Chapter-III
State Excise

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State Excise

3.1 Tax Administration

The State Excise duty is levied on any liquor, intoxicating drug, opium or other narcotics and non-narcotic drugs which the State Government may, by notification, declare to be an excisable article. The Karnataka Excise (KE) Act, 1965 and Rules made thereunder govern the law relating to the production, manufacture, possession, import, export, transport, purchase and sale of liquor and intoxicating drugs and levy of duties of excise thereon. The State Excise Department is working under the administrative control of the Finance Department and is headed by the Excise Commissioner, who is assisted by Joint Commissioners of Excise. The excise duty is administered by the Deputy Commissioners of Excise (DCOE) at the District level and the Superintendents of Excise, Deputy Superintendents of Excise, Inspectors of Excise (IOE) and other sub-ordinate Officers at the distilleries and range Offices.

3.2 Internal Audit

The Internal Audit Wing (IAW) is functional in the Department since 1990. As per the information furnished by the Department, out of 109 Offices due for audit during 2016-17, only five Offices (4.59 *per cent*) were audited. The shortfall in coverage of Offices was attributed to the shortage of staff in the Wing. Year-wise details of the number of objections raised, settled and pending along with tax effect, as furnished by the Department, are given in **Table 3.1**.

Table 3.1
Year wise details of observations raised by IAW

(₹ in lakh)

Year	Observations raised		Observations settled		Observations pending	
	Number of cases	Amount	Number of cases	Amount	Number of cases	Amount
Upto 2012-13	536	1,701.01	43	44.15	493	1,656.86
2013-14	00	0.00	00	0.00	00	0.00
2014-15	06	2.87	02	0.30	04	2.57
2015-16	00	0.00	00	0.00	00	0.00
2016-17	00	0.00	00	0.00	00	0.00
Total	**542**	**1,703.88**	**45**	**44.45**	**497**	**1,659.43**

As could be seen from Table above, it is clear that the activities of IAW in the Department have reduced to a greater extent after 2012-2013 and virtually to nil in the previous two years. This indicates that the Department is not according due importance to internal audit.

It is recommended that due importance may be accorded to strengthen IAW, as internal audit is an important mechanism to ensure compliance by the Department of the applicable laws, regulations and approved procedures.

3.3 Results of Audit

Test check of records of 30 Offices of the State Excise Department during the year 2016-17 revealed non/short levy of licence fee, non-levy of transfer fee, non-levy of penalty on short lifting of Indian Made Liquor (IML) and other irregularities amounting to ₹ 139.64 crore involving 30 paragraphs. Details are given in **Table 3.2**.

Table 3.2
Results of Audit

(₹ in crore)

Sl. No.	Category	No. of Paragraphs	Amount
1.	**Performance Audit on 'Regulation and Control over Manufacture, Possession, Transportation, Distribution and Sale of Alcoholic Products in the State of Karnataka'**	1	132.57
2.	Non-levy of penalty for excess wastage/loss/short lifting	5	2.18
3.	Non-levy of penalty for failure to produce minimum prescribed quantity of spirit	5	2.15
4.	Non/Short levy of licence fee including additional licence fee, transfer fee	7	0.98
5.	Non/Short levy of excise duty, additional excise duty	3	0.37
6.	Other irregularities	9	1.39
	Total	**30**	**139.64**

During the course of the year 2016-17, the Department recovered ₹ 3.53 crore involved in 43 paragraphs pointed out during earlier years.

A Performance Audit on 'Regulation and Control over Manufacture, Possession, Transportation, Distribution and Sale of Alcoholic Products in the State of Karnataka' involving ₹ 132.57 crore is discussed in the following paragraphs.

3.4 Performance Audit on 'Regulation and Control over Manufacture, Possession, Transportation, Distribution and Sale of Alcoholic Products in the State of Karnataka'

Highlights

Delay in revision of norms regarding yield of Rectified Spirit caused potential minimum revenue loss of ₹ 64.84 crore to the Government by 12 distilleries during the period from April 2012 and September 2015.

(Paragraph .3.4.8)

Norms prescribed by the Department did not factor technological advancements and efficiencies designed for the fermentation plants which provided enough "margin" to the distillers to work to their advantage to make additional yield of Rectified Spirit. Audit analysis revealed a "margin" of about 2.19 crore to 4.23 crore Bulk Litres of Rectified Spirit which works out to minimum revenue between ₹ 633.32 crore and ₹ 1,222.62 crore, if converted to potable alcohol.

(Paragraphs 3.4.9.1 and 3.4.9.2)

Deficient performance of Distillery Officers led to control lapses which resulted in:

- Non-accounting for 19,555 MT of molasses purchased by three distilleries in the State between May 2012 and April 2014 with minimum revenue impact of ₹ 124.97 crore;
- Short fall in chemical analysis of samples of molasses in the range of 96.72 to 99.33 *per cent* prevented the Department in estimating actual output; and
- Excess storage loss claimed by four distilleries for the period from April 2012 to March 2017 worked out to 1,119.241 MTs on which penalty of ₹ 7.60 crore was not levied.

(Paragraph 3.4.10)

Database relating to Excise Adhesive Labels was not interlinked with the database of M/s. Karnataka State Beverages Corporation Limited (KSBCL), the wholesale liquor channelising agency, which resulted in release of liquor from KSBCL with unauthorised labels.

(Paragraph 3.4.11)

Violations of licence conditions and the sale of potable liquor by non-licencees were substantial and the enforcement action of the Department did not seem effective enough to control such illegal activities.

(Paragraph 3.4.12)

3.4.1 Introduction

The Constitution of India, vide Entry No.51 of List II of Article 246, vests the power to levy duty on alcoholic liquors for human consumption and narcotics with the States. The scope of the State Excise Administration covers commodities such as Spirits, Indian Made Liquor, Beer, Medicinal and Toilet preparations, etc. The objectives of the Department can be summed up as ensuring public health through regulated procurement of raw-materials, manufacture of various commodities by use of these raw materials, their storage and distribution. The State Excise is the next major source of revenue in the State of Karnataka after Commercial Taxes Department and is regulated by the provisions of Karnataka Excise Act and Rules.

3.4.1.1 Vision and Mission of the Department

The Department has the following 'Vision' and 'Mission' for regulating manufacture, possession, transportation, distribution and sale of alcoholic products and other narcotics in the State of Karnataka.

Vision: Optimisation of Excise Revenue while preventing the use of unsafe liquor and ensuring informed consumption in hygienic conditions.

Mission: Implementing State Excise policies and procedures by regulating manufacture, transport, possession, sale and other activities of the trade in spirit, spirituous preparations, potable liquor and other intoxicants and monitoring collection of associated taxes.

The policies and procedures including levy of Excise Duty, Additional Excise Duty, Fee for issue of various licences, interest, penalties, etc. in this regard are governed by the Karnataka Excise Act (KE Act), 1965 and the Rules made thereunder.

3.4.1.2 Broad framework of Karnataka Excise Act

The KE Act and Rules made thereunder empower the Government/Department to issue licence for various activities such as manufacture of alcoholic products in Distilleries, Breweries and Wineries as well as for possession, transportation, distribution and sale of alcohol and its products.

The Act and Rules also provide for complete supervision over manufacturing activities through its Officers and staff placed in the Distilleries, Breweries and Wineries. The norms of production such as input to output ratios at various stages, loss due to evaporation, maturation, storage, blending, transportation, etc. are stipulated. Control over transportation, distribution and sale is exercised through issue of permits and Excise Verification Certificates (EVCs).

As of March 2017, there were 25 Primary [1] Distilleries, 26 Secondary [2] Distilleries and seven Composite[3] Distilleries. Apart from these, there were six

[1] Primary Distilleries are those which distil spirits out of molasses, any grains, tapioca, sweet potato, sugar beet, cereals, sugarcane juice, cashew, pine-apple, apple, grapes, etc.

[2] Secondary Distilleries are those which use spirit distilled out of molasses, any grains, cereals, sugarcane juice, tapioca, sweet potato, sugar beet, grapes or malt for manufacture of Indian Liquor.

[3] Composite Distilleries are those which distil spirits and use the same for manufacture of Indian Liquor.

Breweries and 22 Wineries (including fruit and fortified wineries) in the State of Karnataka.

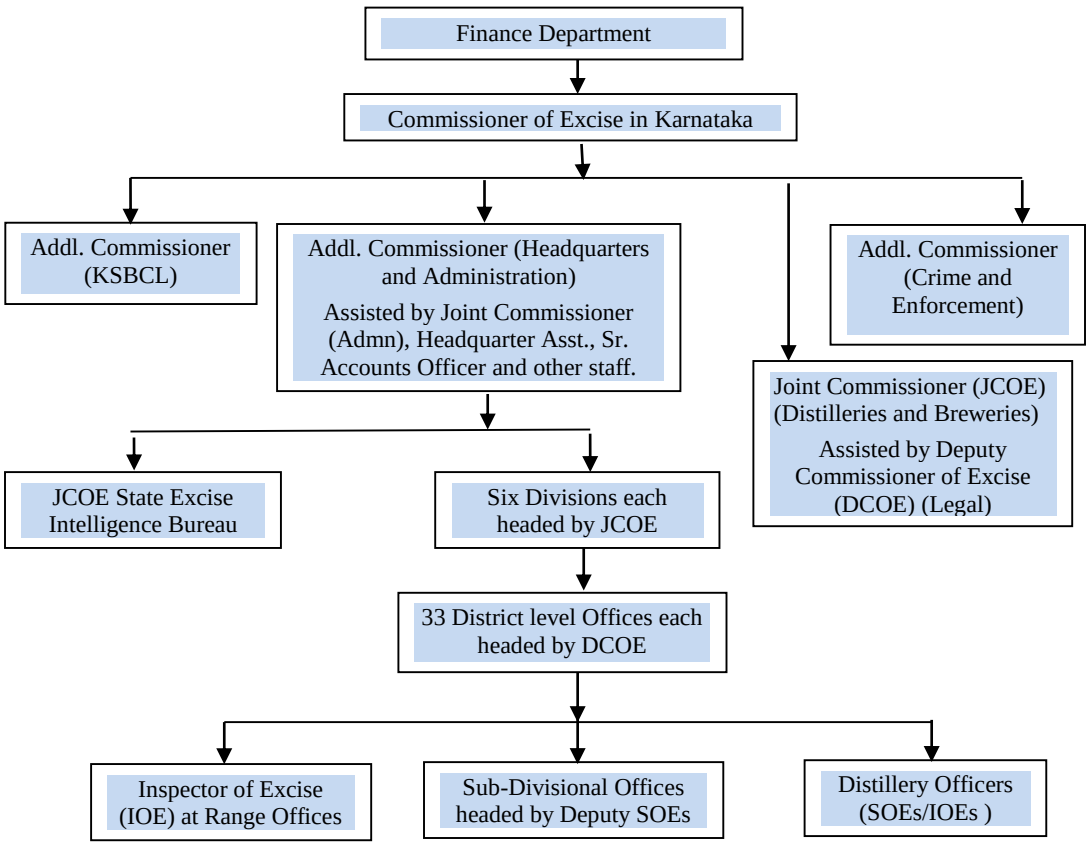
Further, the Government of Karnataka established M/s. Karnataka State Beverages Corporation Limited (KSBCL), in the year 2003, for the purpose of channelising sale of liquor in the State. Distilleries, Breweries and Wineries are required to sell their product through KSBCL to the retailers in the State. For monitoring the supply of quality liquor to the citizens, the Government prescribed affixing of Excise Adhesive Label (EAL) on the bottles and M/s. Marketing Communication and Advertising Limited (MCAL) was entrusted with the work of printing EALs.

The Excise Duty (ED) and Additional Excise Duty (AED) due on all kinds of potable liquors are paid by the manufacturer before transporting the liquor to KSBCL Depots.

Besides, stringent penal provisions are prescribed for violation of the provisions of the Acts and Rules made thereunder.

3.4.2 Organisational set-up

The State Excise Department (SED) is under the administrative control of the Finance Department. The SED is headed by the Excise Commissioner. The organisation chart of SED is given below:



3.4.3 Audit Objectives

The objectives of the Performance Audit were to ascertain whether:

- Controls over manufacture of potable liquor and collection of Excise Duties and Fees are being exercised optimally?
- Monitoring and control mechanisms for preventing and detecting offense cases under the Karnataka Excise Act, or Rules made thereunder, are effective?

3.4.4 Audit Scope

The Performance Audit covered the period from April 2012 to March 2017. Databases[4] of KSBCL and MCAL were obtained and analysed. The records maintained in the Excise Commissioners Office and one third of the Deputy Commissioners of Excise (DCOE) Offices in nine[5] Districts (11 out of 33 Offices in the State) were test checked. Information pertaining to the same period from all the Primary Distilleries were obtained and analysed. Records maintained in one third of the secondary distilleries (10 out of 31 distilleries in the State) were also test checked. Audit analysis of output was based solely on conversion of molasses to Rectified Spirit as this is the process established by majority of the distilleries in Karnataka. Besides, parameters of conversion of molasses are verifiable whereas the conversion of other raw materials like grains, grape, sweet potato etc. does not have verifiable parameters.

3.4.5 Audit Methodology

The information on supply of molasses from 30 out of 60 sugar factories in the State were obtained and cross-checked with the corresponding molasses receipt accounts of the Primary Distilleries. Also, information on issue of raw material for production of spirits, actual production of spirits of different kinds and strengths, adherence to the norms prescribed under the Act, etc. were examined. Supply of spirit from Primary Distilleries to the Secondary Distilleries manufacturing potable liquor was cross-checked in the selected Districts.

Cross-verification of records maintained in distilleries with those of KSBCL and cross-verification of records between MCAL and the distilleries with regard to Excise Adhesive Labels (EALs) were carried out to ensure that only liquor bottles/packs with valid EALs were channelised to the market. Important control deficiencies and other observations made during the course of Audit are brought out in the Report.

3.4.6 Acknowledgements

An Entry Conference was held (April 2017) with the Additional Chief Secretary (ACS) to Government of Karnataka, Finance Department and the Excise Commissioner in which the Audit Objectives, Scope and Methodology were

[4] Databases of KSBCL relating to receipt of liquor consignments from distilleries and their distribution to retail licensees and MCAL who are authorised to issue Excise Adhesive Labels during the same period were analysed to ensure only authorised and duty paid liquor are released to market.

[5] Bengaluru, Dakshina Kannada, Dharwad, Gadag, Kalaburgi, Kolar, Mandya, Mysuru and Yadagir.

explained to the Department. In the Entry Conference, the ACS explained the major initiatives of the Government such as establishment of KSBCL and introduction of EALs and Technical Committee comprising of experts from the Central Food Technological Research Institute, Indian Institute of Science (IISc), etc. formed to look into production norms, to curb sale of illicit liquor and ensuring sale of safe potable liquor in the State. The Audit findings and recommendations were discussed with ACS and the Excise Commissioner in the Exit Conference held in October 2017.

Audit acknowledges the co-operation extended by the State Excise Department in providing the necessary records and information for the conduct of this Performance Audit.

Audit also acknowledges the co-operation extended by Center for Scientific and Industrial Consultancy (CSIC) in arranging the consultancy from Chemical Engineering Department, IISc, Bengaluru.

3.4.7 Audit Criteria

The following are the sources of Audit criteria used in this Performance Audit:

1. The Karnataka Excise Act, 1965;
2. The Karnataka Excise (Distillery and Warehouse) Rules, 1967;
3. The Karnataka Excise (Excise Duties and Fees) Rules, 1968;
4. The Karnataka Excise Licences (General Conditions) Rules, 1967;
5. The Karnataka Excise (Regulation of Yield, Production and Wastage of Spirit, Beer, Wine or Liquors) Rules, 1998;
6. The Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968;
7. The Excise (Possession, Transport, Import and Export of Intoxicants) Rules, 1967; and
8. Notifications and circulars issued by the Government and Commissioner of Excise.

Audit Findings

The sugar manufacturing process broadly involves the extraction, clarification and concentration of sugarcane juice (called ‘mother syrup’). Sugar is extracted from the mother syrup by crystallisation processes. After extraction of sugar, the residue of the mother syrup is called ‘molasses’. Primary Distilleries use these sugarcane molasses as raw material to produce Rectified Spirit (RS). The manufacturing process in the Primary Distillery involves dilution of molasses (the diluted molasses is called ‘wash’) and its fermentation. Fermentation is the actual process in which the Total Reducible Sugar present in the molasses break into ethyl alcohol and carbon dioxide. After fermentation, alcohol is separated from the rest of the materials in the wash through the process of distillation.

3.4.8 Inconsistent and delayed revision of norms

Norms prescribed for manufacture of any product in proportion to the raw material consumed by the industry is a control measure to safeguard the interests of the State against the possibility of under-disclosure of production by the

manufacturers. For this control to be effective, the norms so prescribed shall be as close as to the production efficiencies designed for the plants in the distilleries per unit of the raw material consumed. Alcohol being a very critical and sensitive product both socially and economically, the controls exercised by the State are expected to be stringent and pragmatic, and are to be revised systematically to keep up with the technological upgradations and consequent changes in the efficiency of the processes involved.

Audit studied the controls exercised by the Department in effectively controlling the yield of RS, and noticed the following.

The Government framed Rules for determining the yield, production and wastages of various liquors vide the Karnataka Excise (Regulation of Yield, Production and Wastage of Spirits, Beer, Wine or Liquors) Rules, 1998, which came into force from 4 August 1998. Under the said Rules, the molasses classification as per ISI specifications (IS-1162) had been adopted. The IS-1162[6] stipulates that molasses having Total Reducible Sugar (TRS) of 50 *per cent* and above are classified as Grade I molasses. When TRS is 44 *per cent* or above but less than 50 *per cent*, the molasses are classified as Grade II and those having TRS from 40 to 43.9 *per cent* are classified as Grade-III molasses.

Audit had pointed out in the Comptroller and Auditor General's Audit Report[7] for the year 2004-2005 the need for revision of norms. A four members Technical Committee had been constituted by the Government on 22 December 2005 for revision of norms. This Committee, in its report dated 5 October 2007, observed that the yield on RS would depend upon the TRS and the type of manufacturing process (batch[8] or continuous[9]) followed by the distilleries. The Committee recommended revised norms for yield of RS as mentioned in the **Table 3.3**.

Table 3.3
Yield of RS per MT of molasses prescribed by the first[10] Technical Committee

TRS (*per cent*)	Modifications proposed in bulk litres (BLs) for Batch Process	Modifications proposed in BLs for Continuous Process
Grade 'I' Molasses (then existing minimum requirement–220 BLs)		
(i) > 52	255	>270
(ii) 51 – 51.9	250	265
(iii) 50 – 50.9	245	260
Grade 'II' Molasses (then existing minimum requirement–200 BLs)		
(i) 49 – 49.9	240	255
(ii) 48 – 48.9	235	250
(iii) 47 – 47.9	230	245
(iv) 46 – 46.9	225	240

6 IS 1162 – Specification for Cane Molasses fixed by Bureau of Indian Standards.
7 Paragraph No.3.2.7 of the Performance Audit on 'Working of Distilleries'.
8 In Batch Processing, fermentation is done in separate batches of molasses. The process is stopped once the product is formed.
9 Unlike, batch processing, in Continuous Processing, the fermentation process never stops in between and continues to run for a longer period of time. The process is not stopped for collection of product but the same is continuously taken out.
10 The Committee constituted by Government on 22 December 2005 would be referred as First Technical Committee for the purpose of this Report. The Government constituted another committee at a later stage.

TRS (*per cent*)	Modifications proposed in bulk litres (BLs) for Batch Process	Modifications proposed in BLs for Continuous Process
Grade 'III' Molasses (then existing minimum requirement – 180 BLs)		
(i) 45 – 45.9	220	235
(ii) 44 – 44.9	215	230
(iii) 43 – 43.9	210	225
(iv) 42 – 42.9	205	220
(v) 41 – 41.9	200	215
(vi) 40 – 40.9	195	210

The Committee stated that the range in each grade was wide and recommended to have an incremental increase under each grade. The Table above depicts yield of RS for all the three grades of molasses which has been incrementally devised (even within the same grade) from 195 to 270 BL, depending on the batch or continuous processes read with TRS content. The better yield for continuous process was attributable to the efficiency of this process over the batch process.

These norms were not implemented by the Government. Instead, another Standing Technical Committee was constituted in April 2011 for revising the norms of yield of production of RS from molasses. The Standing Technical Committee's recommendation to revise the norms of yield was received (November 2014) and implemented with effect from 06 October 2015. The revised norms are as detailed in the **Table 3.4**.

Table 3.4
Yield of RS per MT of Molasses prescribed by the second Technical Committee

Molasses as per ISI specifications IS-1162	TRS (*per cent*)	Norms up to September 2015 (Minimum production of RS in BL)	Revised norms from October 2015 (Minimum production of RS in BL)
Grade I	50 and above	220	240
Grade II	from 44 to 49.9	200	220
Grade III	from 40 to 43.9	180	200

Audit analysis of the revised norms revealed the following:

- Though the distilleries have reported production up to 270 BL even before the first Committee was constituted during 2005, revision of norms was implemented only during October 2015;
- There was a delay of eight years in revision of norms after the recommendations made by the first Technical Committee in October 2007. Also, the revised norms were below the standards proposed by the first Technical Committee. The production data in 12 distilleries during the period from April 2012 and September 2015 revealed short production of RS of 22.42 lakh BLs against the revised minimum yield of 240 BLs per metric ton (MT). Potential revenue loss to the Government due to the delay in decision making worked out to a minimum of ₹ 64.84 crore[11]. The details are given in ***Annexure I***;

[11] The revenue impact worked out for the 12 distilleries is only indicative as the data for only three and half years was analysed as against delay of eight years in revising the norms after the first Committee's recommendation.

- Incremental norms of yield on the basis TRS content within the same Grade of molasses was made by the first Technical Committee. This aspect was not even discussed in the second Committee's Report; and
- The first Technical Committee recommended higher norms for continuous process of RS production over the batch process. The second Technical Committee did not consider this factor as a basis for fixation of yield. Nine[12] out of 18 distilleries who furnished technical information on their plants claimed to have adopted continuous processing technologies, therefore the same was also an important factor in the yield estimations.

The reasons for repudiating the earlier Committee's recommendations were not found on record. Audit points out that parameters like nature of processing (batch or continuous), incremental production within the grade, etc. should have been factored within the norms since these significantly influence the output of RS.

3.4.9 Norms fixed for production of Rectified Spirit: An Analysis

With a view to ensuring the adequacy of the controls exercised by the Department through the norms prescribed under the KE Act and Rules made thereunder, the norms were analysed against the actual performances by the distilleries in the State during the five-year period from April 2012 to March 2017. The observations noticed in this regard are discussed in the following sub-paragraphs.

3.4.9.1 Discrepancies noticed in the norms fixed for production

Audit tabulated the yield of RS against the quantity of TRS in the molasses and worked out the mandated output of RS per Kg of TRS. Details are shown in the **Table 3.5**.

Table 3.5

RS output per Kg of Total Reducible Sugar as per adopted norms

TRS Percentage in Molasses	Grade of Molasses	Quantity of TRS applied in the process (in kg per MT of molasses)	RS expected in BL as per the prescribed norms	RS output in ml per Kg of TRS
40	Grade III	400[13]	200	500
41		410	200	488
42		420	200	476
43		430	200	465
44	Grade II	440	220	500
45		450	220	489
46		460	220	478

[12] M/s. Godhavari Biorefineries Limited, Bagalkot, M/s. Shri Doodganga Krishna, Belagavi, M/s. Shree Renuka Sugars Limited, Belagavi, M/s. Sathish Sugars Limited, Belagavi, M/s. Shree Renuka Sugars Limited, Kalaburgi, M/s. NSL Sugars Limited (Distillery Division), Mandya, M/s. Chamundi Distilleries Private Limited, Mysuru, M/s. Nandi Sahakara Sakkare Karkhane Niyamitha, Vijayapura and M/s. Core Green Sugars and Fuels Private Limited, Yadgir.

[13] Molasses of 40 *per cent* TRS (by weight) means 1 MT of molasses contain 400 kg of TRS and so on for the range given in the table.

TRS Percentage in Molasses	Grade of Molasses	Quantity of TRS applied in the process (in kg per MT of molasses)	RS expected in BL as per the prescribed norms	RS output in ml per Kg of TRS
47		470	220	468
48		480	220	458
49		490	220	449
50	Grade I	500	240	480
51		510	240	471
52		520	240	462
53		530	240	453
54		540	240	444
55		550	240	436

From the Table, Audit noticed the following discrepancies in the revised norms of production of RS:

- As per the norms, within a particular grade of molasses, there is a decreasing trend of yield per kg of TRS with an increase of quantity of TRS. This was neither logical nor reasonable;
- Minimum yield fixed for the Grade I molasses, which is considered the most potent, was the lowest in terms of yield per kg of TRS; and
- While the users of the Grade-I molasses with 55 *per cent* TRS content could achieve the stipulated norm with only 436 ml of RS per kg of TRS, users of Grade-III molasses with 40 *per cent* TRS content were required to produce 500 ml of RS per kg of TRS. Thus, as per the norms, the inferior Grade of molasses was expected to give an additional output of 14.68 *per cent* compared to that from a superior Grade of molasses.

This Table depicts the need for incremental increase based on TRS in the molasses. As the TRS increases, yield of RS should also proportionately increase, instead of decreasing as per the norms as shown above. Hence, the norms prescribed provide enough margin to the distillers to work to their advantage to make additional yield. The fact that superior molasses is required to produce less RS in comparison to quantity of TRS present in molasses reveals the flaws of the Department in regulating the manufacture of alcohol and its products at the initial stage itself. Thus, the basis for fixation of norms compromised the administrative control exercised by the Department.

After this was pointed out in July 2017, the Government and the Department stated, in October 2017, that the yield rate of alcohol not only depends on TRS but also on other parameters like volatile acidity, ash content, long storage, caramel content, lactic acid, microbial contamination, quantity of un-fermentable sugar, etc.

The reply was not reasonable as the effects of the various contents of the molasses on RS production would apply uniformly to molasses of all grades. In the grade III molasses, the TRS content, which produce RS, will only be 40 to 44 *per cent* and the other ingredients listed out by the Department would be 56 to 60 *per cent*. While, in the Grade I molasses TRS content will be 50 *per cent* or more and the other ingredients would be 50 *per cent* or less. Hence, as the TRS content increases, the volume of other ingredients decreases and consequently the impact of other ingredients on the output decreases. Hence the

contention of the Department that the presence of other ingredients would affect the yield of RS was not logical.

3.4.9.2 Comparison of production as per norms, good yields and productions reported by distilleries

a. Issues related to production within the distilleries

As described in paragraph No.3.4.9.1, the norms prescribed under the Act itself varied between 436 ml to 500 ml of RS yield per Kg of TRS and the possibilities of the distilleries making additional yield out of such margins provided in the norms cannot be ruled out. Audit compared the production levels of RS achieved by the distilleries to that of the production levels as per the norms prescribed to check whether the norms fixed were realistic. Audit also compared highest yield rates of RS achieved by a distillery with the often lower production levels reported in the same distillery to assess the possibility of reporting short production of RS in different distilleries.

For this purpose, the Chemical Analysis Reports of molasses (to determine TRS *per cent*) given by the Government Chemists authorised by the Department in this behalf were collected from eight[14] Primary Distilleries. Actual output of RS per MT of such chemically analysed molasses[15] by the Distilleries were obtained and tabulated against the TRS factors and then RS output per kg of TRS was worked out. The data used in this analysis constituted 15.25 *per cent* of the 79.65 lakh MT of molasses used by all the Primary Distilleries in the State during the period from April 2012 to March 2017. The analysis showed the following trends:

- Distilleries were generally achieving the norms prescribed under the Rules;
- There was considerable variation in yield per kg of TRS in the molasses to RS over the period which ranged between 434 ml to 599 ml of RS per Kg of TRS; and
- Distilleries which have achieved highest output of RS per Kg of TRS in certain months had failed to meet the same level subsequently.

Audit worked out the short production of RS in these eight test-checked distilleries during the period from April 2012 to March 2017, with reference to their own previous highest yield rates[16], in subsequent months, the details are given in **Table 3.6**.

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[14] M/s. Bannari Amman Sugars Limited (Distillery Division), M/s. Sri Chamundeshwari Sugars Limited Distillery, M/s. Core Green Sugar and Fuels Private Limited, M/s. J.P. Distilleries, M/s. NSL Sugars Limited (Distillery Division), M/s. Renuka Sugars, M/s. Sri Lakshmi Narasimha Distilleries Private Limited and M/s. Vijayanagar Sugars Limited (Distillery Division).

[15] Only in cases where Chemical Analysis Report was available and percentage of TRS was known; the corresponding output of RS was collected from the distilleries to analyse the trend.

[16] Highest production of RS per Kg in any month achieved by a distillery is used as norm for subsequent months till increase in yield rate is noticed by that distillery. For example, Sl.No.4 of table 3.6, 495 ml per Kg of TRS was the initial standard yield rate, later it became 517 ml per Kg of TRS. All other lower levels of production against the previous good yield rates were worked out as short productions.

Table 3.6

Short production of RS with respect to previous good yield rates achieved

Sl. No.	Name of the distillery	(i) Highest yield rate(s) - in terms of RS in ml per Kg of TRS in molasses (in the particular month(s) of production) (ii) Quantity of molasses Distilled	(i) Performance below highest yield rate (RS in ml per Kg of TRS in molasses) (ii) Quantity of molasses Distilled	Quantity of RS produced short when compared with highest yield (in BL)
1.	M/s. Sri Chamundeshwari Sugars Limited, Distillery, Bharathinagar, Maddur, Mandya District	(i) 569 ml of RS per Kg of TRS (July 2012) (ii) 5,171 MT of molasses distilled	(i) 469 ml to 538 ml of RS per Kg of TRS (ii) 1,73,274 MT in 33 subsequent months between August 2012 and December 2016	62,14,403
2.	M/s. Renuka Sugars Havalga Kalaburgi District	(i) 567 ml of RS per Kg of TRS (May 2012) (ii) 12,957 MT of molasses distilled	(i) 495 ml to 554 ml of RS per Kg of TRS (ii) 1,30,339 MT in 11 subsequent months from Nov 2012 to June 2014. Information for the subsequent months not available.	25,00,877
3.	M/s. Core Green Sugar and Fuels Private Limited, Shahapura, Yadgir, District	(i) 599 ml of RS per Kg of TRS (December 2012) (ii) 4,220 MT of molasses.	(i) 447 ml to 555 ml of RS per Kg of TRS (ii) 48,674 MT in 13 months between February 2013 and October 2015. Information for the rest of the months not available.	25,92,537
4.	M/s. NSL Sugars Limited (Distillery Division) Koppa, Mandya District	(i) 495 ml to 517 ml of RS per Kg of TRS (August 2012 and October 2013) (ii) 3,728 MT and 2,649 MT of molasses respectively.	(i) 458 ml to 516 ml of RS per Kg of TRS (ii) 67,597 MT of molasses. (Data available only for 26 months between April 2012 and January 2017).	7,86,400
5.	M/s. Sri Lakshmi Narasimha Private Limited, Distilleries, Maddur, Mandya District	(i) 474 ml and 500 ml of RS per Kg of TRS (April 2012, January 2013 and January 2016) (ii) 1,774 MT, 2,515 MT and 2,511 MT of molasses respectively.	(i) 458 ml to 516 ml of RS per Kg of TRS (ii) 27,011 MT of molasses. (Data available only for 11 months between April 2012 and July 2016)	2,48,438

Sl. No.	Name of the distillery	(i) Highest yield rate(s) - in terms of RS in ml per Kg of TRS in molasses (in the particular month(s) of production) (ii) Quantity of molasses Distilled	(i) Performance below highest yield rate (RS in ml per Kg of TRS in molasses) (ii) Quantity of molasses Distilled	Quantity of RS produced short when compared with highest yield (in BL)
6	M/s. Bannari Amman Sugars Limited (Distillery), Nanjangud, Mysuru District	(i) 502 ml to 523 ml of RS per Kg of TRS (April (5,292 MT), August (6,816 MT) and November (6,533 MT) 2012, March (6,828 MT), July (5,349 MT), August (4,783 MT) and November (6,305 MT) 2015 and June (4,199 MT) and December (5,188 MT) 2016) (ii) 51293 MT of molasses	(i) 485 ml to 500 ml of RS per Kg of TRS (ii) 2,18,774 MT of molasses (Data available for 54 out of 60 months between April 2012 and March 2016)	6,62,133
7.	M/s. Vijayanagar Sugars Private Limited, (Distillery), Yadgir District	(i) 536 ml to 549 ml of RS per Kg of TRS (March 2014 (10,615 MT) and November (10,556 MT) 2015) (ii) 21,171 MT of molasses	(i) 441 ml to 530 ml of RS per Kg of TRS (ii) 2,17,888 MT of molasses (Data available only for 23 months between March 2014 and April 2016)	55,85,251
8.	M/s. J.P. Distilleries, Private Limited, Kunigal, Tumakuru District.	(i) 555 ml of RS per Kg of TRS (June and August 2012) (ii) 695 MT of molasses.	(i) 434 ml to 540 ml of RS per Kg of TRS (ii) 1,17,221 MT of molasses (Data available for 43 months between April 2012 and December 2016)	32,61,871
	Total	**(i) 474 ml to 599 ml of RS per Kg of TRS** **(ii) 1,08,684 MTs of molasses**	**(i) 434 ml to 554 ml of RS per Kg of TRS** **(ii) 10,00,778 MTs of molasses**	**2,18,51,910**

As shown in the Table above, the short production in comparison to the highest production levels of the distilleries worked out to 2.19 crore BLs. The details are given in ***Annexure II-(a) to II-(h)***. As mentioned earlier, this shows that the yield per kg of TRS varied significantly to the extent of 2.19 crore BLs within the sample of 15.25 *per cent* of molasses distilled in the State during period from April 2012 to March 2017. This is the margin over which the Excise Department does not have any control because such productions, though short of the highest yield rates, were within the norms prescribed in the Rules.

After this was pointed out, the Government/Department stated that TRS contains both Fermentable Sugars (FS) and Un-Fermentable Sugars (UFS). With the improvements in technology and better processing at sugar factories, the FS content has come down in molasses with more or less the same TRS value and UFS level has increased.

The reply was not justifiable due to the following reasons:

- Department's claim is general in nature and was not supported by the chemical analysis data of the molasses showing the quantities of FS and UFS content in it. As verified by Audit, in none of the cases, levels of FS and UFS were measured by the Department.
- UFS level in TRS is generally expected in the range of four to six *per cent* or on an average five *per cent*[17] and the same had already been factored in arriving at the expected yield of RS; and
- There are technological improvements in the fermentation industries to enhance ethanol yield from molasses by enzymatic reaction which converts UFS into FS.

b. Issues related to production across distilleries in the State

Fermentation being a process carried out in completely enclosed vessels, it is reasonably expected that the production levels should be uniform across the distilleries. Five best performances from the eight distilleries mentioned in **Table 3.6** are tabulated in the **Table 3.7**.

Table 3.7
Best performances[18] achieved by distilleries in production of RS

Sl. No.	Name of the distillery	RS output in BL per Kg of TRS	Month and year in which best performance achieved
1.	M/s. Core Green Sugar and Fuels Private Limited	0.599162	January 2013
2.	M/s. Chamundeshwari Sugars Limited Distillery	0.568507	July 2012
3.	M/s. Renuka Sugars, Havalga	0.566583	May 2012
4.	M/s. Renuka Sugars, Havalga	0.556570	December 2012
5.	M/s. Core Green Sugar and Fuels Private Limited	0.555884	February 2013
Average RS output		**0.569341**	

It may be seen from above that the highest output was achieved in January 2013. Being on the conservative side, average of the above mentioned five highest levels, which were achieved between May 2012 and February 2013, was considered as benchmark for analysis which worked out to 569 ml per Kg of TRS. This means that the optimum level achieved by these distilleries was 13.80 *per cent* more than the maximum output norm of 500 ml prescribed under the Act (i.e. the first row in **Table 3.5**).

[17] Source: National Sugar Institute, Kanpur.
[18] The top five good yields of RS per Kg of TRS was reported by three out of eight distilleries analysed.

Adopting 569 ml per Kg of TRS as the norm, production of RS expected vis-à-vis achieved was tabulated only for the months for which Chemical Analysis Reports (determining TRS) were available. Such an analysis revealed that the distilleries had made a short production of spirit of 4.23 crore BLs (as against the actual production of 31.48 crore BLs produced by these distilleries) in comparison with the adopted norm of 569 ml per kg of TRS, the details of which are given in ***Annexure III-(a) to III-(h)***.

The actual process of production of alcohol is fermentation. Substantial variation in obtaining alcohol present in the fermented sugar through fermentation should be of great concern in regulation of the production and overall monitoring of distilleries. A sample of 15.25 *per cent* data revealed margin of about 2.19 crore (6.96 *per cent* – Para 3.4.9.2 (a)) to 4.23 crore BLs (13.44 *per cent*– Para 3.4.9.2 (b)) of RS over and above the actual production of 31.48 crore BLs of RS declared by the distilleries. The quantity of potable liquor that could have been expected out of short produced RS ranged between 4.46 crore[19] and 8.61 crore[20] BLs. The minimum revenue expected out of the same, ranged between ₹ 633.32 crore[21] and ₹ 1,222.62 crore[22].

Besides, the technological improvements in the fermentation and distillation processes particularly with regard to conversion of UFS in the molasses to FS using enzymes to have extra yield of alcohol have not been taken into consideration by the Department.

Therefore, Audit concludes that the controls exercised by way of norms prescribed and monitoring over production in distilleries need to be re-looked for more effectiveness.

After this was pointed out in July 2017, the Government and the Department stated in October 2017 that the yield rate of RS depends not only on FS and TRS but also on other contents of molasses.

As all the factors stated to influence the production of RS have been taken into consideration in the design of the fermentation and distillation plants, the reply was not found reasonable. Further, technological advancement in the distilleries in terms of converting UFS into FS to improve the yield of RS was also not taken into account for yield computation.

[19] 2.19 crore BL of RS X 166 (Proof strength of RS) ÷ 75 (Proof strength stipulated for potable liquor) gives expected yield of potable liquor of 4.85 crore BL. After allowing 8 *per cent* wastage under the Excise Act/Rules for wastage during the process of blending and bottling, the net quantity of potable liquor worked out at 4.46 crore BL.

[20] 4.23 crore BL of RS X 166 (Proof strength of RS) ÷ 75 (Proof strength stipulated for potable liquor) gives expected yield of potable liquor of 9.36 crore BL. After allowing 8 *per cent* wastage under the Excise Act/Rules for wastage during the process of blending and bottling, the net quantity of potable liquor worked out at 8.61 crore BL.

[21] ED and AED at the lowest slab rate of ₹ 142 per BL for 4.46 crore BL of potable liquor.

[22] ED and AED at the lowest slab rate of ₹ 142 per BL for 8.61 crore BL of potable liquor.

c. Analysis of production of Rectified Spirit with respect to the designed efficiencies of the plants

The fermentation and distillation plants installed in the distilleries are designed to have a specified efficiency[23] for yield of RS. In this regard, Audit was able to collect information on design and operation efficiencies from eight distilleries and analysed deviations in the operational efficiency from the designed efficiency of the individual plants. The details are given in the **Table 3.8**.

Table 3.8
Efficiencies of fermentation and distillation plants in distilleries

(Efficiency figures in percentages)

Sl. No.	Name of the Distillery	Period of installation	Fermentation efficiency as per plant specification	Distillation efficiency as per plant specification	Overall efficiency of the plant (Column 4 ÷ 100) X Column 5	Corresponding efficiency as computed on the basis of reported production (Lowest to Highest/Average)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1.	M/s. Sri Chamundeshwari Sugars Limited Distillery, Bharathinagar, Maddur, Mandya	March 2003	88	98.5	86.68	72.13 to 87.29 76.88
2.	M/s. Renuka Sugars Limited, Havalga, Kalaburgi	2009	90	98.0	88.20	76.02 to 86.99 81.68
3.	M/s. Core Green Sugar and Fuels Private Limited, Yadgir	2009	90	98.5	88.65	68.64 to 91.99 76.29
4.	M/s. NSL Sugars Limited, Koppa Maddur, Mandya	November 2007	90	98.5	88.65	70.43 to 79.40 76.58
5.	M/s. Sri Lakshmi Narasimha Distilleries Private Limited, Dharwad	November 1996	87	98.0	85.26	69.18 to 76.87 73.19
6.	M/s. J.P. Distilleries Limited, Kunigal, Tumkuru	2000-01	89	98.0	87.22	66.73 to 85.24 76.31
7.	M/s. Bannari Amman Sugars Limited, Mysuru	March 2005	91	99.0	90.09	74.54 to 80.34 78.44
8.	M/s. Vijayanagar Sugar Private Limited, Yadgir	July 2011	90	99.0	89.10	65.12 to 84.36 75.81

As can be seen, the resultant corresponding efficiencies of plants based on reported productions fall in the range between 65.12 and 91.99 *per cent*. This was far below than the efficiencies of different plants as per specifications during most of the months. This was unusual since the fermentation and distillation are the processes carried out in completely enclosed vessels.

[23] Efficiency of distillery refers to the percentage RS output achievable when a given quantity of TRS is fermented.

Recommendation 1: The Government may consider revising the norms after taking into consideration:

(i) RS output per kilogram of Total Reducible Sugar; and

(ii) The designed efficiencies of the fermentation and distillation plants in the distilleries.

In the Exit Conference (October 2017), the ACS agreed that technological improvements need to be watched by the Department and norms are to be revised once every two years.

3.4.9.3 Absence of regulation and control over heavy[24] TRS content in molasses supplied by Sugar Factories

The TRS content in the molasses distilled is important as only the TRS content in the molasses is fermented as ethyl alcohol by the yeast added during fermentation process. Hence, as already discussed in the earlier paragraphs, higher content of TRS should normally be converted to a higher output of alcohol. In cases where the sugar factories do not extract the sugar out of the mother syrup to its optimum level, it would yield higher quantity of molasses per MT of sugarcane crushed and it is also expected to contain higher percentage of TRS than in the normal molasses. In general, the molasses is expected to be between 3.5 and 4.5 *per cent* of the sugarcane crushed i.e. 35 to 45 Kgs of molasses per MT of sugarcane crushed. These kinds of molasses are expected to contain TRS between 40 and 55 *per cent*.

In order to examine the possibility of heavy TRS content in the molasses supplied to the distilleries, Audit collected various month-wise details, such as quantity of sugarcane crushed, and quantity of molasses produced and issued in respect of 16 out of 60 sugar factories (25 *per cent*) in the State during five-year period from April 2012 to March 2017. Analysis of this data revealed the following:

- Total quantity of molasses produced by these 16 sugar factories during last five years was 15.31 lakh MT of molasses from 3.28 crore MT of sugarcane crushed;
- Of these, 13 lakh MT (84.91 *per cent*) of molasses obtained was within the expected range of 3.5 to 4.5 *per cent* of the total sugarcane crushed;
- Remaining 2.31 lakh MT (15.09 *per cent*) of molasses by 13 sugar factories were found to be heavy TRS molasses as the molasses obtained per MT of sugarcane ranged between 5.5 and 13.47 *per* cent. This indicated the existence of molasses with heavy TRS content in the industry which obviously would bring in higher yield of RS; and
- Statements relating to supply of such heavy TRS molasses furnished by these sugar factories showed that out of these 2.31 lakh MT of molasses, 15.293 MT were either exported or supplied to animal feed manufacturers in the State, and out of the remaining 2.16 lakh MT (93.50 *per cent*), 1.26 lakh MT (58.53 *per cent*) were used by the five[25]

[24] Molasses with TRS more than 55 *per cent*.

[25] M/s. Core Green Sugars and Fuels (P) Limited, M/s. Renuka Sugars Limited, Athani, M/s. Renuka Sugars Limited, Manoli, M/s. Renuka Sugars Limited, Nippani and M/s. Ugar Sugar Limited, Nippani.

distilleries owned by the respective sugar factories. The remaining 0.90 lakh MT were supplied to Primary Distilleries in the State.

In view of these, the compliance with the mandatory requirement of conducting chemical analysis of molasses each time it is drawn for processing assumes greater importance. Due to absence of regular conduct of chemical tests, higher percentage of TRS in molasses go unnoticed which leads to concealment of higher yield of RS. This shows absence of regulation by the Government/Department in exercising control over production of spirits and its products in the State.

After this was pointed out, the Government and the Department stated that data relating to cane crushed, sugar produced and the percentage of recovery of sugar for the three years from 2011-12 to 2013-14 were obtained from the Authority concerned. Further, information regarding Chemical Analysis Reports pertaining to distilleries were obtained from Central Chemical Laboratory, Department of Excise. These reports clearly indicated that TRS of molasses samples in all the cases were above 50 *per cent* by mass and classified as Grade I Molasses.

It is evident from the reply that the molasses produced by the sugar factories in the State were of Grade I i.e. with TRS content 50 *per cent* or above. In this scenario, possibility of distilleries receiving molasses with heavy TRS content cannot be ruled out. As per the National Sugar Institute, Kanpur the TRS content in heavy molasses range from 50 to 89 *per cent* which could yield higher quantity of RS. However, this aspect remains unregulated as all Grade I molasses are given common production norm of only 240 BL of RS per MT. At least a sample chemical analysis of molasses receipts at the distilleries would reveal the inflow of molasses with heavy TRS content to the distilleries.

3.4.10 Control lapses and loss of revenue due to deficient performance of Distillery Officers

As per Rule 20 of the Karnataka Excise (Distillery and Warehouse) (KEDW) Rules, 1967, a distillery shall be under the direct supervision of the Distillery Officer (DO) who shall be subordinate to the Deputy Commissioner of Excise (DCOE). The DO supervises the compliance to all the provisions of the Karnataka Excise Act and Rules either in person or through his subordinates, as the DCOE may from time to time direct. The DOs are responsible for ensuring that molasses or any other raw materials received at distilleries are in accordance with the allotment made by the Excise Commissioner. The DOs also ensure that issue of spirits for manufacture of potable liquor at the same distillery or by others or for non-potable purposes is in accordance with the prior allotment and with necessary permits issued for transportation.

Audit evaluated performances of the DOs in enforcing the prescribed controls and thereby checking the effectiveness of the controls in aiding the Department to achieve its mission. The evaluation revealed several gaps both in controls devised, as well as in ensuring that the controls put in place have been implemented. The specific control-wise observations and the lapses on the part of DOs under each control are given in succeeding paragraphs.

3.4.10.1 Non-accounting of molasses procured by the Primary Distilleries

Rule 24 (1) of the KEDW Rules, 1967, prescribes that the distiller shall maintain regular accounts in the forms required by the Commissioner from time to time and such accounts shall be open for inspection at all times by the DO.

With a view to ensuring that the Primary Distilleries are accounting for all their procurement of raw materials, invoice-wise supply of molasses from 30 out of 60 sugar factories in the State were obtained and cross-verified with the purchase accounts of the Primary Distilleries.

The cross-verification revealed that three[26] distilleries had not accounted for 19,555 MT of molasses purchased from 10 sugar factories in the State between May 2012 and April 2014. The quantity of RS that was expected as per the norms prescribed under the KE Act from the 19,555 MTs of molasses was 43.22 lakh BLs which could have produced a minimum of 88.01 lakh BLs of potable liquor. The minimum revenue impact of the same worked out to ₹ 124.97 crore[27].

Though the DOs were empowered to inspect the accounts at all times, such short accounting was not detected. Audit points out that lack of a system in the Department to cross-verify the despatch of molasses from the sugar factories to its receipt at the distilleries, results in short accounting of molasses by distillers going unnoticed as well as the possible availability of non-duty paid liquor in the market.

This was brought to the notice of the Department in June 2017 and reported to the Government in September 2017; their reply has not been received (November 2017).

3.4.10.2 Omission to draw samples for Chemical Analysis

Rule 5 of the Karnataka Excise (Regulation of Yield, Production and Wastage of Spirit, Beer, Wine or Liquors) Rules, 1998, stipulates that the DO shall draw three samples of molasses at the time of preparation of wash from molasses and all such samples shall be sealed by him. One sample shall be sent to the Government Chemical Laboratory, the second one shall be handed over to the distillery for analysis in the Laboratory of the distillery and the third one shall be kept with the DO himself. On receipt of the report from the Government Chemical Laboratory, the DO shall calculate the minimum quantity of RS which could have been produced from the molasses processed by the distillery.

The Chemical Analysis Report is important not only for classification of raw material and to keep a watch over the expected yield of RS as per the norms prescribed under the said Rules, but also to provide a database for any technical and administrative analysis, including revising the production norms previously set by the KE Act and Rules.

Information regarding the number of batches processed and number of samples of molasses drawn by the DOs of all the 33 Primary Distilleries in the State

[26] M/s. Chamundi Distilleries Limited, M/s. J.P. Distilleries Limited and M/s. Vijayanagar Sugars Limited (Distillery Division).

[27] 88.01 lakh BLs of potable liquor X ₹ 142/- per BL (which comprises Excise Duty of ₹ 45/- per BL and Additional Excise Duty at ₹ 97/- per BL applicable for cheapest liquor in the State).

during the period from April 2012 to March 2017 were called for. Information was received only from 24 distilleries[28]. Of the 24 distilleries which furnished the information, only three distilleries furnished the actual number of batches processed and the rest of the DOs did not furnish the actual number of batches drawn[29] but furnished only information on the number of batches where samples were drawn for chemical analysis. The details are given in **Table 3.9**.

Table 3.9
Short fall in chemical analysis of batches of molasses

No. of distilleries	Quantity of molasses processed	Total number of batches drawn for distillation	Number of batches for which chemical analysis was conducted	Short fall in percentage
03 (Distilleries which furnished the total number of batches drawn for distillation)	3.10 lakh MT	4,599	31	99.33
21 (Distilleries which did not furnish total number of batches drawn for distillation)	52.31 lakh MT	80,477[30]	2,640	96.72

Audit observed the following from the analysis of the information collected. The samples drawn for chemical sampling were abysmally low, leave aside conducting their chemical analysis. This deprived the Department of the information regarding chemical composition of the molasses (percentage of TRS). In addition, Chemical Analysis Report was a vital information in identifying heavy grade molasses, considering the possibility of flow of such molasses into the distilleries (as described in paragraph 3.4.9.3). Besides, the jurisdictional DCOEs who had supervisory control over the DOs also failed to take cognisance of omissions to comply with mandatory provisions by the DOs and to take suitable follow-up actions.

Audit points out that the Chemical Analysis of molasses which was a crucial aspect at the start of manufacturing process was not given due importance by the Department. Though the DOs were attached with the responsibility to mandatorily check the potency of molasses, the same was not carried out in adequate measure. The failure to check samples adequately, and as per norms, deters the Department from detecting the actual yield of RS as it is not aware of the potency of the molasses being used. This has wider implications in controlling the possible flow of non-duty paid liquor into the market in the State.

In the Exit Conference, the Department attributed the omissions to the lack of qualified persons and inadequate manpower in the Department.

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[28] Two distilleries did not procure molasses.

[29] Even if these distilleries have established continuous process of fermenting, it is to be noted that continuous process requires more frequent testing to ensure correctness of the parameters concerned.

[30] As the number of batches drawn during the period was not furnished by these distilleries, Audit deduced the batches as 80,477, considering 65 MT (3.10 lakh MT of molasses ÷ 4,599 batches processed by three distilleries) of molasses used per batch, i.e. 52.31 lakh MT of molasses/65 MT per batch= 80,477 batches.

3.4.10.3 Non-reporting of excess storage loss of molasses claimed by distilleries

Rule 8 of Karnataka Excise (Regulation of Yield, Production etc.) Rules, 1998 stipulates maximum limit of one *per cent* for loss of molasses stored in the distilleries. The said Rules also provide that where the Excise Commissioner on examination of the report of the Distillery Officer and after holding such an enquiry as he deems fit is of the opinion that there is no justifiable reason for the licensee to exceed the maximum limit of wastage in the process or production of spirit as specified in Schedule-B, impose the penalty at the rate equivalent to the rate of excise duty leviable on beer, wine or other liquors under the Karnataka Excise (Excise Duties and Fees) Rules, 1968 on such reported excess wastages.

A scrutiny of molasses stock account statements of all the Primary Distilleries in the State for the period from April 2012 to March 2017 revealed that four distilleries had claimed 1380.092 MTs of storage loss of molasses. The permissible loss at one *per cent* in these cases was only 260.851 MTs. Thus the excess storage loss claimed by the distilleries in these cases worked out to 1,119.241 MTs on which penalty of ₹ 7.60 crore was not levied. Also, the DOs did not report these cases to the Commissioner of the Excise to initiate necessary action. Such inaction on the part of the DOs leads to failure of control built into the system to prevent leakage of revenue to the Government.

In the Exit Conference, the Department attributed the omissions to the lack of qualified persons and inadequate manpower in the Department.

3.4.10.4 Other omissions noticed on the part of the Distillery Officers

Apart from the above omissions/lapses noticed on the part of the DOs, several observations were made during the course of local audits on DOs in distilleries and reported to the Excise Commissioner from time to time.

Between April 2012 and March 2017, 35 Distilleries were subjected to the transaction audit, in which 31 observations were raised where DOs failed to take action on issues like under reporting of production, excess claims of loss during manufacture, storage and bottling of spirits, under reporting of liability of Excise Duty and Additional Excise Duty on Indian Made Liquor (IML) and beer, issues relating to grant and renewal of licences of distilleries, etc. The position remains the same despite being pointed out by Audit.

The issues brought out by Audit from the paragraphs 3.4.10.1 to 3.4.10.4 establish laxity on the part of DOs in implementing the controls envisaged in the system to keep the production of alcohol under strict control. Further, the account verification of stock of spirits by the DCOEs as mandated by the Rules also did not throw up any of the issues pointed out in the paragraphs. Hence, Audit points out that the purpose of placing DOs at the distilleries with a view to ensuring hundred *per cent* supervision over them stands compromised and the Department needs to take stringent steps to ensure proper exercise of appropriate controls by the Distillery Officers and supervisory control at the DCOEs.

On these being pointed out, the Government/Department in the Exit Conference accepted that the controls through DOs are not adequate due to shortage of qualified personnel and inadequate manpower in the Department.

3.4.11 Deficiencies in controls devised over potable liquor [31] manufactured and sold

The potable liquor is manufactured at distilleries by reducing the strength of alcohol in RS and Neutral Spirit[32] (NS) to the levels stipulated under the KE Act and Rules made thereunder. The Rules also provide for appropriate loss/wastage during the process of manufacture of potable liquor.

After the manufacturing process, the potable liquor produced are bottled or packed in the permissible containers and supplied to retailers through KSBCL. Channelising the liquor through KSBCL itself acts as a most important control mechanism in prevention of non-duty paid or unauthorised liquor being supplied in the market. Applicable Excise Duty and Additional Excise Duty are paid by the distilleries before dispatch of liquor to KSBCL depots.

Another important control mechanism operated from the stage of bottling/packing of potable liquor to the end point consumer is the Excise Adhesive Labels. Rule 14(4-A) of the Karnataka Excise (Bottling of Liquor) Rules, 1967, stipulates that Excise Adhesive Labels (EAL) shall be affixed on each and every sealed bottle/pack of IML/wine.

EALs are issued through a Government notified agency Marketing Communication and Advertising Limited (MCAL), a Government of Karnataka Undertaking, to the distilleries. The Karnataka Excise Duty Label contains several security features, viz. State Hologram, two dimensional bar code, unique serial number, invisible printing, *guilloche* design[33], *intaglio* printing[34] and signature of the issuing authority on the printed Label, month code, month/year, item code with quantity in millilitre, etc.

Audit test checked the database and other records maintained at selected Excise Divisions and Range Offices, KSBCL and MCAL with a view to ensuring the effectiveness of the aforesaid control mechanism. Audit noticed the following deficiencies:

3.4.11.1 Liquor bottles with invalid Excise Adhesive Labels channelised by the Karnataka State Beverages Corporation Limited

KSBCL is a company formed in June 2003 to substitute all erstwhile whole-sale licensees in the State to channelise liquor and liquor products in the State. However, KSBCL has no power to enforce the Excise Act/Rules or to check any illegal/illicit liquor in the State. It can only receive the spirits and potable liquor of any kind supplied by distilleries and supply the same to the licensed/authorised buyers, whenever indented by them.

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[31] Potable liquor refers to Indian Made Liquor (IML) which contain 42.7 *per cent* alcohol v/v (volume/volume)

[32] RS is 166-degree proof spirit which contain 94.72 *per cent* ethyl alcohol and balance water. Further purified form of this, i.e. increase in quantity of alcohol and reduction in water, is called NS. Usually strength of NS will be 168-degree proof or above. But this term is not defined under the Act.

[33] *Guilloché* is a decorative technique in which a very precise, intricate and repetitive pattern is mechanically engraved into an underlying material.

[34] *Intaglio* is the printing techniques in which the image is incised onto a surface and the incised line or sunken area holds the ink.

The distilleries who supply IML to KSBCL are required to upload online information of each consignment. The consignment details are uploaded in the module "Information of Supplies to KSBCL" provided on KSBCL's website. The information uploaded comprises of various details, such as Order for Supply (OFS) Number, OFS date, Transport Permit Number, Permit Validity Period, Vehicle Number in which delivery given to Depot, the Depot to which Delivery would be given, etc. The most important information uploaded in this screen is the EAL number-wise details of IML bottles/packs of different quantity and of different brands manufactured by that distillery.

Audit verified the database of KSBCL with the database of MCAL to check whether the potable liquor channelised through KSBCL carried EALs issued by MCAL. Audit found instances of potable liquor being channelised through KSBCL with the EALs that were not issued by the MCAL.

A few illustrative cases are given in **Table 3.10**.

Table 3.10
Channelising of liquor through KSBCL without EALs issued by MCAL

Sl. No.	OFS (Order for supply) Number and Date	(i) Item code, (ii) IML brand (iii) Quantity in bottle/pack	(i) Label Prefix (month code in the context of MCAL) (ii) EAL Number 'From' and 'To' (iii) Number of bottles.	Remarks
1.	PUR-141706 3/11/2014	(i) 210100102 (ii) Mysore Lancer Whisky (iii) 375ML	(i) HNK (ii) 2806816849 to 2806838448 **(iii) 21560**	HNK Series EALs not issued by MCAL. Also the serial nos. of EAL running during November 2014 under 375 ml was '190224000' as against '2806816849' to '2806838448'.
2.	YPR-141835 20/11/2014	(i) 206898221 (ii) Black & White Blended Scotch Whisky (iii) 750ML	(i) ANR (ii) 206898221 to 206898940 **(iii) 720**	There was no ANR Series under 750 ml EALs issued by MCAL.
3.	BLG-140883 9/7/2014	(i) 5080100204 (ii) Black Belt Fine Old Whisky (iii) 180ML	(i) EDC (ii) 528483745 to 528488544 **(iii) 4800**	The EDC series was not issued by MCAL. The EAL Nos. falling under the range 524448001 to 530208000 were issued under ANS series to M/s. John Distilleries. Therefore, the series entered under this consignment was incorrect.
4.	KGH-142289 6/1/2015	(i) 90290852 (ii) Amruts Silver Cup Brandy-ASPETIC Pack (iii) 90ML	(i) SGM (ii) 3805430785 to 3805449984 **(iii) 19200**	This series fall under SMG Series, whereas supply details states SGM series.

Hence as mentioned, 46,280 bottles of IML affixed with EALs that were not issued by MCAL were channelised by KSBCL to the retail markets.

Audit points out that this was due to absence of inter-linking of data relating to issue of labels by MCAL with the database of KSBCL. Hence, KSBCL does not validate the EAL information uploaded by the distilleries with reference to labels issued by MCAL to distilleries. Such a validation, and exception reports generated through it, would have prevented such occurrences as pointed out above. Lapses in validation of data by the channelising agency open up opportunities to the traders of illicit liquor and compromise the very objective of establishing the Corporation for prevention of illegal trade of liquor.

In the Exit Conference, the Department stated that the inter-linking of data of MCAL and KSBCL relating to EALs would be done by August 2018.

3.4.11.2 Errors in Excise Adhesive Labels database maintained by Marketing Communication and Advertising Limited

For the controls exercised through EALs to be effective, integrity and accuracy of the database of EALs issued to distilleries in the State shall be maintained by the MCAL.

Audit cross-verified EAL numbers on the liquor bottles/packages confiscated by the Department with the database of MCAL. This revealed three instances where EALs were not issued by MCAL, details of which are given in ***Annexure IV***. On this being pointed as fake EALs by Audit, MCAL stated that those EALs were actually issued to the distilleries concerned but were not recorded in the database. MCAL also admitted that there were errors in their database relating to supply of EALs.

It is evident from the reply furnished by the MCAL that the database which was maintained by them regarding issue of EALs to distilleries was not reliable.

3.4.11.3 Lack of quality assurance on Excise Adhesive Labels produced by Marketing Communication and Advertising Limited

EALs have various security features. It is the responsibility of MCAL to ensure that all the security features are correctly incorporated in the EALs before they are supplied to the distilleries.

Audit noticed that the quality assurance checks exercised by MCAL on EALs were not adequate in view of the omissions and errors in the database as admitted by the company. Audit also noticed issue of defective EALs to the distilleries between June 2011 and August 2015 in two instances mentioned below:

- One of the characteristics of the EAL is its unique serial number along with series. However, six batches involving 2,640 EALs of 180 ml packs of IML, were found to be printed and issued by MCAL to a distillery[35] in August 2015 with only 13 serial numbers instead of 2640 i.e. same serial number were repeated for different EALs; and

[35] M/s. Radico Khaitan Private Limited, Mysuru.

- Five batches involving 1,200 EALs of 90 ml and 180 ml packs of IML were issued by MCAL to another distillery[36]without hologram during June and July 2011.

After this was pointed out, MCAL stated that the above mentioned omissions had occurred due to errors and oversight. Corrective actions have been taken by upgrading the software and the entire process has been automated.

Issue of defective labels from the source indicates lack of quality control checks at the source which provided scope for manipulations. Hence Audit concludes that the erroneous and incomplete database maintained at MCAL had rendered the control mechanism devised to ensure supply of authorised and duty paid liquor to the retail market through EALs ineffective.

3.4.11.4 Lack of information to trace supply of liquor to retailers

The EAL numbers have unique identity for each and every bottle/pack of liquor manufactured in the State. To take advantage of the uniqueness of EAL numbers, KSBCL should maintain details of EAL numbers as affixed on liquor bottles/packages supplied to various retailers which aids in tracking the flow of liquor to the last point of sale and enables detection of cases, if any, of non-duty paid or spurious liquors.

Audit noticed from the database of KSBCL that no such information was getting captured or compiled through their system. This omission rendered the EAL system, less effective, as it was not ascertainable whether any liquor bottle/pack found with a retail licensee was supplied to that particular retailer or not.

Audit points out that maintenance of such database and a mechanism to provide access strengthens the enforcement activities of the State Excise Department. Audit would like to stress the point that though KSBCL, being the sole wholesale distributor of liquor and its products for the entire State, could have played an important, and more active role in assisting the enforcement/intelligence activities of the Department through the more prudent use of information it possessed. Adequate steps were not taken by the KSBCL in this regard.

However, cross-checking of information to the extent available could have been done, i.e. with reference to label series issued by MCAL, extent of information available with the distillery which procured those EAL and the KSBCL Depot to which it was supplied. Audit points out that ensuring accessibility of databases of KSBCL and MCAL would have facilitated the enforcement authorities to perform cross-verification checks.

Recommendation 2: The Government may direct KSBCL and MCAL to:

(a) Interlink KSBCL database with the database of MCAL;

(b) Validate EAL particulars entered online by distilleries in its database on real time basis, so that inconsistencies noticed become inputs for the enforcement authorities of the Excise Department;

(c) Compile EAL-wise information of supply to retailers to track supply of liquor till the last point of sale; and

[36] M/s. United Spirits Limited, Hubbali.

(d) Improve the quality control checks to eliminate issue of defective labels at MCAL.

In the Exit Conference, the Government directed KSBCL to interlink the databases of KSBCL and MCAL. KSBCL agreed to interlink databases of both the companies by August 2018.

3.4.12 Violations of licence conditions by retail licensees and sale of potable liquor by non-licensees

Licences for retail sales of liquors are issued under the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968. The said Rules stipulate several conditions of licences such as licensees to be bound by the provisions of the Karnataka Excise Act, 1965 and any general or special rules framed thereunder, the kind of liquor that are allowed to be sold, maximum quantity of liquors to be sold to a consumer, Maximum Retail Price (MRP), etc. Further, sale of excisable articles without licence as well as consumption or allowing consumption of liquor in unauthorised public places are prohibited[37].

In case of violation of the licence conditions, the KE Act empowers the Deputy Commissioner of Excise (DCOE) under Section 45(1), to accept from the licensee a sum of money not less than five thousand rupees but which may extend to fifty thousand rupees for compounding the offences which may have been committed. Excise authorities are also empowered[38] to cancel the licence on violation of licence conditions.

Enforcement authorities conduct inspections of licensed premises to ensure compliance with the licence conditions by the licensees. Adequate qualified manpower is essential for the Department to ensure better compliance by the retail licensees. Audit noticed from the statistical information on Human Resource Management and Administration maintained by the Department that during the five years' period from 2012-13 to 2016-17, the Department was operating with only about 57 *per cent* of its sanctioned strength and the remaining 43[39] *per cent* was vacant.

With a view to ensuring the level of compliance with the licence conditions and actions taken by the enforcement authorities to ensure compliance by the licensees, Audit reviewed offence cases booked against the retail licensees of 25 ranges of nine Districts for the period 2012-17. The Audit analysis revealed the following:

- In the test checked Range Offices, 83 to 100 *per cent* of the licensees have violated the licence conditions. Also, more than 80 *per cent* of the licensees had repeated the same offences that were detected and compounded earlier. The licensees had repeated the offences under these Range Offices up to 91 number of times. A list of licensees who repeated the offence for more than 20 times in these Range Offices are given in ***Annexure V***;

[37] Section 15 and 15-A of the KE Act.
[38] Section 29(1) (b) of the KE Act.
[39] As on 31 March 2017 the working strength of the Department was 3,115 against the sanctioned strength of 5,485.

- In seven[40] Districts, cases were booked by the enforcement authorities against 25 shops owned by M/s. Mysore Sales International Limited (MSIL)[41] a Government of Karnataka undertaking for offences such as sale of liquor at prices exceeding the MRP, consumption of liquor in the premises, etc; and
- In the Range Offices under the selected nine DCOEs, 10,784 cases were booked against non-licensees for sale/allowing consumption of liquor during the period from April 2012 to March 2017.

The repeated violation of licence conditions by more than 80 *per cent* of licencees and the Government Company itself shows the lack of seriousness towards adherence to licence conditions. It also indicated that that the penal actions meted out by the Department against the offenders were not deterrent enough to curb the un-lawful activities. In all the cases of violation of licence conditions, the offences were always compounded by levy of penalty between ₹ 5,000 and ₹ 30,000 under Section 45(1) of the KE Act by the jurisdictional DCOEs. In none of the offence cases, maximum penalty of ₹ 50,000 prescribed under the KE Act, was levied by the Department. The Department never took any stringent action like cancellation of licences even in cases of multiple offenders.

3.4.13 Conclusion

Alcohol being a critical and sensitive product both socially and economically, the controls exercised by the State are expected to be stringent but practical. The Government and the Department have built several controls in the chain of events commencing from procurement of raw material at Primary Distilleries to delivery of potable liquor to the consumer. This Performance Audit on "Regulation and Control over Manufacture, Possession, Distribution and Sale of Alcoholic Products in the State of Karnataka" revealed that though the controls built in appeared to be adequate theoretically, the Department can improve the performance in certain areas, especially the design and implementation aspects of the controls. Deficiencies noticed were as below:

- Norms of production of spirit from molasses had been kept considerably below the actual production potential of the distilleries. This, in turn, provided the distilleries considerable margin to play to their advantage which could result in unaccounted/illegal manufacture of spirit;
- Norms based on classification of molasses were not scientific, as the actual raw material in the production of alcohol is the TRS present in it. As per the norms, yield of RS per Kg of TRS for Grade III (lower grade) was higher than yield prescribed for Grade I (higher grade) which leaves considerable scope for distilleries to manipulate the final output of spirit;
- Distillery Officers placed at distilleries failed to draw samples and get the molasses chemically analysed as required under the Act. Non-analysis compromised on the control for detection of molasses with

[40] Dharwad, Gadag, Kalaburgi, Kolar, Mandya, Mysuru and Yadgir.

[41] MSIL shops are licenced Government Retail shops who have been sanctioned licences for possession and sale of liquor under Rule 3 (11-C) of the Karnataka Excise (Sale of Indian and Foreign Liquors) Rules, 1968.

sugar content beyond the normal expected level and disabled the Department from determining actual possible yield of spirit;

- No policy was in place to control and regulate the issue of molasses by the sugar factories. Cross-verification of figures between the sugar factories and the distilleries revealed that three distilleries had not accounted for 19,555 MTs of molasses purchased from ten sugar factories in the State;
- Excise Adhesive Labels (EALs), embedded with security features, are affixed on every sealed bottle/pack of IML/wine to uniquely identify each bottle released to the market. However, absence of validation control for the EALs uploaded to its website by distilleries, and absence of a system to keep track of supply of potable liquors till last point of sale, prevented the Department from deriving optimum benefits out of these EALs; and
- In addition, considerable level of non-compliance was noticed with the retail licensees to the conditions attached to their licences. Eighty *per cent* of the retailers were found to be repeated offenders, which indicates the Department's inability to ensure improved compliance.

Also, as discussed in the paragraphs from 3.4.8 to 3.4.10.4, the deficiencies in the controls exercised by the Department were found to have caused loss of revenue to the Government between ₹ 830.73 crore and ₹ 1,420.03 crore during the five-year period from 2012-13 to 2016-17 within the sample (15 *per cent* of the overall transactions in the State) analysed by Audit.