

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

TAX AUDIT FRAMEWORK

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Chairman Taxation Committee
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Background

- All returns filed under the Income Tax Ordinance 2001 are accepted on self assessment basis – Tax audit a deterrence
- The process of tax audits conducted so far similar to tax assessments – result litigation
- In this background, the Government sought ICAP's assistance to carry out tax audits

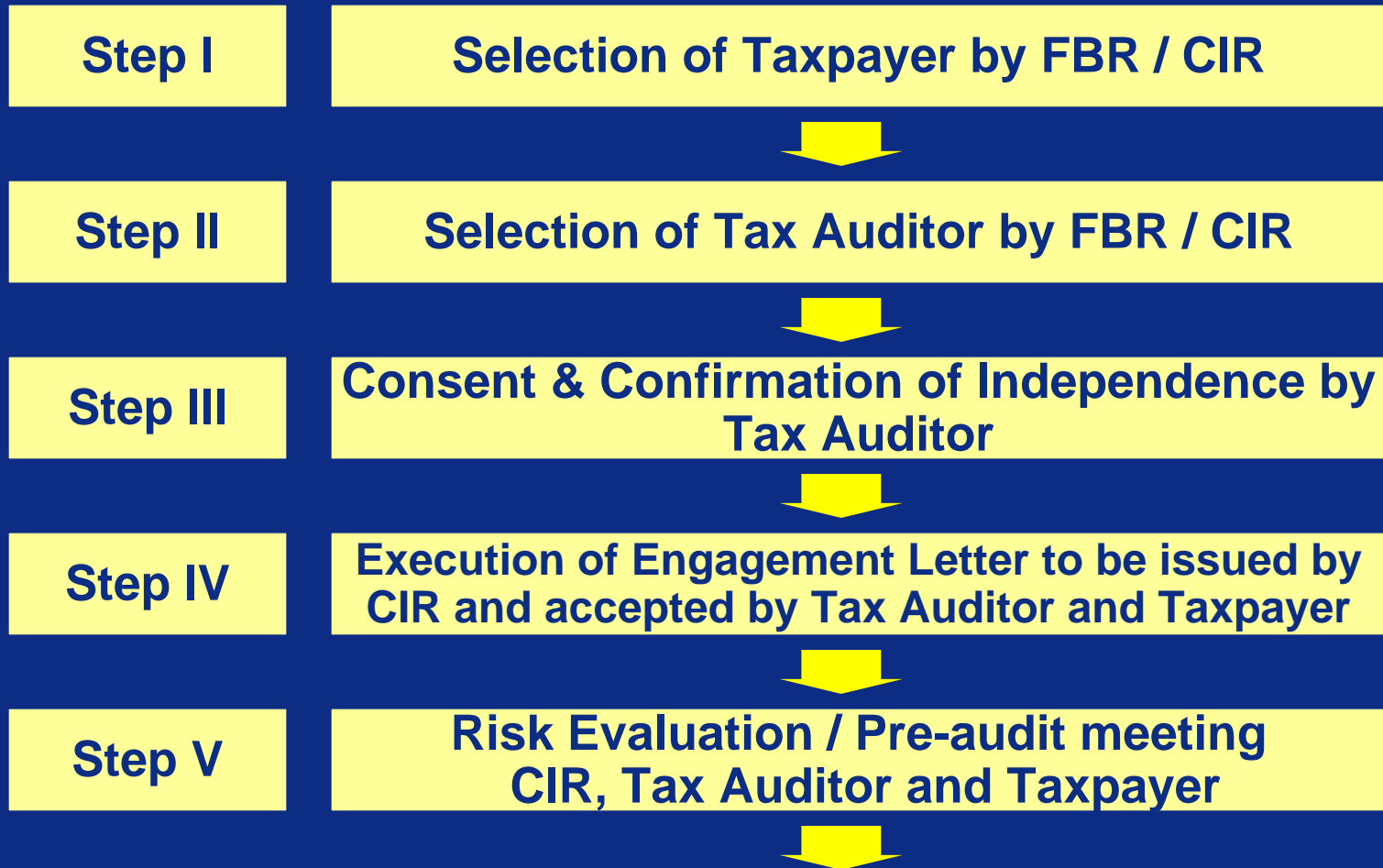
Background ...

- ICAP signed an MOU with MoF on 19 June 2009
- Past experience of outsourcing of tax audit to CA firms under S. 4A of the Repealed Income Tax Ordinance, 1979, S. 32A of the Sales Tax Act, 1990 and S. 46(4) of Federal Excise Act, 2005
- Tax audit experience in other countries – India, Turkey, Iran

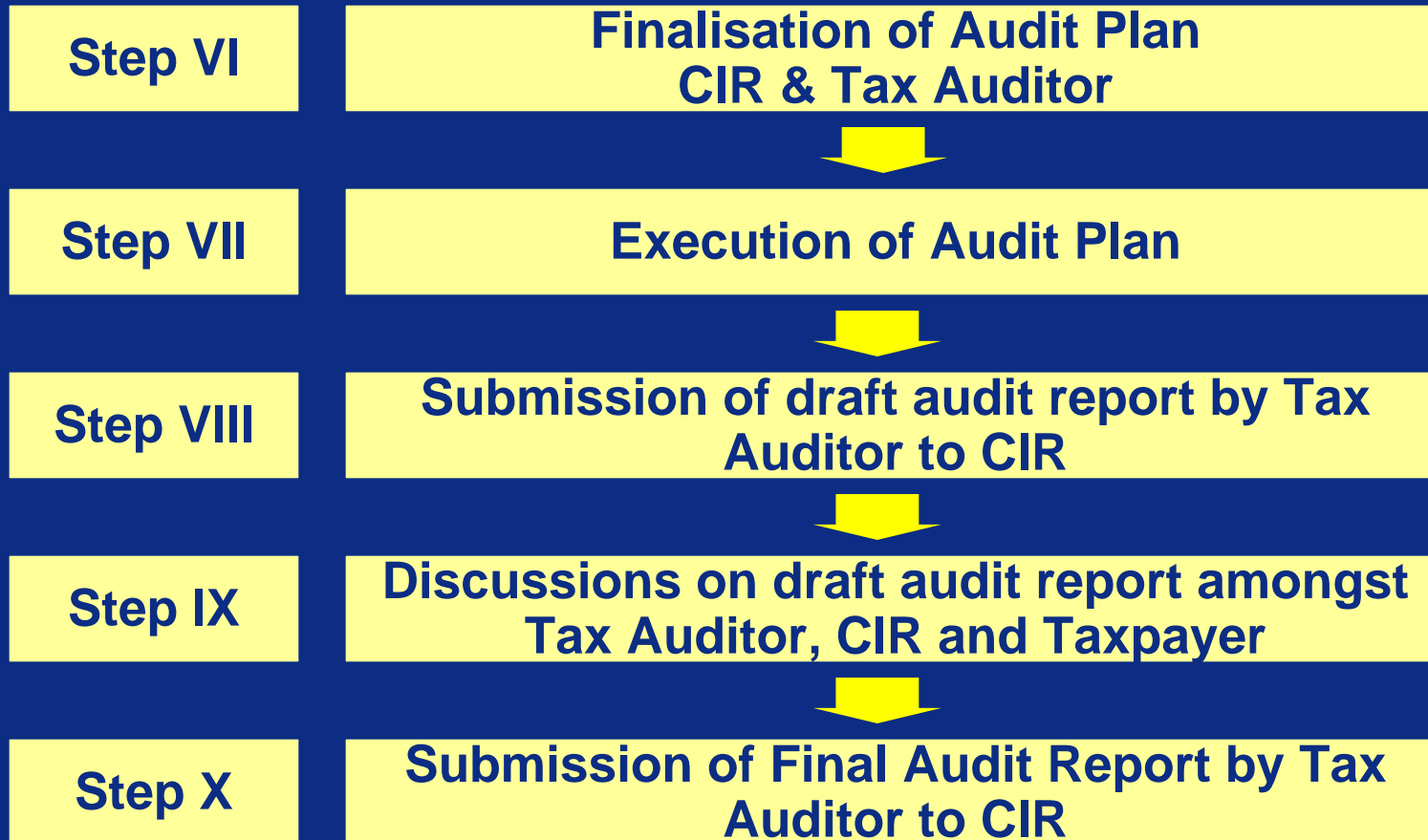
Objectives of outsourcing of tax audits

- **Confidence building**
 - Everything is free from misstatement - taxpayer
 - Nothing is free from misstatement - revenue
- **Development of effective tax audit system**
- **Deterrence to misstatements – not tool for tax recovery**

Tax Audit – Step by Step



Tax Audit – Step by Step ...



Selection of tax auditor

- Selection of tax auditor will be the sole discretion of FBR
- Statutory auditor or tax advisor of a taxpayer shall not be appointed as tax auditor
- Firm whose any partner is working in two firms will not be considered for appointment as tax auditor if other firm is also the statutory auditor or tax advisor
- Internal auditor ??

Selection of tax auditor ...

Suggested Criteria under TAF

Financial Sector

- Banks, NBFCs, Insurance Modaraba and other companies in financial sector
- Category A, B or C firm from SBP Panel of auditors

Non Financial Sector

- Listed companies
- Economically Significant Entities [ESE]
- Medium Size Entities [MSE]
- Small Size Entities [SSE]
- ICAP QCR rated partnership firms
- ICAP QCR rated partnership firms
- ICAP QCR rated partnership and sole proprietorship firms
- ICAP Non QCR rated partnership and sole proprietorship firms

Engagement Letter

- Agreement / contract between FBR and Tax Auditor
- Scope
- Deliverable - Audit Report on tax statement
- Objective of tax audit
- Responsibilities of taxpayer's management
- Representation letter from taxpayer's management

Engagement Letter ...

- **Exclusions**
 - Identification of weaknesses in internal controls
 - Items of possible interest to a third party
- **Confidentiality**
- **Retention of working papers – 5 years**
- **Additional services requested by FBR – Separate engagement**
- **Fee**

Process of tax audit

- **Planning and Risk evaluation** – Tax auditor & CIR will consider
 - Past years' records / history
 - Financial statements and other information filed with return
 - Payment of taxes including advance tax
 - Any other information as available with tax department
- **Documentation** – Tax Auditor to document key risk areas and salient features of discussions in pre-audit meeting
- **Pre-audit meeting** – Participation by Tax auditor, Taxpayer and tax officials

Process of tax audit ...

- **Audit Plan – by Tax Auditor in consultation with CIR**
 - Statement of additional information
 - Models provided in TAF for income tax purposes for manufacturing sector, services sector, banking sector, insurance sector and oil & gas exploration sector
 - Model provided for sales tax / FED
 - Statement of additional information to include taxpayer's information:
 - General information
 - Accounting policies and methodology
 - Information / explanation relating to profit and loss account
 - Information / explanation relating to balance sheet
 - Trends, ratios and analysis
 - Related party transactions
 - Non-recurring transactions
 - Reconciliations with the tax returns filed

Process of tax audit ...

- **Audit Plan ...**

- Design procedures
- Develop materiality level
- Agreement of audit plan with Commissioner

- **Execution of tax audit**

- Assess core areas / transactions
- Obtain substantive audit evidences
- Review the subsequent events

Process of tax audit ...

● Findings, Conclusions and Reporting

- Conformity of contents of return with provisions of law
- Errors, omission, misstatements and concealments detected and their tax implications
- Appropriateness of evidences obtained
- Preparation and submission of draft audit report to the Commissioner
- Discussions with Commissioner and taxpayer on draft audit report
- Revision, if any, and submission of final audit report to the Commissioner

Audit Report

- **Tax auditor will express opinion on:**
 - Whether the income tax return / sales tax cum FED return is in agreement with details provided in the statement of additional information?
 - Whether the statement of additional information contains information as required under TAF?
 - Whether the information contained in statement of additional information is fairly stated?
- **TAF requires separate audit reports for income tax and sales tax / FED purposes**

Tax Audit Fees

- **Minimum fee thresholds provided on the basis of classification of companies:**
 - Listed companies
 - Economically significant entities
 - Medium sized entities
 - Small sized entities
- **Tax auditor and FBR may agree a higher fee having regard to specific circumstances of an engagement and the time required to carry out the tax audit**
- **50% fee payable in advance and balance after final report**
- **Out of pocket expenses will be at 10% of fee plus actual outstation travel cost**

Limitations and exclusions

- Role of tax auditor restricted to provide information relating to facts of the matter
- Tax auditor will not express an opinion on the issues emanating from difference of opinion between tax department and taxpayer
- Audit of withholding tax compliances **OUTSIDE** the scope of tax audit except to the extent transactions verified on test basis

Limitations and exclusions ...

- Role of tax auditor shall stand completed with the submission of final audit report. Tax auditor would not be required to be present in person or furnish any information during adjudication / appeal or any other proceedings subsequent to submission of final audit report
- Tax Department shall issue an order either accepting or altering the tax return. Tax Auditor shall not be responsible for the content of the order (except to the extent of audit report)
- Tax audit to be performed on test basis hence the tax auditor would not be expected to uncover all cases of tax concealment or evasion

Role of ICAP

- ICAP has no role in selection of taxpayers for tax audit
- ICAP has no role in selection and appointment of tax auditors
- ICAP will provide assistance on technical matters for implementation of TAF
- ICAP will carry out investigations of any misconduct by its member

Challenges

- **Transparency and fairness in selection of taxpayers**
- **Transparency and fairness in selection of tax auditors**
- **Ownership by stakeholders**
- **Integrity, independence and professionalism in tax audit**
- **Continuity of process – e.g. change in leadership**
- **Improvement of TAF**
- **Potential litigation**
- **Training**

Presenter's contact details

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