

CHAPTER III INDIAN CUSTOMS ELECTRONIC DATA INTERCHANGE SYSTEM (ICES)

Executive Summary

The Indian Customs Electronic Data Interchange System (ICES) envisages acceptance of customs documents electronically and exchange of information electronically in centralised/structured formats, integrating customs with other agencies and was developed to implement the various provisions of the Customs Act 1962, Customs Tariff Act 1975 (CTA) and Central Excise Tariff Act 1985 (CETA). The system was designed to exchange/transact customs clearance electronically using Electronic Data Interchange (EDI).

A review of the ICES was conducted in audit with the objective to verify that the IT system had mapped the processes and provisions of the Customs Act effectively and to (i) evaluate the software in relation to fulfilment of the business requirements set down in the Customs Act, (ii) ascertain the extent of utilisation of data in the system, (iii) evaluate whether the system has adequate inbuilt controls to ensure accuracy and completeness of assessments etc., (iv) evaluate whether the modifications in the programme were properly authorised, tested, documented and implemented and (v) evaluate whether the system had adequate security controls .

The audit review has revealed deficiencies in design, application and validation controls of the system. Broadly these relate to (i) deficiencies in the system design leading to incomplete capture of data leading to manual interventions and incorrect levy of customs duty, (ii) incorrect mapping of the business rules leading to excess sanctions of drawback, 'duty entitlement passbook (DEPB)' credits and short levy of 'countervailing duty (CVD)', (iii) absence of appropriate input controls leading to entry of incorrect and invalid entries for freight/insurance resulting in undervaluation and incorrect assessment of duty forgone, (iv) absence of validation between 'customs tariff heading (CTH)' and the serial number of the notification to check for ensuring the eligibility for the benefit of exemptions, (v) absence of validation between licences and scheme codes which enabled multiple debiting of schemes such as 'DEPB', 'Duty free replenishment certificate (DFRC)' and 'Target plus scheme (TPS)' in the licences, (vi) inadequate change management control which had resulted in non-matching/duplication of 'CTH' and 'central excise tariff heading (CETH)', non-levy of 'national calamity contingencies duty (NCCD)', non-updating of notification master tables and incorrect updating of 'drawback schedule' and (vii) wastage of resources as the data available in the system was not utilised and manual processes were resorted instead. The short levy, non-levy etc. of the customs duty due to these system deficiencies noticed in cases test checked was Rs. 220.50 crore, of these, observations with money value of Rs. 76.44 crore have been accepted (till December 2008) by the department.

Five specific recommendations designed to address the system deficiencies and mitigate the risk of occurrence of similar irregularities in future have been

included in the report. All of these recommendations were acceptable to the Ministry.

3.1 Highlights

↘ **Deficiencies in the system design led to incomplete capture of data leading to manual interventions and consequently incorrect levy of customs duty.**

(Paragraph 3.11.3)

↘ **Incorrect mapping of the business rules enabled excess sanction of drawback, DEPB credits and short levy of CVD.**

(Paragraphs 3.12.1 to 3.12.3)

↘ **Incorrect and invalid entries for freight/insurance became possible as input controls were insufficient. This had led to undervaluation and incorrect assessment of duty forgone.**

(Paragraph 3.13.1.1)

↘ **Validation check between CTH and the serial number of the notification did not exist and as a result it was not possible to ensure that the benefit of exemptions was taken by only in legitimate cases.**

(Paragraph 3.13.1.2)

↘ **Absence of validation controls between licences and scheme codes led to debiting of licences in multiple schemes like DEPB, DFRC and TPS.**

(Paragraph 3.13.1.3)

↘ **Inadequate change management control led to non-matching of CTH and CETH which resulted in duplication of tariff heads and also non-levy of NCCD.**

(Paragraph 3.14.1)

↘ **Inadequate change management led to non-updating of notification master tables and incorrect updating of 'drawback schedule'.**

(Paragraphs 3.14.2 and 3.14.3)

↘ **Resources were wasted as manual process was resorted to despite the requisite data residing in the system.**

(Paragraph 3.16)

3.2 Introduction

The ICES envisages acceptance of customs documents electronically and exchange of information electronically in centralised/structured formats, integrating customs with other agencies such as Reserve Bank of India (RBI), Director General of Foreign Trade (DGFT) etc. and was developed to implement the various provisions of the Customs Act 1962, CTA and CETA. The system was designed to exchange/transact customs clearance electronically using EDI.

The main objectives of ICES were (i) respond more quickly to the need of the trade, (ii) computerisation of customs related functions including import/export, general manifest control, ex-bond clearance of warehoused goods, goods imported against export promotion schemes, monitoring of export promotion schemes, (iii) reduce interaction of the trade with the Government agencies, (iv) provide retrieval of information from other custom location to have uniformity in assessment and valuation, (v) provide management information system for policy making and its effective revenue and pendency monitoring and (vi) provide quick and correct information on import/export statistics to the 'Director General of Commercial Intelligence and Statistics (DGCIS)'.

The ICES was made operational as a Pilot project at Air Cargo, Delhi in 1995 and the same was introduced in the other customs houses in a phased manner from 1997.

As a part of envisioned move from customs control to trade facilitation the following measures have been adopted for streamlining the customs procedure under the ICES:

- (i) Elimination of divergent practices in the application of customs law and procedure at different customs locations by effective monitoring and analysis of computerised database.
- (ii) Minimised physical examination of goods by effectively using risk management system (RMS).
- (iii) The drawback payment system has been re-engineered to provide for direct disbursement of the amount into the exporter's bank account after the goods have been exported.

A system review on ICES of the Customs department was included in the Report of the Comptroller and Auditor General of India – Indirect Taxes – Customs for the year ended March 2001. That review had focused on the initial stages of computerisation viz. procurement and software development. The present audit was conducted with the major objective of verifying that the IT system had mapped the processes and provisions of the Customs Act effectively and to evaluate the software in relation to fulfilment of the business requirements set down in the Customs Act.

3.3 The system

The ICES software was developed with Oracle as the back-end database and Forms and Reports of Oracle as the front-end. The system is presently under the administrative control of the Directorate General of Systems and Data Management (DGS&DM), department of customs, New Delhi and is assisted by the National Informatics Centre (NIC). All the customs houses are connected with the DGS&DM through leased lines.

E-filing services to the trade and cargo carriers and other clients of customs and central excise (trading partners) are being provided through a portal ICEGATE (Indian Customs and Central Excise Electronic Commerce/Electronic Data interchange (EC/EDI) Gateway). ICEGATE relies

on a high-speed network called ICENET or the Indian Customs and Central Excise Network.

3.4 Master files in the system

The master tables (directory) such as the exchange rate, tariff heading, notifications etc., except anti-dumping duty (ADD), for the purpose of calculation of duty are centrally updated by the DGS&DM at New Delhi and then followed by similar process of updating in the local servers through snapshots⁵.

3.5 Filing of bill of entry (BE)/shipping bill (SB)

All importers/exporters have to declare the details of import/export in the prescribed format. Declaration forms can be submitted by the importers/exporters to the 'Service Centre' in the customs house for making data entry into the system or the same can be filed through ICEGATE⁶ which is connected to the customs server through leased lines. The system allots the BE/SB number after the importer/exporter verifies the data entered through a checklist generated in the service centre. The practice of manual submission of BE/SB has almost been dispensed with. The assessment of BE/SB and sanction of incentives like drawback are done through the system.

3.6 Processing of data

After the BE/SB number are generated by the system, the bills are subject to further processing including registration, examination, verification of goods, assessment and sanction of drawback by the departmental officers. Prior to the introduction of 'RMS'⁷ during January 2006 to May 2007 in respect of the selected states, the system allocated the BE to the Appraising Officer (AO) for assessment and then for further checks by the Internal Audit Department (IAD) before clearance of the goods. However, after the introduction of RMS, the system selects the bills randomly based on the parameters set by the 'System Manager' for post compliance audit in place of internal audit. As regards exports, drawback amounts are sanctioned through the system at the appropriate levels.

⁵A snapshot is a replica of a target master table from a single point-in-time. Whereas in multi master, replication tables are continuously being updated by other master sites, snapshots are updated by one or more master tables via individual batch updates, known as a refresh, from a single master site.

⁶Indian Customs Gate way (ICEGATE) for filing BEs/SBs online using Remote EDI system (RES) package available in CBEC website.

⁷RMS is to enable the department for selective screening of only high risk cargo for customs examination. Under the RMS, BEs filed by importers in the ICES will be processed for risk and a larger number of consignments will be allowed clearance based on the importer's self assessment without examination.

3.7 Output of the system

After assessment, print outs of BEs/SBs, challans for payment of duty by the importers are produced by the system and credits of drawback are effected directly into the exporter's bank account through scrolls.

3.8 Audit objective

The ICES system had been modified from time to time in accordance with the changes in the Customs Act/Rules. The system has been in operation for more than a decade. The present review was conducted to verify that the IT system had mapped the processes and provisions of the Customs Act effectively and further to (i) evaluate software in relation to fulfilment of the business requirements set down in the Customs Act, (ii) ascertain the extent of utilisation of data in the system, (iii) evaluate whether the system had adequate inbuilt controls to ensure accuracy and completeness of assessments etc., (iv) evaluate whether the modification in the system were properly authorised, tested, documented and implemented and (v) evaluate whether the system had adequate security controls.

3.9 Scope of audit and methodology

The review was conducted in 18 customs stations under the control of 14 commissionerates of customs in six states (Andhra Pradesh, Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal). The import and export data for the years 2005-2006 and 2006-2007 was analysed using Oracle SQL queries (except in Delhi where export data was not furnished). The results of the queries were verified with the manual records. A sample size of two percent, subject to maximum of 200 records, was selected for cross verification of each query result with the corresponding manual record. Only 350 out of 21,450 manual records requisitioned were produced to audit in Tamil Nadu, Andhra Pradesh, Gujarat, Maharashtra and Delhi. The responses to the audit observations, wherever received, have been appropriately incorporated in this report.

3.10 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and its field formations in providing the necessary information and records for audit. The draft review was forwarded to the Ministry in October 2008 and an exit conference was conducted with the Ministry officials in November 2008. The written responses to the draft review were received from the Ministry in December 2008 and have been incorporated appropriately in this report.

AUDIT FINDINGS AND RECOMMENDATIONS

3.11 System design

System design is the process of defining the architecture, components, modules, interfaces, and data for a system to satisfy the specified

requirements. It was observed that the system did not have built in provisions to capture all relevant data and further to carry out some of the calculations for the assessment of the customs and other duties.

3.11.1 Lack of provision to calculate/classify export duty

Prior to March 2007, export duty was leviable on 'hides, skin and leather tanned or un-tanned excluding manufactures of leathers' falling under heading 14 of second schedule of CTA. The ICES did not have any provision to calculate the applicable export duty. The department had accepted the shortcoming in January 2007.

Similarly, iron ore and chromium ore were liable to levy of export duty under headings 11 and 12 of second schedule to the CTA respectively. While the system did calculate export duty on iron ore and chromium ore alongwith applicable cess, the challan generated by the system for the total amount payable did not indicate the amounts for export duty and cess, separately. Accordingly, in the monthly details of payment generated by the system, total amount collected was shown as cess and the same was adopted for compilation of accounts by PAO. To this extent the collections under the export duty were understated and collections under the cess overstated.

The Ministry, while accepting (December 2008) the observations and related recommendation of separate account of cess and export duty, stated that the software could be modified to differentiate these.

3.11.2 Non-availability of collections of extra duty deposit (EDD)

The system calculates the aggregate of customs duty, interest, penalty, fine etc. on assessment of each BE. Audit observed that the system did not have a provision to capture details of the collections of EDD due to which these duties were collected manually alongwith the collection of the amount of basic customs duty (BCD), CVD etc.

The Ministry, while agreeing with the observation that ICES does not have provision for calculation of EDD, informed (December 2008) that this duty is calculated manually as calculation of EDD is not a routine assessment feature.

3.11.3 Incomplete capture of the parameters and manual intervention leading to short levy of BCD

In terms of the first schedule to the CTA, textiles being imported are required to be declared in units of 'm² or kgs' and the applicable customs duty is to be calculated at the specified rates per 'm² or kgs' or at ad-valorem rate, whichever is higher. However, in the common trade practice, the quantities indicated in the invoices are in terms of meter or yard and the width is indicated in inches or centimetres or with the weight in grams per square meter (GSM), which require conversion of these units into 'm² or kgs' for the assessment and calculation of BCD. It was observed that these detailed parameters were captured in the system in text format in a single field thus making it unusable by the system for calculation of applicable duties. In fact

the system did not even have a provision for such calculation. This necessitated that the conversion was carried out manually and the quantity with appropriate units of measurement was entered into the system. No verification of such entries was additionally done to ensure the correctness of these quantities. In the absence of the above enabling provisions in the system, it was observed in audit through data analysis that:-

- a) the quantities under unit of measurement were incorrect as the importers did not apply correct conversion formulae while entering the data. This was observed in 380 items in Tamil Nadu, 116 items in Maharashtra and 29 items in Delhi. This errors resulted in short calculation of BCD of Rs. 13.93 crore (Rs. 8.35 crore in Tamil Nadu, Rs. 5.40 crore in Maharashtra and Rs. 18.02 lakh in Delhi).
- b) in respect of 1,661 items, the quantity was shown as 'ZERO' or 'NULL' indicating deficient input and validation controls.

The system has a provision to edit and amend the data with respect to the quantity at the assessing officer's level. However, it was observed that, due to a design deficiency, the duty on specific rate continued to be worked out by the system based on the pre-amended data and the amended data was not utilised to arrive at the duty. This resulted in short calculation of BCD in 91 cases totalling Rs. 1.81 crore in Andhra Pradesh, Delhi, Maharashtra, Tamil Nadu and West Bengal.

While explaining (December 2008) the fact of different units of measurement being adopted in the BEs, as per trade practice and the difficulty to control these through the system, the Ministry informed that the design deficiency pointed out by audit regarding system using pre-amended data has been rectified, post audit, through a software patch.

3.11.4 Data regarding country of origin

The country of origin is used to arrive at the ADD. As per the declaration form for data entry at the service centres, the country of origin was to be captured at two sources on the form depending on the necessity. One, when the country of origin for all items was same at BE level and when the country of origin for the items was different, the country of origin was to be captured separately for all the items, individually at item level. Audit observed that system allowed capture of the country of origin in both sources even in cases where the country of origin for individual items was different. This led to presence of two different countries of origin for the same item (at BE and at item levels) in respect of 9,38,294 items mentioned in 2,06,057 BEs in Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal. This posed the risk of non-levy of anti-dumping duty as the same is levied based on various factors including the country of origin and declaration on the part of importer as to whether the imported goods were liable for such duty.

The Ministry informed (December 2008) that the system has been properly designed by capturing 'country of origin' at two places and using the value at the 'item' level for levy of ADD. Accordingly, any short levy pointed out by audit could be on account of assessment lapse.

3.11.5 SBs not matched with export general manifest (EGM) on DEPB items

Section 41 of the Customs Act, 1962 envisages filing of EGM by the shipping agent before the departure of the conveyance. Every EGM contains the details of goods being exported as in the corresponding SB. The department issues an export promotion (EP) copy based on the details in the SB for availing of duty credit under the DEPB scheme. The EP copy should not be issued in case of any incongruence of details as mentioned in the EGM and the SB. Further, the department has to verify the DEPB licence issued by the DGFT to ensure that the export had actually taken place, for which the system had a provision.

Audit observed that EP copies for claiming benefit on exports from the DGFT under DEPB scheme were issued to the exporters after verification of licences (2,968) in 11,195 SBs (Andhra Pradesh, Gujarat, Maharashtra, Tamil Nadu and West Bengal) with DEPB value of Rs. 84.13 crore even though the details of the SB did not match with the corresponding details of the EGM (shown by the system itself as "EGM Dtls. Mismatch" in the current status of the SB). This indicates that there was a risk of loss of revenue, in case the DEPB benefit had been extended incorrectly.

The Ministry informed (December 2008) that even after correcting the EGM error, the current status of the SB continued to be shown as mismatched in the system, which was subsequently rectified by NIC.

3.11.6 Currency of packing charges

The exporter/custom house agent (CHA) has to specify the invoice value, rate of commission, discount availed and other deductions etc. alongwith the currency code in the declaration form. These details contained in the declaration form are entered in the system. As per the drawback procedure, packing charges incurred is to be included for the purpose of calculation of freight on board (FOB) value of the goods. However, the provision to enter the currency code for packing charges was absent in the system. As such, by default, the currency code of invoice was taken by the system as the currency code for packing charges and the FOB value of the goods exported was calculated for the purpose of drawback mentioned in the SB.

The Ministry agreed (December 2008) to make a provision in the system for capturing packing charges in Indian rupees.

3.11.7 Items imported against licences not checked with revised Indian trade classification code (RITC)

For the levy of duty, the goods are identified through the tariff heads for customs and central excise as per the respective acts, separately. In the ICES, these were captured for different items of the BE/SB. With effect from March 2005, the CETH and the CTH have been aligned as RITC.

Licences issued by the licencing authority under various export promotion schemes like DEEC, EOU, DFRC, EPCG etc., contain details of items of goods to be imported, quantity, value and the RITC. Though the licence

contains RITC, it was not being captured at the time of registration at the port of import. Capturing the RITC, as per the licence, can enable the system to validate the items imported under the licence by comparing it with the RITC contained in the BE. In the absence of such validation of RITC, possibility of import of goods not covered under the licence could not be ruled out.

The Ministry informed (December 2008) that while there is a provision in the ICES system to capture ITC (HS)/RITC, these were not necessarily reflected in the licences issued by the DGFT. Presently, however, mention of ITC (HS) code has been made mandatory in the EDI licence messages received from the DGFT. It further informed that as the verification of the correctness of the ITC (HS) code is not done at the DGFT end and in case of such incorrect data, the CTH in the BE is corrected by the appraising officer. Accordingly, the validation through the system is not under consideration presently, as that would lead to unnecessary hardship to the trade as correction in the BE would then require correction in the ITC (HS) in the licence issued by the DGFT.

3.11.8 Interest on goods cleared from the warehouse

Under section 61 (2) (ii) of the Customs Act, 1962, Board had clarified (February 2005) that interest is to be levied for delayed clearance of goods from the warehouse, in respect of goods cleared under DEPB licence, if the goods are not cleared from the warehouse within 90 days. Similarly, interest was to be levied in respect of goods cleared from the warehouse by debiting the licences under the TPS.

Audit observed that in 2,129 BEs relating to the schemes such as DEPB, TPS etc., interest of Rs. 4.22 crore (Gujarat Rs. 0.30 lakh in 16 BEs, Maharashtra Rs. 2.74 crore in 343 BEs, Tamil Nadu Rs. 1.48 crore in 1,760 BEs and West Bengal Rs. 0.02 lakh in ten BEs) for delayed clearance of goods from the warehouse was not levied in respect of goods cleared from the warehouse beyond 90 days, as the provision for the same was not built into the system.

The Ministry agreed (December 2008) with the audit observations that provision for calculation of interest for clearance from warehouse beyond 90 days has not been built in the ICES which is calculated manually by the assessing officer and short levy pointed out by audit on this account could be due to assessment lapse.

3.12 Incomplete mapping of business rules

The deficiency in customising various business rules in the system, absence of certain provisions as per the rules/Acts in force were observed relating to the following business requirements:

3.12.1 Agency commission

The drawback rules provide that the agency commission, if any, paid to foreign agency shall be included for the purpose of allowing drawback. Further, the agency commission paid shall be restricted to 12.5 per cent of the value of goods exported. The declaration form furnished by the exporter/CHA

did not contain the details whether the commission was paid to the foreign agency or not.

The system, by default, treated the commission paid as foreign agency commission and the FOB value was calculated accordingly. The amount of commission paid was also not restricted to 12.5 per cent of the value of goods. Due to non- restriction of the commission amount paid in foreign currency to 12.5 per cent of the value of goods, there was an excess sanction of drawback of Rs. 1.53 crore and DEPB amount of Rs. 6.17 crore, as detailed below:

Table no. 1
Excess sanction of drawback and DEPB
(Amount in lakh of rupees)

State	No. of invoices	Excess drawback	No. of items	Excess DEPB
Andhra Pradesh	52	0.61	3,350	32.73
Gujarat	267	2.14	3,483	47.85
Maharashtra	4,978	65.08	30,259	479.60
Tamil Nadu	7,579	79.80	10,043	49.84
West Bengal	475	5.20	4,058	7.37
Total	13,351	152.85	51,193	617.39

The Ministry agreed (December 2008) to these audit observations and informed that the ICES application has been modified, post audit, to restrict the agency commission to 12.5 per cent.

3.12.2 Sanction of drawback

As per rule 8 of the Drawback Rules, 1995, no amount of drawback shall be allowed, if the amount or rate of drawback is less than one per cent of the FOB value, except where the amount of drawback per shipment exceeds Rupees five hundred.

Audit observed that in 287 cases (seven cases in Andhra Pradesh, 15 cases in Gujarat, 42 cases in Maharashtra, 169 cases in Tamil Nadu and 54 cases in West Bengal), the drawback amount of less than Rupees five hundred were sanctioned, even though the drawback amount was less than one per cent of the FOB value.

The Ministry assured (December 2008), that the necessary corrections in the logic built in the system will be done.

3.12.3 Abatement of CVD in respect of imported footwear

In terms of central excise notification dated 1 March 2006, for assessment of CVD on footwear falling under heading 6401 to 6405 of CETA on the basis of maximum retail price (MRP), an abatement of 37 per cent was to be allowed in respect of footwear of retail sale price (RSP) exceeding Rs. 250 and not exceeding Rs. 750 per pair and for other, abatement at the rate of 40 per cent

on the MRP is admissible. Audit observed that the provisions have not been mapped correctly in the system.

Data analysis revealed that in 57 cases of footwear in the price range of Rs. 250-750 per pair were allowed 40 per cent abatement instead of 37 per cent, resulting in short levy of CVD and in 11,830 cases (Delhi – 5,843 items, Andhra Pradesh - 11 items, West Bengal - 808 items and Maharashtra – 5,168 items) CVD was levied in excess by allowing incorrect abatement of 37 per cent instead of 40 per cent on footwear falling in the price range other than Rs. 250 – 750 per pair.

On the deficiency in the system design being pointed out, the Ministry informed (December 2008) that the system is designed to capture only a unique abatement rate against a CETH and the provision for multiple abatement rates is handled through manual assessment only.

Recommendation Nos. 1 and 2

- *Review of the business rules mapped in the system may be carried out.*
- *Any changes built into the system should be documented and conformity of the changes to the business rules ensured. The changes should be authorised by an appropriate authority. An audit trail of the changes made to the system and the data should be maintained. For centralised applications, a centralised change management system should be in place.*

While agreeing (December 2008) to the recommendations, the Ministry informed that (i) business rules are mapped into the system on the basis of statutory provisions and circulars of the Board, (ii) deficiencies in mapping pointed out are rectified, (iii) any changes to the system are done after instructions from the DGS&DM, and (iv) audit trail of these changes are trapped in the e-mail system of the directorate. It further assured that in centralised application, 'Information Technology Infrastructure Library (ITIL)' would be put in place.

3.13 Application controls

Every system should have input, processing, validation and output controls to ensure that the data entered in the system, processing of data and output generated are correct, complete and protect the business interest of the department. Data analysis revealed the following deficiencies in various controls.

3.13.1 Input control and validation check

Input controls ensure that data entered into the system are authorised, complete and correct and validation checks ensure that the data conforms to the business rules. Audit observed that the system lacked both input controls as well as validation checks to ensure complete and correct capture of the primary data in its database.

3.13.1.1 Incorrect computation of assessable value

The assessable value of the goods imported is to be determined under section 14 of the Customs Act, 1962. Rule 9(2) of the Customs Valuation Rules, 1988, provides that if the cost of transportation (freight) is not ascertainable, such cost shall be taken as 20 per cent of FOB value of the goods and if the cost of insurance is not ascertainable, it shall be taken as 1.125 per cent of the FOB value, provided further that in the case of goods imported by Air, the cost of freight shall not exceed 20 per cent of the FOB value of goods. The cost of insurance and freight ascertained or computed in accordance with the above rule shall be added to the FOB value of goods to arrive at the cost, insurance and freight (CIF) value of goods. The system has provision to capture the amount as well as the percentage of the freight and insurance.

As per Board's instruction on 'procedure for clearance of imported and exported goods', the importer is required to furnish the documents such as invoice, packing list, import licence, country of origin certificate, bill of lading, delivery order and insurance document (insurance memo/policy). Under the EDI system, the original documents are not required to be furnished at the service centre but the same should be furnished at the time of examination /clearance of goods. Data analysis in audit has revealed the following deficiencies.

i) Acceptance of zero or null values in respect of freight/insurance

The value or percentage rate is essential in respect of the freight or insurance components for computation of assessable value in respect of FOB based imports. However, the system allowed 'null' or 'zero' values against the freight /insurance values and the respective percentage rates in 380 invoices. This showed absence of input controls and validation checks in system leaving the data unreliable and posed the risk of undervaluation and consequent short calculation/payment of duty.

The Ministry, while agreeing with the observation, informed (December 2008) that the defect has since been rectified by implementation of a software patch.

ii) Acceptance of lesser percentage values against freight /insurance

In the absence of input regarding actual value of insurance and freight, system accepted the percentage of freight and insurance. However, it was noticed that system accepted lesser percentages than the specified rates of 20/1.125 per cent in 1,67,010 cases which were assessed based on FOB value. This resulted in undervaluation of goods and proportionate short levy of duty and incorrect assessment of duty foregone to the tune of Rs. 50.97 crore.

Chennai commissionerate confirmed (January 2007) the undervaluation and further stated that the system did not display the percentage rate on the screen. However, the Tuticorin commissionerate stated (November 2007) that the audit finding was in the cases of assessable value arrived at on the declared freight and insurance when the importer produced the documentary evidence. Visakhapatnam commissionerate stated (January 2008) that actual insurance and freight cost were ascertainable as importers submitted the related documents at the time of import.

However, on a test check of 25 cases in Tamil Nadu and Andhra Pradesh, the documentary evidence for payment of insurance at less than 1.125 per cent was not available in 13 cases in Tamil Nadu, and in 12 cases in Andhra Pradesh, the importer had taken comprehensive insurance.

This showed that there was no system to verify the correctness of data entered, since the system did not display data of freight/insurance entered in percentage rate on the screen. Further, the system did not have any provision to check the value covered under the comprehensive insurance policy, since the comprehensive insurance would cover the prescribed period and the same could be utilised in any port in India.

The Ministry stated (December 2008), that there was no bar in accepting lesser percentage of freight/insurance, if documentary evidence to that effect exists and these documents are subject to verification by the customs officers.

3.13.1.2 Benefit of notifications

The importer/CHA has to declare the notification and its serial number for each item of import for availing exemption of duty. The CTH in turn is linked to the serial number of the notification. The EDI system did not have a validation check to ensure whether the item was eligible for the benefit of exemption under the relevant notification.

In terms of customs notifications dated 1 March 2005 and 1 March 2006, the rates of duty non-agricultural items of chapter 25 and onward of the CTA were reduced to 15 per cent and 12.5 per cent respectively. These notifications were fed into the system with serial number as well as with CTH separately.

Data analysis in audit has revealed absence of linkage of the CTH to the serial number of the notification due to which following irregularities occurred: -

- (i) Benefits of exemption under these notifications were incorrectly extended to agricultural items (chapter 1 to 24), though these chapters were not covered under the said notifications. This resulted in short levy of BCD of Rs. 18.03 lakh in Tamil Nadu, Delhi and West Bengal.
- (ii) In respect of other than agricultural items that were not covered under the said notification, the benefit of reduction in duty was allowed to 181 cases in Tamil Nadu and Maharashtra resulting in short levy of BCD amounting to Rs. 75.89 lakh.
- (iii) Lack of validation between the CTH and the serial number of the notification led to incorrect allowance of the exemption benefits. In the case of customs house, Chennai for the CTH 51111130, the exemption could be extended under serial number 29 (with duty of 15 per cent or Rs. 135 per m² which ever was higher). However, the benefit of the notification was allowed under serial number 31 (with duty of 15 per cent or Rs. 80 per m² which ever was higher). As a result the BCD was incorrectly assessed by the system to the tune of Rs. 34.30 lakh.

The Ministry explained (December 2008), that the CETH/CTH is captured in the notification directory of ICES only in cases of unconditional application.

3.13.1.3 Debiting of licences under multiple schemes

Export promotion scheme licences are issued by the DGFT for schemes like DEPB, DFRC and TPS specifying the quantity, CIF value for which imports can be made by the licence holder, value of duty and validity of the licence period. Each licence issued by the licensing authority was to be registered in the ICES and a registration number was assigned. At the time of clearance of goods, the importer has to furnish the registration number and the scheme code in the declaration form and the duty/value/quantity is debited by the system against the licence.

Audit observed that due to absence of linkage between the licences/registration numbers and scheme codes, against which the licences have been issued, debit of duty/value/quantity was made in more than one scheme by the system in respect of 6,408 items of import pertaining to the 528 licences in the states of Andhra Pradesh, Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal. Thus, possibility of undue benefit of advance credit of duty by way of duty foregone could not be ruled out in the case of pre-export benefit schemes.

The Ministry informed (December 2008) that post audit, the validation is now done of scheme code instead of scheme codes groupings by implementation of a software patch.

3.13.1.4 Grant of exemption of special CVD

Special CVD of customs at the rate of four per cent to countervail state taxes was introduced from 1 March 2006 vide custom notification No.19/06 dated 1 March 2006. Vide custom notification No. 20/2006, the special CVD is exempted provided both the BCD and CVD are exempted.

Scrutiny revealed that in 7,505 cases in the selected states, the system allowed exemption of the special CVD without validating/ensuring that both the applicable BCD and CVD were 'zero'. This resulted in incorrect grant of exemption for levy of special CVD of Rs. 123.84 crore.

The Ministry stated (December 2008) that instances of allowing the benefits wrongly are due to assessment lapses and to aid these assessments, necessary checks have been incorporated in the ICES post audit through a software patch.

3.13.1.5 CVD based on RSP

In the Conference of chief commissioners of customs, held on 25 and 26 September 2003 at Visakappattinam, it was held that duty is to be levied on the basis of the transaction value ignoring the RSP, wherever there is evidence that RSP has been deliberately mis-declared. Thus, in cases where the assessable value based on the RSP was less than the normal assessable value, the normal assessable value should be taken for the purpose of calculation of CVD.

Scrutiny revealed that in 41,039 cases in the selected states, the assessable value of goods based on RSP was less than the normal assessable value (assessable value for customs purpose plus customs duty). This had resulted in a probable short levy of CVD of Rs. 6.05 crore by the system.

The Ministry stated (December 2008) that CVD can be levied on the basis of transaction value only when there is evidence of deliberate mis-declaration of the RSP and such cases can be investigated/handled only manually and not through the system.

Recommendation No. 3

↘ *Input controls and validation checks should be reviewed and built into the system, wherever required.*

The Ministry informed (December 2008) that input controls and validation checks have already been incorporated in the system, wherever feasible.

3.14 Change management control

Change management controls are necessary to ensure that standardised methods, processes and procedures are used for all changes, facilitate efficient and prompt handling of all changes and maintain the proper balance between the need for change and the potential detrimental impact of changes. Audit observed lacunae in the change management processes that resulted in the following deficiencies:

3.14.1 Non-matching of the CTH and CETH

Import duty is levied on the goods imported, for which, the goods are classified under CTH. For the purpose of levy of the CVD and NCCD, the goods are classified under the CETH. As far as the goods of 'Work of art and antiques' and goods imported under 'Project import', the goods are to be classified under chapters 97 and 98 of CTA. As there are no corresponding chapters 97 and 98 under CETA, the goods are to be rightly classified under the appropriate chapter heading between 1 and 96 of CETA. From the March 2005, the CTH and CETH have been aligned. Hence, the CTH and CETH of the goods imported are one and same, except for goods imported under chapter 97 and 98 of CTA.

In the absence of the input control to prevent two different codes under CTH and CETH for the same goods imported (excluding project import), the system allowed to enter different codes.

Data analysis in all the selected states revealed that there were different codes in 2,52,897 items involving assessable value of Rs. 3,608.07 crore. Furthermore, the deficiency mentioned above resulted in non-levy of NCCD amounting to Rs. 4.43 lakh in respect of 35 items in Tamil Nadu and Rs. 0.42 lakh in respect of one item in Delhi.

The Ministry stated (December 2008) that validation between CETH and CTH is not done in the ICES.

3.14.2 Non-updating of notification master tables

As per the Handbook for customs officers, all the notifications issued at the time of Budget were updated centrally and the notifications issued

subsequently were to be updated by the System Manager of the respective customs houses. However, it was observed that 14 notifications relating to levy of ADD issued during years 2005 to 2007, were not fed into the database of Chennai commissionerate. This shows that the notification directory (master tables) was not updated/corrected at appropriate time in the local offices.

While agreeing to the observation, the Ministry stated (December 2008) that instructions would be issued to the customs houses to constantly upgrade/correct notification master tables including those belonging to ADD.

3.14.3 Incorrect updating of drawback schedule

The drawback schedule is being updated centrally at New Delhi and the ICES system at each location is being updated through snapshots. Further, the System Manager has been authorised to update the directory, in case, the updating through snapshot was not feasible. The data in the drawback table is used for calculating the drawback.

Audit observed that (i) the rate of drawback on specific rate was incorrect resulting in incorrect apportionment of the drawback between customs and central excise and (ii) the unit of measurement and the rate were incorrect resulting in incorrect sanction of drawback. The above showed inadequacies in the updating of the master data for calculation of duty.

The Ministry agreed (December 2008) that due to the large number of the entries in the drawback schedule some discrepancies may creep in during updation and these discrepancies are rectified on such discrepancies being reported.

3.15 Other points of interest

3.15.1 Difference between the assessment and collection files

Duty calculated by the system and fine, penalty and interest thereon, if any, is collected through designated banks. The relevant data is also made available to the bank by the system. The challan for payment is generated through the system. After collection of duty through the bank, the goods are allowed to be cleared.

Data analysis revealed that the duty amount stated to be collected through various banks (Rs. 19.89 crore) as stored in the system were found to be less by Rs. 9.56 crore than the amount of duty as (excluding fine, penalty and interest) shown in the system as assessed (Rs. 29.45 crore) in respect of 598 BEs in Tamil Nadu, Gujarat, Maharashtra, West Bengal and Delhi for the period April 2005 to March 2007. The reasons for such difference could not be ascertained from the department.

Chennai and Tuticorin commissionerates stated (January and November 2007) that the reasons for the difference could not be identified and the issue has been taken up with the DGS&DM, New Delhi.

The Ministry stated (December 2008) that it was possible that the amount collected was less (upto rupees nine) than the duty assessed, as the system accepts duty payment, if the amount paid is matching upto 'tens' level. It further stated that duty can be recalculated for BEs taken up for post clearance audit, etc. However, the inconsistency is not due to any design deficiency.

3.15.2 Interest for delayed payment of duty

Under section 47 (2) of the Customs Act, 1962, in respect of goods entered for home consumption, when the importer fails to pay duty within five working days from the date on which the BE is returned to him for payment of duty, he shall pay interest on the amount of duty till the date of payment of the duty.

Audit observed that the interest was not levied by the system in respect of ex-bond BE for home consumption though it was levied in certain cases during the year 2005 and there was no consistency in levying interest in all cases.

Data analysis revealed that in 18,294 ex-bond BE, the interest for delayed payment of duty of Rs. 10.65 crore was not calculated by the system in the selected states (Andhra Pradesh - Rs. 3.69 lakh in 98 BEs, Delhi - Rs. 4.42 lakh in 192 BEs, Gujarat - Rs. 2.08 crore in 2,792 BEs, Maharashtra - Rs. 4.94 crore in 9,599 BEs and Tamil Nadu - Rs. 3.55 crore in 5,613 BEs).

3.15.3 Calculation of duty foregone

The system calculates the amount of duty to be levied and amount of duty foregone based on the rates in the customs tariff, notifications and the scheme under which the import takes place. The amount of duty foregone is the difference between the duty to be levied as per the tariff and the effective duty to be levied after allowing the exemptions under various notifications. By definition, the duty foregone cannot be a negative figure.

Audit observed from the data in Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal that the item-wise duty foregone was negative (BCD amount in 30,403 items, CVD amount in 20,093 items and other amount in 2,597 items) indicating inconsistencies in the duty to be levied as per tariff and effective duty to be levied after allowing exemptions. This posed the risk of short calculation of duty to be collected for non-fulfilment of export obligations, while redemption of licences, as the duty foregone was reduced.

The Chennai and Tuticorin commissionerates replied (January 2007 and November 2007) that the reason could be furnished by NIC and the issue has been brought to the notice of the DGS&DM, New Delhi.

3.16 Database not utilised to its potential

The ICES has been developed to implement the provisions of the Customs Act, 1962 and various other laws that impose levy of duties and give effect to exemptions from payment of duties and export promotion incentives. It was noticed that even after lapse of more than ten years, the data was not used for the following functions which were continued to be executed manually: -

(i) Maintenance of bond register

Bonds/bank guarantees were executed by the importer for the amount of duty foregone as envisaged in the customs notification.

The data such as value of the bond, expiry date, enforcement date are fed into the system at the time of registration. As the required data are available in the system, the data can be used for generating notices before expiry of the validity date of the bonds and bank guarantees to avoid loss of revenue to the Government. But it was observed that the bond registers continued to be maintained manually, without using the database in the system.

The Ministry agreed with the observation and stated (December 2008) that the audit recommendation will be considered for implementation.

(ii) Levy of bond interest for delayed clearance of goods

All the required data for calculation of bond interest under section 61 of the Customs Act, 1962, for delayed clearance of goods from warehouse, viz. date of bonding, date of assessment and date of payment of duty were available in the system. Yet, the same was calculated and collected manually.

The Ministry agreed with the observation and stated (December 2008) that the audit recommendation will be considered for implementation.

(iii) Finalisation of the provisional assessment

With the additional details obtained from the importer and the data already available in the system, it could be used for finalisation of the provisional assessments. However, these assessments were being finalised manually.

The Ministry agreed (December 2008) that the module for final assessment of provisional assessment cases is yet to be developed in the system.

Recommendation No. 4

↘ *The system should be modified to use the available data fully so that all business processes are done through the system instead of resorting to manual procedures.*

The Ministry stated (December 2008) that the audit recommendation will be considered for implementation.

3.17 Documentation

The system manual was not available with the department. 'Handbook for customs officers', published in August 2004, was distributed among the officers in the department as user manual. The same was not updated thereafter, even though there were substantial changes in the structure of the database and duty structure.

The Ministry informed (December 2008) that it was in the process of migrating from a distributed system to a centralised system and that the NIC has been asked to provide the system manual of the centralised version of the ICES.

3.18 Business continuity planning

There was no standby/backup server in the department as a measure of business continuity planning. Backup assignments were allotted to NIC as per the MOU with the DGS&DM, New Delhi, and the same was taken daily by the NIC. The data at customs house, Chennai was backed up daily and kept in fireproof cabinet in the same complex and not at a different location at Chennai. At ACC, Mumbai it was kept in the server room itself. The backups were never retrieved or tested. Thus, even though department took backups, the reliability of the same was never tested and ensured.

Recommendation No. 5

↘ *A periodical review of the performance of the system may be put in place to ensure continued efficiency and effectiveness of the system towards the desired/dynamic business objectives.*

The Ministry stated (December 2008) that instructions for safe keeping of back up tapes/cartridges to field formations would be reiterated. It further informed that a data centre at Delhi and disaster recovery centre at Chennai have been set up and gradually the existing ICES locations will migrate to the data centre.

3.19 Conclusions

The ICES has been in place for over ten years. However, the results of audit of the system have shown that the system was yet to incorporate important business rules and built-in provisions to capture all the relevant data. It was also seen that the system had deficiencies in the input control and the validation checks including a deficient control on the data being entered by the third party. The changes in the system were not documented and archived. Further, the changes in the notification etc. were not mapped/captured in the system which led the system liable to yield incorrect results. Even after ten years of implementation, the system did not have provisions for maintenance of bond register, levy of bond interest for delayed clearance of goods, finalisation of the provisional assessment etc., leading to the resorting to manual systems, even though the data for the same was available in the system.