

## **Chapter II: Audit Mandate, Audit Universe and Response to 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 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 (Amendments) 2020 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 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 Indirect Taxes***

Indirect 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 Goods and Service Tax Act, 2017, Integrated Goods and Service Tax Act, 2017, Goods and Service Tax (Compensation to States) Act, 2017 and legacy tax acts viz. Central Excise Act, 1944 and Finance

Act, 1994. Indirect Tax administration 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 Indirect Tax administration, 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 Department of Revenue, CBIC, its subordinate organisations and field formations. The organisational structure of CBIC and the number of departmental units are discussed in Para 1.2 of this Report. Roles and duties of the CBIC and its field formation are discussed in the subsequent paragraphs.

### **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 indirect taxes, prevention of smuggling and administration of matters relating to indirect taxes and narcotics to the extent under CBIC's purview. CBIC is headed by a Chairman and consists of four members.

### **2.2.2 Zones**

Zones are the highest auditable field 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**

Commissionerates are divided in three categories viz. Executive Commissionerates, Commissionerates (Audit) and Commissionerates (Appeal).

The primary function of a Central Goods and Service Tax Commissionerate (Executive Commissionerate) is to implement the provisions of Central Goods and Service Tax Act, 2017, Central Excise Act, 1944, rules framed under these Acts and other allied Acts of the Parliament under which duty of GST/ Central Excise is levied and collected. Administratively, each Commissionerate is a 3-tier set-up with its Headquarters at the helm, four to six Divisions at the

second level and on an average four to seven Ranges under each Division at the third and final level.

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

Commissioner (Appeal) acts as an appellate authority and passes orders on appeals 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 provisional assessments, sanctioning of rebate/refund claims and perform quasi-judicial functions viz. adjudication of cases falling within their competence.

#### **2.2.5 Ranges**

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

### **2.3 Audit Sample**

The details of departmental units audited by us during 2018-19 and 2019-20 are depicted in chart 2.1, as follows:

Chart No. 2.1: Audit Universe and Sample

FY19			FY20		
Auditee Unit	Universe	Sample	Auditee Unit	Universe	Sample
Zones	21	19 (90%)	Zones	21	18 (86%)
Commissionerates	111	71 (64%)	Commissionerates	111	68 (61%)
Divisions	753	263 (35%)	Divisions	753	261 (35%)
Ranges	3912	1007 (26%)	Ranges	3912	1016 (26%)
Other Units*	280	149 (53%)	Other Units	287	134 (47%)
Total	5077	1509 (30%)	Total	5084	1497 (29%)

\* Other units includes Audit Commissionerates, Appeal Commissionerates, Pay and Account Offices, Customs Excise and Service tax appellate Tribunal, Directorate General of GST Intelligence, ADG (Audit) etc.

As can be seen from the above, we audited 1509 units (30 per cent) out of 5077 units, and 1497 units (29 per cent) out of 5084 units, during 2018-19 and 2019-20, respectively.

## 2.4 Audit Efforts and Audit Products

Compliance Audit of GST and legacy indirect taxes was conducted by our nine field offices headed by Directors General (DsG)/Principal Directors (PDs) of Audit.

In GST audit, during the period October 2018 to March 2020, we verified 5,822 transitional credit cases, out of 77,363 transitional credit cases in 81 Central GST Commissionerates and five Audit Commissionerates. We noticed 1,182 instances (20 per cent) of non-compliance/omissions with money value of ₹ 543.70 crore. Out of these 1,182 instances, we have included 62 draft paragraphs consisting of 105 significant observations having monetary impact of ₹ 86.11 crore in this report. Similarly, during the same period we examined the records relating to 4,736 refunds cases, out of 23,106 refund cases in 33 CGST Commissionerates. We noticed non-adherence to extant provisions in processing of refunds in 280 claims (6 per cent) involving an amount of ₹ 16.16 crore. Out of this, we have included 07 draft paragraphs consisting of 25 significant observations having monetary impact of ₹ 8.26 crore in this report. In addition to this, we have also included 08 draft paragraphs, pertaining to other irregularities noticed during GST audit, having monetary impact of ₹ 6.77 crore in this report. Audit observations pertaining to compliance audit of GST are included in Chapter IV of this report.

During 2018-19, we selected records of 2,939 assesseees, in 827 Ranges, for detailed examination with respect to assessment and payment of Central Excise duty and Service Tax. Similarly, during 2019-20, we selected records of

1,471 assesseees for detailed examination, in 451 Ranges. We raised 2,712 audit observations having monetary impact of ₹ 1,036.35 crore. We have included 146 draft paragraphs having monetary impact of ₹ 472.30 crore, in this report. In addition to this, we have also included 66 draft paragraphs having monetary impact of ₹ 667.71 crore pertaining to period prior to the period 2017-18 in this report. Audit observation pertaining to legacy taxes (Central Excise & Service Tax) are included in Chapter VI of this report.

In addition, we conducted IT Audit of GSTN<sup>23</sup> and a Subject Specific Compliance Audit on SCN and Adjudication Processes. IT audit observations are included in Chapter III, and observations on 'SCN and adjudication process' are included in Chapter V of this report.

## **2.5 Response to CAG's Audit**

A large number of audit observations, incorporated in the local audit reports (LAR)<sup>24</sup> are pending for compliance by the Department. As on 31 March 2020, 29,496 paras pertaining to 10,489 LARs were pending for compliance. One of the main reasons for pendency of paras has been lack of replies or delayed replies from the Department. We carried out a detailed study in this regard, for the paras outstanding as on 31 March 2019, the results of which are presented in the subsequent paras.

### **2.5.1 Provisions regarding Local Audit Reports (LARs)**

We elicit response to our observations from the audited entities at different stages of audit. As per provisions of the regulation 136 of CAG's Regulations on Audit and Accounts (Amendments) 2020, on completion of field audit, we issue the LAR to the Department for comments.

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 137 to 152, 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

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<sup>23</sup> Phase-II

<sup>24</sup> Local audit report is issued by the field audit office to each audited departmental unit. Based on their reply significant observations are included in Audit Reports, placed in the Parliament.

of Audit Committee Meetings (ACMs) etc. for the purpose of monitoring and ensuring compliance and settlement of pending audit observations.

### **2.5.2 Audit Scope and sample**

We examined the status of replies of the Department on LAR paras, pending as on 31 March 2019. Out of 109 Commissionerates, 49 Commissionerates<sup>25</sup> were selected for audit. A sample of outstanding paras was selected in the Commissionerates for detailed examination under two categories:

- (i) where response to audit observations was not received.
- (ii) where response to audit observations was received with delay.

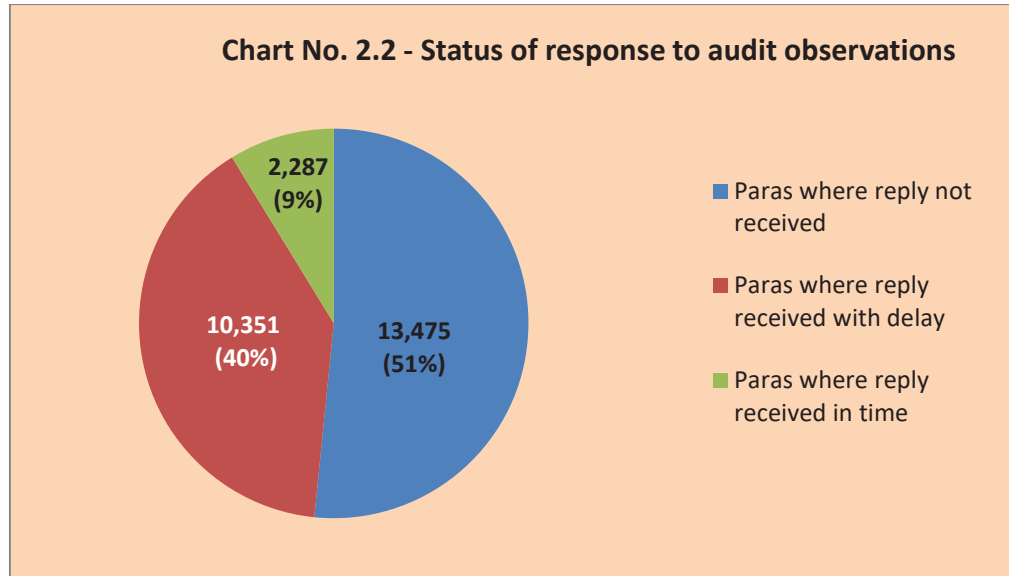
### **2.5.3 Audit findings**

Analysis of outstanding LAR paras revealed that a total of 26,113 audit paras, with a reported tax effect of ₹ 19,970.81 crore were outstanding in 109 Commissionerates, spread across India, as on 31 March 2019. **Out of these, the Department had failed to offer first response to 13,475 audit paras i.e. 51.60 per cent (reported tax effect ₹ 12,017.18 crore), and responded to 10,351 audit paras (39.64 per cent) with delay. Thus, only in 2287 cases (8.76 per cent), the Department gave first response within the prescribed time limit of 30 days.**

Chart 2.2 summarises the status of first response to audit paragraphs included in Local Audit Reports.

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<sup>25</sup> Agartala, Ahmedabad South, Allahabad, Bengaluru East, Bengaluru North-West, Bengaluru South, Bengaluru West, Belapur, Chennai North, Chennai Outer, Chennai South, Delhi-East, Delhi-West, Dibrugarh, Gandhinagar, Ghaziabad, Goa, Gurugram, Guwahati, Haldia, Howrah, Indore, Jaipur, Jalandhar, Jamshedpur, Kochi, Kolkata South, Kuch/Gandhidham, Lucknow, Ludhiana, Madurai, Meerut, Mumbai East, Mumbai South, Nagpur-I, Nashik, Navi Mumbai, Palghar, Patna I, Pune II, Raigad, Raipur, Ranchi I, Rohtak, Shillong, Surat, Thiruvananthpuram, Udaipur and Vadodara.

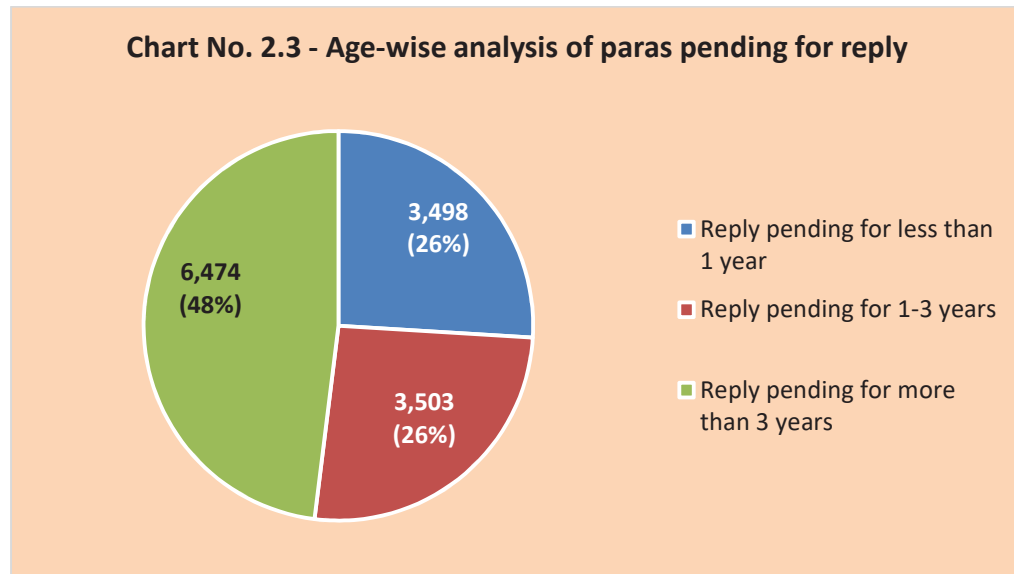


In order to assess the reasons for lack of adequate responsiveness to audit observations, and to ascertain the action taken by Department on audit findings, we examined in detail a sample of LAR paras as stated in para 2.3.3.

#### **2.5.4 LAR paras where Department did not furnish reply**

Out of total 26,113 outstanding audit paras, pertaining to 109 Commissionerates as on 31 March 2019, in 13,475 paras (51.60 per cent), first replies were not received from the Department.

An age-wise analysis of paras, where reply has not been received from the Department, is given in the chart 2.3 below:



As is evident from Chart 2.3 above, replies on 6,474 (48.04 per cent) paras with tax effect of ₹ 8,660.17 crore were pending for more than three years, reflecting lackadaisical approach of the Department in replying to audit observations.

Further, we analysed the reasons for Department's failure to respond to audit paras despite lapse of considerable time and sampled 1,012 audit paras for detailed examination and observed that:

**(a)** Out of these 1,012 paras where first reply was not received, in 547 cases (54 *per cent*), the Department failed to produce case files for verification during the field visit.

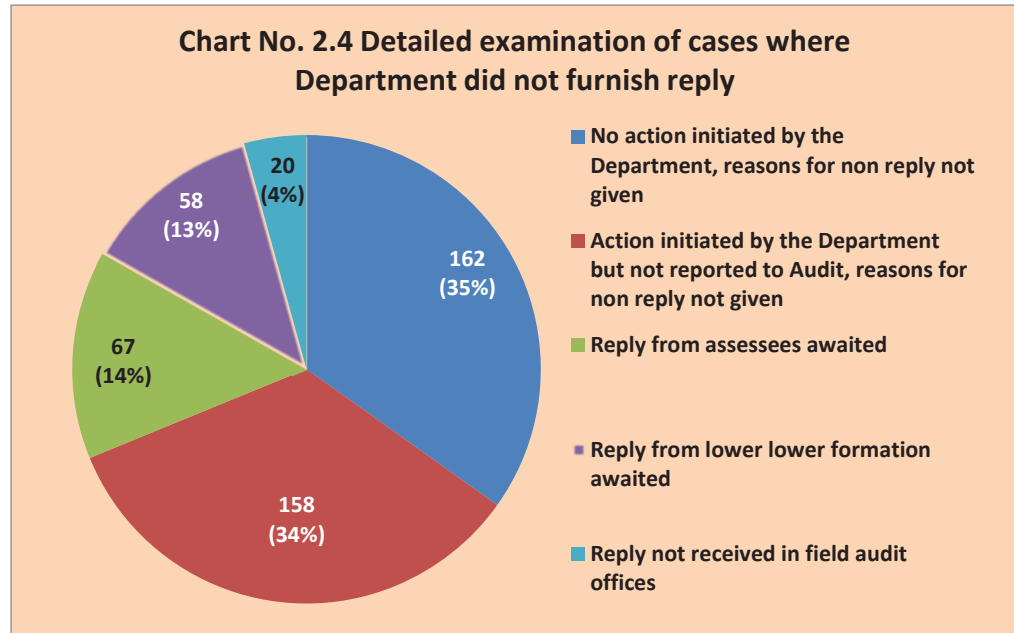
Reasons for non-production of records to Audit were non-traceability of records in 172 cases (31 *per cent*), records awaited from sub-ordinate field formations in 127 cases (23 *per cent*) and transfer of records to other Commissionerates owing to restructuring in 117 cases (21 *per cent*). In 131 cases, no reasons were provided for non-production of records for audit scrutiny.

**(b)** Out of the remaining case files relating to 465 paras, which were produced to Audit:

- (i)** We noticed that in respect of 162 audit paras (34.84 *per cent*), no action was taken by the Department. Out of these 162 cases, 47 cases (29 *per cent*) involving ₹ 13.62 crore are more than five years old, and are thus time barred for taking any action. Reasons for inaction were not available in the records produced to Audit.
- (ii)** We noticed that in 158 cases (34 *per cent*), though the action was initiated by the Department, the same was not intimated to Audit. Reasons for not reporting the action were not intimated to Audit.
- (iii)** In 67 cases (14 *per cent*), we observed that the Department did not reply to audit observations as it required clarifications/responses from the assessees, which were awaited for long period.
- (iv)** In 58 cases (13 *per cent*), we observed that the Department did not respond to LAR paras because the replies sought from lower field formations, for responding to LAR paragraphs, were awaited.
- (v)** In the remaining 20 cases (4 *per cent*), replies were furnished by the Department, however, the same were not received in field audit offices.



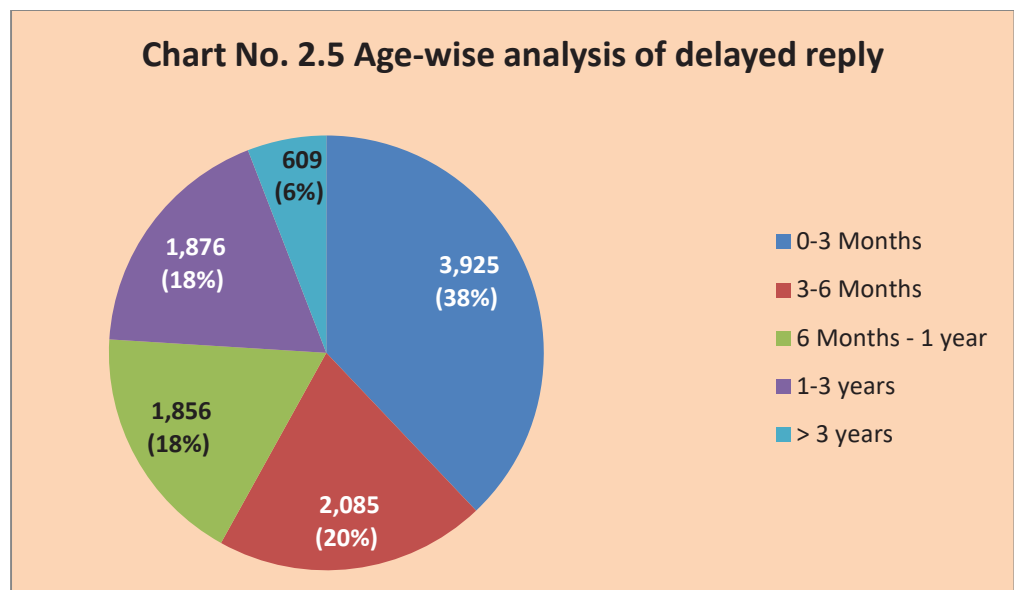
Chart 2.4 depicts the results of examination of cases where Department did not furnish reply.



We pointed this out in August 2020. Reply of the Ministry is awaited (December 2020).

**2.5.5 LAR paras where Department replied with delay**

Out of total 26,113 outstanding audit paras pertaining to 109 Commissionerates, as on 31<sup>st</sup> March 2019, in 10,351 paras (39.64 per cent) first replies were received with delay from the Department. The delays in reply ranged from 1 month to more than 3 years as depicted in the chart 2.5 below:



In order to analyse the reasons for delay in responding to audit observations, we examined 1,137 LAR audit paras in 49 Commissionerates. The results of the examination are given below:

- (a) Out of these 1,137 paras where first reply was received with delay, in 430 cases (38 per cent), the Department failed to produce case files for verification during the field visit.

Reasons for non-production of records to Audit were non-traceability of records in 80 cases (19 per cent), records awaited from sub-ordinate field formations in 236 cases (55 per cent), and Transfer of records to other Commissionerates owing to restructuring in 31 cases (7 per cent). In 83 cases (19 per cent), no reasons were provided for non-production of records for audit scrutiny.

- (b) Out of the remaining case files relating to 707 paras, which were produced to Audit, we examined the reasons for delay in response and observed the following:

- (i) In 164 (23.20 per cent) cases, it was observed that the Department required clarification/response from the assessees, which were delayed.
- (ii) In 33 cases (4.67 per cent), the reply from the subordinate field formation such as Division/Ranges was delayed.
- (iii) In 510 (72.14 per cent) cases, no reason for delay was found on record.

We pointed this out in August 2020. Reply of the Ministry is awaited (December 2020).

#### **2.5.6 Inadequate response by the Department to paras discussed in Audit Committee meetings**

Regulation 145 of Regulations on Audit and Accounts (Amendments) 2020 stipulates that Government may establish audit committees for the purpose of monitoring and ensuring compliance and settlement of pending audit observations. Each committee so established shall comprise of a representative each from the administrative Department, Audit and a nominee from the Finance Department besides the head of the Department of the auditable entity. Minutes of the meetings of the audit committee shall be recorded.

Audit Committee Meetings (ACM) with the Department were planned and conducted periodically for settlement of outstanding audit observations. The details of Audit Committee Meetings held with the Commissionerates under different Zones during the last four years are enumerated below:-

**Table No. 2.1: Audit Committee Meetings (ACMs)**

Year	Number of ACMs conducted	Total number of paras discussed in ACM , where departmental action was awaited	Number of paras where action/reply not received despite discussion/assurance in the ACM	No of paras where reply received	% response of the Department
2015-16	74	5846	2472	3374	57.71
2016-17	75	9102	3479	5623	61.78
2017-18	69	6796	3274	3522	51.82
2018-19	68	7331	3550	3781	51.58
<b>Total</b>	<b>286</b>	<b>29075</b>	<b>12775</b>	<b>16300</b>	<b>56.06</b>

The Department was given additional opportunity to provide replies to outstanding objections by conducting ACMs held with the Commissionerates under different zones. Though, during the last four years, Audit Committee Meetings were planned and conducted with the auditee units but result/response from the auditee organisation was limited. The Department replied to only 56.06 *per cent* of paras discussed during the meetings.

We pointed this out in August 2020. Reply of the Ministry is awaited (December 2020).

### **2.5.7 Audit Conclusion**

A very large number of audit observations were pending for compliance in the LARs as on 31 March 2019. Department's response to these audit observations was intermittent and not substantive leading to persistent accumulation of outstanding paras. Department had not furnished reply to 52 *per cent* (13,477) of the LAR audit paras, pending as on 31 March, 2019, reflecting lackadaisical approach of the Department in replying to audit observations.

### **2.5.8 Recommendations**

- The Department may develop a comprehensive database to monitor compliance on audit observations in CBIC field formations.
- The Department may create an online interface with Audit wherein all audit paras are responded through the system and pendency could be tracked through Management Information System (MIS). A system of periodical reports may be put in place at the Board level to monitor remedial action taken on audit observations.

- Files which are not traceable may be located and suitable rectificatory action may be ensured in all cases.
- LAR paras that are outstanding may be reviewed and followed up by the Department and responses may be sent to Audit without further delay.

## 2.6 Follow-up of CAG’s Audit Reports

In the last five Audit Reports (including current year’s report), we had included 1,322 audit paragraphs pertaining to Central Excise, Service Tax and Goods and Services Tax involving ₹ 3,631.13 crore. The details of follow-up on audit observations are included in Table 2.2.

**Table No. 2.2: Follow-up of Audit Reports**

(Amount in ₹ crore)

Year			FY15	FY16	FY17	FY18	FY19 & FY20	Total
Paragraphs Included		No.	231	255	300	239	297	1322
		Amt.	534.37	435.56	1018.79	401.26	1241.15	3631.13
Paragraphs accepted	As on 31.12.2020	No.	213	237	269	216	183	1118
		Amt.	510.17	384.78	548.56	200.39	504.01	2147.91
Recoveries effected	As on 31.12.2020	No.	139	178	160	116	107	700
		Amt.	83.27	110.97	372.15	58.37	43.24	668.00

The Ministry had accepted audit observations in 1,118 audit paragraphs involving ₹ 2,147.91 crore, and had recovered ₹ 668.00 crore in 700 audit paragraphs.

### 2.6.1 Response by Ministry to audit observations included in this report.

As stated before, we issued only significant observations to the Ministry for comments before inclusion in this 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 have included 289 draft paragraphs with monetary impact of ₹ 1,241.15 crore in the current Audit Report. The Ministry admitted 183 draft paragraphs having monetary impact of ₹ 504.01 crore. Ministry’s reply is awaited with respect to 84 draft paragraphs.

We also issued two draft Paragraphs on IT Audit of GSTN and Subject Specific Compliance Audit on “SCN and Adjudication process”.

In addition to the above, we issued five draft paragraphs related to Indirect Taxes Administration, Compliance verification mechanism under GST, Revenue Trends under GST, and non-furnishing of GST Compensation Fund Account. Ministry has replied on four draft paragraphs. Reply with respect to one draft paragraphs is awaited.