

How to Face Audit - CE ST?

By: [Madhukar N Hiregange](#)

Concept of departmental audit

The departmental auditors look into the assessee's own (private) records to verify whether the assessee is paying central excise duty correctly on excisable goods manufactured or deemed to be manufactured and service tax on taxable services provided and whether proper procedures are followed where required to be followed viz., in case of exports or while claiming the benefit of any exemption from duty or tax. The main intention in having the departmental audit is generally to avoid revenue leakage though the officers are also supposed to act as facilitators for trade and industry.

What we have today is a risk based audit and the risk is one relating to leakage of revenue. The audit generally is carried out periodically and the frequency of such audits would depend on the average duty and tax paid by the assessee. Where the duty and tax paid is higher, the audits would be more frequent as it is also regarded to lead to higher risks of revenue leakage if something were to go wrong. As per [Circular 731/47/2003 CX dated 01.08.2003](#), units paying duty in excess of Rs. 1 crore or above in cash or through banking channels, are to be audited every year. Where the duty amount does not exceed Rs. 10 lakhs, the audit is to be at least once in five years whereas in other cases, at least once in every two years.

The audit exercise is supposed to start even before the audit staff can actually visit the premises of the assessee. The audit staff is supposed to undertake a desk review on the basis of the information already available in respect of the auditee. The information may be in the form of an assessee profile which the auditee is supposed to fill up and submit to the department, the returns filed periodically, copies of the audited financial statements and tax audit reports if they have been obtained from the auditee. This would enable the auditor to have a fair idea of the auditee's business and operations apart from the likely areas requiring attention during the course of audit.

Once the visit has been undertaken and the issues if any have been identified, they are discussed with the auditee and an audit note issued for the finalized points. This forms the basis for recovery of dues from the auditee.

Practical aspects relevant

The need for professionalism has been felt not just by the department but even by the auditees. This has resulted in the need for training of all their officers on understanding the accounting methods and the operational issues in a business enterprise. The auditors often focus on areas of

non compliance and having been trained to look for errors have been largely successful in ferreting out the same. The demands in such cases is sought to be invoked for a period of 5 years even though at times this may not be justified.

Unfortunately they also have a persuasive method to try and get the amount debited immediately, often on oral instructions. This is often the case where the issue involved is of availment of cenvat credits. This however does not preclude the department from issuing a Show Cause Notice for payment of interest and penalty. Therefore the debiting of duty on the oral instructions of the audit party or on the letter asking for compliance from the range may not always be wise. In many such cases the duty might not be payable at all if one were to consider all the facts and circumstances of the case.

At times the only objective of the auditors is to arrive at many errors and quantifying the same along with penalty and interest to arrive at the total amount of demand that can be raised. Then a series of negotiations follow as to the issues which they would drop, the ones requiring the assessee to reverse and the one they would report. The job of the audit is only to note non compliance and the Range on instruction from the Audit would examine the same and may ask for further details. A Show Cause Notice may then be issued if any issue exists where the assessee and department are not in agreement. At such times the advise of a knowledgeable professional is essential to avoid errors of judgment or errors of reversals. taxmanagementindia.com

The department is also gaining through computerization as it enables them to approach auditees by utilizing the information furnished by other auditees. This feature seems to have taken several assessees off guard as they seem to be caught napping by the department on the legal compliance front and consequently face Show Cause Notices from the department and subsequent litigation.

Strategies for facing the departmental audit:

In order to confidently face the departmental audit, the auditee should be fairly well aware of the provisions of law as well as take certain precautions in implementing an internal control mechanism within the organization to ensure compliance with the provisions of law. Moreover, he should also be aware of the areas looked at by the auditors during the audit so that the necessary documents and records can be furnished on a timely basis thereby enabling speedy resolution of possible issues. The following are the areas which can be checked by the Audit Teams:

- All records prepared and maintained by assessee for accounting of transactions in regards to receipt, purchase, manufacture, storage, sales or delivery of goods including inputs and capital goods. Virtually all the books, documents and paper would be required for verification particularly those that are connected with manufacture and document the transaction flow. Auditees may note that the records maintained within the organization for internal control itself could be sufficient evidence in this regard as no statutory records or

registers exist in this regard.

- Cost audit and income tax audit reports, audited annual accounts, Directors reports, auditors reports, notes to accounts, etc. to get an idea as to the financial position and background of the enterprise.
- The depreciation schedules would provide details of additions and sales of assets during year. This would be pertinent as the department can ask for either reversal of credits on capital goods cleared or sold after usage.
- The purchase documents and consumption registers are also checked to ensure usage of inputs for the manufacture of excisable goods on which duty of excise is discharged to ensure validity of the cenvat credits claimed.
- Analysis of input-output ratios in comparison with industry ratio maybe done to find out whether there could a possible case of wrong utilization of cenvat credits in excess of the amounts justified.
- Job work related records maybe analyzed to understand strength and weaknesses of controls that are in place with regard to the goods being sent out to a sub contractor for job work and the receipt of processed goods from him. The follow up of operations at the job worker's end along with the valuation mechanism adopted by him where he discharges duty may also be taken up.
- In case of service providers, the agreements with clients can be reviewed to ascertain the correct classification of the taxable service as well as to ascertain the exact liability once the financial ledgers have been found to show income accruals from provision of services.
- In case of agreements with non residents or business establishments outside India where some services are received from across the border entailing foreign exchange outflow, possible liability for the service receiver in India as a recipient of taxable services from abroad may be addressed
- One of the main areas concentrated upon is that of cenvat credits where issues are raised with regard to the activities relating to business. This is critical if one were to avail credit on certain input services received by the manufacturer/service provider. Here, the auditee should be aware of the role the service received plays in his business as the credits of service tax paid on the same could be at stake. Generally, the views of the department in this regard are quite narrow.
- The absence or presence of exempted services or exempted goods being provided by the auditee in addition to dutiable goods or taxable services could also be an issue. This is because, the credits are to be segregated in terms of [Rule 6 of Cenvat Credit Rules 2004](#) and not allowed in respect of inputs or input services used for the exempted activity.

Certain Do's and Don'ts

- Assessee cannot refuse to produce books of accounts and records as it could invite investigation and subsequent penal action going beyond the limitation period in case of

detection of non payment or short payment of taxes/duties. .

- The audit team should intimate their visit sufficiently in advance and this should be taken in writing and the duration of audit also confirmed.
- A team of responsible individuals who are also aware of the basic provisions of law, should be available at factory/office to answer queries of audit team.
- Access to books and accounts and other facilities should be provided only during working hours to enable them to conduct their functions and no record should be allowed to be removed from the premises. In case the officials seek to retain custody of records and take the same outside, there should be a written request for the same. Delivery of records to them should also be acknowledged by the officials/department.
- It should be noted that departmental officers are public servants and are punishable if they act contrary to Indian Penal Code. The following are punishable offences namely, fabrication of books and accounts, making false reports causing other person to suffer liability, threatening and criminal intimidation, annoyance and assault.
- It maybe possible that the departmental officer does not know the accounting principles, audit methodology and may not be a qualified auditor. This may lead to assessee facing irrelevant, unnecessary questions. Where the officer fails to understand the explanation given, he may be asked to submit his views in writing.
- Here it is very relevant to note that no duty demand can be raised without issuing a show cause notice and auditor cannot act as assessing officer. No summons can be issued during audit at all.
- The assessee cannot be stopped from carrying on his normal business activity for the sake of accommodating the auditors other than providing them the records needed for verification and the explanations or answers to their queries.
- Audit parties can only make factual observations and not conclusion on points of law.
- The information based on which the auditor makes his findings can be made available to auditor under [RTI Act 2005](#).
- The assessee is entitled to his views and opinions and explanations which should be noted before raising objections.
- After audit is over visit by officers should be discouraged.
- An assessee having a legitimate complaint against audit team can make a complaint to Chief Commissioner with copy to Commissioner and other concerned authorities.
- The staff of the concern need not stay beyond office hours. They need not give their phone numbers, personal details etc under law at all.
- Questioning for long hours under duress should be complained immediately.
- Trade secrets, formulas need not be furnished voluntarily by unit until request for the same is given in writing to the auditee.
- Documents need to be furnished only for the period that is covered by the audit and not for other periods.

“Prevention is better than cure.” If the assessee is ethical and diligent while interacting with the department, disputes would be reduced to a great extent. If any dispute arises inspite of his diligence, he should take necessary measures and resolve it. Interaction with the department is the key to avoid disputes with the department.

Finally to summarize, audit by revenue though possibly illegal can serve the purpose of keeping one record in order and getting a third party validation free of cost. A pre audit covering the aspects discussed in this article could g a long way to avoid disruptive audits and their resolution over period of time as well as issue of SCN at the end of the tunnel.