

## Chapter 13

# Audit

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### Statutory provisions

#### **65. Audit by tax authorities**

- (1) *The Commissioner or any officer authorised by him, by way of a general or a specific order, may undertake audit of any registered person for such period, at such frequency and in such manner as may be prescribed.*
- (2) *The officers referred to in sub-Section (1) may conduct audit at the place of business of the registered person or in their office.*
- (3) *The registered person shall be informed by way of a notice not less than fifteen working days prior to the conduct of audit in such manner as may be prescribed.*
- (4) *The audit under sub-Section (1) shall be completed within a period of three months from the date of commencement of audit:*

*Provided that where the Commissioner is satisfied that audit in respect of such registered person cannot be completed within three months, he may, for the reasons to be recorded in writing, extend the period by a further period not exceeding six months.*

*Explanation. - For the purposes of this sub-Section, the expression 'commencement of audit' shall mean the date on which the records and other documents, called for by the tax authorities, are made available by the registered person or the actual institution of audit at the place of business, whichever is later.*

- (5) *During the course of audit, the authorised officer may require the registered person,*
  - (i) *to afford him the necessary facility to verify the books of account or other documents as he may require;*
  - (ii) *to furnish such information as he may require and render assistance for timely completion of audit.*
- (6) *On conclusion of audit, the proper officer, shall within thirty days, inform the registered person, whose records are audited, about the findings, his rights and obligations and the reasons for such findings.*

- (7) *Where the audit conducted under sub-Section (1) results in detection of tax not paid or short paid or erroneously refunded, or input tax credit wrongly availed or utilised, the proper officer may initiate action under Section 73 or 74.*

#### Extract of the CGST Rules, 2017

##### 101. Audit

- 1) *The period of audit to be conducted under sub-section (1) of section 65 shall be a financial year <sup>1</sup>[or part thereof] or multiples thereof.*
- 2) *Where it is decided to undertake the audit of a registered person in accordance with the provisions of section 65, the proper officer shall issue a notice in Form GST ADT-01 in accordance with the provisions of sub-section (3) of the said section.*
- 3) *The proper officer authorised to conduct audit of the records and the books of account of the registered person shall, with the assistance of the team of officers and officials accompanying him, verify the documents on the basis of which the books of account are maintained and the returns and statements furnished under the provisions of the Act and the rules made thereunder, the correctness of the turnover, exemptions and deductions claimed, the rate of tax applied in respect of the supply of goods or services or both, the input tax credit availed and utilised, refund claimed, and other relevant issues and record the observations in his audit notes.*
- 4) *The proper officer may inform the registered person of the discrepancies noticed, if any, as observed in the audit and the said person may file his reply and the proper officer shall finalise the findings of the audit after due consideration of the reply furnished.*
- 5) *On conclusion of the audit, the proper officer shall inform the findings of audit to the registered person in accordance with the provisions of sub-section (6) of section 65 in Form GST ADT-02.*

#### Related provisions of the Statute

Section or Rule	Description
Section 2(13)	<i>Definition of the term Audit</i>
Section 73	<i>Determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilised for any reason other than fraud or any wilful- misstatement or suppression of facts.</i>
Section 74	<i>Determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilised by reason of fraud or any wilful misstatement or suppression of facts.</i>

<sup>1</sup> Inserted vide Notf No. 74/2018 – CT dt 31-12-2018

### 65.1 Introduction

- (a) Audit of records of taxpayers is the bed rock for the proper functioning of a self-assessment-based tax system. This provision provides for audit of the business transactions of any registered person. It is an important tool in the tax administration to ensure compliance of law and prevent revenue leakage.
- (b) In terms of section 2(13) of the CGST Act, 2017, '*audit*' means the examination of records, returns and other documents maintained or furnished by the registered person under this Act or the rules made thereunder or under any other law for the time being in force to verify the correctness of turnover declared, taxes paid, refund claimed and input tax credit availed, and to assess his compliance with the provisions of this Act or the rules made thereunder.
- (c) The following three types of audits are envisaged under the GST laws:
- (i) The first type of audit is to be done by a Chartered Accountant or a Cost Accountant under section 35(5) where the turnover exceeds certain threshold as specified in rule 80(3) of CGST Rules, 2017 i.e., ₹ 5 Crores of aggregate turnover for FY 2018-19 vide *Notification No. 16/2020-CT dt. 23<sup>rd</sup> March, 2020*. It was ₹ 2 Crores for FY 2017-18. However, the same has been omitted vide Finance Act, 2021 through *Notification No. 29/2021 dt. 30<sup>th</sup> July, 2021 w.e.f 01.08.2021*.
  - (ii) The second type of audit is to be done by the Commissioner or any officer authorised by him in terms of section 65 of the CGST Act, 2017 read with section 20(xiv) of the IGST Act, 2017 and section 21(xv) of UTGST Act, 2017.
  - (iii) The third type of audit is called the special audit and is to be conducted under the mandate of section 66 of CGST Act, 2017 read with rule 102 of CGST Rules, 2017.

### 65.2 Analysis

It is probably for the first time in the history of an indirect tax statute that the term 'audit' has been defined. 'Audit' means examination of records, returns and other documents maintained or furnished by the registered person. Hence audit cannot be conducted in case of unregistered person even if he was required to be registered. In the process of audit of records, returns and other documents to be examined, may be those maintained or furnished under this Act or Rules or any other law for the time being in force.

In an audit, examination is done to verify the correctness of the following:

1. Turnover declared by the supplier
2. Taxes paid by the supplier
3. Refund claimed by the supplier
4. Input tax credit availed by the supplier
5. Classification of goods or service by the supplier.

In an audit, examination is also done to assess the compliance with the provisions of this Act or rules.

While this Chapter discusses sections 65 and 66, the audit to be conducted by a Chartered Accountant under section 35 has been dealt with in Chapter 8 of this Background material.

- (a) Section 65 authorizes conduct of audit by the Commissioner or any other officer authorized by him of the transactions of the registered persons only. The Commissioner may issue a general order or a specific order, to authorize officers to conduct such audit. Rule 101(1) provides that the period of audit under sub-section (1) of Section 65 shall be a financial year (or part thereof) or multiples thereof. The frequency and manner for conducting such audit are yet to be prescribed. Normally, such issues could have been dealt with by way of issue of Office orders or circular instructions. It is important to note that the said order of Commissioner must be specific to the auditee and the tax period selected for audit. Any error and deficiency in such orders would abort any preparatory step taken by the audit officer and preparation to respond taken by the auditee.

The audit will be conducted at the place of business of the registered person or office of tax authorities. Intimation of audit is to be issued to the registered person at least 15 working days in advance in accordance with Rule 101(2) in Form GST ADT-01 and the audit is to be completed within 3 months from the date of its commencement, which may be extended by the Commissioner, where required, by a further period not exceeding 6 months.

Commencement of Audit =		
Date on which the records and other documents called for by tax authorities are made available by registered person	OR	Actual institution of audit at the place of business
whichever is later		

- (b) The Commissioner is required to record the reasons in writing for grant of any such extension.
- (c) During the course of audit, the authorized officer may require the registered person to afford him the necessary facility to verify the books of account and also to furnish the required information and render assistance for the timely completion of the audit.
- (d) According to rule 101(4), the proper officer may inform discrepancies noticed during the audit to the registered person and the registered person shall reply to discrepancies. The proper officer shall finalize findings only after due consideration of the reply of the registered person.
- (e) Some of the best practices to be adopted for GST audit among others could be:  
Evaluation of the internal control *vis-a-vis* GST would indicate the area to be focused. This could be done by verifying:

- (a) The statutory audit report which has specific disclosure in regard to maintenance of record, stock and fixed assets.
- (b) The information system audit report and the internal audit report.
- (c) Internal control questionnaire designed for GST compliance.
  - (i) The use of generalised audit software to aid the GST audit would ensure modern practice of risk-based audit.
  - (ii) The reconciliation of the books of account or reports from the ERP's to the return is imperative.
  - (iii) The review of the gross trial balance for detecting any income being set off with expenses.
  - (iv) Review of purchases/expenses to examine the applicability of reverse charge on goods/services. The foreign exchange outgo reconciliation would also be necessary for identifying the liability of import of services.
  - (v) Quantitative reconciliation of stock transfer within the State or for supplies to job workers under exemption.
  - (vi) Ratio analysis could provide vital clues on areas of non-compliance.
- (f) On audit completion, information is required to be provided to the registered person including the findings during the audit as per section 65(6) read with Rule 101(5) in Form GST ADT-02 within thirty days. In cases where tax liability is identified during the audit or input tax credit wrongly availed or utilized by the auditee, the proper officer may initiate action under section 73 or 74. Audit cannot conclude automatically resulting in a demand. *Independent application of mind is necessary for a valid demand to be raised.*
- (g) It is important to identify that audit under section 65 can commence in a routine manner although 100 per cent audit of given taxpayer or all taxpayers in the same industry would not be feasible. Unlike the scope and limitation on the powers under sections 61 to 64, the scope and coverage under section 65 can extend from scrutiny all the way to investigation. New discoveries may be made but not 'spot recovery'. Show cause notice under section 73 or 74 or 76 is a must for any demand to be entertained by the taxpayer.

### 65.3 Comparative Review

1. The central excise law empowers the Central Government to make provision for verification of records of the assessee. However, the GST Act itself specifically provides for audit of registered persons. In EA 2000, the Director General of Audit supervises the audit functions. Separate Audit Commissionerates have been constituted with effect from 15.10.2014 which will plan, delegate and administer the audit. The audit of the assessee is carried out through visits by 'audit groups' which consist of Superintendents and Inspectors.

2. The audit groups shall prepare a master file of the assessee and collect the relevant information and documents. Desk review shall be done before forming the audit plan. As planned, audit will be conducted and corrections and improvements shall be suggested to the assessee.
3. The draft audit report would be discussed and communicated to the assessee and willingness of the assessee to accept the demand etc., the same shall be placed before the monitoring committee. If the assessee does not accept the audit para, adjudication process will be initiated by the jurisdictional GST Officer.

#### 65.4 FAQs

- Q1. Whether audit is mandatory in case of every registered person?
- Ans. No, it is not mandatory. It will be applicable only in cases where the appropriate authorities authorize the same by issue of general / specific orders.
- Q2. Whether any prior intimation is required before conducting the audit?
- Ans. Yes, prior intimation is required and the taxable person should be informed at least 15 days prior to conduct of audit in Form GST ADT-01.
- Q3. What is the period within which the audit is to be completed?
- Ans. The audit is required to be completed within 3 months from the date of its commencement or within the extended period, of upto 6 months in cases where the Commissioner is satisfied, for reasons to be recorded in writing, that the audit cannot be completed within 3 months.
- Q4. What is meant by commencement of audit?
- Ans. It means the date on which the records and documents requisitioned by the tax authorities are made available by the registered person or the actual institution of audit at the place of business whichever is later
- Q5. What are the obligations of the taxable person when he receives the notice of audit?
- Ans. The taxable person should afford necessary facility / information / assistance / documents to the audit party for the smooth conduct of audit and its timely completion.
- Q6. What would be the action by the proper officer upon conclusion of the audit?
- Ans. The proper office must within 30 days inform the registered person (i.e., the auditee) about his findings, reasons for findings and his rights and obligations in respect of such findings.
- Q7. A notice for audit was served to M/s. ABC Ltd, on 20.05.2021. The required information was furnished by M/s. ABC Ltd, on 25.08.2021. The audit officers visited the place of business on 26.09.2021. What is the last date within which the audit is to be completed?
- Ans. It will be 3 months from 26.09.2021, viz., 26.12.2021 or within an extended period which can be granted by Commissioner (*maximum period of 6 months*) by recording the reasons in writing. (*Even a shorter period of extension is permissible.*)

**Statutory provisions****66. Special Audit**

- (1) *If at any stage of scrutiny, enquiry, investigation or any other proceedings before him, any officer not below the rank of Assistant Commissioner, having regard to the nature and complexity of the case and interest of revenue, is of the opinion that the value has not been correctly declared or the credit availed is not within the normal limits, he may, with the prior approval of the Commissioner, direct such registered person by a communication in writing to get his records including books of account examined and audited by a Chartered Accountant or a Cost Accountant as may be nominated by the Commissioner.*
- (2) *The Chartered Accountant or Cost Accountant so nominated shall, within the period of ninety days, submit a report of such audit duly signed and certified by him to the said Assistant Commissioner mentioning therein such other particulars as may be specified: Provided that the Assistant Commissioner may, on an application made to him in this behalf by the registered person or the Chartered Accountant or Cost Accountant or for any material and sufficient reason, extend the said period by a further period of ninety days.*
- (3) *The provision of sub-Section (1) shall have effect notwithstanding that the accounts of the registered person have been audited under any other provision of this Act or any other law for the time being in force.*
- (4) *The registered person shall be given an opportunity of being heard in respect of any material gathered on the basis of special audit under sub-Section (1) which is proposed to be used in any proceedings against him under this Act or the rules made thereunder.*
- (5) *The expenses of the examination and audit of records under sub-Section (1), including the remuneration of such Chartered Accountant or Cost Accountant, shall be determined and paid by the Commissioner and such determination shall be final.*
- (6) *Where the special audit conducted under sub-Section (1) results in detection of tax not paid or short paid or erroneously refunded, or input tax credit wrongly availed or utilised, the proper officer may initiate action under Section 73 or 74.*

**Extract of the CGST Rules, 2017****102. Special Audit.**

- 1) Where special audit is required to be conducted in accordance with the provisions of section 66, the officer referred to in the said section shall issue a direction in Form GST ADT-03 to the registered person to get his records audited by a *Chartered Accountant* or a *Cost Accountant* specified in the said direction.
- 2) On conclusion of the special audit, the registered person shall be informed of the findings of the special audit in Form GST ADT-04.

**Related provisions of the Statute**

<b>Section or Rule</b>	<b>Description</b>
Section 65	Audit by tax authorities
Section 73	Determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilized for any reason other than fraud or any wilful misstatement or suppression of facts.
Section 74	Determination of tax not paid or short paid or erroneously refunded or input tax credit wrongly availed or utilized by reason of fraud or any wilful misstatement or suppression of facts.

**66.1 Introduction**

Availing the services of experts is an age-old practice and a due process of law. These experts have done yeoman service to the process of delivering justice. One such facility extended by the Act is in section 66 where an officer not below the rank of an Assistant Commissioner, duly approved, may avail the services of a Chartered Accountant or Cost Accountant to conduct a detailed examination of specific areas of operations of a registered person. Similar provisions exist under the income tax law as well.

**66.2 Analysis**

- (a) Availing the services of the expert be it a Chartered Accountant or Cost Accountant is permitted by this section only when the officer (considering the nature and complexity of the business and in the interest of revenue) is of the opinion that:
- value has not been correctly declared; or
  - credit availed is not within the normal limits.
- It would be interesting to know how these 'subjective' conclusions will be drawn and how the proper officers determine what is the normal limit of input credit availed.
- (b) An Assistant Commissioner who nurses an opinion on the above two aspects, after commencement and before completion of any scrutiny, enquiry, investigation or any other proceedings under the Act, may direct a registered person to get his books of accounts audited by an expert. Such direction is to be issued in accordance with the provision of Rule 102(1) in Form GST ADT-03
- (c) The Assistant Commissioner needs to obtain prior permission of the Commissioner to issue such direction to the taxable person
- (d) Identifying and appointing the expert is not left to the registered person whose audit is to be conducted but the expert is to be nominated by the Commissioner.
- (e) The Chartered Accountant or the Cost Accountant so appointed shall submit the audit report, mentioning the specified particulars therein, within a period of 90 days, to the Assistant Commissioner in accordance with provisions of rule 102(2) in Form GST ADT-04.



- (f) In the event of an application to the Assistant Commissioner by Chartered Accountant or the Cost Accountant or the registered person seeking an extension, or for any material or sufficient reason, the due date of submission of audit report may be extended by another 90 days.
- (g) Section 66(3) states that special audit may be initiated notwithstanding that the accounts of the registered person have been audited under any other provisions of this Act or any other law for the time being in force. While the report in respect of the special audit under this section is to be submitted directly to the Assistant Commissioner, the registered person is to be provided an opportunity of being heard in respect of any material gathered in the special audit which is proposed to be used in any proceedings under this Act. This provision does not appear to clearly state whether the registered person is entitled to receive a copy of the entire audit report or only extracts or merely inferences from the audit. However, the observance of the principles of natural justice in the proceedings arising from this audit would not fail the taxable person on this aspect.
- (h) The remuneration to the expert is to be determined and paid by the Commissioner whose decision will be final.
- (i) As in the case of audit under section 65, no demand of tax, even *ad interim*, is permitted on completion of the special audit under this section. In case any possible tax liability is identified during the audit, procedure under section 73 or 74 as the case may be is to be followed.

### 66.3 Comparative Review

#### ***Law relating to Central Excise***

- (a) Similar provision existed under the Central Excise law. Unduly large proportion of credit availed considering the nature of the industry is a reason for an audit. This could also be a reason for special audit under GST also. The availing or utilization of CENVAT credit by reason of fraud, collusion or any willful mis-statement or suppression of facts can also be the reason for issuing notice for special audit. Under GST law, no special audit will be directed for wrong utilization of the credit, but wrong availment alone without any reason of fraud, collusion or any willful mis-statement or suppression of facts is sufficient to issue notice for special audit.
- (b) Under Central Excise law, the permission is given by the Principal Chief Commissioner or the Chief Commissioner of Central Excise. Under GST Act, the said permission is to be given by the Commissioner.
- (c) Under Central Excise law, the period within which the Chartered Accountant or the Cost Accountant should submit the audit report is not specified but the maximum extended period within which the audit report should be submitted remains to be 180 days. Under CGST Act, the audit report shall normally be submitted within 90 days and the further extension could be for another 90 days.

**Law relating to Service Tax**

- (a) The authority to direct the special audit rests with the Principal Commissioner or the Commissioner.
- (b) The special audit may be initiated where person liable to pay service tax -
  - (i) has failed to declare or determine the value of taxable service correctly; or
  - (ii) has availed and utilized the CENVAT credit which is not within the normal limits or by means of fraud, collusion or any willful mis-statement or suppression of facts; or
  - (iii) has operations at multiple locations and true and complete picture of his accounts are not possible to get at his registered premises.
- (c) The special audit report shall be submitted within the period as may be specified by the Commissioner. The time limit of maximum 180 days is not applicable.
- (d) No provision exists regarding remuneration payable for the special audit, however, the same shall be paid by the Central Government

**66.4 FAQs**

Q1. Who can serve the notice for special audit?

Ans. An officer not below the rank of an Assistant Commissioner with prior approval of the Commissioner may serve notice for special audit, having regard to the nature and complexity of the case and the interest of the Revenue.

Q2. Under what circumstances notice for special audit shall be issued?

Ans. If the proper officer (not below the rank of Assistant Commissioner) is of the opinion that the value has not been correctly declared or credit availed is not within the normal limits, a special audit may be ordered.

Q3. Who will conduct the special audit?

Ans. A Chartered Accountant or a Cost Accountant as may be nominated by the Commissioner may undertake the audit.

Q4. What is the time limit to submit the audit report?

Ans. The auditor will have to submit the report within 90 days or the further extended period of 90 days.

Q5. Who will bear the cost of special audit?

Ans. The expenses for examination and audit including the remuneration payable to the auditor will be determined and borne by the Commissioner.

Q6. What action the tax authorities may take after the special audit?

Ans. Based on the findings / observations of the special audit, action can be initiated under section 73 or 74, as the case may be, of the CGST Act.