Receipts Audit and Understanding Financial Statements & its impact on Corporation /Income Tax

CA Rajkumar S Adukia

B.Com (Hons), FCA, ACS, ACWA, LLB, DIPR, DLL &LP, IFRS(UK), MBA

email id: rajkumarradukia@caaa.in

Mob: 09820061049/09323061049

To receive regular updates kindly send test email to : rajkumarfca-subscribe@yahoogroups.com & rajkumarfca+subscribe@googlegroups.com

Receipt Audit by CAG

3 wings assist the CAG in overseeing the audit of receipts.

- The Direct Taxes of the Union,
- The Indirect Taxes of the Union and
- The State Receipts

Audit of Non Tax Receipts

Audit of non-tax receipts of the Union government - is overseen by the wing which is in charge of **direction and control of audit of union government's civil expenditure**

Receipt Audit

- Receipt audit is about obtaining evidence that revenue is assessed and collected according to law
- That errors of omission and commission are avoided in assessment.
- Obtain assurance that pre and post control systems operate efficiently
- In accordance with the stated objectives in the sovereign and subordinate legislation

Receipt Audit

- To identify the lacunae in acts/rules that leads to non-fulfillment of stated fiscal objectives of the government
- Suggesting remedies to overcome the legal infirmities
- Checking the collection and accounting system of the Government revenues
- Assuring there is adequate internal control system that provide for secure regular accounting of collection, allocation and credit of the collection to the Government.

Conduct of Receipt Audit

Receipt Audit is conducted with reference to the basic records maintained by the tax offices and the revenue departments.

Pattern of Receipt Audit

- It is cyclical and
- Closely follows the assessment cycles adopted by the assessment officers
- Most fiscal laws have built in provision regarding time limit for rectification of mistakes and reassessments

Modus Operandi

- Examination of Administrative orders/notifications issued by the revenue departments
- Controversial law points often arise in India due to (i) difference with the revenue administration regarding interpretation of law and (ii) contradictory judgements by different High Courts of different States on the same point of law in Individual Assessment Cases

Modus Operandi

- Cases of disagreement between Audit and the revenue department in interpretation of a law point or the application of the correct law, tripartite meetings are held with the Ministry of Law or the cases are referred to the Attorney General.
- Attorney General's opinion is taken as the final advice in matters of law

Understanding Financial Statements

Methods of Accounting

There are 2 accounting methods

- **Cash Method of Accounting**
  - Revenue recognition: Revenue is recognized when cash is received.
  - Expense recognition: Expense is recognized when cash is paid
- **Accrual Method of Accounting**
  - Revenue Recognized: Revenue is recognized when both of the following conditions are met:
    a. Revenue is earned.
    b. Revenue is realized or realizable.
  - Expense Recognized: Expense is recognized in the period in which related revenue is recognized

Financial (Accounting) Statements

- There are two main purposes of financial statements:

(1) To report on the financial position of an entity (e.g. a business, an organisation);

(2) To show how the entity has performed (financially) over a particular period of time (an "accounting period").

Financial Statements

- The Balance Sheet
- The Profit and Loss Account
- Statement of Cash Flows

Finalization of Accounts

1. Refers to the preparation of Profit and Loss Account and the Balance sheet as per the Legislative Framework.
2. Adjusting Entries are to be passed.
3. The revised Trial Balance is generated.
4. Financial Statements are prepared.
5. Relevance of Accrual Concept, Matching Concept, Accounting Period Concept, Conservatism Concept at the time of finalization.

Balance Sheet

- **Assets = Liabilities + Stockholders' Equity**
- The balance sheet states what the firm owns and how it is financed.

Things to Remember – B/S

- When analyzing a balance sheet, the financial manager should be aware of three concerns:-

  1- Accounting Liquidity

  2- Debt versus Equity

  3- Value versus Cost

Income Statement

- **Revenue – Expenses = Income**
- The income statement measures performance over a specific period of time, say, a year.

Things to Remember – P&L

- When analyzing an income statement, the financial manager should keep in mind the followings:-

1- GAAP

2- Noncash items

3- Time and Costs

Statement of Cash Flow

Uses of Fund

- Assets - ↑
- Liabilities and Stock Holder's Equity - ↓

Sources of Fund

- Assets - ↓
- Liabilities and Stock Holder's Equity - ↑

Components of Cash Flow Statement

3 components of Cash Flow Statement

1- Cash flow from Operating Activities

2- Cash flow from Investing Activities

3- Cash flow from Financing Activities

Relevance of Financial Statements

Relevance of Financial Statements

- Financial Statements are generally relevant to
  - principal stakeholders of a company (shareholder’s)
  - tax authorities
  - banks
  - regulators
  - suppliers
  - customers and
  - employees

Government Entities

- Government entities (**esp tax authorities**) need financial statements to ascertain
  - The propriety and
  - The accuracy of taxes and other duties declared and paid by a company

Audit of Companies

- An audit of the financial statements of a public company is usually required for
  - Investment,
  - Financing and
  - Tax purposes

Impact of Financial Statements on Corporation/Income Tax

Income Taxes

- Income taxes are essential in tax collection schemes around the world
- The calculation and determination of deferred taxes are crucial in decision making
- Deferred taxes make it possible to assess the impact income taxes have on companies

Deferred Tax Liability

- A deferred tax liability or asset represents the increase or decrease in taxes payable or refundable in future years as a result of temporary differences and carry forwards at the end of the current year
- It is an incremental concept

Deferred Tax Liability

Deferred Tax Liability is the difference between the following two measurements:

a. The amount of taxes that will be payable or refundable in future years inclusive of reversing temporary differences and carry forwards

b. The amount of taxes that would be payable or refundable in future years exclusive of reversing temporary differences and carry forwards.

Accounting for Income Tax

There are two primary objectives related to accounting for income taxes:

a. To recognize the amount of taxes payable or refundable for the current year

b. To recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity’s financial statements or tax returns.

Measurement of Current and Deferred Income Tax

The following basic requirements are applied to the measurement of current and deferred income taxes at the date of the financial statements:

a. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated.

b. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

Calculation of Taxes

- Deferred taxes calculation supplements to an extent, the proper determination of the current income tax.
- Inaccurate determination of taxes (deferred tax) may lead to decisions not in line with business reality

Difficulties in Determination of Income Taxes

Delayed Tax Computations

- Large number of organizations have difficulties delaying both
  - Preparation of Financial Statements and
  - Determination of Taxes

Reason for Delay/Inaccuracy

The difficulties in calculations mainly lie in the identification of components, most of which stem from

- Domestic Adjustments
- Consolidation with Foreign Parent Companies
- Compliance with specific Financial Reporting Guidelines (namely Indian Accounting Standards and IFRS)

Resultant Impact

- Complications involved lead to either
  - untimely filing of returns or
  - inaccuracies in the calculations

which also result in additional cost to the companies

Measures taken by Organizations

It becomes important for organizations to concentrate on two important processes namely

- Current and Deferred Tax Preparation Process
- Tax Reporting Process

About the Author

- *CA. Rajkumar S Adukia is an eminent business consultant, academician, writer, and speaker. He is the senior partner of Adukia & Associates.*

- *In addition to being a Chartered Accountant, Company Secretary, Cost Accountant, MBA, Dip IFR (UK), Mr. Adukia also holds a Degree in Law and Diploma in Labor Laws and IPR.*

- *Mr. Adukia, a rank holder from Bombay University completed the Chartered Accountancy examination with 1st Rank in Inter CA & 6th Rank in Final CA, and 3rd Rank in Final Cost Accountancy Course in 1983.*

- *He started his practice as a Chartered Accountant on 1st July 1983, in the three decades following which he left no stone unturned, be it academic expertise or professional development.*

About the Author

- *He has been coordinating with various Professional Institutions, Associations, Universities, University Grants Commission and other Educational Institutions.*
- *Authored more than 50 books on a vast range of topics including Internal Audit, Bank Audit, SEZ, CARO, PMLA, Anti-dumping, Income Tax Search, Survey and Seizure, IFRS, LLP, Labour Laws, Real estate, ERM, Inbound and Outbound Investments, Green Audit etc.*
- *The author can be reached at* ***rajkumarradukia@caaa.in***

  Mob – 09820061049 / 09323061049
- *For more details log on to www.caaa.in*

Thank You