100</u>

**Capital Account**

<i>Dr.</i>		<i>Cr.</i>	
<i>Particulars</i>	<i>₹</i>	<i>Particulars</i>	<i>₹</i>
To Cash A/c	500	By Cash A/c	10,000
To Balance c/d			_____
	<u>9,500</u>		
	<u>10,000</u>		<u>10,000</u>

**Solution:*****Trial Balance of X and Co. as at 31.03.2016***

<i>Sl. No.</i>	<i>Name of Account</i>	<i>Debit Balance</i>	<i>Credit Balance</i>
		<i>₹</i>	<i>₹</i>
1.	Cash A/c	7,500	
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c		3,500
5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	4,900	
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c	_____	<u>9,500</u>
		<u>44,000</u>	<u>44,000</u>

**CASE STUDY 2**

2.9 One of your clients Mr. Singhania has asked you to finalise his accounts for the year ended 31<sup>st</sup> March, 2016. Till date, he himself has recorded the transactions in books of accounts. As a basis for audit, Mr. Singhania furnished you with following statement.

	<i>Dr. Balance</i>	<i>Cr. Balance</i>
Singhania's capital		1,556
Singhania's Drawings	564	
Leasehold premises	750	
Sales		2,750



	<i>Dr. Balance</i>	<i>Cr. Balance</i>
Due from customers		530
Purchases	1,259	
Purchases return	264	
Loan from bank		256
Creditors	528	
Trade expenses	700	
Cash at bank	226	
Bills payable	100	
Salaries and wages	600	
Stock (1.4.2015)		264
Rent and rates	463	
Sales return		98
	5,454	5,454

### TRIAL BALANCE

The closing stock on 31<sup>st</sup> March, 2016 was valued at ₹ 574. Mr. Singhania claims that he has recorded every transaction correctly as the trial balance is tallied. Check the accuracy of the above trial balance.

#### Solution:

#### *Corrected Trial Balance of Mr. Singhania As on 31<sup>st</sup> March, 2016*

<i>Particulars</i>	<i>Dr. Amount ₹</i>	<i>Cr. Amount ₹</i>
Singhanian Capital		1,556
Singhanian's Drawing	564	
Lease of Premises	750	
Sales		2,750
Due from customers	530	
Purchases	1,259	
Purchases returns		264
Loan from Bank		256
Creditors		528
Trade expenses	700	
Cash at Bank	226	

<i>Particulars</i>	<i>Dr. Amount ₹</i>	<i>Cr. Amount ₹</i>
Bills payable		100
Salaries and wages	600	
Stock (1.4.2015)	264	
Rent and rates	463	
Sales return	98	
	5,454	5,454

***Reasons:***

1. Due from customers is an asset, so its balance will be a debit balance.
2. Purchases return account always shows a credit balance because assets go out.
3. Creditor is a liability, so its balance will be a credit balance.
4. Bills payable is a liability, so its balance will be a credit balance
5. Stock (opening) represents assets, so it will have a debit balance.
6. Sales return account always shows a debit balance because assets come in.

## JOURNAL AND FINAL ACCOUNTS

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### IMPORTANCE OF JOURNAL

3.1 We are now familiar with the Journal. We also know that:

- (i) Cash transactions are recorded in the cash book;
- (ii) Credit purchases of goods or materials are recorded in the purchases book;
- (iii) Credit sales of goods are recorded in the sales book;
- (iv) Returns from customers are recorded in the sales returns book; and
- (v) Returns to suppliers are entered in the purchase returns book.

Bill transactions are entered in the Bills Receivable Books or the Bills Payable Books, if these are maintained. Apart from the transactions mentioned above, there are some entries also which have to be recorded. For them the proper place is the Journal. In fact, if there is no special book meant to record a transaction, it is recorded in the Journal (proper). The role of the Journal is thus restricted to the following types of entries:

- (i) **Opening entries:** When books are started for the new year, the opening balances of assets and liabilities are journalised.
- (ii) **Closing entries:** At the end of the year the profit and loss account has to be prepared. For this purpose, the nominal accounts are transferred to this account. This is done through journal entries called *Closing Entries*.
- (iii) **Rectification entries:** If an error has been committed, it is rectified through a Journal Entry.
- (iv) **Transfer entries:** If some amount is to be transferred from one account to another, the transfer will be made through a journal entry.

- (v) **Adjusting entries:** At the end of the year the amount of expenses or income may have to be adjusted for amounts received in advance or for amounts not yet settled in cash. Such an adjustment is also made through journal entries. Usually, the entries pertain to the following:
- (a) *Outstanding expenses*, i.e., expenses incurred but not yet paid;
  - (b) *Prepared expenses*, i.e., expenses paid in advance for some period in the future;
  - (c) *Interest on capital*, i.e., the interest which the proprietor thinks proper to allow on his investment; and
  - (d) *Depreciation*, i.e., fall in the value of the assets used on account of wear and tear.

For all these, journal entries are necessary.

## PREPARATION OF FINAL ACCOUNTS

3.2 In case of certain entities, the statute governing the entity prescribes the formats for preparation of financial statements, such as, for companies, Schedule III to the Companies Act, 2013, lays down the presentation formats. Similarly, for Banks, Banking Regulations Act, 1949, prescribes the formats for banks. In such cases, the relevant formats shall be followed for preparation of final accounts (financial statements). Accordingly, the discussion in this chapter regarding preparation of final accounts is relevant for entities for which no formats have been prescribed under any statute, such as, Proprietorship Concerns, Partnership firms, etc.

3.3 The principal function of final statements of account (Profit and Loss Account and the Balance Sheet) is to exhibit truly and fairly the profitability and the financial position of the business to which they relate. In order to ensure that these are properly drawn up, it is essential that a proper record of transactions entered into by the business during the period of account should be maintained. The basic principles in regard to accumulation of accounting data are:

- (i) a distinction should be made between capital and revenue, both income and expenditure;

- (ii) also income and expenses relating to a period of account should be separated from those of another period. What is more, different items of income and expenditure should be accumulated under significant heads so as to disclose the sources from which capital has been procured and the nature of liabilities which are outstanding for payment.

Having regard to these basic principles, the various matters to which attention should be paid for determining the different aspects of transactions, a record of which should be kept, and the different heads of account under which various items of income and expenditure should be accumulated, are stated below :

- (a) Since the final statements of account are intended to show the profitability of the business and not that of its proprietors, it is essential that all personal income and expenditure should be separated from business income and expenditure.
- (b) A distinction should be made between capital and revenue, both receipts and expenditure. Different types of income and expenditure should be classified under separate heads. Assets should be included in the Balance Sheet at a valuation arrived at, on the same basis on which these assets are valued in the preceding year. Likewise, a provision for income and expenses which are accrued but not paid should be made by estimation or otherwise on the same basis as in the previous year.
- (c) Every information considered material for judging the profitability of the business or its financial position should be disclosed. For example, when the labour charges have increased on account of bonus having been paid to workmen, the amount of bonus paid should be disclosed. Similarly, if some of the items of stock are not readily saleable, these should be valued at their approximate sale price and the basis of valuation and value of such stocks shown separately.
- (d) Though the record of the transactions should be maintained continuously, at the end of each accounting period (accounting year), the transactions of the period which has closed should be cut off from those of the succeeding period.

- (e) It should be seen that only the effect of transactions which were concluded before the close of period of account has been adjusted in the accounts of the year unless they qualify to be adjusting event in accordance with AS 4, *Contingencies and Events Occurring After the Balance Sheet*. For example, when a sale of goods is to take place only after the goods have been inspected by the purchaser and the inspection had not been made before the close of the year, it would be incorrect to treat the goods as a sale in the accounts of the year.

### INTER-RELATIONSHIP OF THE TWO STATEMENTS

3.4 One of the points to be remembered is that of total expenditure incurred, some appears in the Profit and Loss Account and some in the Balance Sheet. Consider a few examples: of the total amount spent on manufacturing goods, that part which is attributable to finished goods in stock is shown in the Balance Sheet as closing stock and the amount debited to the Trading (or the Profit and Loss) Account is thereby reduced. When a machine is purchased, that part of it which is attributable to the year concerned, as depreciation, is debited to the Profit and Loss Account and the balance is shown in the Balance Sheet as an asset. Next year again, part of the cost will be debited to the Profit and Loss Account and the remaining cost will be shown as an asset in the Balance Sheet. These illustrations show that the two statements, the Profit and Loss Account and the Balance Sheet, are thoroughly inter-related. The assets shown in the Balance Sheet are mostly only the remainder of the expenditure incurred after a suitable amount has been charged to the Profit and Loss or the Trading Account. For preparing the two statements properly, it is of the greatest importance that the amounts to be charged to the Profit and Loss Account should be properly determined; otherwise both statements will show an incorrect position. The principle that governs this is called the *Matching Principle*.

#### ***Matching Principle***

3.5 This principle demands that the expenses incurred to earn the revenue should be properly matched. This means the following:

- (a) If a certain revenue and income is entered in the Profit and Loss Account all the expenses relating to it, whether or not payment has been actually made, should be debited to the Profit and Loss

Account. This is why, at the end of the year an entry is passed, to bring into account, the outstanding expenses. That is also the reason why the opening stock of goods is debited to the Trading Account (or the Profit and Loss Account) since the relevant sale is credited in the same account.

- (b) If some expense has been incurred but against it sale will take place in the next year or income will be received next year, the expense should not be debited to the current year's Profit and Loss Account, but should be carried forward as an asset and shown in the Balance Sheet and debited to the Profit and Loss Account when the relevant income will be also be credited. It is because of this principle that:
- (i) at the end of the year inventory of all the stocks in hand is prepared and is valued at cost. The credit to the Trading Account (or the Profit and Loss Account) has the effect of reducing the debit in the Trading Account to the extent goods remain unsold or unutilised. These will be sold or used up next year and the cost will therefore, be properly debited to the next year's Trading Account. If the net realizable value, i.e., estimated selling price adjusted by the costs to complete the sale, is lower than the cost, stock will be valued at this value and not at cost. This has the effect of raising the net debit in the Trading Account higher than the cost of goods sold or utilised in the year, but that is proper. The net realisable value below cost means that the loss has occurred in the year and therefore, it is appropriate to debit same in current year's Trading and Profit and Loss Account;
  - (ii) at the end of the year prepaid expenses are brought into the books by debiting prepaid expenses account and crediting the expenses concerned. The effect of this is also to transfer the debit in respect of prepaid expenses to the next year when the benefit from such expenses will accrue; and
  - (iii) at the end of the year, appropriate depreciation of fixed assets is charged to the profit and loss account (and credited to the assets concerned). In this manner, that part of the cost of the assets which has been used up for earning

current year's revenue is debited to the Profit and Loss Account.

- (c) If an income or revenue is received in the current year but the work against it has to be done and the cost in respect of it have to be incurred next year, the income or the revenue is next year's. It should be shown in the Balance Sheet on the liabilities side as "*income received in advance*" and should be credited to the Profit and Loss Account of the next year. Firms, except those which follow the cash system (and such firms are usually of specialised personal service nature), do not credit to the Profit and Loss Account that income or revenue against which service is to be rendered in future. Newspapers or magazines usually receive subscriptions in advance for a year. The part of subscription that covers copies to be supplied in the next year is treated as income received in advance.

*An exception:* There appears to be one exception to the rule that only such costs as have yielded or is expected to yield revenue should only be debited to Profit and Loss Account. For example, if a fire has occurred and has damaged the firm's property the loss must be debited to the Profit and Loss Account to the extent it is not covered by insurance. A loss, resulting from the fall of selling price below the cost or from some debts turning bad, must similarly be debited to the Profit and Loss Account. If this is not done the profit will be over-stated.

In this regard, the definition of '*expense*' given in the *Framework for Preparation and Presentation of Financial Statements* issued by the Institute of Chartered Accountants of India as reproduced below may be noted.

*"Expense: are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity<sup>1</sup>, other than those relating to distributions to equity participants<sup>2</sup>."*

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<sup>1</sup>Capital

<sup>2</sup> Owners of the entity



## TRADING ACCOUNT

3.6 At the end of the year, as has been seen above, it is necessary to ascertain the net profit or the net loss. For this purpose, it is first necessary to know the gross profit or gross loss. Gross Profit is the difference between the selling price and the cost of the goods sold. For a trading firm, the cost of goods sold can be ascertained by adjusting the cost of goods still in hand at the end of the year against the purchases. Suppose, in the first year, the net purchases (that is after deducting returns) total ₹1,00,000 and that ₹15,000 worth of goods (at cost) were not sold at the end of the year. The cost of the goods sold will then be ₹85,000. If in the next year purchases are ₹1,50,000 and the cost of goods in hand at the end of the year is ₹20,000 the cost of goods sold will be ₹1,45,000. Thus:

	₹
Cost of the stock of goods in the beginning of the year	15,000
Purchases	1,50,000
	<u>1,65,000</u>
Less: Cost of the stock of goods at the end of the year	<u>20,000</u>
Cost of goods sold	<u>1,45,000</u>

If net sales, i.e., after adjustment for sales returns, total ₹2,00,000 the gross profit will be ₹55,000, i.e., ₹2,00,000 – 1,45,000. The Profit is called gross profit since from it expenses are still to be deducted for knowing the net profit.

Gross profit is usually ascertained by preparing a Trading Account and will appear as:

### *Trading Account for the year ending*

Dr.	₹		Cr.
			₹
To Opening Stock	15,000	By Sales Account	2, 00,000
To Purchase Account	1,50,000	By Stock in hand	20,000
To Gross Profit carried to P & L A/c	55,000		
	<u>2,20,000</u>		<u>2, 20,000</u>

The opening stock and purchases are written on the debit side. Sales and the closing stocks are entered on the credit side. If the credit side is bigger, the difference is written on the debit side as gross profit. This amount will also be written in the Profit and Loss Account on the credit side. In case of gross loss, i.e., when the debit side of the Trading Account exceeds the credit side, the amount will be written on the credit side of the Trading Account and the debit side of the Profit and Loss Account.

### ***Trading Account Items***

- (a) In a trading firm like a wholesaler, the main business consists of buying and selling the same goods. In addition to the amount of the opening stock, the trading account will also be debited with all expenses incurred in bringing the goods to the godown of the firm and in making them ready for sale. For example, freight paid on purchases, cartage, octroi, customs duty etc. will all be debited to the Trading Account. The rule is that this account will be debited with all expenses incurred in bringing the goods to their present location and condition.
- (b) In a manufacturing concern purchases consist of raw materials. All expenses incurred in bringing them to the godown of the manufacturer-customs duty, freight, cartage etc. will be debited to the Trading Account. In addition, all expenses incurred in the factory for purposes of production such as wages, power and fuel, rent of factory premises, will be debited to the Trading Account.

In a manufacturing business, there are usually three types of stock. Stock of raw materials, stock of finished goods and work in progress, that is the cost incurred on units still incomplete. The cost of all these at the end of the year will be credited to the Trading Account as closing stocks.

3.7 We shall now consider individual items:

- (i) ***Opening Stock:*** Since this was closing stock of the last year, it must have been entered in the opening stock account, through the opening entry. Therefore, it will be found in the trial balance. This item is usually put as the first item on the debit side of the Trading Account. Of course, in the first year of a business there will be no opening stock.

- (ii) **Purchases and Purchase Returns:** The purchase account will have debit balance, showing the gross amount of purchases made of the materials. The purchase returns account will have credit balance showing the return of materials to the suppliers. On the debit side of the trading account the net amount is shown as indicated (with assumed figures):

	₹
To Purchases	3, 00,000
Less: Purchase Returns	10,000
	2, 90,000

It happens sometimes that goods are received but the relevant invoice is not received from the supplier. On the date of the closing of the account, an entry must be passed to debit the purchases account and credit the supplier with the cost of goods. One may also exclude such goods from the closing stock and not pass any entry, but this course is not recommended.

- (iii) **Carriage or Freight Inwards:** This item should also be debited to the Trading Account, as it is incurred to bring the materials to the firm's godown and make them available for use. However, if any freight or cartage is paid on any asset, like machinery, it should be added to the cost of the asset and not debited to the Trading Account.
- (iv) **Manufacturing Wages:** Wages paid to workers in the factory, including stores, should be debited to the Trading Account. If any amount is outstanding, it must be brought into books so that full wages for the period concerned are charged to the Trading Account. However, if wages are paid for installation of an asset, it should be added to the cost of the asset.
- (v) **Power and Fuel:** Fuel used for the boiler or electricity consumed to run the machines will be included under this item. The full amount for the period concerned should be debited to the Trading Account. In other words, the outstanding amount should be brought into books.
- (vi) **Factory Lighting:** Electricity consumed for providing light in the factory or to run fans should also be debited to the Trading

Account. If there is a common meter for the office and the factory, the total bill should be suitably apportioned between the two—only the portion relating to the factory will be debited to the Trading Account. The other portion will be debited to the Profit and Loss Account.

- (vii) **Factory Rent and Rates:** The rent paid for the factory premises, as also the municipal taxes (which are called rates) or charges for water etc. should be debited to the Trading Account. If the office and the factory are in the same premises, total rent and rates have to be suitably apportioned.

The items given above may be grouped as: (i) cost of materials consumed; (ii) manufacturing wages; and (iii) other manufacturing expenses.

- (viii) **Sales and Sales Returns:** The sales account will have credit balance indicating the total sales made during the year. The sales return account will have debit balance, showing the total of the amount of goods returned by customers. The net of the two amounts is entered on the credit side of the Trading Account.

Sometimes, invoice for sold goods might have been prepared but not dispatched. If the sale is complete, that is if the customer is liable to pay the amount, such goods should be kept aside and should not be included in the closing stock. If however, the sale is not yet complete say, when sent to customers on approval basis, that is when the customer has the right to return the goods within the stipulated period, the cost of the goods should be included in the closing stock.

- (ix) **Closing Stock and its valuation:** Usually there is no account to show the value of goods lying in the godown at the end of the year. However, to correctly ascertain the gross profit, the closing stock must be properly taken and valued.

The entry is

Stock Account	Dr.
To Trading Account	

It is possible to pass the following entry:

Stock Account	Dr.
To Purchase Account	

The effect of this entry is to reduce the debit in the Purchases Account. The Stock Account is then not entered in the Trading Account. It will then appear in the trial balance.

To ascertain value of the closing stock, it is necessary to make a complete inventory or list of all the items in the godown together with quantities. Of course, damaged or obsolete items are separately listed. Also the list should be separate for finished goods, semi-finished goods (work-in-progress), raw materials and stores. To the list of finished goods, one should also add the goods lying with agents sent to them on consignment basis and also the goods sent on approval to customers.

The valuation principle is cost or net realisable value whichever is lower. In the case of finished goods, the cost will mean the cost of materials, manufacturing wages and manufacturing expenses. This also applies to work-in-progress.

In the Trading Account, the three types of closing stocks are shown separately. Taking stock is quite a lengthy process. Strictly speaking, immediately at the end of the year the taking of stock should be completed. Sometimes however, this is done either a few weeks before or a few weeks after the closing. In such a case the value of the stock thus taken must be adjusted to relate it to the closing date. The adjustment will be necessary because, in the meantime, purchases and sales must have been made. The main point to remember is that in respect of sales, their cost has been established. Cost will be Sales less Gross Profit.

- (x) ***Duty draw back and subsidies:*** Duty draw backs are refund of duties levied on purchases. This is available to the exporters as an incentive. Subsidies in the form of cash assistance are sometimes received from Government on purchases. AS-2 “*Valuation of Inventories*” recommends that such duty draw back and subsidies should be deducted from the cost of purchases in the year in which these are accounted for.

- (xi) **Excise Duty:** Excise duty should be included in the cost of purchases for the purpose on valuation of inventories. However, for a manufacturing concern, if it is entitled to get the benefit of excise paid on purchases under CENVAT Credit Rules it has to show the entries for excise duty in a different manner. In simple terms, the concept of CENVAT is that the credit of duty of Central Excise and additional duty of excise paid on the goods used in or in relation to the manufacture of final product can be utilized towards payment of duty of excise on the final product. Thus, when manufacturing concern purchases raw materials, the cost of raw materials may include some excise duties. The manufacturer uses the material to produce finished product too. Excise duty is leviable on such finished product too. But the manufacturer can deduct the excise duty already paid on purchases of raw materials from the excise duty payable on finished goods and only the difference is to be paid to the Excise authority. In practice, what happens is that a manufacturer deposits with the excise authority from time to time some amounts depending on his requirement and at the end of financial year reconciles the excise duties payable or recoverable. Thus when he purchases the raw materials to produce finished goods, he should deduct the CENVAT credit utilised from the cost of purchases.
- (xii) **Sales Tax/VAT :** Sales Tax/VAT is an indirect tax in the sense that it is collected by the seller from the customers and deposited in Government's Account as per requirements of the Sales Tax Act. Sales tax is generally deducted from gross sales figures and sales tax liability (net of payments) is shown as current liability in the balance sheet.

3.8 The Trading Account is very useful. With its help, the firm can see the relationship between the costs incurred and the revenues earned and also the level of efficiency with which operations have been conducted. The ratio of gross profit to sales is very significant. It is arrived as

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

In the illustration given under Para 3.6, the rate of gross profit is 27.5%. If the rate of gross profit changes substantially in a year compared to that

in a previous year, the reasons leading to the change should be enquired into. If the rate of gross profit has declined, the reasons may have been the following:

- (i) Excess prices have been paid for the purchase of materials or goods.
- (ii) There has been excessive wastage during the process of manufacture or there has been pilferage.
- (iii) Labour efficiency has declined or wage rates have increased without a corresponding increase in productivity.
- (iv) A part of the sale proceeds has been misappropriated or the finished goods have been stolen.
- (v) The closing stock has not been taken properly and some items have been omitted.
- (vi) The closing stock has been undervalued.
- (vii) The closing stock of the last year (that is the opening stock of this year) was overvalued.
- (viii) Some purchases made last year were not entered in the books at that time and have been brought into books only now.
- (ix) Some sales of the current year have not been entered in the books.

If the rate of the gross profit has increased, the reasons will be the reverse of those given above except those relating to theft or misappropriation. If accounting is correct, increase in the rate of the gross profit will show better performance, higher prices for finished goods or lower prices for materials etc.

Closing entries in respect of Trading Account:

3.9 The following entries will be required:

- (i) *For opening stock:* Debit Trading Account and Credit Stock Account.
- (ii) *For purchases returns:* Debit Returns Outward Account and Credit Purchases Account.
- (iii) *For returns inward:* Debit Sales Account and Credit Returns Inwards Account. (In the trading account, information is usually given both in respect of gross sales and purchases and the respective returns).
- (iii) *For purchases account:* Debit Trading Account and Credit Purchases Account, the amount being the net amount after return.
- (iv) *For expenses* to be debited to the Trading Account, for example wages, customs duty etc; Debit Trading Account and credit the concerned expenses accounts individually.
- (v) *For sales:* Debit Sales Account with the net amount after returns, and Credit Trading Account.

We should see that all the accounts mentioned above will be closed with the exception of the Trading Account.

- (vi) *For closing stock:* Debit Stock Account and Credit Trading Account. The Stock Account will be carried forward to the next year.

After making the entries mentioned in (ii) above, the other entries are usually summarized as follows:

- |                                       |     |
|---------------------------------------|-----|
| (1) Trading Account                   | Dr. |
| To Stock (opening) Account            |     |
| To Purchases Account                  |     |
| To Wages Account                      |     |
| To Fuel and Power Account             |     |
| To Factory Rent and Rates Account     |     |
| To Freight on Purchases Account, etc. |     |
| (2) Sales Account                     | Dr. |
| Stock (closing) Account               | Dr. |
| To Trading Account                    |     |





- (e) Packing expenses.
- (f) Freight and carriage on sales.
- (g) Export duties.
- (h) Sales tax/VAT to the extent it cannot be recovered from the customers.
- (i) Maintenance of vehicles for distribution of goods and their running expenses.
- (j) Insurance of finished goods stock and goods in transit.
- (k) Bad debts.

It would be a good idea to either show these expenses in a separate schedule or to indicate the total of these, prominently in the Statement of Profit and Loss. This rule should be followed wherever the number of items is rather large.

- (ii) Administrative expenses include the following;
  - (a) Salaries paid to the people working in the general office, salaries of executive officers should be shown separately.
  - (b) Rent and rates for the office premises.
  - (c) Lighting in the office.
  - (d) Printing and stationery.
  - (e) Postage, telegrams and telephone charges.
  - (f) Legal expenses.
  - (g) Audit fees, etc.
- (iii) Financing expenses normally include interest paid on loan, discount on bills discounted and the discount allowed to customers. It is possible to show only the net amount of interest if it has been both received and paid. It is however, better to show the two figures separately.

3.11 On the income side of the Profit and Loss Account, besides the gross profit, there may be interest received, discount received, rents from subletting of premises, miscellaneous incomes such as from sale of junk material etc, It would be desirable to show the totals only under each of

the main categories of income. However, interest on fixed deposits, interests or income from investments and other interest should be shown separately, similarly, items which have to be debited/credited to the proprietor should be segregated from other items. Examples would be interest charged on drawings, interest allowed on capital and charges for services rendered by the firm to the proprietor personally.

3.12 We shall now consider a few items individually:

- (i) **Drawings:** Drawings are not expenses for the firm and should therefore not be debited to the Profit and Loss Account. If the proprietor has enjoyed some benefit personally, like use of the firm's car, a suitable amount should be treated as drawing and to that extent, the charge to the Profit and Loss Account will be reduced. Drawings are debited to the proprietor's capital account.
- (ii) **Income Tax:** In case of companies, the income tax payable is treated like other expenses. But in the case of sole proprietorship, income tax is treated as a personal expense. It is debited to the Capital Account and not to the Profit and Loss Account. This is because the amount of the tax will depend on the total income of the partners or proprietor besides the profit of the firm. In case of partnership business, firm's tax liability is to be debited to profit and loss account of the firm but partners' tax liabilities are not to be borne by the firm. Therefore, if the firm pays income tax on behalf of partners, such payment of personal income tax should be treated as drawings.
- (iii) **Discount Received and Allowed:** We have already seen that discount is of two types: Trade discount and Cash Discount. Trade discount is allowed when the order for goods is not below a certain figure. It is deducted from the invoice. Only the net amount of invoice is entered in books. There is no further treatment of the trade discount. Cash discount is allowed to a customer if he makes the payment before a certain date. It is allowance made to him for prompt payment. Discount received is really in the nature of interest received and similarly, discount allowed really means interest paid. Discount received is a gain and is credited to the Profit and Loss Account. Discount allowed is debited to this account.

There is another term – Rebate. It is the allowance given to a customer when his purchases during a period, say one year, total up to a certain figure. Suppose a firm allows a rebate of 4% to those customers whose purchases during the year are at least ₹5,000. One Customer's purchases are ₹4,500, he will not get any rebate. Another customer's purchases total ₹5,100, he will get a rebate of ₹204. The entry for rebate is made only at the end of the year. The Rebate is adjusted from sales. Various customers who have earned the rebate are credited.

- (iv) **Bad Debts:** When a customer does not pay the amount due from him and all hopes of recovering the amount are lost, it is said to be a bad debt. It is a loss to the firm. Therefore, the bad debts account is debited, which is later on written in the Profit and Loss Account on the debit side. Since it is no use showing the amount due still as an asset, the account of the customer concerned is closed by being credited. The entry:

Bad Debts Account	Dr.
To Debtor's (by name) Account	

If later on, the amount is recovered, it should be treated as a gain. It should not be credited to the party paying it. It should be credited to Bad Debts Recovered Account. It will be entered in the Profit and Loss Account on the credit side.

- (v) **Closing entries:** The entries that have to be made in the Journal for preparing the Trading and the Profit and Loss Account, that is for transferring the various accounts to these two accounts, are known as closing entries. We have already seen the entries required for preparing the Trading Account and for transferring the Gross Profit to the Profit and Loss Account. Now to complete the Profit and Loss Account, the undermentioned three entries will be necessary.
- (a) For items to be debited to the Profit and Loss Account this account will be debited and the various accounts concerned will be credited. For example, salaries account, rent account and interest account will be credited to the debit of Profit and Loss Account.

- Profit and Loss Account                      Dr.  
To Capital Account

Capital Account	Dr.
Profit and Loss Account	

- (a) Expenses accrued and accruing, e.g., Rent, Interest, Local Taxes, Wages etc.

Appropriate Expense Account                      Dr.  
To Expenses Accrued Account

- Interest/Fees etc. Accruing Account      Dr.  
To Appropriate Income Account

The expression '*accrued and accruing*' signifies items which though not due for payment but pertain to the period of account, a provision for which has been made. Converse is the position so far as items of income are concerned.

Carrying forward income received in advance e.g., Subscription in the case of a club or fees in case of professional person.

To Income Received in Advance Account

To Appropriate Expenses Account

To Appropriate Expenses Account

(g) Provision for bad and doubtful debts: When it is feared that some of the amount due from customers will not be collected it is prudent to recognize the expected loss by reducing the current year's profit and placing the amount to the credit of a special account called "Provision for Bad and Doubtful Debts Account". The entry is:

Profit and Loss Account

Dr.

To Provision for Bad and doubtful Debts Account

**Note:** The accounts of the customers concerned are not affected until the amount is actually written off for which the entry is,

Bad Debts Account

Dr.

To Customer's A/c

Bad Debts when written off are debited to the provision in this respect where such a provision exists or directly to the Profit and Loss Account the corresponding credit being given (ultimately) to the debtor's account. If, on the other hand, a provision is required to be created, the amount of provision is also debited to the Profit and Loss Account. Where an examination problem requires that certain bad debts should be written off and a provision for doubtful debts made, the amount of bad debts to be written off should be first debited against the existing balance of the provision and the resulting balance in the account afterwards should be raised to the required figure.

3.13 Some service organizations, in place of Profit & Loss Account, prefer to prepare Income and Expenditure Account. The income and expenditure account is equivalent to the Profit and Loss Account and is prepared by following accrual principle. Only items of revenue nature pertaining to the period of account are included therein. The preparation of the account, therefore, requires adjustment in relevant accounts of outstanding items of income and expenditure as also exclusion of amounts paid in advance before these are included in Income and Expenditure Account. In so far as this, it resembles a Profit & Loss Account and serves the same function in respect of a service organization as the later account does for a firm, carrying on business or trade.

#### **FEATURES OF INCOME AND EXPENDITURE ACCOUNTS ARE:**

- It is a revenue account prepared at the end of the financial period for finding out the surplus or deficit of that period.

- It is prepared by matching expenses against the revenue of that period concerned.
- Both cash and non-cash items, such as depreciation, are taken into consideration.
- All capital expenditures and incomes are excluded.
- Only current years' income and expenses are considered.

### BALANCE SHEET

3.14 In the illustration worked out above it will be seen that the under mentioned accounts have not been closed even after preparation of the Profit and Loss Account and the transfer of the net profit to the capital account.

	₹	
Cash in Hand	400	Debit balance
Cash at Bank	1,000	Debit balance
Capital Accounts	16,300	Credit balance
Machinery Account	6,000	Debit balance
Furniture and Fittings Account	1,360	Debit balance
Sundry Debtors	8,500	Debit balance
Sundry Creditors	3,700	Credit balance
Stock Account	2,700	Debit balance

Looking at these accounts, one would know that various assets: *Cash in hand, cash at bank, machinery, furniture etc.* that the firm possesses and the amounts that are owing as liability to *Sundry Creditors* and to the *proprietor as capital*. The capital, of course, will be the difference between the total of assets and of liabilities. The assets and liabilities and capital are usually presented in a statement called the Balance Sheet. This is given below for the accounts mentioned above.



**C. WANCHOO**  
**Balance Sheet as at December 31, 2015**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Sundry Creditors	3,700	Cash in Hand	440
Capital	16,300	Cash at Bank	1,000
		Sundry Debtors	8,500
		Stock	2,700
		Machinery	6,000
		Furniture and Fittings	1,360
	<b>20,000</b>		<b>20,000</b>

The assets are shown on the right hand side and liabilities and capital on the left hand side.

3.15 The balance sheet may be defined as “*a statement which sets out the assets and liabilities of a firm or an institution as at a certain date.*” Since even a single transaction will make a difference to some of the assets or liabilities, the balance sheet is true only at a particular point of time. That is the significance of the word “as at.”

3.16 The balance sheet has certain characteristics, which should be noted. These are the following:

- (i) It is prepared at a particular date, rather the close of a day and not for a period. It is true only on that date and not later. Suppose, in the example given above, a part of the goods were sold on 1st January, 2015. This will mean that the value of the stock will be reduced, the cash in hand will increase and the capital account will be reduced.
- (ii) The balance sheet is prepared only after the preparation of the Profit and Loss Account. This is the reason why the Profit and Loss Account (including the Trading Account) and the Balance Sheet are together called Final Accounts (Of course, the Balance Sheet is not an account, the two sides are not the debit and the credit sides.) Without being accompanied by the Profit and Loss Account, the Balance Sheet will not be able to throw adequate light on the financial position of the firm. For that purpose an appreciation of the profits of the firm is necessary.

- (iii) Since capital always equals the difference between assets and liabilities and since the capital account will independently arrive at this figure, the two sides of the Balance Sheet must have the same totals. If it is not so, there is certainly an error somewhere.

### ***Arrangements of Assets and Liabilities***

- (1) **Assets:** Assets may be grouped in one of the following two ways:
- (i) **Liquidity:** Under this approach the asset, which can be converted into cash first, is presented first. Those assets which are most difficult in this respect are presented at the bottom.
  - (ii) **Permanence:** Assets which are to be used for long term in the business and are not meant to be sold are presented first. Assets which are most liquid, such as cash in hand, are presented at the bottom.

The various assets in order will be as follows:

#### ***In the order of Liquidity***

Cash in Hand  
Cash at Bank  
Investments  
Sundry Debtors  
Stock of Finished Goods  
Stock of Raw Materials  
Partly Finished goods  
Machinery  
Furniture  
Patents  
Goodwill

#### ***In the order of Permanence***

Goodwill  
Patents  
Furniture  
Machinery  
Stock of Partly Finished goods  
Stock of Raw Materials  
Stock of Finished goods  
Sundry Debtors  
Investments  
Cash at Bank  
Cash in Hand

Some of the assets may be capable of being sold easily like investment in government securities or shares of some companies. They should be treated as liquid or permanent according to the intention of the firm. One

should also note that the order in which the assets of a company are to be shown is as prescribed by the Companies Act.

(2) **Liabilities:** Liabilities may also be shown according to the urgency with which payment has to be made. One way is to first show the capital, then long-term liabilities and last of all short term liabilities like amounts due to suppliers of goods or bills payable. The other way is to start with short term liabilities and then show long term liabilities and last of all capital.

(3) **Classification of Assets and Liabilities:** Assets are basically of two types. Those that are meant to be used by the firm over a long period and not sold and those that are meant to be converted into cash as quickly as possible. Examples of the latter are book debts, stocks of finished goods and materials, etc. The latter type of assets is called current assets. These include cash also. The former type of assets is called non-current assets. It is desirable that in the balance sheet the two types of assets should be shown separately and prominently. This would give meaningful and logical information.

The liabilities to outsiders will be of two types. Those that must be settled within one year and those that will be paid after one year. The former type of liability is called current or short term liability. The latter type is non-current liability. Of course, it will include undistributed profits also.

## PROVISIONS AND RESERVES

3.17 *Provision* means “any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy”.

Thus a provision may be either in respect of loss in the value of an asset provided or written off on the basis of an estimate or the one in respect of a liability for expenses incurred in respect of a claim which is disputed i.e., when it is a contingent liability. On the occurrence of a diminution in asset values due to some of them having become irrecoverable or stock items are lost as a result of some natural calamity, amounts contributed or transferred from profit to make good the diminution also are described as provision.

The following are instances of amount retained in the business out of earning for different purposes that are described as provisions.

- (1) Amount provided for meeting claims which are admissible in principle but the amount whereof has not been ascertained.
- (2) An appropriation made for payment of taxes still to be assessed.
- (3) Amount set aside for writing off bad debts or payment of discounts.

3.18 Reserve is defined as the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability.

Also provisions in excess of the amount considered necessary for the purposes these were originally made, are to be considered as reserves. It is thus evident that provisions are a charge against profits, while reserve is an appropriation of profits. Also provisions that ultimately prove to be in excess of amounts required or have been made too liberally are reserves. Such a distinction is essential for truly disclosing in the Balance Sheet, the amount by which the equity of shareholders has increased with the accumulation of undistributed profits.

3.19 *Reserve Fund*: It signifies the amount standing to the credit of the reserve that is invested outside the business in securities which are readily realisable e.g., when the amounts set apart for replacement of an asset are invested periodically, in government securities or shares. The account to which these amounts are annually credited is described as the Reserve Fund.

### **LIMITATIONS OF FINANCIAL STATEMENTS**

3.20 Financial statements suffer from a number of limitations. These must, therefore be studied with care, in order that correct inferences may be drawn. The limitations are less serious if the objective is only to appraise the performance of a single company over a period of years. Where, however, a comparison of the working of different companies for the same period is to be made. It can be misleading unless the companies concerned have followed the same system and basis of accounting. On the account, a comparison of the profitability of different industries on the basis of financial statements should be undertaken only if it is not practicable to make such a comparison on any other basis.

The principal limitations affecting financial statements are the following:

- (a) **Historical Cost:** Accounting records and, on that account, the financial statements are prepared only on the basis of the money value prevailing at the time the transactions were entered into. Thus, the effect of subsequent changes in the value of money is not taken into account. At times this has the effect of making the statements of account quite misleading. Take the obvious example of a house built in 1945, say at the cost of ₹15,000, in 2000 the benefit receivable from its occupation will be as much as that of a house created in 2000, say at a cost of ₹4, 50,000. If the house is included in the financial statements at its original cost, as normally it would not convey a true picture except to a knowledgeable person.

The limitations can be serious in the case of other fixed assets that have been working over a long period over which prices have changed radically. It is, however, not easy to get over this difficulty, since revaluation of fixed assets, apart from being costly is not practicable when the value of money is continuously falling. On this account, historical cost continues to be the accepted basis for the preparation of financial statements.

- (b) **Intangible Strengths and Weaknesses:** A company may have a number of strengths and weaknesses which cannot be shown in the balance sheet e.g., the quality and caliber of its staff. These must be kept in mind while judging the financial position of the company.
- (c) **Different Accounting Policies:** It is permissible for a company within certain limits to adopt different policies for the preparation of accounts-valuation of various assets and distribution of expenditure over different periods of account. For example, a company may decide to depreciate an asset on straight line basis or written down value basis

Whatever basis of accounting is decided upon the same must be followed consistently, from year to year. Whenever it is departed from, the effect of it would have the effect of obscuring the profit of the year in which the change in the basis of accounting is made.

However, through issuance of Accounting Standards on various subjects efforts are being made to harmonise the accounting policies being followed.

- (d) **Management Policies:** There is general impression that each undertaking endeavors to earn as much profit as it can. This is not wholly correct. The management often attempts not to allow its profit to rise above a level that it consider appropriate, in the circumstances it is functioning, due to a variety of reasons. This may be:
- (i) Disinclination to undertake new risks and responsibilities on account of high rates of taxation;
  - (ii) Fear of the odium of profiteering a bad reputation that prices charged by the concern for its goods are not reasonable;
  - (iii) Fear that larger profits may give rise to demand for higher wages which may throw the costs and prices relationship out of gear or impression may gain ground that there has been an increased workload on the workers which may lead to discontentment amongst them;
  - (iv) Fear that the concern may be considered to have developed monopolistic tendencies;
  - (v) Consideration to maintain efficiency; and
  - (vi) Unwillingness to expand, unduly on account of uncertainty of the future.

3.21 To conclude, on these considerations. Financial statements need to be studied with great care. The information disclosed by them has to be judged in the light of the economic change, such as inflationary condition over the short period, as well as, over the long period (like one witnessed in India after 1971) and the nature of management and its basic motives. Despite the limitations, the financial statements, verified by independent auditors, often are the only tangible evidence available as regards the profitability and the financial position of the company. Their importance, therefore, cannot be under-estimated. If properly analyzed, they are capable of yielding a flood of information.

**CASE STUDY**

3.22 From the following trial balance of a manufacturing concern prepare the Manufacturing Account, Profit & Loss Account and Balance Sheet:

**Arvind Textiles**  
**Trial Balance as at 31<sup>st</sup> March 2016**

<i>Particulars</i>		<i>Dr.</i>	<i>Cr.</i>
	<i>Liabilities:</i>		
1.	Capital		10,00,000
2.	Capital Reserve Account		6,50,000
3.	Profit and Loss Account		12,60,000
4.	Term Loan from SBI		25,00,000
5.	Cash Credit from SBI		2,50,000
6.	Secured Loan from PNB		15,00,000
7.	Sundry Creditors		1,50,000
8.	Deposits from customers		15,00,000
9.	<i>Fixed Assets:</i>		
10.	Goodwill	3,87,000	
11.	Land	94,00,000	
12.	Plant and Machinery	8,00,000	
	<i>Investments:</i>		
13.	Shares in X Ltd.	70,500	
	<i>Current Assets:</i>		
14.	Sundry Debtors	1,22,000	
15.	Current a/c with SBI	48,000	
16.	Stock in trade (opening stock)	2,50,000	
17.	Advances to suppliers	1,25,000	
18.	Cash in hand	7,55,000	
	<i>Expenses:</i>		
19.	Purchases	51,85,000	

<i>Particulars</i>		<i>Dr.</i>	<i>Cr.</i>
20.	Purchases returns		22,000
21.	Wages	15,000	
22.	Electricity expenses	2,12,000	
23.	Packaging expenses	1,53,000	
24.	Advertising and Publicity	15,50,000	
25.	Warranty charges	19,600	
26.	Marketing expenses	1,86,000	
27.	Sales promotion expenses	82,000	
28.	Servicing expenses	25,200	
29.	Commission	1,21,000	
30.	Freight	35,000	
31.	Discounts	22,000	
32.	Installation and Commissioning expenses	58,000	
33.	Telephone expenses	31,000	
34.	Central excise	22,000	
35.	Sales tax	32,000	
36.	Octroi	15,000	
37.	Interest on loans	5,20,000	
38.	Charity expenses	1,500	
39.	Salaries	1,85,000	
40.	Refreshments	25,200	
41.	Training expenses	12,000	
42.	Rent for the godown	35,000	
43.	Interest on deposits	25,000	
44.	Insurance	35,000	
45.	Outward handling	23,000	
46.	Rent for returnable containers	1,35,000	
47.	Processing charges	22,000	
48.	Travelling expenses	72,000	



<i>Particulars</i>		<i>Dr.</i>	<i>Cr.</i>
	<i>Income:</i>		
49.	Sales		112,67,000
50.	Sales returns	2,50,000	
51.	Commission received		7,50,000
52.	Rent from property		1,20,000
53.	Discount received		53,000
54.	Miscellaneous Income		18,000
55.	Interest on advances		22,000
	<b>TOTAL</b>	<b>210,62,000</b>	<b>210,62,000</b>

*Closing Stock as on 31.03.2016 was ₹25,48,500*

*Provide for the following:*

Outstanding salaries	55,000
Provision for bad debts	12,000

**Solution:**

**Arvind Textiles**  
***Manufacturing Account for the year ending 31.03.16***

<i>Particulars</i>		<i>Amount</i> ₹	<i>Particulars</i>		<i>Amount</i> ₹
To opening Stock		2,50,000	By sales	112,67,000	
To purchases	51,85,000		Less: Returns	<u>2,50,000</u>	110,17,000
Less: Returns	<u>22,000</u>	51,63,000	By Closing Stock		25,48,500
To wages		15,000			
To electricity		2,12,000			
To Gross Profit c/d		<b>79,25,500</b>			
		<b>135,65,500</b>			<b>135,65,500</b>
To Salaries	1,85,000		By Gross profit b/d		79,25,500
<i>Add:</i>					
Outstanding	55,000	2,40,000			

<i>Particulars</i>		<i>Amount</i> ₹	<i>Particulars</i>		<i>Amount</i> ₹
To Outward handling		23,000	By Commission received		7,50,000
To Telephone expenses		31,000	By Rent from property		1,20,000
To Interest on loans		5,20,000	By discount received		53,000
To Charity expenses		1,500	By misc. income		18,000
To Packing expenses		1,53,000	By interest on advances		22,000
To advertising and publicity		15,50,000			
To warranty charges		19,600			
To Marketing expenses		1,86,000			
To Sales Promotion		82,000			
To Servicing expenses		25,200			
To Commission		1,21,000			
To Freight		35,000			
To Discounts		22,000			
To Installation and commissioning		58,000			
To Central excise		22,000			
To Sales tax		32,000			
To Octroi		15,000			
To refreshments		25,200			
To Training expenses		12,000			

<i>Particulars</i>		<i>Amount</i> ₹	<i>Particulars</i>		<i>Amount</i> ₹
To Rent for godown		35,000			
To Interest on deposits		25,000			
To insurance		35,000			
To rent for returnable containers		1,35,000			
To processing charges		22,000			
To travelling expenses		72,000			
To provision for bad debts		12,000			
To net profit		53,79,000			
Total		<b>88,88,500</b>			<b>88,88,500</b>

**Arvind Textiles**  
**Balance Sheet as on 31.3.16**

<i>Particulars</i>		<i>Amount</i> ₹	<i>Particulars</i>		<i>Amount</i> ₹
Capital		10,00,000	Goodwill		3,87,000
			Land		94,00,000
			Plant and machinery		8,00,000
Profit and loss account	12,60,000		Shares in X Ltd.		70,500
Add: profit for the year	53,79,000	66,39,000	Sundry debtors	1,22,000	
Capital Reserve account		6,50,000	Less: provision for bad debts	<u>12,000</u>	1,10,000

<i>Particulars</i>		<i>Amount</i> ₹	<i>Particulars</i>		<i>Amount</i> ₹
Term Loan from SBI		25,00,000			
Cash credit from SBI		2,50,000	Current a/c with SBI		48,000
Secured loan from PNB		15,00,000	Stock in trade		25,48,500
Sundry creditors		1,50,000	Cash in hand		7,55,000
Deposits from customers		15,00,000	Advances to suppliers		1,25,000
Outstanding salaries		55,000			
Total		142,44,000			142,44,000

## CASE STUDY 2

3.23 From the following trial balance of a service concern prepare the Income and Expenditure and Balance Sheet:

**ABC Courier Company**  
**Trial Balance as at 31<sup>st</sup> March 2016**

<i>Particulars</i>	<i>Dr.</i>	<i>Cr.</i>
<i>Liabilities:</i>		
Capital		1,285,000
Secured Loan from PNB		404,750
Sundry Creditors		226,445
<i>Fixed Assets:</i>		
Land	1,021,575	
Office Equipments	413,500	
<i>Current Assets:</i>		
Sundry Debtors	347,155	
Current A/c with SBI	99,175	

<i>Particulars</i>	<i>Dr.</i>	<i>Cr.</i>
Cash in hand	82,015	
National Saving Certificate	165,000	
<i>Expenses:</i>		
Salary	786,167	
Electricity expenses	544,269	
Handling and Clearing Charges	181,423	
Contribution to provident and other funds	102,986	
Printing, Stationary and Consumables	51,900	
Staff Welfare Expenses	72,720	
Office Expenses	133,044	
Communication Expenses	99,294	
Repair and maintenance- others	71,143	
Insurance	78,480	
Domestic Network operating cost	151,186	
Interest on Secured Loan	44,523	
Bad Debt	6,075	
<i>Income:</i>		
Service Charges		2,418,975
Interest Income		9,900
Rent from property		78,560
Miscellaneous Income		28,000
<b>TOTAL</b>	<b>4,451,630</b>	<b>4,451,630</b>

*Provide for the following:*

Outstanding salaries	67,000
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**ABC Courier Company**  
***Income and Expenditure Account for the year ending 31.03.16***

<i>Particulars</i>	<i>Amount</i> ₹	<i>Particulars</i>	<i>Amount</i> ₹
To Salary 786,167		By Service Charges 2,418,975	
Add <i>Outstanding Salary</i> 67,000	853,167	By Interest Income 9,900	
To Contribution to provident and other funds 102,986		By Rent from Property 78,560	
To Staff Welfare Expenses 72,720		By Misc. Income 28,000	
To Electricity expenses 544,269			
To Handling and Clearing Charges 181,423			
To Printing, Stationary and Consumables 51,900			
To Office Expenses 133,044			
To Bad Debt 6,075			
To Communication Expenses 99,294			
To Repair and maintenance-others 71,143			
Insurance 78,480			
To Domestic Network operating cost 151,186			
To Interest on Secured Loan 44,523			
To Depreciation on Office Equipments 62,025			
To Surplus 83,200			
<b>Total</b>	<b>2,535,435</b>		<b>2,535,435</b>

**ABC Courier Company**  
**Balance Sheet as on 31.3.2016**

<i>Particulars</i>		<i>Amount</i> ₹	<i>Particulars</i>		<i>Amount</i> ₹
Capital	1,285,000		Land		1,021,575
Add Surplus	83,200	1,368,200	Office Equipments	413,500	
			Less Depreciation	62,025	351,475
			Sundry Debtors		347,155
Secured Loan from PNB		404,750	Current A/c with SBI		99,175
Sundry Creditors		226,445	Cash in hand		82,015
Outstanding Salary		67,000	National Saving Certificate		165,000
Total		2,066,395			2,066,395

## **ANALYSIS OF REVISED SCHEDULE VI - TOWARDS BETTER PRESENTATION**

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4.1 With the emergence of multinational corporations and rapid increase in cross border transactions, it is essential that our financial statements speak the global language for attracting foreign funds into India. Internationally, the observance of universally accepted reporting norms is perceived as an important measure of good corporate governance, ensuring financial transparency to the stakeholders of the company. The transparency in financial statements of a company has a significant bearing on the decision of a stakeholder to invest, as well as the quantum of his investment.

4.2 The classification under the old Schedule VI was, however, not in line with the international practices followed by many developed countries, making investors reluctant to invest in the Indian companies. The Indian companies were required to prepare another set of financial statements to make foreign investors understand the performance and position of their companies, which not only resulted in higher costs, but also consumed considerable time and effort.

4.3 With India moving towards Convergence to International Financial Reporting Standards (IFRS), there was an urgent call to revise the old Schedule VI, as it was not compatible to meet either the disclosure requirements or the provisions of the upcoming accounting standards. Though the revised Schedule VI has been framed as per the existing non-converged Indian Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006 and has nothing to do with the converged Indian Accounting Standards, it has taken into consideration the classification accepted internationally.



4.4 The Companies Act, 1956 was replaced by Companies Act, 2013 in totality with effect from 1<sup>st</sup> April, 2014. As a result Schedule VI was renumbered as Schedule III as per Companies Act, 2013. The contents of revised schedule VI and the new Schedule III are the same. Hence where there is a mention of revised Schedule VI, it should be considered as Schedule III (2013) under new Act.

4.5 In this chapter, an attempt has been made to throw some light on the need for revision of old schedule VI, salient features of the revised Schedule III( 2013) and the issues which may initially arise while preparing financial statements as per revised Schedule VI or Schedule III (2013). The aim of this chapter is just to give an outline on the topic in order to make you aware of this recent amendment in the Companies Act.

## **OLD SCHEDULE VI: DRAWBACKS NECESSITATING REVISION**

### **Classification in old Schedule VI not in line with the disclosure requirements under Accounting Standards (AS)**

4.6 After introduction of Accounting Standards on *Leases, Consolidated Financial Statements, Accounting for Taxes, Discontinuing Operations, Impairments of Assets, Provisions* etc., the disclosure requirements of old Schedule VI on the face of balance sheet were felt to be insufficient.

4.7 Further, appropriate heads, under which disclosures prescribed in the accounting standards have to be made, were missing in the Balance Sheet under old Schedule VI. For instance, Accounting Standard 22 requires that deferred tax assets (DTA) and deferred tax liabilities (DTL) should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. In other words, as per AS 22, DTA and DTL have to be disclosed under the heading “non-current assets” or “non-current liabilities”, for which classification was not provided for in the *Old Schedule VI*.

### **No Place for Industry Specific Requirements**

4.8 Old Schedule VI, had a fixed format in which every industry has to present its financial statements. However, the industry specific requirements could not always fit into such format. The old Schedule VI did not address such problems which made it difficult for a preparer of

financial statements to identify the appropriate head for their industry specific items.

### **No Specific Format for Profit and Loss Account**

4.9 One of the shortcomings of old Schedule VI was that it did not contain any specific format for Profit and Loss Account as it had for the Balance Sheet, though the requirements for preparing profit and loss account were detailed in Part II of Schedule VI. However, it was felt that a specific format for presentation of the profit and loss account would have conveyed a clear cut picture to the preparers of financial statements.

### **Measurement Principles under Schedule VI not in Line with Accounting Standards**

4.10 Apart from the disclosure requirements, even the measurement principles as per old Schedule VI were different from what was given in the accounting standards. For instance, AS 11, The Effects of Changes in Foreign Exchange Rates, requires that any exchange difference in foreign currency translation is to be charged/ recognized in the Profit and Loss Account. However, as per old schedule VI, such exchange difference in foreign currency translation should be capitalised. On account of such differences in the measurement principles, it can be said that the old schedule VI was not in conformity with the mandatory requirements of the accounting standards.

### **REVISED SCHEDULE VI OR SCHEDULE III (2013) EFFECTIVE FROM 1<sup>ST</sup> APRIL, 2011**

4.11 The Ministry of Corporate Affairs (MCA) has revised Schedule VI to the Companies Act 1956 on the 28<sup>th</sup> February, 2011 pertaining to the preparation of Balance Sheet and Profit and Loss Account under the Companies Act, 1956. This revised Schedule VI has been framed as per the existing non-converged Indian Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006. The Revised Schedule VI shall come into force for the Balance Sheet and Profit and Loss Account to be prepared for the financial year commencing on or after 1.4.2011.

Subsequently Schedule VI was renumbered as Schedule III as per Companies Act, 2013. The contents of revised schedule VI and the new Schedule III are the same. The format of the Balance Sheet, Profit and

Loss Account and Notes to Accounts (extracted from the Revised Schedule VI or Schedule III (2013)) are given at the end of the chapter as an Annexure.

## **OBJECTIVES FOR REVISING SCHEDULE VI OR SCHEDULE III (2013)**

4.12 In November, 2008, the Ministry of Corporate Affairs issued an Explanatory Memorandum for Revising Schedule VI to the Companies Act, 1956, which clearly stated its objectives as follows:

- To have a '*readable, useful, transparent and user friendly*' form of Schedule VI.
- To set out *minimum disclosure requirements* which are considered essential to ensure true and fair presentation of the financial position and financial performance of the company and comparability both with the company's previous periods and with other companies.
- The Balance Sheet and the Statement of Profit and Loss *should not be burdened with too many disclosure requirements*.
- To *remove the requirements of disclosures no longer considered relevant* in view of the changed socio-economic structure and level of development of the economy.
- To *remove disclosure requirements which are meant for statistical purposes* only e.g. Part IV of Schedule VI.
- To have *inherent flexibility for amendments* and industry/sector specific improvements from time to time and to cater to industry/sector specific disclosure requirements.
- To *harmonize and synchronize the general disclosure requirements with those prescribed in the Accounting Standards* by removing the existing inherent anomalies.
- The specific disclosure requirements prescribed in the Accounting Standards are not incorporated here so that amendment in the Accounting Standard does not necessitate an amendment in the Schedule VI.

- To attain *compatibility* and convergence with the International Accounting Standards and practice.

## **SALIENT FEATURES**

4.13 Following are the Salient Features of Schedule VI.

### **Applicability**

- This revised Schedule VI is applicable to all companies to which existing non-converged notified Accounting Standards are applicable.

### **Flexibility**

- As and when there will be any change in the requirements of the Act including notified Accounting Standards in the treatment or disclosure including addition, amendment, substitution or deletion in the head, sub-head or any changes *inter se* in the financial statements, the revised Schedule VI or Schedule III (2013) will be modified accordingly leaving no scope for any divergence or disagreement with the Accounting Standards.
- The disclosure requirements of revised Schedule VI are in addition to the disclosure requirements specified in the notified Accounting Standards. Additional disclosures (other than specified in the revised Schedule VI or Schedule III (2013)) required by the notified accounting standards may be made either in the notes to account or through additional statement or on the face of the financial statements. In no way, the disclosure requirements of revised Schedule VI will substitute the disclosure requirements specified in the Accounting Standards.
- Any other disclosure required by the Companies Act, 1956 (in addition to the requirements of revised Schedule VI or Schedule III (2013)) shall be made in the Notes to Accounts.
- Schedule VI or Schedule III (2013) sets out the minimum requirements for disclosure on the face of the Financial Statements and Notes to Accounts. Any addition of line or sub-line items or sub-totals shall be presented as addition/substitution to it only when it is required under specific disclosure requirements of

industry/sector or for compliance with the amendments to the Companies Act, 1956 or the Companies Act, 2013 or Accounting standards.

### **Notes to Accounts**

- Notes to accounts, wherever necessary, should include narrative descriptions or dis-aggregations of items recognized on the face of the financial statements and information about items that do not qualify for recognition in the financial statements.
- Cross-reference of each item of the Balance Sheet and Statement of Profit and Loss shall be made to related information in the Notes to Accounts.

### **Unit of Measurement**

- For companies having a turnover of less than one hundred crore rupees, the figures appearing in the Financial Statements may be rounded off to the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
- For companies having a turnover of more than one hundred crore rupees, the figures appearing in the Financial Statements may be rounded off to the nearest lakhs, millions, or crores or decimals thereof.
- Once a unit of measurement is used, it should be used uniformly in the Financial Statements.
- Corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall be given.

### **Assets and Liabilities**

- All the assets and liabilities are classified into current and non-current. Classification of liabilities into secured and unsecured heading as given in the old Schedule VI is now to be given in the Notes to Accounts as a line item.
- Current assets and current liabilities are defined in accordance with the definition given in IndianAS 1/IAS 1.

- The term 'Sundry Creditors' used in the old Schedule VI has been replaced by the word 'Trade Payables'. Similarly, the term 'Sundry Debtors' used in the old schedule VI has been replaced by the word 'Trade Receivables'.
- Trade payables, trade receivables and provisions are further classified as long term (non-current) item and short term (current) item.
- Trade receivable will include only the amount due on account of goods sold or services rendered in the normal course of business. Other receivables will be shown under the heading "Other Current Assets".
- Trade payable will include only the amount due on account of goods purchased or services received in the normal course of business. Other payables will be shown under the heading "Other Current Liabilities".

### **Equity**

- All the details regarding share capital to be shown in the notes to accounts.
- Additions and deductions to every item/head under reserve and surplus, since last balance sheet, are required to be shown.
- Loss from Profit and Loss Account will be shown under the head surplus as a negative figure.
- Balance of reserves and surplus may be in negative (i.e., after adjusting negative balance of surplus).

### **Profit and Loss Account**

- Expenses are grouped on the basis of their nature.
- Any item of income or expenditure which exceeds one per cent of the revenue from operations or ₹1,00,000 (against ₹5,000 given in the old schedule VI), whichever is higher; is to be disclosed separately.

- Net gain or loss on foreign currency transactions/ translation related to finance cost and net gain or loss on others should be separately disclosed.
- The requirements of disclosures in respect of quantity of inventories dispensed with.

### **Status of Part III and Part IV of Old Schedule VI**

4.14 Old Schedule VI had four parts namely – Part I – Balance Sheet, Part II – Profit and Loss Account, Part III – Interpretation and Part IV which contained certain statistical data. The Central Government, in exercise of the powers under section 641(1) of the Companies Act, 1956 has replaced the existing Schedule VI with the revised Schedule VI or Schedule III (2013). Since the entire Schedule VI has been replaced, no part of the old Schedule VI would continue to be relevant. For interpretations given in the Part III of old Schedule VI one may refer to AS 29 “*Provisions, Contingent Liabilities and Contingent Assets*” where the definitions of ‘provisions’ and ‘liability’ are explained in detail.

### **Some Issues Emanating From Revised Schedule VI**

4.15 Though the revised Schedule VI or Schedule III (2013) has reduced the burden in terms of disclosure requirements and made the presentation of Financial Statements more meaningful, yet there are certain issues which need to be addressed by the Ministry. For instance, revised Schedule VI or Schedule III (2013) requires the comparative information in respect of the immediately preceding reporting period for all items given in the financial statements. The same has been exempted only in the case of the first financial statements of a company prepared after its incorporation. Therefore, in the case of other companies, the financial statements prepared as per revised Schedule VI for the first time, have to disclose comparative information in respect of the immediately preceding reporting period. This requires the figures of the immediately preceding reporting period to be reinstated as per revised Schedule VI, which no doubt, is a cumbersome process.

Further, the application of the revised Schedule VI may cast an additional burden, both in terms of cost and consumption of time. It may also require customizing of IT/MIS systems of a company within a short period to prepare its financial statements within the set time.

### To Conclude

4.16 There may be certain other issues as well which may come up while preparing the financial statements as per revised Schedule VI or Schedule III (2013). No doubt, in course of time, these issues will be resolved by the Ministry. The need of the hour is to overcome the resistance to change, especially, since we now function in a Knowledge Economy, which is quite different from a traditional economy. The game in the Knowledge Economy is “*How fast one can learn*”. Therefore, to sustain in a Knowledge Economy, where change is inevitable, adaptation and constant learning are essential prerequisites. With the convergence towards IFRS and the proposed introduction of new legislations like Direct Taxes Code and Goods and Services Tax, one has no option but to learn, unlearn and relearn.

### A COMPARATIVE STUDY - SCHEDULE VI OF THE COMPANIES ACT, 1956.

A comparative chart between the old and revised format of Schedule VI has been prepared. The chart is divided in two parts:

Part I: Balance Sheet

Part II: Statement of Profit and Loss

“All the major changes have been **Bold and Italic** and the major omissions are italicized.”

Schedule VI (OLD)	Schedule VI (Revised – 2011)
<b><u>PART I</u></b>	
<b><u>BALANCE – SHEET</u></b>	
<b>I. SOURCES OF FUNDS</b>	<b>I. EQUITY &amp; LIABILITIES</b>
(1) Shareholders' Funds (a) Capital (b) Reserves & Surplus	(1) Shareholders' Funds (a) Share Capital (b) Reserves & Surplus (c) Money received against share warrants
	(2) Share application money pending allotment
(2) Loan Funds (a) Secured Loans (b) Unsecured Loans (3) Deferred Tax Liabilities (Net)	(3) Non-current Liabilities (a) Long-term borrowings (b) Deferred tax liabilities (Net) (c) Other long term liabilities



(4) Current Liabilities & Provisions (Reclassified) (a) Liabilities (b) Provisions	(d) Long-term provisions
	(4) Current Liabilities (a) Short-term borrowings (b) Trade payables (c) Other current liabilities (d) Short-term provisions
<b>TOTAL</b>	<b>TOTAL</b>
<b>II. APPLICATION OF FUNDS</b>	<b>II. ASSETS</b>
(1) Fixed Assets (a) Gross Block (b) Less: depreciation (c) Net Block (d) Capital Work-in-Progress	(1) (a) Fixed Assets (i) Tangible Assets (ii) Intangible Assets (iii) Capital Work-in-Progress (iv) Intangible Assets under development
(2) Investments (Long term and Current)	(b) Non-current Investments (c) Deferred tax assets (net) (d) Long-term loans and advances (e) Other non-current assets
(3) Deferred Tax Assets (Net)	(2) Current Assets (a) Current Investments (b) Inventories (c) Trade Receivables (d) Cash and Cash equivalents (e) Short-term loans and advances (f) Other current assets
(4) Current Assets, Loans and advances (a) Inventories (b) Sundry debtors (c) Cash and Bank balances (d) Loans & Advances (e) Other current Assets	
(5) (a) Miscellaneous expenditure to the extent not written off or adjusted. (b) Profit and Loss Account	
<b>TOTAL</b>	<b>TOTAL</b>

PART I	
<i>I. SOURCES OF FUNDS</i>	<b><i>I. EQUITY &amp; LIABILITIES</i></b>
➤ Permitted both Vertical and Horizontal forms of presentation.	➤ Permits only <b>VERTICAL</b> form of presentation.
➤ Used “ <b>Sources</b> ” and “ <b>Application of Funds</b> ” as Headings in the Vertical Form.	➤ Uses “ <b>Equity &amp; Liabilities</b> ” and “ <b>Assets</b> ” as Headings.
SHAREHOLDERS' FUNDS	
(1) Shareholders' funds were classified as - (a) Capital (b) Reserves & Surplus	(1) Shareholders' funds are classified as – a. Share Capital b. Reserves & Surplus c. Money received against Share Warrant.
(a) Share Capital For each class of Capital – (a) Authorized (b) Issued (c) Subscribed  (d) Par value per share (e) Calls unpaid ➤ By Directors ➤ By Others (f) Forfeited shares (Amount originally paid – up). Any Capital profit on reissue of Forfeited shares should be transferred to Capital Reserve.	(a) Share Capital For each class of Capital – (a) Authorized (b) Issued (c) Subscribed & Fully paid up (d) Subscribed & not fully paid up (e) Par value per share (f) Calls unpaid ➤ By Directors ➤ <b>By Officers</b> (g) Forfeited shares (amount originally paid-up) (h) <b>A reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period.</b> (i) <b>The rights, preferences and</b>

<p>(g) Terms of redemption or conversion (if any) of any redeemable preference Capital to be stated, together with the earliest date of redemption. Particulars of the different classes of Preference shares to be given.</p> <p>(h) In case of Subsidiary companies, the number of shares held by the holding company as well as by the ultimate holding company and its subsidiaries <i>must be separately stated.</i></p> <p>(i) Shares allotted as fully paid, pursuant to a contract, for consideration other than cash, should be separately shown. Shares allotted as fully paid-up, by way of Bonus shares (<i>specifying the source from which such Bonus shares are issued e.g., Capitalization of Profits or Reserves or from Share Premium Account</i>)</p>	<p><i>restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital.</i></p> <p>(j) <i>Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date.</i></p> <p>(k) Shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by subsidiaries or <b>associates</b> of the holding company or the ultimate holding company in <b>aggregate.</b></p> <p>(l) <i>Shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held.</i></p> <p>(m) <i>Shares reserved for issue under options and contracts/commitments for sale of shares/disinvestment, including the terms and amounts.</i></p> <p>(n) <i>For the period of five years immediately preceding the date as at which the Balance</i></p>
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	<p><b>Sheet is prepared:</b></p> <ul style="list-style-type: none"> <li>➤ Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.</li> <li>➤ Aggregate number and class of shares allotted as fully paid up by way of bonus shares.</li> <li>➤ <b>Aggregate number and class of shares bought back.</b></li> </ul>
<p><b>(b) Reserves and Surplus</b></p> <p>(a) Capital Reserves</p> <p>(b) Capital Redemption Reserve</p> <p>(c) Share Premium Account</p> <p>(d) Other Reserves specifying the nature of each Reserve and the amount in respect thereof.</p> <p>➤ Surplus i.e. the balance in the Profit and Loss Account <i>after providing for proposed allocation, viz. Dividend, Bonus or Reserves.</i></p> <p>➤ <i>Debit balance in the Profit &amp; Loss Account shall be shown as a deduction from the uncommitted reserves, if any. If debit balance of Profit &amp; Loss is in excess of</i></p>	<p><b>(b) Reserves and Surplus</b></p> <p>(a) Capital Reserves</p> <p>(b) Capital Redemption Reserve</p> <p>(c) Securities Premium Reserve</p> <p>(d) <b>Debenture Redemption Reserve</b></p> <p>(e) <b>Revaluation Reserve</b></p> <p>(f) <b>Share Options Outstanding Account</b></p> <p>(g) Other Reserves – (specify the nature and purpose of each reserve and the amount in respect thereof)</p> <p>➤ Surplus i.e. the balance in the balance in the statement of Profit &amp; Loss <b>disclosing allocations and appropriations such as dividends, bonus shares and transfer to/from reserves etc.</b></p> <p>➤ <b>Debit balance of statement of profit and loss shall be shown as a negative figure under the head</b></p>

<p><i>uncommitted reserves, the same shall be shown under “ASSETS” as Profit &amp; Loss.</i></p> <p>➤ Additions and deductions since the last balance-sheet to be shown under each of the specified heads.</p> <p>➤ <i>SINKING FUND</i></p> <p>➤ The word “fund” in relation to any “Reserve” should be used only where such Reserve is specifically represented by earmarked Investments.</p> <p>➤ <i>Proposed additions to Reserve.</i></p>	<p><b>‘Surplus’. Similarly, the balance of “Reserves and Surplus”, after adjusting negative balance of surplus, if any, shall be shown under the head “Reserves and Surplus” even if the resulting figure is in the negative.</b></p> <p>➤ Additions and deductions since the last balance-sheet to be shown under each of the specified heads.</p> <p>➤ A reserve specifically represented by earmarked investments shall be termed as a ‘fund’.</p>		
(2)	(2) <b>Share application money pending allotment</b>		
LIABILITIES			
<p>➤ <i>Secured Loans (SL)</i></p> <p>➤ <i>Unsecured Loans (UL)</i></p> <p>➤ <i>Current Liabilities and Provisions (CLP)</i></p>	<p>➤ <b>Non – Current Liabilities (NCL)</b></p> <p>➤ <b>Current Liabilities (CL)</b>(See note below)</p>		
(3) Secured Loans; Unsecured Loans; Current Liabilities & Provisions.	(3) Non – Current Liabilities	(4) Current Liabilities	
	(a) <b>Long term borrowings(sub-classify as Secured Loans/Unsecured loans)</b>	(a) <b>Short term borrowing</b> s	
(a) Debentures (SL/UL)	(a) Bonds/Debentures		
(b) Loans & Short-term	(b) Term Loans	Loans	

Advances (SL) ➤ From Banks ➤ From Others	Loans and Advances (UL) ➤ From Banks ➤ From Others	➤ From Banks ➤ From Others	Repayable on Demand ➤ From Banks ➤ From Others
		(c) <b>Deferred Payment Liabilities</b>	
(d) Fixed Deposits (UL)	(d) Deposits	Deposits	
(e) Loans and Advances from Subsidiary (SL/UL)	(e) <b>Loans and Advances from Related Parties</b>	<b>Loans and Advances from Related Parties</b>	
	(f) <b>Long term maturities of Finance lease obligations</b>		
(g) Other Loans & Advances (SL/UL) – Specify Nature	(g) Other Loans & Advances (Specify Nature)	Other Loans & Advances (Specify Nature)	
	<b>NOTE:</b> <b>A liability shall be classified as current when it satisfies any of the following criteria:</b> <b>(a) It is expected to be settled in the company's normal operating cycle;</b> <b>(b) It is held primarily for the purpose of being traded;</b> <b>(c) It is due to be settled within twelve months after the reporting date; or</b> <b>(d) The company does not have an</b>		

	<p><i>unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.</i></p> <p><i>All other liabilities shall be classified as non-current.</i></p>
<p>EXPLANATIONS</p> <p>(a) Loans are classified under Secured and Unsecured. Nature of security to be specified in each case.</p> <p>(b) Loans guaranteed by the director – a mention thereof shall also be made and also the aggregate amount of such loan under each head. <i>Loans from Directors and Managers to be shown separately.</i></p> <p>(c) <i>Terms of Redemption or conversion (if any) of debentures issued to be stated together with the earliest date of redemption or conversion.</i></p>	<p>EXPLANATIONS</p> <p>(a) Borrowings to be sub classified as Secured and Unsecured. Nature of security shall be specified separately in each case.</p> <p>(b) Loans guaranteed by the directors and <b>others</b> – aggregate amount of such loans under each head shall be disclosed.</p> <p>(c) <i>Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by installments, the date of maturity for this purpose must be reckoned as the date on which the first installment becomes due.</i></p> <p>(d) Particulars of any redeemed bonds/</p>

(d) Particulars of any redeemed debentures which the company has power to issue must be shown.	debentures which the company has power to reissue shall be disclosed. (e) <b>Terms of repayment of term loans and other loans shall be stated.</b> (f) <b>Period and amount of continuing default as on the balance sheet date in repayment of loans and interest shall be specified separately in each case.</b>
<b>(b)</b> Deferred Tax Liabilities (Net) As a separate line item after unsecured loan.	<b>(b)</b> Deferred Tax Liabilities (Net) Under the head Non-Current Liabilities.
<b>(c)</b> Current Liabilities	<b>(c)</b> Other Long Term Liabilities
(a) Creditors (CL) ➤ <i>MSMED</i> ➤ Others  (b) <i>Acceptances</i>  (c) Interest Accrued but not due on loans (CL)  (d) Interest accrued and due (SL/UL) <i>to be included under appropriate sub-heads.</i> (e) Advance payments and unexpired discounts for the portion for which value has to be given (CL) (f) Unpaid dividend (CL) (g) Unpaid application money	<b>(c)</b> Other Current Liabilities (a) <b>Current maturities of long-term debt</b> (b) <b>Current maturities of finance lease obligations</b> (c) Interest Accrued but not due on borrowing (d) Income accrued and due on borrowings. (e) Income received in advance (f) Unpaid dividend



<p>received by the companies for allotment of securities and due for payment. (CL)</p> <p>(h) Unpaid matured deposits (CL)</p> <p>(i) Unpaid matured debentures (CL)</p> <p>(j) <i>Interest accrued on the above (f-i) (CL)</i></p> <p>(k) Other liabilities</p>		<p>(g) Application money received for allotment &amp; securities and due for refund &amp; <b>interest accrued thereon.</b></p> <p>(h) Unpaid matured deposits and <b>interest accrued thereon.</b></p> <p>(i) Unpaid matured debentures &amp; <b>interest accrued thereon.</b></p> <p>(k) Other Payables (specify Nature)</p>
<b>PROVISIONS</b>		
<b>(d) Provisions</b>	<b>(d) Long term Provisions</b>	<b>(d) Short term Provisions</b>
<p>(a) Provident Fund Scheme</p> <p>(b) Insurance, Pension and other similar staff benefit schemes</p> <p>(c) <i>Provision for Taxation</i></p> <p>(d) <i>Proposed Dividend</i></p> <p>(e) <i>For Contingencies</i></p>	<p>(a) Provision for employees' benefits.</p> <p>(b) Others (Specify Nature)</p>	<p>(a) Provision for employees' benefits.</p> <p>(b) Others (Specify Nature)</p>

II. APPLICATION OF FUNDS	II. ASSETS
	Non-Current Assets
(1) (a) Fixed Assets	(1) (a) Fixed Assets
	(i) Tangible Assets-Classification
Land Building Plant & Machinery Furniture & Fitting Vehicles <i>Railway Sidings</i> <i>Development Property</i> <i>Live Stock</i> <i>Leasehold</i>	Land Building Plant & Machinery Furniture & Fitting Vehicles <b>Office Equipments</b> <b>Others (Specify Nature)</b>  Note: Assets under lease shall be separately specified for each class of Assets.
	(ii) Intangible Assets-Classification
Goodwill Trademarks  Patents	Goodwill Brands/Trademarks <b>Computer Software</b> <b>Mastheads &amp; Publishing Titles</b> <b>Mining Rights</b> Copyrights & Patents Recipes, Formulae Licenses & Franchise Others (Specify Nature)
Capital Work-in-Progress	(iii) Capital Work-in-Progress (iv) Intangible Assets under development
EXPLANATIONS (a) Where any sum has been written off on a reduction of capital or revaluation of assets, every balance sheet	EXPLANATIONS Where sums have been written off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of

<p>subsequent to such reduction or revaluation shall show the reduced figures and the date of the reduction. For a period of five years, the amount of the reduction made shall also be stated.</p> <p>(b) Where sums have been added by writing up the asset, each subsequent balance sheet should show the increased figures with the date of the increase. For a period of five years, the amount of the increase shall also be stated.</p>	<p>assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.</p>
<b>PRESENTATION</b>	
<p><b>Gross:</b>  Opening Balance  Additions        Less: Disposals _____  Gross Block at year end _____       Total Depreciation written off/  Provided _____ upto the  year end _____  Net Block</p>	<p><b>Gross:</b>  Opening Balance  Additions  <b>Acquisitions through  Business combination</b>  Other Adjustments _____  Sub-total  Less: Disposals _____  Gross block at year end _____  Less: Depreciation/Amortization  Opening depreciation/amortization  Depreciation/Amortization of the  year  Impairment loss/Reversal of  Impairment Loss _____  Total depreciation at year  end _____  Net Carrying Value</p>
<b>INVESTMENTS</b>	
<b>(b) Investments</b>	<b>(b) Non-Current Investments</b>

<p><i>Investments</i> were classified as:</p> <ol style="list-style-type: none"> <li>1. Trade Investments</li> <li>2. Other Investments – and further classified as:-             <ol style="list-style-type: none"> <li>(a) Immovable Property</li> <li>(b) Investment in shares- Distinguishing the different classes of shares.</li> <li>(c) Investment in Government or Trust Securities.</li> <li>(d) Invests in Bonds/Debentures</li> <li>(e) Investment in Capital of Partnership Firms</li> </ol> </li> </ol> <p>Balance of unutilized monies raised in issues.</p>	<p><b>Non-current Investments</b> to be classified as:</p> <ol style="list-style-type: none"> <li>1. Trade Investments</li> <li>2. Other Investments – and further classified as:-             <ol style="list-style-type: none"> <li>(a) Investment Property</li> <li>(b) Investment in Equity Instruments</li> <li>(c) Investment in Preference Shares</li> <li>(d) Investment in Government or trust securities.</li> <li>(e) Investments in debentures or bonds.</li> <li>(f) Investments in Mutual Funds</li> <li>(g) Investment in Partnership firms.</li> </ol> </li> </ol> <p>Other Non-current Investments (Specify Nature)</p>
<b>NOTES</b>	
<p>(a) A statement of Investments (whether shown under ‘Investment’ or under ‘Current Assets’, a stock-in-trade) separately classifying trade investments and other investments should be annexed to the balance-sheet, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (<i>including all investments, whether existing or not, made</i></p>	<p>(a) Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities) in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms</p>

<p><i>subsequent to the date as at which the previous balance-sheet was made out) and the nature and extent of the investment so made in each such body corporate; provided that in case of an investment company, that is to say, a company whose principal business is the acquisition of shares, stock, debentures or other securities, it shall be sufficient if the statement shows only the investments existing on the date as at which the balance has been made out.</i> In regard to the investments in the capital of partnership firms, the names of the firms, (with names of all their partners, total capital and the shares of each partner) shall be given in the statement.</p>	<p>(with the names of all their partners, total capital and the shares of each partner) shall be given.</p>
<p>(b) Investments: Mode of Valuation – For example, COST or MARKET VALUE</p>	<p>(b) <b><i>Investments carried at other than COST should be separately stated specifying the basis for valuing them.</i></b></p>
<p>(c) The following shall also be disclosed:</p> <p>(i) Aggregate amount of company's quoted investments and also the market value thereof shall be shown.</p> <p>(ii) Aggregate amount of company's unquoted investments shall also be</p>	<p>(c) The following shall also be disclosed:</p> <p>(i) Aggregate amount of quoted investments and market value thereof;</p> <p>(ii) Aggregate amount of unquoted investments;</p> <p>(iii) Aggregate provision for diminution in value of</p>

shown.	investments
(d) All unutilized monies out of the issue must be separately disclosed in the Balance Sheet of the company indicating the form in which such unutilized funds have been invested.	(d) Where in respect of an issue of securities <b>made for a specific purpose</b> , the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilized amounts have been used or invested.
(c) Deferred Tax Assets (Net) As a separate line item after Investments.	(c) Deferred Tax Assets (Net) Under the head Non-Current Assets.
(d) <i>Current Assets, Loans &amp; Advances</i> (c)(i) <i>Loans and Advances to Subsidiaries</i> (ii) <i>Advances and Loans to partnership firms in which the company or any of its subsidiaries is a partner.</i>	(d) <b>Long Term Loans &amp; Advances</b> <b>(a) Capital Advances</b> <b>(b) Security Deposits</b> <b>(c) Loans and Advances to Related Parties (giving details thereof)</b> <b>(d) Other Loans &amp; Advances (Specify Nature)</b>
NOTES	
Particulars to be given separately of: (a) Secured, considered good (b) Unsecured, considered good (c) Doubtful or Bad	To be separately sub-classified as: (a) Secured, considered good (b) Unsecured, considered good (c) Doubtful Allowances for bad and doubtful loans & Advances shall be disclosed under relevant heads separately.
Loans & Advances due from directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or by private companies respectively in	Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in

<p>which any director is a partner or a director or a member, to be separately stated.</p> <p><i>Loans &amp; Advances due from other companies under the same management within the meaning of sub-section (1-B) of section 370, to be disclosed with the names of the Companies.</i></p> <p><i>The maximum amount due by directors or other officers of the company at any time during the year to be shown by way of a note.</i></p>	<p>which any director is a partner or a director or a member should be separately stated.</p>
<b>(e) Sundry Debtors</b>	<b>(e) Other Non-Current Assets</b> (i) Long term Trade Receivable (Including trade receivable on defined credit terms) (ii) Others (Specify Nature)
<b>NOTE</b>	
<b>CLASSIFICATION</b> Particulars to be given separately of: (a) Secured, considered good (b) Unsecured, considered good (c) Doubtful or Bad	<b>CLASSIFICATION</b> To be separately sub-classified as (a) Secured, considered good (b) Unsecured, considered good (c) Doubtful Allowances for bad and doubtful debts shall be disclosed under relevant heads separately
<b>(2)</b>	<b>(2) Current Assets (See Note Below)</b>
	<b>(a) Current Investments</b> <b><i>Current Investments to be classified as:</i></b> <b><i>(a) Investment in Equity Instrument</i></b> <b><i>(b) Investment in Preference Shares</i></b>

	<p>(c) Investment in Government or trust securities</p> <p>(d) Investments in debentures or bonds.</p> <p>(e) Investments in Mutual Funds</p> <p>(f) Investment in Partnership firms.</p> <p>(g) Other Investments (Specify Nature)</p> <p>Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities) in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given. The following shall also be disclosed:</p> <p>(a) The basis of valuation of individual investments</p>
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	<p>(b) Aggregate amount of quoted investments and market value thereof</p> <p>(c) Aggregate amount of unquoted investments</p> <p>Aggregate provision made for the diminution in value of investments.</p>
	<p><b>NOTE:</b></p> <p>An asset shall be classified as <u>current</u> when it satisfies any of the following criteria:</p> <p>(a) It is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;</p> <p>(b) It is held primarily for the purpose of being traded;</p> <p>(c) It is expected to be realized within twelve months after the reporting date; or</p> <p>(d) It is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.</p> <p>All other assets shall be classified as <u>non-current</u>.</p>
(b) Inventories	(b) Inventories
<p>CLASSIFICATION</p> <p>(a) Raw-Materials</p> <p>(b) Work-in-Progress</p> <p>(c)</p> <p>(d) Stock-in-Trade</p> <p>(e) Stores and Spare Parts</p>	<p>CLASSIFICATION</p> <p>(a) Raw-Materials</p> <p>(b) Work-in-Progress</p> <p>(c) Finished Goods</p> <p>(d) Stock-in-Trade (in respect of goods acquired for trading)</p>

<p>(f) Loose-tools</p> <p>NOTES:</p> <p>(i) Mode of valuation shall be stated.</p>	<p>(e) Stores and Spares</p> <p>(f) Loose tools</p> <p>(g) Others (Specify Nature)</p> <p>NOTES:</p> <p>(i) <b>Goods in transit shall be disclosed under the relevant sub-head of inventories.</b></p> <p>(ii) Mode of valuation shall be stated.</p>
<p><b>(c) Sundry Debtors</b></p> <p>(i) Debts outstanding for a period exceeding six months</p> <p>(ii) Sundry Debtors particulars to be given separately of:</p> <p>(a) Secured-Considered good</p> <p>(b) Unsecured-Considered good</p> <p>(c) Doubtful or Bad.</p> <p>(iii)</p> <p>(iv) Debts due by the directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member to be separately stated.</p> <p><i>Debts due from other companies under the same management within the meaning of sub-section (1-B) of section 370, to be disclosed with the names of the Companies.</i></p> <p><i>The maximum amount due by</i></p>	<p><b>(c) Trade Receivables</b></p> <p>(i) Aggregate amount of Trade Receivable outstanding for a period exceeding six months from the date they are due for payment should be separately shown.</p> <p>(ii) Trade-Receivable shall be sub-classified as</p> <p>(a) Secured-Considered good</p> <p>(b) Unsecured-Considered good</p> <p>(c) Doubtful</p> <p>(iii) Allowances for bad and doubtful debts shall be disclosed under the relevant heads separately.</p> <p>(iv) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.</p> <p>A receivable shall be classified as a "Trade Receivable" if it is in respect of the amount due on account of</p>

<p><i>directors or other officers of the company at any time during the year to be shown by way of a note.</i></p> <p>The amount to be shown under sundry debtors shall include the amounts due in respect of goods sold or services rendered or in respect of other contractual obligations but shall not include the amounts which are in the nature of loans or advances.</p>	<p>goods sold or services rendered in the normal course of business.</p>
<p><b>(d) Cash and Bank Balances</b></p> <p>Classified as</p> <p>(a) Bank Balances:</p> <p>(I) <i>with scheduled banks</i></p> <ul style="list-style-type: none"> <li>• <i>Current account</i></li> <li>• <i>Call account</i></li> <li>• <i>Deposit account</i></li> </ul> <p>(II) <i>With others (with names)</i></p> <ul style="list-style-type: none"> <li>• <i>Current Account</i></li> <li>• <i>Call account</i></li> <li>• <i>Deposit account</i></li> </ul> <p>(b)</p> <p>(c) Cash balance on hand</p>	<p><b>(d) Cash and Cash Equivalents</b></p> <p><b>Classified as:</b></p> <p><b>(a) Balances with Bank</b></p> <ul style="list-style-type: none"> <li>• <b>Unpaid Dividend</b></li> <li>• <b>Margin Money</b></li> <li>• <b>Bank deposits with more than 12 months maturity</b></li> </ul> <p><b>(b) Cheque, Drafts on hand.</b></p> <p><b>(c) Cash-on-Hand</b></p> <p><b>(d) Others (Specify)</b></p>
<p>Note: The name of the bankers other than scheduled banks and maximum amount outstanding at any time during the year from each such banker.</p> <p>The nature of the interest, if any, of any director or his relative in each of the bankers (other than Scheduled Banks).</p>	

(e) <i>Loans &amp; Advances</i>	(e) <b>Short-Term Loans &amp; Advances</b>
<p>(a) (i) <i>Advances and loans to subsidiaries</i></p> <p>(ii) <i>Advances and Loans to partnership firms in which the company or any of its subsidiaries is a partner.</i></p> <p>(b) (i) Bills of Exchange</p> <p>(ii) Advances recoverable in cash or kind or for value to be received, e.g., Rates, Taxes, Insurance etc.</p> <p>(iii) Balances on current account with Managing Agents or Secretaries and Treasurers.</p> <p>(iv) Balances with Customs, Port Trust, etc. (where payable on demand)</p> <p>Some particulars to be disclosed:</p> <p>(i) Loans &amp; Advances particulars to be given separately of:</p> <p>(a) Secured-Considered good</p> <p>(b) Unsecured-Considered good</p> <p>(c) Doubtful or Bad.</p> <p>(ii) Loans &amp; Advances due by the directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a</p>	<p><b>(a) Loans and advances to related parties (giving details thereof)</b></p> <p><b>(b) Others (specify name)</b></p> <p>Sub-classification:</p> <p>(i) The above loans &amp; advances shall be sub-classified as</p> <p>(a) Secured-Considered good</p> <p>(b) Unsecured-Considered good</p> <p>(c) Doubtful</p> <p>(ii) Allowances for bad and doubtful loans &amp; advances shall be disclosed under the relevant heads separately.</p> <p>(iii) Loans &amp; Advances due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a member should be separately stated.</p>

<p>director or a member to be separately stated.</p> <p><i>Debts due from other companies under the same management within the meaning of sub-section (1-B) of section 370, to be disclosed with the names of the Companies)</i></p> <p><i>The maximum amount due by directors or other officers of the company at any time during the year to be shown by way of a note.</i></p>	
<p><b>(f) Other Current Assets</b></p> <ul style="list-style-type: none"> <li>• Interest accrued on investment.</li> </ul>	<p><b>(f) Other Current Assets</b></p> <ul style="list-style-type: none"> <li>• Incorporates current assets that do not fit into any other asset category. (Specify Nature)</li> </ul>
<p><b>Miscellaneous Expenditure (to the extent not written off or adjusted)</b></p> <p>(a) <i>Preliminary expenses</i></p> <p>(b) <i>Expenses including commission or brokerage on underwriting or subscription of shares or debentures</i></p> <p>(c) <i>Discount allowed on the issue of shares or debentures</i></p> <p>(d) <i>Interest paid out of capital during construction (also stating the rate of interest)</i></p> <p>(e) <i>Development expenditure not adjusted</i></p> <p>(f) <i>Other items (specifying nature)</i></p>	

<b>Profit &amp; Loss Account</b>	
Footnotes to the Balance Sheet	Contingent Liabilities and Commitments (to the extent not provided for)
<p><b>A footnote</b> to the balance-sheet may be added to show separately</p> <p>(a) Claims against the company not acknowledged as debts.</p> <p>(b)</p> <p>(c) Other money for which the company is contingently liable. The amount of any guarantees given by the company on behalf of directors or other officers of the company shall be stated and where practicable, the general nature and amount of each such contingent liability, if material shall also be specified.</p> <p>(d) Estimated amount of contracts remaining to be executed on Capital account &amp; not provided for.</p> <p>(e) Uncalled liability on shares partly paid.</p>	<p><b>(i) Contingent Liabilities</b></p> <p>Contingent liabilities classified as:</p> <p>(a) Claims against the company not acknowledged as debt.</p> <p>(b) Guarantees.</p> <p>(c) Other money for which the company is contingently liable.</p> <p><b>(ii) Commitments to be classified separately as:</b></p> <p>(a) Estimated amount of Contracts remaining to be executed on Capital Account and not provided for.</p> <p>(b) Uncalled liability on shares and other investments which are partly paid.</p> <p>(c) Other commitments (Specify Nature)</p>
Arrears of fixed cumulative dividends	<p><b><i>The amount of dividend proposed to be distributed to equity and preference shareholders for the period and the related amount per share shall be disclosed separately.</i></b></p> <p>Arrears of fixed cumulative dividends on preference shares shall also be disclosed separately.</p>

If in the opinion of the Board, <i>any of the current assets, loans and advances</i> have not a value on realization in the ordinary course of business at least equal to amount at which they are stated, the fact that the Board is of that opinion shall be stated.	If, in the opinion of the Board, <b>any of the assets other than fixed assets and non-current investments</b> do not have a value on realization in the ordinary course of business at least equal to the amount at which they are stated, the fact that the Board is of that opinion, shall be stated.
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## PART II

Schedule VI (OLD)	Schedule VI (Revised – 2011)
PROFIT AND LOSS ACCOUNT	STATEMENT OF PROFIT AND LOSS
<p>(I) The Profit and Loss Account shall set out the various items relating to the income and expenditure of the company engaged under the most convenient heads and in particular shall disclose the following information in respect of the period covered by the account:-</p> <p>(i) Turnover, i.e. the aggregate amount for which Sales are affected by the company, giving the amount of Sales in respect of each class of goods dealt with by the company, <i>indicating the quantities of such sales for each class separately.</i></p> <p>In case of companies rendering or supplying services, the gross income derived from services rendered or supplied.</p>	<p><b>Form of Statement of Profit &amp; Loss</b></p> <p>(I) <b>Revenue from Operations</b></p> <p>(i) <b>Revenue from operations in respect of non-finance company:</b></p> <p>(a) <b>Sale of Products</b></p> <p>(b) <b>Sale of Services</b></p> <p>(c) <b>Other Operating Revenues</b></p> <p style="padding-left: 40px;">Less: Excise Duties</p> <p>(ii) <b>Revenue from operations in respect to Finance company:</b></p> <p>(a) <b>Interest</b></p> <p>(b) <b>Other Financial Services</b></p> <p>Revenue under each of the above heads shall be disclosed separately by way of notes to Accounts to the extent applicable.</p> <p>In case of company rendering or supplying services, gross income</p>

In case of other companies, the gross income derived under different heads.	derived from services rendered or supplied under broad-head. In case of other companies, gross income derived from broad heads.
<b>II. Other Income</b> (a) Interest Income, <i>specifying nature of the income.</i> (b) Dividend from subsidiary company. (c) (i) Profit or Loss on investments ( <i>showing distinctly profit/loss earned/incurred from partnership firm</i> ) (ii) Amount of income from investments, distinguishing between Trade Investments and other investments. (d) Profit or Losses in respect of transactions of a kind, not usually undertaken by the company. (e) Miscellaneous income <i>NOTE: 1. Amount of income-tax deducted on (a) and (c) above, if the gross income is stated.</i> <i>2. Dividends declared by the subsidiary companies after the date of balance-sheet should not be included unless they are in respect of period which closed on or before the date of balance-sheet.</i>	<b>II. Other Income</b> (a) Interest income (other than a finance company) (b) (i) Dividend from subsidiary companies (ii) Dividend Income (c) Net Gain/Loss on sale of investment. (d) Other non-operating income (net of expenses directly attributable to such income) (e) Adjustments to the carrying value of investments (Write-back) (f) <b><i>Net gain/loss on foreign currency translation and transaction (other than considered as finance cost)</i></b>
<b>(IV) EXPENSES</b>	
(i) In case of manufacturing companies,- The value of the raw materials consumed, <i>giving item-wise</i>	(i) Cost of Materials consumed (Manufacturing Companies) – Raw Materials under broad heads. In this case, if a company



<p><i>break-up and indicating the quantities thereof. In this break-up, as far as possible, all important basic raw materials shall be shown separately. The intermediates or components procured from other manufacturers may, if their list is too large to be included in the break-up, be grouped under suitable headings without mentioning the quantities, provided all those items which in value individually account for 10 per cent or more of the total value of raw material consumed shall be shown as separate and distinct items with quantities thereof in the break-up. In this case, if a company falls under more than one category, it shall be sufficient compliance with the requirements, if the total amounts are shown in respect of the opening and closing stocks, Purchases, Sales and Consumption of raw materials with value and quantitative break-up and the gross income from services rendered is shown.</i></p> <p>(ii) In case of trading companies, the purchases made and the opening and the closing stocks, giving break-up in respect of each class of goods traded in by the company and indicating</p>	<p>falls under more than one category, it shall be sufficient compliance with the requirements, if purchases, sales and consumption of raw material and gross income from services rendered is shown under broad-heads.</p> <p>(ii) Goods purchased (Trading Companies) – goods traded in by the company under the broad-head.</p> <p>(iii) In case, if a company falls under more than one category, it shall be sufficient compliance with the requirements, if purchases, sales and consumption of raw materials and gross income from services rendered is shown under <b>broad heads</b>.</p> <p>(iv) In case of Work-in Progress, Work-in-Progress under broad heads.</p>
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*the quantities thereof.*

(iii) In case, if a company falls under more than one category, it shall be sufficient compliance with the requirements, if the total amounts are shown in respect of *opening and closing stocks*, purchases, sales and consumption of raw materials, *with value and quantitative break-up* and the gross income from services rendered is shown.

(iv) In case of Work-in-Progress, the amounts for which such works have been completed at the commencement and at the end of the accounting period.

**Note 1:***The quantities of raw materials purchases, stocks and the turnover shall be expressed in quantitative denominations in which these are normally purchased or sold in the market.*

**Note 2:***For the purpose of items for which the company is holding separate industrial licenses shall be treated as a separate class of goods, but where a company has more than one industrial license for production of the same item at different places or for expansion of the licensed capacity, the item covered by all such licenses shall be treated as one class.*

**Note 3:***In giving the break-up of*

<p><i>purchases, stocks and turnover, items like spare parts and accessories, the list of which is too large to be included in the break-up, may be grouped under suitable headings without quantities, provided all those items, which in value individually account for 10 per cent or more of the total value of the purchases, stocks or turnover, as the case may be, are shown as separate and distinct items with quantities thereof in the break-up.</i></p>	
<p>Expenditure incurred on each of the following items, separately for each item:-</p> <p>(a) Salaries, Wages &amp; Bonus</p> <p>(b) Contribution to Provident &amp; other funds.</p> <p>(d) Workmen &amp; Staff Welfare expenses.</p>	<p>Employee benefits expense shall disclose information regarding aggregate expenditure on:-</p> <p>(a) Salaries and Wages</p> <p>(b) Contribution to Provident &amp; Other Funds</p> <p><b>(c) Expense on employee stock option scheme (ESOP) and Employee Stock Purchase Plan (ESPP)</b></p> <p>(d) Staff Welfare Expenses.</p>
<p><i>Amount of Interest</i></p> <p>(a) <i>On company's debentures</i></p> <p>(b) <i>On other fixed loans</i></p> <p>(c) <i>Interest paid to the managing director and to the manager, if any.</i></p>	<p><b>Finance Cost</b></p> <p><b>(a) Interest Expense</b></p> <p><b>(b) Other borrowing costs</b></p> <p><b>(c) Applicable net gain/loss on foreign currency translations &amp; transactions.</b></p>
<p>Expenses on each of the following items, separately for each item:</p> <p>(a) Consumption of Stores &amp; Spares.</p> <p>(b) Power &amp; Fuel</p>	<p>Expenses on each of the following items, separately for each item:</p> <p>(a) Consumption of Stores &amp; Spares.</p> <p>(b) Power &amp; Fuel</p>

<p>(c) Rent</p> <p>(d) Repairs to Building</p> <p>(e) Repairs to Machinery</p> <p>(f) Insurance</p> <p>(g) Rates &amp; Taxes (excluding Income Tax)</p> <p>(h) Miscellaneous Expenditure</p> <p>Note: Any item under which expenses exceed 1 per cent of <i>total revenue</i> or ₹5,000 whichever is higher, shall be shown separately and distinct item against an appropriate account head in P&amp;L account and shall not be combined with any other item under "Miscellaneous Expenditure"</p> <p>(i) Payment to Auditor</p> <ul style="list-style-type: none"> <li>• As Auditor</li> <li>• Taxation Matters</li> <li>• Company Law Matters</li> <li>• Management Services</li> <li>• In any other manner</li> <li>• For Expenses</li> </ul> <p>(j) (i) The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as to which the balance-sheet is made up.</p> <p>(ii) The aggregate, if material, of any amounts withdrawn from such reserves.</p> <p>(k) (i) The aggregate, if material, of the amounts set aside to</p>	<p>(c) Rent</p> <p>(d) Repairs to Building</p> <p>(e) Repairs to Machinery</p> <p>(f) Insurance</p> <p>(g) Rates &amp; Taxes (excluding Income Tax)</p> <p>(h) Miscellaneous Expenditure</p> <p>Note: Any item under which income or expenses exceed 1 per cent of <b>revenue from operations or ₹1,00,000</b> whichever is higher, shall be shown separately and distinct item against an appropriate account head in P&amp;L account and <b>shall not be combined with any other item.</b></p> <p>(i) Net loss on foreign currency transaction and translation (other than considered as finance cost)</p> <p>(j) Payment to Auditors</p> <ul style="list-style-type: none"> <li>• As Auditor</li> <li>• For Taxation Matters</li> <li>• For Company Law Matters</li> <li>• For Management Services</li> <li>• For Other Services</li> <li>• For reimbursement of expenses.</li> </ul> <p><b>(k) Provision for losses of Subsidiary companies.</b></p> <p><b>(l) Adjustment to the carrying amount investments.</b></p> <p><b>(m) Net loss on sale of investments.</b></p> <p><b>(n) Details of exceptional and extraordinary items.</b></p>
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<p>provisions made for meeting specific liabilities, contingencies or commitments.</p> <p>(ii) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.</p>	<p><b>(o) Prior period items</b></p> <p>(p) (i) The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as to which the balance-sheet is made up.</p> <p>(ii) The aggregate, if material, of any amounts withdrawn from such reserves.</p> <p>(q) (i) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.</p> <p>(ii) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.</p>
	<p><b>STATEMENT OF PROFIT &amp; LOSS (FACE REPORTING)</b></p>
	<p><b>Profit before exceptional and extraordinary items and tax</b></p> <p><b>XXX</b></p>
<p>Shall disclose every material feature, including credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of an exceptional nature.</p>	<p><b>Exceptional items</b></p> <p><b>(XXX)</b></p>
	<p><b>Profit before extraordinary items and</b></p> <p><b>XXX</b></p>

	<b>tax</b>	
	<b>Extraordinary items</b>	<b>(XXX)</b>
	<b>Profit Before Tax</b>	<b>XXX</b>
The amount of charge for Indian Income tax and other Indian taxation on profits, including, where practicable, with Indian income-tax, any taxation imposed elsewhere to the extent of the relief, if any, from Indian Income tax and distinguishing where practicable, between income tax and other taxation.	<b>Tax Expense</b> <b>a. Current Tax</b> XXX <b>b. Deferred Tax</b> XXX	<b>(XXX)</b>
	<b>Profit/(Loss) for the period from continuing operations.</b>	<b>XXX</b>
	<b>Profit/(Loss) from discontinuing Operations</b>	<b>XXX</b>
	<b>Tax expense on discontinuing operations</b>	<b>(XXX)</b>
	<b>Profit/(Loss) from discontinuing Operations (after tax)</b>	<b>XXX</b>
	<b>Profit/(Loss) for the period</b>	<b>XXX</b>
	<b>Earnings per equity share</b> <b>1. Basic</b> <b>2. Diluted</b>	<b>XXX</b> <b>XXX</b>
<b>BY WAY OF A NOTE</b> the following information shall be disclosed. a) Value of imports calculated on C.I.F basis by the company during the financial year in respect of –	<b>BY WAY OF A NOTE</b> the following information shall be disclosed. a) Value of imports calculated on C.I.F basis by the company during the financial year in respect of – I. Raw materials;	

<p>I. Raw materials;  II. Components and spare parts;  III. Capital goods;</p> <p>b) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;</p> <p>c) Value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;</p> <p>d) The amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related;</p> <p>e) Earnings in foreign exchange classified under the following heads, namely:-</p> <p>I. Export of goods calculated on F.O.B. basis;</p> <p>II. Royalty, know-how, professional and consultation fees;</p>	<p>II. Components and spare parts;  III. Capital goods;</p> <p>b) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;</p> <p>c) Total value of all imported raw materials, spare parts and components consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;</p> <p>d) The amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the total number of non-resident shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related;</p> <p>e) Earnings in foreign exchange classified under the following heads, namely:-</p> <p>I. Export of goods calculated on F.O.B. basis;</p> <p>II. Royalty, know-how, professional and consultation fees;</p> <p>III. Interest and dividend;</p> <p>IV. Other income, indicating</p>
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III. Interest and dividend; IV. Other income, indicating the nature thereof	the nature thereof
<b>OTHER DISCLOSURES</b>	
<p>(a) <i>Commission paid to sole selling agents within the meaning of section 294 of the act.</i></p> <p>(b) <i>Brokerage and discount on sales, other than the usual trade discount.</i></p> <p>(c) <i>The amount provided for depreciation, renewals or diminution in value of fixed assets.</i>  <i>If such provision is not made by means of a depreciation charge, the method adopted for making such provision.</i>  <i>If no provision is made for depreciation, the fact that no provision has been made shall be stated and the quantum of arrears of depreciation computed in accordance with section 205(2) of the Companies Act shall be disclosed by way of a note.</i></p> <p>(d) <i>The profit &amp; Loss account shall also contain or give by way of a note detail information showing separately, the following payments provided or made during the financial year, to the directors (including managing directors or managers, if any, by the company, the subsidiaries of</i></p>	



<p><i>the company and any other person):-</i></p> <p>(1) <i>The managerial remuneration u/s 198 of the act paid/payable during the financial year to the directors (including managing directors or manager, if any)</i></p> <p>(2) <i>Other allowances and commissions including guarantee commission.</i></p> <p>(3) <i>Any other perquisites or benefits in cash or in kind.</i></p> <p>(4)</p> <p style="padding-left: 40px;">(i) <i>Pensions</i></p> <p style="padding-left: 40px;">(ii) <i>Gratuities</i></p> <p style="padding-left: 40px;">(iii) <i>Payment from Provident funds, in excess of own subscriptions and interest thereon.</i></p> <p style="padding-left: 40px;">(iv) <i>Compensation for loss of office</i></p> <p style="padding-left: 40px;">(v) <i>Consideration in connection with retirement from office.</i></p> <p>(e) <i>The Profit &amp; Loss account shall contain or give by way of a note, a statement showing the computation of net profits in accordance with section 349 of the act with relevant details of the calculation of the commissions payable by way of percentage of such profits to the directors (including managing directors) or manager, if any.</i></p>	
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<p>(f) <i>The amounts reserved for-</i></p> <ul style="list-style-type: none"> <li>• <i>Repayment of share capital and</i></li> <li>• <i>Repayment of loans.</i></li> </ul> <p>(g) <i>The aggregate amount of the dividends paid, and proposed, and stating whether such amounts are subject to deduction of income-tax or not.</i></p> <p>(h) <i>Amount, if material, by which any items shown in the profit and loss statement, is affected by any change in the basis of accounting.</i></p> <p>(i) <i>In case of manufacturing companies, the profit and loss account shall also contain, by way of a note in respect of each class of goods manufactured, detailed quantitative information in regard to the following namely:-</i></p> <ul style="list-style-type: none"> <li>(i) <i>The licensed capacity (where license is in force)</i></li> <li>(ii) <i>The installed capacity and</i></li> <li>(iii) <i>The actual production</i></li> </ul> <p><i>Note-1: The licensed capacity and the installed capacity of the company as on the last date of the year to which the profit and loss account relates, shall be mentioned against items (i) and (ii) above respectively.</i></p> <p><i>Note-2: Against item (iii), the actual production in respect of the finished products meant for sale shall be mentioned. In cases where semi-processed</i></p>	<p>(g) <b><i>The amount of dividends proposed to be distributed to equity and preference shareholders for the period and the related amount per share shall be disclosed separately.</i></b></p>
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products are also sold by the company, separate details thereof shall be given.

*Note-3: For the purpose of this paragraph, the items for which the company is holding separate industrial licenses shall be treated as separate classes of goods but where a company has more than one industrial license for production of the same item at different places or for expansion of the licensed capacity, the item covered by all such licenses shall be treated as one class.*

(j) *The Central government may direct that a company shall not be obliged to show the amount set aside to provisions other than those relating to depreciation, renewal or diminution in value of assets, if the Central Government is satisfied that the information should not be disclosed in the public interest and would prejudice the company, but subject to the condition that in any heading stating an amount arrived at after taking into account the amount set aside as such, the provision shall be so framed or marked as to indicate that fact.*

(k) *Except in the case of the first profit and loss account laid*

(k) *Except in the case of the first Financial Statements laid before*

<p>before the company after the commencement of the Companies Act, the corresponding amounts for the immediately preceding financial year for all items shown in the profit and loss account shall also be given in the profit and loss account.</p> <p>(l) The figures in the balance sheet may be rounded off as under:</p> <ul style="list-style-type: none"> <li>• Less than ₹100 crores : to the nearest hundreds or thousands or decimal thereof</li> <li>• <i>Between ₹100 crore or more, but less than ₹500 crores : to the nearest hundreds, thousands, lakhs or millions or decimal thereof</i></li> <li>• <i>₹500 crores or more, to the nearest hundreds, thousands, lakhs, millions or crores or decimal thereof.</i></li> </ul>	<p>the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given.</p> <p>(l) Turnover Rounding off</p> <ul style="list-style-type: none"> <li>• Less than one hundred crore to the nearest hundreds, thousands, rupees <b>lakhs or millions</b>, or decimals thereof.</li> <li>• One hundred crore rupees or more to the nearest, lakhs, millions or crores, more or decimals thereof.</li> <li>• Once a unit of measurement is used, it should be used uniformly in the Financial Statements.</li> </ul>
<b>PART III – Interpretations</b>	
<b>PART IV – Balance Sheet abstract and a company's general business profile</b>	

**Annexure**

**Format as per Revised Schedule VI**  
**PART I – FORM OF BALANCE SHEET**

*Name of the Company.....*

*Balance Sheet as at .....*

(Rupees in.....)

	<b>Particulars</b>	<b>Notes Reference Number</b>	<b>Figures for the current reporting period</b>	<b>Figures for the previous reporting period</b>
	<b>EQUITY AND LIABILITIES</b>			
<b>1.</b>	<b>Shareholders' funds</b>			
a	Share capital	1		
b	Reserves and Surplus	2		
c	Money received against share warrants			
<b>2.</b>	<b>Share application money pending allotment</b>			
<b>3.</b>	<b>Non-current liabilities</b>			
a	Long-term borrowings	3		
b	Deferred tax liabilities (Net)			
c	Other long term liabilities	4		
d	Long-term provisions	5		
<b>4.</b>	<b>Current liabilities</b>			
a	Short-term borrowings	6		
b	Trade Payables			
c	Other current liabilities	7		
d	Short-term provisions	8		

		Total		
		ASSETS		
<b>1</b>	<b>Non-current assets</b>			
a	Fixed assets			
i	Tangible assets	9		
ii	Intangible assets	10		
iii	Capital Work-in-progress			
iv	Intangible assets under development			
b	Non-current investments	11		
c	Deferred tax assets (Net)			
d	Long-term loans and advances			
e	Other non-current assets			
<b>2</b>	<b>Current assets</b>			
a	Current investments			
b	Inventories	12		
c	Trade receivables	13		
d	Cash and cash equivalents			
e	Short-term loans and advances			
f	Other current assets			
	<b>Total</b>			

**PART II – FORM OF STATEMENT OF PROFIT AND LOSS**

*Name of the Company.....*

*Profit and loss statement for the year ended .....*

(Rupees in.....)

	<b>Particulars</b>	<b>Note No.</b>	<b>Figures for the current reporting period</b>	<b>Figures for the previous reporting period</b>
I.	Revenue from operations		xxx	xxx
II.	Other income		xxx	xxx
III.	Total Revenue (I + II)		xxx	xxx
IV.	Expenses:		xxx	xxx
	Cost of materials consumed		xxx	xxx
	Purchases of Stock-in-Trade		xxx	xxx
	Changes in inventories of finished goods work-in-progress and Stock-in- Trade			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expense			
	Other expenses			
	Total expenses		xxx	xxx
V.	Profit before exceptional and extraordinary items and tax (III-IV)		xxx	xxx
VI.	Exceptional items		xxx	xxx
VII.	Profit before extraordinary items and tax (V - VI)		xxx	xxx
VIII.	Extraordinary Items		xxx	xxx
IX.	Profit before tax (VII- VIII)		xxx	xxx

Particulars		Note No.	Figures for the current reporting period	Figures for the previous reporting period
X	Tax expense: (1) Current tax (2) Deferred tax		xxx <u>xxx</u> xxx	xxx <u>xxx</u> xxx
XI	Profit (Loss) for the period from continuing operations (VII-VIII)		xxx	Xxx
XII	Profit/(loss) from discontinuing operations		xxx	Xxx
XIII	Tax expense of discontinuing operations		xxx	Xxx
XIV	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)		xxx	Xxx
XV	Profit (Loss) for the period (XI + XIV)		xxx	xxx
XVI	Earnings per equity share: (1) Basic (2) Diluted		xxx xxx	xxx xxx

**NOTES TO ACCOUNTS  
(EXTRACTED FROM REVISED SCHEDULE VI)**

			Figures for the current reporting period	Figures for the previous reporting period
1.	<b>Share Capital</b> Equity share capital Authorised share capital Issued, subscribed and fully paid share capital Calls unpaid			



			<b>Figures for the current reporting period</b>	<b>Figures for the previous reporting period</b>
	Forfeited shares Preference share capital Authorised share capital Issued, subscribed and fully paid share capital Calls unpaid Forfeited shares Total			
<b>2.</b>	<b>Reserves and Surplus</b> Capital Reserves Capital Redemption Reserves Securities Premium Reserves Debenture Redemption Reserves Revaluation Reserve Other reserve/ fund Surplus Total			
<b>3.</b>	<b>Long-term borrowings</b> Secured Bonds/ Debentures Term loans Deferred payment liabilities Deposits Unsecured Bonds/ Debentures Term loans Deferred payment liabilities Deposits Total			

			Figures for the current reporting period	Figures for the previous reporting period
4.	<b>Other long term liabilities</b> Trade payables Others  Total			
5.	<b>Long-term provisions</b> Provision for employee benefits Others  Total			
6.	<b>Short-term borrowings</b> Secured Loans repayable on demand Loans and advances from related parties Deposits Other loans and advances Unsecured Loans repayable on demand Loans and advances from related parties Deposits Other loans and advances  Total			
7.	<b>Other current liabilities</b> Current maturities of long term debt Current maturities of finance lease obligation Interest accrued but not due on borrowings Interest accrued and due on borrowings Income received in advance Unpaid dividends Refundable share application money			

			Figures for the current reporting period	Figures for the previous reporting period
	Unpaid matured deposits and interest accrued thereon			
	Unpaid matured debentures and interest accrued thereon			
	Other payables			
	Total			
<b>8. Short-term provisions</b>				
	Provision for employee benefits			
	Others			
	Total			
<b>9. Tangible assets</b>				
	Land/ Building/Plant & Equipment/Furniture & Fixtures/ Vehicles/Office Equipment/Others (individually)			
	Opening balance			
	Add: Acquisition through business combination			
	Other adjustments			
	Sub total			
	Less: Disposals			
	Gross block at year end (a)			
	Less: Depreciation			
	Opening depreciation			
	Depreciation for the year			
	Total accumulated depreciation (b)			
	Net carrying value (a) - (b)			
	Total			
<b>10. Intangible assets</b>				
	Goodwill			

			Figures for the current reporting period	Figures for the previous reporting period
	Brands/Trademarks/ Computer Software/Mastheads and publishing titles/Mining rights/Copyrights/Patents/Licenses, etc (individually) Opening balance Add: Acquisition through business combination Other adjustments Sub total Less: Disposals Gross block at year end (a) Less: Amortisation Opening amortisation Amortisation for the year Total accumulated amortisation (b) Net carrying value (a) - (b) <div style="text-align: right;">Total</div>			
<b>11. Non-current investments</b>	Trade Investments Investment Property Investments in Equity Instruments Investments in Preference Shares Investments in Government and Trust Securities Investments in Debentures or Bonds Investments in Mutual Funds Investments in Partnership Firms Other non-current Investments			
	Total			

			<b>Figures for the current reporting period</b>	<b>Figures for the previous reporting period</b>
<b>12.</b>	<b>Long Term Loans and Advances</b> Secured considered good Capital Advances Security Deposits Loans and advances to related parties Other loans and advances Total Unsecured considered good Capital Advances Security Deposits Loans and advances to related parties Other loans and advances Total Doubtful Capital Advances Security Deposits Loans and advances to related parties Other loans and advances Total			
<b>13.</b>	<b>Other non-current assets</b> Long term trade receivables Secured considered good Unsecured considered good Doubtful Others Total			
<b>14.</b>	<b>Current Investments</b> Investments in Equity Instruments Investments in Preference shares			

			Figures for the current reporting period	Figures for the previous reporting period
	Investments in Government or Trust securities			
	Investments in debentures or bonds			
	Investments in Mutual funds			
	Investments in Partnership firms			
	Other current investments			
	Total			
<b>15. Inventories</b>				
	Raw materials			
	Work in progress			
	Finished goods			
	Stock in trade			
	Stores and spares			
	Loose tools			
	Others			
	Total			
<b>16. Trade receivables</b>				
	Secured/ Unsecured/ Doubtful			
	Less: Allowance for Bad debts			
	Total			
<b>17. Cash and cash equivalents</b>				
	Balances with banks			
	Cheques, drafts on hands			
	Cash on hand			
	Others			
	Total			
<b>18. Short term loans and advances</b>				
	Loans and advances to related parties (Secured/unsecured/doubtful)			

			Figures for the current reporting period	Figures for the previous reporting period
	Others			
	Total			
<b>19.</b>	<b>Contingent liabilities and commitments (to the extent not provided for)</b>			
	Contingent liabilities			
	Claims against the company not acknowledged as debt			
	Guarantees			
	Other money for which the company is contingently liable			
	Total			
	Commitments			
	Estimated amount of contracts unexecuted on capital account			
	Uncalled liability on shares and other investments partly paid			
	Other commitments			
	Total			
<b>20.</b>	<b>Revenue from Operations (for companies other than a finance company)</b>			
	Revenue from - Sale of products			
	Sale of services			
	Other operating revenues			
	Less: Excise duty			
	Total			
<b>21.</b>	<b>Revenue from Operations (for finance companies)</b>			
	Interest			
	Other financial services			
	Total			

			Figures for the current reporting period	Figures for the previous reporting period
<b>22.</b>	<b>Finance Costs</b> Interest expense Other borrowing costs Applicable net gain/loss on foreign currency transactions/translation Total			
<b>23.</b>	<b>Other Income</b> Interest income Dividend income Net gain/loss on sale of investments Other non-operating income (net of expenses directly attributable to such income) Total			
<b>24.</b>	<b>Employee Benefits Expense</b> Salaries and wages Contribution to provident and other funds Expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), Staff welfare expenses Total			
<b>25.</b>	<b>Other expenses</b> Consumption of stores and spare parts Power and fuel Rent Repairs to buildings Repairs to machinery Insurance Rates and taxes, excluding, taxes on income Miscellaneous expenses Total			



## HOW TO SCRUTINIZE – JOURNAL AND LEDGER

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### SCRUTINY OF JOURNAL VOUCHERS

5.1 The transactions which cannot be accounted through sales, purchase, payment, receipt vouchers etc. namely "*Rectification Entries*", "*Adjustment Entries*", "*Closing or Opening Entries*" and making or providing for estimates are passed through Journal Voucher. Even though primary purpose of journal vouchers is to account miscellaneous transactions. Journal voucher may use different series of ledger according to type of transaction on double entry system of accounting, hence, probability of compensating error is much higher in comparison of other transaction, which may impact the service tax liability.

### IMPORTANCE OF STUDY OF JOURNAL VOUCHERS (JVS)

5.2 Study of JVs reflects the entire working of a company. Accounting systems and procedures adopted for various transactions can also be found out. For example, if a company is following a system of cost centers for all the main divisions of a unit, in that case, purchases, expenses, sale, and other incomes relating to each such cost center would be accounted for separately. A study of JVs in such system may help a tax auditor in finding out use of various raw materials and capital goods in cost centers not undertaking excise related activities. In case of a manufacturing company, if construction department, repairs and maintenance department and training center are separate cost centers, in that case, use of input and capital goods in these departments would be accounted for separately and study of JVs may show such ineligible items if Cenvat Credit has been taken. Similarly, input and capital goods used in R&D department may be eligible for Cenvat credit but company may not be availing credit on such items, and study of JV may help an auditor in

advising the company to avail the credit. Numbers of adjustment entries are also passed through JVs. Most of adjustment and rectification entries are also passed through JVs at the year-end or on a monthly basis, therefore JVs for year-end month and one or two other months must be studied by a tax auditor. Following case studies may explain the importance of study of a JV.

### CASE STUDY – 1

5.3 A company is manufacturing machineries, where steel is one of the inputs and steel waste is generated during the production of final product. Following two JVs were found at the year-end.

#### JV-1

Water Drainage system A/c	... Dr.
Building repair A/c	... Dr.
Electrical fittings A/c	... Dr.
Sales Promotion A/c	... Dr.
To Steel control A/c	

(Being accounting of steel consumption during the year to various revenue and capital jobs as per annexure)

#### JV-2

Factory building construction A/c	...Dr.
To Steel scrap A/c	

(Being accounting to steel scrap generated by E.1 Plant used for construction of chimney and flooring of factory building - E.10).

Explanation: Following facts were noticed on study of above mentioned two JVs and annexures.

#### (a) JV-1

- (i) Steel items have been used for water drainage system (pipes), building repair (angles and frames), electrical fittings (wires) and sales promotion (steel sheet used for making signboards).

- (ii) Steel control A/c was debited on purchase of steel items meant for production activities. On the basis of monthly issues made by store department to various manufacturing divisions in the factory, a monthly JV for following entry was passed to account for raw material consumption.

E.1 R.M. consumption A/c ...Dr.

E.2 -- A/c ...Dr.

E.3 -- A/c ...Dr.

E.4 - - A/c ...Dr.

To Steel Control A/c

(Monthly consumption of four production centers booked as per statement received from stores department)

- (iii) Steel items issued to other divisions like building repair were not booked on monthly basis because most of the material required by these sections were generally purchased separately but whenever materials like steel were available in the plant, same was used and its accounting was done at the year end.
- (iv) On all steel items purchased for production centers, Cenvat credit was availed. But, Cenvat credit was not reversed on steel used by non-production departments like water drainage, building repair, etc. Hence, a tax auditor could detect wrong availment of credit by study of said JV.

**(b) JV – 2**

- (i) Steel scrap was generated in each manufacturing divisions and it was transferred to a common scrap yard. Value of steel scrap (estimated basis) transferred to the scrap yard was given as credit to the concerned division by passing the following JV:

Steel scrap stock A/c ... Dr.

To Raw material consumption – Plant E.1 A/c

The impact of this entry is that raw material consumption has been reduced by scrap value.

- To E Duty payable A/c

- (iv) As per normally accepted accounting principles, sale of scrap or waste is required to be shown separately in the Profit & Loss A/c but this company is not showing sale of scrap but reducing the value of raw material consumption.

5.4 A company manufacturing motor vehicle is having number of divisions in the factory and each division is a cost center. Unit is availing Cenvat credit on capital goods. Following JV was found at the end of a month:

<i>Sl. No.</i>	<i>Head of A/c</i>	<i>Account code</i>	<i>Debit ₹</i>	<i>Credit ₹</i>
01	<i>CENVAT Credit availed on capital goods A/c</i>	110107	5,20,500	-
02	<i>Special repair for machinery</i>	420130		10,500
03	<i>Power plant division</i>	210314		10,000
04	<i>Building repair (painting shop)</i>	610310		50,000
05	<i>Marketing Expenses (warehouse)</i>	71310		20,000
06	<i>Pay Roll Department (computers)</i>	50010		36,000
07	<i>Plant &amp; Machinery (engine division)</i>	EP610		64000
08	<i>Plant &amp; machinery (body shop)</i>	FR 210		3,30,000

CENVAT credit items issued during December 2015 as per statements received from Stores Department)

***Explanation:***

- (i) During 2015-2016, credit on capital goods was available, subject to the condition of installation of capital goods. Therefore, the company followed a system where based on monthly issues of capital goods items (including spares), the CENVAT credit was availed.
- (ii) Following entries were passed for purchase of a machinery and availing the credit.
  - (a) On purchase of a machinery of basic value of ₹1000 and excise duty of ₹160.
 

Stores A/c	...Dr.	1160
To Supplier		1160
  - (b) On issue of machinery to a production unit say Engine Division
 

Plant & Machinery A/c (Engine Division)	...Dr.	1160
To Stores A/c		1160
  - (c) Availing of credit of ₹160
 

CENVAT credit availed on capital goods A/c	...Dr.	160
To Plant & Machinery A/c (engine division)		160
- (iii) On going through the JV and its annexure, it was noticed that even though capital goods were issued to divisions like building repair (electric cables), marketing warehouse (computers for marketing sections), pay-roll department (computers and other office equipments), the credit on such items were availed which appears to be wrong.

- (iv) Study of one JV for each month could show use of capital goods in divisions other than manufacturing divisions and therefore study of these ledger accounts like Building Repair A/c (A/c No. 610310) could show wrong availment of credit for entire period.

### CASE STUDY – 3

5.5 A petroleum company was importing motor spirit and was also having its refinery at Mumbai. The company was transferring the imported and refinery produced stock to its terminals at Pune and other places through a common pipeline. The said goods were transferred under bond and custom duties on imported products and excise duties on refinery products were paid at terminal. At Pune terminal, total quantities of motor spirit received were accounted for in a combined RG.I register and based on telephonic instructions received every day, the quantity of imported stock was entered in imported bond register and balance quantity was entered as excise bonded goods. Import duties were paid on imported quantities as per details available in imported bond register and on balance quantities excise duties were paid at the time of clearances from terminal. A tax auditor noticed following JV:

Motor spirit stock (imported) difference A/c	Dr.	50 lakh
H.O. A/c	Dr.	75 lakh
To Motor Spirit stock (Refinery) difference A/c		75 lakh
To H.O. A/c		50 lakh

(Being the differences in quantities of imported stock and refinery stock for the month of December 2015 as per calculation below)

	<i>Imported</i>	<i>Refinery</i>	<i>Total as as per RG.I</i>
As Per			
Pune record	15000 KL	38,000KL	53000 KL
HO statement	15500 KL	37,500KL	53000 KL
Difference	(-) 500 KL	(+) 500KL	
Value		₹10,000/KL	15,000KL

***Explanation:***

- (i) Following entries were passed for receipt of product from HO
- |  |           |           |
|--|-----------|-----------|
| Motor Spirit (Imported) Stock A/c ...Dr. | 15 crores |           |
| To H.O. A/c                              |           | 15 crores |
- (During December 2015, 15000 KL @ ₹10,000/- per KL motor spirit (imported) received as per daily statements)
- (ii) For receipt of refinery product
- |  |          |          |
|--|----------|----------|
| Motor Spirit (refinery) Stock A/c ...Dr. | 57crores |          |
| To H.O. A/c                              |          | 57crores |
- (During December 2015, 38000 KL @ ₹15000 KL motor spirit (refinery) received as per daily statements)
- (iii) Payment of customs duties
- |                          |        |             |
|--------------------------|--------|-------------|
| Basic Customs Duties A/c | ...Dr. | 4.5 crores  |
| SCD A/c                  | ...Dr. | 1.5 crores  |
| CVD A/c                  | ...Dr. | 2.10 crores |
| To Bank A/c              |        | 8.10 crores |
- (BCD @ 30%, special customs duties @ ₹1 per liter and CVD @ 10% paid for imported product)
- (iv) Payment of excise duty
- |                         |        |            |
|-------------------------|--------|------------|
| Excise Duty A/c         | ...Dr. | 5.7 crores |
| Special excise duty A/c | ...Dr. | 3.8 crores |
| To Bank A/c             |        | 9.5 crores |
- (Excise duty paid on refinery products cleared during the month)
- (v) Scrutiny of JV revealed that actually 15500 KL of imported motor spirit was received but by mistake it was entered at 15000 KL only. The mistake had occurred due to wrong noting of telephonic message at Pune. But it resulted in paying excise duty on 500 KL of ₹7.5 lakhs (10% duty on value of ₹75 lakhs) instead of correct payment liability of customs duty of ₹15 lakhs (30% duty on value of ₹50 lakhs). Hence, the company short paid duties by ₹7.5 lakhs.

**CASE STUDY-4**

5.6 A Company was engaged in the manufacture of shampoo and they were also getting it manufactured on job work from other manufacturers and marketing the same. The company was charging a cum-duty price from their customer, which was inclusive of excise duty and sales tax, hence they were claiming a deduction for sales tax on equalised basis. Following JV was found by a tax auditor.

Sales Tax payable A/c	...Dr	28 lakhs
To Sales-tax – Trading goods A/c		18 lakhs
To Sales-tax – Manufactured goods A/c		10 lakhs

(Total sales tax payable during the month segregated as per statements received from depots enclosed)

***Explanation:***

For claiming deduction for sales tax, the company was submitting a certificate from a chartered accountant certifying that based on total amount shown in Sales tax payable A/c, per unit sales tax payable was arrived at say ₹5.50 and same was claimed as discount in arriving at the assessable value. The above JV showed that total amount as per Sales tax payable A/c comprised of sales tax payable on both manufactured goods and trading goods. Therefore, actual sales tax paid on per unit of manufactured goods was much less than the amount claimed as deduction. In fact, actual amount of sales tax payable on manufactured goods was only ₹2 per unit, and assessee paid lesser excise duty based on lower assessable value.

**CASE STUDY-5**

5.7 A Company manufacturing milk based nutrients drink for children introduced a new variety of product and initially supplied the same as free samples in the market. They paid duty based on a costing certificate issued by a chartered accountant showing the cost @ ₹3 per packet, because no comparable price was available.



Following two JVs were found

JV-1	Marketing expense A/c	...Dr.	1,20,000	
	To Free sample A/c			1,20,000

(Cost of free sample of 30,000 packets cleared during January to March 2000 charged to marketing expenses)

JV-2	Free sample A/c	...Dr.	1,20,000	
	To Raw Material consumption A/c			70,000
	To Packing material consumption A/c			20,000
	To Labour A/c			10,000
	To Other manufacturing overhead A/c			12,000
	To Office overhead A/c			8,000

(Cost of free samples allocated to various costs as per statement of production planning Deptt.)

***Explanation:***

- (i) From the above JV it was noticed that cost of manufacture of free samples was charged to Marketing expenses A/c. In the absence of said accounting treatment the cost of production of goods sold would have increased.
- (ii) From the cost-sheet enclosed with JV, it was noticed that actual cost of such samples was ₹4 per packets. Moreover notional profit was also required to be added to arrive at correct assessable value as per the Valuation Rules.
- (iii) CA certificate had shown total raw material and packing cost per unit at ₹1.5, all over head at ₹1.00 and profit of ₹0.5 (20%) whereas as per company's own statement, actual cost were much higher.

**CASE STUDY – 6**

5.8 A company manufacturing machineries as per the specification provided by the customer passed following JV:

Customer A/c	...Dr.	67,375	
To Interest A/c			67,375

(Interest charged for non-payment of advances by M/s ABC as per details below)

<i>Advance Amt</i>	<i>Advance payable Date</i>	<i>Date of payment</i>	<i>Days</i>	<i>Interest Amt @ 16%</i>
5 lakh	1.1.2015	30.6.2015	180	39452
7 lakh	1.4.2015	30.6.2015	91	27923
				67375

***Explanation:***

- (i) In the Profit & Loss Account, interest income was shown but generally no further explanation is called for such income by auditors because interest income is earned on investments made by a company.
- (ii) Study of JV showed that the company had the system of taking advances in two installments. In case of non-payment of advances, the company was charging interest. The said interest amount is an additional consideration, which may be required to be added in the assessable value.

**CASE STUDY – 7**

5.9 Following JV was found while scrutinising records of a company.

XYZ Ltd., New York, USA A/c                      ...Dr      57 lakhs  
To Custom duties paid A/c    57 lakhs

(Being the amount of customs duties to be recovered from XYZ Ltd., USA because of damage of DG set imported by us and got damaged in transit from Mumbai Port to factory, as per condition of agreement and insurance policy)

***Explanation:***

- (i) On going through the LC (letter of credit) and other correspondences with the supplier of machinery, it was noticed that insurance was taken by the supplier and insurance cover was for delivery upto the factory. In this case after payment of customs duties at Mumbai Port, the machinery got damaged in transit from the Port to the factory. Hence, as per the conditions of the

insurance policy, even the customs duties paid were required to be reimbursed by the insurance company. Hence, the JV was passed.

- (ii) Further scrutiny of CENVAT credit revealed that company had availed CENVAT Credit on said machinery, which was not even installed.
- (iii) In fact they said machine was exported and a free replacement was received, on which company had paid customs duties and availed the CENVAT credit also.

The above-mentioned case studies clearly show that scrutiny of JVs is very important and number of tax related issues can be discovered. Such issues could escape the attention of a tax auditor in case of their failure to study the financial records.

## **SCRUTINY OF GENERAL LEDGER**

### ***Which ledger to be seen***

5.10 A company maintains different types of ledgers like Debtor's ledger, Creditor's ledger and General Ledger. A General Ledger contains the accounts of assets, liabilities, incomes and expenditures. A tax auditor may be interested in finding out whether a unit has paid taxes on the correct value or the input tax credit availed by them is in order. These aspects can be verified by a study of income and expenditure accounts. Since the General Ledger contains all the income and expenditure accounts, its study is most important as a part of audit. Study of the debtor's ledger and the creditor's ledger may also reveal important points to a tax auditor. The study of General Ledger has been discussed in detail in this chapter along with important aspects of debtor's and creditor's ledgers.

### ***Which Accounts to be scrutinized?***

5.11 A General Ledger may contain 100-500 accounts depending upon the size of a company and also depending upon the accounting policy followed by a company. For example, a company may account for the purchases of all types of raw material in one account, whereas another company may maintain separate accounts for each major raw material. As the General Ledger contains a large number of accounts, and a tax auditor may not be interested in all accounts, therefore selection of accounts for

scrutiny is very important. The first step in this direction is to obtain the list of accounts in the ledger. The list of accounts is normally available as an index in the General Ledger. Account numbers are generally allotted keeping all similar account in same series. For example, all assets accounts may be given 500 series, liabilities accounts may be given 600 series, expenditure accounts may be given 700 series and so on. An understanding of the account code logic helps an auditor in identifying the nature of a particular account. Another method for finding out the account number is to ask for the trial balance. The trial balance contains the account no., description of account, debit amount, credit amount and the balance. In other words, a list of all accounts having a balance is available in the trial balance. It is advisable to obtain the trial balance showing total debits and trial credit amount for each account in the ledger because if the company furnishes a trial balance, where only net balance (debit or credit) is given, in that case it is possible that some accounts, whose balance at the end of the year is NIL, may not be reflected in the trial balance and there may escape the auditors scrutiny. For example, if a company is recovering packing charges from customers and crediting in a account viz. Packing Material Recovery Account, but if at the end of the month the balance in that account is transferred to the Packing Material Purchase Account in that case the Packing Material Recovery Account may not be shown in trial balance showing only net balances. For a tax auditor the said account could be very important for determining correct value for payment of central excise duty or sales tax. Therefore, it should be ensured that a trial balance showing the total debit and credits should be obtained for audit purposes.

### ***General Rules for Selection of Accounts for Scrutiny***

5.12 There are no fixed rules as to which accounts should be selected for scrutiny by a tax auditor because companies manufacture different products, follow different accounting policies, different marketing policies, or use different types of accounting software packages. The selection of accounts also depends upon the audit plan. For example, for a unit liable to pay excise duty based on the Maximum Retail Price of the product, the type of account selected may be totally different from a unit which is paying excise duty on the basis of the transaction value. However, following general rules may be kept in mind while selecting the accounts for scrutiny.

- (a) Credit entries in raw material or other input purchase account

- (b) Credit entries in expense account
- (c) Income accounts
- (d) Unusual accounts

### **CASE STUDY 8**

5.13 Let us consider the following ledger account of a company manufacturing aluminum pipes and maintaining computerized accounts.

<i><b>Date 2016</b></i>	<i><b>Document reference</b></i>	<i><b>Description</b></i>	<i><b>Debit Amount</b></i>	<i><b>Credit Amount</b></i>
01.04	P.Inv.5802	To HINDALCO	5,50,000	
02.04	P.Inv.5880	To HINDALCO	1,40,000	
02.04	D/N.150	By HINDALCO		35,000
28.04	D/N 158	By HINDALCO		8,440
30.04	JV-121	By CENVAT A/c		96,000
30.04	JV-122	By R.M. Consumption A/c		5,25,000
30.04	JV.123	By Building A/c		5,000

From the above account, please state what is your understanding of each entry:-

**Solution:**

<i><b>Entry No</b></i>	<i><b>Transaction</b></i>
<i><b>Entry 1</b></i>	Company purchased aluminium from Hindalco for ₹5,50,000.
<i><b>Entry 2</b></i>	Company purchased aluminium from HINDALCO for ₹1,40,000.
<i><b>Entry 3</b></i>	Debit note No.150 dated 02.04.2016 issued to HINDALCO for ₹35,000/-.It means company has to collect ₹35,000/- from HINDALCO. Debit note might have been issued for reasons like :- (a) Rejection and return of goods. (b) Price charged more by HINDALCO (c) Quality not proper, hence prices reduced

	(d) Discount not given by HINDALCO in purchase invoice as agreed by them in purchase order confirmation.
<b>Entry 4</b>	Debit Note No.158 dated 28.04.2016 issued to HINDALCO for recovering ₹8440 for various reasons discussed above.
<b>Entry 5</b>	Journal Voucher No.121 dated 30.04.2000 passed for transferring an amount of ₹96,000 to MODVAT A/c. It means, initially Purchase Account is debited for full value including excise duty and at the end of the month, modvat amount is transferred to CENVAT Account..
<b>Entry 6</b>	JV No: 122 passed whereby Raw Material Consumption Account has been debited.
<b>Entry 7</b>	JV No. 123 passed for transferring ₹5000 to Building A/c.

A reading of the said Aluminum Purchase Account, will show that entries in the credit side of the account are important because these might have a bearing on CENVAT credit availment. In the present case, the tax auditor should call for Debit Note No.150 & 158 and JV No.121, 122 and 123 to find out exact reasons for such transaction.

On examination of these documents, the following facts were noticed:

- (a) DN 150 was issued because of short receipt of aluminium ingot from HINDALCO. Initially GRN was prepared based on quantity mentioned in Invoice and Delivery Challan of HINDALCO. Thereafter a remark was made on GRN about short receipt. Copy of GRN was also enclosed with Debit Note.

Exercise:13-D: What accounting entry have been passed for recording this transaction in the books.

..... A/c. Dr.  
To.....A/c.....

[Being short receipt of 3500 kg. of ingot against purchase invoice No. 5802 dt. 24.03.2000. Debit Note No. 150 issued to HINDALCO.

- (b) D.N. 158 has been issued to HINDALCO as they have charged a higher rate than that agreed as per the Purchase Order. The description in the debit note reads as below:

— Rate charged in Invoice No: 5880 dated 28.03.2016 ₹85/Kg.

—	Rate as per P.O.No. IND-59 dated 20.03.2000	₹80/Kg.
—	Difference in prices for 1300 Kg	₹6,500
—	Difference in Sales Tax & E.duty (1040 + 900)	₹1,940

Note: In case of DN 150 & 158, a tax auditor may like to verify whether CENVAT or sales tax credit was reversed by the company or not.

- (c) JV.No 121: Following entry has been passed.

CENVAT A/c	Dr. 96,000/-	
To Aluminium Purchase A/c		96,000/-

(Being the CENVAT availed for the month of April 2016 on purchase of Aluminium transferred to CENVAT Account)

Exercise 13-E: As a tax auditor what would you like to verify to confirm the correctness of above information?

Exercise: 13-F: As per the CENVAT return filed with the department the total Credit availed on Aluminium Ingot is ₹1,20,000. What would you like to verify further and why?

- (d) JV.122 – Following entry has been passed

R.M. Consumption A/c	Dr. 5,25,000/-	
To Aluminium Purchase A/c		5,25,000/-

(Being consumption of Aluminium for April 2016 as per statement of Stores Department).

From this JV, one fact comes to the knowledge of the tax auditor that the company has a regular system of determining consumption of raw-material based on total issues made by the store department to production departments. Therefore he may find out what are the statements/report generated by stores and production department about raw-material consumption, wastage, damage and obsolete items. This may help him in determining the input-output ratio, any unusual happening like theft of material or destruction of material or percentage of wastages etc.

- (e) JV No. 123 – The description in the JV shows that some of the aluminium item namely rods were used for construction of a

building, Therefore, the value of such pipes has been debited to the building account. A tax auditor should verify whether credit was reversed on such goods or not.

### ***Scrutiny of Other Income Accounts***

5.14 A quick study of description of income accounts from the trial balance may help a tax auditor to select relevant accounts for further scrutiny. For example, accounts like interest on investment, or dividend may not be of much relevance from the central excise or service tax point of view. For other accounts, a detailed scrutiny of nature of these incomes is very important. The scrutiny of these accounts should be done from the following two angles: -

- (i) Whether the nature of income is such that excise duty / service tax is liable to be paid or which is required to be added to the assessable value of manufactured goods cleared or services provided by them.
- (ii) If (i) is yes, whether all such transactions/recoveries have suffered payment of duty / service tax.

### ***Nature of Account***

5.15 After selection of accounts, the first task of a tax auditor is to find out the exact nature of transactions covered by such account. Study of details in source documents like description in invoice or narration in voucher or study of other related documents like copies of agreements may help in finding out correct nature of transaction.

### ***Unusual Accounts***

5.16 Before commencement of audit, a tax auditor should acquaint himself with the working of the unit. Once the broad working of the unit is known to the auditor, study of the trial balance become easier. With the experience, a tax auditor may know as to what type of accounts are commonly prepared by a particular industry. Therefore, sometimes, study of a trial balance may reveal some unusual accounts, which are commonly not found in a particular industry or the nature of account itself may show some relevance to the determination of the tax liability.



# 6

## **HOW TO STUDY FINANCIAL DOCUMENTS**

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### **STUDY OF ANNUAL REPORT OF A COMPANY**

#### ***What is Annual Report***

6.1 As per the provisions of the Companies Act all companies are required to prepare an annual report for submission to the shareholders for consideration in the annual general meeting. The Annual report is prepared every year and it contains the following :

- (i) Directors' Report
- (ii) Statutory auditor's Report
- (iii) Financial statements i.e., Balance Sheet, P & L A/c, notes and Cash Flow Statements etc.
- (iv) Disclosure as required under SEBI Act.
- (v) Financial statements of subsidiary companies, *if any* (~~Section 212~~)
- (vi) Corporate Governance report
- (vii) Management discussion and analysis report

Whenever copies of Balance Sheet and profit and loss account are called for from the assessee, they submit the said annual report only. To a tax auditor not only the Balance Sheet and the Profit and Loss Account but all other information available in the annual report is useful.

#### ***General Information***

6.2 Details such as names of directors, addresses of manufacturing plants, registered office, corporate office, name of auditors etc are

available on first few pages of the annual report. Composition of the board of director may show whether the company is closely held company (mostly family members) or otherwise. Information about location of service provider/ manufacturer may be used to find out some more details about type of services provided or products manufactured.

***Director's Report (Section 134 of the Companies Act, 2013)***

6.3 Directors are required to submit certain reports to the stakeholders about the activities and progress of the company, one such report is Directors Report. This report is given by the directors of the company to the shareholders and it is given after statutory audit of the company is completed. It contains the following information:

- (i) Financial highlights;
- (ii) Amounts proposed for transfer to reserves;
- (iii) Proposed dividend;
- (iv) the extract of the annual return as provided under sub-section (3) of section 92;
- (v) a statement on declaration given by independent directors under sub-section (6) of section 149;
- (vi) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report; and by the company secretary in practice in his secretarial audit report;
- (vii) particulars of loans, guarantees or investments under section 186;
- (viii) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form;
- (ix) Important happenings, trends, future plans;
- (x) Explanation on auditor's qualification;
- (xi) Details of conservation of energy, technology absorption, foreign exchange earning and outgo

(xii) Key Managerial Personnel

(xiii) Corporate Social Responsibility(CSR)

Overall financial results like income (Turnover of Goods or Services and other income), total expenditure, gross profit, depreciation, interest, tax expense, net profit or loss are reported in summarized form in the director's report. The director's may also inform the shareholders about any important events or development or material charges and commitments affecting financial position of the company during the year. The auditor may go through the reports to see whether any of the remarks of the authority of the assessee has any adverse aspect on the excise/service tax valuation and tax liability. Report also contains the director comments on adverse report of statutory auditor.

### CASE STUDY – 1

6.4 Following observations were found in the director's report in the Annual Report of three companies:

**Illustrations (a):** *"During the year a major fire broke out at our Pune plant in August, 2005 resulting in substantial damage to the paper making plant and the burning of raw-material and finished goods. The company has lodged the insurance claim. However, we were able to repair the plant and manufacturing activities were restarted by end of February 2016. Due to stoppage of this plant our profits have reduced substantially".*

**Explanation:**

The above remarks in director's report could be very useful to a tax auditor to find out following aspects:-

- (i) Whether CENVAT credit was reversed on input or input contained in work in progress and finished goods destroyed by fire.
- (ii) Whether remission of duty on finished goods has been claimed.
- (iii) Whether any of the capital goods, which got damaged, have been cleared as scrap and whether CENVAT credit was availed in the past on the said capital goods.

Copies of insurance claim should be obtained to find out the details of the claim lodged with insurance company. One important area to be verified is

whether excise duty element has also been claimed from insurance company. If so, whether provisions of Section 11D can be invoked.

Similarly, any other major happening like theft, loss by flood etc. may also find place in director's report and it may be useful to a tax auditor. A Company may acquire shareholding in other company by which it may become a holding company or some other company may acquire majority shares, whereby, this company may become a subsidiary company would be mention in the director's report.

### **CASE STUDY – 2**

6.5 *“In order to strengthen marketing activities, your company have acquired majority shares in ABC Marketing Ltd., which had become a subsidiary company from this year”.*

#### ***Explanation :***

The above information is very important to a tax auditor and he may inquire the matter further from valuation angle. He may like to find out whether the company is supply of services or goods to the subsidiary company or *vice-versa*. In the present valuation provisions, holding and subsidiary company have been treated as “*related person*” and the rate at which the buyer company is supplying goods or services is considered as the assessable value for payment of service tax.

### **CASE STUDY – 3**

6.6 Please read the following excerpts from a director's report. What further information should be called for by a tax auditor and why?

*“Your company has initiated various actions to meet the challenges of the market. Among the steps taken are introduction of state of the art new products, provision of technical and engineering services and starting of e-commerce marketing. Your company is among the first few in the country to start trading though web-site”.*

#### ***Explanation:***

- (i) Exact nature of engineering services provided to customer should

be inquired into. These may be related to or in connection with sale of goods, which may affect valuation. Otherwise, it may even attract payment of service tax.

- (ii) Exact system of trading on e-com basis should be found out to verify correctness of payment of duty.

#### **CASE STUDY – 4**

6.7 Please read following excerpts from director's report of a machinery-manufacturing unit. As a tax auditor which important areas you may like to inquire into.

*"Performance and profitability: During the year under reference your Company has incurred a loss of ₹ 9002.73 lakhs ( for 18 months) on a turnover of ₹ 8785.39 Lakhs The expenses to the extent of ₹ 3589.20 lakhs has been charged to the profit and loss account pertaining to earlier years. The loss is mainly attributable to higher depreciation, write off of slow and non-moving and obsolete inventory, as suggested by the concurrent auditors appointed by the lead bank and higher interest burden. In addition there has been increase in cost of raw materials and components consumed which could not be absorbed in the selling price."*

#### **Explanation:**

- (i) Details of write-off of slow, non-moving and obsolete inventory. Whether these have been sold subsequently and whether CENVAT availed has been reversed.
- (ii) What is the impact of increase in raw-material cost to PLA/ CENVAT ratio.
- (iii) Expenses of previous years- Does it include inputs on which credit was availed in the past.

#### **CASE STUDY – 5**

6.8 Following facts are available to a tax auditor about a unit.

M/s. A Ltd is engaged in manufacture of PFY, texturised yarn and weaving of man-made fabric. The woven fabric is sent to another company

viz., Process and Print ltd (PPL) for processing and printing who pays the excise duty on processed fabric.

While taking round of factory of A Ltd it was noticed that processing house of PPL was situated adjacent to its plant in the same compound.

Following excerpts are noticed from the director's report of A Ltd for the year 2014- 2015

(₹ In Lakhs)

<b>Financial Results</b>	<b><u>2014-15</u></b>	<b><u>2013-14</u></b>
<i>Total Income</i>	38073.37	35655.44
<i>Profit before Depreciation &amp; Tax</i>	2688.27	4200.30
<i>Less: (i) Depreciation</i>	1652.20	1247.87
<i>(ii) Tax</i>	0.50	0.50
<b><i>Net Profit</i></b>	<b><u>1035.57</u></b>	<b><u>2951.93</u></b>
<i>Add: Balance brought forward from</i>		
<i>Earlier years</i>	3123.37	1653.02
<i>Balance available for appropriation</i>	<b><u>4158.94</u></b>	<b><u>4604.95</u></b>
<i>Appropriations</i>		
(a) <i>Debenture Redemption Reserve</i>	42.00	221.90
(b) <i>Proposed Dividend</i>	973.10	959.68
(c) <i>Investment Allowance Reserve</i>	1115.00	---
(d) <i>General Reserve</i>	105.00	300.00
(e) <i>Balance carried forward</i>	1923.84	3123.37
	<b><u>4158.94</u></b>	<b><u>4604.95</u></b>

### **Dividend**

Your Board of Directors recommends a dividend at the rate of 10% on its equity capital of ₹ 97.31 Crores. In view of the fall in net profits, the Board of Directors finds it appropriate to conserve its resources and accordingly reduce the rate of dividend from 19% declared for the year 2013-14 on the capital of 50.51 Crores. The total outflow of dividend for the year 2014-15 will be ₹ 973.10 lakhs.

### **Fixed Deposits**

During the year the company accepted Fixed Deposits from the public amounting to ₹ 6 crores.

### ***Operations***

The Company's business was adversely hit by a continued and substantial increase in the cost of raw materials. This compounded by sluggish indigenous demand of polyester filament yarn which put pressure on the profit margins of the Company.

On the traditional synthetic fabric front, the Company was hit by the introduction of excise duty on texturised yarn, which hitherto was exempt. The increased cost of texturised yarn, which is an input component for manufacture of good quality fabric, for which the company has earned its brand value, increased the cost of production of fabric. The Company was, in the short run, unable to pass on the increase to its consumers due to demand recession experienced in this business, thereby further eroding the operating profits.

The year saw a steep across the board increase in international prices of paraxylene, PTA and MEG which unfavourably affected the prices of polyester chips, the core raw material for making of polyester filament yarn.

This increase in the input cost, accompanied with a stagnant demand for polyester filament yarn in India, evidenced by subdued yarn prices in the domestic market squeezed the Company of its operating profits in yarn manufacturing activity, which otherwise was expected to contribute to the overall profitability of the Company.

The Company, however, continued to concentrate on its inherent strengths and introduced new qualities, weaves and prints, during the year to counter the unfavourable outcome of the hostile external factors.

The Micra and Micrel range of dress materials and sarees received a good response from the consumer as well as the ready-made garment industry.

The exports of the company fell marginally during the year due to international demand recession. The company, however, for the first time exported ready-to-wear garments, which were received well. The company is exploring possibilities of export of its traditional fabrics as well as ready-to-wear garments to new and virgin markets.

### ***Future Outlook***

The company has invested in a highly sophisticated state-of-the-art CAD-CAM system used for printing of fabrics. This will not only allow the

company to introduce superior, precise and intricate designs but will also enable the company to respond to quick trend changes in a highly competitive market.

The company is in the process of developing new microfilament and blended qualities to increase its market share in premium silk- like polyester fabrics. New printing styles like "flock" and "rubber" print developed by the company will go a long way in maintaining the appeal the consumer has always had for the company's products.

The company has franchised eight outlets in different cities to market its Men's Designer Wear under the brand name "K CLOTHING" and the response is promising.

The company expects to improve its performance in the current year in view of stabilized raw material prices, aggressive product innovation and strict cost control.

#### ***Environment & Pollution Control***

The management has undertaken the upkeep of the areas surrounding its factories and offices and made efforts to keep the nearby habitat healthy and hygienic. It also supports local groups which function to make the environment cleaner and pollution-free.

The major part of the company's activities does not generate any effluents. Steps to minimize the damage to the environment and ecology caused by printing and processing of synthetic textiles are being taken by the management.

#### ***Energy, Technology and Foreign Exchange***

Information on conservation of energy, technology absorption, adoption and innovation and foreign exchange earnings and outgo, as required by Section 134 of the Companies Act, 2013 read with the Companies (Disclosure of particulars in the report of Board of Directors) Rules, is annexed to the Directors Report marked as Annexure "A".

#### ***Personnel***

A statement giving details of the employees in accordance with section 134 read with companies (Particulars of Employees) Rules, , as amended, is annexed to the report marked as Annexure "B".



***Directors***

Shri. S.K.Chandra, Shri. K.P. Ramnan and Smt. K. Subramani retire at the forthcoming Annual General Meeting and being eligible, offer themselves for reappointment.

***Auditors***

The company's Auditors Messrs. Vasudev & Co. Chartered Accountants retire at the forthcoming Annual General Meeting and being eligible offer themselves for reappointment.

***Comments on The Auditors Report***

The observations made in the Auditors Report are self explanatory and therefore do not call for any further comments under Section 134 of the Companies Act, 2013.

**ANNEXURE “A”**

Information as per Section 134 read with the Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, and forming part of the Directors Report.

**1. CONSERVATION OF ENERGY**

- (a) Energy Conservation measures taken:
  - (i) Warm water generated through the heat exchanger during the cooling process in jet dyeing machines is re-used for other processes requiring warm water, thereby saving on steam and fuel.
  - (ii) Installation of press switches on jet dyeing machines for view glass illumination lamp, thereby saving on electricity.
  - (iii) Installation of FRP sheets on the factory roofs to facilitate penetration of sunlight, thereby saving on artificial lighting and electricity.
  - (iv) Use of electronic ballast to reduce power consumption
  - (v) Efficient use of 100 KVA sub-station for uninterrupted power supply.
- (b) Additional investments and proposals being implemented for reduction of consumption of energy :

- (i) The Company has entered into an association with National Productivity Council (NPC), Government of India and United Nation Industrial Development Organisation (UNIDO) for control of industrial waste.
- (ii) Efforts are going on across the company for achievement of international standard for water consumption per linear meter,
- (c) Impact of measures (a) & (b) above for reduction of energy consumption and consequent impact on cost of production :  
  
With the various measures undertaken and proposed to be undertaken, the energy consumption is likely to go down and result in reduction in cost of production.

**ANNEXURE “A”****“FORM A”**

From of Disclosure of Particulars with respect to Conservation of Energy

	2014-15	2013-14
<b>A. Power and fuel consumption</b>		
1. Electricity		
(a) Purchased Units in lakhs	533	484
Total amount ₹ in lakhs	1419	1232
Rate/Unit ₹	2.66	2.54
(b) Own Generation :		
(i) Through Diesel Generator		
Units in lakhs	6.12	7.56
Units per Ltr. of Diesel Oil	2.73	2.86
Cost/Unit ₹	3.35	2.73
(ii) Through Stem turbine/Generator Units	NIL	NIL
Units per Ltr. of Oil/gas	NIL	NIL
Cost/Unit ₹	NIL	NIL

2.	Coal/Lignite for Generation of Steam for Jet dyeing:		
	Usage in Boilers and Thermo-Pack. Quantity used "C" Grade		
	Quantity (M.T)	24917	20725
	Total Cost ₹ in lakhs	387.24	278.99
	Average rate ₹ /M.T	1554	1346
3.	Furnace Oil		
	Quantity (K Lts)	NIL	NIL
	Total Amount	NIL	NIL
	Average rate ₹ /Tonne	NIL	NIL
4.	Others/Internal generation		
	Quantity	NIL	NIL
	Total cost	NIL	NIL
	Rate/ Unit ₹	NIL	NIL

**B. Consumption per unit of production**

Product : Textile Fabrics	Mtr.	Mtr.
* Electricity (Unit)	1.17	1.14
Furnace Oil	NIL	NIL
* Coal / Lignite (kg)	0.67	0.51
Others	N.A.	N.A

\* Increase in Consumption per unit of production for textile fabrics is due to change in product mix and installation of additional printing machinery for product improvement.

**What important points can be noticed by a tax auditor from reading of above directors report and what further information would he like to obtain.**

**Key learning:**

- (i) Para on Future Outlook mention that company has invested in CAD-CAM system used for printing of fabric.
- (ii) Para on Environment and Pollution Control mention about steps taken to minimise damage to environment by printing and processing.
- (iii) Annexure A on Conservation of Energy mention about use of jet-dyeing machine.
- (iv) Power and Fuel Consumption report shows use of coal/lignite for Jet-dyeing machine.

All the four factor show that even though A Ltd. was not having textile processing and printing facilities still they were spending on such activities and invested in such facilities, *prima facie* it shows that A Ltd., and Process and Print Ltd., are functioning as one unit.

Further information to be called for from A Ltd & PPL:

- (a) Share holding pattern of both company and common directors shareholding.
- (b) Details of plant and machinery used by PPL – who owns it.
- (c) Actual use of coal/lignite? Expenditure for running of Jet-dyeing machine of PPL incurred by whom?
- (d) Comparison of assessable value of processed fabric declared by PPL and sale price of A Ltd.
- (e) Whether PPL is undertaking processing only for A Ltd or any other customer also?
- (f) Processing charges charged by PPL to A Ltd and to other customer.
- (g) Any other transactions between A Ltd and PPL.

The investigation revealed following points:

- (i) Difference between assessable value of fabric adopted by PPL for payment of excise duty and sale price of fabric by A Ltd (excluding excise duty and sales tax) was in the range of 60% to 80%.

- (ii) Both companies were promoted by same group of directors. More than 50% directors were common.
- (iii) Scrutiny of details in Balance Sheet showed that PPL had sold part of the processing house to A Ltd but still the said plant and machineries were used by PPL for processing of fabric of A Ltd.
- (iv) A Ltd had undertaken R & D activities for PPL in the areas of printing designs, etc., and all expenses were incurred by A Ltd.
- (v) Entire quantity of coal/lignite used by PPL were purchased by A Ltd and paid by them.
- (vi) Process charges recovered from A Ltd were 30% to 40% lower than charged to other customers by PPL.
- (vii) Common facilities were provided by A Ltd without compensation.
- (viii) Profits were diverted to PPL by way of trading in yarn and showing sale of goodwill by PPL to A Ltd.

Investigation proposed PPL as a related person of A Ltd and demanded duty on the fabric at the value sold by A Ltd.

## **STUDY OF INDEPENDENT AUDITOR'S REPORT**

### ***Statutory Audit***

6.9 This audit is mandatory for all companies incorporated under the Companies Act like Private Limited or Public Limited Company. Only a Chartered Accountant is authorized to carry out such audit. The statutory auditor is appointed by the shareholders in the annual general meeting. The report is given by the auditor after thorough examination of the book of accounts and all related records and documents. Once this report is given, the accounts of the company are finalized and thereafter no changes can be made in the accounts of a company.

6.10 Based on study of the records of a company, a statutory auditor is required to give his opinion on following important aspects:

Whether the financial statements give the information required by the Companies Act in the manner so required and give a true and

fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company.

***A specimen format of Independent auditor's report is given below:***

***"Independent Auditor's Report to the members of ABC Ltd."***

**Report on the Financial Statements**

*We have audited the accompanying financial statements of of ABC Ltd., which comprise the Balance Sheet as at March 31, 2016, the Profit and Loss, the Cash Flow Statement for the year then ended, and a summary of the significant accounting policies and other explanatory information.*

**Management's Responsibility for the Financial Statements**

The Company's Board of Directors is responsible for the matters stated in Section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation and presentation of these standalone financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these standalone financial statements based on our audit. We have taken into account the provisions of

the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of the Act and the Rules made thereunder. We conducted our audit in accordance with the Standards on Auditing specified under Section 143(10) of the Act. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and the disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal financial control relevant to the Company's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the accounting estimates made by the Company's Directors, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the standalone financial statements.

### **Opinion**

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at 31 March 2016 and its profit and its cash flows for the year ended on that date.

### **Report on Other Legal and Regulatory Requirements**

1. As required by the Companies (Auditor's Report) Order, 2016 ("the Order") issued by the Central Government of India in terms of sub-section (11) of section 143 of the Act, we give in the Annexure A, a statement on the matters specified in the paragraph 3 and 4 of the order.
2. As required by Section 143 (3) of the Act, we report that:
  - (a) we have sought and obtained all the information and explanations

which to the best of our knowledge and belief were necessary for the purposes of our audit.

- (b) in our opinion proper books of account as required by law have been kept by the Company so far as it appears from our examination of those books;
- (c) the balance sheet, the statement of profit and loss and the cash flow statement dealt with by this Report are in agreement with the books of account;
- (d) in our opinion, the aforesaid standalone financial statements comply with the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014;
- (e) on the basis of the written representations received from the directors as on 31 March 2016 taken on record by the Board of Directors, none of the directors is disqualified as on 31 March 2016 from being appointed as a director in terms of Section 164 (2) of the Act;
- (f) with respect to the adequacy of the internal financial controls over financial reporting of the Company and the operating effectiveness of such controls, refer to our separate report in “Annexure B”; and
- (g) with respect to the other matters to be included in the Auditor’s Report in accordance with Rule 11 of the Companies (Audit and Auditors) Rules, 2014, in our opinion and to the best of our information and according to the explanations given to us:
  - i. the Company has disclosed the impact of pending litigations on its financial position in its financial statements – Refer Note (No) to the financial statements;
  - ii. the Company did not have any long-term contracts including derivative contracts for which there were any material foreseeable losses.
  - iii. There has been no delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the Company.

*CHARTERED ACCOUNTANTS*



### ***Qualified Opinion***

6.11 Sometime, an auditor may not be satisfied with the profit/loss determined by the unit or with the financial position of a unit reflected in the balance sheet on account of reasons like making of insufficient provisions for expenses or non verification of stock or non-receipt of confirmations of amount due from other unit etc. In that case, auditor gives his opinion subject to certain reservations and he is said to have given a qualified opinion. For example, an auditor may state “subject to non-provision of gratuity amounting to ₹ 120 lakhs (note 8 in notes on account), non- provision for obsolete items for ₹ 328 lakhs (note 12 in notes on account) we report that the balance sheet shows a true and fair view .....”. In other words, auditor has given his opinion that balance sheet shows true and fair view of the affairs of the company subject to the fact that company has not made provisions for said two liabilities and accordingly profits of the company have been over reported to the extent of said amounts.

Some more examples of qualification given in auditors report are given below:-

- (a) *“Subject to note No. 9 regarding non-reconciliation of certain stocks of finished goods between stock records and central excise records at one of the units and subject to note No. 13 regarding non-provisions for diminution in value, if any, in respect of slow/non-moving inventory, effect of which is not ascertainable by us, the balance sheet gives true and fair view of the state of affairs as at 31<sup>st</sup> March, 2016: and .....”*
- (b) *“In our opinion and to the best of our information and according to the explanations given to us, the Balance Sheet, subject to our remarks in paragraph 2.1 below, also gives a true and fair view of the state of the Company’s affairs as at March 31, 2016.”*

Para 2.1 reads as under:-

“2.1 As explained in Note 10 in Schedule 8, no provision has been made in the accounts towards the installments of Technical Know-how fee

payable aggregating to ₹ 3,97,45,000 which however, does not have any effect on the net worth of the Company.”

**A careful reading of auditor’s report reveals number of important point to a tax auditor. In the case of illustrations given above following areas are of interest to a tax auditor: -**

- (i) Obsolete items – whether credit reversal is necessary.
- (ii) Non-reconciliation of stock as per central excise records and stock records- reason to be examined.
- (iii) Technical know-how fee – why provision not made? Whether service tax paid by service provider? Whether service provider is also a customer of the company.

### ***Disclaimer of Opinion***

6.12 Sometimes, an auditor may fail to obtain sufficient records or evidences to satisfy himself about correctness of certain transactions in that case he may make a disclaimer opinion. For example, an auditor may report that *“due to a major fire at the administrative office of the company most of the records were destroyed but these were reconstructed. In view of non-availability of original records, we are unable to state whether the balance sheet shows a true and fair ....”*

A tax auditor should carefully read the statutory auditors report and if any qualified opinion or disclaimer of opinion has been given, he should examine these opinions carefully and draw up his audit plan accordingly.

## **FINANCIAL STATEMENT**

Financial Statements will have Balance Sheet, Statement of Profit and Loss as also cash Flow Statement. Notes attached and forming part of the above gives significant information which can be of interest to the tax auditor such as segment wise results and related party transactions.

### **Study of Balance Sheet**

6.13 In financial accounting, a Balance sheet is a summary of the

financial balances of a Business organization. It may be defined as “a statement which sets out the assets and liabilities of an organization at a certain date. However, since the balance sheet is prepared on a particular date, the same does not constitute the summary of the activities of the assessee. Traditionally, the balance sheet used to be prepared in horizontal form (tabular format) showing assets and liabilities on two sides. In the revised format of Schedule III, the balance sheet is prepared in vertical form showing “Sources of Funds” and “Application of Funds”. These two headings are same as liabilities and assets of a company as we have already study in details under **Chapter 4**.

The auditor may review the balance sheet to see that the CENVAT credit availed on capital goods has not been reflected as fixed assets and correct CENVAT credit has been availed on the capital goods. The auditor may also compare the balance sheet with the previous year’s details to find out whether there are any major developments in the financial structure of the assessee and if there are any, the auditor may enquire into the same. Loans taken or given may be reviewed, so that the impact of the same on valuation may be investigated.

### CASE STUDY – 6

6.14 Please read the following excerpts from a Balance Sheet Schedule.

What further information should be called for by a tax auditor and why?

(₹ in Thousands)

#### Schedules forming part of the Balance sheet as at 31<sup>st</sup> March, 2016

	31 <sup>st</sup> March, 2016	31 <sup>st</sup> March, 2015
<b>Schedule ‘1’</b>		
<b>Share capital:</b>		
<b>Authorised:</b>		
32,000,000 Equity Shares of ₹ 10 each	₹ 320,000	₹ 320,000
<b>Issued and Subscribed:</b>		
31,568,000 Equity Shares of ₹ 10 each	₹ 315,680	₹ 315,680

<b>Paid-up @ ₹ 5 each for 31,568,000 Equity Shares of the above shares</b>	₹ 157,840	₹ 157,000
(i) 31,301 shares are allotted as fully paid-up to Roxel Inc., USA to in consideration of supply of technical know-how.		
(ii) 23,360,000 shares are held by the Holding Company, S.S. Company New Jersey, U.S.A.		

From the study of share capital schedule in the balance sheet, a tax auditor may find out whether the company is a subsidiary company and who is the holding company of this company. *Moreover, the extent of shares held by the holding company or the ultimate holding companies can also be found out. This aspect becomes very important if the goods or services have been supplied or received from such a holding company, in that case the valuation aspect need to be examined in detail in view of the valuation provisions in the central excise law or service tax law.*

### CASE STUDY-7

6.15 Following details of reserve and surplus as found in the balance sheet of a company is given below:

(₹ In Lakhs)

<b>Reserves &amp; surplus:</b>	<b>31.3.2016</b>	<b>31.3.2015</b>
1. Capital Reserve (on sale of Fixed Assets) As per last Balance Sheet	125	125
2. General Reserve As per last Balance Sheet Add: Transfer from Profit & Loss Account	305 80	250 55
3. Debenture Redemption Reserve Transfer from Profit & Loss Account	-- 30	-- --
4. Surplus as per profit and loss account.	329	267

From the above details it will be noticed that during the year certain amount has been transferred from the Profit & Loss account to the General Reserve. Debenture Redemption Reserve has also been created during the year by transferring an amount of ₹ 30 lakhs from Profit &

Loss Account because debentures valued at ₹ 30 lakhs have to be redeemed in the next year. Similarly, a capital reserve has been created out of the profit earned on sale of fixed assets and this reserve is to be utilized in future for purchase of a new plant by the company. *A Tax auditor may get an idea about the financial health of the company by reading the changes taken place under the head “Reserves and Surplus”. If the company is profit making, their balances under this head would be on the increasing trend. But if the company is making losses, reserves may show negative amount.*

## **Non-Current Liabilities**

**Non-Current Liabilities consists of the following items:**

- 1. Long Term Borrowings**
- 2. Bonds/Debentures**
- 3. Term Loans from Banks and Others**
- 4. Deferred Payment Liabilities**
- 5. Deposits**
- 6. Loans and Advances from Relative Parties**
- 7. Long term maturities of Finance lease obligations**

## **Classification of Assets and Liabilities into Current and Non-Current**

Concept of classified balance sheet was introduced, according to which all assets and liabilities are classified into current and non-current categories applying the definitions of Current / Non-current asset / liability and operating cycle provided in the Schedule itself.

In case the company has a practice of taking advances from the customer, whether service tax liability has accrued under the Point of Taxation Rules requires to be looked into. Other Current liabilities include Income

received in advance, Statutory remittances, Payables on purchase of Fixed Assets, Advances from Customers, Security deposits received, etc..

The amounts due to Micro, Small and Medium Enterprises have to be disclosed whether CENVAT credit has been reversed if not paid within the prescribed period may be verified by the tax auditor.

### ***Contingent Liabilities***

6.18 As per the provisions of Schedule III to the Companies Act, 2013, contingent liabilities are required to shown as a note to the Balance Sheet. Contingent Liabilities mean any liability which may accrue in the future subject to the happening of certain events. In other words, as on the date of balance sheet these liabilities are not confirmed but there is probability of these liabilities being confirmed in the future. Following are some of the commonly known contingent liabilities:-

- (a) Claims against the company not acknowledged as debt such as demand raised by central excise or service tax department where the department had issued a show cause notice which is pending decision. Similarly, a customer may have filed a compensation case against the company which is pending before the court.
- (b) Unexpired letter of credit/guarantees issued by the company.
- (c) Estimated amount of contracts remaining to be executed on capital account. Under this category all the outstanding demands on the capital account are covered where the company has placed order for capital equipment which are still pending execution or supply.

A tax auditor should carefully go through the items mentioned under contingent liability and sometimes very interesting aspects may be found out. Details like pending cases of income tax or excise duty or customs or service tax should be inquired into. It is possible that sales tax department had booked an offence case which might have a direct bearing on excise liability also.

Details of contingent liabilities in the Balance Sheet of a company is given below:

<b>Contingent liabilities not provided for:</b>	<b>31<sup>st</sup> March, 2016</b>	<b>31<sup>st</sup> March, 2015</b>
(a) Estimated amount of contracts remaining to be executed on capital account and not provided for (net of advances	25,75,000	28,00,000
(b) Claims against the Company/disputed liabilities not acknowledged as debts	5,75,000	4,00,000
(c) Bills discounted and remaining outstanding.	70,00,000	60,00,000
(d) Sales Tax/Excise matters in dispute.	25,50,000	23,00,000
(e) Bank guarantees/corporate guarantees/ outstanding letter of credit for which the company has given counter guarantees.	50,00,000	50,00,000

### ***Fixed Assets***

6.19 Fixed assets are classified into Tangible and Intangible Assets. Tangible assets consists of Buildings, Plant & Machinery, Furniture & Fixtures, Office Equipments, etc. The Intangible Assets consists of Goodwill, Computer Software, Trade marks and Designs, Mining Rights, Licences and Franchise, etc. A separate schedule is required to be given as part of the Balance Sheet in which under each head the original cost, the additions made during the year, the deductions during the year, the total depreciation provided and closing balance value is required to be given. The details of additions made during the year and sale/disposals made during the year should be scrutinized carefully by the tax auditor for the heading 'Plant and Machinery'. Credit of duty paid on the purchase of capital goods is allowed under the Central Excise law. For the plant and machinery sold/disposed off during the year, the tax auditor should find out whether the capital goods credit was availed on such machineries in the past and whether at the time of its disposal credit has been reversed or appropriate duty has been paid or not. For this purpose, details of all such plant and machinery sold during the year may be obtained by scrutinizing the plant and machinery account in the general ledger and relevant vouchers like sales invoice or journal voucher should be called for and studied.

### CASE STUDY – 8

6.20 Please study the following schedule of Fixed Assets for plant and machinery obtained from the Balance Sheet of a company. As per the information available, the unit has availed capital goods credit of ₹ 1.89 crs. during the year. What is your observation as a tax auditor.

(₹ in crores)

Particulars	GROSS BLOCK				DEPRECIATION				
	As at 1.4.15	Additi on during the year	Deduc tion	Total as at 31.3.16	As at 1.4.15	For the year	Adjust Ment	Total	As at 31.3.16
Plants & Machinery	210.50	13.54	12.10	211.94	110	12.94	5	117.94	94

#### Key Learning :

- (i) The rate of central excise duty on all the plant and machinery is 12% during the year 2015-2016. As per the Schedule, the company has made an addition of ₹ 13.54 crs. for plant and machinery during the year. Assuming that all the plant and machinery purchased by the company is eligible for capital goods credit, the maximum amount of capital goods credit available would be ₹ 1.62 crores. As against this the company has availed the credit of ₹ 1.89 crores. On further investigation, it was noticed that some of the machines on which assessee have taken the credits were in fact installed in factory of another company of the same group and the said company was undertaking only job-work, hence were not entitled to avail capital goods credit.
- (ii) Full details about disposal of machinery of ₹ 12.10 crores should be called for to examine whether capital goods credit was availed on any of such machines in the past and whether appropriate excise duty have been paid on such clearances.



## Claiming of depreciation under Section 32 of the Income Tax

6.21 As per the provisions of Central Excise law capital goods credit is allowed subject to the condition that depreciation under Sec.32 of the Income Tax Act is not availed on the excise duty element ( which has been taken credit) of the said capital goods. The aspect about verification of availment of depreciation is an important verification. But this verification cannot be made only from the study of balance sheet or even by the study of financial records of the company because the depreciation in the books of account is generally provided as per the provisions of the Companies Act and not as per the provisions of Income Tax law. Therefore, this aspect can be verified only on the scrutiny of income tax return filed by the company with the income tax department and on study of income tax audit report under Sec.44AB of the Income Tax Act (commonly known as form 3 CD report). In the income tax return following details are generally available.

Profit as per Profit and Loss A/c	-----
Add: Depreciation as per Profit and Loss A/c	-----
Less: Depreciation as per Income Tax Law	-----
(As per schedule attached)	_____
Taxable Profit	_____

Reasons for different amount of depreciation as per books of account and as per income tax law is that rate of depreciation adopted by the company for working out profit and rate as per income-tax law generally vary. Since the rate of depreciation varies, the value of an asset after depreciation also varies. The tax auditor should therefore scrutinize the worksheet for calculation of depreciation for income tax purpose. Firstly, the value of asset shown in the said work sheet should be verified with the value as per books of account. If the company is taking the value for newly acquired assets same as the value shown in the Plant and Machinery Account in ledger, in that case, the said ledger account may be scrutinized to find out whether value of excise duty has been deducted from total value of machinery or not. Generally companies book the total value of machinery in the ledger account and at the end of month, total amount of

capital goods credit availed is deducted by passing a Journal entry. Following illustration explains the accounting method.

**Machinery A/c**  
**A/c.No. 310**

Date 2015	Particulars	Document Ref.	Debit Amount	Credit Amount	Balance
¼	O.B	-	5,00,000	-	5,00,000
20/4	To WIDIA Ltd.	PV.202	2,32,000	-	7,32,000
21/4	To Finolex Cables Ltd.	PV 1527	58,000	-	7,90,000
22/4	To M M Metal	PV 210	5,000	-	7,95,000
30/4	By CENVAT Credit A/c	JV – 30	-	40,000	7,55,000

In the above account it would be seen that machineries have been purchased from three firms and initially full value as per purchase invoice has been debited to Machinery Account. At the end of the month, total amount of credit availed as per excise record of ₹ 40,000 has been deducted and balance of 7,55,000 is available. If the company consider the said amount for calculating depreciation for income tax purpose, it is correct. In the above mentioned example, following accounting entry has been passed for purchase of machinery from WIDIA Ltd. (Basic value ₹ 2,00,000 and excise duty ₹ 32,000)

Machinery A/c	Dr.	2,32,000	
To WIDIA Ltd.			2,32,000

Alternative method for passing accounting entry is as below:

Machinery A/c	Dr.	2,00,000	
CENVAT A/c	Dr.	32,000	
To WIDIA Ltd.			2,32,000

In the second method, the Machinery A/c have been debited only by net value of ₹ 2,00,000 and if this value is considered for claiming depreciation for income tax purpose, it is correct. It is important to note that an amendment has also been made in the Income Tax Act, 1961 (which was given retrospective effect from 1.3.94) and as per the said section an income tax payer cannot claim depreciation for income tax

purpose on the value of excise duty credit availed by them. In spite of said amendment some of the assesseees have been found to be availing both the benefit. It should also be kept in mind that assessment in the income tax are done on selective basis covering less than 5% assesseees every year. Therefore, a tax auditor of central excise or service tax should examine this aspect in detail.

## **INVESTMENT**

6.22 Investment have to be disclosed as Current Investments and Non-Current Investments separately in the Balance Sheet. Under Schedule III the current and non-current investments are to be shown separately under relevant heads. Accordingly, Current Investments are shown under Current Assets and Non-current investments are shown under head non-current assets.

Current Investments shall be classified as Investments in Equity Instruments, Preference Shares, Government or Trust Securities, Debentures or Bonds, Mutual Funds, Partnership Firms and other Investments. As per disclosure requirements, details of investment such as class of shares, partly paid or fully paid up, market value of shares are required to be given separately. Details of investment in subsidiary company and companies under the same management are also required to be shown separately.

Non-Current Investment shall be classified as Trade investments and other investments.

A tax auditor may come to know the names of companies/partnership firms in which investment have been made or names of subsidiary company and if the assessee has business transactions like receipt on account of service render with these units, he may like to examine these transactions in greater details.

## **CASE STUDY – 9**

6.23 X Ltd. was engaged in the manufacture of computers. From a study of investment details in the balance sheet it was noticed that they have invested in 25 shares of Y Ltd. (a company under the same management). Scrutiny of depot sale invoices showed that about 80% sales were made to

Y Ltd. Study of Share Capital details of X Ltd. also showed that it was a subsidiary company of Z Ltd. Being a subsidiary company, balance sheet of X Ltd. was available in annual report of Z Ltd. On further study of investment details of Z Ltd., it was noticed that they have also invested in 75 shares of Y Ltd and it was their subsidiary company. In fact, total share capital of Y Ltd was only 100 shares, out of which 25 shares were held by X Ltd and 75 shares hold by Z Ltd. Detailed investigation revealed that Y Ltd. was a fictitious company created only to market the goods of X ltd., and to pay less excise duty or service tax by way of under-valuation. Investigation further revealed that all the dealers of Y Ltd were dealers of X Ltd. prior to the formation of Y Ltd., and there were also no office premises of Y Ltd.

### **CURRENT ASSETS**

6.24 Under this heading, assets like Current Investments, Inventories, Trade Receivables, Cash and Cash Equivalents, Short-term Loans and advances and other Current assets are shown.

Schedule III of the Companies Act also requires a separate disclosure for debts or loans and advances due from following categories of person:

- (i) dues from directors or other officers of the company either severally or jointly with any other person
- (ii) dues from firm or private companies in which any director is a partner or director

In all the above cases, even though at the end of the year no balance may be due but still disclosure about maximum amount due during the year is required to be made in the balance sheet.

The above information may be very useful to a tax auditor to find out dealing with related companies and if necessary these transaction may be examined in detail.

One of the illustration of details of sundry debtors shown in the balance sheet of a company is given below:-

**S.S. Pharmaceuticals Ltd.**

	<b>For the year ended 31<sup>st</sup> March, 2016</b>	<b>For the year ended 31<sup>st</sup> March, 2015</b>
<b>SCHEDULE '9'</b> <b>Trade Receivables *</b> (Unsecured, considered good) Debts outstanding for a period exceeding six months from the date they are due for payment	89,61,420	76,78,202
<b>Other Trade Receivables</b> (Unsecured, considered good)	Nil	Nil
* Includes due from Companies under the same management/Managing Director (a) ₹ NIL (Previous year ₹ 5 Lakhs) from SS Pharmacaps Pvt. Ltd. (b) ₹ 124567 (Previous year ₹ 21308) from SM Medicare Ltd. (c) ₹ 901900 (Previous year ₹ NIL) from SS Pharmcaps Inc., (d) ₹ 250000 (Previous year ₹ NIL) from Managing Director of the Company		
	89,61,420	76,78,202

From the above details it would be seen that the company have sold goods to related companies under the same management. The transactions with these units may be examined in detail from related persons angle. However, it may be kept in mind that companies under the same management by itself do not make them related person under the Central Excise Law.

## INVENTORIES

6.25 This heading shows closing stock of all types of goods viz., raw materials, component, stores, spares, finished goods, work-in-progress and trading goods.

A tax auditor should compare the stock of last 2-3 years and if variation is large, he should examine the case in greater detail. It is possible that in order to avail cenvat credit, a unit may have shown purchase of raw material but goods would not have been received.

One more aspect which needs proper verification is "stock in transit". It covers items which have been sent by the supplier but have not been received in the factory and for which either payment has been made or liability for payment has been created. As the purchase documents have been received by the unit there are chances of assessee availing credit prior to receipt of goods. This aspect should be verified by calling details of goods in transit and verify the credit availment.

## CASE STUDY – 10

6.26 Following information are available under the head "Inventories" in the balance sheet of a company manufacturing aluminum wires.

[₹ In Lakhs]

	31 <sup>st</sup> March 2016	31 <sup>st</sup> March 2015
Aluminium Wire-Rod	170	40
Finished Goods	60	52

Since raw-material stock had increased substantially in the current year the quantitative information about purchase, consumption and stock as found in the balance sheet was referred and following details were noticed by the tax auditor.

### Details of Raw Material (in MT)

	Op. Stock	Purchase	Consump tion	Closing Stock
Aluminium Wire-Rod	44 (38)	635 (530)	430 (524)	199 (44)

[Figures in bracket are for previous years]

Sales: Aluminium Wires - 490 MT

What are your findings on the basis of above mentioned details?

**Key Learning :**

Monthly consumption of Aluminium Wire Rod is about 40 MT, whereas closing stock is 199 MT which is inventory for 5 months. The said quantity appears to be unusual. Therefore purchase made in last few months need to be verified with stores and other records. If necessary, physical stock taking at the time of audit can also be undertaken. Investigation in this case resulted in establishing that input were not received by the unit and only purchase invoices were received on which credit was availed.

**STUDY OF PROFIT AND LOSS ACCOUNT/ INCOME STATEMENT**

6.28 It is a company's Income statement that indicates how the revenue (money received from the sale of products and services) is transformed into Net Profit (the result after all revenues and expenses have been accounted for). It displays the revenues recognized for a specific period, and the cost and expenses charged against these revenues, including write-offs and taxes. The purpose of the income statement is to show managers and investors whether the company made or lost money during the period being reported. Income statement is prepared as required under the Companies Act 2013 or for any other statutory purpose.

6.29 The auditor may review this account to see whether there is any miscellaneous income in the credit side as recognized by the assessee on which tax liability may be attracted. The auditor may also review the expenditure pattern of the assessee to ascertain whether the CENVAT credit availed is in proportionate to the expense reflected in debit side of account. The auditor may also review as to whether service tax has been paid under reverse charge mechanism in respect of the specified services e.g., if the income statement shows cab charges being paid to a non-corporate assessee, legal charges etc auditor may check that service tax has been paid by the assessee on such charges or not.

Profit and Loss account of a company is given below.

***Profit and Loss Account for the Year ended 31<sup>st</sup> March, 2016***

Particulars	Note No.	Year ended 31.03.2016	Year ended 31.03.2015
<b>Income</b>			
Revenue from Operations	12	5375.55	5243.36
Other Income	13	47.75	47.52
		<b>5423.30</b>	<b>5290.88</b>
<b>Expenditure</b>			
Purchase of finished goods		894.82	1045.81
Materials consumed	14	2017.87	1993.73
Changes in Inventories of finished goods and work-in-process		(95.01)	70.84
Excise Duty	15		168.71
Manufacturing Expenses	16	302.50	171.40
Employee Benefits Expense		160.38	
Finance Costs	17		102.28
Depreciation and amortization expense	18	111.61	
Other Expenses		165.34	54.69
Depreciation		1545.30	1390.24
		<b>5102.81</b>	<b>4997.70</b>
Profit for the year		320.49	293.18
Less: Tax expense		128.13	100.08
i) Current Tax	xxx		xxx
ii) Deferred Tax	xxx		xxx
Profit for the year		<b>192.36</b>	<b>193.10</b>



<b>Earnings per Equity Share</b>			
Basic			
Diluted			
Notes to accounts and Significant Accounting Policies forming integral part of accounts	20		

6.30 Following are some of the important points which should be kept in mind while studying a Statement of Profit and Loss Account.

- (i) There are different Notes for most of the headings, therefore Profit and Loss Account needs to be studied by referring to these schedules.
- (ii) Details of Profit and Loss Account should be studied along with other notes to the accounts forming part of the final accounts
- (iii) A comparative study of figures with previous year should be made to find out unusual variation.

### **CASE STUDY – 11**

6.31 Please study details available in the Profit and Loss account of a company manufacturing Chewing gum, medicated tablets and breath freshners.

What is your first reaction, without referring to details in schedules?

**Statement of Profit and Loss Account for the Year ended 31<sup>st</sup>  
March, 2016**

	Schedule	2015-16 Rupees ₹ in Lakhs	2014-15 Rupees ₹ in Lakhs
<b>Income</b>			
Revenue from	11	5,891	6,116
Operations	12	<u>102</u>	<u>56</u>
Miscellaneous Income		<u><b>5,993</b></u>	<u><b>6,172</b></u>
<b>Expenditure</b>			
Cost of Materials	13	1,697	2,154
Consumed	14	5,295	5,835
Expenses	15	511	514
Interest		<u>214</u>	<u>139</u>
Depreciation		<u><b>7,717</b></u>	<u><b>8,642</b></u>
Loss Before Tax		(1,723)	(2,470)

**Key Learning:**

Revenue from operations during 2015-16 has decreased marginally whereas cost of material has decreased by 25%. A Tax Auditor may like to study purchases of raw material and CENVAT availment of 2015-16 in detail. There may be unusual loss of materials by way of spoilage, loss during trial production or input becoming obsolete. This case study would be further discussed in the next chapter dealing with "Quantitative details under Schedule VI."

Some of the important headings of Profit and Loss Account are discussed below:

**SALE OF PRODUCTS**

6.32 It includes all types of sales such as sale of manufactured goods, trading goods parts & accessories, scrap and export. Some companies may even include job work income or income from activities related to sales of

goods like erection and commissioning charges also as part of sales in the Profit and Loss Account. As per the Accounting Standards issued by the Institute of Chartered Accountants of India, the said accounting practice is not recommended, and statutory auditors are required to confirm this fact in the statement on accounting policies annexed to the Profit and Loss account. Study of Note on Income from Operations in the Profit and Loss account provide an overall view of the main activities of the unit and help a tax auditor to find out whether company is also engaged in trading activities, job work activities, sale of parts etc. The said information is very useful to study the dossier of a unit before the start of an audit and to prepare an audit plan.

### **OTHER INCOMES**

6.36 This is one of the most important area which a tax auditor is required to analyse very carefully. It may include income under following heads:

- (i) Sale of Scrap
- (ii) Insurance claims
- (iii) Profit on sale of fixed assets
- (iv) Interest/Dividend
- (v) Commission received
- (vi) Royalty
- (vii) Tech- know how or tech consultancy charges
- (viii) Erection and Commissioning charges
- (ix) Training Income
- (x) Miscellaneous Income
- (xi) Freight/Insurance recovered

Some times a detailed breakup of various items of other income may not be available in the schedule of other income in the Statement of Profit and Loss. In that case ledger account grouping should be obtained from the assessee. Study of trial balance also shows different heads of other income. Exact nature of each income account should be ascertained from

the company. This should be verified with the study of the ledger account. These ledger accounts should be scrutinized with reference to documents like invoices or debit notes or journal vouchers used for passing entries in the ledger accounts. It may happen that exact nature of these income may be different than what has been declared. With the introduction of Negative list under service tax, it is possible that these income may attract levy of service tax also.

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

**(a) Sale of scrap:** A tax auditor should ascertain the series of sales invoice used for sale of scrap. Other documents like debit notes or journal voucher may also be used for recording sale of scrap. This fact can be found out from the study of the ledger account. A tax auditor should examine these documents to confirm payment of excise duty or sales tax. If a common series of sales invoice is maintained, in that case, scrap sale account in the ledger should be scrutinized along with vouchers to confirm whether excise duty have been paid or not. Apart from above, it may be to check that whether any GTA services has been utilized for sale of scrap and service tax has been paid on the same, if any. **(b) Insurance claim:-** Insurance claim may be lodged for damage or destruction of raw material, work in process, finished goods or capital goods. A tax auditor should examine exact details of such claims. Following type of insurance claim cases should be examined in detail.

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

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

One more area which a tax auditor should examine is whether excise duty has also been claimed in case of loss of finished goods lying in the factory because in that case remission of duty under rule 9 and 49 cannot be granted and excise duty claimed and received from insurance company becomes payable under the section 11D of the Central Excise Act.

**(b) Profit/loss on sale of fixed assets:** This income shows profit or loss earned on sale of a fixed asset. The ledger account should be scrutinized by a tax auditor to find out the details of fixed assets sold during the year. If sale of machineries or other capital goods have been made, the voucher should be studied to find out complete details such as year of purchase, depreciation availed and profit or loss on sale. If machinery have been purchased after 1994, whether capital goods credit was availed should be ascertained and at the time of sale, whether appropriate duty have been paid or not, should be verified as per the provisions of CENVAT Credit Rules, 2004.

**(c) Development/Design Charges:** Some time a manufacturer is required to use a particular mould or die for manufacture of an item for the customer. The said mould or dies can be made by him or can be purchased from other person. The cost of such die or mould made may be charged separately from the customer and it is shown as income of the company. The said income has direct relation to the goods manufactured by the assessee. Therefore, a tax auditor should examine the exact nature of such charges and decide as to whether the full value needs to be added in the assessable value or only amortized value of dies or mould should be added to the assessable value of the final product manufactured them.

**(d) Technical knowhow fee or Engineering service charges or Training charges:** Such incomes are earned for providing technical services like design engineering, feasibility study, technical know-how for manufacture of a product. Training for operation of machines supplied by the assessee may also be given on charging training income. Exact nature of such recoveries should be inquired into by verifying agreement copies and other correspondences. If such incomes have any relation to the goods manufactured and sold by the company, these may be required to be added to the assessable value in terms of definition of transaction value under new valuation provision. Alternatively, payment of service tax may also be examined.

(e) **Interest/Commission received:** Generally interest income arises from investment made by the company. Commission may be on account of sale of certain products of other company. But if interest or commission is received from customers of the company, such transaction of interest/commission should be examined in details to find out whether additional consideration is being received in the guise of interest or commission from same customer.

(f) **Commission Income:** In the case of a unit manufacturing steel products such as S.S. Flats, the Profit and Loss account showed receipt of Commission/Service charges to the extent of about ₹ 30 crores in 5 years. On scrutiny of ledger account it was found that company had received commissions from well known companies like TELCO, DEAWO MOTORS, TRIVENI ENT etc., for providing services of obtaining export orders for and for arranging certain machineries etc., Since the business of company was totally different than the areas where commission was charged, further investigation were made with companies who were supposed to be have paid commission and it revealed that, these companies did not pay any commission charges. In fact, said amount pertained to sale proceed of S.S. Flats removed without payment of duty. The amounts were recovered from assessee by demand drafts and credited to the income account showing receipts from fictitious companies. The value of the said commission also tallied with the value of finished goods manufactured out of excess consumption of raw materials or differently, service tax has been paid on the commission charged.

**(g) Recovery of Advertisement Charges, Crate Hiring Charges and Delivery Charges.**

An assessee was engaged in the manufacture of aerated water. On going through the schedule for 'Other Incomes' forming part of Profit and Loss account it was noticed that they have shown following three items under the heading 'other income'.

- (i) Advertisement and management service charges
- (ii) Crate Hiring Charges
- (iii) Net delivery charges on re-sale of goods

On going through the ledger accounts of these incomes and supporting vouchers it was noticed that the company was recovering additional

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

#### **CASE STUDY – 14**

6.38 A is manufacturing laminated sheet (LAMIWEB) made of aluminium foil and P.P Sheet. The said Lamiweb is supplied only to ‘B’ who is using it for manufacture of collapsible tubes for packing of tooth paste. The study of revenue pattern showed that A was paying all most full duty through input credit (about 98%) for the last 2 years. The study of the Profit and Loss account showed a substantial amount of ‘Other Income’ and it included a heading ‘Facility Charges’. On inquiry company informed that this amount represented recoveries made by them from B on account number of common facilities provided by them to B like security, canteen, supervisory staff, transport facility etc., which were incurred by them and part of the expenditures were recovered from 'B'. As an excise auditor what further inquiries, you may like to make.

#### **Key learning :**

- (i) Raw material to Sales value ratio - A quick method is to find out ratio of cost of material consumed to the value of goods sold. In the present case, based on the figures of Profit and Loss account the ratio was about 63%. In other words, out of total value of goods sold, 63% was accounted for by way of raw material cost and balance 37% was value addition on account of labour cost, manufacturing overhead and all other costs. Therefore, assuming

raw material and finished goods rate of duty as same, in normal circumstances, the company should have paid at least 37% of duty in cash.

- (ii) Cost of product and its comparison to sales value - In the present case cost was about ₹ 120 per Kg., whereas they were selling at ₹ 104 per Kg. Further, inquiries revealed that 2 years ago sale price was ₹ 130 per Kg., which was reduced to ₹ 104 per Kg.
- (iii) Trend of facility charges - It was noticed that amount of facility charges recovered from 'B' was very less two years ago and only in last 2 years the amount of facility charges had increased substantially.
- (iv) Scrutiny of all Journal vouchers passed for recovery of facility charges revealed that every month one voucher was passed for recovery of facility charges for sale of lamiweb to B and voucher clearly showed rate per Kg., for goods sold to "B" during the month. In fact one more voucher was passed every month for recovery of common expenses and when auditor asked to show the voucher, they deliberately showed few of these voucher showing recovery of such common expenses from B.
- (v) Comparison between actual expenditure incurred on such common series and amount recovered from B showed that actual amount incurred was much less than amount collected from B

Similar procedure can also be follow in the case of service provider.

## EXPENDITURES

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



marketing expenditure. The scrutiny of ledger account for expenses revealed that the company was recovering marketing expenses from their customers and only net expenses were shown in the Profit and Loss Account. They were not paying excise duty on such recoveries.

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

### ***Expenditure accounts having credit entries***

6.40 Even though study of details of expenditures in profit and loss account may not show the accounts having credit entries but some of the expenditure accounts where recoveries are possible from customers like packing expenses, freight expenses, advertisement expenses, after sales service expenses etc., should be scrutinized in the ledger. In case of services for example recoveries from employee etc. become chargeable to service tax so accounts having credit entries become important including in the case of payment of service tax under reverse charge.

### ***Cost of Material Consumed***

6.41 This heading covers consumption of raw materials, components, packing material etc. used for the manufacture of finished goods. As per the disclosure requirement of Schedule III of the Companies Act, details of main raw materials consumed are required to be given as part of the Profit and Loss Account. All materials which in value individually account for 10% or more of the total value of the raw material consumed should be shown as separate and distinct items. Companies having a good accounting system accounts for consumption based on issues made by the stores department to the production department for manufacture of goods. But in a number of small units generally the value of the raw materials consumed is calculated by: Opening Balance + Purchases – Closing Stock. As per the Accounting Standards issued by the Institute of Chartered Accountants of India raw material used for manufacture of finished goods should only be considered under this heading. Therefore, if the raw material has been used for other purposes or the material has been lost for activities not related to manufacture in those cases

companies are required to show such value thereof separately. It is the duty of statutory auditors to verify this aspect. In practice the statutory auditors examine this point and wherever they find that raw material has not been used for the purpose of manufacture they ask the company to make a separate disclosure for the same. In case of their failure to make the disclosure, this point can also be given as a qualification in the auditor's report. The following are examples of situations where raw materials have not been used for the purpose of manufacture of the finished goods:

- (a) Raw material used for construction activities like steel used for construction or cement used for construction.
- (b) Raw material used for repairing activities.
- (c) Raw material sold as such or given on loan.
- (d) Obsolete items or damaged goods.
- (e) Material destroyed by fire or lost by theft.
- (f) Shortage found at the time of physical verification.

6.42 Information under the head 'cost of material consumed' is very useful and it can be used for verifying CENVAT credit availed on the inputs by a unit. Assuming that most of the raw materials and packing materials consumed by a unit are eligible for availing CENVAT credit and if the rate of duty on the inputs and outputs is same, in that case, a quick ratio of cost of goods consumed with the sales value (adjusted for excise duty) or service tax value can be worked out to find out whether CENVAT credit availment appears to be reasonable or not. The above aspect can be explained from following illustration.

### CASE STUDY – 15

6.43 The following information were obtained from the Profit & Loss Account of a company.

	(₹ in lakhs)
1. Raw material cost	₹ 50
2. Labour	₹ 20
3. Manufacturing & Administrative overheads	₹ 30
4. Marketing and other Overheads	₹ 20

5.	Profit	₹ 30
	TOTAL	
6.	(Selling price excluding excise duty).	₹ 150

Out of the total selling price of ₹ 150, raw material cost is ₹ 50 i.e. 33% of the price of the product. Assuming that most of the raw material attracts duty of 12% and final product also attracts same rate of duty, the ratio of PLA and CENVAT credit should be about 2:1 (CENVAT credit of ₹ 6 is available on raw material and total duty on final product is ₹ 18). Hence, duty payment should be ₹ 12 through PLA and ₹ 6 through CENVAT credit. If the PLA & CENVAT ratio is varying, it needs further investigation. In this connection, it is important to note that quantity and value of closing stock as compared to the quantity and value of opening stock also needs to be considered while working out this ratio because if there is substantial increase in the quantity of closing stock, this may result in to extra availment of CENVAT credit. Other factors like export may also distort the said ratio. It is important to note that if exports are made on payment of excise duty (claiming rebate of duty paid on exported goods), in that case export will not affect PLA – CENVAT ratio. Similar ratio may be calculated in the case of supply of services and CENVAT credit availed against those services. It is suggested that this exercise should always be carried out as a first step during audit.

### ***Expenditure Attracting Service Tax:***

6.44 There are a number of services like technical and engineering service, advertisement service, manpower recruitment service, clearing and forwarding services etc. on which service providers are liable to pay service tax. . The payment vouchers along with bills of the service provider should be examined to verify whether service tax has been paid by them or not. If service tax has not been paid, in that case exact nature of services provided by them should be examined to ascertain whether service tax is payable or not. Especially in the case of new manufacturing unit or the companies which have expanded their manufacturing activity, this aspect needs to be looked into. In the case of a new unit, generally, a number of services are provided by consulting engineers in the field of setting up of plant or development of product or by architects etc. and in that case the payment of service tax needs to be examined critically because the amount involved may be quite large. Some times even these

expenses may be capitalised as part of plant and machinery and may not figure as a revenue expenditure. In that case an inquiry may be made about all the expenditures capitalized or shown as deferred revenue expenditure.

**Illustration:**

During the audit of a A Ltd., it was noticed from the study of the Trial Balance that they have incurred an expenditure of more than ₹ 30 crores towards technical and engineering services. On inquiry it was noticed that the said expenditure was on account of consultancy provided by a foreign company for setting up of the steel plant and no service tax was paid on the said amount.

**CASE STUDY – 16**

6.45 Evaluate under which categories is the company liable to pay service tax under reverse charge mechanism on the basis of the given financial statements for the financial year 2015-16.

	Annexure	31-Mar-16	31-Mar-15
<b>Annexure: Other Expenses</b>			
1 Power & Fuel			
Electricity Charges		22,969,205	13,780,348
Petrol Expenses		588,910	111,760
2 Rent			
Rent & Other amenities Charges		90,165,477	56,701,304
3 Repairs & Maintenance			
Plant & Machinery		5,289,395	2,189,586
Furniture & Fixtures		3,306,344	2,088,455
Others		2,291,257	1,777,133
(a) Civil Work of office (material + labour charges)	2,000,000		
(b) AMC charges for Air Conditioner (comprehensive contract)	200,900		

	(c) AMC charges for Computer (non- comprehensive contract)	90,357		
4	Insurance			
	Insurance Charges	482,117	360,134	
5	Rates & Taxes			
	License & Legal Fees	556,639	253,647	
	NMMC Cess and LBT Expenses	250,770	220,468	
	Octroi Charges	905,338	689,384	
	Profession Tax-Company	2,500	2,500	
	Profession Tax Expense	200	0	
	Property Tax	143,355	0	
	Service Tax Expenses	644,047	177,054	
	Stamp Duty Charges	403,240	781,845	
	TDS Expenses	36,275	10,100	
	VAT Expenses	64,782	1,947	
6	Other Expenses			
	Advertisement Expenses	4,871,825	8,683,240	
	Affiliation Charges	103,461	0	
	Auditors' Remuneration	623,500	352,500	
	Cable charges	220,960	147,434	
	Call Centre charges	847,384	0	
	Car Leasing Charges	589,458	513,825	
	Valet Parking Charges	3,426,037	809,038	
	Cleaning Charges	303,360	300,910	
	Commission & Brokerage	12,368,000	8,517,672	
	Conveyance	2,732,907	1,452,104	
	Courier Charges	875,128	212,811	
	Delivery & Transport Charges	318,841	350,124	
	Transport charges - Kangaroo Transport Ltd	150,000		
	Pawan Transport	161,841		
	Donation	41,197	9,101	

Festival Expenses	482,473	812,570
Fines and Penalties	409,400	0
Foreign Travelling Charges	370,785	391,910
General & Miscellaneous Expenses	2,573,529	2,503,864
Guest House Expenses	202,312	0
Hospitality & Promotional Expenses	2,557,665	1,279,873
House Keeping Charges (House keepers supplied by M/s Globe Services, a proprietary concern)	18,673,180	1,137,676
Interest on NMMC CESS & LBT	19,236	0
Interest on Service Tax	2,969	20,733
Interest on TDS	41,594	18,546
Interest on VAT	15,174	10,725
Laundry Expenses	2,658,774	1,976,179
Legal Expenses	32,927	0
Lodging & Boarding Expenses	696,815	0
Membership & Subscription	40,075	54,000
Newspapers & Periodicals	152,971	129,801
-	861,474	0
Pest Control Expenses	327,509	49,052
Printing & Stationery	1,455,645	1,075,378
Professional Fees	15,428,261	13,619,904
(a) ₹ 50000/- paid to Advocate Mr. Goyal		
(b) ₹ 30000/- paid to Mr. Rahul Khanna towards ESIC, PF consulting		
(c) ₹ 10000/- paid for obtaining shop establishment license		

ROC Filing Fees	10,310	4,500
Sales Promotion Expenses	8,261,998	7,202,558
Security Charges	4,738,869	3,552,488
(Paid to Dragon Security Ltd)	1,400,000	
(Paid to Ram Avatar Securities)	265,348	
Software License Fees	1,665,348	225,000
Sponsorship Fees (Includes sponsorship of ₹ 2 Lacs given to ABC Ltd)	307,000	0
Staff Recruitment Charges (Paid to Centril Enterprises)	1,710,702	292,381
Staff Training Expenses (Training programme conducted in UK)	394,685	0
Sundry drs/crs write off	18,910	(69,250)
Sundry Expenses	71,306	20,465
Telephone & Internet Charges	4,632,513	2,274,392
Travelling Charges	2,953,039	1,713,309
Uniform Expenses	859,033	1,200,861
Water Charges	1,996,966	763,425
	230,045,355	140,754,765

### **TIPS**

1. Repairs & Maintenance
2. Professional Fees
3. Security Charges
4. Staff Recruitment Charges
5. Staff Training Expenses
6. Transport Charges
7. Sponsorship Expenses

## STUDY OF NOTES TO THE ACCOUNTS

6.46 Notes to financial statements (accounts) are additional information added to the end of financial statements. It helps in explaining specific items in the financial statements as well as provides a more comprehensive assessment of a company's financial condition. It may include information on debt, going concern criteria, accounts, contingent liabilities or contextual information explaining the financial numbers (e.g., indicate a lawsuit).

These notes are part of Balance Sheet and Profit and Loss account of a company. The auditor may go through notes to accounts to see whether any notes have any bearing on the central excise duty or service tax liability. The information contained in the notes to accounts is important to the auditor since the same contains the relevant information which cannot be provided in the financial statement but which are required for the proper explanation of the financial statement

6.47 Some of the notes as found from the final account of companies are given below.

- (a) *“Plant and Machinery includes machinery acquired under lease/ hire purchase scheme costing ₹1.58 crores ( 1.28 crores last year )”.*

**Comments:** In this case Tax Auditor may like to verify whether the unit has availed CENVAT Credit as capital goods on such machinery has been taken on lease/hire purchase and whether all the condition like non availment of depreciation by lessor and lessee have been complied with.

- (b) *“Inventories includes ₹ 7.8 crores for products under development in house (Previous year ₹10.25 crores)”*

**Comments:** A tax Auditor may like to verify what is the manner of disposal of these products which are developed in house for R & D purposes, and whether any credit has been availed on various material gone into manufacture of these items. If the said product were cleared without payment of duty or destroyed, in that case, CENVAT credit availment should be examined.



- (c) *“The value of raw-material, spare parts and components consumed includes write off on account of obsolete and scrap valued at ₹ 27,167,000 (Previous year 24,201,100).”*

**Comments:** Tax Auditor may like to examine the points about the reversal of credit on the item declared as obsolete and also ensure that if any services e.g. GTA has been utilized for sale of such material, appropriate service tax has been paid..

- (d) *“Company has preferred an appeal to Sales Tax authorities involving an amount of ₹ 106 lakhs towards sales Tax dues, hence not provided in the books and shall be adjusted in the year in which the same is decided.”*

**Comments:** Auditor may like to examine nature of cases pending before Sales Tax authority and find out whether it has got any implication on payment of excise duty also.

- (e) *“Materials worth ₹ 120 lakhs has been considered at nil value owing to its non suitability for production and discontinuing of certain production range. The concurrent auditors appointed by the lead institutions have opined that these amounts should be written off and accordingly management has agreed to write off such goods.”*

**Comments:** Tax auditor may like to verify whether these materials have been cleared and whether appropriate duty has been paid or not. Other points raised in the report of concurrent auditor should also be examined.

- (f) *“On 10.6.2000 a fire broke out at Mumbai premises where books of accounts were kept for finalisation of yearly accounts including those of branches and Delhi office which were destroyed beyond retrieval and the current period accounts have been presented based on available information and compilation of various data from time to time.”*

**Comments:** Since the original records are not available in the unit, the Tax Auditor should be very careful while verifying various records and if necessary for important transaction cross verification from third parties should be carried out.

- (g) *“Purchases includes provision on account of replacement of spares and accessories of ₹30 lakhs.”*

**Comments:** By reading this note, Tax Auditor may come to know that company has the policy of supplying free replacement and therefore whether appropriate duty has been paid on such free replacement should be inquired into.

- (h) *“Adjustment in respect of discrepancies regarding materials with sub-contractors/on loan have not been made pending confirmation/reconciliation and the impact, if any, on the profits is not ascertainable.”*

**Comments:** Tax auditor finds that company has been sending material to job worker and there are number of cases where reconciliation with job worker have not been made. This may have direct impact on the input credit. Similarly, verification needs to be made for payment of appropriate duty wherever materials have been sent on credit.

- (i) *“Pending reconciliation, stock verification discrepancies for the year, shortages of ₹230 lakhs (₹189 lakhs) and surplus of ₹82 lakhs (₹103 lakhs) have not been adjusted in the account.”*

**Comments:** List of stock verification needs to be obtained to find out final shortages and CENVAT credit reversal may be necessary.

- (j) *“Company have not provided for ₹210 lakhs on account of a demand raised by excise authorities as the matter is pending with appellate authorities. Necessary adjustment shall be made at the time of decision of appeal.”*

**Comments:** This liability was for another factory on classification matter, which was not disputed for factory under audit where audit is undertaken.

All the above referred points could be useful to a Tax Auditor and on reading such notes, he may like to inquire further about these matters.

***Quantitative Information as per the disclosure requirement provided in Part II of Schedule VI of the Companies Act:***

6.48 In the case of a manufacturing company, the following quantitative information are required to be given as notes in the final account of a Company.

- (a) Opening stock and closing stock of the raw-materials and finished goods.
- (b) Consumption of raw material.
- (c) Licensed and installed capacity of production.
- (d) Actual production of finished goods.
- (e) Turnover details of finished goods.
- (f) Purchase and sale of trading goods(if engaged in trading activities also)

Quantitative information are very important source of information and in some cases a broad input-output ratio can also be worked out. Details of major raw materials can be known before start of the audit. Similarly, details of main final products manufactured by a company can also be found out by a tax auditor. Consumption pattern over a period of time and per unit value of major material can also be worked out for analysis purposes.

Under the Companies Act 2013 quantitative details are not required to be given, but details of raw materials consumed with value have to be furnished

**CASE STUDY – 17**

6.49 Quantitative information in respect of a company manufacturing hydrolic pumps and other equipment as find from the Profit and Loss Account is given below.

## Quantitative Information as on 31.3.2015

			2014-15		2013-14	
<b>I</b>	<b>Hydraulics division:</b>		Nos.	Nos.		
	(i) Licensed Capacity		N.A.	N.A.		
	(ii) Installed Capacity		240	180		
	(iii) Actual Production					
	(a) Pumps Production		211.00	164.000		
	(b) Pumps recovery by rectification		125	309		
	(c) Other Hydraulic Equipments		3,678	2,041		
	Information in respect of Finished Goods:					
<b>II</b>	<b>Hydraulic gear pumps:</b>		<b>Qty. Nos.</b>	<b>Value ₹</b>	<b>Qty. Nos.</b>	<b>Value ₹</b>
	Manufacturing:					
	(a) Opening Stock		8,357	12,939,600	12,602	11,224,682
	(b) Sales Pumps		197,033	339,597,310	166,724	285,814,242
	(c) Scrapped & written off		604	-	1,529	-
	(d) Captive Consumption		488	-	346	-
	(e) Closing Stock		21,687	35,995,634	8,357	12,939,600

	<b>2. Other hydraulic equipments</b>					
	A. Manufacturing					
	(a) Opening Stock		230	971,943	121	665,166
	(b) Recovery by rectification		34	-	-	-
	(c) Sales		3,704	41,479,666	1,782	11,367,304
	(d) Scrapped & Written of		2	-	150	-
	(e) Captive consumption		-	-	-	-
	(f) Closing Stock		236	1,000,446	230	971,943
	B. Trading:					
	(a) Opening Stock					
	(b) Purchases					
	(c) Sales					
	(d) Scrapped & written of					
	(e) Closing Stock					
			<b>2014-15</b>		<b>2013-14</b>	
<b>III</b>	<b>Hydraulics division:</b>	<b>Unit</b>	<b>Qty. Nos.</b>	<b>Value ₹</b>	<b>Qty. Nos.</b>	<b>Value ₹</b>
	Consumption of Raw					
	Materials and Components:					
	(a) Aluminium Extrusion	Kgs.	191,187	21,142,860	169,007	17,585,161

	(b) Castings	Nos.	1,364,506	32,328,884	1,098,942	23,691,089
	(c ) Forgings	Nos.	482,172	14,217,488	388,658	10,576,630
	(d) Components	Nos.	8,142,068	70,163,740	5,760,186	43,117,382
				<b>137,852,972</b>		<b>94,970,262</b>

On study of above referred quantitative information following points are noticed by a tax auditor.

- (i) Company is also engaged in the activity of repairs and rectification as found from details of production [b] - Pumps recovery by rectification). Whether repair activity also involve use of credit availed input and whether rectification amount of manufacture of a new product, should be inquired by a tax auditor.
- (ii) Company has scrapped and written off pumps and other equipment also. Payment of duty or reversal of credit need to be examined.
- (iii) Company is captively consuming some of the produced goods also.
- (iv) Since detailed records are maintained for consumption of major raw material like extrusions, casting and forgings, it necessary input out ratio can be worked out for main items of production.

Under the companies act 2013 quantitative details are not required to be given but values have to be given.

### **Disclosure for foreign exchange transactions**

6.50 As per requirement of schedule III to the companies Act, the Profit and Loss Account shall also contain by way of a note the following information, namely,

- 4D. The profit and loss account shall also contain by way of a note the following information namely,
  - (a) value of imports calculated on C.I.F. basis by the company during the financial year in respect of:
    - (i) raw materials; (ii) components and spare parts; (iii) capital goods;

- (b) expenditure in foreign currency during the financial year on account of royalty, know-how, professional consultation fees, interest, and other matters;
- (c) value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;
- (d) the amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related;
- (e) earnings in foreign exchange classified under the following heads, namely:-
  - (i) export of goods calculated on F.O.B. basis;
  - (ii) royalty, know-how, professional and consultation fees;
  - (iii) interest and dividend.
  - (iv) other income, indicating the nature thereof.

Following disclosures were made in the notes to the accounts forming part of Profit and Loss Account of a company regarding foreign exchange transactions.

<b>Note: 21</b>	<b>2015-16</b>		<b>2014-15</b>	
	<b>%</b>	<b>Value (₹ in lakhs)</b>	<b>%</b>	<b>Value (₹ in lakhs)</b>
Value of imported and indigenous Raw Materials, Store, Spare parts and Component consumed				
(a) Raw Material				

Imported				
Indigenous	62	25,75	68	2613
(b) Store, Spare parts and Component	38	1578	32	1229
Imported				
Indigenous	12	48	11	39
	88	352	89	311

<b>Note: 22 (a)</b>	<b>2015-16</b>	<b>2014-15</b>
<b>Value of imports calculated on CIF basis</b>		
(a) Raw Material	2575	263
(b) Store, Spare parts & Component	48	39
(c) Capital goods	160	--
(d) Computer Software	35	--
(e) Goods for resale	110	120
<b>Note: 22(b)</b>	<b>2014-15</b>	<b>2013-14</b>
<b>Expenditure in foreign currency</b>	25	28
(a) Instant on debenture	15	10
(b) Traveling	82	78
(c) Technical know how	60	72
(d) Royalty and engineering fee		
<b>Note: 22 (c)</b>	<b>2015-16</b>	<b>2014-15</b>
<b>Earnings in foreign exchange on account of</b>		
(a) Exports in FOB basis	780	450
(b) Freight and Insurance on exports	28	13
(c) Commission	25	20



Study of foreign exchange transaction provide a overall view of import content in the cost of production, export performance and other heads of major expenditure and income of foreign exchange. In case of payment on activities like technical and engineering charges, consultation charges etc., aspect about payment of service tax, by service provider, if applicable, may be examined by a tax auditor. In case of import of plant and machinery, the payment for technical services, engineering services, design and development etc may have relevance to valuation of imported goods for payment of custom duties.

## RATIO ANALYSIS

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### RATIOS AND COMPARATIVE ANALYSIS

7.1 The basis for financial analysis, planning and decision-making is financial information. A business firm prepares its final accounts *viz.*, Balance Sheet and Profit and Loss Account, which provide useful financial information for the purpose of decision-making. Financial information is needed to predict, compare and evaluate the firm's earning ability. The former statement *viz.*, profit & loss account shows the operating activities of the concern and the latter *viz.*, balance sheet depicts the financial position of the entity at a particular point of time. However, these statements do not disclose all of the necessary and relevant information. For the purpose of obtaining the material and relevant information necessary for ascertaining the financial strengths and weaknesses of an enterprise, it is necessary to analyze the data depicted in the financial statements. The financial manager has certain analytical tools, which help in financial analysis and planning. For instance, a cash flow statement is a valuable aid to a financial manager in evaluating the inflows and outflows of cash i.e., sources and applications of cash during particular period. In addition, ratio helps the manager to analyze the past performance of the firm and to make future projections.

### RATIO ANALYSIS

7.2 Ratio Analysis is a widely used tool of financial analysis. The term ratio in it refers to the relationship expressed in mathematical terms between two individual figures or group of figures connected with each other in some logical manner and are selected from financial statements of the concern. The ratio analysis is based on the fact that a single accounting figure by itself may not communicate any meaningful information but when expressed as a relative to some other figure, it

may definitely provide some significant information. The relationship between two or more accounting figures/groups is called a financial ratio. A financial ratio helps to express the relationship between two accounting figures in such a way that users can draw conclusions about the performance, strengths and weaknesses of a firm.

7.3 Ratio analysis is not just comparing different numbers from the balance sheet, income statement, and cash flow statement. It is comparing the number against previous years, other companies, the industry, or even the economy in general. Ratios look at the relationships between individual values and relate them to how a company has performed in the past and might perform in the future.

7.4 All stakeholders within the company need to be able to appreciate how the company is performing. Their understanding of how the firm is performing is enhanced through ratio analysis.

### **ANALYSIS AND INTERPRETATION OF RATIOS**

The analysis or interpretations may be of various types. The following approaches are usually found to exist:

- (a) Interpretation or Analysis of an Individual (or) Single ratio.
- (b) Interpretation or Analysis by referring to a group of ratios.
- (c) Interpretation or Analysis of ratios by trend.
- (d) Interpretations or Analysis by inter-firm comparison.

### **PRINCIPLES OF RATIO SELECTION**

The following principles should be considered before selecting the ratio:

- (1) Ratio should be logically inter-related.
- (2) Pseudo ratios should be avoided.
- (3) Ratio must measure a material factor of business.
- (4) Cost of obtaining information should be borne in mind.
- (5) Ratio should be in minimum numbers.
- (6) Ratio should be facilities comparable.

### **ADVANTAGES OF RATIO ANALYSIS**

Ratio analysis is necessary to establish the relationship between two accounting figures to highlight the significant information to the management or users who can analyse the business situation and to monitor their performance in a meaningful way. The following are the advantages of ratio analysis:

- (1) It facilitates the accounting information to be summarized and simplified in a required form.
- (2) It highlights the inter-relationship between the facts and figures of various segments of business.
- (3) Ratio analysis helps to remove all type of wastages and inefficiencies.
- (4) It provides necessary information to the management to take prompt decision relating to business.
- (5) It helps to the management for effectively discharge its functions such as planning, organizing, controlling, directing and forecasting.
- (6) Ratio analysis reveals profitable and unprofitable activities. Thus, the management is able to concentrate on unprofitable activities and consider to improve the efficiency.
- (7) Ratio analysis is used as a measuring rod for effective control of performance of business activities.
- (8) Ratios are an effective means of communication and informing about financial soundness made by the business concern to the proprietors, investors, creditors and other parties.
- (9) Ratio analysis is an effective tool which is used for measuring the operating results of the enterprises.
- (10) It facilitates control over the operation as well as resources of the business.
- (11) Effective co-operation can be achieved through ratio analysis.
- (12) Ratio analysis provides all assistance to the management to fix responsibilities.

- (13) Ratio analysis helps to determine the performance of liquidity, profitability and solvency position of the business concern.

## TYPES OF RATIOS

7.5 Broadly speaking, the operations and financial position of a firm can be described by studying its short term and long term liquidity position, profitability and its operational activities. Therefore, ratios can be classified into following five broad categories:

- (i) Profitability Ratios
- (ii) Activity Ratios
- (iii) Liquidity Ratios
- (iv) Stability Ratios (Capital Structure/Leverage Ratios)
- (v) Investors ratio

In the following pages we have given the ratios which would be useful from excise and service tax point of view:

### (i) Profitability Ratios

These ratios tell us whether a business is making profits - and if so whether at an acceptable rate. Profitability Ratio is used to measure the overall efficiency or performance of a business. Generally, a large number of ratios can also be used for determining the profitability as the same is related to sales or investments. The key ratios are:

<i>Ratio</i>	<i>Calculation</i>	<i>Comments</i>
<i>Gross Profit Margin</i>	$\left[ \frac{\text{Gross Profit}}{\text{Revenue}} \right] \times 100$ (expressed as a percentage)	This ratio indicates us something about the business's ability to consistently control its production costs or to manage the margins it makes on products it buys and sells. Whilst sales value and volumes may move up and down significantly, the gross profit margin is usually quite stable (in percentage terms). However, a small increase (or decrease) in profit margin, however caused can produce a substantial change in overall profits.

<i>Operating Profit Margin</i>	$\left[ \frac{\text{Operating Profit}}{\text{Revenue}} \right] \times 100$ (expressed as a percentage)	Assuming a constant gross profit margin, the operating profit margin indicates about a company's ability to control its other operating costs or overheads.
<i>Net Profit Ratio</i>	$\left[ \frac{\text{Net Profit after tax}}{\text{Revenue}} \right] \times 100$	It is also known as Sales margin ratio or profit margin ratio or Net profit to sales ratio. It reveals the firm's overall efficiency in operating the business. Net profit includes non-operating incomes and profits. Higher Net Profit Ratio indicates the standard performance of the business concern. This ratio facilitates to make or buy decisions. It is very much useful as a tool of investment evaluation.
<i>Return on Investment Ratio</i>	$\left[ \frac{\text{Net Profit (after tax and interest)}}{\text{Shareholder's Fund}} \right] \times 100$	This ratio is also called as ROI. It measures a return on the owner's or shareholders' investment. It establishes the relationship between Net profit after interest and taxes and the owner's or shareholder's investment. This ratio helps the management for important decision making. It helps to measure an income on the shareholders' or proprietor's investments.
<i>Return on Capital Employed Ratio</i>	$\left[ \frac{\text{Net Profit after taxes before interest}}{\text{Average Capital employed or Net Capital Employed}} \right] \times 100$	This ratio is also called as Return on Investment Ratio. This ratio measures a relationship between Profit and Capital employed.

**(ii) Efficiency Ratios**

These ratios give us an insight into how efficiently the business is employing those resources invested in fixed assets and working capital.

<i>Ratio</i>	<i>Calculation</i>	<i>Comments</i>
<i>Capital Turnover Ratio</i>	Sales / Capital employed(or) Cost of Sales/Capital employed	A measure of total asset utilisation. Helps to answer the question - What sales are being generated by each rupee's worth of assets invested in the business? This ratio establishes the relationship between the Cost of sales or sales and Capital employed or Shareholders' funds Note: when combined with the return on sales, it generates the primary ratio – (Return on Capital Employed) ROCE.
<i>Fixed Assets Turnover Ratio</i>	Cost of goods Sales / Fixed Assets or Sales/Net Fixed assets	This ratio indicates the efficiency of assets management. This Ratio is used to measure the utilization of fixed assets. A reducing sales being generated from each rupee invested in fixed assets may indicate overcapacity or poorer-performing equipment. Higher the ratio meaning that the firm has successfully utilized the fixed assets.
<i>Stock Turnover Ratio or Inventory Ratio or Stock velocity Ratio</i>	Cost of Sales / Average Stock Value	This Ratio is used to measure whether the investment in Stock in trade is effectively utilized or not. Stock Turnover indicates the number of times the stock has been turned over in business during a particular period. This ratio is widely used as a measure of investment in stock is within proper limit or not, This ratio helpful in evaluating the stock utilization.

<i>Ratio</i>	<i>Calculation</i>	<i>Comments</i>
<i>Debtor's Turnover Ratio</i>	Net Credit Sales/Average Receivables	This ratio is also known as Receivables Turnover Ratio or Debtor's Velocity. Debtors or Receivables represent the uncollected portion of credit sales. Debtor's velocity indicates the number of times the receivables are turnover over in business during a particular period. This ratio establishes the relationship between receivables and sales.
<i>Creditors Turnover Ratio</i>	Net Credit Purchases/Average Accounts Payable	This Ratio is also called as Payables Turnover Ratio or Creditor's Velocity. This ratio establishes the relationship between the net credit purchases and the average trade creditors. Creditor's Velocity ratio indicates the number of times with which the payment is made to the supplier in respect of credit purchases.
<i>Working Capital Turnover Ratio</i>	Net Sales/Working Capital	This ratio highlights the effective utilization of working capital relating to sales. It represents the firm's liquidity position. It establishes the relationship between Sales and Working Capital. This ratio is an index to know whether the working capital has been effectively utilized or not in making sales. A higher working capital turnover ratio indicates efficient utilization of working capital.



**(iii) Input-Output Ratios**

<i>Ratio</i>	<i>Calculation</i>	<i>Comments</i>
Material Consumption	Material Consumed/ Goods Produced	This will establish the linkage between the material input and the final output. The quantum of work in progress is also to be taken into account for a proper reconciliation. Further, the quantum of goods declared for excise purposes is also a good figure for comparison. This ratio can be computed both in terms of quantum and value.
Power Consumption	Power Consumed / Goods produced	For calculating this ratio the power directly attributable to production is to be considered.

**CASE STUDY**

7.6 In a meeting held at Solan towards the end of 2015, the Directors of HPCL Ltd. have taken a decision to diversify. At present HPCL Ltd. sells all finished goods from its own warehouse. The company issued debentures on 01.01.2015 and purchased fixed assets on the same day. The purchase prices have remained stable during the concerned period. Following information is provided to you:

<i>Income Statements</i>				
	<i>2014 (₹)</i>		<i>2015 (₹)</i>	
Cash Sales	30,000		32,000	
Credit Sales	<u>2,70,000</u>	3,00,000	<u>3,42,000</u>	3,74,000
Less: Cost of goods sold		<u>2,36,000</u>		<u>2,98,000</u>
Gross profit		64,000		76,000
Less: Expenses				
Warehousing	13,000		14,000	
Transport	6,000		10,000	
Administrative	19,000		19,000	

Selling	<u>11,000</u>		14,000	
Interest on Debenture		<u>49,000</u>	<u>2,000</u>	<u>59,000</u>
Net Profit		<u>15,000</u>		<u>17,000</u>

**BALANCE SHEET**

	<i>2014 (₹)</i>		<i>2015 (₹)</i>	
Fixed Assets (Net Block)	-	30,000	-	40,000
Debtors	50,000		82,000	
Cash at Bank	10,000		7,000	
Stock	<u>60,000</u>		<u>94,000</u>	
Total Current Assets (CA)	<u>1,20,000</u>		<u>1,83,000</u>	
Creditors	<u>50,000</u>		<u>76,000</u>	
Total Current Liabilities (CL)	<u>50,000</u>		<u>76,000</u>	
Working Capital (CA - CL)		<u>70,000</u>		<u>1,07,000</u>
Total Assets		<u>1,00,000</u>		<u>1,47,000</u>
<b>Represented by:</b>				
Share Capital		75,000		75,000
Reserve and Surplus		25,000		42,000
Debentures		—		<u>30,000</u>
		<u>1,00,000</u>		<u>1,47,000</u>

Assume opening stock of ₹ 40,000 for the year 2014.

You are required to calculate the following ratios for the years 2014 and 2015.

- (i) Gross Profit Margin Ratio
- (ii) Operating Profit Ratio
- (iii) *Sales or Profit / Fixed Assets*

### Solution

	<i>Computation of Ratios</i>	
	<i>2014</i>	<i>2015</i>
1. Gross profit ratio <i>Gross profit / sales</i>	$\frac{64,000 \times 100}{3,00,000}$	$\frac{76,000 \times 100}{3,74,000}$
	21.3%	20.3
2. Operating profit ratio <i>Operating profit / Total sales</i>	$\frac{15,000 \times 100}{3,00,000}$	$\frac{19,000 \times 100}{3,74,000}$
	5%	5.08%
3. Cost of Sales / Fixed Assets	$\frac{2,36,000}{7.86 \text{ times}}$	$\frac{2,98,000}{7.45 \text{ times}}$
4. Stock turnover ratio COGS / Average stock*	$\frac{2,36,000}{50,000} = 4.7$	$\frac{2,98,000}{77,000} = 3.9$

\*Calculation of Average Stock:  $(40000+60000)/2 = 50,000$        $(60000+94000)/2 = 77,000$

### Ratios –Indirect tax perspective

#### 1. Cenvat credit utilization ratio

[Cenvat credit utilized/ Cenvat credit available]\*100

#### 2. Service tax/duty payment ratios

### Out of Cenvat credits

[Cenvat credit utilized/Total liability] \*100

### Out of cash

[Cash (GAR-7 challans)/ Total liability]\*100

#### 3. Ratio of cash outflow in terms of interest

[Total interest paid/ (outstanding tax dues + wrong availment of credit)] \*100

## **SERVICE TAX – RELEVANT ACCOUNTING STANDARDS**

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8.1 After studying the various statutory provisions of service tax law, one must understand the inter-relationship of this law with accounting, i.e., how service tax is recorded in the books of accounts which accounting standards or guidance notes issued by the ICAI are applicable in respect of this tax and what are the points of convergence and divergence between the provisions of this tax law and accountancy principles. In order to understand the practical implications of these tax provisions, it becomes utmost necessary to know that how service tax related transactions are accounted for in the account books. In this chapter we will try to understand these issues.

### **ACCOUNTING STANDARDS ISSUED BY ACCOUNTING STANDARDS BOARD (ASB) OF ICAI**

8.2 Accounting Standards (ASs), are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements globally. In India, accounting standards are issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India. The composition of ASB is such that due representation is given to industry, associations, banks, company law authorities, taxation authorities and the C&AG. The representatives of Central Board of Direct Tax and Central Board of Excise and Customs have been invited to join the Board. The Accounting Standards have also been notified by the Central Government. Hence, these Accounting Standards are mandatory in nature.

8.3 The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in the company's economic performance. The Accounting Standards reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises. The following Accounting Standards have relevance in service tax matters:

***(i) AS 1: Disclosure of Accounting Policies***

The purpose of this Standard is to promote better understanding of financial statements through disclosure of Accounting policies which are followed by an entity. Such disclosure would facilitate a more meaningful comparison between financial statements of different enterprises.

There are three fundamental accounting assumptions namely going concern, consistency and accrual. They should be followed in preparing and presenting the financial statements.

All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. Any change in accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. If such material effect could not be computed, such fact also shall be disclosed.

Therefore, the accounting policies relating to treatment of CENVAT, valuation of inventories with respect to CENVAT, recognition of service income etc. should be disclosed as per this accounting standard.

***(ii) AS 7: Accounting for Construction Contracts***

This standard prescribes that in respect of construction contracts the revenue and expenses of the contract should be accounted for as per the percentage completion method prescribed by this accounting standard.

Under this method, contract revenue is matched with the contract cost incurred in reaching the stage of completion at the reporting date. Therefore, only the revenue, expenses and profit that can be attributed to the proportion of work completed are reported. This method provides

useful information on the extent of contract activity and performance during a period.

Therefore, service providers engaged in taxable construction services should recognize their revenue in the account books in accordance with AS 7 read with Point of Taxation Rules, 2011.

**(iii) AS 9: Revenue Recognition**

The revenue received from manufacturing business or rendering of services should be recognized in the books of accounts in accordance with this standard. This standard provides that for normal transaction of sale of goods, revenue shall be recognized when substantial risk and title to goods is transferred to buyer. Similarly, for the revenue from rendering of services, income should be recognized when the service is performed, either by completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as achieved, when no significant uncertainty exists regarding:

- (a) the amount of consideration that will be derived from rendering the service;
- (b) the collectability of the amount when services are rendered.

*Completed Service Contract Method* is a method of accounting which recognises revenue only when the rendering of services under a contract is completed or substantially completed. This method should be applied when the act to be performed is a single act and either it is performed or not performed so as to entitle the service provider to revenue. There cannot be any partial performance in such kind of services e.g., insurance commission, facsimile services, advertising services etc. In case of insurance agency commission, revenue can be recognized on the effective commencement or on the renewal date of the related policies.

*Proportionate Completion Method* is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract. This method can be applied where performance is measured in terms of a series of acts performed e.g., tuition fee can be recognized proportionate to period of instruction.

***(iv) AS 10: Accounting for Fixed Assets***

This standard prescribes that the import duties, if any, and other non-refundable taxes paid on purchase of fixed assets should be included in the cost of the fixed assets while recording the same in the account books. However, the amount of CENVAT (a refundable tax) should not be included in the cost of the fixed asset.

***(v) AS 11: Accounting for the Effects of Change in Foreign Exchange rates***

Accounting for the import/export of goods, services and assets should be done as per the principles prescribed by this accounting standard.

AS 11 *Accounting for Effects of Changes in Foreign Exchange Rates* provides that a foreign currency transaction should be initially recognized in the reporting currency on the basis of exchange rates between the reporting currency and the foreign currency prevalent at the date of transaction (an average rate for the period may be used). However, the average rate may not be used when exchange rate fluctuates significantly. A foreign currency transaction involves buying or selling of goods, services, or assets whose price is denominated in a foreign currency.

The exchange gain/loss arising from the difference between the rate prevalent at the date of transaction and rate on the date of settlement of monetary item should be adjusted in Profit and Loss Account, if settlement is in same period as initial recognition. However, if the settlement does not take place in same period as that of recognition, the balances of monetary items should be restated at the closing rate at the balance sheet date. The gain/loss resulting from such restatement should also be adjusted in the Profit and Loss Account.

However, MCA vide notification no. G.S.R. 913(E) dated 29.12.2011 has provided the option that the exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital assets, can be added to or deducted from the cost of the asset and shall be depreciated over the balance of life of the asset and in another cases, can be accumulated in 'Foreign currency Monetary Item

Translation Difference Account' in the enterprise financial statements and amortised over the balance period of such asset. The above option has been granted till March, 2020.

**(vi) AS 12: Accounting for Government Grants**

Import quotas or import licences are considered as intangible assets. If such import quotas or import licences are given at concessional rate or free of cost in the form of Government grants, they should be accounted for as per the provisions of this accounting standard.

When these intangible assets are given at concessional rate, they should be recorded at actual (concessional) rate by debiting asset account and crediting bank account. However, if certain conditions are not fulfilled the Government grant becomes refundable. Where, the grant becomes refundable and the asset is taken back, the book value of the asset should be written off.

In case, where the asset is given free of cost, the asset should be recorded at token value say Re.1 or ₹ 100 by debiting the asset account and crediting profit and loss account. However, if the grant becomes refundable (on account of non-fulfillment of certain conditions), the book value of the asset should be increased to the extent of the refund by debiting the asset account.

The refund of Government grant should be treated as an extraordinary item as per AS 5 *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*. Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore are not expected to recur frequently or regularly. Such items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period in a manner that its impact on current profit or loss can be perceived.

**(vii) AS 17: Segment Reporting**

AS 17, establishes principles for reporting financial information about the different types of products and services an enterprise produces and the different geographical areas in which it operates.



Large manufacturing companies producing multiple products or having multi-location manufacturing operations or big service providers operating from multi-locations (*viz.* banks) should follow this accounting standard for reporting *inter alia* segment wise revenue and expenses. While income tax expenses are not recorded as segment expenses, excise duty, customs duty and service tax, being operating expenses, have to be recorded as segment expenses.

***(viii) AS 18: Related Party Disclosures***

This accounting standard requires the disclosure of all related parties (as per the definition of the standard) and the transactions effected with them in the financial statements. Therefore, rendering or receiving of services involving related parties must be valued correctly so as to avoid unnecessary litigations

***(ix) AS 19: Leases***

This Standard applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation and maintenance of such assets.

*A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.*

*A lease is classified as a finance lease if it transfers substantially all the risk and rewards incident to ownership. Title may or may not eventually be transferred. A lease is classified as an operating lease if it does not transfers substantially all the risk and rewards incident to ownership.*

*In case of finance leases the lessor aims to allocate finance income over the lease term reflecting a constant periodic return on investment of the lessor. In case of operating leases lease income is recognized in the statement of profit and loss on a straight line basis over the lease term.*

***(x) AS 26: Intangible assets***

*An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.*

This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. This Standard also applies to rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. Intangible assets used such as computer software, and other expenditure such as start-up costs are also covered in this standard.

*An intangible asset should be recognised if, and only if:*

- (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
- (b) the cost of the asset can be measured reliably.

If given free of cost or at concessional prices by the Government, accounting should be done as per AS 12 – *Accounting for Government Grants* (discussed in point (vi) above).

**(xi) AS 29: Provisions, Contingent Liabilities and Contingent Assets**

The liability for service tax arises as soon as the services are completed. This accounting standard provides that a provision should be recognized when there is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation. A disclosure is also required for such provision. Further, AS 29, prescribes that effect of new legislation should be considered in estimation of provision when there is sufficient objective evidence that the legislation is virtually certain to be enacted e.g., a provision may be made in respect of a retrospective amendment made by the Finance Bill which affects the tax liability of the assessee when at the Balance Sheet date. The Bill has been passed by the Parliament and is awaiting President's assent. In this case, it is virtually certain that the Bill will be enacted by obtaining the assent of the President.

However, the variety of circumstances that arise in practice usually make it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required for both, i.e., what the legislation will demand and whether it is virtually certain to be enacted

and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

***(xii) Guidance Note on Accounting Treatment for MODVAT/  
CENVAT***

Service tax paid on inputs may be debited to a separate account, e.g., CENVAT Credit Receivable (Inputs) Account. As and when CENVAT credit is actually utilised against payment of service tax or excise duty on final products or services, appropriate accounting entries will be required to adjust the service tax paid out of CENVAT Credit Receivable (Inputs) Account

The debit balance in CENVAT Credit Receivable (Inputs) Account should be shown on the assets side under the head ‘advances’.

## SERVICE TAX – ACCOUNTING ISSUES

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### ACCOUNTING ISSUES IN RECORDING VALUE OF TAXABLE SERVICES

9.1 No specific records are required to be maintained by the assessee under Service Tax Provisions. The records (including computerized data) as maintained by the assessee in accordance with the various other laws in force from time to time shall be acceptable – Rule 5(1).

#### *Records maintained under other fiscal laws are acceptable*

9.2 Assessee is maintaining various records under different laws for various purposes. Assesses are required to maintain certain records under Section 44AA of the Income Tax Act, 1961, similarly companies are required to maintain specified records under the Companies Act, 2013, assesses registered with sales tax departments in various states are also require to maintain specific records. Assessee is also under statutory obligation to maintain records under Labour Law, Excise Law etc. The object and purpose of maintenance of records under various statutes is that assessee can correctly work out the liability of taxes under each statute and could discharge his onus of making payment of taxes as per the provisions of each statute.

**Thus, under Service Tax also, the assessee should maintain such records as would enable him:-**

- (a) To calculate the value of taxable services as per the provisions of Section 67;
- (b) To calculate his service tax liability correctly; and
- (c) To ensure that proper credit of service tax paid on input services which are received/used in providing output taxable services is availed.

(A) *Suggested Records*

- (i) Service tax invoices serially numbered.
- (ii) Receipts (serially numbered) issued to client/customer/policy holder as the case may be.
- (iii) Copies of debit/credit notes.
- (iv) Files containing service agreements entered into between the assessee and its client's or customer as the case may be.
- (v) Bills/vouchers/documents in support of reimbursable expenses claimed in invoices raised on service receiver.
- (vi) Bills/vouchers/documents in respect of value of goods sold and separately charged in the invoices raised on service receiver.
- (vii) Copies of supplementary bills, if any, and
- (viii) Correspondence files with the clients or customer as the case may be.

(B) *Service Tax Invoice Register:* It should contain the following information :

- (i) Invoice no. and its date of issue
- (ii) Name and address of the service receiver
- (iii) Description of service
- (iv) Amount of service charges
- (v) Reimbursement of expenses
- (vi) Value of goods sold
- (vii) Amount of service tax payable
- (viii) Details of payments received from service receiver
- (ix) Receipts issued as acknowledgement of payment

(C) *Register for Input services:* It should contain the following information

- (a) Date and invoice number of input service received

- (b) Name and address of input service provider
- (c) Service tax registration number of input service provider
- (d) Description of input service
- (e) Value of input service
- (f) Amount of service tax paid
- (g) Amount of service tax paid under reverse charge, if any
- (h) Date of payment of service tax
- (i) Date of payment to input service provider
- (j) Details with regard to availment of service tax credit, like :-
  - (i) date of receipt of invoice of the input service
  - (ii) Eligible input service as per input service definition
  - (iii) Proper document on which credit availed
  - (iv) Amount of service tax credit availed
  - (v) balance available at the end of the month/quarter

### ***Accounting for Service Tax***

9.3 The following ledger accounts shall be maintained in the books of the service provider:

- (i) 'Service tax payable' under head "*Current Liability*"
- (ii) 'CENVAT credit receivable' under head "*Current Assets*"

9.4 At the time of billing to the client service tax payable account should be credited as the liability to pay service tax arises on the issue of invoice or receipt of payment or completion of service [*in terms of Point of Taxation Rules, 2011*]. Service tax payable a/c should be debited when the service tax is paid by the relevant due date as provided under Rule 6 of the Service Tax Rule, 1994.

9.5 '*CENVAT Credit Receivable*' account represents the amount of total service tax paid on the input services, which is eligible to be set off against the output service tax liability and should be debited at the time of receipt of invoice (subject to a condition that payment has been made to the input service vendor within the time stipulated as per Rule 4(7) of

Cenvat Credit Rules, 2004) from the input service provider. CENVAT credit shall be utilized only to the extent such credit is available on the last day of the month or quarter, as the case may be, for payment of tax relating to that month or the quarter, as the case may be (in terms of Rule 3(4) of Cenvat Credit Rules, 2004). Credit receivable is to be set off against the Service Tax payable account and difference left in the Service Tax payable account is to be paid in cash through internet banking.

***Provision in case the provider of taxable service is providing service in relation to banking and other financial services***

9.6 As per first proviso of Rule 4A of Service Tax Rules, 1994, that “*in case the provider of taxable service is a banking company or a financial institution including a non-banking financial company, providing service to any person, an invoice, a bill or, as the case may be, challan shall include any document, by whatever named called, **whether or not serially numbered and whether or not containing address of the person receiving taxable service** but containing other information in such document’s as required under this sub-rule.*”

***Provision in relation to input service distributor***

9.7 As per the Rule 4A(2) of Service Tax Rules, 1994, every input service distributor distributing credit of taxable services shall, in respect of credit distributed, issue an invoice, a bill or, as the case may be, a challan signed by such person or a person authorized by him for each of the recipient of the credit distributed, and such invoice, bill or, as the case may be, challan shall be serially numbered and shall contain the following, namely:-

- (i) the name, address and the registration number of the person providing input services and the serial number and date of invoice, bill, or as the case may be, challan issued under sub-rule (1);
- (ii) the name, address and the registration number of the said input service distributor;
- (iii) the name and address of the recipient of the credit distributed;
- (iv) the amount of the credit distributed.

As per first proviso of Rule 4A(2) of Service Tax Rules, 1994, wherein it has been provided that “*in case the input service distributor is an office of*

*a banking company or a financial institution including a non-banking financial company, providing service to a customer, in relation to banking and other financial services, an invoice, a bill or, as the case may be, challan shall include any document, by whatever named called, **whether or not serially numbered** but containing other information in such document as required under this sub-rule.”*

In other words, in case the input service distributor is an office of a service provider in respect of Banking and Financial Services Invoice, bill or challan will include any document whether or not serially numbered. However it must contain other information as required in Rule 4A and specified herein above.

***Preservation of records for five years***

9.8 Rule 5(3) has been inserted w.e.f. 01.03.2006 *vide* Notification No. 5/2006-ST 01.03.2006 to provide that all such records shall be preserved at least for a period of five years immediately after the financial year to which such records pertain.

**9.9 Accounting for value of taxable services**

- Service provider could account on cash basis or accrual basis. Difference between accrual and cash basis to be clearly kept in mind at the commencement of audit.
- Requirements of Section 67 read with Service Tax Determination of Value Rule, 2006 should be kept in mind.
- ***Accrual Entry*** is as follows:

For raising an Invoice:

Party's A/c	Dr	11,500	
To Service Income A/c			10,000
To Service Tax Payable A/c			1,400
To Swachh Bharat Cess Payable A/c			50
To Krishi Kalyan Cess Payable A/c			50

***Alternative entry:***

Party's A/c	Dr	11,500	
To Service Income A/c			11,500



***Possible Issues***

- (i) The tax payer could credit the fee income to some other account for e.g. Suspense a/c, supplier's a/c, or other undisclosed credits, etc.
- (ii) The value of taxable service should capture the entire value including incidental expenses.
- (iii) Additional consideration receivable, if any, over and above the service income should be carefully scrutinized
- (iv) In case of a service provider who is also a manufacturer and / or trader, care should be taken to ensure that service element, if any, should be separately accounted and proper reversal of cenvat credit on input service is done in accordance with Rule 6 of Cenvat Credit Rules 2004.
- (v) In case of composite contracts, taxable value should be carefully scrutinized.
- (vi) In case of services rendered free of charge, accounts do not throw up the value of taxable service. The transaction needs to be scrutinized only if there seems to be a probability of receiving consideration other than in monetary terms, as service tax is not payable on service rendered free of cost.
- (vii) Reasons for reversal of excess billing done to the clients.
- (viii) Excess / short service tax charged to the clients.
- (ix) Additional bills raised on the clients.
- (x) Write-off of some invoices due to bad debts.
- (xi) Refund of excess amount collected from clients; adjusted in subsequent bills
- (xii) The transaction between associated enterprises. ***Accounting for value of Taxable Service for International transactions***

***Import of Services***

- Any liabilities accrued for import of any taxable service should be thoroughly examined. For e.g.: Cross charges by overseas parent company to the Indian subsidiary, actual import of services, etc.

- Any cross charges, debit note by the overseas branch office of Indian company.

### *Export of Services*

- Any receivables accrued for export of any taxable service should be thoroughly examined.
- Cross charges by an Indian company to its overseas parent company / branch.

### *Accounting for realization of value of taxable services*

- For realisation of the invoice / advance money

Bank A/c	Dr	11,500	
To Party's A/c			11,500

- For subsequent set-off against the actual invoice

Party's A/c	Dr	11,500	
To Service Income A/c			11,500

- For adjusting the receivable against the payable from the same party

Party's A/c	Dr	1,00,000	
To Party's A/c			1,00,000

- For payment made by service receiver to third party on behalf of service provider.

Expense A/c	Dr	1,00,000	
To Third party's A/c			1,00,000

Third Party's A/c	Dr	1,00,000	
To Party's A/c			1,00,000

### *Possible Issues*

- Exchange fluctuations may go unnoticed.
- Amount billed is ₹ 1,00,000. But amount realised is ₹ 1,10,000. What is the value of taxable service? Another eg: If amount realized is ₹ 95,000; what is the value of taxable service.

- Part realisation of the service income. In such a case, reasons for part realization should be ascertained. There may be various reasons for part realization i.e. bad debts, short settlement due to deficiency in service or termination of contract premature etc.
- TDS is required to be deducted by the service receiver under the provisions of Income-tax Act. Such TDS is deemed to be received.

### KEY ISSUES – ACCOUNTING OF SERVICE TAX

#### *Identifying Credits in Expenditure Account*

9.10 With the introduction of negative list based taxation, any income other than the list specified in the negative list has become taxable. Pursuant to this, it would be imperative to examine the sources of income or credits in the profit and loss account, from a taxability perspective.

Further, it is ordinary practice that recoveries made with respect to expenses incurred are charged to expenditure accounts. For instance, the Company may have incurred group insurance expenditure for its employees and the same is recovered back from the employees. As per accounting prudence, since the recovery is made from the expenses incurred, the same is charged to the particular expense head. Accordingly, the expenses accounted, is net of recoveries made from the employee. To illustrate, if the total expenses incurred by the Company for providing group insurance is say, ₹ 100,000/- and ₹ 25,000/- is recovered from the employees, then the said expenditure account would appear as follows in the Trial Balance:

Particulars	Debit	Credit	Net Amount
Employee Group Insurance Expenditure A/c	100,000	25,000	75,000

In the profit and loss account of the Company, ₹ 75,000/- would appear as the net expense under the head 'Employee Group Insurance'.

It is possible that the recoveries made from the employees may be subjected to service tax, whilst the entitlement of the Company to take credit on full expenditure value of ₹ 100,000/-. Accordingly, it would be necessary to examine the credits from a taxability perspective.

***Accounting of Education cess separately***

9.11 In terms of Cenvat Credit Rules, 2004 and Service Tax Rules, 1994, education cess and secondary higher education cess need to be accounted separately.

9.12 Certain accounting softwares account service tax at 12.36% (including cess), but disclose or report, the cess components separately in the invoice and in the balance sheet. This would be sufficient compliance to the law as the component of service tax is being disclosed separately.

9.13 Certain softwares have inheriting limitation in disclosing the education cess and secondary higher education cess separately. In such cases, it appears that mere non-disclosure of education cess should not be non-compliance, so long as the service tax returns and the totals in the books of account match with the tax and cess payable/ collected.

***The above might not be relevant for audits conducted for the period post 01.06.2015, since the education cess and secondary higher education cess were ceased with effective from 01.06.2015.***

***Set off of Education cess with Education cess***

9.14 In terms of Rule 3(7) of Cenvat Credit Rules, 2004, the credit of education cess and secondary higher education cess can be utilized only against education cess and secondary higher education cess payable by the Company. Accordingly, it would be imperative for the assessee to account for the credit and the liability separately, to enable matching of the credit with the said liability.

***The above might not be relevant for audits conducted for the period's post 01.06.2015, since the education cess and secondary higher education cess were ceased with effective from 01.06.2015.***

***Swachh Bharat Cess cannot availed as Cenvat Credit:***

**9.14A** It is to be remembered that Swachh Bharath Cess cannot be availed as Cenvat Credit in terms of proviso to Rule 3 of Cenvat Credit Rules, 2004. Hence, the Swachh Bharath Cess cannot be availed as credit and the question of utilization does not arise.

***Krishi Kalyan Cess cannot availed as Cenvat Credit:***

**9.14B** It is to be remembered that Krishi Kalyan Cess cannot be availed as Cenvat Credit in terms of proviso to Rule 3 of Cenvat Credit Rules, 2004. Hence, the Krishi Kalyan Cess cannot be availed as credit and the question of utilization does not arise.

***Meaning of Export of Services is based on realization***

9.15 Finance Act, 2012, has amended the meaning of Export and has done away with Export of Services Rules, 2005. In this regard, Rule 6A has been inserted in Service Tax Rules, 1994 to provide the conditions for transaction to be regarded as export. Further, Notification No. 18/2012 – Central Excise (N.T.), dated 17-Mar-2012, has been issued to provide that Export turnover of services to mean as follows:

- (i) Export turnover of services means the value of the export service calculated in the following manner, namely:-

*Export turnover of services = payments received during the relevant period for export services + export services whose provision has been completed for which payment had been received in advance in any period prior to the relevant period – advances received for export services for which the provision of service has not been completed during the relevant period*

Hitherto, Export of Services was linked to invoicing and by virtue of the aforesaid amendment, the meaning of Export of Service, has changed to amounts realized for exports. Accordingly, the turnover of financials, which is recorded based on billings, will not match with the turnover of exports as per service tax. Accordingly, it would be imperative to maintain a reconciliation of the said turnover.

***Domestic Reverse charge***

9.16 Ordinarily, the liability to pay service tax is on the provider. In respect of specified services, the liability to pay service tax is on the person receiving the services, which list has been expanded by issuance of Notification No. 30/2012-ST, dated 20-Jun-2012. In this regard, in certain cases, the liability to discharge the service tax is fully on the recipient and in certain cases, it is shared with the service provider.

9.17 In respect of the said services, while accounting the expenses, the liability to pay service tax will need to be accrued. The liability to pay service tax for non-associated transactions will arise on payment to the vendor.

9.18 Further, in case the liability is shared between the provider and the recipient, then the invoice of the provider would carry the portion of the service tax liable as the provider and the balance will be accrued by the recipient as his liability.

***Reverse charge liability for Associated enterprise transactions & others***

9.19 The reverse charge liability on import of services from associated enterprise transactions accrue on accounting of the said transaction or payment, whichever is earlier.

However, with effect from 1.10.2014, for non-associated enterprise transactions, the liability to discharge service tax liability will arise on payment to the vendor, provided the payment is made within 3 months from the date of the invoice. However, if payment is not made within three months of date of invoice, then the service tax liability will arise on the date of payment to the vendor or the first day after three months from the date of Invoice, whichever is earlier.

Accordingly, the accounting of such transactions should reveal transactions with associated enterprise, transactions with non-associated enterprise and details of payments made to them with the invoice dates.

***CENVAT Credit taken on accrual basis but vendor not paid until 3 months***

9.20 In terms of CENVAT Credit Rules, 2004, the assessee is entitled to take credit on invoices raised by domestic service providers on accrual basis. However, it is provided that the payments to the said service provider needs to be made within 3 months from the date of invoice, bill or challan as the case may be. In the event the payment is not made within the stipulated time, the assessee is required to reverse the credit taken on accrual basis and avail the same, when the payment to the said vendor is made.

With effect from 01/03/2015, the time limit to avail the cenvat credit has been increased to 1 year from 6 months and the said limit shall be counted

from the date of invoice or date of payment challan in respect of reverse/partial reverse charge mechanism. The requirement of payment to input service provider for availing credit under partial reverse charge mechanism has been done away with effect from 01/04/2015 by virtue of Notification 06/2015-CE(NT) dated 01/03/2015.

Accordingly, the assessee would be required to record details of credit taken on accrual basis along with record of payment details. In case the payment made to the vendor is beyond the stipulated time, the assessee would be required to ensure that the credit was reversed and taken back only upon payment to the vendor.

***Reversal of Cenvat credits& reconciliation of Cenvat account***

9.21 In terms of Notification No. 27/2012-CE (NT), dated 18-Jun-2012 and Notification No. 12/2013-ST dated 01.07.2013, the assessee claiming refund of service tax is required to reverse the Cenvat credit on making an application for the refund. In case the refund application is rejected, the assessee will be entitled to claim the credit of valid input services.

Accordingly, while accounting the transactions the credit in the books of accounts should match with the ST-3 return and should reveal the credits availed, reversed and taken back. Further, the assessee should prepare monthly reconciliation of cenvat credit reflecting in Books of Accounts, ST-3 and the Cenvat Register.

***Exchange Rate with respect to Export and Import of Services***

9.22 Finance Act, 2012, has inserted Section 67A providing that the rate of service tax, value of a taxable service and rate of exchange, if any, shall be the rate of service tax or value of a taxable service or rate of exchange, as the case may be, in force or as applicable at the time when the taxable service has been provided or agreed to be provided. In this regard, the "rate of exchange" has been defined to mean the rate of exchange determined in accordance with such rules as may be prescribed.

***Related party transactions and notes to accounts***

9.23 In the Notes to Accounts of signed financial statements of corporate assesseees, they are required to disclose the foreign exchange expenditure incurred and transactions with related parties. In this regard, it is possible that a transaction with a related party incurred in foreign exchange is disclosed in transactions of foreign exchange expenditure incurred and transactions with related parties.

It is same transaction which is disclosed and not that they are separate. Due cognizance needs to be given to this.

***Levy of VAT and service tax on same base value***

9.24 Certain transactions such as the works contract, catering, supply of food at hotels, construction contracts, etc., are subject to both VAT and service tax. It would be possible that VAT and service tax is being paid on the same base value. In such composite transactions, while VAT is levied on material value of the transaction and service tax on the service value inbuilt into such transactions, it cannot be made that the service tax be leviable on the value including VAT and VAT on the value including service tax. While both the Statutes state gross value, the gross value ought to be understood as value excluding VAT and service tax. For instance, presently, service tax is charged on the restaurant service at 40% of the gross amount, which means VAT should be charged on the remaining 60% of the gross amount billed. However, in most of the state's VAT law, VAT is charged on gross billed amount, which results in double taxation on 40% of the gross amount billed.



## SERVICE TAX - RECONCILIATION

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### RECONCILIATION AND ITS PURPOSE

10.1 Reconciliation, in the common parlance means a statement of reasons as to why a difference exists between two or more sources of information. In accounting, '*reconciliation*' may be defined as a "*calculation that demonstrates how one figure (such as a balance) is derived from another*".

10.2 This normally results in circumstances where the treatment or disclosures of the same transaction is different in various sources. On the question as to why the treatment of the same transactions in different sources is different, it must be noted that in the accounting or tax treatment of various transactions are in specific to the subject, statute and the business practices. For example, a contractor recognizes revenue in the books of accounts as per Accounting Standard 7, whereas for the purposes of service tax, the revenue has to be recognized as per Point of Taxation Rules, 2011.

10.3 A reconciliation statement serves the purpose of ensuring compatibility and consistency of figures and balances generated and reported by an enterprise. For example, a bank reconciliation statement ensures that the bank balance as per the entity's books are tallied with the bank balance as per the bank's books and if there are any discrepancies they are for genuine legitimate reasons. Thus, '*reconciliation*' helps in ensuring comprehensiveness in the verification process.

10.4 At this juncture, it is relevant to understand that preparation of a reconciliation statement does not essentially mean that there are no differences or that there are no deviations. A reconciliation statement is a step towards determining such areas which require further substantive checks to be applied.

10.5 From a service tax perspective, '*reconciliation*' statements could serve a useful tool to compare the figures reported in the financial statements and in the service tax returns. A difference between what is reflected in the service tax returns *vis-à-vis* books of account could arise due to various reasons. Some of them are listed hereunder:

- *Liability to pay service tax arises at the time of receipt of consideration:* Hitherto, as per Rule 6 of the Service Tax Rules, 1994, service tax was payable only on the receipt of the consideration (including advances) thereof. However, the recognition of income/ revenue in the books of account was on the basis of accrual principles of accounting income. This gave rise to differences between value of services entered in the books and the value offered in the returns.

Insofar as it relates to payment of service tax on advances, though service tax is payable, the same would not be recognized as revenue/ income in the books of account. Again, even this differential treatment gave rise to differences between books of account and service tax returns.

However, with effect from, 01.07.2011, a set of Rules called the *Point of Taxation Rules, 2011* was introduced. With the introduction of these Rules, service tax is payable upon issuance of invoice or receipt of consideration, whichever is earlier. Separate provisions are provided for certain specific services which qualify as '*continuous supply of services*'.

However, an exception is provided in respect of individuals or partnership firms (incl. LLPs) or one person company (OPC) only whose value of taxable service provided from all premises is less than or equal to ₹ 50 Lakhs in the previous financial year. In such cases, service tax will be payable on the basis of receipt of consideration for the first 50 Lakhs in the current year.

- A thirty days (30 days) time limit is provided to raise invoice from the date of completion of service. Hence, even if the service is completely provided, service tax liability would not arise until the invoice is raised, provided the invoice is raised within thirty days (30 days).

- *Reverse Charge Transactions:* In case of service tax payable under reverse charge mechanism, viz., import of service, general insurance service, goods transport agency (GTA) service sponsorship services and other notified services, the liability to pay service tax would arise only on payment basis, viz., as and when the consideration is paid to the service provider.

However, with effect from 1.10.2014, this is subject to the condition that the payment of consideration is made to the service provider within three months from the date of invoice. In circumstances where the payment is not made within three months of the date of invoice, the liability will be the first day after three months from the date of Invoice.

- *Books of account maintained on cash basis, but service tax payable on accrual basis* – in respect of certain specific businesses/ professions, the books of account may be maintained on cash basis as far as income tax is concerned. However, service tax may be payable on accrual basis as indicated above. Even in such circumstances, the need for reconciliation arises.
- Service tax is payable on reimbursements whereas the same may not normally be recognized as revenue in the books of account.
- Under the service tax provisions, branch of a Company situated outside India and the Company in India is treated as separate permanent establishments. Therefore, the service rendered by the branch to the Company is also liable to service tax. However, the value attributable to such transactions may not necessarily be recognized as an expenditure/ income in the books of account.
- *Unbilled revenue and work in progress* – in respect of continuous projects, the revenues are normally recorded in the books of account based on work completion. However, the same may not necessarily result in a requirement to pay service tax.
- *Method of recording the entries in the books of account* – the revenues in the books of account may be classified based on the management requirements and or the business practices. It may not directly provide the information required for service tax purposes, viz., the revenues in the books of account may be

recorded based on geographical segmentation, industry specific classification etc.

- *CENVAT Credits:* May be availed as and when the invoice is recorded in the books of account. However, where the payment against the invoice is not made within 3 months, the same would have to be reversed and reclaimed at the time of payment. Thus, the CENVAT ledger in the books of account may not match with the CENVAT claim in the service tax returns.
- *Exemptions:* when an exemption is granted for a specific service or an exemption is withdrawn, it is but obvious that the services provided prior to that particular date and after that date would have to be identified and reconciled separately to compute service tax.
- *Transactions attracting both, Service Tax and VAT* – in respect of such transactions, only the service element in the total works contract is liable to service tax. However, the break-up of revenue from goods and services may not readily be available in the books of account.
- In many cases the service tax returns are filed in a decentralised manner say, where each branch premise is registered. However, the financial statements of the entity would be prepared for the entity as a whole. In such case, branch accounts, if available may be reconciled with the service tax returns in the same manner.
- In many cases, the assessee might claim abatements for the purposes of payment of service tax. However, while disclosing in the ST-3 Returns, the assessee might show only the value after abatements. In such cases, the turnover as per the books of accounts do not match with the ST-3 Returns.
- In certain cases, assessees might generate income which is covered under the negative list. By such a reason, the assessee might think the same is not required to be disclosed in the ST-3 Returns. In such a cases, the turnover as per the books of accounts do not match with the ST-3 Returns.

The above is only an illustrative list of reasons as to why the amounts reflected in the service tax returns may not match with the corresponding

amounts in the books of account. Depending upon the nature of business, the accounting practices and the disclosure requirements, there could be additional reasons for the differences.

### **DOCUMENTS TO BE EXAMINED**

10.6 There are several sources of information in order to ensure that the verification is comprehensive. Some of the documents which may be examined are as follows:

- (i) Audited/ Unaudited Financial statements i.e., Balance Sheet and Profit and Loss Account together with schedules, sub-schedules/ groupings and trial balance.
- (ii) Income-Tax Audit Report - Form No. 3CD attached alongwith the income tax return;
- (iii) VAT Audit Report under the State level Value Added Tax laws and the relevant returns filed;
- (iv) TDS returns under the Income Tax Act, 1961;
- (v) Internal Audit Reports and Management Reports;
- (vi) Records – Sales register, input credit register, etc;
- (vii) Customer and Vendor confirmations;
- (viii) Statements/ information submitted to Banks;
- (ix) Back up working papers/ work sheets for service tax returns;
- (x) Chart of Accounts/ Accounts Tree and the method recording entries impacting service tax may also be verified. In cases where, an accounting manual is prepared, the same may be verified.

### **HOW TO RECONCILE DOCUMENTS**

10.7 In order to ensure full and complete compliance and impart uniformity in assessments, service tax returns may be compared with others returns submitted by the assesseees to other statutory authorities. For example, figures reported in service tax returns can be cross verified with relevant information/ data submitted to Income Tax department through Income tax returns, TDS returns etc. Return filed with Ministry of Corporate Affairs namely Form 23AC, Form 23ACA (prior to FY 14-15) and AOC-4

(from FY 14-15) can also be used for verifying the data submitted for service tax purposes. Return filed with State VAT departments may also be useful to certain extent for the purpose of such verification, e.g., works contract returns filed with the state VAT department may be used to verify the valuation adopted by the works contract service provider for valuing service portion of the works contract.

For verifying the reverse charge payment for import of services, the data can be verified with Form 15 CA and Form 15 CB filed for the purposes of Income Tax Act, 1961.

10.8 Some of the most commonly used records/ documents and the audit requirements for the same are discussed below:

**(i) Trial Balance**

After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as Trial Balance. A trial balance is a list of all the General Ledger Accounts (both revenue and capital) contained in the ledger of a business. This is a summary of all the ledger accounts of assessee. It facilitates the preparation of financial statements i.e., Profit & Loss Account and Balance Sheet.

**How to verify:** The Trial Balance serves as a summary of what is contained in the ledger. The ledger may have to be seen only when details are required in respect of an account. Auditor may review the Trial Balance to see the accounts, which may have an impact on his audit.

**(ii) Income Statement (Profit & Loss Account/ Receipt & Expenditure Account)**

It is a company's Income statement that indicates how the revenue (money received from the sale of products and services) is transformed into Net Profit (the result after all revenues and expenses have been accounted for). It displays the revenues recognized for a specific period, and the cost and expenses charged against these revenues, including write-offs and taxes. The purpose of the income statement is to show managers and investors whether the company made or lost money during the period being reported. Income statement is prepared as required under the Companies Act 2013 or for any other statutory purpose.

**How to verify:** The auditor may review this account to see whether there is any miscellaneous income in the credit side as recognized by the assessee on which tax liability may be attracted. The auditor may also review the expenditure pattern of the assessee to ascertain whether the CENVAT credit availed is in proportionate to the expense reflected in debit side of account. The auditor may also review as to whether service tax has been paid under reverse charge mechanism in respect of the specified services e.g., if the income statement shows cab charges being paid to a non-corporate assessee, auditor may check that service tax has been paid by the assessee on such charges or not.

**(iii) Balance Sheet**

In financial accounting, a Balance sheet is a summary of the financial balances of a business organization. It may be defined as “a statement which sets out the assets and liabilities of an organization at a certain date. However, since the balance sheet is prepared on a particular date, the same does not constitute the summary of the activities of the assessee.

**How to verify:** The auditor may review the balance sheet to see that the CENVAT credit availed on capital goods has not been added with the value of fixed assets and correct CENVAT credit has been availed on the capital goods. The auditor might also see the Work –in– Progress on the Asset’s side, to see whether any liability arises from reverse charge. Example, a company might issue an order for construction of warehouse to a non-corporate entity and the construction is in progress. In such a case, an analysis of Work-In-Progress also gives an understanding about the service tax liability. The auditor may also compare the balance sheet with the previous year’s details to find out whether there are any major developments in the financial structure of the assessee and if there are any, the auditor may enquire into the same. Loans taken or given may be reviewed, so that the impact of the same on valuation may be investigated.

**(iv) Notes to Financial Statements (Accounts)**

Notes to financial statements (accounts) are additional information added to the end of financial statements. It helps in explaining specific items in the financial statements as well as provides a more comprehensive assessment of a company's financial condition. It may include information on debt, going

concern criteria, accounts, contingent liabilities or contextual information explaining the financial numbers (e.g., indicate a lawsuit).

**How to verify:** The auditor may go through notes to accounts to see whether any notes have any bearing on the central excise duty or service tax liability. The information contained in the notes to accounts is important to the auditor since the same contains the relevant information which cannot be provided in the financial statement but which are required for the proper explanation of the financial statement.

**(v) Report of the Management**

Directors are required to submit certain reports to the stakeholders about the activities and progress of the company. One such report is Director Report. This report contains valuable information for the auditors regarding the achievements and the future goals of the assessee, reason for failure, etc.,

**How to verify:** The auditor may go through the reports to see whether any of the remarks of the authority of the assessee has any adverse aspect on the excise/ service tax valuation and tax liability. Report also contains the director comments on adverse report of statutory auditor.

**(vi) Internal Audit Report**

Internal audit is mandatory only for specified assessees under Companies Act, 2013 and RBI Act, 1935 etc. However, it is the practice of the industry to engage internal auditors to ensure a better internal accounting control. The scope of internal auditing within an organization is broad and may involve topics such as the efficiency of operations, reliability of financial reporting, deterring and investigating fraud, safeguarding assets and compliance with laws and regulations.

**How to verify:** The auditor may review this report to ascertain whether the adverse comments of the internal auditor has any bearing on the service tax liability. This report may contain the details of under invoicing, wrong invoices, wrong availment of CENVAT credit etc.

**(vii) Major Contracts and Agreements**

A contract or an agreement is entered voluntarily by two parties or more with the intention of creating a legal obligation. These documents describe



the terms of supply of goods or services, consideration and other terms and condition.

**How to verify:** The auditor may go through the conditions of the contract or agreement to see if there is any discrepancy with respect to financial statements, whether consideration is undervalued or there is a probability of any service tax liability.

**(viii) Invoices**

Invoices are raised as required under Rule 4A of the Service Tax Rules, 1994 in which the name, address, registration number, details of the service provided, name and address of the person receiving service, and service tax charged etc. are recorded. Different series of invoices may be raised under proper authorizations from the service tax officer.

**How to verify:** The auditor may review the invoices to see whether the valuation of the services is done correctly and the applicable service tax is charged and paid to the exchequer. Since invoices should contain the details, which are prescribed under the above said Rule, the auditor may ensure the same.

The auditor may also ensure that input tax credit has been taken and accounted only when invoices are issued as per Rule 4A and may reject the input tax credit in case of wrong invoices issued by the service tax provider to the assessee. Invoices can be used as a tool to verify the compliance of reverse charge mechanism, in case of services where service tax is to be paid by the service receiver.

**(ix) Debit / Credit Notes**

A credit note is issued for a transaction that reduces amounts receivable from a customer e.g., a credit note is issued when a customer returns damaged goods to the seller. A debit note is issued for a transaction that reduces amounts payable to a vendor e.g., a debit note is issued when the assessee sends back damaged goods to its vendor. These notes are used to debit/credit miscellaneous transactions to the debtor's ledger and the creditor's ledger accounts. These are the residuary documents that are used to account the transactions, for which the basic documents such as invoices, payment vouchers, receipt vouchers, etc. cannot be issued.

**How to verify:** The auditor may review the debit notes issued on the creditors to see if there is any debit note on account of services received and if yes, whether the applicable CENVAT credit has been reversed. Similarly, debit notes raised on the debtors indicate that the assessee is receiving additional consideration from the customers, and hence the auditor may check as to whether applicable service tax has been paid on the same. On the other hand, credit notes raised on the creditor may indicate that there may be subsequent price hikes and hence the auditor may check whether the supplementary invoices are received from such creditors so that CENVAT credit can be availed on the same. Similarly the credit note issued to the debtor may indicate that there may be reduction in the value of the services received and the auditor should ensure that proportionate reversal of cenvat credit has been done by the assessee.

**(x) Income-tax returns (ITR)**

Income-tax return is required to be furnished by the assessee to the Income Tax department every year as per the requirements of the Income-tax Act. Various returns have been prescribed under the Income-tax Act according to the class of the assessee and the type of the income of the assessee. Following are the types of Income-tax returns submitted by different types of assessee to Income-tax Department:

Form No.	Used by Assessee	Applicability
ITR 1 (SAHAJ)	Individual	<p><b>Who can use this Return Form :</b></p> <p>This Return Form is to be used by an individual whose total income for the assessment year includes:</p> <ul style="list-style-type: none"><li>(a) Income from Salary/ Pension; or</li><li>(b) Income from One House Property (excluding cases where loss is brought forward from previous years); or</li><li>(c) Income from Other Sources (excluding Winning from Lottery and Income from Race Horses)</li></ul> <p><b>Who cannot use this Return Form :</b></p> <p>This Return Form cannot be used by;-</p> <ul style="list-style-type: none"><li>- Any resident having any asset (including</li></ul>

Form No.	Used by Assessee	Applicability
		<p>financial interest in any entity) located outside India or signing authority in any account located outside India</p> <p>- Person have claimed relief under section 90, 90A or 91 of foreign tax paid.</p>
ITR 2	Individual & HUF	<p><b>Who can use this Return Form :</b></p> <p>This Return Form is to be used by an individual or a Hindu Undivided Family whose total income for the assessment year includes:-</p> <p>(a) Income from Salary / Pension; or</p> <p>(b) Income from House Property; or</p> <p>(c) Income from Capital Gains; or</p> <p>(d) Income from Other Sources (including Winning from Lottery and Income from Race Horses).</p> <p>Further, in a case where the income of another person like spouse, minor child, etc. is to be clubbed with the income of the assessee, this Return Form can be used where such income falls in any of the above categories.</p> <p><b>Who cannot use this Return Form</b></p> <p>This Return Form should not be used by an individual whose total income for the assessment year includes Income from Business or Profession.</p>
ITR 2A	Individual & HUF	<p><b>Who can use this Return Form :</b></p> <p>This Return Form is to be used by an individual whose total income for the assessment year includes:</p> <p>(a) Income from Salary/ Pension; or</p> <p>(b) Income from House Property;; or</p> <p>(c) Income from Other Sources (excluding Winning from Lottery and Income from</p>

Form No.	Used by Assessee	Applicability
		Race Horses) Who cannot use this Return Form : This Return Form cannot be used by;- <ul style="list-style-type: none"><li>- Any resident having any asset (including financial interest in any entity) located outside India or signing authority in any account located outside India</li><li>- Person have claimed relief under section 90, 90A or 91 of foreign tax paid.</li></ul>
ITR 3	Individual & HUF	For Individuals/ HUFs being partners in firms and not carrying out business or profession under any proprietorship
(ITR-4S)	Individual & HUF & Partnership Firms	Sugam - Presumptive Business Income Tax Return <b>Who cannot use this Return Form :</b> This Return Form cannot be used by ;- <ul style="list-style-type: none"><li>- Any resident having any asset (including financial interest in any entity) located outside India or signing authority in any account located outside India.</li><li>- Person have claimed relief under section 90, 90A or 91 of foreign tax paid</li></ul>
ITR 4	Individual & HUF	For Individuals and HUFs having income from a proprietary business or profession
ITR 5	For persons other than <ul style="list-style-type: none"><li>a) Individuals</li><li>b) HUF</li><li>c) Company and Person filing ITR-7</li></ul>	For Firms, LLPs AOPs and BOIs, artificial juridical person referred to in section-2(31)(vii)
ITR 6	Companies	For Companies other than Companies Claiming Exemption under Section 11

Form No.	Used by Assessee	Applicability
ITR 7	Trust	For persons including companies required to furnish return under section 139(4A) or section 139(4B) or section 139(4C) or section 139(4D) i.e., Charitable Purpose, Research etc.

ITR Forms can be download from the following link:  
<https://incometaxindiaefiling.gov.in>.

**How to verify:** The auditor may verify the data reported by the assessee in its service tax returns with the information furnished in the income tax returns. The auditor may review the ITR return to see if there are any differences between the turnovers shown under ITR returns and service tax returns and if there are any such differences found, the auditor may enquire into the same. There are many others details/information available in the ITRs which can be of use for the service tax officers. Further, since this information is readily available with Central Board of Direct Taxes (CBDT), lot of time, energy and cost of both the assessee and the Department can be saved if instead of seeking such data from the assessee (during audit), the information is directly accessed from the CBDT. ITR forms can be downloaded from the following link: [http://www.incometaxindia.gov.in/download\\_all.asp](http://www.incometaxindia.gov.in/download_all.asp).

**(xi) Tax Audit Report (Form 3CD)**

The Tax Audit Report in Form 3CD is required to be submitted to the income tax department as per the requirements of the Income-tax Act. In this Report various information such as comments / observations of the tax auditor on the inventory, accounting system of the assessee, physical verification of stock, accounting and verification of capital goods, details about the statutory dues not paid within the due dates, etc. are need to be furnished.

**How to verify:** The auditor may review this report to see if the nature of business, books of accounts maintained, expenditure of personal nature, and other aspects discussed above are sufficient for the requirements of his audit. Form 3CD can be downloaded from the following link:  
<https://incometaxindiaefiling.gov.in>

***(xii) Works Contract Return***

“*Works Contract*” includes any agreement for carrying out for valuable consideration, the building construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, repair or commissioning of any moveable or immovable property. The assessee registered as works contract is required to submit WCT return with the respective State VAT authorities. The return contains relevant details about the consideration, material and labour bifurcations etc.

***How to verify:*** The auditor may review this return to verify the details relevant for service tax valuation etc.

***(xiii) Annual Returns (Form AOC-4)***

The Annual Returns containing the details of shareholders, directors, and debts, meeting of the Board and General Meetings and other information is required to be filed by a company, with the Registrar of Companies concerned, is covered under by section 92 of the Companies Act, 2013, and now required to be made at the close of financial year, unlike the position as at the date of AGM under the Companies Act, 1956. The form of Annual Return now is MGT-7. The Annual return of a Company other than a One Person Company and Small Company shall be certified by a Company Secretary in practice, in addition to the Director of the Company.

Further, the Annual Return, filed by:

- (i) a listed company; or
- (ii) a company having paid-up share capital of ₹ 10 Crores or more; or
- (iii) a company having turnover of ₹ 50 Crores or more

shall be certified by a Company Secretary in practice in the form of a Certificate in MGT-8, to be attached to the Annual return form (MGT-7), stating that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of the Act.

Similarly, the Annual Accounts are required to be filed by companies with the Ministry of Corporate Affairs, in Form 23AC (Balance Sheet) and Form

23ACA (Profit & Loss Account), upto the Financial Year ending 31.03.2014, under the provisions of the Companies Act, 1956.

The Ministry of Corporate Affairs had made filing of Balance Sheet and Profit & Loss Account in XBRL (Extensible Business Reporting Language) mandatory, for the following class of companies for the financial year ending on or after 31.03.2011, vide the Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2011, Dt:05.10.2011, as amended from time to time.

- (i) All companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or
- (ii) All companies having paid up capital of ` 5 Crores and above; or
- (iii) All companies having turnover of ` 100 Crores and above;

However, banking companies, insurance companies, power companies, and Non-Banking Financial Companies (NBFCs) and Housing Finance companies, need not file financial statements in are exempted from filing returns in XBRL.

XBRL is the acronym for Extensible Business Reporting Language. As the name itself suggests, it is a language for presentation of data which permits easy analysis and interpretation thereby reducing cost, time and effort. XBRL is only a method of presentation or reporting. It does not attempt to make any changes in the content to be reported. The idea behind XBRL is simple. Instead of treating financial information as a block of text - as in a standard internet page or a printed document - it provides an identifying label (tag) for each individual line item of data. XBRL reporting is done in XML file and that XML file is attached along with Form 23AC-XBRL and Form 23ACA-XBRL.

Form 23AC-XBRL (Balance Sheet) and Form 23ACA-XBRL (Profit & Loss Account), were the forms, to which the XBRL document to be attached and filed with the Registrar of Companies concerned up to the Financial Year ending 31.03.2014,

Effective from 01.04.2014, the form of filing Financial Statements with the Registrar of Companies concerned is Form AOC-4, by a non-XBRL company and in Form AOC-4(CFS), for which filing of Consolidated Financial

Statements are applicable and in Form AOC-4-XBRL, by a company to which XBRL is applicable.

How to verify: Department officials may use Annual Accounts and Annual Returns filed with Registrar of Companies (ROC) to verify the details filled in service tax returns. They may check whether there is any mismatch between the two and may obtain the reason for the same. Form 23-AC, and Form 23-ACA, Form AOC-4, in XBRL and Non-XBRL mode is available, for Public inspection, at the website of Ministry of Corporate Affairs [www.mca.gov.in](http://www.mca.gov.in) under link “View Public Documents” on payment of prescribed fees. The xmls of the financials filed in XBRL formatted xml file can be converted in to readable format by using XBRL validation tool as available in the MCA Portal, or using an XBRL software.

### **RECONCILIATION STATEMENTS THAT COULD BE PREPARED**

10.9 The following reconciliation statements could be prepared –

1. Reconciliation of value of services provided – charged and collected with financial statements. The reconciliation starts with the turnover as per accounts to arrive at the turnover on which service tax is paid / payable.
2. Reconciliation of CENVAT credits in the books of account with that reflected in the returns
3. Reconciliation of CENVAT credits in the books of account with the Cenvat Register
4. Reconciliation of service tax on overseas payments with financial statements.
5. Reconciliation of the value of goods as per the financials with the VAT / CST returns and audit reports
6. Reconciliation of amount of advances received with the amounts reflected in the financial statements.
7. Reconciliation of service tax payments made as per the returns with the bank statements
8. Reconciliation in respect of amounts deducted from the employees with the payroll statements



9. Reconciliation between the CENVAT credit reflected in the Central Excise returns with that reflected in the Service Tax returns
10. Month wise statements of taxable transactions / CENVAT credits - separate statements for 'amounts as per books of account' and 'amounts as per service tax returns'.

**TEMPLATES – ILLUSTRATIVE**

**Reconciliation of value of services provided**

<b>Sr #</b>	<b>Particulars</b>	<b>Source</b>
1	Total revenue as per the audited financial statements	Audited financial statements
2	Less:	
2.1	Transactions not liable to Service Tax	
	Value of goods sold	Audited financial statements
	Value of services specified in the negative list	
	Unbilled Revenue / Work in progress	
	Value of services liable to tax on 'cash basis'	
	Value of services which are liable to tax in the hands of the recipient	
2.2	Transactions exempt from payment of service tax	
	Value of export of services	Audited financial statements
	Value of services exempt - wholly	
	Value of services exempt - partial exemption	
	Amounts collected as a 'pure agent'	
3	Add:	
3.1	Transactions which are not included in the financials but are liable to service tax	
	Unearned Revenue	Ledger accounts
	Reimbursements claimed which are liable to service tax	Ledger accounts and Invoices / Debit Notes
	Amounts collected from employees	Ledger accounts and Payroll statements
4	Other Adjustments	
4.1	Transactions where advances are received	

Sr #	Particulars	Source
	Less: Taxed at the time of receipt of advance but invoice raised during this period	Previous computation statement and invoice register
	Add: Advances received during this period but no invoices raised and not included as revenue during this period	Ledger accounts
4.2	Transactions where point of taxation has occurred in another period	
	Add: Value of transactions for which POT has occurred during this period but no invoice is raised	Contracts / Correspondence
	Less: Value of transactions subjected to tax in an earlier period but invoice raised now	Previous computation statement and invoice register
	<i>Eg: Continuous supply of services where the due dates for invoices / payments is specified in the agreements, but no invoice is raised and no advance is received</i>	
4.3	Transactions liable to both, Service Tax and VAT	
	Less: Proportionate value of the contract not liable to service tax	Contracts, Computation statements, Invoices
4.4	Adjustments to invoice value	
	Less: Discounts, Rebates in terms of the agreements, if included above	Debit Notes, Ledger Accounts, Client balance confirmation
	Less: Value of invoices cancelled due to non-provision of services, if included above	
4.5	Others	
	Add / Less, as the case may be- such as, TDS included / excluded in the above	Debit Notes, Credit Notes, Contracts, Correspondence, Ledgers, Supporting documents
5	Net value of Services liable to Service Tax	

The above is only an illustrative format. It should be modified depending upon on the facts and circumstances of the case.

**Reconciliation of Service Tax Paid on Overseas Payments with Financial Statements**

Sr #	Particulars		Amount
1	Overseas Payments		
	(a) as per Profit and Loss accounts	xxx	
	(b) Capitalised in accounts	xxx	
	(c) Total of (a) and (b)		xxx
2	Amounts paid not liable to Service Tax		Xxx
3	Total overseas payments (booked) on which service tax is payable		xxx
4	Prior years payments paid in the current year		xxx
5	Less :		
	(a) Amounts booked in accounts but not paid	xxx	
	(b) Previous year's advances booked in the current year - service tax already paid in the previous year	xxx	
	(c) Total of (a) and (b)		xxx
6	Total overseas payment		xxx
7	Advances paid in the current year		xxx
8	Total amount on which service tax is payable (6+7)		xxx
9	Service tax payable on 8 above		xxx
10	Paid as per return		
	(a) April to September	xxx	
	(b) October to March	xxx	
	(c) Total of (a) and (b)		xxx
11	Shortfall /excess		xxx

**Reconciliation of CENVAT credit claimed**

Sr #	Particulars	Source
1	Total input tax credit claimed during the period	Ledger
2	Less:	
2.1	Input credit utilised for discharge of output tax	Ledger
2.2	Input services which are claimed earlier but not paid within 90 days	
2.3	Service tax claimed on services which do not qualify as 'input services'	
3	Add:	
3.1	Reversed during earlier months due to non-payment within 90 days but paid during this period	Invoices, Ledger
4	Other Adjustments	
4.1	Add: Service Tax paid as recipient of services, if not included above	GAR 7 / TR 6 challans
4.2	Less: Reversal of input credits as per Rule 6(3) of CENVAT Credit Rules, 2004	Computation
4.3	Less / Add: Re-computation of service tax under Rule 6(3) at the end of the year	
4.4	Others	
	Add / Less, as the case may be	Debit / Credit Notes
5	Total input credit of service tax to be claimed	

## **SERVICE TAX AUDIT – DESK REVIEW AND SUBSTANTIVE**

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### **SERVICE TAX AUDIT - DESK REVIEW**

11.1 This is the first stage of the audit exercise done in the office. As soon as the Auditor receives the list of Taxpayers that has to be audited by him, he should immediately write a letter to all of them. This letter seeks information in the format given as Annexure - I.

11.2 On receiving the documents along with filled up Questionnaire and reconciliation data sheet in the prescribed Proforma, the Audit Group should put them up before Additional/Joint Commissioner (Audit) through Deputy/Assistant Commissioner (Audit) after carrying out preliminary reconciliation identifying discrepancies, if any, and carrying out detailed examination of the records and information (including that already captured in the Master File for taxpayer)

11.3 For carrying out the detailed analysis, the following points should be kept in mind.

- (a) Check whether the description of the service has been changed during the past three to four years, without affecting the nature of the service provided.
- b) The auditor should check the data provided by the taxpayer for reconciliation with other documents such as gross trial balance, Annual Accounts, Ledgers etc. collected by them and carry out a preliminary reconciliation for the purpose of identifying any amount that might have escaped Service Tax.
- (c) Auditor has to be careful when the services are for personal consumption because in such cases, there is a possibility of non-availment of CENVAT by the service recipient or his not likely to

claim expenses as deductions under Income tax. To illustrate, if the individual consumer is not eligible to get CENVAT credit of input tax received because he is not a provider of any taxable output service, he may like to make payment to the service provider in cash. The service provider may also oblige such individual by accepting the consideration in cash without charging service tax, though it will not result in any saving to him so far as service tax is concerned. It may be because of any of the following reasons:-

- (i) Savings of Direct Taxes (Income Tax) by the service provider
- (ii) Making its business more competitive Vis-a Vis other competitions.

11.4 While looking into the books of account of the taxpayer, the following points should also be looked into by the auditor:

- (a) In case consideration is received by way of account payee cheques, the auditor must ensure that the consideration is properly recorded in the books of accounts. Auditor should verify that the name of the bank in which payment has been received is recorded in the account books and is appearing in the balance sheet. Auditor should also verify the Bank Reconciliation Statement prepared by the taxpayer.
- (b) In case consideration is received in cash, generally there is no check available for verification of such payment. However, few checks as under may be carried out when amount for services provided or to be provided is received in cash.
  - (i) In case of long outstanding balances appearing in the books of account of the assessee, reason for the same must be ascertained from the assessee. In other words, ageing of amount receivable must be examined particularly when services are not in relation to business or commerce.
  - (ii) In case of taxable services where material is transferred during the provision of services like construction, outdoor caterer and similar services, the ratio of value of material consumed to gross receipts may be calculated to have a fair estimate of the service tax liability of the taxpayer. Industry's trend or past record of the taxpayer in this respect may also prove to be a useful tool in the hands of Auditor.

- (iii) Auditor should ask for receipts, billing etc., especially if payment is not received at all or in case of bad debts or discounts claimed by the service provider.
- (c) Auditor should analyses both debit and credit side of the profit & loss a/c, trial balance, ledgers etc., because it is a myth that while ascertaining the service tax liability of the taxpayer, one has to look only at the credit side of P&L A/c. Debit side is equally important or rather more prone to frauds and errors. Therefore, the auditor needs to pay attention towards debit side also. Debit side is important because of
  - (i) Reverse charge mechanism – under this mechanism, the recipient of services is liable to pay service tax (e.g. GTA Services, services received from abroad, repair and maintenance etc). In such cases nothing appears on the credit side of the P&L a/c. However, service tax has to be calculated on the amount paid towards taxable services received.
  - (ii) Reimbursement – unless the concept of pure agent is applicable, reimbursements are includible in the value of Taxable Service. Reconciliation should cover all receivables including reimbursements, sale of goods etc.
- (d) Auditor should check as to whether there is any netting of income with amount payable e.g. a person is acting as a commission agent and receives commission amounting to Rs. 5,000/- taxable under the category of Business Auxiliary Services (BAS). He is also engaged in trading of goods wherein he is required to pay a commission of ₹ 3,000. It may be possible that the amount of commission appearing in the P & L A/c is only ₹ 2,000/- the detail of which is given in Notes on Accounts or is available from the Gross Trial Balance. In this case, if Notes to Accounts are not studied properly or the Gross Trial balance is not studied, then the Auditor may not be able to determine the correct value of taxable service rendered by the taxpayer.

## **SCRUTINY OF VAT RETURNS AND VAT AUDIT REPORT**

11.5 The VAT Returns should be scrutinized for ensuring that the value of services which attract both service tax & VAT are consistently reported. Some of such services which attract both Service Tax & VAT are:-

- (i) Commercial or Industrial Construction Services

- (ii) Complex Construction Services
- (iii) Works Contract Services
- (iv) Annual Maintenance Services
- (v) Outdoor Caterer Services
- (vi) Mandap Keeper Services
- (vii) Pandal or Shamiana Contractor Services

The VAT Audit Report should be scrutinized for ascertaining the quantum of income offered to VAT/CST. This would help in ascertaining the quantum of income liable to service tax out of the total income of the taxpayer.

### **SCRUTINY OF THE TAX AUDIT REPORT IN FORM 3CD**

11.6 Clause 4 of the Tax Audit Report (Form 3CD) provides information about Registration Number or any other Identification Number allotted to assessee who is liable to pay any Indirect Taxes.

11.7 Clause 18 of the Tax Audit Report (Form 3CD) provides information about amount of depreciation under Section 32 of the Income Tax Act, 1961 and that of CENVAT credit availed by the service providers on capital goods.

11.8 Clause 27 of the Tax Audit report (Form 3CD) gives the details of CENVAT Credit claimed by the service provider. It also provides the details of credit available and carried forward to the next year. Hence, the auditor can authenticate the amount of credit carried forward in the service tax returns with the information provided in terms of this clause.

11.9 Clause 27 of the Tax Audit Report (Form 3CD) also gives information regarding prior period incomes and expenses booked in the year under Tax audit. The Auditor shall ensure that service tax is paid on these amounts in case they are subject to service tax.

11.10 Clause 37 of the Tax Audit Report (Form 3CD) provides the information relating to Cost audit. If such an audit has been carried out, the auditor should examine the Cost audit Report.

11.11 Clause 38 of the Tax Audit Report (Form 3CD) provides the information relating to Excise audit. If such an audit has been carried out, the auditor should examine the Excise Audit Report.



11.12 Clause 39 of the Tax Audit Report (Form 3CD) provides the information relating to Special audit under Service Tax. If such an audit has been carried out in relation to valuation of taxable service, the auditor should examine the Service Tax Audit Report.

11.13 Clause 40 of the Tax Audit Report (Form 3CD) provides the important accounting ratios.

11.14 Clause 41 of the Tax Audit Report (Form 3CD) provides the details of demand raised or refund issue during the previous year under any Indirect Tax Law along with details of relevant proceedings.

### **SCRUTINY OF TAX DEDUCTED AT SOURCE (TDS) CERTIFICATES**

11.15 The total receipts for services can be verified from TDS certificates in the following manner:-

- i By deducting the amount of service tax from the value on which tax has been deducted at source, the receipts an account of service appearing in the books of accounts can be reconciled.
- ii The nature of services can also be confirmed from these certificates and in case of any discrepancy in the categorization of services under proper head, elaborate checks need to be carried out by the Auditor.
- iii. Details of TDS credit claimed in the Income Tax Return may also be examined.

### **STUDY OF VARIOUS FINANCIAL RECORDS**

11.16 **Notes on accounts:** In case of debtors, notes indicate debtors which are outstanding for a period exceeding 6 months. Foreign Exchange related transactions are also given in the notes on accounts. Management can use these figures to show book profit to suit their requirements. Netting of amounts of revenue or expenditure can also be resorted to by the management although as per accounting standards it is mandatory to specify the figures separately. Notes containing Earning in Foreign Currency is relevant to study for determining earnings from export. Similarly, Expenditure in Foreign Currency is relevant for determining service tax liability under reverse charge mechanism for import of services.

Scrutiny of Notes will also reveal whether there was any change in the system of accounting. For example – a taxpayer changes from cash system of

accounting to mercantile accrual system. The notes also indicate the impact of accounting policies on various liabilities including the tax liability of the taxpayer. Therefore, the auditor must read the notes carefully.

**11.17 Director' Report:** Director's report may, *interalia*, contain information about.

- (a) Foreign Exchange earned during the year.
- (b) Foreign Exchange paid during the year, e.g. – may be on account of taxable services availed by the taxpayer where he is liable to pay service tax under reverse charge mechanism.
- (c) Information on the operations carried out by the taxpayer during the year under report. This may help in finding the exact nature of services provided by the taxpayer.
- (d) The facts stated in Director's Report should be reconciled with the ST – 3 Returns.

**11.18 Statutory Auditor's Report:** It is the most important report contained in the Annual Accounts of a company. The Statutory Auditor Certifies as to whether the books of account of the company are properly maintained or not and also whether internal control mechanism exist commensurate with the size and extent of business of the company. Any adverse noting of the Statutory Auditor has to be replied by the management of the company.

**11.19 The Trial Balance:** The most important use of Gross Trial Balance is that it contains balances of individual ledger accounts whereas in balance sheet and P&L A/c. many ledger accounts are grouped together, e.g.

- (a) In the P&L A/c. all the incomes are clubbed together under the head 'Gross Receipt', 'Sales' as the case may be. However Trial Balance shows income earned under each category of revenue separately.
- (b) Not only Trial Balance is important in relation to income side, but it is very important in relation to expenditure side also. For instance – Payment made towards Sponsorship services may be clubbed in the category of Advertisement and Sales Promotion Expenses which can be identified only from the Trial Balance.

- (c) Similarly, Freight paid may be clubbed with purchases of Fixed Assets. If the freight paid to GTA, the company is liable to pay service tax under reverse charge mechanism.

11.20 Indicative list of items to be examined in the Trial Balance / Profit & loss Account / Balance Sheet / Tax Audit Report.

The perusal of the Trial Balance could achieve the following:

- i. familiarization with chart of accounts / account code and understand as to what extent the information is detailed and integrated with other subsystems ; few sample journal vouchers may also be seen to understand the information mentioned therein.
- ii. Understand the grouping of sub accounts under main accounts for the purposes of summarization into Profit & Loss account and the Balance Sheet.
- iii. Identification of accounts, which have a prima facie relevance for service tax payment (may be direct or indirect) e.g. payment towards sponsorship, payment towards goods transport agencies, payment towards cab charges, repair and maintenance etc. These accounts may have to be seen in detail at later stage of audit depending upon the result of subsequent audit processes ;
- iv. Understand the tax accounting system in so far as it pertains to Service Tax payment and treatment of credit of service tax on input services.

11.21 **Profit & Loss Account:** The auditor is required to examine income and expenditure accounts in the Profit & Loss Accounts:

- (a) **Income Accounts:** Normally, the Profit & Loss Account would show a consolidated entry for business income for all sources. According to accounting standards, non-business income such as interest income or dividend income is required to be shown separately. To begin with, auditor should call for the grouping of business income shown in the Profit & Loss Account. The said grouping would show the different heads under which the incomes have been accounted for. They should carefully study the nature of business income – some of which may have accrued from the sale of taxable services and the balance from the sale of non-taxable services. The exact nature of these services may be determined from the supporting documents such as vouchers,

bills or contracts. In doing so auditors need to be guided by the nomenclature (used for each these services) in the Trial Balance or Annexures to the Profit and Loss Accounts. It is possible that the true nature of the service may be obscured or disguised by using a nomenclature that is either non-taxable or exempted. Further, studying the income side of the P/L A/c would also give an idea to Auditor in respect of whether the reversal to be made under Rule 6(3) of the CENVAT Credit Rules, (required when assessee provides both taxable and exempted services/goods ) is correct or not.

- (b) **Expense Accounts:** Scrutiny of expense accounts would enable the Auditor to identify major expenditure heads. In specific terms, such scrutiny may be useful in the following manner :
- (i) Useful for verification of out of pocket expenses where deductions for these have been claimed from the value of taxable services.
  - (ii) Correlation between expenditure head & value of taxable service e.g. fuel expenses and the value of taxable service in the case of tour operators.
  - (iii) Analysis of trend in total expenses vis-à-vis the previous year to check whether income grew proportionately or not.
  - (iv) Analysis of expenditure head relevant for service tax liability under reverse charge mechanism.

11.22 The Reconciliation Data Sheet given by the Taxpayer should be analysed along with the Questionnaire submitted by him. These should be compared with the Financial Documents like Balance Sheet, Profit & Loss Accounts, Ledger etc. to find out whether there exists any discrepancies and whether there are some areas which have escaped payment of tax. During this stage, a discussion with the Taxpayer should also be held, at the Office premises to gather information about the taxpayer and documenting the business systems or processes in use at his unit. The discussion with the taxpayer is intended to settle issues which can be cleared by simple discussion. This will help avoid inclusion of non-relevant matters in Audit Plan and expedite the audit process. Discussions with the senior Management of the taxpayer are critical for developing a meaningful audit plan. Keeping in mind the objective of gathering accurate and complete

information, it may be useful not to conduct a formal interview, but to engage the taxpayer in informal discussions. At the same time, it is important to prepare points / questions beforehand on which information is required. Important non-compliance issues derived from the profiles should also be discussed during the discussions and while gathering information from the taxpayer. Special emphasis should be placed on any organization or systemic changes that may have occurred since the last audit. Finally, an audit plan for the taxpayer should be prepared. The objective of desk review is to devise a focused audit plan. The proper desk review, preferably, under the supervision of a senior officer is vital for drawing up a meaningful audit plan.

11.23 The desk review is the most important step in the audit and needs to be given more attention so that audit plan is a result of a more informed Desk Review. In order to achieve this, in addition to data already collected from the assessee, a questionnaire and certain data relating to reconciliation will also be obtained. On the basis of data received for reconciliation, a preliminary reconciliation will be done and the same will be available to the Auditors along with the questionnaire. After examining the data and the documents, a meeting with the Authorized Representative of the assessee will be conducted so that doubts in the data and questionnaire are clarified and only those issues which cannot be clarified on the basis of reconciliation, questionnaire and meeting with the assessee are referred in the Audit Plan. The meeting could cover areas like the systems of purchase and purchase invoicing, the system of sale and sales invoicing, issues relating to registration (centralized registration, if any), the Information Technology (IT) systems used to process data, various returns submitted to third party regulatory organizations and also matters relating to Indian standards institute (ISI) quality certifications which would mean availability of certain important audit reports. In addition the following benefits would arise from this:

- (i) Major issues will be discussed and examined at the level of joint Commissioner / Additional Commissioner conducting Desk Review.
- (ii) The period of visit by the Audit Party can be considerably shortened as there will be fewer and more precise Audit Points to verify.
- (iii) The desk review will pinpoint the important issues in Audit Plan.
- (iv) No frivolous issues will be raised in Audit Plan.

- (v) The officer doing the Desk Review will be better aware of the facts.
- (vi) After meeting with the assessee no issues will be raised because of communication gap between the Department and the assessee.
- (vii) It will give incentive to assessee to come clean at Desk Review stage so that physical intervention of Audit Party at his premises is minimized.

There are three major areas which require attention during the audit:-

- (i) The risk based on revenue earned on services provided by the assessee.
- (ii) The risk based on expenditure made on services received by the assessee.
- (iii) The risk based on CENVAT credit taken by the assessee.

The issues at S.Nos,(i) & (ii) would be identified by Revenue & Expenditure Reconciliation between the Books of Accounts and the returns filed by the assessee. For this, the data is being called at the time of Desk Review itself. To standardize the Revenue Reconciliation, a detailed format is prescribed. There cannot be exhaustive format for Revenue Reconciliation. However, most commonly accruing entries have been taken care of. It is felt that all the receipts whether income or others needs to be tested for Service Tax liability. Therefore, reliance is being placed not only on the Balance Sheet but also on the gross Trial Balance of the assessee. In the Service Tax Law, the assessable value is based on various factors and care has been taken to incorporate most common factors in the format for Revenue Reconciliation. Similarly, on the expenditure side, there are certain expenditures which needs to be tested / checked.

For point (iii), CENVAT register maintained by the assessee may be called for and examined.

## Annexure I

**QUESTIONNAIRE FOR ASSESSEE*****(Information to be given for the period covered in Audit)*****1 General:**

01.	Name & address of Service Provider	:	
02.	Name and contact number of the Authorized person for Audit.	:	
03.	Service tax Registration No. & date	:	
04.	Whether Service Tax Registration is Centralized?	:	
05.	Whether the assessee is also registered as an Input Service Distributor?	:	
06.	Whether the assessee is a Proprietary, Partnership firm, LLP (Limited liability Partnership firm), Pvt. Ltd Company, Public Limited Company?	:	
07.	Details of Associated Enterprise as defined in Section 65(7b) or Section 65B(13) of Chapter V of the Finance Act, 1994.	:	
08.	Details of Taxable Services provided.	:	
09.	Details of Taxable Services received for which tax has to be paid under reverse charge.	:	
10.	Details of exempted Services provided if any, & Notification No.	:	
11.	If both Taxable and Exempted Services are provided, whether separate accounts are maintained in terms of Rule 6 of CENVAT Credit Rules, 2004.	:	
12.	Details of Taxable Service Exported	:	
13.	Whether Service Tax is being paid through E-payment?	:	
14.	Whether list of records maintained is filed with the S.T. department? (Rule 5(2) of the Service Tax Rules 1994)	:	

15.	Whether any periodical report/statement is furnished to any State/ Central Govt. / Authority/ Regulatory bodies? If yes, details thereof.	:	
16.	Whether any trading of goods/ materials carried out? If so details thereof.	:	
17.	Whether Registered with Central Excise? If so, details thereof.	:	
18.	Whether any offence case is booked in respect of Service Tax, Central Excise, Income Tax, VAT/ Sales Tax. If so, details thereof.	:	
19.	Whether any service is sub-contracted partially or wholly? If so, details thereof.	:	
20.	Is there any case where services provided in the State of Jammu & Kashmir?	:	
21.	Whether CENVAT Credit on input services availed? If so details of 10 major input services, along with ratio of CENVAT credit taken on that service as a proportion of total CENVAT credit taken.	:	
22.	Whether CENVAT Credit on inputs availed? If so details of 10 major inputs, along with ratio of CENVAT credit taken on that input as a proportion of total CENVAT credit taken.		
23.	Whether CENVAT Credit on Capital Goods availed? If so details of major Capital goods, along with their CETH (Central Excise Tariff Heading).		
24.	Whether CENVAT credit is taken after making payment of the invoice amount (including Service Tax) to the input service provider?	:	
25.	In case the assessee is also registered as an Input service distributor, whether he is	:	



	having any unit in which only exempted products manufactured or exempted services provided? If yes, whether he is distributing the credit of that unit also?		
26.	Whether any amount payable/ paid to the Client has been adjusted against the receipt/ receivable and net income shown in the P&L Account.	:	
27.	Whether any advance payment is received towards providing services? If yes, whether Service Tax is paid on such receipts?	:	
28.	Is there any expenditure to any entity abroad which has been made but on which assessee is not required to pay service tax under reverse charge mechanism? If yes, details thereof.	:	
29.	Whether service tax is paid on the gross value received including TDS amount deducted by the service recipients?	:	
30.	Whether P.F/ ESI or any other charges of the personnel of the service provider are being directly paid by the service recipients? If so whether service tax is paid on such amount.	:	
31.	Details of Agreements entered into with service recipients for providing services	:	
32.	Details of expenditure on which service tax has neither been charged by the service provider nor it is required to be paid by service recipient under reverse charge mechanism	:	

**2     *Invoicing pattern***

01.	Is invoice issued in all transactions? If not reasons for not issuing invoice.	:	
02.	How many series of invoices are being used	:	
03.	If more than one series is used, give details of each such series.	:	
04.	If there are more than one series of invoices, is service tax paid on all the series of invoices	:	
05.	If not, then the reasons for not paying service tax on such series of invoices (e.g. exempted/ exports/ trading/ non-taxable services). Give details	:	
06.	Whether the invoice contains the STC number?	:	
07.	Is invoice issued on the date of provision of service or before or later?	:	
08.	List the different heads under which amounts are billed in invoices and their corresponding heads in the Trial Balance.	:	
09.	Name the heads in the invoice on which Service Tax is not paid.	:	
10.	Is there any sale of goods involved?	:	
11.	Is sales tax or VAT paid on value of goods sold?	:	
12.	Is the value of sale of goods included in the Gross amount charged declared in ST3	:	
13.	Are there any reimbursements billed in the invoice.	:	
13.1	Are there any debit/ credit notes issued for claiming reimbursements?		
14.	If yes, is service tax paid on these reimbursements. If not reasons thereof.	:	
15.	Whether invoices are generated on Computer. If yes, then whether the Invoice Numbers are generated automatically or is fed manually. What safe guards are provided in the system for data security? Give the name and designation of the	:	

	person having the authority to cancel an invoice.		
16.	Whether any amount is recovered by issue of debit note and whether it is included in the gross value of services?	:	
17.	Give a brief on sale pattern of services liable to service tax	:	
18.	Are any goods or services provided by the service receiver free of cost or at subsidized price?	:	

### **3      *Accounts and records***

01.	Whether accounts are prepared on mercantile basis or cash basis?	:	
02.	Whether the Accounts are maintained Electronically? If yes, the name of accounting packages/ computer software installed for maintaining accounts in the units like Tally, FAS etc :	:	
03.	Whether present accounting software switched over to some other software during the audit coverage period.	:	
04.	Whether any changes have been made in the accounting policies affecting ST liability relating to reimbursement of expenses, timing of payment of Service Tax and treatment of payments in Foreign Currency?	:	
05.	Whether accounts are audited by Statutory Auditor? If so name and address of the auditor.	:	
06.	Whether Cost Accounting records as prescribed undersection 148 of the Companies Act, 2013 are maintained?		
07.	Whether Cost Audit is conducted and if yes report thereof is prepared?	:	
08.	Whether there any system of Internal Auditing?	:	

**4 Making of ST3 Return**

01	Whether payment of Service Tax is on Billing basis or receipt basis?	:	
02	List the ledger/ accounts from where the monthly gross amount received is taken for taxable service.	:	
03	List the ledger/accounts from where the amount received towards gross monthly amount of exports taken.	:	
04	List the ledger/accounts from where the amount received towards gross monthly amount of exempted service taken.	:	
05	List the ledger/accounts from where the gross monthly amount received as pure agent taken.	:	
06	List the ledger/ accounts from where the gross monthly amount billed is taken.	:	

**5 Exports**

01	What is the sub clause of section 64 (105) of Finance Act where the service claimed to be exported categorized.	:	
02	Whether conditions of Rule 6A of Service Tax Rules 1994 read with Place of Provision of Services Rules 2012 are fulfilled.	:	
03	Please elaborate how the conditions of the said rule are fulfilled.	:	
04	Whether Place of Provision of Services Rules 2012 are followed for determining the import of services.	:	
05	Is the service provided from India and used outside India for all such transactions?	:	
06	Is the payment for such service received by the service provider in convertible foreign currency for all such transactions?	:	

07	Is proper set off schedule showing correlation between export invoice and FIRC is maintained.		
08	Is original FIRCs and Bankers Realisation Certificate (BRC) is available with the company		

## 6 *Exemption*

01	Please list the exemptions being claimed.	:	
02	Please list the conditions prescribed in each of the exemption claimed. Please specify if the conditions of exemption are fulfilled.	:	
03	If abatement is being claimed, is the CENVAT of capital goods, inputs or input services claimed. Please give details.	:	
04	If abatement is being claimed, is benefit of notification 12/03-ST dated 20/6/2003 claimed?	:	

## 7 *MIS*

01	What is the organization structure	:	
02	Who is responsible for billing and sales	:	
03	What reports are given to his seniors on the daily, weekly, monthly sales? Give sample copies.	:	

## Annexure II

**A. RECONCILIATION QUESTIONNAIRE DATA FOR RECEIPTS:**

Name of the assessee being audited.....:

Service Tax Registration No.....:

Period covered for audit.....:

Type of Accounting.....: Mercantile /  
Cash**Data For Reconciliation of year wise total income/ sales as shown in the Annual Financial Accounts and Ledgers:**

Sr. No.	Particulars	Year 1	.....	Year 5	Source of data as shown in the col.-2
1	2	3	4	7	8
1	Gross Receivables as per ledgers (Credit side)				
1.1	Service Tax charged, if not included in Ledgers' receipt				
1.2	Amount of entries reversed / debited other than related to expenditure (Has no relevance with opening Gross Receipts)				
2	Gross Income as per Annual Report (Trial Balance in case of multiple registrations)				
2.1	Service Tax charged, if not included in the income				
	3.1 Opening debtors				
	3.2 Advance payments received (w.e.f. 16.05.2008)				

	3.3	TDS received related to unpaid bills				
	3.4	Value of free material received, if any				
	3.5	Receipt of re-imbursement of expense (other than as a pure agent)				
	3.6	Withheld retention money released by clients				
	3.7	Recovery of Bad debts earlier written off				
	3.8	Reimbursement of expenses made during provision of service if not included				
	3.9	Outstanding amount in respect of bills raised to Associated Enterprises [Section 65(7b)]				
	3.10	Others additions (specify):				
	4.1	Closing debtors (Taxable services related)				
	4.2	Exported service income (Pl see Foot note 1)				
	4.3	Exempted service income (Pl see Foot note 2)				
	4.4	Non-taxable service income (Pl see Foot note 3)				
	4.5	Trading income, if any				
	4.6	Sales of goods not linked with provision of service (if any)				
	4.7	Sale of goods linked to Service under Notification No. 12/2003-ST				
	4.8	Interest income				
	4.9	Dividend income				

	4.10	S.T./L.T. Capital gain				
	4.11	Tax refund (including IT, Central Excise, ST, Customs, VAT, Sales Tax, etc.)				
	4.12	TDS received in previous year related to bills paid in current year (related to taxable services)				
	4.13	Receipt of re-imbursement of expenses incurred as a pure agent (related to taxable services)				
	4.14	Bad debts related to taxable services written off				
	4.15	Advance payments adjusted on which S.T. paid in previous year(s)				
	4.16	Adjustment for Previous year in respect of bills raised to Associated Enterprises [Section 65(7b)]				
	4.17	Others deductions (specify):				
8	Abatement admissible, if any (%) Noti. No. & date					

Signature of the Taxpayer/  
Representative

**FOOT NOTES:**

- |   |                                    |   |
|---|------------------------------------|---|
| 1 | Export of services.....<br>..... : | Please furnish here details as to under which category exports fall, as well as what conditions have been fulfilled                           |
| 2 | Exempted service income.....:      | Please furnish here Exemption Notification No. and date. If the exemption is conditional, please comment as to fulfillment of such conditions |



- |   |                                     |   |
|---|-------------------------------------|---|
| 3 | Non-taxable service income.....:    | Please furnish details of each type of non-taxable service(s) and offer comment(s) as to non-taxability |
| 4 | Abatement claimed.....:             | Please indicate Noti. No. and date  |
| 5 | Cash basis accounting system..... : | In the case of cash basis accounting system, Opening Debtors and Closing Debtors to be taken as zero    |

S.No.	Explanations:	
1	Gross receivable/ income as per all income ledgers (Credit side):	The Gross receivable/ income consist of all the income receivable by the service provider and shown in the income ledger. Some entries of the income ledger should be checked with journal entries, vouchers and invoices at the time of walk through. In case of discrepancies all the entries should be checked with invoices.
1.1, 2.1	Service Tax charged, if not included in Ledgers' receipt/ income in Annual Report/ Trial balance	If Service tax charged is not included in the income ledger then the same should be added to get the Gross Receipts as per Ledgers inclusive of Service Tax

3.1, 4.1	Opening/ Closing balance of debtors (Taxable Services related)	Adjustment for opening and closing balance of debtors has to be made in case the Service provider is following accounting on Mercantile basis. In cases of Cash basis of accounting, it should be nil
3.5	Receipt of re-imbursement of expense (other than as a pure agent)	Any reimbursement in any form is to be added to the Gross Income except the reimbursements received as pure agent
3.6	Withheld retention money released by clients	Some times on the basis of a contract or otherwise the customer withholds a part of the money which is paid after satisfactory completion of the Service. This money could be in the form of retention money, caution money etc. Any such receipt must be added in the Gross income.
4.13	Receipt of re-imbursement of expenses incurred as a pure agent	Reimbursements received as pure agent are deductible from the Gross income receipts

## B. RECONCILIATION QUESTIONNAIRE DATA FOR GTA (EXPENDITURE):

Period covered for audit.....:

**Data for Reconciliation of year-wise expenditure incurred by the recipient of services towards transportation of goods by road (GTA), as shown in the Annual Financial Accounts/ Ledgers:**

Type of  
Accounting.....:                      **Mercantile /Cash**

Sr. No.	Particulars	(YEAR)	(YEAR)	Source of data as shown in the col.-2
1	2	3	4	5
1	1.1	Gross expenditure towards transportation of goods by road (expenditure ledger debit side)		
	1.2	Transportation charges capitalized		
	1.3	Amount of entries reversed / credited for expenditure booked. (i.e. Services not received)		
2				
	2.1	Opening creditors (Relating to taxable GTA service)		
	2.2	Opening provisions for GTA expenditure		
	2.3	Creditors related to GTA service earlier written off and now written back		
	2.4	Any Other Additions (please specify)		
3				
	3.1	Closing creditors (Relating to taxable GTA service)		
	3.2	Closing provisions for GTA expenditure		
	3.3	Transportation expenses, if any, on which S.T. paid by transporters		
	3.4	Creditors related to GTA service, written off		

	3.5	Freight expenses for exempted GTA service (Noti. No.33/2004)			
	3.6	Freight expenses for exempted GTA service (Noti. No. 34/2004)			
	3.7	Any Other Deductions (please specify)			
5		Abatement admissible (%) Noti. No. 13/2008 dated 1.3.2008 or Noti. No. 26/2012 dated 20.06.2012			

**FOOT NOTES:**

- 1 Cash basis accounting system..... :

In the case of cash basis accounting system, opening creditors, closing creditors and opening provisions, closing provisions to be taken as zero.

Signature of the Taxpayer / Representative

**(C) RECONCILIATION QUESTIONNAIRE DATA FOR  
EXPENDITURE OTHER THAN GTA:**

Name of the Assessee being  
audited.....:

Service Tax Registration  
No.....:

Period covered for  
audit.....:

Type of  
Accounting.....: **Mercantile/Cash**

**Data for Reconciliation of year-wise expenditure by recipient of specified  
service other than GTA, as shown in the Annual Financial Accounts:**

Sr. No.	Particulars		Year	Year	Source of data as shown in the col.-2
1	2		3	4	8
1	1.1	Gross expenditure on the services received from associated enterprises located abroad as per Place of Provisions of Services Rules 2012 (expenditure ledger debit side)			
	1.2	Gross expenditure on the services received from non-associated enterprises located abroad as per Place of Provisions of Services Rules 2012			
	1.3	Gross expenditure in case of service provided by insurance agent			
	1.4	Gross expenditure for receipt of business auxiliary service of distribution of mutual fund by a mutual fund distributor or an agent			

	1.5	Gross expenditure for receipt of sponsorship service by a body corporate or firm			
	1.6	Gross expenditure in case of service provided by Goods Transport Agencies (GTA) for transportation of goods by road			
	1.7	Gross expenditure in case of legal service provided by individual lawyer or firm of lawyers			
	1.8	Gross expenditure in respect of payment to non-executive directors for service provided to company or body corporate			
	1.9	Gross expenditure in respect of renting of motor vehicle			
	1.10	Gross expenditure in respect of manpower supply services such as security services etc.			
	1.11	Gross expenditure works contract services such as repairing, AMC of movable assets etc.			
	1.5	Amount of entries reversed / credited other than related to expenditure			
	Gross expenditure for services mentioned in 1 above as shown in Annual Report/ Trial Balance				
2					
	2.1	Opening Creditors for services mentioned in 1 above.			
	2.2	Opening provisions for services mentioned in 1 above			
	2.3	TDS/ Withholding tax, if any, paid on behalf of the service provider			
	2.4	Outstanding amount in respect of bills raised to Associated Enterprises [Section 65(7b)]			
	2.5	Other additions, if any (Pl specify)			
3					
	3.1	Closing Creditors relating to services mentioned in 1 above			
	3.2	Closing provisions for services mentioned in 1 above			

	3.3	Expenditure made against non-taxable service (Please specify)			
	3.4	Expenditure made against exempted services (Please specify)			
	3.5	Adjustment for Previous year in respect of bills raised to Associated Enterprises [Section 65(7b)]			
	3.6	Other deductions from expenditure (Please specify)			
7		Abatement admissible, if any (%) Noti. No. & date			

**FOOT NOTES:**

- 1 Cash basis accounting system..... :

In the case of cash basis accounting system, opening creditors, closing creditors and opening provisions, closing provisions to be taken as zero.

Signature of the Taxpayer/Representative

## Annexure III

**MASTER ASSESSEE FILE**

Some of the information for the master file may be kept in Computerised form. The electronic form of data may be comprised of the following:-

**Part I - Taxpayer Profile**

1. Name of the Service Provider.

[illegible]

2. Address of the Service Provider.

- (i) Name of Premises/Building

[illegible]

- (ii) Flat/Door/Block No.

[illegible]

- (iii) Road/Street/Lane

[illegible]

- (iv) Village/Area/Locality

[illegible]

- (v) Block/Taluka/Sub-Division

[illegible]

- |                                      |   |
|--------------------------------------|---|
| (vi) Town/City/District<br>No. 6(a)) | (vii) State/Union Territory ( <i>Please see instruction</i> |
|--------------------------------------|---|

[illegible]

- |        |     |             |
|--------|-----|-------------|
| (viii) | PIN | Post office |
|--------|-----|-------------|

[illegible]

- (ix) Telephone Nos.:

[illegible]

- (x) Fax Nos. (xi) E-mail Address

[illegible]

- ### 3. Details of Permanent Account Number (PAN)

Tick any one box

- (i) Not applied for PAN ☐ (ii) Applied for PAN but not received number ☐

- (iii) Allotted PAN number

If (iii) provide the following details:



(a) PAN

[illegible]

4. Description of the services provided.

[illegible]

5. Service-wise details of value of service and tax paid (for 3 years).

Period	Name & Description of Service	Value of taxable services	Service Tax payable/paid	Total input credit utilized	Net Service Tax paid in cash (GAR-7)
Year 1 H <sub>1</sub> H <sub>2</sub>					
Year 2 H <sub>1</sub> H <sub>2</sub>					

6. Details of show cause notices issued along with brief facts and issue involved- Last 3 years.

7. Details of cases pending with CESTAT/High Court/Supreme Court.

## Part II-Other information

1. Whether package of services is standardized (an example could be tour operators, Rent-A-Cab, Mandap Keepers, etc.) or customized.

Yes ☐ No ☐.

2. Form of Organisation (i.e. whether individual/partnership/Limited Liability Partnership or private or public limited company etc.) (tick only one box)

Proprietorship ☐ Partnership ☐ LLP ☐ Registered Co. ☐ Unregistered Co. ☐  
☐others☐.

3. Details of proprietor / partner / CEO / Chairman / Managing Director (as applicable).

Details of Proprietor/Partners/CEO/Chairman /Managing Director/Member etc.

[illegible][illegible][illegible][illegible][illegible][illegible][illegible][illegible][illegible][illegible][illegible][illegible]

---

**The Institute of Chartered Accountants of India**

4. Details of registration with any other Government Department/Agency or Regulatory Authority as the case may be.

1. Customs registration No. (BIN No.) ☐ yes ☐ no ☐ if yes give detail.

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

2. DGFT's IEC No.	yes <input type="checkbox"/>	no <input type="checkbox"/>	if yes
give details.			

[illegible]

3. VAT Registration Nos.

State ST No. \_\_\_\_\_ yes ☐ no ☐ if yes \_\_\_\_\_  
give details.

[illegible]

CST No. \_\_\_\_\_ yes ☐ no ☐ if yes \_\_\_\_\_  
 give details. \_\_\_\_\_

[illegible]

4. Registrar of Company's CIN No. yes ☐ no ☐ if yes  
give details.

[illegible]

5. Tour Operators with RTA details.	yes <input type="checkbox"/>	no <input type="checkbox"/>	if yes give
-------------------------------------	------------------------------	-----------------------------	-------------

[illegible]

6.	Stock Brokers with SEBI details.	yes <input type="checkbox"/>	no <input type="checkbox"/>	if yes give
----	----------------------------------	------------------------------	-----------------------------	-------------

[illegible]

5. Name and designation of the authorized person of the Service Provider.

(a) Name

[illegible]

(b) Designation

[illegible]

(c) Residential address

(i) Name of Premises/Building

[illegible]

(ii) Flat/Door/Block No.

[illegible]

- (iii) Road/Street/Lane

[illegible]

(iv) Village/Area/Locality

[illegible]

(v) Block/Taluka/Sub-Division

(vi) Town/City/District															(vii) State/Union Territory														
(viii) PIN										Post office																			
(ix) Telephone Nos.:																													
(a) Office															(b) residence														
(x) Fax Nos.															(xi) E-mail Address														

*In case of more names provide the information in the above format.*

6. Details of sub-contractors in case any service or part thereof is got done through subcontractors.

Name, designation and address of sub-contractor(s):

(a) Name																													
(b) Address																													
(i) Name of Premises/Building																													
(ii) Flat/Door/Block No.																													
(iii) Road/Street/Lane																													
(iv) Village/Area/Locality																													
(v) Block/Taluka/Sub-Division																													
(vi) Town/City/District															(vii) State/Union Territory														
(viii) PIN										Post office																			
(ix) Telephone Nos.:																													
(a) Office																													
(x) Fax Nos.															(xi) E-mail Address														

*In case of more names provide the information in the above format.*

7. Name of the designated bank where the Service Tax is deposited.

(i) Name of the bank

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

(ii) Name of the branch

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

8. Details of the Bank accounts used for business transaction with name of the bank, its specific branch and account number.

(a) Account 1

(i) Name of the bank

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

(ii) Name of the branch

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

(iii) Account No.

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

Details of more Accounts used for business transactions      yes ☐    no ☐

If yes,-

(b) Account 2

(i) Name of the bank

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

(ii) Name of the branch

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

(iii) Account No.

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

Note: In case of more than two bank accounts, two major bank accounts may be entered above.

9. Accounting system- whether centralized or not.    Yes ☐      No ☐

10. Billing pattern - (a) whether centralized or decentralized, Yes ☐      No ☐

(b) billing stages e.g. billing of 20% of gross amount on conclusion of contract, another 20 % on completion of preliminary work and so on.

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

11. List of branch offices, along with their respective value of taxable services.

***Part III - List of hard copies to be kept in Master File.***

The other part of the master file should consist of hard copy of certain documents as illustrated below:-

- (i) A copy of the taxpayer's application for registration (ST-1).
- (ii) A copy of STC (ST-2)
- (iii) A copy of the list of all records maintained by the taxpayer in relation to Service Tax including memoranda received from his branch office as submitted under Rule 5 (2) of Service Tax Rules, 1994.
- (iv) Copy of Balance Sheets, Profit & Loss Statement, Trial Balance, Annual Reports.
- (v) Copies of Tax Audit reports (under Income Tax Act) for 2 years.
- (vi) Copies of Cost Audit Reports, if any for 2 years.
- (vii) A copy of the previous audit reports (if taxpayer was audited previously) – whether by Internal Audit or CAG.
- (viii) Copy of Service specific Profiles, if any, prepared in the department.
- (ix) A copy of any other return / declaration sent to any other department / agency or to designated regulatory authority.
- (x) Scored Working Papers.
- (xi) Minutes of Service Tax Monitoring Cell.
- (xii) Any other documents relevant for audit for service tax assessment.

**Annexure IV****TOTAL REVENUE SUMMARY**

Name of the registered Assesses:

STC:

Year	Revenue (Rs in lakhs)			CENVA T/ Total Ratio (%)	Interest Paid	% variation (over last year)		
	Cash	CENVAT	Total			Cash	CENVAT	Total
2007 -08								
2008 -09								
2009 -10								
2010 -11								
2011 -12								

**Remarks on the variation seen in the revenue:****Remarks on the variation seen in the CENVAT / Total Ratio:****E-payment status**

- A. Are you required to e-pay its tax: Yes/ No
- B. Are you presently paying by e-payment: Yes/ No

If answer to A is Yes and B is No, the reasons for the same may be mentioned:

**Do you have any other ST registration? If yes details thereof:**

**Do you have any other ST registration under the jurisdictional Service Tax Commissionerate? If yes details thereof:**

**Do you have any related/ sister concerns rendering taxable service(s)? If yes, the details of their ST registration under the jurisdictional Service Tax Commissionerate may be provided:**

(Signature)

Authorized Signatory

M/s \_\_\_\_\_

\_\_\_\_\_



## Annexure V

## FINANCIAL DATA SUMMARY SHEET (FDSS) (YEAR \_\_\_\_\_)

(To be furnished separately for *each financial year* for the period of Audit)

**Name of the Assessee:**

**STC:**

Details of Income	(Amount in Rs)
-------------------	----------------

[illegible]

### 304 Training Manual

Non-taxable Services												
Service 1												
Service 2												
Service n												
Sale of Goods												
Others Receipts												
<b>Total Receipt**</b>												

**Details of Expenditure in Indian Currency [Rule 2(1)(d)(iii); 2(1)(d)(v); 2(1)(d)(vi) and 2(1)(d)(vii) where the service tax needs to be paid by service recipient]**

Category	Amount payable as per TB/ P&L A/c / BS*	Amount paid (including TDS) against services received	Amount paid as advance for services (including TDS)	Amount accrued in case of Associated Enterprise on or after 10.5.2008	Exemption	Abatement	Amount paid (Taxable Value)  8=3+4+5-6-7	Taxable Value as per ST3	Total Service Tax Payable	Service Tax Paid (GAR7)	Reasons, if Service Tax not paid/ difference. Also indicate the exemptions availed
1	2	3	4	5	6	7	8	9	10	11	12
2(1)(d)(iii) : Insurance Agent											

**Service Tax Audit – Desk Review and Substantive 305**

2(1)(d)(v): GTA®											
2(1)(d)(vi) : Distributi on of MF											
2(1)(d)(vii) ): Sponsors hip											
Any Others Services (Please Specify)											
Reimburs ements on account of above services											
<b>Total Expendi ture**</b>											

@ indicate expenditure only wherein the concern is liable to pay service tax; if not liable, please indicate the values and reasons in the last column

**Details of Expenditure in Foreign Currency [Rule 2(1)(d)(iv) and Sec 66A]**

Category	Amount payable as per TB/ P&L A/c / BS*	Amount paid (including withholding tax) against services received	Amount paid as advance for services (including withholding tax)	Amount accrued in case of Associated Enterprise on or after 10.5.2008	Exemption	Abatement	Amount paid (Taxable Value)  8=3+4+5-6-7	Taxable Value as per ST3	Total Service Tax Payable	Service Tax Paid (GAR7)	Reasons, if Service Tax not paid/ difference. Also indicate the exemptions availed
1	2	3	4	5	6	7	8	9	10	11	12
Professional Services including Consultancy Services and Management Consultancy											
Advertisement / Publicity											
Business Auxiliary/ Support Services including Commission											
Royalty/ IPR/ Franchise											

## Service Tax Audit – Desk Review and Substantive 307

Others Services (Please Specify)											
Reimbursements on account of above services											
Non-Taxable Service (pl specify)											
Goods imported											
Any other (pl specify)											
<b>Total Expenditure**</b>											

**Details of (1) Goods/ Services provided free of cost (2) Reimbursements (3) Any other expenditure incurred for rendering of services which is borne by the service recipient**

	Type	Value	Whether included in the value of services	Reasons, if not included
1	Goods / Services supplied free of cost			
2	Reimbursements			
3	Any other expenditure borne by the service recipient			

*\*Relevant to the registered concern*

*\*\* figures should match with those in BS/P&L Ac/ Trial Balance*

*Whether any expenditure incurred on the above heads has been capitalized? If yes, whether service tax liability has been discharged?*

*In case of companies, the above information should match with the information contained in Schedule VI.*

*The above information is correct and no information has been suppressed or omitted or misrepresented. It is understood by us that the department can rely on the above information amongst other available information.*

**Signature with seal/ stamp**

**Name:**

**Designation:**

**Email:**

**Mobile/ contact number:**

## SERVICE TAX AUDIT - SUBSTANTIVE

11.24 Substantive procedures (or substantive tests) are the activities performed by an auditor to detect material misstatement or fraud at the assertion level of the management. The assertions made by the management are usually with respect to –

- *the accounting balances*, the different assertions are - completeness, existence, rights + obligations, valuation + allocation, and presentation + disclosure, and
- *the transactions*, the different assertions are - occurrence (validity), completeness, accuracy, cut-off and classification.

Management implicitly asserts that account balances and underlying classes of transaction do not contain any material misstatements: in other words, that they are materially complete, valid and accurate. Auditors use substantive procedures to validate these assertions. For example, an auditor may inspect supporting documents like invoices and bank statements to confirm that sales or provision of service did occur (occurrence); and arrange for suppliers to confirm in writing the details of the amount owing at balance date as a evidence that accounts payable is a liability (rights and obligation assertion).

There are two categories of substantive procedures - ***analytical procedures and tests of detail***. Analytical procedures generally provide less reliable evidence than the tests of detail. Note also that analytical procedures are applied in several different audit stages, whereas tests of detail are only applied in the substantive testing stage.

The auditor's reliance on substantive tests to achieve an audit objective related to a particular assertion may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedure or procedures should be used to achieve a particular audit objective is based on the auditor's judgment on the expected effectiveness and efficiency of the available procedures.

***Analytical procedures*** (the comparison of sets of financial information, and financial with non-financial information, to see if the numbers 'make sense' and that unexpected movements can be explained) are an important part of the audit process and consist of evaluations of financial information made by a study of possible relationships among both financial and nonfinancial data.

Analytical procedures range from simple comparisons to the use of complex models involving many relationships and elements of data.

A basic premise underlying the application of analytical procedures is that plausible relationships among data may reasonably be expected to exist and continue in the absence of known conditions to the contrary. Particular conditions that can cause variations in these relationships include, for example, specific unusual transactions or events, accounting changes, business changes, random fluctuations, or misstatements.

Analytical procedures involve comparisons of recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the auditor's understanding of the assessee and of the industry in which the client operates. Following are examples of sources of information for developing expectations, i.e., identifying the areas where gaps could be found:

- comparison of the financial information with information for the comparable prior period(s), e.g. service turnover of say three consecutive financial years can be compared with the corresponding manpower deployed (thru direct employees and thru external agencies) and major equipment purchases/deployment for provision of service (in case equipments are required for provision of such service), number of sites on which services are being performed etc.- This comparison would give a broad idea about the reasonableness of the turnover. However, for using this data as basis for developing an 'expectation', i.e. 'gap in the reported figures', adjustment should be made for the known factors like closure of particular line of services, industry market position etc.
- Relationships among elements of financial information within the period - Monthly amounts can be compared (which are more effective from annual amounts), e.g., monthly value of goods procured may be compared with the monthly expense on GTA services. Further, comparisons by location or line of business can also be very effective.
- study of the relationships among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience (e.g., gross margin percentages);

- comparison of the financial information with similar information based on industry averages, results of competitors or other operators in the same industry—for example, gross margin information
- Study of the relationships between the financial information and relevant nonfinancial information (e.g., in cable industry receipts can be matched with the number of set top boxes installed).

Some of the examples of the ratios which could be particularly relevant for service tax audit are as under –

**A. Ratio - Major inputs service cost : Value of Taxable Service**

**Source Document:** Profit & Loss Account and ST3 return

Compare the annual ratio for a period of 3-4 years. If the ratio is increasing, there is possibility of the following irregularities.

- Rendering of unaccounted output services.
- Undervaluation of output services.
- Splitting of output service income into non-taxable services income.

**B. Ratio – Credit availed: Total Service Tax payable**

**Source Document:** ST3 return

This ratio should have some parallel relation with the above ratio. If there is a gap in these two ratios, there is a need to look into the reason – there could be a situation of wrong credit availment.

**C. Ratio – Other incomes not charged to Service Tax : Value of taxable services**

**Source Document:** Profit & Loss Account and ST3 return

Compare the ratio over a period of 3-4 years or with the taxpayers rendering the same services. If the ratio is increasing over a period of time or it is more as compared to the other service providers, there is a possibility of undervaluation by splitting of output service income into non-taxable/exempted service income. For example, income from renting of immovable property may be incorrectly bifurcated into income from renting of residential dwelling which is not taxable.

**D. Ratio – Additions to plant and machinery/ fixed assets during the year: Total value of assets at the beginning of the year**

**Source Document:** Fixed Assets Schedule in the Balance Sheet)



A comparison of this ratio with the rate of growth of the value of taxable service during the year may be useful in verifying whether the value of taxable service has been correctly **declared** particularly in cases where the additions to plant and machinery/ fixed assets directly impact the volume of taxable services. For instance, the installation of additional processing equipment by a photographic laboratory would normally result in some increase in its value of taxable service. In the same manner, increase in the number of computers in an internet cafe would generate additional business for the taxpayer.

Like the above ratios, many more ratios may be developed depending upon the nature of industry being audited which may be very useful for the purpose of service tax audit.

Analytical review procedures vary from simple comparisons to reasonably complex regression analysis and at times series modeling. The expected effectiveness and efficiency of an analytical procedure in identifying potential misstatements depends on, among other things, (a) the nature of the assertion, (b) the plausibility and predictability of the relationship, (c) the availability and reliability of the data used to develop the expectation, and (d) the precision of the 'expectation'. i.e. 'identified gap'.

When an analytical procedure is used as the principal substantive test of a significant financial statement assertion, the auditor should document all of the following:

- (a) The expectation, where that expectation is not otherwise readily determinable from the documentation of the work performed, and factors considered in its development
- (b) Results of the comparison of the expectation to the recorded amounts or ratios developed from recorded amounts
- (c) Any additional auditing procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures

The auditor should evaluate significant unexpected differences and should use the concept of materiality to decide where further investigation is required and what should be dropped. Reconsidering the methods and factors used in developing the expectation and inquiry of management may assist the auditor in this regard. Management responses, however, should

ordinarily be corroborated with other evidential matter. Here the role of detailed test procedures comes.

***A test of Details*** is the most significant substantive procedure for audit. This involves selecting a sample of items from the major account balances, and finding hard evidence (e.g. invoices, bank statements) for those items and verifying and reconciling them with the physical material as well as with the records or details submitted with the various statutory or other authorities. The tests which are more relevant for a service tax audit are -

- Inspection of Records or Documents - It consists of examining records or documents whether internal or external, in paper form, electronic form, or other media. Inspection provides evidence of varying degrees of reliability depending on their nature and source and in the case of internal records, on effectiveness of controls over their production.
- Inspection of Tangible Assets - It consists of physical examination of the assets. It may provide reliable audit evidence of their existence
- Inquiry - It means seeking information of knowledgeable persons throughout the entity or outside the entity. Those may be formal written or informal oral. It provides an auditor with new information or corroborative evidences. It may also bring to high information different from the one possessed by the auditor. Certain oral inquiries might be got confirmed through written representations.
- Confirmations - It is a specific type of inquiry. It is the process of obtaining a representation of information or an existing condition directly from a third party. Confirmations are sought from debtors, creditors, bankers, legal advisors etc.
- Reconciliation – matching two independent sets of records.

Out of the above audit procedures, the procedure which requires discussion in detail is ‘inspection of records and documents’ in view of the fact that identifying the document which needs to be inspected, the relevant data in that document and sourcing that document is an area where one may add good value particularly from the perspective of service tax audit.

Some of the documents which are particularly useful in substantive audit are—

1. Basic financial documents - Financial Statements, Credit Registers, invoices etc.

2. Service Tax Records of the assessee – Service Tax Returns, respective ledgers and invoices etc.
3. Income Tax Records of the assessee – Balance Sheet along with the P&L Account submitted with Income Tax Authorities, TDS return, Form 3CD ( tax audit report) if applicable, Form 26AS (TDS deduction form)
4. ROC Records – Balance Sheet and P&L Account submitted with the ROC
5. Bank Statements and the financial details submitted to Bankers in case of loan etc.
6. VAT Records – Copies of VAT returns
7. Relevant data from regulatory authorities

All the above records may contain relevant information supporting to assess service tax liability/credit position depending upon the mix of turnover of a company and the nature of industry. Some of the records provide the relevant data independently and some other records

Some of the examples of the manner in which the above records may be used are as under –

- A. Bank Statement of an assessee may be cross verified with the income/revenue receipts shown in the ST-3 returns of the assessee – this may identify the gaps in the income which people may net off at times.
- B. TDS return filed by an assessee contains the details of expenses on which they deduct TDS – many of these are input services chargeable to service tax – this data can highlight the possible leakage of service tax in case of input services where service tax is payable on reverse charge.
- C. Form 26AS is a form which lists out the incomes of an assessee on which others have deducted TDS, most of which relates to the taxable services – this form may be very useful in identifying the taxable income of an assessee.
- D. A reconciliation of service turnover shown in the ST-3 Return with the turnover shown in the P&L Account of an assessee would be helpful in identifying the possible tax leakage.

- E.** A figure of sales shown in the P&L Account can be reconciled with the figures of sale in the VAT returns of the assessee to ensure the correctness of this data.
- F.** Data from regulatory authorities may be very useful. For example, in case of insurance brokers, they are supposed to file an annual return of commission earned to the IRDA. This data may be very useful in identifying the respective service tax position of the assessee.

Apart from the inspection of records and documents, reconciliation, enquiries, confirmations and physical checking are other tools for test in detail for the audit. Given the so many tools of substantive audit, the point is that how to balance out the needs of a given audit in terms of selecting the most appropriate audit procedure and the tool. This would largely depend upon the nature of industry and the size and complexity of the business of an assessee and thus availability of an industry wise database with the Service Tax Department may prove to be a big asset for the purposes of Service Tax Audit.

# 12

## SERVICE TAX REPORT UNDER TALLY

---

Recently, Tally has introduced many changes in facilities and features in statutory related matters. There are some major changes in settings, user interface and reports in VAT, Service Tax, TDS and Excise in Tally.

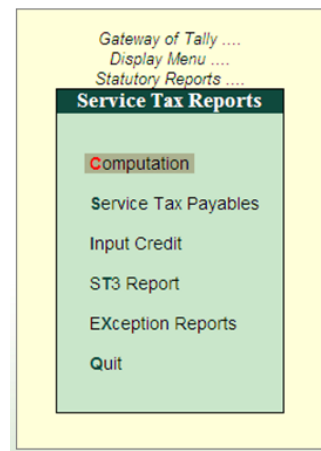
To use Tally's service tax feature for our purpose, we need to understand two types of scenarios in Tally.

Scenario 1 : Upto Release 4.93

Scenario 2 : From Release 5.0 onwards

### SERVICE TAX REPORT

Gateway of Tally > Display > Statutory Reports > Service Tax Reports



Tally.ERP 9 offers variety of reports on the topic service tax. First menu for service tax reports is shown above.

- Computation – This report shows computation of service tax payable during the selected period.

- Service Tax Payables – There are four different reports under this menu.
  - Bill Date Wise
  - Realization Date Wise
  - Tax on Service Received
  - Import of Services
- Input Credit – This menu has two parts inside it.
  - Summary
  - Reversal Details
- ST3 – This menu has three sub parts inside it.
  - Report
  - E-Filing
  - E-Filing (XML)
- Exception Reports – This menu is subdivided in three parts as under.
  - Update Service Category
  - Un-migrated Vouchers
  - Un-migrated Bills

These screens are demonstrated below.

## SERVICE TAX COMPUTATION REPORT

Service Tax Computation		Crystal Services (P) Ltd.		Ctrl + M
Particulars		Crystal Services (P) Ltd. 1-May-2011 to 31-May-2011		
		Total Amount	Assessable Value	Tax Amount
<b>A. Input Credit</b>		1,20,28,103.000	1,08,77,699.910	11,20,403.091
<i>Current Period</i>		1,20,28,103.000	1,08,77,699.910	11,20,403.091
<i>Previous Period</i>				
<b>B. Service Tax Payable</b>		27,11,195.000	25,36,459.650	2,61,255.344
<i>Current Period</i>		27,11,195.000	25,36,459.650	2,61,255.344
<i>Previous Period</i>				
<b>C. Service Tax Payments / Credit Adjustments</b>				33,694.130
<i>G.A.R. 7 Payments</i>				7,292.180
<i>CENVAT Credit Adjustment</i>				15,450.000
<i>Adjustment towards Advance Tax paid</i>				6,749.770
<i>Other Adjustments</i>				4,202.180
<b>D. Balance Service Tax Payable (B-C)</b>				2,27,561.214
<b>E. Refund of Service Tax Input Credit</b>				
<b>F. Balance Available Credit</b>				11,28,653.321
<i>Advance Tax Paid</i>				8,250.230
<i>Service Tax Credit</i>				11,20,403.091
<b>G. Other Payments</b>				5,800.000
<i>Arrears</i>				5,000.000
<i>Interest</i>				800.000

## SERVICE TAX PAYABLES

Gateway of Tally > Display > Statutory Reports > Service Tax Reports > Service Tax Payables



## SERVICE TAX PAYABLES (BILL DATE WISE) REPORT

Service Tax Payable (Bill Date - wise)		Crystal Services (P) Ltd.		Ctrl + M				
Type of Bills		Realised Bills		1-May-2011 to 31-May-2011				
Date	Ref. No.	Party's Name	Category	Bill Amount	Total Tax	Realised Amount	Total Tax Payable	Paid / Adjusted
2-May-2011 Jml/2-1		Kamal Advertisers	Event Management Service	55,150.000	5,150.000	55,150.000	5,150.000	1 more ... →
10-May-2011 Sale/3-1		Cash	Event Management Service	11,03,000.000	1,03,000.000	11,03,000.000	1,03,000.000	19,652.180
11-May-2011 Rcpt/2-1		Sahakar Constructions	Architects Services	3,86,050.000	36,050.000	3,86,050.000	36,050.000	
12-May-2011 Rcpt/3-1		Sahakar Constructions	Architects Services	1,48,905.000	13,905.000	1,48,905.000	13,905.000	
13-May-2011 Rcpt/4-1		Matrix Ad	Design Services	25,550.000	2,385.900	25,550.000	2,385.900	
14-May-2011 Sale/4-2		Matrix Ad	Design Services	74,450.000	6,952.270	74,450.000	6,952.270	
Total				17,93,105.000	1,67,443.170	17,93,105.000	1,67,443.170	19,652.180

## SERVICE TAX REALISATION DATE WISE

Service Tax Payable (Realisation Date-wise)		Crystal Services (P) Ltd.		Ctrl + M				
Type of Bills		Realised Bills		1-May-2011 to 31-May-2011				
Date	Vch Type	Vch No.	Party's Name	Category	Realised Amount	Realised Assessable Value	Total Tax Payable	Paid / Adjusted
2-May-2011 Journal		2	Kamal Advertisers	Event Management Service	55,150.000	50,000.000	5,150.000	1 more ... →
10-May-2011 Sales	3		Cash	Event Management Service	11,03,000.000	10,00,000.000	1,03,000.000	19,652.180
11-May-2011 Receipt	2		Sahakar Constructions	Architects Services	3,86,050.000	3,50,000.000	36,050.000	
12-May-2011 Receipt	3		Sahakar Constructions	Architects Services	1,48,905.000	1,35,000.000	13,905.000	
13-May-2011 Receipt	4		Matrix Ad	Design Services	25,550.000	23,164.100	2,385.900	
26-May-2011 Journal	8		Matrix Ad	Design Services	74,450.000	67,497.730	6,952.266	6,749.770
Total					17,93,105.000	16,25,661.830	1,67,443.168	26,401.950



## TAX ON SERVICE RECEIVED

Tax on Services Received		Crystal Services (P) Ltd.					Ctrl + M	
Type of Bills : Party Paid Bills							1-May-2011 to 31-May-2011	
Date	Ref. No.	Party's Name	Category	Bill Amount	Total Tax	Paid Amount	Total Tax Payable	Paid / Adjusted
								2 more ... →
25-May-2011	Purc/10-1	SR Road Lines	Transport of Goods by Roa...	40,000.000	4,120.000	40,000.000	4,120.000	
Total				40,000.000	4,120.000	40,000.000	4,120.000	

## IMPORT OF SERVICE

Tax on Services Received		Crystal Services (P) Ltd.					Ctrl + M	
Type of Bills : Party Paid Bills							1-May-2011 to 31-May-2011	
Date	Ref. No.	Party's Name	Category	Bill Amount	Total Tax	Paid Amount	Total Tax Payable	Paid / Adjusted
								2 more ... →
25-May-2011	Purc/10-1	SR Road Lines	Transport of Goods by Roa...	40,000.000	4,120.000	40,000.000	4,120.000	
Total				40,000.000	4,120.000	40,000.000	4,120.000	

## INPUT CREDIT SUMMARY

Input Credit Summary Crystal Services (P) Ltd. Ctrl + M								
Type of Bills : Paid Bills 1-May-2011 to 31-May-2011								
Date	Ref. No.	Party's Name	Category	Bill Amount	Total Tax	Paid Amount	Total Input Credit	Input Credit Utilised
2-May-2011	Jrnl/3-1	Matrix Ad	Advertising Agency	1,10,300.000	10,300.000	1,10,300.000	10,300.000	1 more ... →
4-May-2011	Purc/2-1	Ram Agency	Advertising Agency	33,090.000	3,090.000	10,000.000	3,090.000	
5-May-2011	Purc/3-1	Ram Agency	Advertising Agency	22,060.000	2,060.000		2,060.000	
5-May-2011	Purc/3-2	Ram Agency	Design Services	44,120.000	4,120.000		4,120.000	
6-May-2011	Purc/4-1	Ram Agency	Advertising Agency	22,060.000	2,060.000		2,060.000	
9-May-2011	Jrnl/4-1	Ajay Tours	Air Travel Agency	90,446.000	8,446.000		8,446.000	
10-May-2011	Purc/5-1	Cash	Advertising Agency	4,41,200.000	41,200.000	4,41,200.000	41,200.000	
21-May-2011	Jrnl/6-1	Spice & Dice Caterers	Outdoor Catering	63,090.000	3,090.000	63,090.000	3,090.000	
23-May-2011	Purc/8-1	Kamal Advertisers	Advertising Agency	1,10,30,000.000	10,30,000.000		10,30,000.000	
24-May-2011	Purc/9-1	Sampath Associates	Chartered Accountants	94,527.000	8,827.090	9,453.000	8,827.090	
28-May-2011	Purc/11-1	Ram Agency	Advertising Agency	77,210.000	7,210.000	33,090.000	7,210.000	
Total				1,20,28,103.000	11,20,403.090	6,67,133.000	11,20,403.090	

## INPUT CREDIT REVERSAL DETAILS

Input Credit Reversal Details Crystal Services (P) Ltd. Ctrl + M										
Credit Utilised But Payment Not Made- Overdue more than 3 Months 1-Apr-2011 to 30-Sep-2011										
Bill Date	Ref. No.	Party's Name	Category	Bill Value	Billed Assessable Value	Availed Input Credit	Utilised Input Credit	Input Credit Need To Be Reversed	Balance Input Credit	Pending From No. of Days
2-Jun-2011	Purc/12-1	Kamal Advertisers	Advertising Agency	1,98,540.00	1,80,000.00	18,540.00	18,540.00	18,540.00		120 Days
Total				1,80,000.00	18,540.00	18,540.00	18,540.00			

## ST3 FORM

Printing	
<b>Printer</b> : Snaglt 7 (Ne00:) <b>No. of Copies</b> : 1 <b>Print Language</b> : English <b>Method</b> : Neat Mode <b>Page Range</b> : All	<b>Paper Type</b> : Letter <div style="text-align: right; font-size: small;">(Printing Dimensions)</div> <b>Paper Size</b> : (8.50" x 10.98") or (216 mm x 279 mm) <b>Print Area</b> : (8.03" x 10.63") or (204 mm x 270 mm)
Report Titles	
<b>Form ST - 3</b> (with Print Preview) <i>Without Company Phone No.</i>	
ST-3 Period	
<b>Period For</b> : [April - September] <b>Place</b> : Bangalore <b>Date</b> : 10-10-2011	<b>Print ?</b> <div style="color: red; font-weight: bold;">Yes or No</div>

Service Tax Return can be generated in Tally for two purposes.

- (a) For Printing
- (b) For e-Filing.

## ST3 RETURN PREVIEW

FORM ST-3																																																																																																																																																																																																																																								
(Returns under section 79 of the Finance Act, 1994)																																																																																																																																																																																																																																								
[ ORIGINAL / REVISED RETURN ]																																																																																																																																																																																																																																								
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For the period																																																																																																																																																																																																																																								
<input checked="" type="checkbox"/> April-September <input type="checkbox"/> October-March																																																																																																																																																																																																																																								
1A. Has the assessee opted to operate as Large Taxpayer? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <small>(As defined under Rule 2 (al) of the Central Excise Rules, 2002 read with rule 2 (i)(cccc) of the Service Tax Rules, 1994)</small>																																																																																																																																																																																																																																								
1B. If reply to column "1A" is "yes", name of Large Taxpayer Unit (LTU) opted for: <span style="border: 1px solid black; display: inline-block; width: 150px; height: 1.2em; vertical-align: middle;"></span>																																																																																																																																																																																																																																								
2A. Name of the assessee: <span style="border: 1px solid black; display: inline-block; width: 150px; height: 1.2em; vertical-align: middle;">ABC Company</span>																																																																																																																																																																																																																																								
2B. STC No.: <span style="border: 1px solid black; display: inline-block; width: 150px; height: 1.2em; vertical-align: middle;"></span>																																																																																																																																																																																																																																								
2C. Premises code No.: <span style="border: 1px solid black; display: inline-block; width: 150px; height: 1.2em; vertical-align: middle;">C0000045</span>																																																																																																																																																																																																																																								
2D. Constitution of assessee: <div style="display: flex; justify-content: space-between; margin-top: 5px;"> <div style="width: 45%;"> <input type="checkbox"/> (i) Individual / Proprietary  <input type="checkbox"/> (ii) Partnership  <input type="checkbox"/> (iii) Registered Public Ltd Company  <input type="checkbox"/> (iv) Registered Private Ltd Company  <input type="checkbox"/> (v) Registered Trust  <input type="checkbox"/> (vi) Society/Co-op Society  <input type="checkbox"/> (vii) Other         </div> <div style="width: 5%; text-align: center;"> <input checked="" type="checkbox"/>  <input type="checkbox"/>  <input type="checkbox"/>  <input checked="" type="checkbox"/>  <input type="checkbox"/>  <input type="checkbox"/>  <input type="checkbox"/> </div> </div>																																																																																																																																																																																																																																								
3. Computation of Service Tax <div style="display: flex; justify-content: space-between; margin-top: 5px;"> <div style="width: 45%;">           A1. Name of Taxable service Event Management Service            A2. Assessee is liable to pay Service Tax on this taxable service as:-  <input type="checkbox"/> (i) a service provider; or  <input type="checkbox"/> (ii) a service receiver liable to make payment of Service Tax            B. Sub-class No. of class(105) of section 65            C1. Has the assessee availed benefit of any exemption notification (Y/N)            C2. If reply to column "C1" is "Yes", please furnish notification nos. 5/2005 Dated 23-3-2005            D. If abatement is claimed as per notification no. 1/2005-ST, please furnish Sr. No. in the notification under which such abatement is claimed            E1. Whether previously assessed (Y/N) <input type="checkbox"/> E2. Prev. assessment order No. (if any) <span style="border: 1px solid black; display: inline-block; width: 100px; height: 1.2em; vertical-align: middle;"></span>            F. Value of taxable service, service tax payable and gross amount charged         </div> <div style="width: 50%;"> <table border="1" style="width: 100%; border-collapse: collapse; font-size: x-small;"> <thead> <tr> <th></th> <th>Month / Quarter</th> <th>April</th> <th>May</th> <th>June</th> <th>July</th> <th>August</th> <th>September</th> </tr> <tr> <th>(1)</th> <th>(2)</th> <th>(3)</th> <th>(4)</th> <th>(5)</th> <th>(6)</th> <th>(7)</th> </tr> </thead> <tbody> <tr> <td>(a) Service Tax Payable</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>(i) Gross amount received / (paid) in money</td> <td></td> <td>7,60,000.00</td> <td>18,80,000.00</td> <td>3,72,528.88</td> <td></td> <td></td> <td></td> </tr> <tr> <td>(ii) against service provided</td> <td></td> <td></td> <td></td> <td>45,792.88</td> <td></td> <td></td> <td></td> </tr> <tr> <td>(iii) in advance for service to be provided</td> <td></td> <td></td> <td></td> <td>30,000.00</td> <td></td> <td></td> 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provided				45,792.88				(iii) in advance for service to be provided				30,000.00				(iv) Money equivalent of considerations received / (paid) in a form other than money								(c) Value on which Service Tax is exempt / not payable								(i) Amount received / (paid) towards exempted service other than export of service, i.e., (ii) above								(ii) Amount received as / (paid) to pure agent								(d) Exemption amount claimed								(e) Taxable value = (a)-(b) minus (c)-(d)		7,60,000.00	18,70,797.88	3,72,528.88				(f) Service Tax rate wise break-up of taxable value = (e)								(i) Value on which Service Tax is payable @ 5%								(ii) Value on which Service Tax is payable @ 8%								(iii) Value on which Service Tax is payable @ 10%		7,60,000.00	18,70,797.88	3,72,528.88				(iv) Value on which Service Tax is payable @ 12%								(v) Other rate, if any								(g) Service Tax Payable = (5% of (i)) + (8% of (ii)) + (10% of (iii)) + (12% of (iv)) + (Other rate)		75,000.00	1,07,079.79	37,252.88				(h) Education Cess payable = (8% of Service Tax)		6,000.00	8,566.38	2,980.23				(i) Secondary and Higher Education Cess payable = (4% of Service Tax)		3,000.00	4,283.19	1,490.12				(j) Taxable amount charged		7,60,000.00	18,80,000.00	3,72,528.88				(k) Gross amount for which bills / invoices / challans are issued relating to service provided to be provided (including export of service and exempted service)								(l) Money equivalent of other consideration charged, if any, to a firm other than money								(m) Amount charged for exported service provided to be provided								(n) Amount charged for exempted service provided to be provided other than export of service given at (i)								(o) Amount charged as pure agent								(p) Amount claimed as abatement								(q) Net taxable amount charged = (j) + (k) minus (l) + (m) + (n) + (o)		7,50,000.00	11,75,000.00	5,50,000.00			
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All the above reports can be correctly generated in Tally provided –

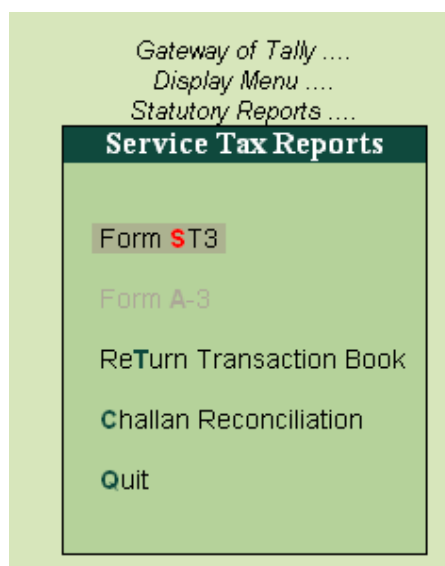
- (a) Basic settings related to service tax are correctly done.
- (b) Voucher entries are done as per Tally's service tax settings

If any of the above condition is not followed, a user may not get correct result in Tally's service tax reports.

At the time of viewing any of the service tax related reports in Tally, user shall always compare it with audited financial reports like Balance Sheet, Profit and Loss Account, etc.

Let us now understand Scenario 2, i.e. Release 5.0 and onwards

To start with service tax reports in Tally, go to Gateway of Tally > Display > Statutory Reports > Service Tax (This path is unchanged as compared to release 4.93)



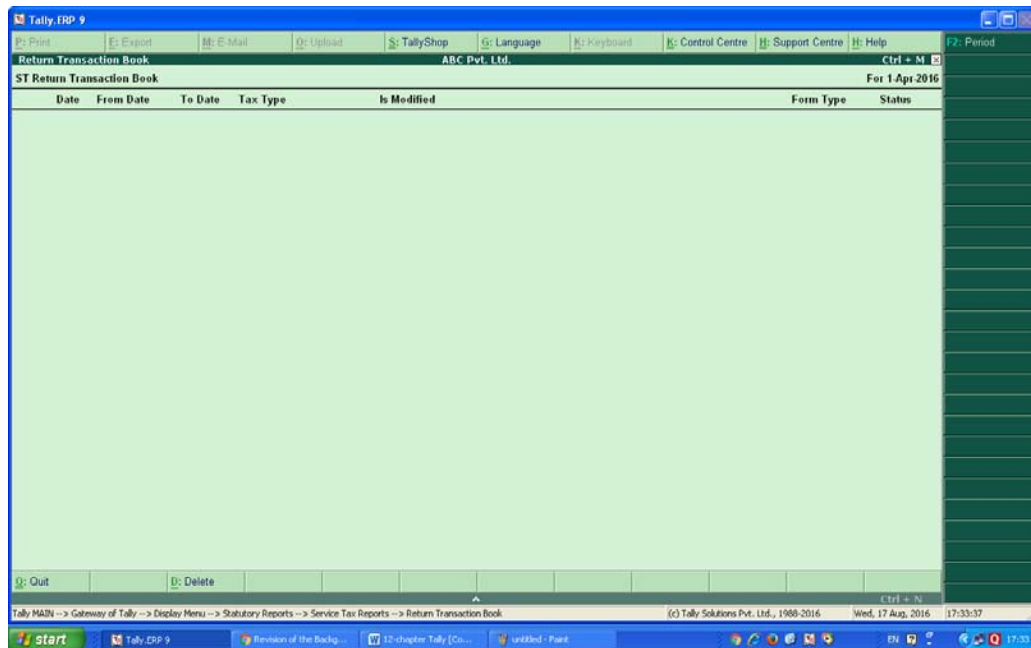
**Form ST3 :** This is the most important report for viewing all types of service tax related information. This report is as under.

Service Tax Computation			1 Apr 2015 to 30 Jun 2015	
<b>Statistics of Vouchers</b>				
Total Number of Transactions			281	
Included Transactions			13	
Excluded Transactions			134	
Uncertain Transactions			134	
<b>Particulars</b>			<b>Service Value</b>	<b>Tax Value</b>
Service Tax Liability			1,40,000.00	17,304.00
Service Tax Credit Available				
Less: Credit Utilized				
Input Credit Adjustments	1,836.00			1,836.00
Balance Available Credit				
Balance Tax Payable after Adjustments				15,468.00
<b>Payments Details</b> 1 Apr 2015 to 1 Jun 2015				
Tax Payments(Included)			0	
Tax Payments(Not Included)			1	
Service Tax Payment made for the return period				
Balance Service Tax Payable				15,468.00
Other Payments				

To check details of any figure, Enter key can be pressed on the particular line.

## RETURN TRANSACTION BOOK

Tally.ERP9 can be used for filing of Service Tax returns. Tally can keep a track of returns filed. This information can be viewed using this report.



## CHALLAN RECONCILIATION

This menu can be used to confirm payments made to government towards deposit of service tax. BSR code of branch and challan number can be entered here by accountant along with amount paid. This can be checked with physical challans.

## **COMPANIES (AUDITOR'S REPORT) ORDER, 2016 (CARO)**

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13.1 In accordance with the provision of Section 143(11) of the Companies Act, 2013, the Auditor's report of certain class or description of companies shall include a statement on certain specified matters. These reporting requirements on specified matters has now been prescribed under the Companies (Auditor's Report) Order, 2016(CARO-2016) issued by the Ministry of Corporate Affairs (MCA) vide Order No.S.O.1228(E) dated 29<sup>th</sup> March, 2016.

CARO, 2016 has been issued in supersession of the Companies (Auditor's) Report Order,2015 and is made applicable from the financial year 2015-16.

Prior to CARO-2016, the Companies (Auditor's Report) Order, 2015 (CARO, 2015) was issued vide MCA Order no.S.O.990(E) w.e.f. 10<sup>th</sup> April, 2015. CARO,2015 had replaced the Companies(Auditor's Report) Order,2003 issued by MCA in pursuance of the provisions of Section 227(4A) of the Companies Act, 1956.

### **APPLICABILITY**

13.2 The Companies (Auditor's Report) Order, 2016 is applicable from FY 2015-16 and the matters specified therein shall be included in each report made by auditor under Sec.143 on the accounts of every Company to which CARO,2016 applies.

### **COVERAGE**

13.3 CARO,2016 is applicable to every Company including a foreign Company as defined in clause (42) of Section 2 of the Companies Act, 2013 except

- (i) Banking Company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- (ii) Insurance Company as defined under the Insurance Act, 1938;
- (iii) a Company licenced to operate under Section 8 of Companies Act, 2013.
- (iv) a One Person Company(OPC) as defined under clause (62) of section 2 of Companies Act, 2013.
- (v) a Small Company as defined under Section 2(85) of the Companies Act, 2013.

Small Company is defined as a Private Limited Company, not being a Subsidiary or holding Company of a Public Company having a Paid-up Capital and Reserves and surplus not more than Rs.one crore as on the Balance Sheet date and which does not have loan outstanding exceeding Rs.one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Schedule III to the Companies Act, 2013(including revenue from discontinuing operations) turnover exceeding Rs. ten crores during the financial year as per the financial statements.

#### **AUDITOR'S REPORT TO CONTAIN MATTERS SPECIFIED IN PARAGRAPHS 3 AND 4.**

13.4 Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by him, to which this Order applies, for the financial years commencing on or after 1st April, 2015, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable:

Provided the Order shall not apply to the auditor's report on consolidated financial statements.

#### **MATTERS TO BE INCLUDED IN AUDITOR'S REPORT**

13.5 The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-



- (i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;
- (b) whether these fixed assets have been physically verified by the management at reasonable intervals ; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;
- (ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;
- (iii) whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,
  - (a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;
  - (b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;
  - (c) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;
- (iv) in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.
- (v) in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections

73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed thereunder, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

- (vi) whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.
- (vii)
  - (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;
  - (b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).
- (viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).
- (ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

- (x) whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;
- (xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;
- (xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;
- (xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;
- (xiv) whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;
- (xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;
- (xvi) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained

**REASONS TO BE STATED FOR UNFAVOURABLE OR QUALIFIED ANSWERS**

13.6 (1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

The Indirect Tax perspective on review of CARO, 2016 is to know about the undisputed tax liabilities as on the last day of the financial year concerned for a period of more than six months from the date they became payable and also to know the status about the disputed demands.