Chapter II: Audit Mandate, Products and Impact

2.1 Authority of the C&AG for audit of receipts

Article 149 of the Constitution of India provides that the Comptroller and Auditor General of India shall exercise such powers and perform such duties in relation to the accounts of the Union and of the states and of any other authority or body as may be prescribed by or under any law made by Parliament. Parliament passed the Comptroller and Auditor General's DPC Act (CAG's DPC Act) in 1971. Section 16 of the CAG's DPC Act authorises C&AG to audit all receipts (both revenue and capital) of the Government of India and of Governments of each State and of each Union Territory having a legislative assembly and to satisfy himself that the rules and procedures are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed. Audit & Accounts Regulations, 2007 lay down the principles for Receipt Audit.

2.2 Examination of systems and procedures and their efficacy

Audit of receipts includes an examination of the systems and procedures and their efficacy mainly in respect of:

a. identification of potential tax assessees, ensuring compliance with laws as well as detection and prevention of tax evasion;

b. exercise of discretionary powers in an appropriate manner including levy of penalties and initiation of prosecution;

c. appropriate action to safeguard the interests of the Government on the orders passed by departmental appellate authorities;

d. any measures introduced to strengthen or improve revenue administration;

e. amounts that may have fallen into arrears, maintenance of records of arrears and action taken for the recovery of the amounts in arrears;

f. pursuit of claims with due diligence and that these are not abandoned or reduced except with adequate justification and proper authority;

2.3 Audit products and Impact

In pursuance of audit mandate and provision in Regulation 205 of Audit & Accounts Regulations, 2007, we prepare annual compliance audit reports and periodical performance audit reports for submission to President under Article 151 of the Constitution. C&AG of India has the authority to decide the form, content and time of submission of Audit Reports under Regulation 205 of the Audit & Accounts Regulations, 2007.

2.4 Impact of audit

2.4.1 We analyse the impact of Audit resulting into amendments to the Income Tax Act and Rules framed thereunder, based on our recommendations. During 2014-15, we presented four Performance Audit Reports viz. (a) Report No. 7 of 2014 – Assessment of Firms, (b) Report No. 20 of 2014 – Allowance of Depreciation and Amortisation, (c) Report No. 32 of 2014 – Appreciation of Third Party (Chartered Accountant) Reporting in Assessment Proceedings and (d) Report No. 5 of 2015 – Assessment of Assessees in Pharmaceuticals Sector. Following paragraphs enumerate the impact of Audit.

2.4.2 While examining the 'Additional exemption claimed by partners under section 10(2A)' we had pointed out the ambiguity in the definition of 'total income' of Firms which contemplated into the partners getting excess exemption under section 10(2A) of the Act. Audit had recommended[24] that the Ministry may amplify the explanation to section 10(2A) so as to give proper meaning of total income of the Firm to be divided among the partners in the cases where the total income is reduced due to deduction/ exemption.

2.4.3 The Ministry thereafter issued a circular dated 31 March 2014 wherein it was clarified that the 'total income' of the firm for sub-section (2A) of section 10 of the Act as interpreted contextually, includes income which is exempt or deductible under various provisions of the Act. Further the income of the firm is to be taxed in the hands of the firm only and the same under no circumstances be taxed in the hands of its partners.

2.4.4 The second proviso to section 32(1) of the Act inter *alia* provides that the additional depreciation would be restricted to 50 *per cent* where the period of use of new plant or machinery acquired and installed by the assessee, is less than one hundred and eighty days in the previous year.

2.4.5 We pointed out[25] that AOs are allowing additional depreciation on new plant and machinery acquired and put to use in the year for less than 180 days and remaining additional depreciation in the subsequent year which was not mentioned in the Act.

2.4.6 The Government has inserted third provision to section 32(1) with effect from 1st April, 2016 providing that the balance 50 *per cent* of the additional depreciation on new plant or machinery acquired and used for less than 180 days which has not been allowed in the year of acquisition and installation of such plant or machinery, shall be allowed in the immediately succeeding previous year.

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24 Report No. 7 of 2014 – PA on Assessment of Firms.
25 Report No. 20 of 2014 – PA on Allowance of Depreciation and Amortisation.

2.4.7 We pointed out[26] a case of furnishing of report in Form 56F by an auditor in respect of a closely held company whose managing director was the auditor's brother. Audit recommended prohibiting a chartered accountant (CA) who is a relative of the assessee or directors of the assessee company, from signing any report or certificates.

2.4.8 To ensure the independence of an auditor, the Government amended section 288 of the Act to provide that an auditor who is not eligible to be appointed as auditor of a company as per the provisions of sub-section (3) of section 141 of the Companies Act, 2013 shall not be eligible for carrying out any audit or furnishing of any report/certificate under any provisions of the Act in respect of that company. On similar lines, ineligibility for carrying out any audit or furnishing of any report/certificate under any provisions of the Act in respect of non-company has been provided.

2.4.9 Under section 35(2AB) of the Act, weighted deduction of 200 *per cent* is allowed to a company engaged in the business of bio-technology or manufacturing of goods (except items specified in Schedule-XI to the Act) for the expenditure (not being expenditure in the nature of cost of any land or building) incurred on scientific research carried out in an approved in-house research and development facility, for which various procedures have been prescribed under the Act.

2.4.10 Considering the recommendations[27] of the Audit relating to monitoring of this weighted deduction, the provisions of section 35(2AB) of the Act have been amended with effect from 1st April 2016 to provide that deduction under the said section shall be allowed if the company enters into an agreement with the prescribed authority for cooperation in such research and development facility and fulfils prescribed conditions with regard to maintenance and audit of accounts and also furnishes prescribed reports. It has also been proposed to insert reference of the Principal Chief Commissioner or Chief Commissioner in section 35(2AA) and section 35(2AB) of the Act so that the report referred to therein may be sent to the Principal Chief Commissioner or Chief Commissioner having jurisdiction over the company claiming the weighted deduction under the said section.

26 Report No. 32 of 2014 – PA on Appreciation of Third Party (Chartered Accountant) Certification in Assessment Proceedings.

27 Report No. 5 of 2015 – PA on Assessment of Assessees in Pharmaceuticals Sector.

2.5 Incidence of errors

2.5.1 ITD completed 2,25,695 scrutiny assessments[28] in FY 2013-14 in those units which were audited during audit plan of FY 2014-15, of which we checked 2,10,507 cases. Apart from this, we have also audited 48,637 cases completed in previous financial years, during FY 2014-15. The incidence of errors in assessment checked in audit relating to assessment completed by ITD in FY 2013-14 was 15,557 cases (7.4 *per cent)* which was less than the previous year (9.52 *per cent*). We pointed out mistakes in 4,446 cases where Internal Audit of ITD failed to deduct.

2.5.2 State-wise incidence of errors in assessment is given in *Appendix-2.1.* Table 2.1 below shows details of top eight States where more than 10,000 assessments were checked in audit during 2014-15.

Table 2.1: Details of top eight states having more than 10,000 assessments (₹ in crore)

State	Assessments completed during 2013-14	Assessments checked in audit during 2014-15	Assessments with errors	Total revenue effect of the audit observations	Percentage of assessments with errors
Andhra Pradesh	15,660	13,600	1,133	2,688.63	8.33
Delhi	28,563	26,421	1,191	1,672.80	4.51
Gujarat	23,914	22,518	1,052	1,498.96	4.67
Karnataka	17,222	13,783	802	1,339.37	5.82
Maharashtra	35,109	34,164	1,791	3,020.31	5.24
Tamil Nadu	17,296	16,324	1,684	1,606.93	10.32
Uttar Pradesh	20,879	18,093	1,101	821.93	6.09
West Bengal	14,552	14,155	2,541	3,464.38	17.95
Total	**173,195**	**1,59,058**	**11,295**	**16,113.31**	

This indicates that West Bengal has the highest percentage of assessments with errors (17.95 *per cent*) followed by Tamil Nadu (10.32 *per cent*). It has also been seen that in the last five years both these states were having the highest percentage of assessments with errors.

2.5.3 Table 2.2 below shows the details of errors noticed in local audit during FY 2014-15.

Table 2.2: Tax wise details of errors in assessments (₹ in crore)

Category	Cases	Tax effect
a. Corporation tax & Income tax	16,631	19,632[29]
b. Wealth tax	904	334
c. Other Direct taxes	99	3
Total	**17,634**	**19,969**

Note: The above findings and all subsequent findings are based exclusively on audit of selected assessments.

28 Total scrutiny assessment completed in the ITD during FY 2013-14 was 2,84,750.
29 Includes 395 cases of over assessments with tax effect of ₹ 850 crore

2.5.4 Table 2.3 below shows the category-wise details of underassessment in respect of Corporation tax and Income Tax. *Appendix-2.2* indicates details in respect of sub-categories under them.

Table 2.3: Category-wise details of errors		**(₹ in crore)**
Category	**Cases**	**Tax effect**
a. Quality of assessments	4,377	2,032
b. Administration of tax concessions/exemptions/deductions	6,778	11,201
c. Income escaping assessments due to omissions	2,639	2,799
d. Others	2,442	2,750
Total	**16,236**	**18,782**

2.5.5 High value and important cases among the errors detected in local audit are included in this Audit Report. The present Audit Report discusses 455 cases reported to the Ministry[30]. *Appendix 2.3* gives the details of such cases. Table 2.4 shows category wise details of these cases[31].

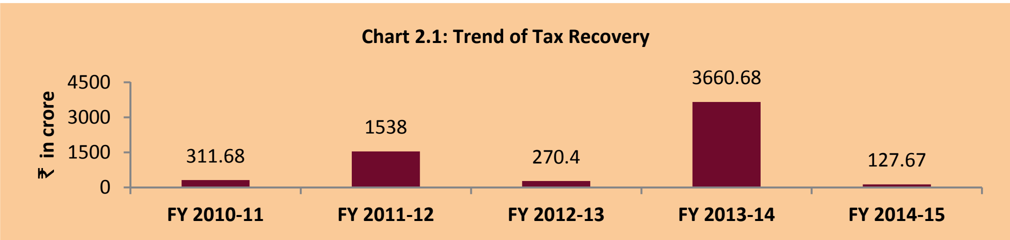
Table 2.4: Category-wise details of errors of high value cases						**(₹ in crore)**
Category	**CT**		**IT**		**Total**	
	No.	**TE**	**No.**	**TE**	**No.**	**TE**
a. Quality of assessments	93	426.84	54	165.18	147	592.02
b. Administration of tax concessions/exemptions/ deductions	155	1,796.79	49	93.18	204	1,889.97
c. Income escaping assessments due to omissions	44	176.56	33*	17.11	77	193.67
d. Overcharge of tax/ interest	20	58.84	07	11.00	27	69.84
Total	**312**	**2,459.03**	**143**	**286.47**	**455**	**2,745.50**

*includes six cases of under assessment of wealth involving TE of ₹ 0.18 crore.

We discuss some important cases in Chapters III and IV.

2.5.6 Recovery at the instance of audit

ITD recovered ₹ 5,908.43 crore in the last five years from demands raised to rectify the errors in assessments that we pointed out. This includes ₹ 127.67 crore recovered in FY 2014-15.



30 Ministry of Finance, Central Board of Direct Taxes.
31 Sub-categories-wise details are in *Appendix-2.4*

Chart 2.1 above shows a sudden jump in recovery in FY 2011-12 (₹ 1,538 crore) which declined in 2012-13 (₹ 270.40 crore) and again suddenly jumped to ₹ 3,659.68 crore in FY 2013-14 which again declined in FY 2014-15 to Rs 127.67 crore.

2.6 Response to Audit

2.6.1 We elicit response from the audited entities at different stages of audit. On completion of field audit, we issue the local audit report (LAR) to ITD for comments. Further, we issue important and high value cases out of these to the Ministry for comments before inclusion in the Audit Report.

2.6.2 Table 2.5 below depicts the position of replies received and observations accepted in respect of cases issued in Local Audit Reports during FY 2010-11 to FY 2014-15.

Table 2.5: Response to local audit

Financial Year	Observations raised	Reply received		Reply not received	Percentage of cases accepted	Percentage of reply not received
		Cases Accepted	Cases not accepted			
2010-11	20,130	4,354	3,568	12,208	21.6	60.7
2011-12	19,624	3,945	2,971	12,708	20.1	64.8
2012-13	18,548	3,343	4,124	11,081	18.0	59.7
2013-14	19,312	3,642	3,131	12,534	18.9	64.9
2014-15	17,626	3,631[32]	3,535	10,450	20.6	59.3

2.6.3 We give six weeks to the Ministry to offer their comments on high value cases before their inclusion in the Audit Report. Out of 455 high value cases included in the current Audit Report, the Ministry/ITD accepted 159 cases[33] (34.9 *per cent*) while ITD did not accept 16 cases as of 15 December 2015. Table 2.6 shows details of remedial action taken by the ITD.

Table 2.6: Details of action taken **(₹ in crore)**

Categories	Action completed and amount recovered		Action completed but amount to be recovered		Action initiated only	
	No.	TE	No.	TE	No.	TE
a. Corporation Tax	0	0.00	239	1,317.17	23	127.22
b. Income Tax	0	0.00	111	251.68	17	24.67
c. Wealth Tax	2	0.07	04	0.11	0	0.00
Total	**2**	**0.07**	**354**	**1,568.96**	**40**	**151.89**

The ITD has taken/initiated remedial action in 396 cases out of 455 cases. Details of remedial action taken in the remaining cases were not available as of 15 December 2015.

32 1,574 - Cases accepted and remedial action taken; 2,057 - Cases accepted but remedial action not yet taken.
33 Ministry-79 cases; ITD-80 cases.

2.6.4 Chapters III and IV bring out details of errors in assessments in respect of Corporation Tax, Income Tax and Wealth Tax respectively.

2.7 Pendency of audit observations

2.7.1 CBDT issued instructions (2006) that replies to LARs should be provided within six weeks. Assessing officers (AOs) are required to initiate remedial action within two months to correct errors in demands lest they become time barred leading to loss of revenue.

2.7.2 Table 2.7 below shows the pendency of observations.

Table 2.7: Details of outstanding audit observations **(₹ in crore)**

Period	**CT**		**IT**		**ODT**		**Total**	
	No.	**TE**	**No.**	**TE**	**No.**	**TE**	**No.**	**TE**
Upto Mar 2011	6,648	12,643.52	7,726	2,215.50	1,948	84.64	16,322	14,943.66
2011-12	2,497	8,839.55	2,772	1,059.36	612	26.03	5,881	9,924.94
2012-13	3,409	5,946.07	3,318	2,733.89	1,159	95.20	7,886	8,775.16
2013-14	4,618	9,370.11	6,150	2,484.13	1,295	6.98	12,063	11,861.22
2014-15	3,378	14,073.72	3,813	2,765.98	662	70.49	7,853	16,910.19
Total	**20,550**	**50,872.97**	**23,779**	**11,258.86**	**5,676**	**283.34**	**50,005**	**62,415.17**

The accretion in pendency in replies to audit findings each year has resulted in pile-up of 50,005 cases involving revenue effect of ₹ 62,415.17 crore as of 31 March 2015.

2.7.3 Table 2.8 below shows the details of time-barred cases during FY 2010-11 to 2014-15.

Table 2.8: Details of time-barred cases **(₹ in crore)**

Year of Report	**Cases**	**Tax effect**
2010-11	7,942	5,335.0
2011-12	3,907	1,083.0
2012-13	2,207	899.9
2013-14	2,427	1,121.2
2014-15	3,881	2,490.8

2.7.4 During FY 2014-15, 3,881 cases with tax effect of ₹ 2,490.8 crore became time-barred for remedial action, of which Tamil Nadu alone account for 86 *per cent* of tax effect. *Appendix-2.5* indicates state-wise details of such cases for FY 2014-15.

2.8 Non-production of records

2.8.1 We scrutinize assessment records under section 16 of the C&AG's (DPC) Act, 1971 with a view to securing an effective check on the assessment, collection and proper allocation of taxes and examining that regulations and procedures are being observed. It is also incumbent on ITD to expeditiously produce records and furnish relevant information to audit.

2.8.2 *Appendix 2.6* shows the details of non-production of records during FY 2012-13 to FY 2014-15. Non-production of records has increased in Chhattisgarh, Haryana, Himachal Pradesh, Jharkhand, Kerala, Madhya Pradesh, UT Chandigarh and Delhi significantly over previous years during FY 2014-15. ITD did not produce 33,536 records out of 2,78,957 records requisitioned during FY 2014-15, (12.02 *per cent*) which is less than from FY 2013-14 (13.44 *per cent*). Table 2.9 shows details of records not produced to audit pertaining to same assessee in three or more consecutive audit cycles.

Table 2.9: Records not produced to audit in three or more audit cycles

	States	Records not produced
a.	Andhra Pradesh	44
b.	Gujarat	59
c.	Karnataka	58
d.	Madhya Pradesh	89
e.	Odisha	8
f.	Tamil Nadu	7
	Total	**265**

In FY 2014-15, 265 records pertaining to same assessees in six states were not produced to audit in last three or more consecutive audit cycles.