

(ANNEXURE – CE - III)

I. Documents required during Desk Review -

1. Annual report and Director's report
2. Profit and Loss Account
3. Balance Sheet
4. Cash flow statement
5. Notes to the Accounts
6. Trial Balance
7. Cost Audit Report
8. Manufacturing process chart
9. ER-4, ER-5 and ER-6 Returns
10. Tax audit report

I. Documents required during Desk Review -

Sr.No.	Name of the Record/Document	Relevance of the documents and checks to be done
1.	Annual Report & Director's Report	
		<p>The Annual Report prepared by a company <i>inter alia</i> contains the following:</p> <p>i) Director's Report (ii) Statutory Auditor's Report (iii) Balance sheet and Profit & Loss Account (iv) Financial statements of subsidiary companies, if any.</p> <p><u>Director's Report:</u> This gives information like overall financial results of the company, important happenings during the year and future plans of the company. Some of the important happenings like fire and loss of material in the company, details of new products launched, change in the marketing pattern etc. reported in the report may be useful to the auditor.</p> <p><u>Auditor's Report:</u> These may be reports of Statutory auditor or Internal auditor or C & AG Audit. In the case of statutory audit, a separate report under CARO (Companies Auditor's Report Order, 2003/2015) is required to be given.</p> <p><u>Nature of verification:</u> (i) The Auditor's Report should be studied to find out any qualified/adverse opinion given by the auditors which may have impact on Central Excise liability. For example, Auditor may report that finished goods stock were not reconciled between stock records and Central Excise records or provision for obsolete items have not been made during the year. Tax auditor may like to examine such opinion in detail.</p> <p>ii) CARO Report may be studied to find out whether the fixed assets records have been maintained properly or whether physical verification of raw material and finished goods was undertaken and whether any discrepancies were noticed on such verification or whether the company has maintained proper records for unserviceable or damaged goods or not.</p> <p>iii) CARO Report also shows disputed tax liabilities separately for Sales Tax, Customs, Central Excise and Income Tax. Cases booked under Sales Tax or Income Tax may be examined to find out any implication on Central Excise.</p> <p>iv) In the case of Public Sector unit, C & AG report and comment of the company available in the Annual Report should be examined.</p>
2.	Profit & Loss Account	
		<p><u>Nature of the Account:</u> The Profit and Loss Account shows major items of expenditure and income. This is one of the important documents used during desk review to find out the overall working of the unit. In the main body of the Profit & Loss Account, only major heads of expenditure and income are given and the constituents of these headings are given in a separate annexure. The said annexure should be studied in detail.</p> <p><u>Types of verification:</u></p> <p>(i) Scrutiny of sales: Sales may include sale of manufacturing goods, trading goods, parts and accessories, scrap and export. The trading sales may be verified in detail in order to find out whether CENVAT credit has been availed on such trading goods or whether these are similar to the goods manufactured and sold by the unit or whether these are essential parts of components or accessories of goods manufactured by the unit. Purchase and sales price of such trading goods may also be inquired into in order to rule out the possibility of overvaluing the trading goods in order to undervalue the manufactured goods, if these are supplied to same customers.</p>

	<p>(ii) Other incomes like sale of scrap, insurance claims receipt, profit on sale of fixed assets, commission received, erection and commissioning income, freight and insurance recovered etc. may be examined in detail to find out the exact nature of such incomes and whether these have any bearing on the valuation of the manufacturing goods or whether these are liable for Service tax.</p> <p>(iii) In the expenditure side, the account of raw material purchased or cost of material consumed should be examined in detail. For this purpose, the relevant ledger account may be scrutinized as discussed under the head General Ledger. Ratio of raw material consumption to sales may be worked.</p> <p>(iv) Along-with the Profit & Loss Account, quantitative details of the consumption of major raw materials is also required to be given as per the requirements of the Companies Act. Such quantitative details show the quantity of major raw material consumed and value thereof. Such information may be helpful in working out the input-out ratio. Notes given along with the said schedule should be studied carefully to find out cases of use of material for non-production activities.</p> <p>(v) The expenditure or income of the major heads should be compared with the previous year's amount in order to find out cases of major variations.</p>
3.	Balance Sheet
	<p><u>Nature of document :</u> Balance sheet is a statement of assets and liabilities of a unit on a particular day. The overall financial health of a company can be determined from the study of a Balance sheet.</p> <p><u>Types of verification</u></p> <p>(i) Study of schedule of Share Capital may reveal if the company is subsidiary company and in case the company is holding company, in that case, the name of subsidiary company will be disclosed in the Schedule of Investment. If there are sale/purchase transactions with the holding/subsidiary company, in that case, the valuation of such products needs to be examined in the light of Valuation Rules.</p> <p>(ii) Study of fixed assets schedule may show additions and deductions to the fixed assets during the year. For the deductions made during the year, verification may be made as to whether appropriate excise duty have been paid, if the Cenvat credit was availed in the past.</p>
4.	Notes to the Accounts
	<p>These notes are part of the Profit & Loss Account and Balance Sheet. These notes may be inserted by the company as per the requirement of the Companies Act or may be added at the instance of Statutory auditor. These notes are very important to a Tax auditor as these reveal important transactions or the important accounting policies followed by the unit.</p> <p><u>Nature of verification:</u></p> <p>(i) Notes of Significant Accounting Policies may be studied to find out the accounting policy in the areas like revenue recognition or determination of obsolete stock.</p> <p>(ii) Notes on quantitative information on consumption of major raw material, production of the finished goods and purchase and sale of trading goods may reveal number of interesting aspects and the input output ratio may also be studied. Cases of use of raw material for non production purposes may also be noticed from the study of such information. Adjustment for shortages, losses etc. may also be reported in the said information.</p> <p>(iii) Any important transaction/happening during the year like non-reconciliation of accounts of material lying with job worker, major expenditure on research and development, destruction of record and reconstruction of duplicate records may also be noticed from the study of such notes.</p> <p>(iv) As per the Accounting Standard issued by the Institute of Chartered Accountant of India, the specified companies are required to disclose transactions with the related parties under the Companies Act as part of the Notes to the Accounts. The said information gives all types of transactions like purchase, sales, payment made or payment received from various related parties by the Company. Such information is very useful to find out the details of the related parties and the type of transactions made by them. If necessary these transactions may be examined in detail. However, the related parties as per the Companies Act may not be considered as 'related person' under the Central Excise Law.</p>

5.	<p>Trial Balance</p>																																																																					
	<p><u>Nature of Document</u> :-</p> <p>Trial Balance is a statement showing balances of all accounts in the ledgers as on a particular date. In other words, it is a summary of the ledger account maintained by an assessee. The final accounts, namely, Profit & Loss account and Balance Sheet are prepared from the Trial Balance only. From the Trial Balance, similar accounts are grouped together and these are transferred to the Profit & Loss Account and Balance Sheet.</p> <p><u>Types of verification</u> :-</p> <p>i) Familiarization with account coding system and understanding the grouping of sub account under main accounts for the purpose of summarization into Profit & Loss Accounts and Balance Sheet.</p> <p>ii) Main purpose is to select the accounts for further scrutiny as a part of audit plan. Accounts which have a prima facie relevance for Excise duty payment or availment of CENVAT credit or payment of Service Tax need to be identified during Desk review. There might be some of the ledger accounts whose exact nature may not be clear on reading of Trial Balance and these accounts may also be identified for further inquiry during the further course of audit.</p> <p>iii) Unusual ledger accounts like Raw Material Loss Account or unusual income accounts may also be noticed in the Trial Balance. However, such accounts will not be reflected in the Profit & Loss Accounts as these accounts are adjusted against other accounts. Such account may be selected for finding of exact nature and detailed scrutiny.</p> <p>iv) Various income accounts (credit balances) available in the Trial Balance like Job Work Income Account, Erection and Commissioning Income Account, Commission Account, Recovery of Freight/Advertisement Charges Account Technical Consultation Income Account etc. should be selected to verify whether these income can be added to the assessable value for payment of Excise duty or whether these are liable for payment of Service Tax.</p> <p>v) Some of the expenditure accounts like Security Service Expenditure Account, Sales Commission Account, Advertisement Expenditure Account, Repairs and Maintenance Account, Royalty Account etc. should also be selected to find out whether Assessee has paid Service Tax or not.</p> <p style="text-align: center;">GROSS TRIAL BALANCE PREPARED ON TOTAL METHOD AS AT MARCH, 31,</p> <table border="1" data-bbox="277 1319 1358 1946"> <thead> <tr> <th style="text-align: center;">Heads of Account</th> <th style="text-align: center;">Dr. Total Rs.</th> <th style="text-align: center;">Cr. Total Rs.</th> </tr> </thead> <tbody> <tr><td>Purchases</td><td></td><td></td></tr> <tr><td>Stock (April, 1, 2007)</td><td></td><td></td></tr> <tr><td>Sales</td><td></td><td></td></tr> <tr><td>Sundry debtors</td><td></td><td></td></tr> <tr><td>Discount Received</td><td></td><td></td></tr> <tr><td>Carriage Outwards</td><td></td><td></td></tr> <tr><td>Cash in hand</td><td></td><td></td></tr> <tr><td>Machinery</td><td></td><td></td></tr> <tr><td>Provision for depreciation</td><td></td><td></td></tr> <tr><td>Drawings</td><td></td><td></td></tr> <tr><td>Return inwards</td><td></td><td></td></tr> <tr><td>Premises</td><td></td><td></td></tr> <tr><td>Sundry Creditors</td><td></td><td></td></tr> <tr><td>Discount allowed</td><td></td><td></td></tr> <tr><td>Carriage inwards</td><td></td><td></td></tr> <tr><td>Cash at Bank</td><td></td><td></td></tr> <tr><td>General Expenses</td><td></td><td></td></tr> <tr><td>Packing Expenses</td><td></td><td></td></tr> <tr><td>Bad debts written off</td><td></td><td></td></tr> <tr><td>Provision for Doubtful debts</td><td></td><td></td></tr> <tr><td>Capital</td><td></td><td></td></tr> <tr><td>Total</td><td></td><td></td></tr> </tbody> </table>	Heads of Account	Dr. Total Rs.	Cr. Total Rs.	Purchases			Stock (April, 1, 2007)			Sales			Sundry debtors			Discount Received			Carriage Outwards			Cash in hand			Machinery			Provision for depreciation			Drawings			Return inwards			Premises			Sundry Creditors			Discount allowed			Carriage inwards			Cash at Bank			General Expenses			Packing Expenses			Bad debts written off			Provision for Doubtful debts			Capital			Total		
Heads of Account	Dr. Total Rs.	Cr. Total Rs.																																																																				
Purchases																																																																						
Stock (April, 1, 2007)																																																																						
Sales																																																																						
Sundry debtors																																																																						
Discount Received																																																																						
Carriage Outwards																																																																						
Cash in hand																																																																						
Machinery																																																																						
Provision for depreciation																																																																						
Drawings																																																																						
Return inwards																																																																						
Premises																																																																						
Sundry Creditors																																																																						
Discount allowed																																																																						
Carriage inwards																																																																						
Cash at Bank																																																																						
General Expenses																																																																						
Packing Expenses																																																																						
Bad debts written off																																																																						
Provision for Doubtful debts																																																																						
Capital																																																																						
Total																																																																						
6.	<p>Cost Audit Report</p>																																																																					
	<p>Cost Audit Report provides quantitative and financial details regarding production,</p>																																																																					

clearance, capacity utilization, input-output ratio, related party transaction, valuation of production along with reconciliation of annual turnover with assessable value of excise product as per excise return.

The Cost Auditor in his report gives the information/details on the cost data for the company as whole as well as in the respect of each plant/unit of the company located at different locations, thus study of the report helps the audit officer in comparison of various information/details across the plants and units. The details of relevant paras useful for Central Excise Audit are given in the table below:

In case an assessee is not covered under the cost audit, the Audit Officer may examine the Cost Accounting records maintained by them on the lines of Cost Audit Report.

The auditor may examine the following aspects from the Cost Audit report.

S. No. in Annexure to the Cost Audit Report and subject	What is to be seen
1 & 3 - General Information	Auditors may use this information at time of Desk Review.
4 - Quantitative details	It contains details of : <ul style="list-style-type: none"> • Installed Capacity • Capacity enhanced during the period • Total production for self, under lease, on loan licence, by third parties on job-work. • Total available quantity • Samples/ Quantity Captively consumed. • Quantity sold with break-up of Export & domestic clearance Auditors should reconcile this data with Excise Return and major variation (if noticed) should be looked into.
5 - Cost Statements/ Cost of production statement	Separate cost statements would be available in respect of each product/ activity group. Auditors may utilise the same for valuation aspects. It also helps to compute assessable value under cost Construction method in terms of Cost Accounting Standard-4, for determining assessable value under captive consumption, related party transaction (Rule 9 provision) etc.
5 - Royalty & Technical Know-how Charges	As the information contain is product wise, the auditor may find it useful in determining the tax liability of the assessee under reverse charge mechanism if any in case the same was paid to foreign entities. Moreover, auditor may go through the source documents about the scope of work and terms of payment to assess the tax-compliance aspect of service tax on Royalty & Technical Know-how.
6 - Operating ratio analysis.	Auditors may use the same for comparison of operating costs of each product/ group, over a period of time.
10 - Related party transactions.	Auditors may use this information with regard to valuation of related party transactions.

7. Manufacturing process chart

Types of Verification :-

- i) Study the process chart to find out whether intermediate/by-product arises attracting Excise duty, specifically in case where final product is exempted.
- ii) It is useful in determination of classification and availment of exemption.

8	ER-4, ER-5 & ER-6 Return	
	<p>Nature of Documents</p> <p>Compare the figures with Profit & Loss A/c. to ensure that information provided in the ER-5 Return matches with financial records.</p> <p>ER-5 return and ER-6 returns are filed by the assessee paying annual revenue of Rs.1 Crore and above and manufacturing specified commodities. ER-5 is an Annual Return in which assessee is required to provide input-output norms for the major finished goods manufactured by them. ER-6 return is filed on monthly basis providing details like opening balance, quantity consumed, cleared as such and quantity of finished goods manufactured. Details of waste and scrap arising during manufacture and cleared/destroyed is also given in the said return.</p> <p>Types of Verification</p> <ol style="list-style-type: none"> 1) Compare the norms of consumption of inputs as mentioned in the ER-5 with the norms given in the Standard Input-Output Norms (SION) published by the DGFT for different Export Product group as part of the Foreign Trade Policy. 2) Compare the input-output ratio as provided in ER-5 with the input-output ratio worked out as per ER-6. If the consumption of input as per ER-6 is more, as compared to the quantity determined as per ER-5, same needs to be examined during verification. 3) The Notes to the Account annexed to the Balance Sheet and Profit & Loss Account provides quantitative details of consumption of principal raw materials, quantity of major finished goods produced, quantity of input sold as such etc. The auditor should compare the said figure with figures available in ER-5. 4) Compare the Input-Output Norms of the Assessee as given in ER-5 with the other assessees, if any in the Commissionerate manufacturing same products. 5) Study quantity of waste and scrap cleared as percentage of total production with the other units manufacturing similar goods. <p>ER-4 returns are filed by all the assessees excepting those units who had paid less than Rs. One Crore during the previous year, ordinance factory and Biri units. (Refer Notification No. 17/2006-CE (NT) dated 01.08.2006 as amended and Notification No. 26/2009-CE (NT) dated 18.11.2009. The information contained in ER-4 return is to be verified in detail.</p> <p>List of items to be examined in the ER-4 return filed by the assessee with the details available in Profit & Loss Account, Balance Sheet and ER-1 returns filed by the assessee.</p>	
	Ref. No. and particulars sought for	Purpose
	3(i)(a) to (c) [ER-4] - Details of expenditure	To compute the ratio of value of Cenvatable purchase to Gross sales of excisable goods and to match it with the ratio of CENVAT to Cash duty.
	3(ii)(a) & (b) [ER-4] - Item-wise value and quantity of major raw material consumed	(i) Computation of physical input-output ratio. (ii) Co-relation with CENVAT availment. (iii) Computation of unit value of raw material for checking value addition.
	3(iii)(a) to (h) [ER-4] - Details of other expenditure Total Freight/Advertisement/ Sales Promotion Commission paid for sales of manufactured goods/R & D Expenditure/ Wages/Power & Fuel and other expenses (other than (a) to (g) above	To calculate ratio of individual items of expenditure to Gross sales Value to find out possibility of unaccounted sales (e.g. where electricity charges are accounted for in the books but goods produced are removed without accounting for, on comparing the ratio of similar units, variation in ratio may show such cases. The said ratio coupled with trend of freight outward to sale value ratio may also indicate same trend). Also it indicates whether any taxable service received for taking action against service provider.

	3(iv)(a) to (c) [ER-4] – Details of goods manufactured from Job worker	To co-relate with valuation and verify whether CENVAT credit provisions are complied with	
	4(i) - Total Sales value (Gross)	Used in determining all the ratios and derive the value of excise duty payable and match with duty payment in the tax return	
	4(ii) - Item-wise value and quantity of major finished goods sold	(i) Computation of unit value of finished products for checking value addition. (ii) Computation of physical input output ratio	
	iii) - Details of trading activity (other than trading of inputs on CENVAT Credit availed and removed as such)	(i) To calculate ratio of Trading Sales Value to gross sales value (chances of clearance of manufactured goods in the guise of trading goods & clearances of credit availed goods as Trading goods) (ii) To ascertain the trend in profit margin of trading goods vis-à-vis goods manufactured by the assessee.	
	4(iv) - Sales value of Non excisable / exempted goods	To calculate ratio of value of exempted goods to gross sales value.	
	4(v) & (vi) - Value of goods exported under Bond and/or under rebate	To derive value of dutiable sales and compare with value shown in tax return.	
	4(vii) - Total value of scrap sales	To calculate ratio of scrap sales value to gross sales value.	
	4(viii) - Value of inputs on which CENVAT credit availed and cleared as such.	To facilitate scrutiny of CENVAT availment during audit i.e. whether appropriate duty payment made.	
	4(ix) - Total Sales Tax paid	To calculate ratio of Sales Tax to Excise duty.	
	4(x) - Details of other incomes as per Profit & Loss A/c	Whether individual elements of other income form part of valuation of goods. Whether appropriate ST has been discharged on' each of the elements under specified service tax category.	
	4(xi) - Total "Other income" as per Profit & Loss A/c.	To calculate ratio of other income to total sales value. To validate the information Given in 4(x)	
	4(xii) (a) to (d) - The information on Job Work carried out Whether own raw material/inputs used in manufacture of job work goods. Job Work goods cleared on payment of duty. Total amount of job work received during the financial year.	To ascertain whether Job Work is relevant as a source of risk. To co-relate with valuation and availment of CENVAT credit on inputs. To co-relate with valuation and to study trends in job work income vis-à-vis total sales value.	
	5 - CENVAT Credit details	To co-relate with actual availment of CENVAT credit and to calculate ratio of CENVAT credit availment to total duty payment. The availment and utilization of taxable input service credit would indicate cross sectoral service tax credit trend.	
9	Scrutiny of the Tax Audit Report		
	<ul style="list-style-type: none"> i. Clause 18 of the Tax Audit Report 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. ii. Clause 27(a) of the Tax Audit report 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. iii. Clause 21(b) of the Tax Audit Report 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. iv. Clause 38 of the Tax Audit Report provides the information relating to Cost Audit. If such an audit has been carried out, the Auditor should examine the Cost Audit Report. v. Clause 40 of the Tax Audit Report provides the important accounting ratios. 		