

## Chapter II

### Audit Mandate, Audit Universe and Extent of Audit

#### 2.1 Audit Mandate

Article 149 of the Constitution of India provides that the Comptroller and Auditor General of India (CAG) 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 the Parliament. The Parliament passed the Comptroller and Auditor General's DPC Act (CAG's DPC Act) in 1971. Section 16 of the CAG's DPC Act authorizes CAG to audit all receipts (both revenue and capital) of the Government of India and of Government 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. Regulations on Audit & Accounts, 2007 (Regulations) lay down the principles for Receipt Audit.

##### 2.1.1 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 interest of the Government on the orders passed by 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 to ensure that these are not abandoned or reduced except with adequate justification and proper authority.

##### 2.1.2 Audit of Central Excise and Service Tax

Indian Central Excise and Service Tax System is a self-assessment system in which the tax payers prepare their own tax returns and submit it to the Department. This system is guided by the fiscal laws including the Central Excise Act, 1944 and Finance Act, 1994. Central Excise and Service Tax Department assesses and scrutinizes the returns by way of preliminary

scrutiny, detailed scrutiny, internal audit etc. and ensures the correctness of the tax so deposited by the tax payer.

To examine the efficacy of the systems and procedures of the Central Excise and Service Tax Department, CAG examines the records related to the returns submitted by the assesseees along with the records of the various field formations and functional wings of the Board.

## **2.2 Audit Universe**

The audit universe includes the CBIC, its subordinate organisations and field formations. Accordingly, as on 1 April 2017 audit universe had 4,898 Units which accounted for a revenue of ₹ 6,34,994<sup>13</sup> crore (₹ 3,80,495 crore Central Excise and ₹ 2,54,499 crore Service Tax) and included 27 Zones, 141 Commissionerates, 737 Divisions, 3,530 Ranges and 463 other Units.

Due to implementation of GST with effect from 1 July 2017, Department underwent restructuring and the number of the departmental units changed as mentioned in the Para 1.3 of this Report.

### **2.2.1 CBIC**

The Central Board of Indirect Taxes and Customs, in the Ministry of Finance, is the apex body for administering the levy and collection of indirect taxes of the Union of India. It deals with the tasks of formulation of policy concerning levy and collection of Customs & Central Excise duties and Goods and Service Tax, prevention of smuggling and administration of matters relating to Customs, Central Excise, Goods and Service Tax and Narcotics to the extent under CBIC's purview. CBIC is headed by a Chairman and consists of six members.

### **2.2.2 Zones**

Zones are the highest auditable entities headed by Principal Chief Commissioner/Chief Commissioner. Principal Chief Commissioner/Chief Commissioner of Zone exercises supervision and control over the technical and administrative work of all the Commissionerates in the Zone. They monitor the revenue collection by each Commissionerate in the Zone and the proper implementation of Acts/Rules and Board's instructions/guidelines issued from time to time.

### **2.2.3 Commissionerates**

Each Zone comprises several Commissionerates headed by Principal Commissioner/Commissioner. Administratively, each Commissionerate is a 3-tier set-up with its Headquarters at the helm, four to six Divisions at the

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<sup>13</sup> For FY17

second level and four to six Ranges under each Division at the third and final level. Commissionerates are divided in three categories viz. Executive Commissionerates, Commissionerates (Audit) and Commissionerates (Appeal).

The primary function of a Central Excise Commissionerate/Service Tax Commissionerate (Executive Commissionerate) is to implement the provisions of Central Excise/Service Tax Act, rules framed under these Acts and other allied Acts of the Parliament under which duty of Central Excise/Service Tax is levied and collected.

In each Central Excise/Service Tax zone there may be one or more Audit Commissionerates headed by a Commissioner (Audit). The main function of the Audit Commissionerate is to conduct audit of the assessees falling under its jurisdiction, convening of monitoring committee meetings, helping executive Commissionerates in pursuing the cases against the assessees etc.

Commissioner (Appeal) acts as an appellate authority and passes orders on appeal in relation to all adjudication orders passed by an authority subordinate to the rank of a Commissioner.

#### **2.2.4 Divisions**

Each executive Commissionerate has four to six Divisions headed by a Deputy/Assistant Commissioner. The Divisional heads are responsible for proper compliance of laws and procedures within their jurisdiction. They are also responsible for collection of intelligence, organizing the anti-evasion operations and perform quasi-judicial function, viz. adjudication of cases falling within their competence. They are the original authority to decide classification of goods and their assessable value.

#### **2.2.5 Ranges**

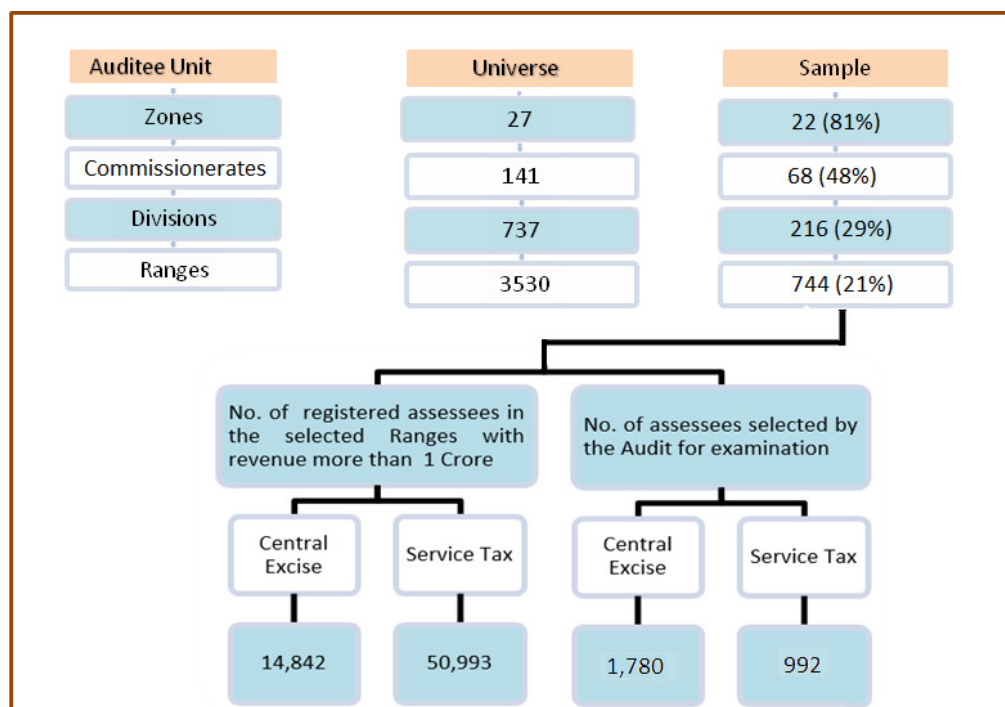
Each Division consists of four to seven Ranges. The Range, headed by a Superintendent, is the first office of contact between the assessee and the Department. The assessees are registered with the Range office. Scrutiny of the assessment is done by the Range on the basis of prescribed returns filed by the assessees. Apart from the assessment work, the Range officials also check the correctness of statutory declarations filed by the assessees.

### **2.3 Audit Sample**

As discussed in Para 2.2.5, the Ranges are the departmental units where the assessees are registered and submit returns. Ranges are, therefore, responsible for verification of the registrations, scrutiny of returns, monitoring of revenue collection etc. We examined the efficacy of the system and procedures, as envisaged in Para 2.1.1.

As on 1 April 2017, the total number of assessees registered with the Department were 36,87,815 (5,27,534 Central Excise assesses and 31,60,281 Service Tax assessee) of that 3,32,421 assessees (54,269 Central Excise assesses and 2,78,152 Service Tax assesseees) were paying revenue more than one crore per annum. We selected 2,772 assessees (1,780 Central Excise and 992 Service Tax) on various criteria<sup>14</sup> for examination as shown in figure 2.1 below:

**Chart 2.1: Audit Universe and Sample**



Further, we also audited 90 (19.44 per cent) out of 463 other departmental units such as Audit Commissionerates, Appeal Commissionerates, Directorate of Data Management, Directorate of Legal Affairs, Directorate General of Performance Management etc., to assess the efficacy of monitoring mechanism of the Department.

## 2.4 Audit Efforts and Audit Products

Compliance Audit was conducted by our nine field offices headed by Directors General (DsG)/Principal Directors (PDs) of Audit, who audited 1,140 departmental units and records of 2,772 assessees in FY18 as per Regulations on Audit and Accounts, 2007 and in conformity with the Auditing Standards, issued by the Comptroller and Auditor General of India. Data/information

<sup>14</sup> High revenue, high percentage of CENVAT and low percentage of PLA, nature of commodities/services, nature of transactions, number of SCNs issued, confirmed demand cases, year of last CAG audit etc.

from the Union Finance Account, and Management Information System (MIS), Monthly Technical Reports (MTRs) of the Board were also used.

During FY18, in 744 Ranges we examined 69,610 returns (Central Excise 51,610 and Service Tax 18,000) submitted by the selected 2,772 assesseees and raised 4,641 observations involving revenue of ₹ 1,485.91 crore. Out of these 4,641 observations, we included 102 (Central Excise 43 and Service Tax 59) significant observations involving ₹ 201.32 crore (Central Excise ₹ 33.32 Crore and Service Tax ₹ 168.00 crore) in this report. We also raised 1788 observations involving revenue of ₹ 732.30 crore related to other functions like issuance of SCN and adjudication, broadening of tax base, anti-evasion, refunds etc. of the Field Formations and included 125 (Central Excise 05 and Service Tax 120) observations involving ₹ 39.01 crore (Central Excise ₹ 0.72 crore and Service Tax ₹ 38.29 crore) in this report.

Further, we examined the Monitoring Mechanism of Appeal cases and Monitoring Mechanism of Arrear cases and results of audit are included in the Chapter III and Chapter IV of this Report. Apart from this, we also included 142 (Central Excise 45 and Service Tax 97) observations involving revenue of ₹ 225.22 crore (Central Excise ₹ 141.26 Crore and Service Tax ₹ 83.96 Crore) which came to notice in the course of test audit during earlier years but could not be reported in the previous Audit Reports. Significant observations pertaining to Service Tax and Central Excise are discussed in Chapter V and VI respectively of this report.

## **2.5 Response to CAG's Audit, Revenue Impact/Follow-up of Audit Reports.**

**2.5.1** We elicit response to our observations from the audited entities at different stages of audit. As per provisions of the regulation 193 of CAG's Regulations on Audit and Accounts, 2007, on completion of field audit, we issue the Local Audit Report (LAR) to the Department for comments.

As per the provisions of the regulation 197, the officer in charge of the auditable entity shall send the reply to an audit note or LAR within four weeks of its receipt. Even if it is not feasible to furnish the final replies to some of the observations in the audit note or LAR within the aforesaid time limit, the first reply shall not be delayed on that account and an interim reply may be given indicating the likely date by which the final reply shall be furnished.

Further, Board's circular No. 1023/11/2016-CX dated 8 April 2016 prescribed the procedure for dealing with audit observations raised by CAG Audit and instructed its field formations to reply to the Local Audit paragraphs within thirty days. The circular also provided for the Zones to hold quarterly

coordination meetings with Audit to discuss and settle the pending LAR paragraphs.

As per provisions of regulations 193 to 204, ibid we took measures like sending of important audit observations to head of the Commissionerates for follow-up, communicating the significant audit observations to Zonal Heads, convening of Audit Committee Meetings etc. for the purpose of monitoring and ensuring compliance and settlement of pending audit observations.

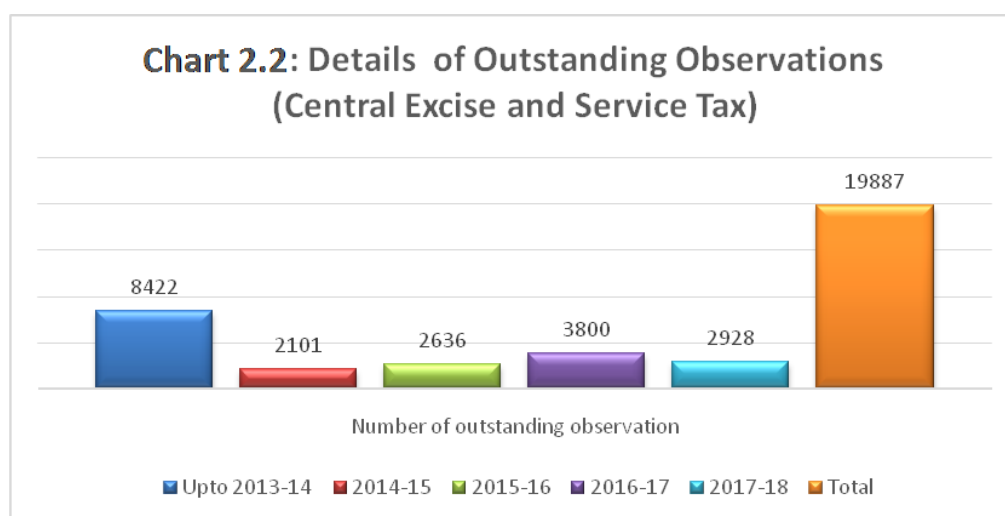
**2.5.2** Table 2.1 below depicts the position of number of observations included in the LARs during FY14 to FY18, replies thereto and observations accepted by the Department.

**Table 2.1: Observations raised and Department replies thereto**

Year	Observations Raised	Observations Accepted	First reply not received	Percentage of observations accepted	Percentage of First reply not received
FY14	7,064	3,724	1,300	52.72	18.40
FY15	5,957	2,994	1,176	50.26	19.74
FY16	7,099	3,669	1,313	51.68	18.50
FY17	6,656	3,624	1,641	54.45	24.65
FY18	6,429	1,999	3,067	31.09	47.71
<b>Total</b>	<b>33,205</b>	<b>16,010</b>	<b>8,497</b>	<b>48.22</b>	<b>25.59</b>

During the last five years we raised 33,205 observations, of that the Department accepted 16,010 observations (48.22 per cent). The Department did not furnish even first reply in large number of cases which increased from 1,300 cases (18.40 per cent) in FY14 to 3,067 cases (47.71 per cent) in FY18 which resulted in accumulation of 8,497 cases awaiting first reply.

**2.5.3** Chart 2.2 below shows the position of pendency of Local Audit observations<sup>15</sup>.



<sup>15</sup> LAR observations raised up to 30.09.2017 and outstanding as on 31.03.2018.

The accretion in pendency in replies to audit findings each year has resulted in accumulation of 19,887 observations as of 31 March 2018<sup>16</sup>.

The main reason for the huge pendency of the LAR observations is lack of timely response from the Department. An age wise analysis of the outstanding observations revealed that 8,422 (42.37 per cent), 2,101 (10.57 per cent), 2,636 (13.26 per cent), 3,800 (19.12 per cent), 2,928 (14.73 per cent) were pending for more than five years, four years, three years, two years and one year, respectively. It is evident from the huge accumulation of LAR observations that the field formations did not adhere to the instructions issued by the Board. The Board/Ministry need to ensure compliance and effectiveness of its instructions and evolve an appropriate mechanism to fix responsibility in case of non-compliance.

#### 2.5.4 Recovery at the instance of Local Audit Reports

During FY18, the Department recovered ₹ 29.40 crore in 1,614 cases raised during Local Audits up to FY18.

Table 2.2: Recovery at the instance of Audit<sup>17</sup>

	Admitted		Recovered	
	Numbers	Amount	Numbers	Amount
Central Excise	2,918	123.33	833	12.02
Service Tax	2,361	517.39	781	17.38
<b>Total</b>	<b>5,279</b>	<b>640.72</b>	<b>1,614</b>	<b>29.40</b>

(₹ in crore)

#### 2.5.5 Follow-up of CAG's Audit Reports

In the last five Audit Reports (including current year's report), we had included 1,295 audit paragraphs pertaining to Central Excise duty and Service Tax involving ₹ 3,351.46 crore.

Table 2.3 Follow-up of Audit Reports

Year		FY14	FY15	FY16	FY17	FY18	Total	
Paragraphs Included	No.	246	231	255	300	263	1,295	
	Amt.	897.19	534.37	435.56	1,018.79	465.55	3,351.46	
Paragraphs accepted	As on 15.11.18	No.	232	213	237	269	230	1,181
	Amt.	568.29	510.17	384.78	548.56	345.22	2,357.02	
Recoveries effected	As on 15.11.18	No.	134	139	178	160	122	733
	Amt.	194.75	83.27	110.97	372.15	68.15	829.29	

(₹ in crore)

<sup>16</sup> LAR observations raised up to 30.09.2017 and pending on 31.03.2018.

<sup>17</sup> Recoveries at the instances of observations in LAR which are not included in the CAG's Audit Reports.

The Ministry had accepted audit observations in 1,181 audit paragraphs involving ₹ 2,357.02 crore and had recovered ₹ 829.29 crore in 733 cases.

## **2.6 Report Overview**

Out of the total audit observations raised by Audit, we issued significant observations to the Ministry for comments before inclusion in the Audit Report. We gave six weeks to the Ministry to offer their comments on cases issued to them before inclusion in the Audit Report. We included 263 draft paragraphs containing 369 observations of ₹ 465.55 crore in the current Audit Report. The Ministry furnished replies to all draft paragraphs, of which the replies to three draft Paragraphs i.e. the Monitoring Mechanism of Appeal cases in CBIC, Monitoring Mechanism of Recovery of Arrear cases in CBIC and other functions of the Field Formations of CBIC were partial. The Ministry accepted 230 Draft paragraphs (87.78 per cent) having tax effect of ₹ 345.22 crore (74.15 per cent).