

# Reading of Financial Statements under Indirect Taxes

**CA Akshay M Hiregange**  
**CA Madhukar N Hiregange**

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## **Introduction**

With the removal of CA/CMA mandatory external audits under GST and the beginning of GST departmental audits, it is important that a chartered accountant can support the client during their self-certification of the GSTR 9C. This increases the risk of completeness and accuracy of details filed by the entity and burdens top management. Being aware of the various issues/clarifications that can be obtained by reading the Audited Financial Statements (AFS) is an important tool presently. In this article, we aim to provide some insights on important areas to focus upon, areas not having a bearing under indirect taxes and value additive indicators.

## ***Utility of reading AFS correctly***

1. Integral part of 'Desk Review' function - informed about client and industry before first meet.
2. Indicators to verify indirect tax compliance/non-compliance
3. Clarification on queries without disturbing the client
4. Indicators of areas that need to be considered outside of AFS
5. Enhanced services during GST reviews, GSTR 1, 3B, 9 & 9C filing assistance.

### Useful tips on reading AFS:

- Notes to Accounts may be used to understand related party transaction and details against information provided in Balance sheet and Profit & Loss.
- Opinion of auditor - sometimes, qualifications are made in dire circumstances w.r.t going concern, non-compliance of major statutory provisions. Basis of Opinion, Emphasis of Matter helps identify other important issues.
- Director's report - summarized performance, changes in nature of business, capital expenditure details, remuneration to non-executive/independent directors, etc. gives concise IDT indications.

## ***AFS Areas not having IDT Impact***

- |                                                                          |                                                                        |
|--------------------------------------------------------------------------|------------------------------------------------------------------------|
| 1. Reserves & Surplus                                                    | 2. Bad debts written off/back                                          |
| 3. Interest Income (borrowings) (although exempt supply no ITC reversal) | 4. Provisions against expenses (other than associated enterprises-RCM) |
| 5. Finance costs                                                         | 6. Other statutory dues payable (other than RCM possibility)           |
| 7. Loans & Advances (assets)                                             | 8. Cash flow statements/balances                                       |
| 9. Depreciation & Amortization (ITC not be availed on depreciation)      | 10. Forex gain/loss                                                    |
| 11. Majority of employee benefits                                        | 12. Change in inventory                                                |
| 13. Deferred tax                                                         | 14. Earnings per Share                                                 |

# Indicators from Balance Sheet (BS) with Notes

<b>Balance sheet &amp; Notes</b>	<b>GST Impact</b>
<b>Share holding</b>	GST liability & ITC impact w.r.t merger/de-merger/transfer; Registration in portal - Amend & Signing (change in signatory)
<b>Gratuity</b>	ITC eligible on gratuity insurance as it is not life/health insurance
<b>Govt. Grants</b>	Other than CG/SG, consideration received in form of grants/subsidy would be liable under GST. (Ex: NGOs/ NPOs)
<b>Trade payables</b>	Rule 37 - 180 days ITC reversal provision can be verified. ITC to be reversed and re-claimed upon payment. <i>Note: Rule not applicable w.r.t Retention money unpaid.</i>
<b>Current liabilities</b>	GST not applicable on mobilization advance. GST applicable on advance against services only (not goods)
<b>Property, Plant &amp; Equipment</b>	1. Land & Buildings: Additions - GST eligible on ancillary; Deletions - ITC reversal (common credits) 2. Plant & Machinery (others): Additions - ITC eligibility incl. civil structures/construction; Deletions - Section 18(6) 3. Motor Vehicles: Additions - ITC eligibility check; Deletions - Margin method/full rate liability. <i>Note: Rule 43 - ITC reversal w.r.t Capital Goods used for taxable + exempt supply. (Computational challenge)</i>
<b>Intangible assets</b>	Cross charge implications if multiple GSTINs. <i>Absence of asset/expense may indicate related party transaction.</i>
<b>Trade Receivables</b>	Decision to raise credit note before September month GSTR3B due date following the financial year (only due to deficiencies) <i>Note: Option of Refund against write-off of non-receivables - Payment from customer and valuation can be said to be linked, and if payment fails, levy fails. (disputable)</i>
<b>Inventories</b>	1. Imports: Possible Customs/FTP benefits to be explored 2. Related party purchase: Valuation check 3. Write-off/disposals: Raw material - ITC reversal, semi/FG - ITC eligible ( <i>as used in business - disputable</i> ) 4. Scrap/Further supply: Classification & Rate applicability 5. Loss: ITC reversal may be required for abnormal loss only
<b>GST dues &amp; Balance with govt. authorities</b>	1. Indicates - interest & possible SCN/demand on past dues 2. Identify - Status, accumulation reason & re-claim to bank 3. Credit & cash balance - books vs GST portal

**Balance sheet & Notes**

**GST Impact**

**Other current assets**

1. Type of incentives (Ex: MEIS, CER, etc.), possible GST on scrip/security sale
2. Time of supply implication (Accounting standards vs GST)

## **Indicators from Profit & Loss (PL) with Notes**

**Profit and Loss & Notes**

**GST Impact**

**Revenue from operations (goods/services)**

1. Levy, valuation, classification, Time & Place of Supply verification
2. Exempt supplies/certain Sch III items - ITC reversal impact

*Other indicators: E-invoice compliance/PLI scheme/State incentives*

**Other Income (identify goods/services only)**

Levy, valuation, classification, Time & Place of Supply verification

*Indicates - Non-GST supplies/Sch III items for GSTR 9 disclosure.*

**Segment reporting**

1. SEIS, MEIS/RODTEP benefits realized against exports.
2. Imports - FTA between countries, CEPA and can also be explored.

**Employee benefit expenses**

1. Sch III no GST. (incl. ex-pat salary)
2. ITC eligibility to be verified (ex: insurances, necessity goods like water, medicine, gifts, recreational/business trip, etc.)

**Conveyance**

1. Women employee travel beyond 8:30 pm - statutory obligation - ITC eligible (Ex: in Karnataka)
2. 13-seater + vehicles - ITC eligible
3. Goods vehicle - ITC eligible
4. Reimbursements GTA/rent-a-cab - RCM liability

**Power & fuel**

Table 5 GSTR 3B - inward - exempt & non-GST supply disclosure

<b>Profit and Loss &amp; Notes</b>	<b>GST Impact</b>
<b>Freight</b>	<ol style="list-style-type: none"> <li>1. GTA (agency) vs GTO (operator - exempt and not under RCM)</li> <li>2. FCM vs RCM (5% vendor beneficial if credit ineligible)</li> </ol>
<b>Rent</b>	<ol style="list-style-type: none"> <li>1. ITC eligibility (different state billing - ineligible)</li> <li>2. Residential - exempt - even if recovered from employees</li> </ol>
<b>Repairs &amp; Maintenance/Building expenses</b>	<ol style="list-style-type: none"> <li>1. Motor Vehicle: Depends on vehicle eligibility</li> <li>2. Premises: Eligible when it is an expenses</li> <li>3. Plant &amp; Machinery: Eligible</li> </ol>
<b>Communication costs &amp; Bank charges</b>	ITC eligible but GSTIN missed in Tax Invoices - Internet, Telephone, bank charges (tax invoice not just statements.)
<b>Food &amp; Beverages (F&amp;B)</b>	<p>Canteen - mandatory - ITC eligible as per Factories Act/Rules.</p> <p>Water - ITC eligible (it is not 'beverage')</p> <p>Others F&amp;B - ITC ineligible</p>
<b>Professional fee</b>	<ol style="list-style-type: none"> <li>1. ITC eligibility</li> <li>2. Possible RCM on import of services</li> </ol>
<b>Legal fee</b>	<ol style="list-style-type: none"> <li>1. RCM &amp; ITC</li> <li>2. Non-advocates/non-legal activity considered under this head for RCM incorrectly.</li> </ol>
<b>Rates &amp; Taxes; Subscriptions</b>	<ol style="list-style-type: none"> <li>1. RCM on CG/SG/LA services not being exempt (ex: Leased line license from Ministry of Telecom). Verification of 'supplier' not being governmental authority/entity and transaction if liable/exempt as per rate notifications.</li> <li>2. Subscriptions - Import of services - Form 27Q/Credit card forex payments</li> </ol>
<b>CSR</b>	<p>Possibility to claim ITC subject to general ineligibility. (disputable)</p> <p><i>Helps increase social expenses, positive for India.</i></p>
<b>Other common costs (Ex: IT Costs)</b>	Requirement of ISD to transfer credit to GSTINs utilizing such services. (multiple GSTINs)
<b>Profit/Loss of sale of FA</b>	<ol style="list-style-type: none"> <li>1. Motor Vehicle: Margin/full value liability</li> <li>2. Section 18(6) - 5% per quarter reduction requirement.</li> <li>3. WDV block concept can be adopted instead of date of sale.</li> </ol> <p><i>Generally, a reconciliation item for GSTR 9C Vs AFS.</i></p>
<b>Related Party disclosures</b>	<ol style="list-style-type: none"> <li>1. Classification of goods/services</li> <li>2. Valuation supply-wise</li> <li>3. ITC eligibility</li> </ol>
<b>RPT - Directors</b>	RCM liable on directors sitting fees/any other services rendered in the capacity of director.
<b>Advertisement, Sales promotion expenses</b>	<ol style="list-style-type: none"> <li>1. RCM on sponsorship</li> <li>2. ITC eligibility on sales promotion</li> </ol>

## Other Inferences & Areas outside AFS

Few important areas being part of the Notes to Accounts but not part of BS / PL is:

- Globally accepted HSN code for business conducted
- Annexure IV import of service details
- Key concerns from management's report
- CARO Report - to identify consideration in kind.
- Requirement of registration under Acts - possible RCM liability
- **Foreign currency transactions** - Indicates:
  - Possible RCM liability on Import of services (obtain Form 27Q for verification).
  - ITC eligibility against Import of Goods & RCM payments
  - Refund issues due to non-receipt of forex (FIRC/e-BRC)
  - FTP & Customs benefits on outward forex. (Exemptions, SEIS, RoDTEP, MOOWR)
- **Contingent Liability** - Indicates:
  - Possible liability which may have GST impact when transaction is with related party (ex: corporate guarantee)
  - Disputed payments which may be liable under RCM (ex: Govt./related expenses)
- **Pending Disputes** - Indicates:
  - Areas of contention, and ability to provide an independent view on the dispute under indirect taxes - Reason for dispute, value, status can be identified.
- **Other areas outside AFS**
  - RCM on purchases from unregistered persons (Jul - Oct 2017)
  - ITC on import of goods received free of cost (Delivered Duty Paid)
  - Refund eligibility on Exports without receipt of forex. (Ex: Samples)
- Absence of certain common expenses or incomes may indicate possible GST/RCM liability, different accounting practices followed too.

## Conclusion

The self-certification of Form 9C by the taxpayer would need the ability to identify issues and provide solutions. In the process of doing so, value addition is also possible. Interpreting and analyzing a Financial Statement keeping in mind GST, Customs, FTP rules and regulations, helps to also focus on critical areas, reduces costs & client interaction and therefore results in overall client satisfaction. This article would be useful for qualified professionals, assistants and articles engaged in GST compliance.

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Suggestions or feedback can be sent to [madhukar@hiregange.com](mailto:madhukar@hiregange.com) or [akshay@hiregange.com](mailto:akshay@hiregange.com)



### **Bengaluru (HO)**

Hiregange & Associates  
1010, 2nd Floor (Above Union Bank)  
26th Main, 4th "T" Block, Jayanagar  
Bengaluru - 560 041  
Phone: 080-26536404/05 / 080-41210703 /  
9611598140  
E-mail: [madhukar@hiregange.com](mailto:madhukar@hiregange.com)

### **Hyderabad**

4th Floor, West Block, Srida Anushka  
Pride,  
Beside SBI Bank, Road Number 12,  
Banjara Hills,  
Hyderabad, Telangana - 500034  
Phone: 040-23318128 / 9908113795  
E-mail: [sudhir@hiregange.com](mailto:sudhir@hiregange.com)

### **NCR (Gurgaon)**

202-203, Vipul Trade Centre,  
Sector 48, Sohna Road,  
Gurugram, Haryana - 122 009  
Phone: 8510950400  
E-mail: [ashish@hiregange.com](mailto:ashish@hiregange.com)

## **Mumbai**

409, Filix, Opp. Asian Paints,  
LBS Marg, Bhandup West,  
Mumbai - 400 078  
Phone: 91-9867307715  
E-mail: [vasant.bhat@hiregange.com](mailto:vasant.bhat@hiregange.com)

## **Chennai**

Fagun Chambers, Third Floor,  
No.26 Ethiraj Salai, Egmore,  
Chennai - 600 008.  
Phone: 9962508380 / 044-48580801  
E-Mail: [vikram@hiregange.com](mailto:vikram@hiregange.com)

## **Visakhapatnam**

Flat No. 101, D. No. 9-19/18  
Sai Sri Kesav Vihar, Behind Gothi  
Sons Show room, CBM Compound  
Visakhapatnam - 530 003.  
Phone: 91-9989604111  
E-mail: [anil@hiregange.com](mailto:anil@hiregange.com)

## **Guwahati**

2A, 2nd floor, Royal Silver Tower,  
Near HomeTown Lachitnagar Main  
Road,  
Ulubari, Guwahati - 781007  
Phone: 91-7670087000  
E-Mail: [mannu@hiregange.com](mailto:mannu@hiregange.com)

## **Pune**

Rajyog Creations Apartment,  
Flat No. 5, IV Floor, Anand Park,  
Above HDFC Bank, Aundh,  
Pune - 411 007.  
Phone: 7680000205 / 020-41202013  
E-Mail: [ravikumar@hiregange.com](mailto:ravikumar@hiregange.com)

## **Noida**

Skybox Business Center,  
Office No. B2 Basement C-22,  
C Block, Sector 65, Noida (UP)  
Phone: 012-44634496 / 8510950400  
E-mail: [ashish@hiregange.com](mailto:ashish@hiregange.com)