

## Chapter 2

### Verification of applications

We scrutinized whether the RLAs were ensuring that the applications for grant of licences were submitted in a complete form and the declarations submitted with applications were verified to be correct.

#### 2.1 Submission of mandatory documents by applicants

In terms of paragraph 5.2 of HBP<sup>5</sup>, the holder of an IEC may submit an application for an EPCG authorisation in specified form (ANF5A) along with mandatory documents. These, inter alia, include certificate from Chartered Engineer establishing nexus between the manufacturer's export product and the capital goods proposed to be imported, certificate from Chartered Accountant stating exports made by the applicant in the preceding three years and registration-cum-membership certificate (RCMC) from the concerned Export Promotion Council.

The applicant is also required to declare that none of its proprietor/partners/directors are attached to any firms that have been defaulters with DGFT and give the details of unrealised foreign exchange pending beyond six months.

**2.1.1** We found that RLAs at Andhra Pradesh, Maharashtra, Delhi, West Bengal and Kerala have devised checklists to ensure that the mandatory documents were filed along with the applications. RLAs at other states did not have any checklists. Out of 52,114 authorisations in nine states, we test checked 1814 cases and found 49 cases where licences were issued without obtaining valid documents. The break up is given below:

Table 1 - Issue of authorisation on the basis of incomplete/ invalid documents				
State	Number of authorisations issued from April 2007 to Sept 2010	Number of cases scrutinised	Number of cases of issue without obtaining valid documents	Whether any checklist was used
(1)	(2)	(3)	(4)	(5)
Maharashtra	14444	560	Nil	Yes
Delhi	8867	267	Nil	Yes
West Bengal	3510	108	1	Yes
Kerala	723	23	Nil	Yes
Tamil Nadu	11949	383	44	No

<sup>5</sup> Hand Book of Procedures (HBP)

State	Number of authorisations issued from April 2007 to Sept 2010	Number of cases scrutinised	Number of cases of issue without obtaining valid documents	Whether any checklist was used
Andhra Pradesh	3014	147	Nil	No
Karnataka	4054	134	4	Yes
Punjab	4457	136	Nil	No
Gujarat	1821	56	Nil	No
<b>Total</b>	<b>52114</b>	<b>1814</b>	<b>49</b>	

We found that the authorisations issued mostly had a complete set of documents. The proportion of exceptions was not significant except in Karnataka and Tamil Nadu.

- At RLAs, Coimbatore, Madurai and Chennai in Tamil Nadu, out of 383 licences (duty saved ₹ 769.75 crore) examined, 44 licences (11 per cent) with duty saved amount of ₹ 170.69 (22 per cent) crore were issued with invalid RCMCs. This included 16 cases where the RCMCs submitted had expired; 20 licences valuing ₹ 74.75 crore where the RCMCs did not mention the export products of the applicant; seven licences with CIF value of ₹ 5.55 crore where RCMCs were issued for an indefinite period. In one licence with CIF value of ₹ 71 lakh, the RCMC was issued by the Synthetic & Rayon Textiles Export Promotion Council, Mumbai which was not the appropriate authority. The appropriate authority was the Cotton Textiles Export Promotion Council, Mumbai since the Export commodity was 'cotton yarn'. RLA, Coimbatore in their reply stated that RCMC is to be valid on the date of application only and not on the date of issue of authorisations. Audit scrutiny revealed that the RCMC submitted by the licencees in the cases pointed out by audit were valid upto 31 March 2007, whereas the applications for the licences were received after 31 March 2007.
- In RLA, Bengaluru, Karnataka, three licences were issued without the requisite CAs certificate and one licence without obtaining the nexus certificate. The CIF value of these cases was ₹ 63.03 crore. RLA, Bengaluru accepted the audit observation and stated that action has been taken to call for the documents from the licencees.

Our findings indicated that there was a high degree of compliance in submission of complete set of documents. We had observations in four RLA offices where the scrutiny of application is required to be strengthened. As a good practice, all RLAs could use a checklist as being done by five RLAs, as stated earlier.

## 2.2 Verification of declarations made by applicant

DGFT had issued an instruction in January 2000 under which a Post Issue Audit Wing (PIAW) was required to be constituted in all RLAs for the purpose of test audit of five percent of the licences issued for ensuring the veracity of documents submitted along with application for EPCG authorisation (ANF5A).

The documents submitted by the applicant provide third party authentication of its identity and activities and act as an in-built check prior to issue of authorisation. Therefore, the DGFT introduced a system to establish their veracity through a sample check.

We ascertained that in spite of the passage of eleven years, the PIAW had not been constituted in any of the RLA Offices except Mumbai. Even in Mumbai, where PIAW is functional, out of 11,249 licences issued during 1 April 2007 and 30 September 2010, the department selected 475 licences (4.2 per cent) for random checking of the veracity of the declaration made in the authorisation application. The verification is carried out by issuing references to various authorities requesting verification and confirmation of documents within 30 days. Out of 475 cases, in more than 50 per cent cases (248), no response was received.

The RLA, Mumbai replied (May 2011) that the 'no response received (NRR)' cases were not disposed unless the replies were received from the concerned authorities.

RLA, Hyderabad replied that due to shortage of manpower, PIAW verification become difficult. Therefore, 100 per cent verification is not feasible. Such verification is required only in the cases of doubtful applicants who had come to their adverse notice, especially on Proprietary and Partnership firms.

Reply of the RLA is not acceptable as the DGFT instruction dated January 2000, PIAW was required to be constituted in all RLAs for the purpose of test audit of five per cent of the authorisations issued ensuring veracity of documents submitted along with the application for authorisation.

In the course of our scrutiny, we detected instances of incorrect declarations by applicants. We also found that there were no procedures in place in the RLA offices to verify these aspects.

- Paragraph 5.7 of Foreign Trade Policy 2009-14 stipulates that in case of domestic sourcing of capital goods, export obligation shall be reckoned with reference to notional customs duties saved on FOR (Free on road) value.

In RLA, Ahmedabad, eight applicants (13 licences) declared the duty saved amount on capital goods sourced from domestic suppliers by considering only countervailing duty (CVD) whereas the notional customs duty was also required to be included as per paragraphs 5.6 and 5.7 of FTP. This was not verified by the RLA and resulted in short fixation of EO by ₹ 19.31 crore. The RLA

accepted the observation and stated that no specific procedure has been prescribed in the Foreign Trade Policy (FTP) for applying correct rates. However, RLA assured that necessary corrections would be carried out after obtaining details from the concerned parties. Reply of the RLA that no procedure has been prescribed in the FTP is contradictory to the provisions of paragraphs 5.7 of FTP.

- In RLA, Ludhiana we found from the scrutiny of the balance sheets/export records that there were six licences whose exports were much higher than declared as they had not included indirect/deemed export in their declarations. In the absence of any system for verification of export figures given in the declarations, the average export obligation was fixed short by ₹ 55.54 crore in the above mentioned six cases.

On being pointed out (February 2011), the RLA, Ludhiana replied that since there were no stipulations in the Foreign Trade Policy/Procedures to carry out verification of documents/statements of previous exports submitted by the applicant in their application, this was not done.

- It was observed in RLA, Ernakulum that in one case, RCMC submitted along with the application was invalid on the date of application. The RLA had not taken any action to obtain valid RCMC which is a mandatory document. In four other cases, the actual FOB value of exports from the Kochi port exceeded the declared FOB value (Form ANF5A). Cross-verification of one of these licences (M/s Kitex Childrens Wear Ltd) indicated that the declared value furnished by the unit in ANF5A was the figure from bank realization certificate, i.e. the payments received in foreign currency which was lower than the actual exports through Kochi port. The reasons for the difference in remaining cases had been called for from the JDGFT.
- As per declaration in ANF5A form, format of application, the applicant has to declare details of past export where foreign exchange realisation is pending beyond six months. Such declaration needs to be authenticated by a certificate from a Chartered Accountant. We found that in eight cases ( five in RLA, Kolkata, one in RLA, Ludhiana and two in RLA, Bengaluru), the applicants, while applying for EPCG authorisation, declared that no amount was pending realisation beyond prescribed time period for the earlier exports made by them. However, the statements of unrealised foreign exchange issued by RBI showed that total export proceeds of ₹ 16.88 crore had remained unrealised against the IEC numbers of these applicants. The Ministry of Commerce, Enforcement guideline dated 29 April 1998, clarified that under Rule 7 (1) (f) of the Foreign Trade (Regulation) Rules, 1993, licences can be refused to an applicant who is or was a managing partner in a partnership firm or is or was a Director of a private

Limited Company having controlling interest, against which any action is for the time being pending. It directed that a list of the Directors and partners of the firms against which action was pending was to be prepared and referred to at the time of considering grant/renewal of a licence.

We found that such reference list of persons as per the Enforcement guideline was not being maintained by the RLAs. Even the Denied Entities List (DEL) available on the DGFT website did not carry the PAN identity of individual directors/ partners. Thus, over a thirteen year period, the department have not put in place any mechanism to adhere to the guidelines. In the absence of any data to link directors etc. of applicant firms to the directors of firms on whom action was pending, it was not possible for us to ascertain and establish whether there were any such cases amongst the test checked applications.

- We found one application at JDGFT Ernakulum, where the name of one of the directors of an applicant firm, M/s. BPL Mobile Communications Ltd, Ernakulum was also the same as the name of a director of M/s BPL Ltd, Palakkad, a company that had been placed on the Denied Entity List by the DGFT since 2006. The applicant firm was issued five EPCG licences and availed duty benefit of ₹ 3.38 crore. In this case, there was adequate indication for the RLA to enquire whether the two directors were the same person and withhold/ cancel the authorisation if this were the case. However, in the absence of any post verification mechanism, no enquiry was made.

Our findings indicated that wrong declarations by the applicants are a real risk and requires deterrence. Since the RLAs have to issue the licences within three days, it is not practicable that the irregularities pointed out by us could have been detected by them in this short time frame. However, the DGFT had issued instruction in 2000 to cover this risk through post verification by PIAW wings to detect wrong declarations. In the absence of any post verification, there is no deterrence mechanism against wrong declarations in the applications which are resulting in short fixation of export obligations.

***Recommendation 1: DGFT's instructions on post issue verification have been largely ignored by the RLAs. The DGFT should prescribe a time-bound schedule and monitor the implementation of this control mechanism.***

The DGFT in their reply stated (August 2011) that the Head of Office of each of the RLAs has been directed to ensure implementation of the monitoring mechanism and send a report to the DGFT on monthly basis.