

CHAPTER I

Overview of Advance Authorisation Scheme

1. Introduction

The Advance Licensing Scheme also known as 'Duty Entitlement Exemption Certificate (DEEC)' was introduced in the Foreign Trade Policy (FTP) in the year 1976. The objective of the Scheme was to provide registered exporters with their requirement of basic inputs/raw materials at international prices without payment of Customs duty in India subject to the condition of export of manufactured goods with specific percentage of value addition. The name of the Scheme was subsequently changed to 'Advance Authorisation Scheme' (AAS) under FTP 2004-09 effective from 1 September 2004.

Advance Authorisation (AA) is issued to allow duty free import of inputs, which are physically incorporated in the export product, allowing normal allowance for wastage. In addition, fuel, oil and catalyst that is consumed/utilised in the process of production of the export product, is also allowed duty free. AAs are issued based on Standard Input Output Norms (SION) fixed by the Directorate General of Foreign Trade (DGFT) and also on the basis of *ad hoc*/self-declared norms subject to approval by the Norms Committees (NC)/Self-ratification Scheme of FTP.

1.1 Authorities involved in implementation of the Scheme

The Scheme is administered by the DGFT (Ministry of Commerce) while exemption from levy of Customs duty on imported inputs is allowed by the Central Board of Indirect Taxes and Customs (CBIC), Department of Revenue (DoR) under Ministry of Finance (MoF).

The application for licence is to be submitted to the jurisdictional Regional Authority (RA) under DGFT, as specified under the Hand Book of Procedure (HBP). The RA verifies the information furnished in the application and issues the licence, which is then registered with the specified Customs Port for import of inputs and export of goods under the licence. The registration is subject to execution of bond, and if necessary, Bank Guarantees (BG)¹with the Customs Department. On discharge of Export Obligation (EO), the Authorisation Holder (AH) makes an application of redemption to the RA, who issues an Export Obligation Discharge

¹Bank Guarantees are taken by Customs at the time of registration of AAs at the Customs Ports as per Customs Circular 58/2004 dated 21-10-2004 as amended from time to time. BG is exempted for certain categories of exporters under the AA Scheme, viz., Public Sector Undertakings (PSUs), Star House Exporters, exporters with export turnover of more than ₹5 crores in the current or preceding financial year and having good track record, Manufacturer exporters registered with Central Excise exporting in the previous two financial years with export turnover of more than ₹one crore and Manufacturer exporters registered with Central Excise and having paid excise duty (pre-Goods and Service Tax (GST) era) or GST of more than ₹one crore during the preceding financial year. All other manufacturer exporters are required to submit 15 per cent BG and others 100 per cent BG.

Certificate (EODC) to the AH and sends a copy of the same to the Customs Department for redemption of bond and BG, if any.

1.2 Norms for AAs

As per Para 4.03 of FTP, AAs are issued for inputs in relation to the resultant product based on the following:

- (a) SION notified in the HBP;
- (b) Self-declaration, where SION is not notified;
- (c) Applicant specific prior fixation of norms;
- (d) Self-ratification Scheme.

The SION determines the proportion of various inputs required in the manufacture of different resultant products. In case where norms have not been notified, the RA may issue AA based on self-declaration by the applicants. Wastage so claimed shall be subject to wastage norms as decided by the NCs. Applicant specific prior fixation of norms was introduced with effect from 20 September 2017 vide PN 26 and Self Ratification Scheme (SRS) was introduced with effect from 22 March 2018 vide PN 68.

1.3 Salient features of the Scheme

The registered exporters have to apply online for AA and upload the prescribed documents. RA issues the AA and communicates it to the Customs Port under the Message Exchange System (MES) for registration at the Port for import and export of goods through that authorisation. Inputs specified in quantities in the authorisation as per SION are free from Customs duties. Alternatively, inputs can also be procured domestically without duties by invalidating the licences for imports.

BGs are taken by Customs at the time of registration of AAs at the Customs Ports as per Customs Circular 58/2004 dated 21-10-2004 as amended from time to time. In exceptional cases, Para 4.13 of HBP provides for authorisation in excess of entitlement of Cost, Insurance and Freight (CIF) mentioned in paragraph 4.12(a) subject to furnishing of 100 per cent BG to the Customs authority to cover exemption from customs duties. RAs shall make specific endorsement to this effect on the authorisation. Similarly, as per Par 2.29 (b) of HBP, RAs may also insist for BG from AH in case of indigenous sourcing of inputs.

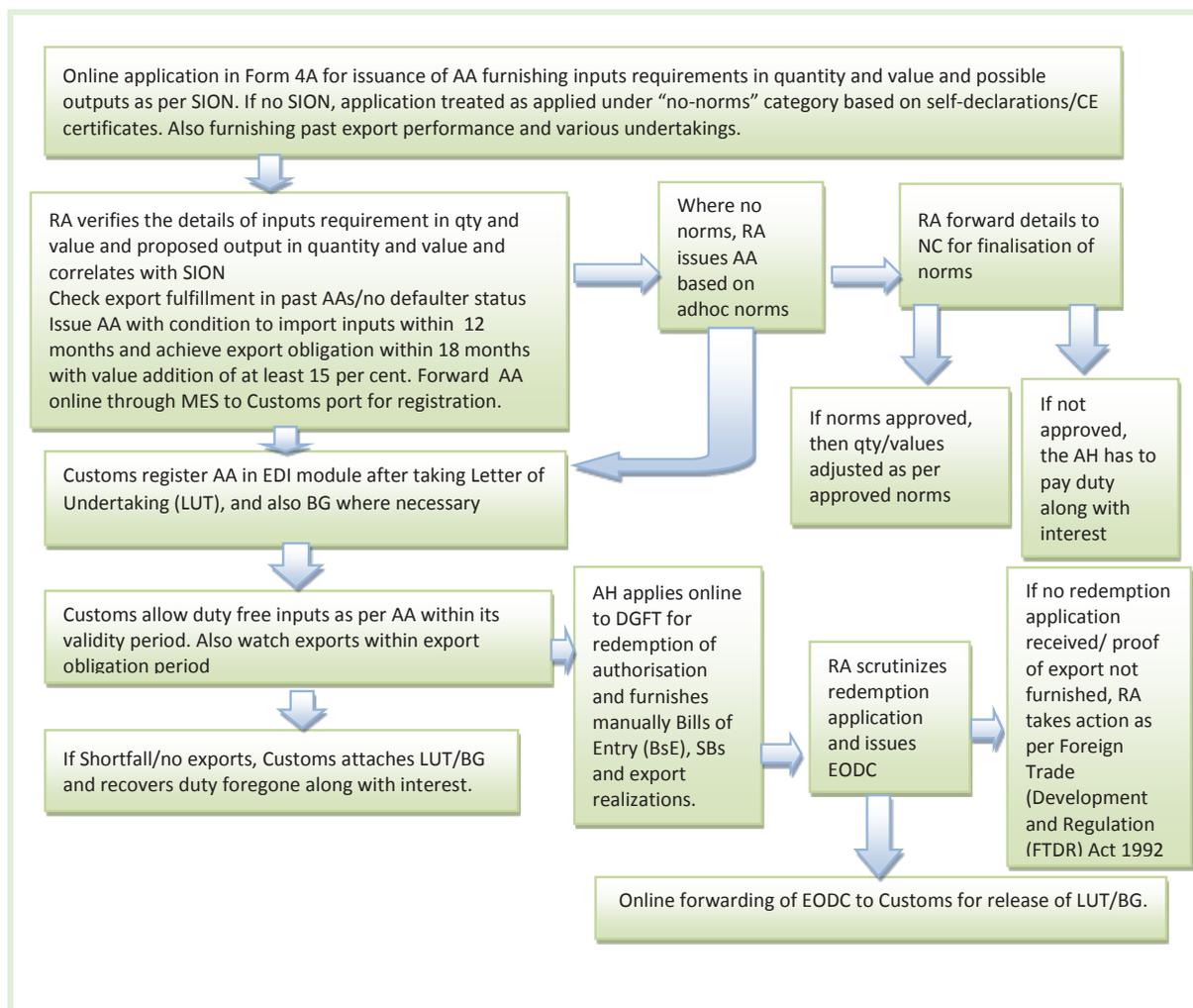
Licences are issued on condition of achieving EO with Minimum Value Addition (MVA) of 15 per cent within the period of 18 months (other than Appendix 4J inputs). The time limit is further extendable twice, for six months each, subject to the stipulated conditions. Non-fulfillment of EO in terms of quantity requires regularization of authorisation by paying custom duties foregone, along with interest on inputs proportionately required for export quantity not

fulfilled. Failure in value terms requires regularization by paying penalty at one per cent of shortfall in value.

On fulfillment of EO, the exporter applies for EODC to the RA by furnishing Shipping Bills (SBs) and Electronic Bank Realization Certificates (e-BRCs) of export proceeds. When EODC is issued, the same is also communicated to the Customs Authorities through MES for redeeming Bond and BGs, if any, executed at Ports.

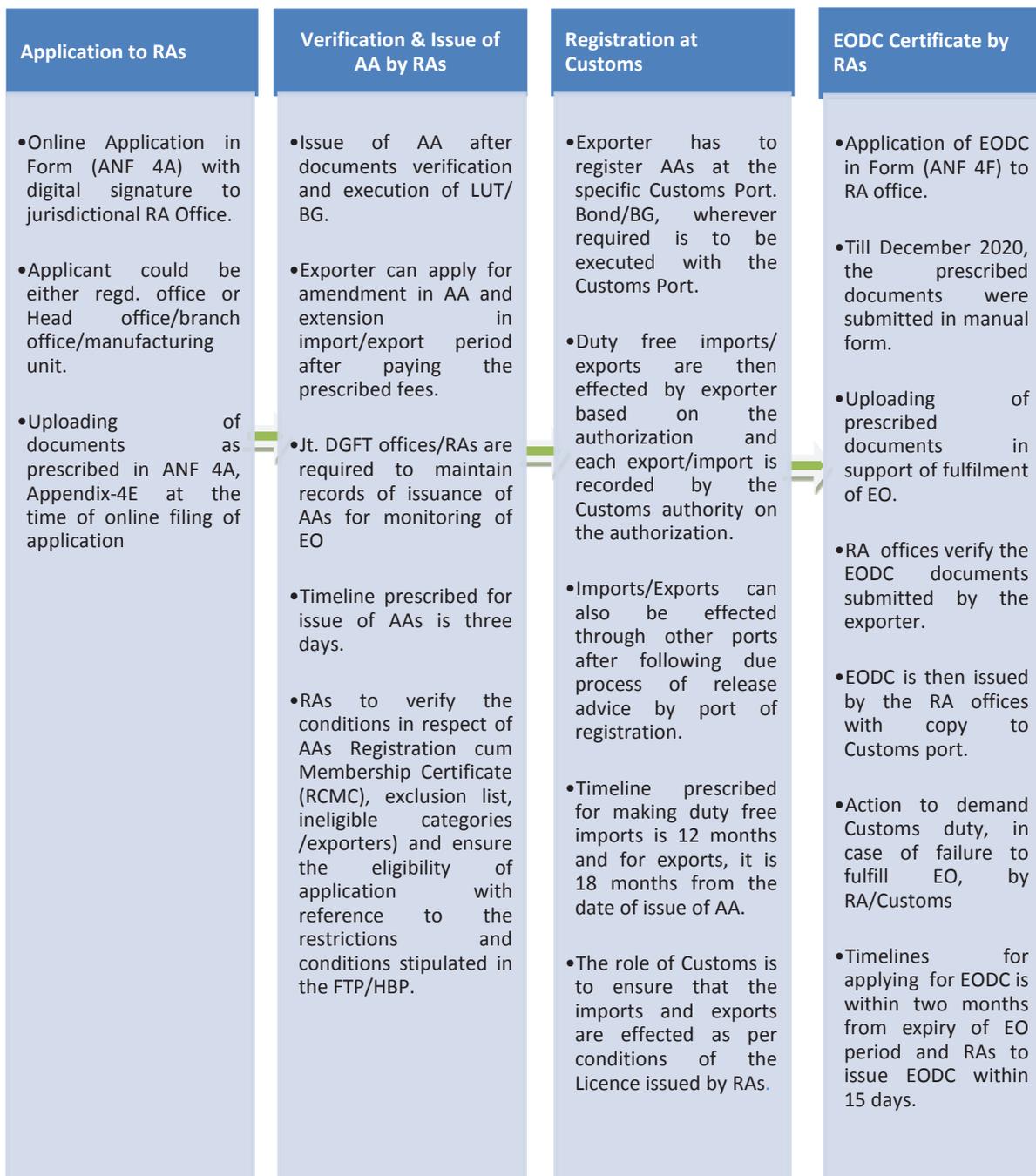
As per Para 4.44 (f) of HBP, in case the AH fails to complete EO or fails to submit relevant information/documents, RAs shall enforce condition of authorisation and Undertaking and also initiate penal action as per law including refusal of further authorisation to the defaulting exporter. The process involved in the AA Scheme from issuing of AAs to EODC is depicted in the following flow chart:

Figure 1: Summary flowchart of processes in the AA Scheme



The process involved in AAS vis-à-vis authorities involved is summarized below in Figure 2:

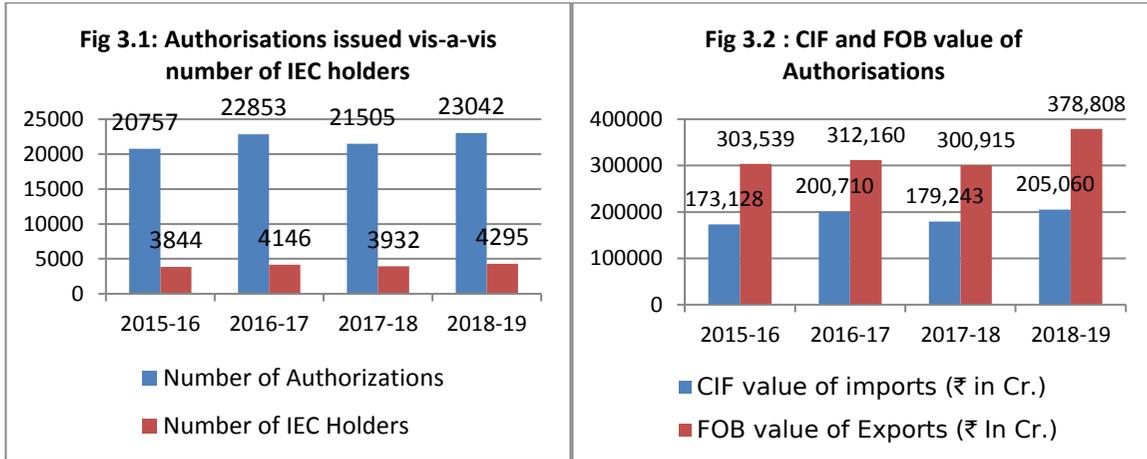
Figure 2: Process involved in AA Scheme



1.4 Statistical Overview

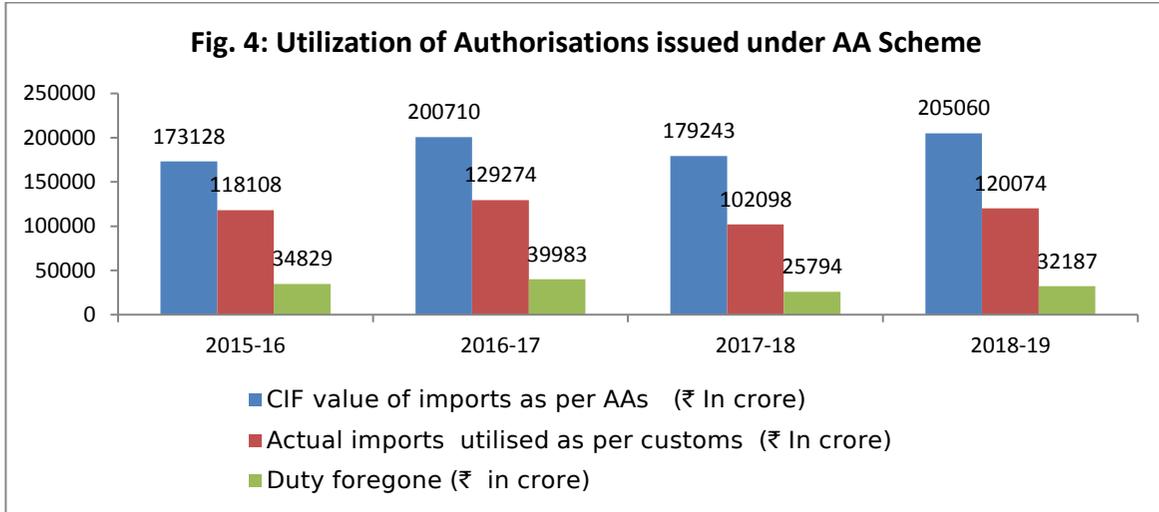
An analysis of AA Scheme for the period covered under the PA from 2015-16 to 2018-19 was done in terms of number of AAs and number of Importer Exporter Code (IEC) holders to total imports and exports allowed under the Scheme as detailed hereunder:

Figure 3: Authorisations issued and value of Exports/Imports allowed under AA Scheme



The Free on Board (FOB) value of exports increased by 25 per cent from ₹3,03,539 crore in 2015-16 to ₹3,78,808 in 2018-19. Similarly, the number of AAs and AHs and CIF value of imports also increased by 11 per cent, 12 per cent and 18 per cent respectively.

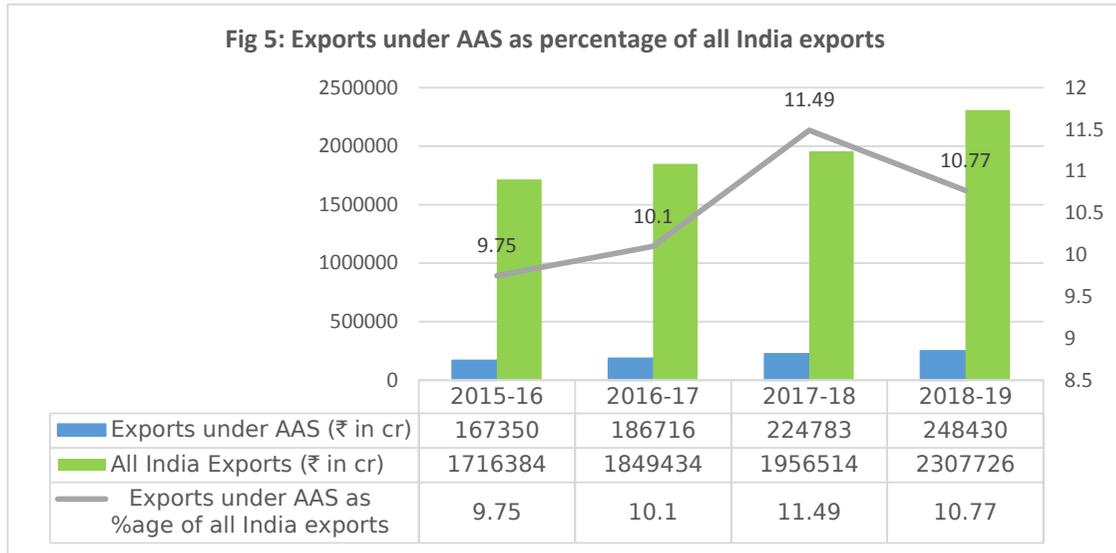
Actual utilization of AAs at Customs ports was analysed from Customs EDI (Electronic Data Interchange) data as detailed in Figure 4 below:



As can be seen above, the percentage of utilization of AAs decreased from 68.22 per cent in 2015-16 to 58.56 in 2018-19 and the corresponding duty foregone decreased from 29.49 per cent in 2015-16 to 26.81 in 2018-19.

1.4.1 Share of exports under the AA Scheme

The share of exports under the AA Scheme to that of total physical exports in value terms stood at 9.75 percent in 2015-16, which increased to 10.77 percent in 2018-19 as detailed hereunder:



Duty foregone for achieving ₹One crore of exports undertaken through AA scheme, varied from ₹21 lakh in 2015-16 to ₹13 lakh in 2018-19 as detailed below:

Table 1: Duty foregone vis-à-vis FOB value

Year	2015-16	2016-17	2017-18	2018-19
Duty foregone (₹ in crore)	34828.72	39982.55	25793.52	32187.01
FOB (₹ in Crore)	167349.93	186715.94	224782.57	248430.08
Duty foregone/One crore of FOB (₹ in Crore)	0.21	0.21	0.11	0.13

1.4.2 Sectoral distribution of Authorisations:

Details of AAs (number and CIF value of imports) under various sectors for the period from 2015-16 to 2018-19 is given hereunder:

Table 2 : Sectoral distribution of AAs

Sectors	2015-16		2016-17		2017-18		2018-19		%age change	
	No. of AA	CIF Value (₹ in Cr.)	No. of AA	CIF Value (₹ in Cr.)	No. of AA	CIF Value (₹ in Cr.)	No. of AA	CIF Value (₹ in Cr.)	Numbers	Value
Chemical	9589	57064.29	9849	57822.56	9259	65196.81	9309	77052.82	-2.92	35.03
Electronics	185	777.09	187	984.26	126	856.74	143	1830.41	-22.70	135.55
Engineering	4293	48835.99	4333	60869.03	4157	57697.25	4299	64687.82	0.14	32.46
Fish	23	147.01	19	108.35	14	127.1	19	170.96	-17.39	16.29
Food	582	6154.85	1400	14067.76	841	9626.42	814	8546.5	39.86	38.86
Gems and Jewellery	77	40707.9	63	44000.78	51	21840.52	94	18700.32	22.08	-54.06
Handicrafts	31	47.36	34	21.82	31	20.28	47	31.52	51.61	-33.45

Sectors	2015-16		2016-17		2017-18		2018-19		%age change	
	No. of AA	CIF Value (₹ in Cr.)	No. of AA	CIF Value (₹ in Cr.)	No. of AA	CIF Value (₹ in Cr.)	No. of AA	CIF Value (₹ in Cr.)	Numbers	Value
Leather	55	153.65	86	270.41	105	290.96	84	388.11	52.73	152.59
Plastics	3749	15072.71	4039	17737.89	4120	18347.46	4471	26258.11	19.26	74.21
Sports	0	0	0	0	0	0	2	2.56	200.0	256.00
Textiles	1917	3549.16	2393	3791.51	2529	4426.05	3225	5597.36	68.23	57.71
Misc.	256	617.87	451	1035.32	272	1139.26	535	1793.81	108.98	190.32
Total	20757	173127.9	22853	200709.7	21505	179568.9	23042	205060.3	11.01	18.44

Sectoral analysis of AAs in terms of CIF value showed a declining trend in respect of Gems and Jewellery and Handicrafts from 2015-16 to 2018-19 and significant growth in electronics, textiles, chemicals, leather, etc. As of 2018-19, the chemical, engineering and plastic sectors accounted for nearly 82 per cent, by CIF value, of the AAs. Overall, there is a growth of around 18.44 per cent in terms of CIF value and 11 per cent in terms of number of AAs issued from FY 16 to FY 19.

Details of FOB fixed in AAs under major sectors was compared with the total physical exports effected as shown below:

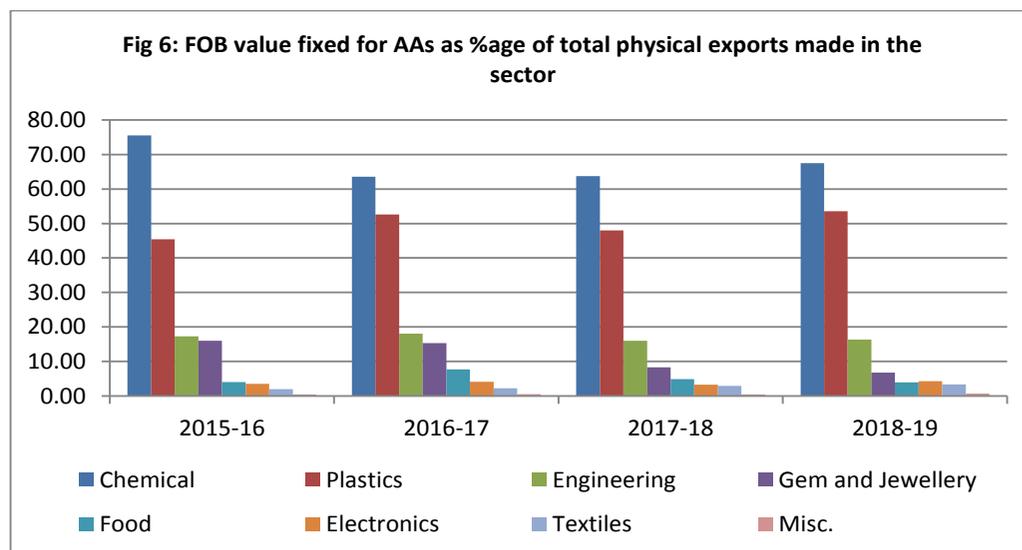
Table 3: FOB fixed in AAs vis-à-vis total physical exports made in the sector

Sectors	2015-16			2016-17			2017-18			2018-19			%age change	
	FOB fixed in AAs (A)	Value of total Physical Exports (B)	%age of (A) to (B)	FOB fixed in AAs (A)	Value of total Physical Exports (B)	%age of (A) to (B)	FOB fixed in AAs (A)	Value of total Physical Exports (B)	%age of (A) to (B)	FOB fixed in AAs (A)	Value of total Physical Exports	%age of (A) to (B)	EO fixed	Total Exports
	(₹ in Cr.)	(₹ in Cr.)		(₹ in Cr.)	(₹ in Cr.)		(₹ in Cr.)	(₹ in Cr.)		(₹ in Cr.)	(₹ in Cr.)			
Chemical	159008	210542	75.52	139760	219810	63.58	154302	242114	63.73	206517	306131	67.46	29.88	45.40
Electronics	1312	37453	3.50	1566	38144	4.11	1275	39148	3.26	2516	58858	4.27	91.77	57.15
Engineering	67847	391359	17.34	78595	435769	18.04	78705	490244	16.05	92161	564688	16.32	35.84	44.29
Food	8612	212459	4.05	17140	223207	7.68	12130	247708	4.90	10743	270618	3.97	24.74	27.37
Gem and Jewelry	41334	257421	16.06	44672	290903	15.36	22206	267833	8.29	19173	281408	6.81	-53.61	9.32
Plastics	19077	42029	45.39	22725	43173	52.64	23449	48814	48.04	35365	66059	53.54	85.38	57.17
Textiles	4900	243030	2.02	5681	249575	2.28	6976	240949	2.90	8990	267108	3.37	83.47	9.91
Misc.	1449	322091	0.45	2024	348853	0.58	1870	379704	0.49	3342	492856	0.68	130.64	53.02
Total	303539	1716384	17.68	312163	1849434	16.88	300913	1956514	15.38	378807	2307726	16.41	24.80	34.45

It is seen that the growth of AAs (in terms of EO fixed) increased in Electronics (92 per cent), Plastics (85 per cent) and Textiles (83 per cent) while it declined sharply in case of Gems and Jewellery (54 per cent) from ₹41,334 crore (FY16) to

₹19,173 crore (FY 19). Overall, there was a growth of around 24.80 per cent in terms of FOB value fixed in AAs from FY 16 to FY 19.

The FOB values fixed for AAs when compared with total physical exports effected under the sector revealed the following:



Analysis of FOB value fixed in AAs vis-à-vis total physical exports effected during the year revealed that in two sectors, chemicals and plastics, the FOB value for AAs was more than 50 per cent of the total physical exports, as of 2018-19, followed by engineering. In these three sectors, the AA Scheme was an important driver of total sectoral exports.

Possible reasons² for significant growth in the electronics and plastics sectors may be attributed to dedicated exports promotion councils offering an array of services (facilitating Global Trade Shows/Expositions and Conferences, providing commercially useful information and assistance to its members, undertaking Market research/studies and publicity campaigns, etc.) to its members for accelerating exports. Besides, SION norms are already fixed for most of the products falling in these industries and AHs have the option of making duty free imports even after effecting the exports.

The Gems and Jewellery sector suffered significantly on account of the global economic slowdown³. Besides, presence of other FTP schemes specifically for the sector, levy of Integrated Goods and Services Tax (IGST), discontinuance of AA scheme for import of precious metals for exports of gold medallions and coins, etc., were other possible reasons for reduction of the share of Gems and Jewellery sector in the AA Scheme.

Ministry has taken various initiatives to revive the growth of the sector as well the trade at large by restoring GST exemption since October 2017, removing the pre-import conditions for availing IGST exemption, extending the exemption of

² MOCI Annual Report 2019-20

³ MOCI Annual Report 2019-20

Integrated Tax and Compensation Cess to deemed supplies and 3 per cent IGST on gold sourced by exporters from nominated agency to help the Gems and Jewellery sector by freeing blocked capital since January 2019.

Overall, in the new FTP 2015-20, many facilitation measures have been enabled through digital platforms in the administration of the scheme which include online submission of all information and certificates from Chartered Accountants/Engineers during application. For redemption of licence, any copy of shipping bill can now be submitted instead of Export Promotion (EP) copy of SBs⁴, and there is no need to attach e-BRCs. DGFT also enabled to ratify Authorisations issued on adhoc norms at RA level based on Authorisations issued to the applicant earlier or to other applicants⁵ for the same products. Status of redemption application can be known from the public portal 'eodc.online'⁶.

DGFT implemented mandatory online filing of prescribed documents along with online application for issuance of AAs in May 2019 and has subsequently rolled out a new IT system effective from 1 December 2020 wherein all the prescribed documents (including for redemption) are required to be uploaded online, deficiencies and their responses be handled online and data would be seamlessly transferred to Customs for better monitoring of EODC finalization and making the AA scheme paperless. The period covered during the audit was 2015-16 to 2018-19; therefore, the implementation of these features, effective May 2019 and December 2020, would be reviewed in subsequent audits.

1.5 Audit Objectives

The objectives of the Performance Audit were to assess:

- i) Whether the issue, utilisation and redemption of Authorisations by DGFT offices is being done in an efficient and effective manner;
- ii) Whether the implementation of AAS by the Customs Department is being done in an efficient and effective manner;
- iii) Whether the inter-departmental co-ordination mechanism involved in administration of the Scheme is effective;
- iv) Whether the internal control measures are sufficient to minimize the risks of revenue loss, misuse etc.

1.6 Audit scope

The Performance Audit covered the records and transactions over a four year period from 2015-16 to 2018-19. Audit covered DGFT, its RAs and the Customs field formations where the AAs were registered.

⁴PN 9/2015-20 dated 9.7.2018 of DGFT

⁵ PN No.64/2015-20 dated 27.12.2018 of DGFT

⁶ Trade Notice 1/2018-19 dated 4.4.2018 of DGFT

1.7 Audit Coverage

There are a total of 38 RAs across India wherein 88,157 AAs involving CIF value for imports of ₹7,58,141 crores were issued during the period 2015-16 to 2018-19 covered under the PA. Audit selected a sample of 4,048 AA files (4.96 per cent) involving CIF value of ₹2,08,126 crores (29.56 per cent) from the 23 major RAs (60.52 per cent) which accounted for 92.64 per cent number-wise (81,674 licences) and 92.86 per cent value-wise (CIF value of ₹7,04,008 crores) of the total of 38 RAs (**Appendix 1**). Audit also selected jurisdictional Customs field offices where the selected sample cases were registered for effecting duty free imports and exports.

Out of the 4,048 selected cases, 405 AA files involving CIF value of ₹9,906.73 crores pertaining to seven RAs (mainly Mumbai, Ahmedabad and Delhi) were not produced for audit, despite repeated requests/reminders to RAs (**Appendix 1**).

1.8 Audit criteria

Audit used the relevant provisions of the applicable Acts, manuals, rules, government notifications as criteria, to benchmark the findings. The important provisions are listed below:

- FTP 2015-20;
- HBP and its Appendices;
- Public Notices (PNs)/Circulars etc., issued by the DGFT;
- Foreign Trade (Development and Regulation) (FTDR) Act,1992;
- The Customs Act, 1962;
- Customs Tariff Act, 1975;
- Customs Notifications and Circulars on Advance Authorisation Scheme;
- Foreign Exchange Management Act (FEMA),1999;
- Conservation of Foreign Exchange, Prevention of Smuggling Activities Act, 1974.

1.9 Audit methodology

The Performance Audit was conducted using the Performance Auditing Guidelines of the CAG of India, and in line with the CAG's DPC Act, 1971.

Audit was conducted during the period November 2019 to March 2020. DGFT provided Dump data in two installments i.e. data upto October 2018 on 18 December 2018 and data for the period from November 2018 to March 2019 on 3 January 2020. Audit examination included analysis of DGFT data and test check of authorisations issued and fulfillment of EO by the AHs in the selected RA offices of the DGFT and test check of utilization of authorisations in the selected Customs Ports. Coordination between DGFT and Customs Department in the administration of the Scheme was also analysed.

The Entry/Exit Conference for the PA was conducted on 18 December 2019 and 19 January 2021 respectively with members of DoC/DoR. The first draft was sent to MOCI/DoR on 6 October 2020, reply to which was received 9 December 2020 (DGFT) and 16 December 2020 (DoR). The second draft was issued on 9 January 2021, response to which was received on 1 February 2021 (DGFT) and 12 February 2021 (DoR).

1.10 Acknowledgement

Audit wishes to acknowledge the cooperation received from MoF, DoR and Ministry of Commerce and Industry (MOCI), Department of Commerce (DoC) and its field formations at each stage of the audit process.

