

Chapter VI

Effectiveness of Internal Controls

6.1 Introduction

Internal control is an integral process carried out by an entity's management and personnel which is designed to address risks and provides reasonable assurance that in pursuit of the entity's mission, the entity is achieving the following general objectives:

- executing orderly, ethical, economical, efficient and effective operations;
- fulfilling accountability obligations;
- complying with applicable laws and regulations;
- safeguarding resources against loss, misuse and damage.⁷

6.2 Audit findings

During the course of examination of records, we observed nine cases where due processes were not followed by departmental officers. We communicated these observations to the Ministry through nine draft audit paragraphs having financial of ₹ 15.47 crore. The Ministry/Department accepted (December 2014) the audit observations in eight draft audit paragraphs having financial implication of ₹ 14.98 crore of which ₹ 2.10 crore have been recovered. Out of above eight draft audit paragraphs, the Ministry/Department in three cases, initiated/completed corrective action having financial implication of ₹ 0.40 crore. We have furnished the details of these three paragraphs in Appendix III. The objection are covered under two major headings i.e. Internal Audit and other issues.

6.3 Internal Audit

Internal audit is one of the main compliance verification mechanisms in the department. Internal audit teams carry out audit at assessee premises by following prescribed procedures for examination of records of the assessee to ascertain the level of compliance with the prescribed rules and regulations. Internal audit is authorised under the Central Excise Rules, 2002 to access the records of assessees at their registered premises. The Directorate General of Audit with its seven zonal units at Ahmedabad, Mumbai, Delhi, Bengaluru, Kolkata, Chennai and Hyderabad is to provide a focal link between the

⁷ INTOSAI GOV 9100 – Guidelines for Internal Control Standard for Public Sector.

Commissionerates (who actually implement the audit process) and the Board on all audit-related matters. On the one hand, it aids and advises the Board in policy formulation and on the other, it guides and provides functional direction in planning, co-ordination, supervision and conduct of audits at the local level. Every Commissionerate has an Audit cell, manned by an Assistant/Deputy Commissioner and auditors and headed by an Additional/Joint Commissioner. Internal audit parties consisting of Superintendents and Inspectors carry out the audits.

We sought to get an assurance on the quality of actual audit done by Internal audit parties by verifying some assessee records already audited by Internal audit parties. We came across certain instances of non-detection by internal audit teams of assessee's lapses. A few cases are illustrated in the following paragraphs.

6.3.1 Non-detection of incorrect availing of Cenvat credit on common input services

As per Annexure E of the Central Excise Audit Manual 2008, the departmental auditors are required to verify the Cost Audit Report with a view to ascertain, inter alia, whether any related party transaction is made so as to unearth undervaluation of excisable products transferred within group companies/related parties. Rule 8 read with proviso to rule 9 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 envisages that where excisable goods are not sold by the assessee but are consumed by it or by a related person of the assessee in the manufacture of other articles, the assessable value of such goods shall be one hundred and ten per cent of the cost of production or manufacture of such goods. Further, the Board had clarified (13 February 2003) that the value of goods consumed captively should be determined in accordance with the Cost Accounting Standard (CAS-4) method only.

M/s Savita Oil Technologies Ltd. in Belapur Commissionerate, engaged in manufacture of goods falling under Chapter 27 of CETA, 1985, made clearances valued at ₹ 31.00 crore during the period 2011-12 to its sister unit located at Mhape by adopting valuation under CAS-4. However, the assessee increased the value by adding 30 per cent to the cost instead of 10 per cent. The assessee utilised Cenvat credit for payment of excise duty. Thus, there was over-assessment of ₹ 4.77 crore in the value of goods and excess payment of duty of ₹ 49.12 lakh in order to inflate the assessable value and transfer the surplus unutilised credit to its other units. Irregular adoption of cost in contravention to the provisions of the said rules resulted in excess utilisation and transfer of credit of ₹ 49.12 lakh between the assessee and sister units.

When we pointed this out (March 2013), the Commissionerate admitted the objection (September 2013) and intimated (June 2014) that the matter was referred to Joint Director (Cost).

We await the Ministry's response (December 2014).

6.3.2 Non-detection of non-compliance with Rule 6(3) of Cenvat Credit Rules

According to Rule 6 (2) of Cenvat Credit Rules, 2004, manufacturers of final products manufacturing goods chargeable to duty as well as exempted goods or services, shall maintain separate accounts for receipt, consumption and inventory of inputs and input services and take Cenvat credit only on that quantity of input or input service which are intended for use in the manufacture of dutiable goods or in providing output service on which Service Tax is payable. Rule 6(3) stated that the manufacturer opting not to maintain separate accounts shall either pay an amount equal to five per cent (6 per cent upto 6 July 2009) of value of exempted goods and services or pay an amount as determined under sub-rule 6 (3A). As per explanation under Clause 2(iii) of Notification dated 1 March 2011, exempted services include trading.

M/s. FCI OEN Connectors Ltd., in Cochin Commissionerate, was engaged in trading of goods in addition to manufacturing activity. Even though the assessee was discharging duty liability through Cenvat credit and availed credit of inputs and input services, no separate accounts were maintained for receipt, issue and inventory of inputs and input services. An amount of ₹ 42.77 lakh or an amount equal to the proportionate credit involved in trading activities was payable as per Rule 6(3), for non-maintenance of separate accounts during the period April 2011 to March 2012.

When we pointed this out (October 2012), the department intimated (March 2014) that the assessee reversed credit of ₹ 1.03 crore towards amount payable under Rule 6(3) for the period 1 April 2008 to 31 December 2012 and paid interest of ₹ 21.61 lakh on 4 January 2013 and ₹ 0.56 lakh on 8 April 2013.

We await the Ministry's response (December 2014).

We observed that though Internal Audit was carried out by the Internal Audit Party of the Commissionerate in all the above cases, the lapse remained undetected until pointed out by the CERA.

6.4 Other issues

6.4.1 Ineffective functioning of Anti-evasion and Preventive unit

Enhancing the tax revenue by enlarging the tax base is an important function of any tax administration department. In Central Excise, Anti-Evasion is one of the identified key performance areas. The Anti-Evasion and preventive branch of the department is responsible for collection of intelligence about evasion of duties by keeping secret track of duty payment records of individual assesseees, engaging informers, collecting information through market and other sources, making surprise visit to the factories, whether registered or not and take effective steps to thwart any attempt for evasion.

According to Section 6 of Central Excise Act 1944, any prescribed person who is engaged in the production or manufacture or any process of production or manufacture of any specified goods included in the first schedule and the second schedule to the Central Excise Tariff Act (CETA) 1985, shall get himself registered. As per rule 25 (C) of Central Excise Rules, 2002, any producer, manufacturer, registered person of a warehouse or a registered dealer engaged in the manufacture, production or storage of any excisable goods without having applied for the registration certificate required under section 6 of the Act, shall be liable to a penalty not exceeding the duty on the excisable goods or rupees two thousand, whichever is greater.

Audit collected information regarding manufacturers of medicaments falling under Chapter 30 of CETA from Sales Tax/VAT returns filed in Office of the Commercial Taxes Department in Kozhikode District and observed that two major manufacturers viz. Sidhasamajam Sivananda Vijayam Oushadhasala and Kerala Ayurvedic Co-op Society under the jurisdiction of Calicut Commissionerate, were neither registered with the Central Excise Department even after crossing the small scale exemption limit of ₹ 150 lakh nor submitted any declaration after crossing the small scale exemption limit of ₹ 90 lakh which is mandatory for SSI unit. The Commissionerate failed to detect these cases through its preventive and other wings despite the fact that Kerala state is well known for alternative medical tourism.

When we pointed this out (May 2013), the Ministry admitted the objection (December 2014) and intimated that recovery of ₹ 29.84 lakh alongwith interest of ₹ 8.73 lakh and penalty of ₹ 6.03 lakh had been made from M/s Sidhasamajam and SCN was under process of issue to M/s Kerala Ayurvedic Co-op Society.

6.4.2 Absence of departmental action to recover dues

As per Rule 8 (1) of the Central Excise Rules, 2002, Central Excise duty on goods removed from the factory during a month shall be paid by 5th/6th of the following month. Further, as per rule 8(4), the provisions of Section 11 of the Central Excise Act shall be applicable for recovery of duty with interest. The instructions for action to recover the dues were reiterated by Board's circulars dated 15 December 1997 and 15 December 2003. Board vide its letter F. No. 224/37/2005-CX-6, dated 24 December 2008, specified the duties of Range Officer, also mandates initiation of action by the Range Officer to recover the defaulted amount.

M/s Sree Mataliks Ltd. and M/s Jay Jagannath Castings (P) Ltd., in Bhubaneswar-I Commissionerate defaulted and paid duty of ₹ 35.16 lakh and ₹ 41.02 lakh out of a total duty liability of ₹ 91.58 lakh and ₹ 52.08 lakh resulting in short payment of Central Excise duty of ₹ 56.42 lakh and ₹ 11.06 lakh during 2010-11 and 2011-12. However, the department did not initiate any action to recover the defaulted amount except including the unpaid amount in respect of M/s Sree Mataliks Ltd. in 'Tax Arrear Report'. As both the units have since closed down, possibility of recovery of dues is remote.

When we pointed this out (February 2013), the Commissionerate intimated (October 2013) issue of Show Cause Notices in both the cases.

We await the Ministry's response (December 2014).

6.4.3 Non-transfer of amount to Consumer Welfare Fund

Section 11B of Central Excise Act provides for grant of refund if duty relating to refund claim was paid by manufacturer and the incidence of such duty had not been passed on by him to any other person. In case the duty incidence had been passed on to any other person, the amount of refund shall be credited to the Consumer Welfare Fund (CWF).

Scrutiny of records in Belapur Commissionerate revealed a long pending refund claim of M/s. New Reshma Dyeing Ltd. was decided in favour of the assessee in November 2003 and was remanded back to adjudicating authority to ensure whether the refund was to be provided to the assessee or credited to Consumer Welfare Fund. The case was adjudicated by the Assistant Commissioner who ordered (February 2005) the transfer of the amount of refund to the CWF after verifying the correctness of the amount of refund. However, no action had been taken by the Department to credit the amount of ₹ 59.53 lakh to the Consumer Welfare Fund till August 2009 even after a lapse of more than 4 years.

When we pointed this out (August 2009), the department intimated (January 2014), that the amount of ₹ 59.53 lakh was transferred to the Consumer Welfare Fund in January 2014.

We observe that even after the lapse was pointed out by CERA in August 2009, there was a delay of more than four years in transferring the amount to the Consumer Welfare Fund.

We await the Ministry's response (December 2014).

6.4.4 Irregular payment of Central Excise duty by wrong utilisation of Cenvat credit

As per Rule 8(3A) of the Central Excise Rules, 2002, if the assessee defaults in payment of duty beyond thirty days from the due date, as prescribed in sub-rule (1), then notwithstanding anything contained in said sub-rule (1) and sub-rule (4) of rule 3 of Cenvat Credit Rules, 2004, the assessee shall, pay excise duty for each consignment at the time of removal, without utilizing the Cenvat credit till the date the assessee pays the outstanding amount including interest thereon; and in the event of any failure, it shall be deemed that such goods have been cleared without payment of duty and the consequences and penalties as provided in these rules shall follow.

M/s Gangotri Iron and Steel Co. Ltd., in Patna Commissionerate, paid ₹ 55.17 lakh through Cenvat credit out of the total duty liability of ₹ 74.42 lakh for the month of June 2008 and ₹ 15.09 lakh was paid along with interest on 6 August 2008 (32 days after the due date). Further, ₹ 4.14 lakh was paid on 5 December 2008 and balance ₹ 1,493 was paid on 3 December 2012 after 1,612 days from due date along with interest. As the assessee delayed payment of duty beyond 30 days, the department should have restricted assessee from utilisation of Cenvat credit under Rule 8(3A) of Central Excise Rules, 2002. The department, however, did not restrict utilisation of Cenvat credit and the assessee utilised Cenvat credit of ₹ 10.65 crore irregularly during August 2008 to March 2011. Such payment from Cenvat credit was irregular and recoverable with interest.

When we pointed this out (March 2012), the department stated (October 2013) that the assessee had defaulted in payment of duty beyond 30 days and rule 8 (3A) was applicable in the facts and circumstances of the case. The assessee was required to pay Central Excise duty for each consignment without utilizing Cenvat credit till the payment of outstanding amount of duty. The department also added that as the duty was paid along with interest after 1,612 days of default, utilisation of Cenvat credit during the default period had been made good.

The reply of the department is not tenable and is contrary to the provisions prescribed in rule 8(3A). The assessee is required to pay interest on the entire amount paid through Cenvat credit during the default period which is not considered as payment of duty. The reply did not explain as to why no action was taken by the department to restrict utilisation of Cenvat credit in this case.

We await the Ministry's response (December 2014).

New Delhi

Dated: 20 March 2015



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Dated: 21 March 2015



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