



**NANGIA & CO LLP**  
CHARTERED ACCOUNTANTS

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## Foreword

We are delighted to bring to you Assurance Gazette – August 2023. This Gazette provides you with insights into key announcements released by regulatory authorities – NFRA & ICAI in the last month that are extremely relevant for the Companies and the professional firms from a financial reporting and auditing perspective.

As part of the publication, we have explained in detail the order issued by NFRA indicating gross financial irregularities observed by Financial Reporting Review Board (FRRB) of ICAI in the financial statements of FY 2013-15 of a listed Company that will act as a guidance for the professionals/ professional firms to maintain proper audit file, to comply with applicable accounting standards while doing the audit and to give true and fair opinion in their audit report.

Further, we wish to bring to our reader's attention the recent release by ICAI "Exposure Draft on Guidance Note on Tax Audit" providing certain clarity on missing points in the last guidance note and Direct Taxes Committee (DTC) of ICAI has requested the comments on this exposure draft. By soliciting public feedback and incorporating industry insights, this draft ensures that the final guidance note aligns with real-world challenges. This iterative approach not only enhances the effectiveness of tax audits but also fosters a collaborative framework for accurate financial reporting and robust tax compliance. Until the exposure draft is final, guidance note issued last year will be effective for AY 2023-24 and subsequent years.

We aim to provide you always with the timely information on recent accounting and auditing related updates in a lucid manner. Hope you will find it useful and informative. Wishing your health and happiness!!

We would be delighted to receive feedback/ suggestions from you on any topic that you wish us to cover in our forthcoming publications.





## Enhancing Tax Compliance and Reporting: Analysis of ICAI's Exposure Draft on Guidance Note on Tax Audit under Section 44AB of the Income-tax Act, 1961 for AY 2023-2024

### Introduction:

In the realm of taxation, accuracy and transparency are paramount for both taxpayers and authorities. To achieve this, tax audit plays a crucial role in scrutinizing financial records and ensuring compliance with tax laws. In India, tax audits are governed by Section 44AB of the Income Tax Act, 1961, and the Institute of Chartered Accountants of India (ICAI) issues guidance notes to provide clarity on the auditing procedures.

Since the publication of the last issue of guidance note in the year 2014, the formats of tax audit reports have undergone significant changes, thereby expanding the scope of reporting and verification by our chartered accountants. Considering the need of updating the knowledge and enhancing the professional competencies of the members of our fraternity, the Direct Taxes Committee of the Institute of Chartered Accountants of India has come out with the Eight edition of Guidance Note in 2022 effective for AY 2022-23 and subsequent years.

In pursuit of continuous improvement and providing certain clarity on missing points in last guidance note, ICAI has issued an Exposure Draft of the Guidance Note and Direct Taxes Committee (DTC) of ICAI has requested the comments on this Exposure Draft.

This article aims to highlight the impact of these updates on tax compliance and reporting as updated in Exposure Draft for AY 2023-24 and last released guidance note for AY 2022-23.

### Impact of Exposure Draft on Guidance Note for AY 2023-2024:

To mitigate the hardships faced by tax auditors/entities and to provide more clarification, some of the changes are proposed in exposure draft which were likely to have a considerable impact on tax audits:

- **Clause 16(c):** An item of income might be subject to taxation under a certain section, for example, section 145B (related to enhanced compensation) might also require reporting under clause 16(c). If so, the tax auditor may disclose pertinent information in the observation para of the audit report without disclosing the amount in this section of Form No. 3CD.

- **Clause 17:** Since the second proviso to sub-section (1) of section 43CA which deals with “Special provision for full value of consideration for transfer of assets other than capital assets in certain cases” is not applicable for the audit of AY 2023-24, so ideally in all cases, the reporting shall be 'No' in this clause.
- **Clause 18:** Due to introduction of new section 115BAE of Income Tax Act, 1961 by Finance Minister in Budget 2023 for FY 2023-24 (AY 2024-25), assessee being a specified co-operative society opting for payment of income-tax under that section, claim for additional depreciation under section 32(1)(iia) cannot be made under this clause. However, this amendment will be applicable w.e.f. AY 2024-25 onwards.
- **Clause 21(e) & Clause 13:** If the assessee uses the mercantile system of accounting, and if Provision for Gratuity is not created, the Tax Auditor shall be required to report the same and may qualify his/her Tax Audit Report in Form No. 3CA/3CB and appropriate disclosure should be made in Clause 13 of the Tax Audit Report, and such observation can also be disclosed in “Observation and Remarks” part of Form 3CA/3CB, in accordance with the relevant auditing standards and other issuances of the ICAI from time to time.
- **Clause 21(f):** In accordance with Section 40A(9) of the Income-tax Act of 1961, the Tax Auditor is required to maintain detailed working papers documenting the factual nature of any expenses incurred and debited to the Profit and Loss for the year under consideration. As a necessary precaution, the Tax Auditor should obtain the assessee's confirmation of the pertinent information contained in the documents prepared for such a disallowance.
- **Clause 21(g):** The Tax Auditor should exercise caution because it has been observed that sums by means of Contingent Liabilities included in the Notes to Accounts in the Audited Financial Statements are accidentally reported under this provision. Therefore, only Contingent obligations that are debited to Profit & Loss account must be reported, not the value of contingent obligations disclosed in the notes to the accounts of audited financial statements of the corporates.
- **Clause 25:** The tax auditor may disclose the fact in the observation paragraph of the tax audit report if the amount provided in this clause about Section 41 of the Act is not routed through a profit and loss account.
- **Clause 26:** Provisions of section 43B, is now also applicable to interest on any loan or borrowing from such class or classes of non-banking financial companies (NBFC) as notified or any sum payable by the assessee to a micro or small enterprise (MSME) beyond the time-limit specified in MSME Act, 2006. Accordingly, reporting of interest will come under this clause w.e.f. AY 2024-25.
- **Clause 30A:** As per sub-section (2A) of section 92 CE related to Transfer Pricing (TP) adjustment the assessee may, at his option, can pay additional income-tax @ 18% on such excess money or part thereof i.e. primary adjustment. Tax paid by the assessee shall be treated as the final payment of tax in respect of the excess money or part thereof not repatriated and no further credit therefore shall be claimed by the assessee or by any other person in respect of the amount of tax so paid. Accordingly, no secondary adjustment is required to made and no interest will be computed thereon. Further, LIBOR rate was no longer to be used and was to be replaced by new risk-free interest rates by adopting Alternative Reference Rates (ARR).



### **Nangia's Take:**

The continuous evolution of tax laws and the dynamic economic landscape necessitate the periodic update of guidance notes on tax audit. The release of these exposure draft for AY 2023-2024 and subsequent years by ICAI demonstrate the institute's commitment to improving tax compliance and reporting standards.

However, it's essential to note that the exposure draft is subject to amendments made by law, judiciary or administration, and any modifications made based on the suggestions received could further shape the final guidance note for AY 2023-2024 and subsequent years. Until the exposure draft is final, guidance note issued last year will be effective for AY 2023-24 and subsequent years. Taxpayers and professionals must stay informed and comply with the latest guidelines to navigate the complexities of tax audit seamlessly. By doing so, businesses can build trust with stakeholders and foster a compliant tax environment that benefits the economy as a whole.

## **Order issued by NFRA regarding irregularities observed by Financial Reporting Review Board (FRRB) of ICAI in the financial statements of FY 2013-15 of a listed Company.**

NFRA is a statutory authority set up under Section 132 of the Companies Act, 2013 to monitor implementation and enforce compliance of the auditing and accounting standards and to oversee the quality of service of the professions associated with ensuring compliance with such standards. NFRA has powers of a civil court and is empowered under Section 132(4) of the Act to investigate the prescribed classes of companies and impose penalties for professional or other misconduct of individual members or firms of chartered accountants.

The statutory auditors are appointed by the members of the Company under Section 139 of the Act. The statutory auditors, including the engagement partners and engagement team, that conduct the audit are bound by the duties and responsibilities prescribed in the Act, the rules made thereunder, Standards on Auditing (SA), including the Standards on Quality Control and the Code of Ethics, the violation of which constitutes professional misconduct, and is punishable with penalty prescribed under Section 132(4)(c) of the Act.

On a reference received vide letter from the Ministry of Corporate Affairs indicating gross financial irregularities observed by FRRB of ICAI in the Financial Statements of a listed Company for FY 2013-15, NFRA initiated investigation into the role of statutory auditor in the audit of the financial statements for FY 2013-15 under Section 132(4) of the Act.

The following is the summary of the order:

### **I. Major lapses in the audit**

- a. Non submission of audit file: The Engagement partner (EP) was required to provide Audit File for the engagement and the SQC policy of the audit firm, which he failed to do despite several extensions of time.

Non-submission of Audit File lead NFRA to conclude that either no such documents are available with the EP or the EP is unwilling to cooperate with NFRA in discharging its statutory authority and responsibility under Section 132 (4) of the Act.

b. Misuse of Emphasis of Matters for issuing a modified audit opinion:

The EP issued an unmodified audit opinion certifying that the financial statements presented a true and fair picture of the affairs of the company.

Under the "Emphasis of Matter" (EoM) part in the audit report the EP reported the following and the following was the conclusion of NFRA:

S.No.	Contents of EoM paragraph	Comments in order of NFRA
a.	The company has not provided interest on unsecured loans as terms are not clearly available with the Company and consequently uncertainty arises in Financial Statements as to the exact amount	Provision interest on unsecured loans is not properly disclosed in the financial statements. Since the matter is not adequately disclosed in the financial statements, the matter cannot be included in the EoM para in the Auditor's report.
b.	Reference is invited to Note 15(i)(a) of the financial statements, the Company's capital advances to the extent of Rs.9,062.09 Lakhs. We are unable to ascertain whether such balances are fully recoverable.	The EP has referred to the firm's inability to ascertain whether the balances were recoverable and if not, the impact of the same.
c.	Trade Receivables to the extent of Rs.81,264.11 Lakhs are more than three years old and in respect of which the company provided only Rs. 7,030.67 lakhs. The auditors are unable to form an opinion on the extent to which the debts may be recoverable.	EP has stated that they were unable to form an opinion on the extent to which the debts may be recoverable. As per para 6 of SA 706, the auditor may include an EoM paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. In this case, it is clear that the EP is not sure about the recoverability of the old debts and the extent of misstatements on account of the same. These matters, hence, should not be included in the EoM para in the Auditor's Report.

d.	Non-repayment of FCCB amounting to Rs.31,302.20 Lakhs which has fallen due as of February 2013 and the Company has defaulted the payments even after the expiry of extended time sought by it from the RBI.	Point (d) regarding the non-repayment of FCCB and point (e) regarding uncertainties relating to MCD Project are matters concerning the Going Concern status of the company and should have been evaluated separately whether they needed to be considered for qualification.
e.	Without qualifying our opinion, the auditors invite attention to Note no 43 forming part of the financial statements regarding the uncertainties relating to MCD Project - "Apke Dwar Project", the matter is in arbitration. "	

Further, NFRA also observed that Trade receivables which are more than three years old account for more than 50% of the Balance Sheet size and FCCB which have not been paid are more than 20% of the Balance Sheet size. These are material balances warranting sufficient appropriate audit procedures before forming audit opinion. NFRA concluded that EP has abdicated its responsibility by simply including them in the EoM section of his report.

#### I. Other lapses in the audit

- a. Erroneous Application of Financial Reporting Framework by the Company
- b. Failure to report the company's non-compliance with the provision of AS 5 and the Framework
- c. Deferred Tax Assets - Failure to report non-compliance with AS 22
- d. Significant Accounting Policies not as per applicable accounting standards:

#### Nangia's Take:

Regulators worldwide have recognized the critical importance of compliance with auditing and accounting standards in safeguarding the integrity and stability of financial markets. By ensuring organizations adhere to these standards, they aim to promote transparency, comparability, and investor confidence. Through rigorous oversight and enforcement, they strive to create an environment where accurate financial reporting is the norm, benefiting all stakeholders. The NFRA orders are issued for such enforcement.

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