GST CONSIDERATIONS WHILE FINALIZING THE AUDIT

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Finalization of Accounts

The term 'Finalization of Accounts' refers to the process of planning and control of activities relating to the preparation of the Financial Statements of a business entity. There must exist a well-defined system to ensure,

(a) Timely preparation of the Financial Statements,

(b) Compliance with the various statutes applicable to the entity, and

(c) That the Financial Statements represent a true & fair view of the financial status of the entity. The procedure must encompass all the financial activities conducted or entered into, during the financial year of the business entity.

Impact of GST law on finalization of Financial Statements

The primary objectives of an auditor is to

(a) Obtain reasonable assurance as to whether the Financial Statements, as a whole are free from material misstatement, whether due to fraud or error; and

(b) to ensure that the Financial Statements give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the entity as at the date of closing of accounts, of its profit/ loss and other comprehensive income, consolidated changes in equity (if applicable) and cash flows for the year/ period then ended.

To achieve the above stated objective, it is imperative that an auditor should check for compliance with GST law and regulations.

Under GST there is requirement for filing of Annual return and Reconciliation in Form GSTR 9 & 9C respectively. Previously Chartered Accountant or Cost Accountant was required to certify and submit GSTR 9C. However, from FY 20-21, Assessee is required to Self-certify and submit the same. Due Date for submission for GSTR 9 & 9C is on or before the thirty-first day of December following the end of such financial year.

It is evident from the above, that the due date for filing of FORM GSTR-9 & FORM GSTR-9C is 31st of December, following the end of the financial year. The due date prescribed for submission of audited accounts under various other Acts such as Companies Act, 2013 and the Income Tax Act, 1961 is earlier to the date prescribed under the GST Act. Consequently, the business entities and the auditors generally finalize the Financial Statements and file the same with the Registrar of Companies (in the case of corporates) and the Income Tax authorities and then commence the process of preparing the Annual Return prescribed under the GST Act. This process may not be the right approach as errors of omission and commission noticed during the GST audit process may result in material misstatement of the Financial Statements affecting the 'True & Fair' view of the same.

Points to be kept under Consideration at the time of Closure of Financial Statements

Now we will discuss area wise Audit approach for finalization of accounts with GST perspective:

Sales

I. Test of scope of supply – Sec 7 – One should check whether the Income on which GST has not been discharges does fall within the scope of supply or not.

II. Whether Tax Invoice issued correctly – Sec 31 provides format and requirements as per which tax invoice should be issued.

III. Applicable exemptions – Sec 2(47) Exempt Supply, Sec 2(78) – Non Taxable Supply – In case any income is not offered under GST, then whether the said income is exempt or non-taxable under GST or not is to be checked.

IV. Determining the point of taxation in terms of the 'time of supply 'provisions laid down by law – Sec 12 & Sec 13

V. Determining the liability to tax in terms of the 'value of supply' provisions laid down by law – Sec 15

VI. Determining the place of supply of goods and services to pay the tax correctly to either the Central or State Government

VII. Correct classification of the goods &and services as per HSN/ SAC

VIII. Applying the correct rate of tax/ Changes in rate over the period – Sec 14

IX. Whether rate for any product is under Inverted duty structure, if yes then refund claimed or not.

X. Impact of Discounts on GST

XI. Impact of GST on Advance received – There is requirement under GST wherein GST is to be discharged on advance received against supply of services.

XII. Whether Branch Transfer correctly reported, in case of multiple registration

What is the impact of discount provided after the sales are made?

- Discount offered can be reduced from the transaction value, if there is a written agreement entered into before or at the time of supply, mentioning the discount conditions and timeline and the discount offered can be linked to the supply invoice for which it is made

Action Points for Auditor

- The auditor should review the GSTIN-wise returns filed with GST authorities in FORM GSTR-1 and ensure that the data presented are appropriate. The auditor should also understand the methods, processes and controls around preparation of data obtained for different registrations

- An auditor at the time of finalization, has to verify the impact of cross utilization of services, if any, for an entity registered in multiple States and should ensure that proper liability is accounted and discharged as per the provisions of the Act.

  - The auditor must satisfy himself that the entity has classified according to the relevant Chapter the goods dealt by it. In case there is a difference in the Chapter heading, GST liability may vary and, if material, would affect the true and fair view of the Financial Statements.

- The auditor must verify the nature of discounts provided by the entity to its customers and review the corresponding impact on the GST liability.
- The various types of advances like Security Deposit, retention money, Advance for material and advance for services, will have different impact on GST. The auditor should carefully investigate every type of advance and review its standpoint from the perspective of GST and conclude before finalizing the financial statements

Purchase/Expense

I. Whether the Expenditure on which ITC is claimed is for furtherance of business or not is to be checked.

- One of the Primary conditions for claiming ITC is that the goods or services received by the company should be used in the course of furtherance of business

II. For the purpose of claiming ITC - The entity should be in possession of the tax invoice or debit note, or any other document issued by the supplier – Sec 16(2)

III. It should have received the goods or services or both - Sec 16(2)

- One important aspect to be noted by the auditor is to deal with a situation where the tax authorities allege non-receipt of goods or services. There are various cases where the tax authorities allege that certain transactions of inward supplies are fictitious and that the ITC claimed by the company is not eligible. There can be instances where the company might have contested the allegation, though the credit might have been reversed under protest due to coercion from tax authorities.

IV. Test eligibility for claiming ITC and reversal if found ineligible – Sec 17

- Section 17 deals with two aspects, one being apportionment of ITC and the second being blocked credits. The first part, i.e., apportionment of ITC, comes into the picture when inward supplies are used for making outward supplies which are used for making taxable supplies as well as exempt supplies. In such cases, compliance with provisions of Rules 42and 43 (already discussed in the earlier part of this article) should be analyzed. The auditor should specifically check if the compliance is done on a monthly basis, whether the true-up as mandated u/r 42 and 43 is done within the prescribed time limit and, lastly, the accounting for the apportionment u/r 42and 43 – whether the amount of reversals / re-credit is booked to specific expense or a general expense? The auditor should also analyze the method of reporting the true-up effect of Rules 42 and 43 in the subsequent financial year – whether as prior period expense or regular expense?
- The second part, i.e., blocked credits, is trickier. There has been a lot of controversy on this subject, be it inputs or capital goods.

V. Discharge GST liability on certain goods and services under reverse charge mechanism – Sec 9(3)

VI. Reverse ITC for non-payment to vendors within the stipulated time – Second Proviso to Sec 16(2)

Let us discuss some common queries at the time of finalization of accounts with respect to expenses:

Whether Interest & Penalty paid under GST are allowed as expenditure at the time of finalization of accounts?

- Penalty on late payment and interest are to be shown as part of rates and taxes in the other expenses and charged to statement of profit and loss.

Whether deduction from employee's salary towards penalty for causing deliberate damages due to wrong handling of machinery, is liable for GST levy?

- The recoveries on account of default by the employee shall not be considered as supplies under GST as the employer-employee relationship subsist and hence it will not attract GST levy.

While accounting year end provisions for services like rent, audit fee, retainer fees, etc. Should it be inclusive or exclusive of GST component?

- Section 16 of the GST Act, stipulates conditions for claiming input tax credit. As per the provisions unless the goods or services are received by the entity along with the tax invoice or any other tax documents input tax credit is not available to an entity. Input tax credit should not be accounted in case of year end entries as there are no valid tax invoice / documents. However, in case of services were RCM is attracted (e.g. import of services, legal fees, GTA, etc.,) the provision should include GST.

Whether ITC on Gold coins given to Distributor as a business promotion expenditure is allowed?

- Held no, in case of Biostadt India Ltd (GST AAR Maharashtra)

After Profit & loss no we come to Balance sheet items. Let us discuss the same in detail:

Assets

Property Plant & Equipment

I. There are certain categories of assets for which input tax credit is not available and in certain cases input tax credit is available with restrictions, more commonly known as blocked/ ineligible credits.

II. Ineligible credits, if any, are to be considered as part of cost of an asset and cannot be treated as input tax credit.

III. Reverse charge mechanism on certain items of capital goods, like plant and machinery.

IV. Impact of GST on disposal of assets on which input tax credit may or may not be already taken.

V. Transfer of assets to related parties/ distinct persons

Sec 17(5) provides list of Input tax credit which are ineligible under GST. One of them is ITC of Motor Vehicle (with certain conditions) & ITC on Immovable Property. At the time of Audit of Fixed asset addition the above points are to be kept under consideration.

Important AAR Ruling

Whether ITC on Civil support structure to Plant & machinery is allowed as Input credit?

- Held no, in case of Maruti Ispat & Energy Private Limited (GST AAR Andhra Pradesh)

Whether ITC on Malls & building allowed, which are used for lending purpose?

- Held Yes, in case of Safari Retreats Private Limited (Orissa High court) [Appeal in supreme court pending]

Whether ITC available in case of Demo Vehicles used for furtherance of business?

- Held no, in case of Khatwani Sale and Service LLP (GST AAR Madhya Pradesh)

Whether GST Applicable on sale of Assets under Slum sale?

- Held no, in case of M/s. Innovative Textile Ltd (GST AAR Uttarakhand)

Whether GST Applicable in case of Sale of Assets by liquidator in case of Defunct Company?

- Held Yes, in case of Mansi Oils and Grains Pvt. Ltd (GST AAR West Bengal)

Note:

If Assessee is into the business of 100% Export of goods/ services then ideally he must not claim input on capital goods and must capitalize the same as same is not eligible for refund in case of Exports without payment of tax.

Inventories

I. ITC on Goods in Transit – ITC will be available only when goods are received – Important from booking of Purchase/ Disclosure of goods in transit in financials

II. Goods at third Party - It must be noted that the goods sent to the job worker, must be returned to the principal within prescribed time limit – Sec 19

An entity has not received goods as on 31st March for which invoice from the vendors are dated before 31st March. Whether input tax can be taken in the present scenario?

- Section 16(2)(b) of the CGST Act, mandates that input tax credit in respect of any supply of goods/ services shall be available to the registered person, after he has received such goods/ services. Therefore, input tax credit cannot be taken in the present scenario.

Whether GST is to be included in the calculation of closing stock?

- GST should not be included as part of closing stock as GST paid on purchases lying in closing inventory. The GST component is considered as input tax credit. As per AS-2: "Valuation of Inventories" any recovered/ recoverable duties will not be considered as part of cost of inventory.

Trade Receivable

I. Export Sales – With or without payment – To be verified whether LUT availed or not

II. Refund Claimed/ Pending to be verified – Important information as refund received are to be disclosed under clause 41 of Tax Audit Report

III. BRC for Foreign remittance received are to be checked as same are important for claiming refund.

Liabilities

Trade Payable

I. Foreign Creditors – One Should verify the impact of import of services and where applicable should review whether RCM has been properly discharged

II. Domestic Creditors – To check whether Payment made within 180 days or not

Contingent Liability

In order to identify whether there is any contingent liability on account of GST or not, one must check for any Non-compliances with regards to following :

I. Whether any Show cause notice/ Demand notice issued by GST department.

II. Whether EWAY bill issued along with sale invoice or not.

III. Whether Tax Invoice issued as per requirement under GST law or not.

IV. Whether any delayed payment of GST without interest is made or not

V. Whether any ineligible ITC credit is claimed or not

VI. Whether ITC claimed in GSTR 3B is within limit of 5% as available in GSTR 2B or not.

Points mentioned above summarizes major common noncompliance with GST law and how to spot and rectify the same. The approach is to review the various line items in the asset and liabilities in the balance sheet and the likely impact that GST law has on them.

Now after discussing Area-wise key points with respect to Finalization of Accounts GST perspective, let us now discuss points to be kept under consideration at the time Tax Audit report with GST perspective.

GST & Tax Audit Report

Tax audit report has a considerable amount of disclosure to be made in relation to GST.

Following disclosures are to be made under tax audit report:

- The auditor should ensure proper disclosure of registrations under Part A clause 4 i.e. all registrations taken by an entity across all States including input service distributor registration. – Clause 4
- The auditor should have a reconciliation of GST on the various items mentioned as part of inclusive accounting under Income Tax Act. – Clause 14
- The auditor should verify whether the cost of addition to asset has been properly disclosed in the tax audit report. The cost of the asset disclosed in the tax audit report should be in line with the capitalization policy followed for tangible and intangible assets, in the books. – Clause 18
- Review FORM GST DRC-07, FORM GST PMT-06 and FORM GST DRC-03 forms/ chalans from the GST portal to ascertain if any penalties/ demands had been paid by the entity. – Clause 21(a)
- The auditor should review the payments made after the year end to ascertain if the liability at the end of the year is discharged completely – Sec 43B under Clause 26
- Reconciliation of Input tax credit claimed during the year – Clause 27
- Details of Demand raise/ Refund received during the year – Clause 41

To ensure that there are no major/ material misstatements, it is imperative that an auditor checks compliance with GST laws and rules during the finalization of accounts.

The Common list of reconciliations which takes care of the points/common mistake mentioned above which is to be carried out before finalization of accounts is set out below:

I. Balance of Electronic Credit ledger with ITC in books

II. Balance of Electronic Cash ledger with excess cash paid in books

III. GST paid in cash in March return, with payables as per books

IV. Refund claimed in GST portal with GST ITC refund receivable in books

V. Refund rejected in GST portal with Rates and taxes in books

VI. Turnover and output liability in GST returns and books

VII. Adjustments of previous year, done in subsequent GST returns

VIII. Review of Previous year GSTR 9 & 9C

IX. RCM, TDS and TCS compliances

X. ITC Reconciliation in FORM GSTR-2A v. in Books

XI. Point of Taxation for Cut off entries of March.

Conclusion:

It is often said that tax and accounting are strangers. However, they invariably overlap since both of them are based on underlying transactions. Since the scope of the auditor also includes ensuring correct compliance with various laws including tax laws, in cases where the treatments under the two domains are different, statutory auditors may be required to do a balancing act and suitably customize their audit processes to ensure that the auditors have reasonable confidence in the true and fair nature of the financial statements.