

Chapter 3

Fixation of export obligation

The EPCG Scheme permits a licensee to import capital goods at a concessional duty rate who, in turn, has to fulfil an Export Obligation. The total export obligation consists of two parts, specific and average, which has to be achieved over eight years. The specific EO imposed on an authorisation holder was equivalent to five times the duty foregone under FTP, 2004-09, which was revised to eight times under FTP 2009-14. The average EO is the arithmetic mean of exports of the same and similar products, made in previous three years by the authorisation holder. We scrutinised the fixation of average export obligation and specific export obligation and we found irregularities in their fixation in 143 and 26 cases respectively.

3.1 Fixation of Average Export Obligation (AEO)

In December 2004, the DGFT had issued a clarification marked to all RLAs that for calculation of average EO, the aggregate FOB value of exports in the three preceding years was to be divided by the actual number of years of export.

3.1.1 In our sample of 1814 licence files, there were 95 cases where the licensees had declared exports for less than three years preceding the licensing period. We scrutinised the method of calculation of average EO and found that the DGFT's instructions were not followed in 94 out of 95 cases. Since the applicants had declared exports for only one or two previous years in these cases, the average should have been calculated dividing by one or two respectively. However, the average was calculated dividing by three. Only RLA, Ernakulum had done the calculation correctly in the sample scrutinised. The wrong calculation resulted in short fixation of average EO by ₹ 1,082.34 crore as tabulated below:

Table 2 - Lower fixation of average export obligation			
State	No. of application with less than 3 years' prior export	No. of cases with wrong calculation where under declaration of export noticed	Average EO fixed lower by (₹ In crore)
Tamil Nadu	12	12	7.38
Punjab	6	6	42.56
Maharashtra	32	32	162.08
West Bengal	8	8	18.48
Kerala	1	Nil	Nil
Karnataka	3	3	61.30
Gujarat	3	3	19.82
Delhi	15	15	730.53
AP	15	15	40.19
Total	95	94	1082.34

- The JDGFT Kolkata admitted (March 2011) short fixation of average EO by ₹ 18.48 crore in the eight cases pointed out and informed that all eight licences were being recalled on top priority for necessary corrective action.
- The JDGFT Ludhiana admitted three out of six cases pointed out and replied (Feb 2011) that the average EO had been refixed. For the remaining three cases, it stated that the average export obligation was fixed correctly in view of the decision taken at the Open House Meeting organised under the chairmanship of Commerce Secretary on 1 June 2010. It further stated that it had also been decided that a policy circular had to be issued for uniform practice in all zones. However, this had not been issued thereafter.
- The RLA, Hyderabad stated (March 2011) that wherever average export obligation had been fixed wrongly, the cases would be corrected under intimation to audit.
- The RLA, Mumbai, has refixed AEO in eight cases and similarly, RLA, Pune have refixed AEO in eight cases.

Recommendation 2: *The DGFT should examine the matter and reiterate the exact method of calculation of average EO as almost all the selected RLAs had adopted a method other than what was specified in 2004. Moreover, such licences should be identified in a time bound manner and the average EO refixed. This may be co-ordinated and monitored by DGFT.*

The DGFT in their reply stated (August 2011) that the DGFT is already seized of the matter and a circular in this regard is again being issued to ensure uniform method for calculation of AEO.

In our opinion, only issue of a circular to adopt uniform method for calculation of AEO is not sufficient. RLAs may also be instructed to identify the cases where AEO had been fixed wrongly and remedial action should be taken in those cases.

3.1.2 We also examined the remaining 1719 (1814-95) files in our sample and found another 49 exceptions in which errors and inadequate scrutiny by RLAs resulted in short fixation of average EO by ₹ 1,832.67 crore. A few illustrations are given below:

3.1.2.1 In three licence files in RLA, Mumbai, 11 licence files in RLA, Pune and 10 licence files at RLA, Ahmedabad, there were calculation errors due to incorrect adoption of export values declared in the CA certificates. These errors resulted in short fixation of average export obligation to the tune of ₹ 60.02 crore, ₹ 152.69 crore and ₹ 1,462.44 crore respectively. On being pointed out, RLA, Ahmedabad, Mumbai and Pune accepted the omission and rectified the mistakes by issuing amendment sheets.

3.1.2.2 M/s Uflex Ltd. and M/s Promed Exports Pvt. Ltd. were issued EPCG licences in February 2009 and July 2009 respectively by RLA, Delhi

but the average export obligation was fixed short by ₹ 37.20 crore due to calculation error. The department accepted the observation and amended the average EO in one licence (M/s Promed Exports Pvt. Ltd.) and initiated action in the second case.

3.1.2.3 RLA, Kolkata issued a licence to M/s McNally Bharat Engineering Co. Ltd in June 2008 fixing the average EO of ₹ 40,519 instead of ₹ 405,19,000. The mistake occurred as the words 'in thousands' in the CA's certified export figures was ignored. As a result, the average EO was fixed lower by ₹ 4.05 crore. Reply had not been received from the RLA (October 2011).

3.1.2.4 In 14 licence files in RLA, Pune, the average export obligation was fixed by taking into account the years in which the licensee had not exported, instead of previous three years exports. This resulted in short fixation of average export obligation of ₹ 26.31 crore. RLA, Pune has initiated action to refix AEO in these cases.

3.1.2.5 Exporters with FOB export value over ₹ 7,500 crore are categorised as Premier Trading Houses (PTH). The Foreign Trade Policy 2004-09 provides that PTH shall have an option of fixing average level of exports based on arithmetic mean of export performance in the last five years instead of three years applicable to all other exporters.

We found that the benefit of five year averaging was extended to three licencees in RLA, Mumbai and five licencees in RLA, Pune who were not holding the status of PTH. This resulted in incorrect fixation of average export obligation to the tune of ₹ 61.32 crore and ₹ 28.88 crore respectively. RLA, Mumbai has refixed AEO in all the cases and RLA, Pune has refixed AEO in two cases each.

3.2 Fixation of specific Export Obligation

We found 26 other cases where errors by RLAs resulted in short fixation of specific EO by ₹ 144.51 crore. The cases are illustrated below:

3.2.1 M/s Indian Oil Corporation was issued an EPCG authorisation on 22 July 2008 by RLA, Delhi. The Export Obligation had been fixed at six times instead of eight times of duty saved. This resulted in short fixation of Export obligation by ₹ 76.47 crore. The department accepted the short fixation of EO and enhanced the same accordingly.

3.2.2 As per the provisions of FTP 2009-14, concessional duty of three percent is paid under EPCG Scheme, subject to an export obligation equivalent to eight times of duty saved, to be fulfilled in eight years. In case of Small Scale Industry (SSI) units, the EO is lower, equivalent to six times of duty saved on capital goods imported, provided the CIF value of such imported capital goods under this scheme does not exceed ₹ 50 lakh and total investment in Plant & Machinery after such imports does not exceed SSI limit.

We observed that in eight SSI licence files in RLA, Pune, the export obligation was not fixed at six times but at three to five times the duty saved amount. This resulted in short fixation of EO of ₹ 18.50 crore. Audit scrutiny of another five licence files in RLA, Pune revealed that the licencees had exceeded the total investment limit for SSI on plant and machinery after import of the capital goods. The export obligation was however fixed at six times the duty saved amount instead of eight times. This resulted in short fixation of export obligation of ₹ 10.14 crore. Out of these 13 cases, RLA, Pune have re-fixed EO in four cases.

3.2.3 Another four units were given SSI benefit (six times EO fixation) in RLA, Ahmedabad, despite being ineligible for such exemption as the CIF value of the capital goods proposed to be imported was above ₹ 50 lakh under EPCG Scheme. This resulted in short fixation of EO of ₹ 5.24 crore. There is no module in the system to validate the SSI eligibility conditions like CIF value of capital goods proposed to be imported, total investment in plant and machinery. On being pointed out, RLA, Ahmedabad accepted the observation and rectified the mistake in these authorisations.

3.2.4 In RLA, Ahmedabad, we also observed eight EPCG licences, where the EO was fixed at six times instead of eight times for the reason that the parties claimed the EO at six times of duty saved on the ground that it was an SSI unit. We observed that these units were in fact not falling in the category of SSI unit. This resulted in short fixation of EO of ₹ 34.16 crore. The RLA accepted the observation and rectified the mistake in these cases.

Except where mentioned, replies were awaited as on October 2011.

In conclusion, we found a total of 168 cases (9.3 per cent) out of 1814 in which errors in calculation resulted in short fixation of export obligation by ₹ 3,060 crore. Such errors indicate a lack of professionalism in approach and should be arrested by taking deterrent action.

Recommendation 3: *In view of the large number of incorrect calculations, it is recommended that the calculations of EO should also be covered in the test check by PIAW and the DGFT should ensure that the PIAW become operational in the RLAs within fixed time frame.*

The DGFT in their reply stated (August 2011) that DGFT circular guiding RLAs to adopt uniform method of computing annual average export obligation is being issued and, therefore, the test check of Post Issue Audit Wing (PIAW) for this purpose will hardly be required. DEA & CAG are also auditing EPCG files.

The reply of the DGFT is not acceptable as checks by any external agency do not absolve the normal functioning of departmental internal control mechanism in any manner. Test check by PIAW would enhance the calculation accuracy and mitigate the risk of authorisation being issued with incorrect AEO and EO. PIAW, being their internal control mechanism for post issue verification of the authorisation issued, should ensure the correctness of the authorisation issued.