

**Report of the
Comptroller and Auditor General
of India**

for the year ended March 2001

Union Government

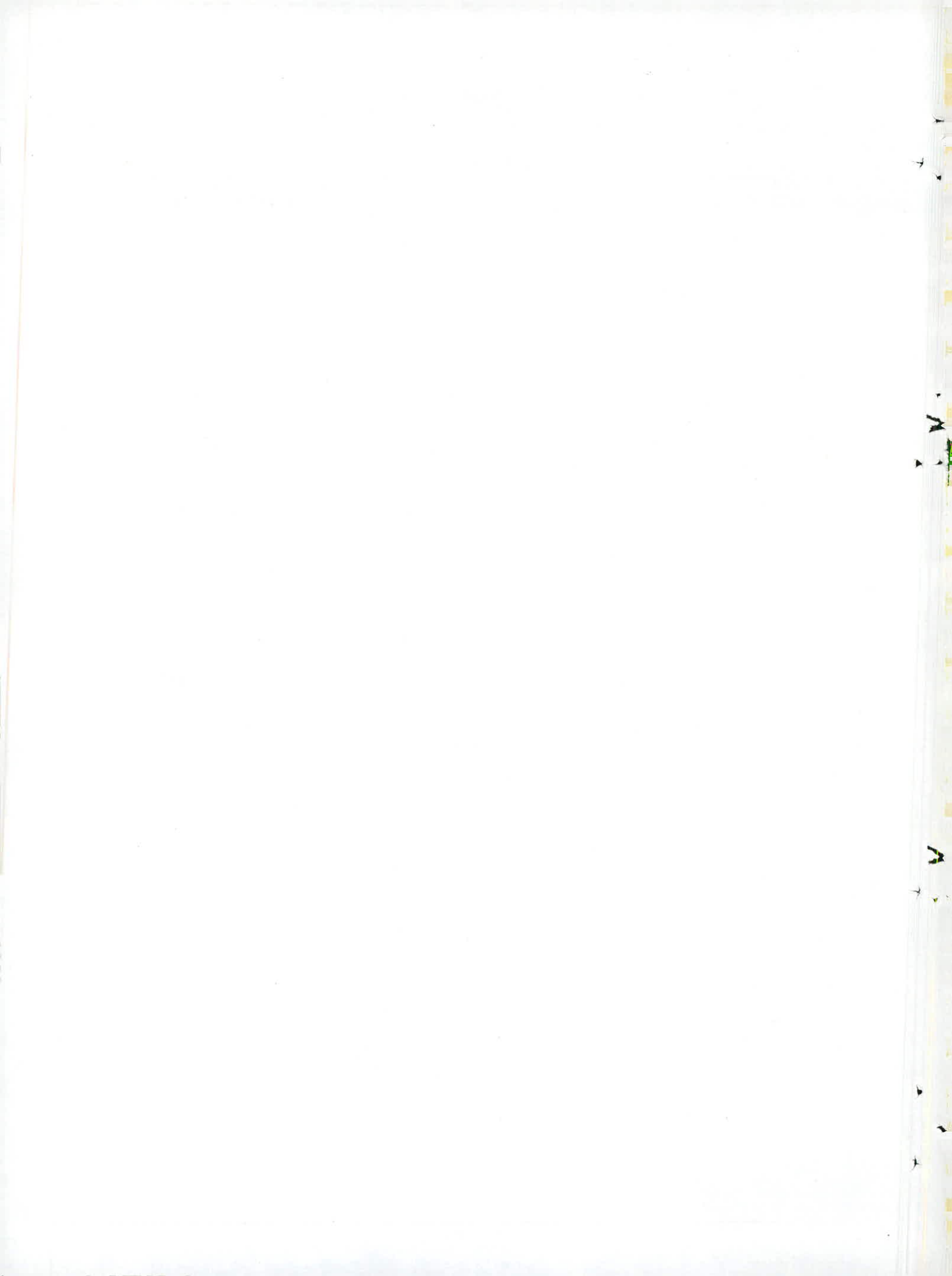
(Indirect Taxes - Customs)

No.10 of 2002

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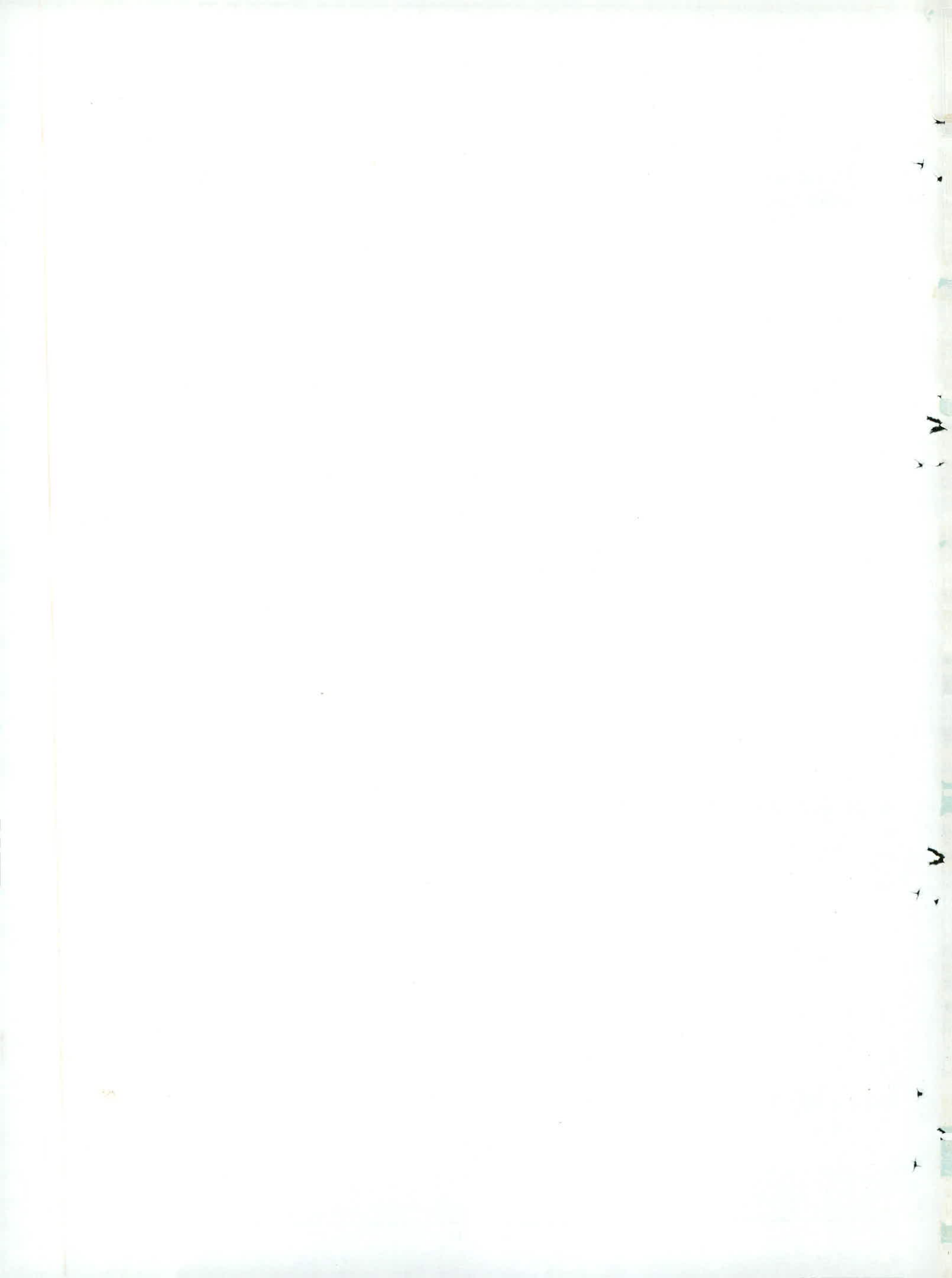
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PREFATORY REMARKS

This Report for the year ended 31 March 2001 has been prepared for submission to the President under Article 151 of the Constitution based on the audit of Customs Receipts of the Union of India in terms of Section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971.

The cases mentioned in the Report are among those which came to notice in the course of audit during 2000-2001 as well as those which came to notice in earlier years but could not be reported earlier.



OVERVIEW

This report contains two reviews and 209 paragraphs involving non levy/short levy of customs duty of Rs.1422.43 crore. Some of the important audit findings included in the Report are highlighted below:

I. General

- Net receipts of Rs.47542 crore collected from customs duties during 2000-2001 fell short of the Budget Estimates by Rs.6030 crore. In fact collections fell short of the budget estimates in all the previous four years, the shortfall ranging from 4 per cent to 24 per cent.
- The total amount of duty foregone under export promotion schemes during the year was Rs.21,658 crore which was 46 per cent of the total customs receipts.

(Chapter 1)

II. Review on Indian Customs Electronic Data Interchange System (ICES)

A comprehensive appraisal of the ICES highlights concerns regarding performance, efficiency, economy, security etc.

- Even after 9 years since conception the project is far from complete. Software has been developed for only 33 modules out of the envisaged 73. Poor planning, inadequate allocation of resources and not following the well established life cycle of a computerisation project were essentially responsible for the delay. No major gains in trade facilitation are visible since EDI connectivity has not been established and only a very small percentage of consignments are being cleared within the three days stipulated in Citizen's Charter.
- Financial estimates both for the pilot and the All India projects had to be revised due to poor formulation of the initial estimates, over-looking necessary ingredients of the project. Optimum value for money was not realized due to procurement of underconfigured servers, accepting hardware without testing, failure to obtain price/technology advantage at the time of delivery and insisting on composite procurement of hardware and software. The delay in completion of site preparation work resulted in delay in commencement of on-line operations in 21 locations besides keeping hardware idle for periods ranging from 4 to 17 months. Imprudent selection of VSAT technology for large volume of data access led to infructuous expenditure of Rs.1.03 crore.
- The department is yet to formulate a security policy identifying threat perceptions and safety measures. WORM (write once read many) optical disk installed in the servers has not been made use of. Failure to establish system controls like change of passwords at regular intervals, cross verification of data entered in the system etc., facilitated fraudulent payment of drawback of Rs.1.95 crore at Delhi Custom House.
- Incorrect/non-updation of drawback rates/import duty, absence of validation controls at the time of data entry and deficiency in software have resulted in leakage of revenue.

(Chapter 2)

III. Review on Non realisation of Foreign Exchange

Export proceeds aggregating Rs 11,735 crore were pending realisation as on June 2000. Of this Rs 7549 crore, or two third was outstanding for more than two years. Test check revealed 5262 cases involving unrealised foreign exchange of Rs.2182.63 crore where export incentive were availed. Duty incentive of Rs.521.58 crore along with interest of Rs.188.63 crore were recoverable in these cases. 60 percent of this amount was recoverable from only 20 units. These exporters were also liable for penal proceedings. The efficacy of XOS as a control instrument for monitoring export incentives was limited due to delay in transmission of these statements to Customs Houses by the Regional offices of RBI; inadequate, incomplete or incorrect information; poor follow up action at Custom Houses and keeping licensing offices out of the loop. Incentives availed in respect of Rs 177.25 crore of non realised export proceeds had not been ascertained before write off and extensions for realisation of outstanding export proceeds of Rs.199 crore were granted in 873 cases by Regional offices of RBI in violation of provisions of Exchange Control Manual.

(Chapter 3)

IV. Irregularities in assessments

- In 12 cases dutiable imported goods were incorrectly classified and assessed to duty at lesser rates leading to short levy of Rs.4.09 crore.

(Chapter 4)

- Extending the benefit of exemption notifications to dutiable goods not covered by them resulted in short collection of duty of Rs.49.31 lakh in 8 cases.

(Chapter 5)

- Short levy on account of undervaluation of assessable goods in 2 cases amounted to Rs.2.78 crore.

(Chapter 6)

- Additional duty leviable under Section 3 of the Tariff Act amounting to Rs.3.62 crore was not levied/short levied in 6 cases.

(Chapter 7)

- Special Additional duty leviable under section 3A of Tariff Act amounting to Rs.1.52 crore was not levied/short levied in 4 cases.

(Chapter 8)

V. Recoveries from defaulting export houses

- Non levy/loss of customs revenue of Rs.567.71 crore due to failure to recover benefits of export incentives under schemes like Advance Licensing Schemes and EOU from defaulting exporters.

(Chapter 9)

CHAPTER 1 : ANALYSIS OF RECEIPTS

1.1 Customs Receipts

Receipts from customs duties during the years 1999-2000 and 2000-2001, alongwith the budget estimates and the revised estimates for 2000-2001 are presented in the table below :

(Rupees in crore)

Net Customs Receipts from	Actual Receipts 1999-2000	Budget estimates 2000-2001	Revised estimates 2000-2001	Actual Receipts 2000-2001
Imports	47635	52756	49066	46729
Exports	86	01	01	102
Cess on exports	226	149	141	266
Sale proceeds of confiscated goods	56	--	--	79
Other receipts	417	666	573	366
Net receipt	48420	53572	49781	47542

(N.B. (i) The figures shown have been arrived at after deducting refunds and drawback paid)

(ii) Collection from import duties are inclusive of Special additional duty and Special customs duty.

Source :Ministry of Finance, New Delhi.

Customs receipts fell short of the Budget Estimates by Rs.6055 crore. Infact this has been a recurring phenomenon in the last four years indicative of over-estimation of receipts. Details are as under :

(Rupees in crore)

Year	Budget Estimate	Actual receipts	Shortfall	Percentage shortfall
1997-1998	52550	40193	12357	24
1998-1999	48148	41278	6870	14
1999-2000	50369	48420	1949	4
2000-2001	53572	47542	6030	11

1.2 Trend of Receipts

A comparison of total year-wise imports with the corresponding net customs duties collected during 1996-97 to 2000-2001 has been shown in the table below :

VALUE OF IMPORTS AND IMPORT DUTY COLLECTED 1996-97 TO 2000-2001 (YEAR-WISE)

(Rupees in crore)

Year	Value of Imports	Import duties	Import duty as percentage of value of imports
1996-97	138920	42110	30.31
1997-98	154176	41480	26.90
1998-99	176099	42110	23.91
1999-2000	204583	49517	24.20
2000-2001	226773	46729	20.60

1.3 Trend in imports vis a vis index of industrial production

The percentage change in index of industrial production vis a vis imports during 1996-97 to 2000-2001 are given below along with projected figures of 2001-2002 and does not demonstrate any secular relationship.

Year	Percentage change in index of industrial production	Percentage change in imports in US \$	Percentage change in collections from import duty
1996-97	6.1	6.6	21.3
1997-98	6.6	6.0	-1.5
1998-99	4.1	2.2	1.5
1999-2000	6.6	11.3	14.9
2000-2001	5.1	0.3	2.1

Source: Monthly Review of the Indian Economy by Centre for Monitoring Indian Economy

1.4 Import figures based on customs inputs short of RBI figures

Import figures based on Customs House inputs fell short of the import figures of RBI based on foreign exchange outgo as under

Year	Value of imports (US \$ million)			Percentage shortfall
	RBI	DGCI&S	Shortfall	
1990-91	27914	24073	3841	16
1991-92	21064	19411	1653	9
1992-93	23240	21882	1358	6
1993-94	25069	23306	1763	8
1994-95	33804	28654	5150	18
1995-96	41727	36675	5052	14
1996-97	46230	39132	7098	18
1997-98	48472	41484	6988	17
1998-99	47373	42389	4984	12
1999-2000	55370	47212	8158	17

It would be seen that the shortfall in 1999-2000 is about US\$ 8 billion equivalent to Rs.34,000 crore. This is 17 per cent of the customs figure of imports. The Government have not found a satisfactory explanation for this huge difference.

1.5 Commoditywise details of Customs Receipts

Major commodity wise value of imports and exports and the gross duty realised therefrom during the financial year 2000-2001 and the previous year 1999-2000 are given overleaf.

a) Imports

(Rupees in crore)

Sl. No.	Commodities	Value of imports*		Import duties**		Percentage share in total import duties collection	
		99-2000-	2000-01	99-2000	2000-01	99-2000	2000-01
1.	Food and live animals chiefly for food	12714.66	8629.70	1952.29	2699.33	3.94	5.57
2.	Mineral, fuels and related materials	64992.26	79922.44	12772.56	11472.01	25.79	23.66
3.	Chemicals and related product	19804.36	18114.46	4645.48	4578.16	9.38	9.44
4.	Manufactured goods	4634.47	5283.83	3285.26	3176.02	6.63	6.55
5.	Machinery excluding electric and electronic and transport equipment	17952.80	16519.07	7678.42	7085.23	15.51	14.62
6.	Iron, steel, non ferrous metals and products	7950.73	7373.12	2244.66	1851.84	4.53	3.82
7.	Others	87479.26	90930.85	16937.89	17614.30	34.22	36.34
	Total	215528.54	226773.47	49516.56	48476.89		

b) Exports

(Rupees in crore)

Sl. No.	Commodities	Value of exports**		Export duty and cess*	
		99-2000	2000-01	99-2000	2000-01
1.	Food items	20353.74	23144.33	72.48	70.49
2.	Beverages and tobacco	1452.51	1637.36	5.78	3.99
3.	Mineral, fuels and related material	2282.04	11907.60	23.62	42.28
4.	Leather, leather products, chemical and related products	22270.97	29498.36	--	--
5.	Cotton, woolen, silk yarn, fabrics, carpets and products	36061.76	43612.42	--	--
6.	Others	76674.18	92709.69	36.39	47.21
	Total of exports and re-exports	159095.20	202509.76	138.27	163.97

Source - *Ministry of Finance, New Delhi.

**Directorate of Statistics and Intelligence, New Delhi.

1.6 Duty forgone**1.6.1 Under export promotion schemes**

(a) The break-up of the duty forgone in respect of export promotion schemes viz., Advance Licence, DEPB, EPCG, EPZ, EOUs, refund of duty under the drawback and other schemes for the period from 1997-98 to 2000-2001 are shown in the table below:

**CUSTOMS DUTY FORGONE UNDER EXPORT PROMOTION SCHEMES
AND DUTY DRAWBACK SCHEME**

(Rupees in crore)

Year	Advance licence	DEPB	EPCG	EPZ	EOU	Duty Drawback	Others	Total
1997-98	3547	469	1385	1200	2004	3661	891	13157
1998-99	3615	2631	1343	974	2178	4081	670	15492
1999-2000	3804	4063	1299	1096	2938	4257	709	18166
2000-2001	5311	4631	1513	1223	3940	4308	732	21658

(b) The total duty forgone under various export promotion schemes for the period 1997-98 to 2000-2001 are shown in the table below:

CUSTOMS DUTY FORGONE

(Rupees in crore)

Year	Customs duty collected	Total duty forgone under export promotion schemes	Duty forgone as a percentage of customs receipts
1997-98	40193	13157	33
1998-99	41278	15492	38
1999-2000	48338	18166	38
2000-2001	47542	21658	46

Duty forgone under export promotion schemes has gone up from 33 per cent of customs duty receipts in 1997-98 to 46 per cent of customs receipts in 2000-2001.

(c) The basic objective of forgoing duty on imports made under the export promotion schemes was to enhance foreign exchange earnings and thereby reduce the deficit in the Balance of Trade. Audit enquiries and scrutiny of records revealed that duty exemptions were allowed at the time of import based on a commitment of export obligation and drawback is allowed on the basis of shipping documents of export. The prevalent monitoring mechanism in the Custom Houses and the offices of Director General of Foreign Trade did not, however, enable them to ensure that the full amount of foreign exchange due against the export value declared on the shipping bills presented by export houses were actually realised. An appraisal of the 'Non realisation of foreign exchange' is included in Chapter 3 of this Report.

1.6.2 Other duty forgone

Duty forgone under Section 25 (1) and (2) of the Customs Act, 1962 {other than in respect of export promotion schemes vide para 1.5 (b)} during 1997-98 to 2000-2001 are shown in the table below:

(Rupees in crore)

Year	No. of notifications issued under 25(1)	No. of total notifications issued under 25(2)	Total No. of notifications issued	Duty forgone under 25(1)	Duty forgone under 25(2)	Duty forgone
1997-98	76	136	212	2624	16.80	2640.80
1998-99	57	NA	NA	4185	NA	NA
1999-2000	66	NA	NA	4156	NA	NA
2000-2001	60	NA	NA	6733	NA	NA

Section 25(1) General exemption
Section 25(2) Adhoc exemption

1.7 Cost of collection of Customs Receipts

The expenditure incurred on collection of customs duty during the year 2000-2001 alongwith the figures for the previous year are given below:

Cost of collection	(Rupees in crore)	
	99-2000	2000-2001
Revenue cum import export and trade control functions	97.26	110.71
Preventive and other functions	382.20	469.93
Total	479.46	580.64
Cost of collection as percentage of Customs receipts	0.99	1.22

There has been a sharp increase in the cost of collection as a percentage of customs receipts.

1.8 Searches and Seizures

The details of searches conducted and seizures effected by the Customs officers as given by Ministry are indicated below :

SEARCHES AND SEIZURES

Sl. No.	Description	99-2000	2000-2001
1.	Number of searches	2040	1612
2.	Value of goods seized (Rupees in crore)	333.96	498.28
3.	Number of seizure cases adjudicated	21047	17397

These figures relate to 20 Custom Houses/Commissionerates

1.9 Arrears of Customs Duty for recovery

The amount of customs duty assessed upto 31 March 2001 which was still to be realised as on 30 June 2001 was Rs.1866.13 crore in 22 Custom Houses

1.10 Demands of duty barred by limitation

Demands raised by the department up to 31 March 2001 which were pending realisation as on 30 June 2001 and where recovery was barred by limitation amounted to Rs.0.01 crore in 22 Custom Houses and Commissionerates.

1.11 Duty written off

Customs duties written off, penalties waived and exgratia payments made during the year 2000-2001 and the preceding two years are given overleaf:

(Rupees in lakh)	
Year	Amount
2000-2001	61.68
1999-2000	77.10
1998-1999	7.90

1.12 Number of pending audit objections

The number of audit objections raised in audit upto 31 March 2001 and the number pending settlement as on 30 September 2001 in the various Custom Houses and combined Commissionerates of Central Excise and Customs are given below :

OUTSTANDING OBJECTIONS AND AMOUNT INVOLVED

(Rupees in crore)			
Sl. No	Commisionerate	Number	Amount
1.	Ahmedabad	34	30.46
2.	Ahmedabad (Prev.)	53	106.93
3.	Bhubaneshwar	28	80.28
4.	Kolkata	968	665.31
5.	Cochin	92	51.53
6.	Delhi	1117	31.16
7.	Hyderabad	286	65.48
8.	Mumbai(Air)	317	9.44
9.	Mumbai(Sea)	364	322.33
10.	Chennai	1261	109.74
11.	West Bengal (prev)	232	38.70
12.	Others	1717	571.95
	Total	6469	2083.31

1.13 Categories of outstanding audit objections

(Rupees in crore)			
Sl. No.	Categories of objections	No. of objections	Amount
1.	Short levy due to misclassification	1328	24.90
2.	Short levy due to incorrect grant of exemption	616	22.09
3.	Non levy of import duties	892	41.02
4.	Short levy due to undervaluation	176	11.25
5.	Irregularities in grant of drawback	494	5.99
6.	Irregularities in grant of refunds	22	0.62
7.	Irregularities in levy and collection of export duty	27	5.82
8.	Other irregularities	2914	1971.62
	Total	6469	2083.31

1.14 Contents of the report

The Report includes two reviews on 'Non realisation of foreign exchange' and 'Electronic data interchange (EDI) system' highlighting leakage of revenue to the tune of Rs.715.76 crore. Besides there are 209 paragraphs (including 99 cases of Total Under Assessment) featured individually or group together, arising important finding from test check in audit pointing out leakage of revenue aggregating Rs.705.83 crore. Of this the Department/Ministry of Finance had till December 2001 accepted audit observations in 169 paragraphs involving Rs.194.15 crore and reported recovery of Rs.9.11 crore.

CHAPTER 2 : INDIAN CUSTOMS ELECTRONIC DATA INTERCHANGE SYSTEM

2.1 HIGHLIGHTS

Indian Customs Electronic Data Interchange System (ICES) envisages acceptance of Customs documents electronically and exchange of information electronically with other agencies involved in international trade.

Performance

- Even after nine years the project is far from complete. Software has been developed for only 33 modules out of the envisaged 73. This resulted in non-realisation of some of the major objectives of the programme apart from unending liability towards monthly software development charges.

(Paragraph 2.5 (a)(i))

- Poor planning, inadequate allocation of resources and not following the well established life cycle of a computerisation project were essentially responsible for the delay.

(Paragraph 2.5 (a)(iii))

- No major gains in trade facilitation are visible since EDI connectivity has not been established and only a very small percentage of consignments are being cleared within the three days stipulated in Citizen's Charter.

(Paragraph 2.5 (b))

Financial Management

- Financial estimates both for the pilot and the All India projects had to be revised due to poor formulation of initial estimates, over-looking necessary ingredients of the project.

(Paragraph 2.6)

Procurement

- Optimum value for money was not realized due to procurement of underconfigured servers, accepting hardware without testing, failure to obtain price/technology advantage at the time of delivery and insisting on composite procurement of hardware and software.

(Paragraph 2.7)

Implementation

- The delay in completion of site preparation work resulted in delay in commencement of on-line operations in 22 locations, besides keeping hardware idle for periods ranging from 4 to 17 months, the department had to incur infructuous expenditure on maintenance of the earlier system.

(Paragraph 2.8 (a)(i))

Economy

- Incorrect estimation of the volume of documents to be handled at ICD Surat resulted in incurring infructuous expenditure of Rs.49.31 lakh towards site preparation work.

(Paragraph 2.9 (a))

- Imprudent selection of VSAT technology for large volume of data access led to infructuous expenditure of Rs.1.03 crore.

(Paragraph 2.9 (b))

- Non-invitation of open tenders for annual maintenance contract for equipments such as air conditioning sets, UPS, diesel generator, computer hardware/software etc. at Delhi Custom House resulted in avoidable expenditure of Rs.53.11 lakh.

(Paragraph 2.9 (c))

Security

- The department is yet to formulate a security policy identifying threat perceptions and safety measures. WORM (write once read many) optical disk installed in the servers has not been made use of.

(Paragraph 2.10 (b) to 2.10 (c) (iv))

- Failure to establish system controls like change of passwords at regular intervals, cross verification of data entered in the system etc., facilitated fraudulent payment of drawback of Rs. 1.95 crore at Delhi Custom House.

(Paragraph 2.10 (e) (ii))

System Lapses

- Incorrect/non-updation of drawback rates/import duty, absence of validation controls at the time of data entry and deficiency in software have resulted in leakage of revenue.

(Paragraph 2.11)

2.2 Introduction

Titled Indian Customs EDI System (ICES), the all India computerisation of Custom Houses envisages acceptance of customs documents and exchange of information electronically in centralized/structured formats, integrating customs with other agencies such as Reserve Bank of India, Director General Foreign Trade, Custodians of Imports and Exports Goods and Regulatory agencies involved in international trade. Within the customs house, the documents would move from the desk of one customs officer to another in electronic form.

The main objectives of ICES defined by the Department were: (i) respond more quickly to the needs 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 Government agencies, (iv) provide retrieval of information from other custom locations 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 Director General of Commercial Intelligence and Statistics. Initially, the Department commenced (January 1994) computerisation programme under ICES at Delhi Customs house as a Pilot project. In March 1996, it was decided to extend it to 20 other customs locations. Data for the clearance of customs documents is captured under ICES by two methods viz. (i) establishment of service centres in each custom location which would accept document from importers/exporters for data entry and (ii) transfer of data by importers/exporters from their premises in the prescribed format using a communication link.

The project has been successfully commissioned at 23 locations in the country covering all major ports, air ports, Inland Container Depots and land customs stations. The department has created an awareness for the acceptance and use of computer at the user level thus paving way for the smooth change from the traditional method of clearance of customs documents to electronic clearance. ICES promotes transparency by reducing arbitrariness and uncertainty in the processing of documents. There is an automated random allocation of electronic declarations to the Appraising officer. A declaration, once registered with the system, is handled on a first-come-first serve basis. At the time of declaration the validation features ensure that only valid data is accepted by the system and invalid data is rejected at the service centre. The system provides for management of parameters such as exchange rates, drawback rates, rates of duty on the basis of directories which are updated by the systems manager, thereby eliminating errors previously encountered in the manual processing of documents. A concept of 'Green Channel' has been introduced which provides waiver of examination by customs on the basis of importers profile. The only interface between customs and trade is at the time of collection of goods.

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

Procedures at different customs stations by effective monitoring and analysis of the computerised data base. (ii) Minimised physical examination of goods by effectively using risk management based targeting techniques. (iii) The drawback payment system has been re-engineered to provide for direct disbursement of the amount into the exporter's bank accounts after the goods have been exported. Generally, the drawback is credited within 48 hours of the departure of the vessel or the aircraft.

2.3 Organisational Set up

The overall planning and implementation of the computerization programme was looked after by the Joint Secretary (Customs) at CBEC till June 1997. A Directorate of Systems (DOS), New Delhi was formed in July 1997 headed by a Commissioner (Systems), who is the nodal authority for implementation and monitoring of the programme under the supervision of Member (Customs). The DOS is assisted by Additional/Deputy Commissioners at Chennai, Mumbai and Kolkata Custom locations.

2.4 Scope of Audit

A comprehensive review of planning and execution of ICES was taken up to:

- a) assess the effectiveness of the project in realising its objectives within the stipulated time frame,
- b) confirm that standard good practices were followed to ensure that the project was executed efficiently and at least cost,
- c) ascertain the adequacy and effectiveness of controls in the system.

For this purpose, records of the Directorate of Systems, CBEC were checked. In addition, Sea Customs, Chennai was selected for evaluating system controls. Information from other Customs locations was also collected wherever necessary. Findings are contained in the succeeding paragraphs.

2.5 Performance of ICES

(a) *Slow progress*

(i) Even though nine years have elapsed since the project was conceived in August 1992, it is far from complete. Its progress and current status are as under:

	Coverage of locations Under ICES	Number of modules (Maximum:73)
Up to 1996-97	1	25
1997-98	5	--
1998-99	9	--
1999-2000	4	--
2000-01	4	8
Total	23	33

It took four years to implement the pilot project. 22 remaining locations were covered in a staggered manner over five years thereafter. Likewise, out of a maximum of 73 modules required for covering all types of transactions, software was developed by NIC for only 25 in the pilot project. Thereafter only eight additional modules were taken up during 2000-01, leaving forty modules undeveloped. Some of the important modules which have not yet been covered are: (i) ex-bond clearance of goods under imports, (ii) goods imported under schemes like DEEC, EPCG, 100 per cent EOU, DEPB, (iii) unaccompanied baggage clearance, (iv) controlling of Import general manifest and transshipment of goods from seaports to various places, (v) final assessment of the provisional assessment done under the system for imports, (vi) internal audit module for exports, (vii) monitoring of import licence and export obligations, (viii) levy of anti dumping duty and (ix) incorporating sample test results under import.

The Department stated (October 2001) that only 23 modules remained to be developed. This does not take into account the 17 modules that were identified but not included in the MOU with NIC.

- (ii) The slow progress had the following consequences:
- (a) As of March 2001, only half the customs revenue comes through the ICES. This is particularly low in respect of Sea customs which accounts for a larger proportion of imports.
 - (b) The full potential of the system in monitoring and generating Management Information System (MIS) has not been realised. For instance, imports under export incentive schemes are yet to be covered. As such, the additional controls on monitoring export performance are not in place.
 - (c) Protracted and staggered implementation in an Information Technology (IT) project whose main characteristic is a high rate of obsolescence tends to cause further delays. For instance, had the project been completed before 2000, the delays in development and extension due to the project being put on hold to address Y2K could have been avoided.
 - (d) Failure to cover all the modules has created several problems. Some of these are:
 - i) While the system provides for provisional assessment, no record is maintained for tracking final assessment and collection of balance revenue. Test check in Chennai Sea Customs revealed that documents of two importers were being assessed provisionally since January 1996 and August 1999 through ICES. The final assessment (December 2000 – January 2001), which is yet to be accepted by the importers, was done manually only. This resulted in additional demand of Rs.27.75 crore remaining realised. The system fails to flag such delays.
 - ii) Statistics for submission to Director General of Commercial Intelligence and Statistics (DGCI & S) have to be consolidated manually at each

ICES location due to continuance of manual clearance of customs documents. This delays the process thereby depriving DGCI &S of timely MIS.

- iii) Ex-bond clearance of imported goods whose incidence is generally quite high in Sea Customs continues to be done manually.
- (e) The department continues to pay Rs.5.5 lakh per month to NIC for software development charges. The total payment on this account between April 1998 and March 2001 has been Rs.2 crore. This is being paid even though a one-time charges of Rs.2.10 crore had been paid to NIC for development of software for Delhi pilot project. The complete development of software being nowhere in sight, there is likely to be unending liability on this account.
- (f) Continuance of manual assessment due to non-completion of software development under ICES resulted in loss of revenue of Rs.2.41 crore by way of service charges which would otherwise be collected from Importers/exporters for the assessment under EDI, besides non-fulfillment of objectives of paperless clearance of customs documents.

In response, the Department stated (October 2001): (a) There were discernible improvements in MIS as compared to the manual system; (b) Development of software for ex-bond clearance would take a long time; (c) Several changes were required in the software due to changes in computation procedure or introduction of new levies; (d) Efforts were being made to increase the proportion of revenue through ICES. The fact remains that the progress of ICES has been slow and behind schedule.

(iii) Audit analysis revealed that the following factors were largely responsible for this delayed implementation.

(a) The decision to go in for All India Computerisation of Custom Houses through National Informatics Centre (NIC) was taken in August 1992. However, no formal MOU was signed with NIC stipulating details of the task to be performed and their time schedule. The project was, therefore, left to adhoc target formulation and monitoring.

(b) Correspondence exchanged between the CBEC and NIC revealed that the department had almost entirely left the initiative to the NIC. In the Board, the task was assigned to the Joint Secretary (Customs) in addition to his own duties. The Directorate of Systems was established only in 1997. Allocation of trained human resources was obviously not commensurate with the ambitious project. NIC perceived this as a major impediment to the progress of the project.

(c) Computerisation programmes require adoption of a well established life cycle which includes a conceptual plan, a detailed system study, formulation of system requirement specification and user requirement specification and a system design document. This process ensures that the system, including both hardware and software, fully meets the present and future requirements of the organisation. This life cycle was not followed in respect of the ICES. Only an initial system study was conducted by the

NIC in December 1992 after which the project is being implemented on a piece-meal basis. For instance, of the 73 modules for which software was to be developed by NIC, only 33 modules were completed till March 2001.

(d) Even though the pilot project was delayed, concurrent action was not taken to prepare the other locations for replication. Consequently it took five years to cover the other locations.

(e) Connectivity within the Customs Department and between Custom Houses and other agencies was made integral to the project. Inadequate preparations in partner agencies has delayed the project and also rendered any firm estimation of the likely completion date impossible. Focus on computerisation of the processing of customs documents before venturing into EDI connectivity would have ensured early completion of the former.

In response, the Department stated: (a) Delay in signing of MOU was due to difficulty in estimating the requirements; (b) A system study was carried out (March – July 1994) besides the initial study (December 1992) and a System design document (SDD) was also prepared; (c) Concurrent action was taken for implementation of the project in other locations. Scrutiny of records, however, revealed that the Department had themselves felt (June 1997) the ‘System Study report’ prepared by NIC could not even remotely be termed as SDD and it provided various screen print outs which would be of interest only to a user/data entry operator. Moreover, SDD for exports is incomplete, while none has been prepared for imports. The implementation of ICES project in other locations over five years could not be termed as concurrent action.

(b) *EDI connectivity not established*

(i) An important objective i.e. establishing EDI connectivity between various agencies like Importers/Exporters, custodians, Director General of Foreign Trade, RBI, Export Promotion councils etc has not yet been achieved. Consequently the major advantage to be gained through trade facilitation and information sharing has not been realized.

(ii) Scrutiny of the records indicated that the department could not establish EDI connectivity due to the absence of the following capabilities (i) EDI front end PCs to provide internet protocol address for identification (ii) customised EDI software to check the validity of the message received and transfer the data for further processing to the customs server and (iii) intrusion detection system like firewall software to monitor the incoming messages.

In response the Department stated (October 2001) that EDI connectivity required preparedness of all the partners and it is under various stages of implementation.

(c) *Faster clearance not visible*

One of the major objectives of ICES was faster clearance of import/export consignments. An analysis made by Audit of the Bills of Entry filed at Chennai Sea

Customs and JNPT, Nhava Sheva during the year 1999-2000 revealed that only 12 percent and 9 percent of the bills respectively were cleared within the 3 days stipulated in the Customs Citizen's Charter. Thus, the project had not realised the objective of enabling the department to fulfil its commitment to Trade.

The Department stated (January 2002) that the time taken in actual clearance of documents depends on a number of factors including time taken to pay duty and it would be incorrect to put the onus of delay entirely on Customs. They also stated that a study conducted by them covering a period of two weeks in March 2001 at Chennai Sea Customs revealed that the average time taken to assess a Bill of Entry/Shipping Bill is 2 days and 0.31 days respectively. The reply of Department has to be viewed in the context of it being based on only two weeks performance in a year at only one port as against the audit conclusion based on a whole year.

(d) Personnel not equipped

The department has failed to train its personnel in adequate numbers to progressively become self reliant. Even though the CBEC had decided (August 2000) to monitor progress in computer training on a monthly basis, the department failed to furnish details of the personnel trained. Test check of records at Chennai Sea Customs by audit revealed that the progress was rather inadequate particularly in Group A and Group B cadres. The training imparted was mostly for three days duration that too in computer awareness and basic applications. This resulted in continued dependence on NIC for which the department had to pay Rs.2.71 crore between April 1998 to March 2001.

The DOS stated (October 2001) that handling of an online mission critical application like ICES could be done only by a professional IT vendor and advanced training to selected departmental officers would aim at complementing the role of professional IT vendors only. The reply is not tenable in the context of Department's intention to move towards a 'regime of paperless electronic commerce with least human interface'. This would require complete system familiarity of all the officers and staff.

2.6 Financial management

A total amount of Rs.87.41 crore has been incurred on this project till March 2001. Audit scrutiny revealed that the financial estimates were not prepared with due care resulting in wide variations between estimates and expenditure. A detailed analysis follows:

(a) Delhi pilot project

The Delhi Customs house project was estimated (January 1994) at Rs.4.24 crore (hardware Rs.2.14 crore; one time software development Rs.2 crore and training Rs.0.1 crore). In March 1996, the department revised the cost to Rs.8.46 crore, an increase of 100 per cent. Audit scrutiny revealed that the initial estimates had not been prepared

with due care since these did not include (i) the cost of introduction of remote electronic data interchange though already decided earlier in September 1993, (ii) complete hardware requirement and (iii) site preparation cost. Keeping the initial estimate below Rs.5 crore resulted in going ahead with the project without obtaining prior approval of Committee on Non Plan Expenditure (CNE) which the project really required.

The Department stated (October 2001) that a case for CNE approval was not made out for the pilot project because (i) one time software development charges was common and it should be distributed over all the ICES locations, (ii) the increase in hardware cost was approved by Secretary (Expenditure) who happened to be the Chairman of CNE and (iii) the cost of site preparation work would not form part of the project cost. Reply is not tenable as the cost of a project should take into account all types of expenditure. An increase in expenditure by 100 per cent was a reflection on poor estimation of project cost.

(b) Other locations

(i) In December 1995, the Department of Revenue decided to extend ICES to another twenty locations. Accordingly, approval of the CNE was obtained (March 1996) for a total estimated cost of Rs.64.19 crore including Hardware: Rs.43.67 crore; Site preparation; Rs.19 crore and Connectivity: Rs.1.52 crore to be completed in eighteen months. In spite of the fact that there was a downward trend in the prices of hardware in the market, the estimated final expenditure incurred for the ICES project (excluding Delhi pilot) increased to Rs.78.95 crore as detailed below:

(Rupees in crore)

Items of work	Estimated cost as approved by CNE	Expenditure	Increase (+)/ Decrease(-)	Reasons
Hardware	43.67	32.85	(-) 10.82	Fall in prices despite increase in number of sites and quantity tendered
Site preparation	19.00	20.20	(+) 1.20	Increase in number of sites
Connectivity	1.52	20.30*	(+) 18.78	Contemplation of EDI Gateway due to non-establishment of EDI connectivity
Application Software	--	3.01	(+) 3.01	Procurement of Oracle software not envisaged
Development of Software	--	2.00	(+) 2.00	Continued payment of software development charges against one-time payment agreed earlier
Message exchange server	--	0.40	(+) 0.40	Contemplation of EDI connectivity between custodian and custom location
Tele-enquiry system	--	0.19	(+) 0.19	Provision of tele-support for the status of clearance of documents
Total	64.19	78.95	(+) 14.76	

(ii) It is apparent that there was wide variation between items of work projected in the paper put up to the CNE and the actual expenditure finally incurred. Some of the major factors responsible for this are: (a) even though EDI connectivity was central to the ICES, adequate provisions were not made in the CNE paper of 1996 on this account. As a result, another proposal had to be mooted in October 2000 for Rs19.27 crore, (b) no proposal was made in the CNE paper for software, either application or

development. Eventually savings due to the global decline in hardware prices enabled purchase of software without seeking additional sanction.

The Department stated (October 2001) that (i) expenditure for application software was due to inability of NIC to supply the same, and (ii) the cost incurred on message exchange servers (MES) and Tele-enquiry system are for clearly defined purpose besides the investment to be made is below the limits prescribed for the approval of CNE. Reply is not tenable as the implementation of MES is an integral part of EDI connectivity.

2.7 Procurement issues

(a) Procurement of under-configured servers

Audit scrutiny of the relevant records revealed that the department procured under configured servers as is evident in the following:

(i) The Tender specification (July 1996) in respect of hardware for other locations prescribed a response time of three seconds for an estimated Transaction Processing Council – A Grade benchmark rating of 200+ to 600+ transactions for online data entry, queries, precedent search on a database size of 2 to 8 GB for the servers to be procured. Audit scrutiny of the minutes of the technical evaluation committee revealed that they had computed the average normalised transaction time of the best bid (M/s.WIPRO Infotech Group Limited) with a database size of 2 GB at 53.70 minutes. Neither the details of computation of average normalized transaction time nor the inputs considered for its calculation were made available to Audit. It is, therefore, not clear as to how the bid of M/s.WIPRO Infotech Group Limited was accepted even though it did not meet the technical requirement.

(ii) Audit enquiries regarding working of the System at Chennai indicated that the server was not equipped to handle the volume of work as (i) some of the users have to be de-linked from the System during peak hours, (ii) statistical reports have to be generated after office hours and (iii) slowing of the system while capturing of data relating to Import General Manifest (IGM) through floppy submission.

(iii) The utilization of the total hard disc storage capacity in seven locations varied between 60 and 81 per cent even though a substantial proportion of the work was still being done manually. In two other locations viz. Sahar Air Cargo and Patparganj, the hard disc capacity had been increased by 6.1 times and 1.8 times respectively within three years of commencement of online operations.

(iv) No provision was made in the software to have audit trails for history database.

(v) Data was being archived to a standby system in view of system performance.

(vi) 'Autosecure', a software to create log files recording the transactions carried out by the System Manager, could not be implemented due to the debilitating effect on the efficiency of the system performance.

(vii) The volume of documents which were a critical determinant of hardware/software capacity were grossly underestimated. Details gathered in 12 ICES locations indicated that the volume of documents handled exceeded the estimation by 19.2 to 227.4 per cent in seven locations as detailed in **Annexure I**.

In response the Department stated (October 2001) that : (i) No officer from CBEC was involved in the technical evaluation; and (ii) The doubling of data volume and addition of new modules affected the system response.

(b) Acceptance tests not conducted

The department did not conduct acceptance tests for the servers supplied by M/s.WIPRO Infotech Group Limited to prove the performance for the complete functionality of the System with reference to bench mark results obtained at the time of technical evaluation as stipulated in clause 7.9 of Section 3 of the General Conditions of Contract in the Tender specification. This is a critical control in IT procurement requiring scrupulous adherence. While conceding that acceptance tests were not carried out, the Department stated (October 2001) that deterioration in the performance of servers was largely due to increase in the load.

(c) Failure to take advantage of contractual provisions for getting state of the art technology

(i) While finalising the contract in January 1997 the department did not specify the time schedule for the supply of hardware by M/s.WIPRO Infotech Group Limited. The orders were placed under the contract for twenty three locations spread over five occasions between March 1997 and March 1999 due to delay in site preparation work. Clauses 12, 36 and 35 of Section 3 of the General conditions of the contract in the tender stipulated that the hardware supplier would supply the current models, incorporate all the improvements in design on account of advancement in technology and reduce the prices when there is reduction in the prices.

(ii) Audit scrutiny of the invoices available in the records revealed that the supplier delivered between March 1997 and March 1999, 1275 numbers of P120 Mhz based personal computers with configuration of 16 MB RAM/1 GB Hard disk/1.44 MB FDD/14" mono monitor at Rs.43423 per PC as originally stipulated in the tender. Neither the supplier made available the latest hardware configuration that were available in the market, nor was the benefit of reduction in the prices of hardware due to downward trend in prices passed on to the department.

(iii) Further scrutiny by Audit with reference to the records of the same supplier indicated that M/s.WIPRO had supplied higher configuration PCs viz PC 233 Mhz 16 MB RAM/2.1 GB Hard disk/1.44 MB FDD/14" mono monitor to M/s.S.Kumar Computers, Gujarat at a cost of Rs.27,800 per PC during February 1999. By supplying

the PCs at the contracted price rather than at the prevalent market price the supplier failed to comply with the contractual provisions. The department also failed to monitor the market trends to enforce the contractual provisions. They could have saved Rs.1.07 crore and obtained PCs with higher specifications. Assuming a similar down ward trend in prices of servers, another Rs.1.39 crore could have been saved.

The Department, in their reply contended (October 2001) that configuration of machines were enhanced to the latest at the time of ordering and in particular the PCs received in the last order in March 1999 was of higher configuration with colour monitor. Audit scrutiny of all the invoices raised by the supplier till March 1999 clearly indicated that the supplies were with the configuration based on the contract finalised in January 1997. Similarly, the order issued (March 1997) to the supplier about the configuration of P120 MHz based personal computers also specifically stipulate the supply with 14" mono monitor for a unit price of Rs.43,423 only. Hence the contention of the Department is not tenable.

(d) *Insistence on composite procurement of hardware and software for EDI connectivity leading to excess expenditure*

(i) The Department initiated (February 1999) a proposal for introducing EDI/E-commerce services under EDI Gateway project on a single point access at Delhi for the whole country. The Notice Inviting Tender stipulated that the vendor should provide (a) Gateway servers for handling of messages to be interchanged among the trading partners, (b) firewall intrusion detection system for monitoring network management system, (c) various servers to provide different type of gateway functions like Email, Internet facility and certification, (d) operating system and application software like oracle (e) development software for message handling and its validation before transfer to the customs servers for processing and (f) communication connectivity through Internet Service Provider (ISP) as well as taking leased lines from DOT. Tenders were invited in January 2000. The proposal, involving a financial outlay of Rs.19.27 crore (Rs.13.53 crore for Hardware and software including payment to Internet Service Providers; Rs.4.75 crore for the cost of leased lines payable to DOT for three years for interconnectivity between Customs locations; Rs.0.99 crore towards unforeseen expenses), was approved by CNE in October 2000.

(ii) No reasons were found on record for going in for a complete solution from a single vendor. This however restricted the response as only five bids were found technically acceptable. Of the five short listed tenderers, only two were considered responsive to the commercial evaluation. This could not be considered as a competitive bidding process. If hardware and software were separately tendered the response would have definitely been higher in both categories enhancing cost effectiveness.

(iii) In so far as software is concerned the bid of M/s Global at Rs.2.80 crore was much lower than the bid of Rs.5.48 crore of M/s Wipro. The latter was finally awarded after negotiation at Rs.3.75 crore. This was done by reducing technical support from 3 to 1 year and accepting lower power units of oracle software; but for these changes the bid would be Rs.4.95 crore. The Government would have saved Rs.2.15 crore if the software order was separately invited and awarded to the lowest bidder.

In response, the Department stated (October 2001) that multi-vendor system might affect timely completion and result in cost overrun besides difficulty in fixing responsibility on any particular agency and the final analysis of the Committee for evaluation of the commercial proposals disqualified M/s.Global on several counts. The response of the Department is presumptive. In any case, the disqualification of M/s.Global on various counts was not due to software related issues. As such the software could have been procured from them.

2.8 Implementation issues

(a) Delay in commencement of on-line operations

The Delhi pilot project was to become operational for on-line assessment by 1 September 1994. Against this schedule, NIC placed orders in September 1994 for hardware procurement with HCL. The on-line assessment for import and exports clearance at Custom House, New Delhi was made operational only in May 1995 (8 months delay) and May 1996 (22 months delay) respectively due to delay in software development. Moreover the on-line operations were commenced only for a few customs functions.

(i) Idle equipment

Of the 23 locations taken up during extension of the ICES, the Department commenced on-line operations in 22 locations after a delay ranging from 2 to 31 months mainly due to delay in completion of site preparation work entrusted to M/s. CMC Limited. The delay was 12 months and above in 13 locations. Consequently, the hardware procured was kept idle for periods ranging from 4 to 17 months. The idle investment varied between Rs.0.54 crore and Rs.3.79 crore for the above locations. Besides, the annual maintenance contract both for hardware and software for the existing spherry computer system had to be extended in six locations for hardware and two locations in respect of software for varying period ending between March 1997 and March 1998 at an additional avoidable expenditure of Rs.1.17 crore (Hardware maintenance Rs.1.08 crore and Software maintenance Rs.0.09 crore). In Bombay Sea Customs, the Department placed orders for 82.6 per cent of the total work for site preparation between August and November 1998, while orders for procurement of hardware were issued in January 1998 itself indicating non-synchronisation of related activities in the project implementation. Of the remaining two locations, while the hardware procured for Inland Container depot (ICD), Surat was diverted to other existing ICES location, the hardware procured for Mulund at a cost of Rs.54.84 lakh in March 1999 has been diverted to Mangalore and Raxaul where the on-line operation is yet to commence (September 2001). Thus, the hardware procured in March 1999 is still lying idle.

(ii) Delay in remittance of revenue collected under ICES

Scrutiny by Audit of the customs duty collection through ICES at Sea Customs, Chennai for January to March 2000 revealed that despite introduction of ICES the designated branch viz. Indian Bank was taking 3 to 6 clear days after excluding the date

of collection and the following day. The delays in remittance to Government account vitiates the objective of introduction of ICES for faster collection of revenue. It is likely that such delays take place in other locations too.

2.9 Economy issues

(a) Incorrect estimation in the volume of documents to be handled at Surat

The inclusion of a Customs location under the ICES was based on the estimated volume of documents. The proposal indicated an estimated volume of 32500 (250 days X 130) for Surat. The actual volume of documents (Both BEs and SBs) handled at Surat was 1995 in 1997-98, 969 in 1998-99 and 748 documents in 1999-2000. The hardware procured for this location was therefore diverted to another location and the assessment continued to be done manually. However, the site preparation work at ICD, Surat had already been entrusted to M/s.CMC Limited in May 1997 at a cost of Rs.49.31 lakh which became infructuous.

(b) Connectivity through VSAT infructuous

To provide interchange of information between custom house agents through NICNET and also retrieval of data from database of other Customs/Excise Commissionerates, the Department proposed (August 1992) to avail Very Small Aperture Terminals (VSAT) connectivity. Accordingly, the Department paid Rs.35.47 lakh (March 1997) and Rs.67.56 lakh (March 1999) to NIC for availing VSAT connectivity for 7 and 12 locations respectively. The VSATs were installed between July 1997 and March 2000. The department soon realised that the VSAT connectivity did not fulfill all their needs due to throughput problems for the large volume of data access. These were, therefore used for the troubleshooting work of the software development team and distribution of software amendments/patches to various ICES locations.

Audit examination of the issues revealed that (a) use of VSAT for multisite interconnection for large data access is not considered a prudent option and (b) satellite technology has limitations that disqualify it from interactive applications (such as ICES). In other words the VSAT option was abinitio incorrect leading to infructuous expenditure of Rs.1.03 crore.

The DOS replied that the limited bandwidth available in VSAT technology was known and would be overcome after the commencement of the proposed electronic commerce platform under EDI gateway and VSAT would be used as a limited back up for the proposed EDI gateway connectivity. They also stated (October 2001) that the decision was guided by NIC. However, the fact remained that selection of VSAT technology for large volume of data access was imprudent. Its potential as a backup is therefore limited.

(c) Avoidable expenditure on Message Exchange Servers

Even though a separate proposal for a single EDI gateway through Delhi was mooted in October 2000, the department proposed installation of message exchange servers (MES) in two locations at a cost of Rs.40.46 lakh for handling messages between the local agencies functioning within the custom house as well as between custom house and the gateway. The scope of the work included supply of a server, unix operating system software, pentium PC for EDI front end*, firewall software and customised software development for message handling. The MES has higher capacity than the existing ICES servers in each location.

Scrutiny by Audit indicated that installation of MES for handling messages alone was necessitated due to the following reasons: (a) As per the original plan the existing ICES server was to handle messages with external agencies besides processing regular customs documents. However, the servers procured were under configured. (b) The software developed by NIC for handling of message with external agencies and implemented at Delhi pilot project did not provide quality EDI services. As a result, the department had to incur an additional expenditure of Rs.37.72 lakh in two locations for exchange of messages. This will entail further avoidable expenditure of Rs.3.96 crore in other twenty more locations.

The Department stated (October 2001) that the large number of number of transactions with banks/custodians/service center required installation of MES and therefore amount spent on it was not avoidable. It was further stated (January 2002) that the message exchange with outside agencies was not planned on ICES servers. The reply is not tenable as the installation of MES with EDI software was on account of incorrect selection of ICES server and failure to execute MOU with NIC before commencement of the project to enforce obligations since NIC was paid one-time software development charges including EDI software. As EDI connectivity was central to the ICES, the contention that message exchange with outside agencies was not planned earlier is also not tenable.

(d) Annual maintenance contract

(i) In June 1996, the Custom House, Delhi awarded annual maintenance contract (AMC) for equipments such as Air conditioning set, UPS, Diesel generator sets at a cost of Rs.12 lakh for each year during 1996-97 and 1997-98 to M/s. Group 4 Securities (Systems) Private Limited without calling for open tenders. In December 2000, the Department conveyed expost-facto sanction for Annual maintenance charges to be paid to M/s Group 4 Security (Systems) Private Limited for the period from July 1998 to December 2000 (two years and six months) at Rs.6.60 lakh per annum based on the annual maintenance charges decided for the year 2000-01 with reference to the open tenders in which 14 firms participated. Thus payment of annual maintenance charges for two years 1996-97 and 1997-98 at Rs.12 lakh per annum

* Installation of a PC is for network address identification to the external users without giving the network address of internal ICES servers which does the regular processing

without calling for open tenders resulted in avoidable extra expenditure of Rs.10.80 lakh.

(ii) Similarly, the Department had awarded the AMC to M/s. HCL Infosystem for maintaining Computer hardware/software at IGI Airport, New Delhi till February 1999 on the expiry of the warranty period in November 1995/February 1996 without calling tenders for the AMC. The Department awarded two AMCs to M/s HCL Infosystem at Rs.19.10 lakh and Rs.20.25 lakh for the two systems (Export/import) available at the same place instead of a single comprehensive contract for both the systems for the period from March 1996 to February 1997. However, with effect from March 1997 a single AMC was awarded at Rs.20.60 lakh to the same contractor for both the Systems which was only 50 per cent of the cost for earlier years. The Annual maintenance charges paid to M/s.HCL Infosystem for the period December 1995 to February 1999 (Three years and three months) amounted to Rs.87.63 lakh. Finally, the Department invited tenders in March 2000 for the AMC and finalised the contract at Rs.14.50 lakh per annum for the period from March 1999 to February 2001 (Two years). Normally the maintenance charges would be lower in the initial period after the installation and higher as it becomes old. In this case the actual annual maintenance charges paid for the initial period was higher and substantially lower in the later period. Thus failure to execute a single contract for the two systems in the initial period and non-invitation of tenders resulted in avoidable expenditure of Rs.42.31 lakh till February 1999.

While admitting the audit observation, the Department stated (October 2001) that providing maintenance service at a short notice and the need to have continuity with single agency were some of the reasons for the non-invitation of tenders.

(e) Cost of collection paid to banks under ICES not rational

The department is making a payment to the collecting bank at the rate of 11.8 paise for every one thousand rupees of duty/cess collected. Audit scrutiny revealed that rate was not related to cost of collection under ICES and had not taken into account (i) work involved for the maintenance of accounting records (ii) provision of infrastructure like accommodation, hardware and other peripherals and development of software for the collection of the revenue for the collecting bank by the department and (iii) single point collection as against the earlier multipoint collection for departmental collection.

A rough estimation at Chennai indicated that as against the 0.12 per cent collection charges being paid to the Bank the departmental collection cost was less than .01 per cent or one tenth. There is therefore definite scope to negotiate and reduce the rate. Even a 50 per cent reduction could save the Government Rs.10 crore per annum.

The Department intimated (January 2002) that a Committee had since been set up to review the existing rates.

2.10 Security issues

The customs organisation collects around Rs.50,000 crore as revenue and disburses Rs.4000 crore as drawback payment annually. Manipulation of critical parameters such as classification, rate of duty, value, etc have crucial bearing on revenue. Therefore, security of the system with restriction on access is of utmost importance. The ICES has two types of users viz. (a) System Manager and (b) other users, each with a defined role. Further, the ICES also provides use of the system by outside agencies for data entry operations (service centres managed by M/s.CMC Limited) and connectivity to Container Freight station situated outside custom premises. This enhances the security risk necessitating additional safeguards.

(a) No security policy

The department is yet to formulate a security policy identifying threat perceptions and safety measures. The following features of ICES enhance security risks: (i) connectivity to the ICES database from outside area where Computer terminals are accommodated in private/Government buildings through dial-up technology using Public Switched Telephone Network for use by warehouses/container freight stations situated away from custom houses, (ii) establishment of service centers for data entry operation as well as transferring semi-processed documents for carrying out amendments by outside agencies. This risk is enhanced in the context of strategic sale of M/s. CMC Limited, (iii) direct connectivity to the main server by service center operator in the absence of separate hardware for service center operations in some locations and (iv) introduction of EDI connectivity through gateway and MES. However, DOS is yet to initiate action either on the proposal received from NIC in February 1999 or on the draft security policy formulated by the Additional Commissioner, Chennai based on the experience gained at Air Cargo, Chennai after the introduction of the software 'Autosecure' in December 1999.

(b) System Manager log file not maintained

The administration of the information system rests with the System Manager, who possesses root privilege, a special privilege by which he gets unlimited access to different parts of the information system. System administration includes (i) updation of the intermediary changes in the rates of duty, duty drawback and exchange rates with reference to notifications and (ii) other general functions like creation of users, etc. Besides the System Manager, root privilege is also given to NIC and M/s.CMC Limited, hardware maintenance agency. It is necessary to record the operations carried out in the system by the System Manager and the other root privilege users to trace and determine responsibility for changes made in the system which may also include processed customs documents.

A review made by Audit indicated that, in June 1999, the DOS had procured a software called 'Auto Secure' to create a log file wherein all activities carried out in the System by the root privilege user would be recorded and the log file would not be allowed for any modification. This software was introduced (September 1999) in ICES at Air

Cargo Chennai on an experimental basis. However, no action has been initiated for its implementation under ICES on regular basis either at Air cargo, Chennai or any of the other locations. Consequently, even though six years have elapsed since implementation of ICES, the operations carried out by the root privilege users are not being recorded. The DOS stated (March 2001) that 'Autosecure' software would be evaluated at ICD, Tughlakabad before rolling it out to other ICES sites.

Scrutiny of records revealed that two incidents occurred (July/August 1998) at Air Cargo, Delhi where an unauthorized user had logged into the System through the operating system and deleted certain files. Consequently, the System hanged completely. In the absence of the log file, the department could not identify the persons who misused the system.

While conceding to the absence of log file (audit trail) for the processed documents, DOS stated February/May 2001 that all escape keys had been trapped and no user would have access to the operating system. This did not address the issue of misuse of the operating commands by the persons having this privilege.

(c) Non utilisation of WORM

The department spent Rs.53.90 lakh for making available a facility called WORM (write once read many) optical disk drive in the servers of the ICES extension project as an additional item for recording essential transaction on security considerations. However, this facility is yet to be made use of by the department resulting in incurring infructuous expenditure of Rs.53.90 lakh.

(d) Poor access controls

The other users of ICES with defined roles in the system are following simple authentication procedure based on password mechanism. Ideally the password mechanism should provide for (i) changing the password by the users on their own before the expiration of a specified period. If not followed, the system should not allow the user to perform his/her role, (ii) usage of the password by the users in a specified terminal only and (iii) automatic disconnect option if the user is not making use of the system continuously for a specified period of time. Audit scrutiny revealed that no such access controls has been stipulated. The Department stated (October 2001) that the automatic disconnect option has been implemented now.

(e) Security failure-Fraudulent drawback payments

Commissioner, Air Cargo, Delhi, reported (December 1998) fraudulent payment of drawback under ICES. As per the report, a service centre operator entered data unauthorisedly and transferred it to the main server for further processing. The Commissioner reported that the Service Centre Operator misused the passwords of an Inspector and Superintendent and substituted their action for clearance of documents without any physical export of goods. It was further stated that substitution of action

had taken place from a terminal other than the one specified for those officers. The estimated loss on this account amounted to Rs.1.95 crore.

Audit scrutiny further revealed that the fraudulent payments were possible because of the following system lacunae:

- a) Even though the manual of Handbook for Customs officers lays down that Customs officers were to change passwords at regular intervals, there was no in-built check by way of designing a programme in the operating system for change of passwords. Further, the operating system also did not restrict the usage of the password by the users from a specified terminal only.
- b) Absence of a cross verification of the EGM data entered in the System by the service center operator with the original documents submitted along with the EGM print out received by the Export Wing of the Customs Department resulted in non-detection of fraudulent case immediately.
- c) ICES provides for movement of the document electronically after data entry to the examination yard where the system allots the documents to different officers. Selection of particular document by an officer should therefore be difficult to achieve. As the selection of a particular document was done by the intruder, the system is unreliable.

Thus, the department lost Rs.1.95 crore on the fraudulent payment of drawback due to deficiencies in system security.

The Department stated (January 2002) that instructions had since been issued to system managers to make password change mandatory and suitable measures would be taken to enforce controls to minimise risk in future.

2.11 System lapses

(a) Non-updation of rates in the System

The DOS had issued (August 1999) instructions that the updation of rates of duty/drawback for each year would be undertaken centrally and all the field formations were advised to compare the directories with notified rates and carry out amendments, if any, for inaccuracies. The subsequent updation with reference to any new notification/rates is the responsibility of the System Manager of the concerned Customs House.

Audit noticed cases of incorrect feeding of drawback rates/duty rates in the System at Air Cargo, Chennai and Sea Customs, Chennai resulting in excess payment of drawback and short collection of import duty amounting to Rs.23.39 lakh and Rs.1.04 lakh respectively. ACC, Chennai replied (March 2001) that demand notices were issued for an amount of Rs.20.22 lakh and of this, an amount of Rs.19.32 lakh had been recovered. Similar lapses would have occurred in other Custom Houses.

(b) Absence of validation controls

(i) Incorrect data entry was noticed in Chennai Air cargo and JNPT, Nhava Sheva in 110 cases of export documents as the exporter had either not furnished the drawback units (i.e. quantity details left blank) or furnished incorrect drawback accounting units (i.e. unit measurement in terms of pieces/square foot instead of weight/square metre). The incorrect data entry could have been avoided at the data entry stage itself if the system performed the following validations: (i) Detect the omission to furnish drawback units and (ii) cross verify the drawback accounting units furnished with the type of drawback accounting units available in the drawback directory maintained in the system. As a result, there was excess payment of drawback (Drawback serial number 55.01/57.01) amounting to Rs.3.85 lakh in 39 cases where details were available. In the remaining cases where details not available, assuming a similar trend with reference to the cases quantified, the excess payment of drawback (Drawback serial number 57.01) could have amounted to Rs.16.60 lakh.

(ii) In 31 export documents at Chennai Sea Customs, it was noticed that the entire drawback as claimed under EPCG/general drawback was sanctioned even though the classification code indicated that the items were exported under Duty Entitlement and Exemption Certificate Scheme (DEEC). Thus, absence of validation controls to check inconsistent declaration resulted in excess payment of drawback amounting to Rs.14.25 lakh.

The Department stated (October 2001) that it is the responsibility of the exporter/customs officers to ensure the correctness the data entered in the System. It was further stated (January 2002) that efforts were being made to improve the software wherever possible. Reply is not acceptable as the very purpose of computerisation is to minimise the manual dependence on checking the correctness/computation of data and introduction of validation control is essential.

(c) Deficiency in software

(i) The exports under DEEC scheme is classified in the ICES in two categories viz. one involving payment of drawback the rest. The fact of export under DEEC scheme involving payment of drawback is identified in the System by three different simultaneous classification of alphanumeric code viz. 'E', '2A' and '5B' to facilitate restriction of the drawback to be allocated to the Central Excise as indicated in the drawback schedule.

Scrutiny by Audit, however, revealed that the System has been designed to calculate the full drawback including that allocable to Customs. As the ICES provides a facility to effect change in the quantum of drawback payable at the time of sanction of drawback, the Customs portion was being withheld manually thereby making payment of drawback for the Central Excise portion alone. A review made by Audit on the export made under DEEC scheme involving payment of drawback at Chennai Sea Customs revealed that the Custom House failed to restrict the drawback amount manually that should be allocated only to Central Excise resulting in excess payment of drawback of Rs.5.29 lakh in 23 cases for the period from January 1999 to December

2000. Similar analysis made on the exports made under DEEC scheme not involving payment of drawback showed that the System granted incorrect drawback amounting to Rs.3.86 lakh in 13 cases during the same period due to absence of a unique code to identify this category of export. Thus dependence on the manual operation to be performed in the system resulted in a total excess payment of drawback amounting to Rs.9.15 lakh at Chennai Sea Customs alone.

(ii) Lesser amount of drawback is payable in respect of goods manufactured with in-bond facility and exported. The export under in-bond facility is covered by four different classifications in the drawback Schedule. However, the software designed under ICES did not provide any facility to capture such information even though exporters furnish Appendix III along with the export document which contains clause 9 disclosing this information. This resulted in acceptance of incorrect classification declared by exporters. As a result, Air Cargo, Chennai had made excess payment of drawback amounting to Rs.0.47 lakh in one of the four different classifications. On being pointed out (December 2000), demand notice for recovery of excess drawback of Rs.47059 was issued in February 2001 and details in respect of similar three cases relating to the same exporter have been called for to recover the excess drawback.

(iii) According to the Manual of Handbook for Customs Officers, the System assigns Shipping Bill numbers automatically for the bills filed by the exporters under ICES. A scrutiny by audit of the numbers assigned revealed that the System assigned 476478 numbers at JNPT, Nhava Sheva during the period from December 1997 to April 2001, while the bills available in the database was only 194482 numbers indicating that there is deficiency in the software in assigning the numbers automatically. However, no reasons could be found in the database for such huge variations in assigning numbers.

In response, the Department stated (October 2001) that, though the System was designed to provide greater flexibility, it was the duty of the customs officers to check the details furnished by the exporters. Reply is not tenable as the concept of computerisation is to reduce the manual operations.

(d) Failure to evolve cess classification code in the System

Cess is leviable on certain selected imported goods under various Acts as per Appendix II Central Excise Tariff. The importers are required to furnish cess serial number at the time of filing of Bill of Entry for the levy of cess by the ICES. Scrutiny by Audit data indicated that there was no column specifically to accept data relating to cess serial number in the System. Consequently, the System could not levy cess automatically resulting in loss of revenue amounting to Rs.23.62 lakh in two Commissionerates.

The Department replied (January 2002) that the issue had since been taken up with Ministries to realign cess schedule with Custom Tariff headings.

(e) Absence of IGM control

A review made by Audit on the pendency in uncleared cargo as well as import documents filed under ICES indicated that there is no monitoring mechanism under

ICES to (i) pursue the pending import documents filed, (ii) ascertain the non-filing of import documents though the System provides data for all IGMs filed and (iii) identify duplicate filing of import documents both manually and under ICES. As a result, in respect of 39 of 497 cases test checked in Audit at Chennai Sea Customs, duty amounting to Rs.4.54 crore out of Rs.34.74 crore remained uncollected for the import documents filed under ICES as on April 2001 for the goods pending clearance. Besides escapement of collection of interest of Rs.1.80 lakh was noticed due to non-identification of the duplicate filing of the import documents both under ICES and manually.

While conceding the non-development of software for the closure of IGM electronically, the Department stated (October 2001) the action for the pendency in realisation of duty and non-clearance of goods has to be initiated by the customs officers. However, the fact remains that there is no effective monitoring.

2.12 Conclusion

The implementation of the Indian Customs EDI System on such a large scale in terms of number of locations, volume of transaction and the diverse agencies involved is no doubt a challenging task. To realise full benefits from the project the department needs to expedite completion; accord greater priority by committing more human resources particularly at senior and middle management level; develop in house expertise through training and take adequate steps to ensure system security and data validation. Particular attention also needs to be accorded to ensure compatibility and concurrent development of IT infrastructure in the other agencies.

CHAPTER 3 : NON-REALISATION OF FOREIGN EXCHANGE

3.1 HIGHLIGHTS

- Export proceeds aggregating Rs 11,735 crore were pending realisation as on June 2000. Of this Rs 7549 crore, or two third was outstanding for more than two years. 44 percent of the total was outstanding from only nine countries. The share of outstanding from UAE, Russian Federation and Singapore was more than their share in India's exports. Commodity wise analysis revealed that 70 percent was pending realisation only with respect to thirteen commodities, the major ones being readymade garments and computer software.

(Paragraph 3.5)

- Test check revealed 5262 cases involving unrealised foreign exchange of Rs.2182.63 crore where export incentive were availed. Duty incentive of Rs.521.58 crore along with interest of Rs.188.63 crore were recoverable in these cases. 60 percent of this amount was recoverable from only 20 units. These exporters were also liable for penal proceedings.

(Paragraph 3.6)

- The efficacy of XOS as a control instrument for monitoring export incentives was limited due to delay in transmission of these statements to Customs Houses by the Regional offices of RBI; inadequate, incomplete or incorrect information; poor follow up action at Custom Houses and keeping licensing offices out of the loop.

(Paragraph 3.7)

- Incentives availed in respect of Rs 177.25 crore of non realised export proceeds had not been ascertained before write off by RBI regional offices .

(Paragraph 3.8)

- Extensions for realisation of outstanding export proceeds of Rs.199 crore were granted in 873 cases mostly in violation of provisions of Exchange Control Manual.

(Paragraph 3.9)

3.2 Introduction

The Government has been sacrificing a significant amount of Customs Revenue through the several export promotion schemes such as Duty drawback, Export Oriented Units/Export processing Zones, advance licences, Duty entitlement pass Book, and Export promotion of capital goods scheme etc. The quantum of revenue foregone during 1999-2000 was Rs.18,166 crore which was 38.21 percent of customs receipts of Rs.47,541 crore. During the last five years a total amount of Rs.71,030 crore was foregone on this account.

While discussing the issue of effective monitoring of export obligation and realisation of foreign exchange, PAC in their 24th Report (1997-98) (Eleventh Lok Sabha) observed that the one and only yard stick for evaluating the efficacy of various schemes as an export promotional measure would be additional foreign exchange actually generated through its operation. In its 4th Report (Thirteenth Lok Sabha) on Action Taken on 24th Report of PAC (11th Lok Sabha) the PAC further desired that the laxity/failure of the machinery in monitoring export obligation should be inquired into and responsibility fixed for lapses.

In this background effectiveness of the administrative machinery in handling cases of non realisation of foreign exchange assumes great importance. A mention was made in para 1.5 (c) of the Audit Report No.10 of 2001 of the Comptroller & Auditor General of India that "Duty exemptions were allowed at the time of import based on a commitment of export obligation and drawback is allowed on the basis of shipping documents of export. The prevalent monitoring mechanism in the Custom Houses and the offices of Director General of Foreign Trade did not, however, enable them to ensure that the full amount of foreign exchange due against the export value declared on the shipping bills presented by export houses were actually realised".

3.3 Monitoring Mechanism

Pivotal role in monitoring of realisation of foreign exchange against exports is entrusted to the Reserve Bank of India (RBI). All Authorised dealers of foreign exchange are required to furnish to the RBI, half yearly, a consolidated statement in form Export Outstanding Statement (XOS) giving details of all export bills outstanding beyond the period prescribed for realization as at the end of June and December every year, within 15 days from the close of the relative half-year. The XOS generated on this basis is to be forwarded by the RBI to all the nodal Custom Houses within a month from the close of the relevant half-year. Nodal Custom Houses are required to disseminate the information contained in the XOS to the Customs Authorities at the port of export within 15 days for monitoring the realisation of outstanding foreign exchange. All the export incentive schemes envisage that in the event of non-realisation of export sale proceeds within the permissible time or within the extended period permitted by the Reserve Bank of India, duty incentives availed by the exporters are to be repaid to the Government. Scheme wise details of these provision are given in **Annexure-II**.

3.4 Scope of Audit

A horizontal review of the records of Custom Houses and Director General of Foreign Trade (DGFT) and information supplied by regional offices of RBI was conducted between January to July 2001 to:

- (a) Analyse trends & pattern in the cases of outstanding foreign exchange realisation.
- (b) Evaluate the adequacy & efficacy of the procedure prescribed for monitoring of realisation of export proceeds.
- (c) Seek an assurance that in the event of non-realisation of foreign exchange within the permissible period, all incentives/concessions/duty benefits availed by the exporters were recovered along with interest and penalty.
- (d) Review the efficiency of the system of interdepartmental cooperation and exchange of information between administrative agencies i.e. Reserve Bank of India, Director General of Foreign Trade (DGFT) and Customs Department.

Findings are contained in the succeeding paragraphs.

3.5 Analysis of XOS Statement.

The six monthly XOS statement generated by RBI for 30 June 2000 contains 1,56,608 export bills with outstanding export proceeds of Rs.11,735 crore. Analysis of the statement revealed the following :

(a) Age-wise Analysis

Outstanding for	Amount (Rs. in crore)	Percentage
Above 5 years	2929	24.95
4-5 years	1117	9.51
3-4 years	1732	14.75
2-3 years	1771	15.09
1-2 years	3382	28.81
Less than one year	804	6.85
Total	11735	100.00

Rs.7,549 crore, 2/3 of the total, was outstanding for more than two years.

(b) Country wise Analysis

44 percent of the outstanding amount related to the following nine countries as detailed overleaf:-

(Amount in crore)

Sl. No.	Name of Countries	Percentage of export in total exports for 99-2000	No. of cases	Amount	Percentage
1.	U.S.A.	22.69	26959	1845	15.71
2.	U.A.E.	5.71	9998	1044	8.90
3.	Hongkong	5.98	2707	565	4.81
4.	Russian Federation	2.53	2282	333	2.83
5.	U.K.	5.97	9597	584	4.97
6.	Germany	4.79	6412	261	2.22
7.	Singapore	1.83	3414	391	3.33
8.	Suadi Arabia	1.98	1239	70	0.59
9.	South Africa	0.79	1019	63	0.53
10.	Others	47.68	87837	6579	56.07
	Total	100.00	151464	11735	100.00

The share in outstanding of U.A.E, Russian Federation, and Singapore was more than their share in India's exports.

(c) *Commodity wise Analysis*

Commodity wise Analysis of 43,190 cases in eight Customs Commissionerates involving export proceeds of Rs.4239.71 crore revealed that more than 70 percent of foreign exchange was pending realisation only with respect to thirteen commodities as given below :

(Amount in crore)

Sl. No.	Name of the Commodity	No. of Cases	Amount	Percentage
1.	Ready made Cotton Garments, Silk, Textile, etc.	13065	760.41	17.93
2.	Computer Software & Electronics	886	436.36	10.29
3.	Drugs & Pharmaceuticals	1793	259.92	6.13
4.	Dyes and Chemicals	694	239.11	5.63
5.	Miscellaneous manufactured products	1489	250.89	5.91
6.	Gem and Jewellery	797	215.95	5.09
7.	Woollen yarn, Fabric, Carpets	782	200.50	4.72
8.	Leather Goods	3969	187.59	4.42
9.	Tea and Coffee	1064	138.80	3.27
10.	P.P. food	145	90.22	2.12
11.	Rice and Pulses	106	75.82	1.78
12.	Sea Food & Marine Products	673	67.98	1.60
13.	Granite	841	53.74	1.26
14.	Others	16886	1262.42	29.77
	Total	43190	4239.71	100.00

3.6 Export incentives availed

It is not possible to discern from the XOS statement the export incentives availed by the exporters or whether any action had been taken to recover these benefits in view of the non realisation of foreign exchange. For this purpose 13,123 cases involving outstanding export proceeds of Rs.5262 crore from the XOS of 30 June 2000 were test checked in audit.

Commissionerate wise details of the sample is given below :-

Sl. No.	Commissionerate	As per XOS of 30.6.2000		Cases Audited	
		No.	Forex	No.	Forex
1.	Delhi	49978	2679	3020	1001
2.	Cochin	2273	126	218	19
3.	Kandla	5144	555	1038	188
4.	Bangalore	6135	386	*76	144
5.	Kolkata	7028	755	1310	379
6.	Guwahati	11	10	--	--
7.	Hyderabad-II & Visakhapatnam	2614	352	632	127
8.	Mumbai	62088	5461	6545	2677
9.	Chennai	21337	1411	284	727
	Total	156608	11735	13123	5262

**In the absence of Export bills No. of Exporters adopted*

Of the sample only 1416 cases involving Rs.614 crore (11.67 percent) did not involve any export incentives. In 6445 cases appearing in 6 XOS statements of Mumbai, Kandla, Cochin, Chennai, Hyderabad and Delhi Rs.2466 crore were realised either before 30 June 2000 or after issue of XOS but before test check by audit. In the balance 5262 cases involving non realisation of Rs.2182.63 crore, export incentives had been availed under various schemes. However the Department of Customs and DGFT had not taken action to recover the amount of incentives amounting to Rs.521.58 crore alongwith interest of Rs.188.63 crore.

Sr. No.	Name of the Scheme	No. of cases	(Rupees in crore)		
			Forex involved	Duty foregone	Interest
1.	DBK	1798	354.42	35.02	29.23
2.	EOU/EPZ	1378	774.34	243.48	42.61
3.	DEEC/Adv.Lic	687	416.36	102.19	59.74
4.	VABAL	449	245.78	70.89	23.92
5.	QBAL	149	43.53	13.24	0.92
6.	DEPB	788	338.60	55.58	32.17
7.	EPCG	13	9.60	1.18	0.04
	Total	5262	2182.63	521.58	188.63

In reply to EOU/EPZ cases, Ministry of Commerce have stated that Development Commissioners have been advised to coordinate with RBI and obtain reports of realisation. Since the incentives of direct taxes and indirect taxes are subject to

realisation of export proceeds, their contention that there is no case for recovery of export incentives is not tenable.

Exporter wise analysis showed that almost half of the outstanding forex was on account of 20 firms. These firms account for almost 60 per cent of the duty benefits and half of the due interest.

(Rupees in Crore)						
Sl. No.	Exporters	Commissionerate	Unrealised forex	Duty	Interest	Scheme
1.	J.T.S Technology Ltd	Chennai	261.99	111.79	N.A.	EOU
2.	Wool Worth	Kolkata	156.72	31.35	16.58	EOU
3.	Sabara Impex	Mumbai	92.16	15.92	10.19	DEEC
4.	Viplav Trading	Mumbai	55.62	10.08	8.36	DEEC
5.	Rajindra Brothers	Delhi	53.99	17.99	N.A.	DEEC
6.	Orchid Chemical and Pharmaceuticals	Chennai	50.93	17.42	N.A.	EOU
7.	Harshita Organics	Delhi	48.85	9.77	7.82	DEPB
8.	Square D Software Ltd	Chennai	44.77	11.56	N.A.	EOU
9.	Kanhiya Exports	Kolkata	39.85	8.04	1.25	DEPB
10.	Premier Vinyl	Delhi	35.32	8.83	N.A.	VABAL
11.	Beeta Exports	Delhi	33.99	5.72	4.72	DEPB
12.	Premier Vinyl flooring	Delhi	28.84	9.61	N.A.	QBAL
13.	Fab Worth	Kolkata	25.60	5.07	2.27	EOU
14.	G.R. Magnets	Kolkata	24.56	14.98	22.35	VABAL
15.	S.O. L. Pharmaceuticals	Hyderabad	24.22	13.08	13.31	DEEC
16.	Sahil Trends	Delhi	25.76	6.44	N.A.	VABAL
17.	M.S. Shoes	Delhi	22.08	5.52	N.A.	VABAL
18.	Dr. Reddys Lab.	Hyderabad	16.33	9.11	8.73	DEEC
19.	Shanti Associates	Delhi	14.55	4.85	N.A.	DEEC
20.	Yatin Prints	Delhi	7.15	1.30	0.89	DBK
	Total		1063.28	318.43	96.47	

3.7 Efficacy of Controls

XOS statements being the primary instrument of control any deficiencies in their formulation and transmission is likely to adversely impact the effectiveness of the administrative machinery. Audit findings in this regard are contained in the succeeding paragraphs.

(a) Delay in receipt of XOS Statement

Timing is a critical parameter in any instrument of control. Audit scrutiny of the relevant records of Nodal Custom Houses revealed delays in receipt as under :

Sl. No.	Name of the Commissionerate	Delay in receipt of XOS in Nodal Custom Houses	
		Half yearly period ending	Delay in Months
1.	Delhi	12/99 & 6/2000	1-3
2.	Cochin	12/97 to 6/2000	3-10
3.	Kandla	12/97 to 6/2000	4-6
4.	Bangalore	12/98 to 6/2000	2-5

5.	Kolkata	12/97 to 6/99	1-5
6.	Hyderabad	12/97 to 6/2000	3-4
7.	Mumbai	12/97 to 12/99	1-7
8.	Chennai	12/97 to 6/2000	4-6

It is apparent that XOS statements were not being received in time by the nodal Custom Houses from the Exchange Control Departments of regional offices of the RBI thereby reducing their effectiveness as a control instrument.

(b) Inadequacies in the XOS statement

An instrument of control can be fully effective only if it contains all information necessary to take follow up action. Audit scrutiny of the XOS format & statement revealed the following inadequacies.

(i) There is no provision in the XOS statements to indicate whether the shipping bill was in discharge of an export obligation or if any drawback incentive had been paid. It does not, therefore, create any immediate "Management Information System" (MIS) for the Custom House, leaving it to the initiative of the Customs officers to find out the relevant information. Given the pressure to clear export consignments this fails to get a high priority.

(ii) In a large number of cases, the port of shipment, shipping bill number and GR number, commodity details, date of export are either not mentioned or wrongly mentioned.

(iii) Amount already realised are shown outstanding in XOS statements, while in other cases, outstanding export bills due for inclusion in the XOS were not entered in the XOS. Similarly exports not yet due for inclusion in the XOS statements were found included.

Such deficiencies apart from reducing the utility of the MIS also lead to lesser reliance on them for control.

(c) Non maintenance of records in Custom Houses

On receiving the XOS statement from the RBI, the Nodal Custom House is required to forward the XOS statements to the Custom authorities at the port of export. A monthly report is also required to be sent to the Ministry.

Customs Houses are required to maintain a Master Register containing, name of licencees, Licence No and date, Licensing authority, Date of first import, Date of expiry of export obligation, Details of Telegraphic Release Advice (TRA) issued and details of notices issued under para 5 (2) of circular No.3/92 dated 1 June 1992. They are also required to maintain a record of Bonds and Bank Guarantee executed in terms of circular No.45/96-Cus dated 28 August 1996 for protecting revenue.

Scrutiny of records of eight commissionerates revealed that :

a) No monthly return is being submitted to the Ministry.

b) Master Registers are not being properly maintained to watch realisation of export proceeds, as the full particulars were not incorporated in the relevant columns of the registers.

c) Even though shipping bills are being processed through the EDI system, the Custom Houses do not correlate and analyse the XOS with reference to the data available in EDI. Only in Delhi Commissionerate further payment of drawback are being blocked in the EDI system for exporters mentioned in XOS. The EDI environment has not been utilised for effectively monitoring realisation of export proceeds and linking it with the incentives availed.

(d) Lack of co-ordination

Even though DGFT is the licensing authority for export incentive schemes, neither the RBI nor the Nodal Customs House sent the XOS to them. Inadequate follow up action also results from the duality of responsibility between Customs authorities and the DGFT. While the Bank Guarantee/Legal Undertaking/Bonds are executed by the exporters with the Customs authorities, their redemption/release is authorised by the DGFT. This is generally done based on proof of physical exports without waiting for Bank Certificate of Exchange Realisation. Thus, even though the Customs authorities get XOS statements they consider the responsibility to take action only if drawback has been paid. The control over duty benefits under other export incentive schemes remains ambiguous and extremely weak.

(e) Failure to issue show cause notices

Scrutiny of records revealed that except Delhi & Cochin no other Commissionerate issued show cause notice to the exporters listed in the XOS to either furnish proof of receipt of export proceeds or a waiver certificate from the Reserve Bank of India, or alternatively proof of extension if any, granted by Reserve Bank of India. On the basis of XOS for 12/99, Delhi Commissionerate issued 2200 show cause notices in respect of drawback cases, out of a total of 55,816 cases outstanding. Of this 248 were received back undelivered. Only in 62 cases further payment of drawback was blocked in the EDI system.

3.8 Write off of Unrealised Export Bills

As per RBI Exchange Control Manual, in cases where the exporter has not been able to realise the outstanding export dues despite his best efforts, he may approach the authorised dealer, who had handled the relevant shipping documents, with appropriate supporting documentary evidence with a request to write off the unrealised portion. Authorised dealer may accede to such request (with the approval of its controlling office) subject to the following conditions :

a) Relevant amount remained outstanding for 360 days or more.

- b) The aggregate amount of write off during a calendar year does not exceed five per cent of total export proceeds realised by the exporter through the medium of that branch during the previous calendar year.
- c) Satisfactory documentary evidence is furnished in support of the fact that the exporter made all efforts to realise the dues but has been unsuccessful due to reasons beyond his control
- d) The exporter has surrendered proportionate export incentives availed in respect of the relative shipments.

Audit scrutiny of write off orders issued by the Reserve Bank of India revealed that nine regional offices of RBI/AD Banks allowed write off of unrealised bills of export for Rs.229.61 crore in 2406 cases during 1995 to 2001. Rather than ensure that write off was granted only after export incentives were surrendered these orders were endorsed to the Custom Houses/DGFT. None of these offices could confirm if the incentives availed had been recovered.

Some major irregularities that come to notice were:

In Cochin Commissionerate, an AD bank allowed write off of Rs.6.77 crore in 1998 against the foreign exchange realisation of Rs.46.46 crore in the relevant previous year. The write off allowed by the AD bank was in contravention of condition No. (i) (b) of para 6c.14 as the percentage of write off comes to 14.57 percent instead of 5 percent as provided.

In Ahmedabad Commissionerate an exporter was allowed write off of Rs.52.36 crore during June 2000 in respect of exports made under DEPB scheme during 1997-1999 against 349 shipping bills. The write off was granted without confirmation regarding surrender of DEPB credit of Rs.3.35 crore alongwith interest of Rs.2.20 crore.

3.9 Extension of time granted by RBI

As per the RBI Foreign Exchange Control Manual, short extension could be granted by RBI, for realisation of foreign exchange if it is satisfied that the exporter will be able to realise proceeds in the extended period. The manual stipulates that extension will not ordinarily be granted unless the Reserve Bank is satisfied that the exporter is in no way directly or indirectly responsible for the delay in realisation of proceeds.

Audit scrutiny of data of extensions furnished by the RBI/XOS statements revealed 873 cases wherein the extensions were granted by the RBI and export proceeds of Rs.199 crore were pending realisation for upto twenty two years.

(Rupees in crore)		
RBI's regional office	No. of cases	Forex involved
Mumbai	5	0.46
Cochin	693	185.08
Delhi	175	13.64
Total	873	199.18

Commissionerate wise details of audit findings are narrated below:

(i) In five cases of Mumbai Commissionerate, exports were made between January 1978 to November 1983. In two cases realisation was pending without extension orders since 1992 and 1996 respectively. Such long extensions raise serious doubts about the possibility of realisation.

(ii) In Delhi and Cochin Commissionerates extensions were granted for a maximum period upto five years but the exporters had not been able to realise the export proceeds even in the extended periods. In two cases in Delhi the extension period had expired in February and October 1997 but the proceeds were pending realisation till June 2000 without a valid extension order covering the period 1997-2000. In 45 cases extensions had been applied for exports made between 1991 and 1999 but realisation were pending even though no approval was accorded by RBI till June 2000.

Several cases where realisation were pending without relevant extension orders from the RBI and remarks such as extension applied for, extension form submitted ,extension applied late find mention in the XOS statements. This clearly indicates that rules have been flouted since all cases of unrealised proceeds within the prescribed period should be covered by valid extension orders.

3.10 Conclusion

Despite the primacy accorded to realisation of foreign exchange as the one and only yardstick for the efficacy of export incentives, the Government has not able to devise an appropriate institutional framework to ensure monitoring and follow up action in cases of default. The control instrument of XOS generated by RBI has failed to contribute significantly in this regard. There is a need to utilise the full potential of IT/EDI environment to facilitate an early generation of export incentive related cases of non realisation and effective follow up action to ensure that export incentives are not misused.

CHAPTER 4 : SHORT LEVY DUE TO INCORRECT CLASSIFICATION

Some illustrative cases of short levy of customs duty arising from incorrect classification of goods are briefly narrated below :

4.1 Bedding, mattresses etc.

Articles of bedding and similar furnishings stuffed with any material merit classification under Customs Tariff heading 94.04.

Five consignments of 'Sleep pad, down comforter and pillows' imported by M/s. Frontier Trading and M/s. Indkar Mega Byte (P) Ltd. during October 1999 and August 2000 through Sea Customs Commissionerate, Mumbai were declared as Magnetic acupressure treatment instruments and classified under Customs heading 9019.10 (Mechano therapy appliances). The invoices indicate that these goods were items of bedding, hence meriting classification under heading 94.04. The incorrect classification resulted in short levy of duty amounting to Rs.3.13 crore.

On being pointed out (between February to September 2000), the department stated (December 2000) that show cause notice has been served in four consignments.

Reply in respect of one consignment is awaited (December 2001).

4.2 Electrical/electronic machinery and equipments

Electrical machines and apparatus having individual function are classifiable under chapter sub-heading 8543.89 of Customs Tariff Act.

17 consignments of 'Crystal oscillators' imported by M/s. ITI and two others through Air Cargo Complex, Bangalore between August 1996 to February 1997 were assessed under chapter sub heading 8543.20 treating them as signal generators. A signal generator is an electrical test equipment that delivers a sinusoidal output of accurately calibrated frequency (anywhere from audio to microwave), while an oscillator is an electronic circuit that converts energy from a direct current source into a periodically varying electrical output. Thus 'Crystal oscillators' with individual functions merit classification under heading 8543.89. The incorrect classification resulted in short levy of duty of Rs.25.03 lakh.

On being pointed out (between August 1997 to November 2000), the department admitted the objection (March 2000) and recovered duty to the extent of Rs.15.30 lakh in respect of six consignments. Recovery particulars of the balance amount is awaited (December 2001).

4.3 Measuring instruments

Tribunal in the case of M/s. Searle (India) Ltd. Vs. Collector of Customs, Mumbai {1996(87) ELT 640 (Tribunal)} held that software supplied alongwith the equipment is to be classified with the equipment itself.

'Software' intended for use with measuring instrument of Chapter heading 9030.40 imported by M/s. ARM Ltd., Hyderabad (July 1996) through a major Air Customs were classified under heading 8524 as magnetic tapes. In terms of the above decision of the Tribunal, software was to be classified with the above measuring instruments under sub heading 9030.40. The incorrect classification resulted in short levy of duty of Rs.21.78 lakh.

On being pointed out (September 1997), the department reported (May 2001) recovery of 50 per cent of duty (Rs.10.89 lakh) under Kar Vivad Samadhan Scheme.

Since the SCN was issued on 19 September 1997 and the declaration under KVS Scheme was filed on 30 December 1998, failure of the department to complete the adjudication proceedings early in light of CEGAT decision enabled the importer to discharge his liabilities by paying only half his liability.

4.4 Men's trousers

Trousers made of cotton are classifiable under Chapter sub heading 6203.42.

9547 pieces of men's trousers made of 100 per cent cotton imported (August 2000) by M/s. Indian Rayon and Industries Ltd. through the Inland Container Depot, Bangalore were assessed under chapter sub heading 6103.42. The incorrect classification resulted in short levy of duty to the extent of Rs.10.95 lakh.

On this being pointed out (November 2000) the Ministry reported (July 2001) recovery of the short levied amount.

4.5 Machinery and mechanical appliances

'Spares for 'Cement making machinery' are classifiable under Customs/Central Excise Tariff heading 8479.90.

A consignment of 'Spares for cement making machinery' was imported by M/s. Larsen Tubro Ltd. (October 2000) through Air Customs Commissionerate, Mumbai by an importer was assessed under Customs/Central Excise Tariff heading 8471.90 resulting in short levy of duty amounting to Rs.9.03 lakh due to incorrect classification.

On being pointed out (December 2000), the department reported (March 2001) the recovery of the short levied amount.

4.6 Other cases

Seven other cases of incorrect classification of goods imported by 11 importers involving short levy of duty of Rs.28.96 lakh was reported to the Ministry. Out of these the department admitted two cases involving Rs.12.41 lakh and reported recovery of Rs.12.41 lakh as per details below:

(Rupees in lakh)

Sl. No.	Details of product	No. of importers	Heading where classifiable	Heading where classified	Amount short levied	Amount admitted	Amount recovered
1.	Film processors	1	90.10	9018.90 9022.14	6.61	6.61	6.61
2.	Sensors, valves and nozels	1	9032.89 8481.80	8411.99	5.80	5.80	5.80
3.	Routers	5	8517.50	84.73	5.39	--	--
4.	Cooling pads	1	4823.90	4808.90	4.99	--	--
5.	Insulated cable	1	85.44	9015.80	2.48	--	--
6.	Line test card	1	9030.40	8517.90	2.15	--	--
7.	Oil seals	1	8708.00	8488.90	1.54	--	--
	Total	11			28.96	12.41	12.41

CHAPTER 5 : SHORT LEVY DUE TO INCORRECT GRANT OF EXEMPTION

Short levy of duties aggregating Rs.49.31 lakh on account of incorrect grant of exemption were pointed out to the Ministry. Some illustrative cases are narrated below:

5.1 Incorrect application of exemption notification

(a) Customs notification No.51/96-Cus. dated 23 July 1996 exempts research equipments imported by Public Funded and non commercial research institute or university/Indian Institute of Technology (IIT) etc.

'Computer software and protocol analysers' imported by M/s. Mekaster Telematics Ltd., New Delhi in July 1999 was assessed allowing the benefit of notification dated 23 July 1996. The importer was not covered under the notification and the incorrect grant of exemption resulted in short levy of duty of Rs.11.23 lakh.

On being pointed out (November 1999), the department stated (February 2000) that the case was adjudicated confiscating the impugned goods assessed at Rs.24.75 lakh, confirming the duty of Rs.11.23 lakh and imposing penalty of Rs.10 lakh.

(b) Initial charge of all types of 'Catalysts' required for setting up crude petroleum refinery are chargeable to concessional rate of duty under Customs notification No.20/99 dated 28 February 1999.

A consignment of 'ZSM-5 catalyst additive' imported (September 1999) by M/s. Hindustan Petroleum Corporation Ltd. through a major Custom House was assessed allowing the benefits of the notification dated 28 February 1999. As the importer was an established petroleum refinery and the goods were not utilised for setting up a new crude petroleum refinery, the exemption amounting to Rs.8.09 lakh allowed was incorrect and recoverable from the importer.

On being pointed out (March/December 1997), the department/Ministry recovered the amount (January 2001).

5.2 Other cases

In six other cases, objections were issued to the Ministry on incorrect grant of exemption involving short levy of Rs.29.99 lakh. The department admitted the objection in one case and reported recovery of Rs.5.61 lakh as per table below :

(Rupees in lakh)				
Sl. No.	Product on which exemption granted	Amount short levied	Amount admitted	Amount recovered
1.	Video equipments and video mixers	6.66	--	--
2.	Components for relays	5.61	5.61	5.61
3.	Transceiver equipments	5.56	--	--
4.	Ink Ges-12	4.43	--	--
5.	Rafting equipments and spare parts	3.99	--	--
6.	Cobalt modified gamma iron oxide	3.74	--	--
	Total	29.99	5.61	5.61

CHAPTER 6 : SHORT LEVY DUE TO UNDERVALUATION

6.1 Incorrect adoption of assessable value

As per Section 14 of the Customs Act 1962 a duty of customs is chargeable on any goods by reference to their value. The value of such goods shall be deemed to be the price at which such or like goods are ordinarily sold, or offered for sale, for delivery at the time and place of importation or exportation in the course of international trade where price is the sole consideration for the sale or offer for sale. Rule 10 A of Customs Valuation Rules 1988 prescribes that when the proper officer has reason to doubt the truth or accuracy of the value declared in relation to any imported goods, he may ask the importer of such goods to furnish further information including documents or other evidence and if, after receiving such further information, the proper officer still has reasonable doubt about the truth or accuracy of the value so declared, it shall be deemed that the value of such imported goods cannot be determined under the provisions of sub rule (1) of rule 4.

Audit scrutiny revealed that in 15 consignments of Metaphynylene diamine, Tobias acid, Para nitro toluene, Lauric acid, Polycarbonate resin, and 2 Ethyl hexyl acrylate imported by M/s. Gayatri Intermediates and eight others through a major Sea Commissioneate during December 1999 to August 2000 from USA, UK, China, Indonesia and Malaysia, the invoice value was 31 per cent to 83 per cent lower than the prices indicated in the 'Chemical Market Reporter' (CMR) for the corresponding period. As such the proper officer should have called for further information under rule 10A of the Customs Valuation Rules 1988. Failure to do so resulted in short levy of duty of Rs.2.75 crore.

On being pointed out (July and November 2000) the department stated (December 2000/March 2001) that show cause notice for Rs.13.70 lakh has been issued in respect of one consignment (Lauric acid). For the other consignments the department stated that the prices quoted in the Chemical weekly could not take precedence over the transaction value, which reflected the negotiated price and that specific provisions of Section 14 of the Customs Act and Customs Valuation Rules formed the statutory basis for assessment.

Reply of the department is not tenable because the CMR records average prices at which transactions take place. Discounts ranging from 31 to 83 per cent appear incredible. Further the valuation rules, cast a responsibility on the importer to satisfy the authorities that the declared transaction price entered into was in the normal course of international trade and was not hit by any one of the conditions as set out under sub rule (2) of rule 4.

6.2 Incorrect adoption of rates in assessment of goods sold on high seas

As per Rule 3 of Customs Valuation (Determination of Price of Imported Goods) Rule 1988, the value of imported goods shall be the transaction value. The Ministry of Finance, Department of Revenue had clarified (November 1988) that in respect of imported goods sold on high seas by the original buyer, the relevant transaction for determination of value is the one that takes place on the high seas and the last buyer should be regarded as the importer. In Board's letter dated 20 June 1990, it was mentioned that adopting the sale price at high seas for the purpose of valuation is within the provisions of the GATT valuation code, and the sale price of goods sold on high seas constituted transaction value for the purpose of valuation of imported goods.

Two consignments of 'protection relay' for control panels imported by M/s. Reliance Petroleum Ltd. through Air Customs Commissionerate, Mumbai during January and February 2000 were sold on high sea sale basis to another buyer for total value of Rs.62.94 lakh.

The department assessed the goods to duty, based on the total invoice price instead of the high sea sale price resulting in short levy of duty of Rs.2.70 lakh.

This was communicated to department in May 2000. Reply is awaited (December 2001).

CHAPTER 7 : NON LEVY/SHORT LEVY OF ADDITIONAL DUTY

As per section 3 of the Customs Tariff Act, 1975, any article which is imported into India shall also be liable to 'Additional duty' equal to the Central Excise duty for the time being leviable on a like article produced in India.

Short levy of additional duties amounting to Rs.3.63 crore were reported to the Ministry in six cases, as narrated below:

7.1 Non levy of additional excise duty

Notification Nos.30/97-Cus. dated 1 April 1997, 48/99-Cus. dated 29 April 1999 and 51/2000-Cus. dated 27 April 2000 exempts raw materials from levy of customs and additional duty of excise under Actual User Duty Exemption Entitlement Certificate (DEEC) Scheme. However, the additional duty of excise leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, is not covered under these exemption notifications.

Several consignments of cotton fabrics, man made fabrics and Nylon Tyre cords fabrics imported by M/s. Wipro Ltd. and others during December 1999 to September 2000 under the DEEC Scheme, were cleared without levy of customs and additional excise duty. However, additional duty of excise leviable under Additional Duties of Excise (Goods of Special Importance) Act, 1957 was not levied. This resulted in short levy of additional duty of excise amounting to Rs.1.77 crore.

On being pointed out (May 2000 to February 2001), the department justified the non levy of the additional duty of excise on the grounds that Section 3 of the Customs Tariff Act, 1975, covered more than one central excise duty. They argued that while sub section 1 dealt with the normal countervailing duty, sub section 3 of Section 3 dealt with various central excise duties levied under various laws for the time being in force. The department further stated that notwithstanding the levy of excise duty under various notifications, sub section 3 of Section 3 covered all such notifications and they were not leviable when the exemption was given under Section 3 of the Customs Tariff Act, 1975. The Additional Duties of Excise (Goods of Special Importance) Act, 1957, was also, therefore, covered by sub section 3 of Section 3 of the Customs Tariff Act, 1975.

The reply of the department is not tenable in view of the fact that "excise duty" and "additional duty of excise (Goods of Special Importance Act)" are separate entities and levied under two different Acts, the contention of the department that a Customs notification issued exempting the subject goods from the levy of additional duty leviable under Section 3 of the Customs Tariff Act, 1975 would automatically exempt

the levy of additional excise duty leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, is not correct.

It was also judicially held in the case of Gokak Mills Vs. Commissioner of Central Excise {2001 (129) ELT 523 (T) Bangalore} that where a notification granting exemption was issued under a particular rule without reference to any other statute making the provisions of levy and collection of Special, Auxiliary or any other kind of excise duty levied under such statute, the exemption must be read as limited to the duty of excise payable under the Central Excises and Salt Act, 1944 and cannot cover such Special, Auxiliary or other kind of duty of excise.

7.2 Non levy of additional duty due to incorrect grant of exemption

Sewing machines other those with in built motor are exempted from Central Excise duty vide notifications Nos.5/99 dated 28 February 1999 and 6/2000 dated 1 March 2000.

23 consignments of Industrial sewing machines imported by M/s. India Agencies and M/s.Natural Textiles Ltd., Bangalore (December 1999 to June 2000) through an inland container depot and Air cargo complex were assessed by extending benefit of Central Excise notification Nos.5/99 and 6/2000.

Since the imported machines had in built motors which were separately packed only for transportation convenience, the goods were not eligible for the exemption *ibid*. The incorrect application of the exemption notification resulted in short levy of additional duty of Rs.1.46 crore.

On being pointed out (April to September 2000) the department/Ministry stated (December 2000/October 2001) that to treat industrial sewing machines as one with in built motors, the motor should be within/attached directly to the sewing machine head or drive shaft, without the need of a pulley and belt mechanism.

Department's contention is not tenable in the light of the CEGAT judgement in the case of Collector Vs. Alkaw Overseas {1999 (106) ELT 165(T)} wherein it was held that 'Motor clutch motor' used in a stitching machine is an integral part of such machine.

7.3 Short levy of additional duty due to incorrect application of rate

Colour television sets of screen size 29 inches (73.66 cms) attracts additional duty at the rate of Rs.11,200 per set in terms of Central Excise notification No.5/99 dated 28 February 1999.

A consignment consisting of 342 pieces of colour television sets of screen size 29 inches imported by M/s. Videocon International Ltd. through Sea Customs Commissionerate, Mumbai (March to December 1999) were assessed to additional duty at a lower rate resulting in short levy of additional duty of Rs.27.84 lakh.

On being pointed out (September 1999), the department admitted the mistake and reported recovery of Rs.8.14 lakh in respect of the 100 sets (July 2000). Recovery particulars in respect of the remaining cases are awaited (December 2001).

7.4 Other cases

In three other cases, incorrect grant of exemption and incorrect classification resulted in short levy of additional duty of Rs.11.56 lakh, of which one case involving Rs.4.43 lakh was admitted and recovery made by the department, as per details below:

(Rupees in lakh)					
Sl. No.	Details of product	Irregularity	Amount short levied	Amount admitted	Amount recovered
1.	Nylon tyre card fabrics	Exemption	4.66	--	--
2.	Pouches	Misclassification	4.43	4.43	4.43
3.	Upholstery fabrics	Misclassification	2.47	--	--
	Total		11.56	4.43	4.43

CHAPTER 8 : NON LEVY OF SPECIAL ADDITIONAL DUTY OF CUSTOMS

As per Section 3A of the Customs Tariff Act, 1975, inserted with effect from 2 June 1998, any article which is imported into India shall be liable to special additional duty of customs (SAD), which shall be levied at a rate specified by the Government having regard to sales tax and local levies for the time being leviable on the article on its sale or purchase in India

8.1 Misuse of Exemption Orders

a) Imports for trading

As per Customs notification Nos.29/98 dated 2 June 1998 and 34/98 dated 13 June 1998, special additional duty (SAD) was exempted for the goods imported for trading purpose.

99 consignments of dutiable goods imported by M/s. Photo King and others through Mumbai Commissionerate during 1998-99 and 1999-2000 were exempted from levy of special additional duty of customs in terms of notification ibid on the importer's declaration that these were imported for trading purpose. However, the importers also furnished declarations of their intention to avail Modvat credit under Rule 57 of Central Excise Rules 1944 which is applicable to goods meant for further use in the manufacture of finished goods. As such goods were not meant for trading purposes. The special additional duty of Rs.78 lakh exempted in these cases was therefore incorrect.

On being pointed out (December 1998 to March 2000), the department reported (May/October 1999) recovery of Rs.4.87 lakh in eight cases and confirmed demand of Rs.35 lakh in 37 cases. Reply in remaining cases is awaited (December 2001).

b) Imports for sale as such

In terms of Customs notification No.22/99 dated 28 February 1999, exemption was granted from levy of special additional duty of customs to vegetable oils of edible grade imported for sale as such or for manufacture of oil commonly known as 'Vanaspati'.

Two consignments of 'Degummed soyabean oil' imported by M/s. Gem Refineries Pvt. Ltd. through a major Custom Commissionerate in April 1999 were allowed exemption from the SAD in terms of the notification of 28 February 1999. The imported goods were subsequently used for manufacture of refined soyabean oil and as such were not eligible for duty exemption of Rs.6.02 lakh.

On being pointed out (October 2000), the department stated (August 2001) that a show cause notice has been issued. Recovery particulars are awaited (December 2001).

8.2 Inadmissible benefit of an exemption notification

(a) Notification No.29/98-Cus. dated 2 June 1998 exempts goods specified in the table annexed to the notification from levy of SAD.

A consignment of 'Cylinder mould VAT made water marked bank note paper' (chapter 48) imported through a major Customs House by M/s. Bhartiya Reserve Bank Note Mudran Ltd. in July 1998 under an adhoc exemption order No.41/98 dated 27 April 1998 exempting whole of customs duty and additional duty of customs leviable thereon was allowed to be cleared without payment of SAD amounting to Rs.14.92 lakh. The benefit of exemption from the levy of SAD under the notification dated 2 June 1998 issued under sub section 1 of Section 25 of the Customs Act, 1962 could not be extended to the imported goods which were covered by an adhoc exemption issued under sub section 2 of the Customs Act, 1962. The exemption of SAD was therefore incorrect.

On being pointed out (December 1998/January 2000), the department (January 2000) stated that since both BCD and Additional duty were exempted, SAD was also exempted with reference to the notification No.29/98-Cus.

However, subsequent verification revealed that apart from recovering the short levy pointed out by audit, the department reviewed subsequent clearances and recovered Rs.63.26 lakh (including Rs.14.92 lakh pointed out by audit) from the importer.

(b) Customs notification No.29/98 dated 2 June 1998 granted exemption from levy of special additional duty of customs (SAD) to all goods which were exempted from the duty of customs and additional duty of customs. The notification was superseded by another notification on 13 June 1998 to include goods specified with 'Free rates' in the Customs Tariff and also exempted from the additional duty. Goods specified with 'Free rates of customs duty' in the customs tariff and which were not excisable in the Central Excise Tariff for reasons other than exemption, were exempted from levy of special additional duty vide notification No.56/98-Cus. dated 1 August 1998.

Eight consignments of 'Polypropylene carpets, Electric lamps and Tinplate sheets etc.' imported by M/s. Bengal Carpet Pvt. Ltd. and seven others through Kolkata Commissionerate between 2 June 1998 and 30 June 1999 were granted exemption from SAD though the goods were not exempted under the above notifications. The incorrect grant of exemption from SAD resulted in non levy of Rs.4.88 lakh.

On being pointed out (between January 1999 and March 2000), the department realised Rs.0.67 lakh (October 1999) in respect of one consignment, in respect of another consignment stated (April 2000) that the date of budget changes would be effective from 3 June 1998 onwards. Replies to the objection regarding other six consignments were awaited (April 2001).

The reply of the department is not tenable since the budget notification was effective from the midnight of 1-2 June 1998 unless specifically indicated otherwise.

CHAPTER 9 : DUTY EXEMPTION SCHEME

9.1 Non fulfilment of export obligation

(a) EOU Scheme

Customs notification No.13/81 dated 9 February 1981 as amended and the Exim policy 1992-97 granted exemption from customs duty for the goods imported by any 100 per cent export oriented undertaking (EOU) for the manufacture and export of articles, subject to fulfilment of specified export obligation and value addition. In the event of failure to fulfil the export obligation/value addition, duty forgone was recoverable together with interest.

(i) M/s. ABN Granite, a 100 percent EOU in Cochin was permitted (July 1991) to manufacture and export polished granite slabs/tiles. Between 1993 and 1996 the unit imported duty free capital goods, spares and consumable valued at Rs.13.05 crore. The unit started commercial production in July 1995 and exported goods worth Rs.10.15 lakh upto 31 March 1997 against the export obligation of Rs.149.67 crore prescribed for five years. The unit became defunct in April 1997. The case was referred to the Director General of Foreign Trade, New Delhi in February 1998 by the Development Commissioner for penal action against the non-fulfilment of export obligation. However, no action was initiated by Customs department to recover the duty forgone (Rs.15.44 crore) and interest (29.93 crore) upto March 2001.

On being pointed out (January 2000), the Ministry stated (August 2001) that the case has since been adjudicated ordering confiscation of imported goods valued at Rs.13.05 crore with an option to redeem the goods on payment of fine of Rs.1.30 crore. The customs duty forgone alongwith interest at the rate of 24 per cent has also been demanded. A penalty of Rs.10 lakh has also been imposed on the unit. An appeal filed by the unit is pending before the Tribunal.

(ii) M/s. Solid Carbide Tools Pvt. Ltd., a 100 per cent EOU unit in Mumbai licensed in 1991 was issued a Letter of Permission (LOP) with value addition of 45.34 per cent. However, the unit could achieve only 33 per cent value addition. The unit is therefore liable to pay Rs.10.67 crore on account of the duty forgone and interest of Rs.15.34 crore.

On being pointed out, the Ministry replied (September 2001) that action of EOU/EPZ units are monitored as per the minimum NFEP/value addition prescribed in the Exim Policy and not as per the value addition indicated in the LOI/LOP.

The reply of the Ministry is not tenable. As per para 98 of the Exim Policy 1992-97, the unit is bound to discharge export obligation as specified in the LOI/LOP. Para 179 of Handbook of Procedures Vol.I 1992-97 clearly provides that the value addition

specified in the Exim Policy indicate only the minimum level, the Board of Approval being competent prescribed higher percentages where warranted.

(b) EPZ Scheme

In terms of para 98 of Exim policy read with Para 178 of Handbook of Procedures Vol.I, 1992-97, an EOU is required to execute a legal undertaking with the Development Commissioner in the prescribed form given in Appendix XXXI to Handbook of Procedures, Vol.I, 1992-97. In the event of failure to fulfil the export obligation, the unit is liable to pay:

- i) the amount of customs duty that would be leviable at the relevant time on the items of plant, machinery, equipment, raw materials, components and consumables, imported duty free by the unit,
- ii) excise duty leviable on the indigenous goods, purchased duty free by the unit,
- iii) interest at 24 per cent on the duty of customs and excise forgone from the date of import/supply to the date of payment of duty and
- iv) the liquidated damages as determined by the Development Commissioner.

In addition, as per Section 11(2) of the Foreign Trade (Development and Regulation) Act, 1992, penalty is also leviable.

(i) M/s. Balmer Lawrie Frieght Containers Ltd. located in Export Processing Zone, Chennai completed five years of operation in August 2000 but achieved value addition of 5.89 per cent as against the 27 per cent prescribed. Furthermore, the FOB value of exports realised was Rs.201.67 crore as against the prescribed FOB of Rs.516.03 crore resulting in shortfall of Rs.314.36 crore. The unit is therefore liable to pay customs and central excise duty of Rs.97.63 crore alongwith interest (upto March 2001) of Rs.102.24 crore on the goods imported and procured indigenously.

On being pointed out (January and May 2001), the Ministry stated (November 2001) that the unit achieved the export obligation of Rs.201.67 crore and 21 per cent NFEP as against the minimum export obligation of Rs.70 crore (five times the value of capital goods) and 20 per cent NFEP as per the Exim Policy.

The reply of the Ministry is not tenable because:

a) As per para 98 of the Exim Policy 1992-97, the unit is bound to discharge export obligation as specified in the LOP/LOA. Para 179 of the Handbook of Procedures Vol.I 1992-97 clearly provides that the value addition specified in the Exim Policy indicate only the minimum level, the Board of Approval being competent prescribe higher percentages where warranted.

b) While calculating NFEP/EO, the department adopted only the actual consumption of raw material. Since the unit had completed the five years permitted for

discharging export obligation, the entire value of raw material needs to be considered to account for the entire outgo of foreign exchange.

c) Moreover, the department accepted the unit's figure of Rs.4.81 crore outflow of the foreign exchange on travel, dividends, interest etc. as against Rs.8.61 crore reflected in the Audited Financial Account.

(ii) M/s. Gemplus Jewellery India (P) Ltd., a unit in Santa Cruz Electronics Export Processing Zone (SEEPZ) which had completed five years of commercial production in August 1997 could achieve value addition of 10.72 per cent as against 15.63 per cent prescribed. The FOB value of exports realised was Rs.210.62 crore as against prescribed FOB of Rs.232 crore. The unit is therefore liable to pay customs duty and Central Excise duty of Rs.137.27 crore alongwith interest of Rs.103.70 crore (upto March 2001) on the goods imported and procured indigenously.

On being pointed out (February 2001) the Ministry stated (November 2001) that the unit is required to achieve minimum export obligation and NFEP prescribed in the Exim Policy and the unit has achieved export obligation and NFEP as per the norms.

The reply of the Ministry is not tenable. As per para 98 of the Exim Policy 1992-97, the unit is bound to discharge export obligation as specified in the LOI/LOP. Para 179 of Handbook of Procedures Vol.I 1992-97 clearly provides that the value addition specified in the Exim Policy indicate only the minimum level, the Board of Approval being competent prescribed higher percentages where warranted.

(iii) M/s. Intimate Apparels Pvt. Ltd., in Cochin EPZ was permitted in July 1995 to import duty free capital goods and raw materials against manufacture and export of six lakh pieces of readymade garments valuing Rs.20.69 crore. The unit imported capital goods and raw materials valuing Rs.0.92 crore and Rs.1.40 crore respectively. The unit could export 3.19 lakh pieces valuing Rs.2.70 crore within the prescribed period. As the unit failed to achieve the export obligation it is liable to pay duty saved amounting to Rs.1.79 crore and interest of Rs.1.97 crore (upto March 2001).

On being pointed out (October 2000), the Ministry stated (November 2001) that the unit achieved 74.35 per cent NFEP as against prescribed 41 per cent. The reply of the Ministry is not acceptable to audit as the Ministry while calculating NFEP consider exports of Rs.3.63 crore from another unit and exports of Rs.1.65 crore for which the foreign exchange was not realised.

(iv) M/s. Abad Exim Pvt. Ltd. in Cochin EPZ was permitted (October 1992) to manufacture and export marine products with an export obligation of Rs.54.26 crore. The unit was also to fulfil the export obligation of Rs.47.25 crore of another unit approved in February 1992, whose assets were purchased by this unit. Against the total export obligation for the first five years of Rs.101.51 crore (upto November 1997), the unit could export goods worth Rs.83.73 crore resulting in a shortfall in export obligation amounting to Rs.17.78 crore. Further as against prescribed NFEP of 92 per cent the unit could achieve only 85.52 per cent. Duty forgone on the goods imported

and procured indigenously amounting to Rs.2.86 crore and interest amounting to Rs.3.82 crore (upto March 2001) were therefore recoverable.

On being pointed out (January 2000), the department replied (August 2000) that the NFEP achievement of the units was 86 per cent as against the minimum requirement of only 20 per cent as per Industrial Norms. The reply of the department is not tenable as the minimum NFEP of 92 per cent was prescribed by the Development Commissioner vide letter dated 13 March 1995. As such the unit is liable to pay duty forgone together with interest.

(v) M/s. Frozen Foods Ltd. in Cochin EPZ was permitted (February 1994) to manufacture and export snacks etc. with an export obligation of Rs.19.91 crore (3975 MTs) fixed for five years, against which the unit could achieve export obligation of Rs.1.09 crore upto August 1998 and NFEP of minus (-) 11.82 per cent as against 36 per cent. The unit ceased to operate from 1999-2000. As the unit could not achieve the prescribed export obligation and NFEP, duty foregone on the goods imported/procured amounting to Rs.71.44 lakh and interest amounting to Rs.86.79 lakh (upto March 2001) were recoverable.

On being pointed out (July 1999), the Ministry of Commerce stated (September 2001) that action was initiated to recover the duty/interest.

(vi) M/s. Intech International Ltd. in Cochin EPZ had to fulfill export obligation of 30 lakh pieces of oscillators and amplifiers within 5 years. The value addition fixed was at 21.77 per cent. The unit commenced commercial production in June 1997. Against the prescribed export obligation, the unit could export only 15 thousand pieces achieving value addition of minus (-) 326 per cent upto September 1998. Thereafter it ceased to operate.

The duty exempted on the imported/indigenous goods amounting to Rs.1.13 crore alongwith interest of Rs.1.08 crore (upto March 2001) was therefore recoverable from the unit.

On being pointed out (June 2000), the Ministry stated (September 2001) that show cause notice had been issued for non fulfillment of export obligation.

(vii) M/s. MAK Games and Musical equipments Ltd. in Cochin EPZ was permitted (March 1993) to manufacture and export Rs.1.50 lakh bows for playing stringed musical instruments within 5 years. The NFEP was fixed at 35.32 per cent. The unit which completed five years of commercial production in March 2000 could export only 0.27 lakh bows and achieve value addition of 28.48 per cent. The Customs and Central Excise duty exempted on the imports/indigenous goods amounting to Rs.53.91 lakh alongwith interest of Rs.68.54 lakh upto March 2001 was therefore recoverable from the unit.

On being pointed out (February 2000) the Ministry (Commerce) stated (September 2001) that action against the unit is under process.

(c) EPCG Scheme

(i) Nil exports

In terms of para 38 of the Exim Policy 1992-97 read with para 106 of the Handbook of Procedures 1992-97, an EPCG licensee is permitted to import 'capital goods' at concessional rate of customs duty subject to fulfilment of prescribed export obligation within the stipulated period. In the event of failure to fulfil the export obligation, the licensee is liable to pay amount of customs duty saved plus interest thereon.

Five EPCG licences were issued by the licensing authority at Mumbai and Bangalore between December 1993 and September 1996 for import of capital goods valuing Rs.11.26 crore at concessional rate of duty against prescribed export obligation of Rs.49.06 crore. Against the import of goods worth Rs.11.14 crore, the licensees failed to export any goods till the period of export obligation was over. As the units failed to fulfil export obligation, they are liable to pay duty forgone amounting to Rs.3.32 crore plus interest of Rs.3.53 crore (upto March 2001).

On being pointed out (October 1999 to February 2000), the Ministry reported (October 2001) recovery of Rs.54.70 lakh in one case. The licensing authority at Bangalore reported (March 2001) recovery of Rs.1.13 crore in two cases and that for the remaining cases recovery proceedings have been initiated.

(ii) Partial exports

In terms of para 106 of Hand Book of Procedures 1992-97 read with para 5 of notification No.110/95-Cus. dated 5 June 1995, if an importer fails to discharge a minimum of 25 per cent of the export obligation prescribed for any particular year, for three consecutive years, he shall be liable to pay forthwith the whole of the duty of customs leviable on the goods imported but for the exemption contained in the notification together with interest at the rate of 24 per cent per annum from the date of clearance of the goods.

Three EPCG licences were issued by a licensing authority at Delhi, Bangalore and Mumbai between August 1993 to October 1995 for a CIF value of Rs.9.82 crore with an obligation to export Rs.47.47 crore, to be completed within a period of 5 years from the date of issue of licence.

The licensees failed to fulfil prescribed export obligation and were, therefore, liable to pay the differential duty of Rs.2.34 crore alongwith interest of Rs.3.34 crore (upto March 2001).

The matter was referred to the department in September 2000, no reply was received (December 2001).

(d) Hardware/software Technology Park

Customs notification Nos.138/91 dated 22 October 1991 and 96/93-Cus. dated 2 March 1993 grants exemption from payment of customs duties on the goods imported by a 100

per cent export oriented units in a Software Technology Park (STP)/Electronic Hardware Technology Park (EHTP) for the purpose of development of software/Hardware for export out of India.

In Cochin, M/s. KRAN Systems, one unit in a software technology park and M/s. Transmatic Systems Ltd., another in hardware technology park were permitted in December 1995/April 1993 to develop/manufacture and export computer software/Hardware subject to conditions that the unit should implement the project and commence commercial production within three years and export the entire production within five years from the date of letter of permission. The units imported capital goods during April 1995 and November 1996 worth Rs.70.56 lakh free of customs duty under the notification ibid, but failed to commence commercial production till September 2001. Hence the duty foregone of Rs.34.15 lakh together interest amounting to Rs.41.20 lakh (upto 31 March 2001) was recoverable.

On being pointed out (November 1999), the Ministry admitted the objections (August 2001) and intimated that a show cause notice was issued in July 2000 demanding duty amounting to Rs.34.15 lakh with interest chargeable thereon. Further report is awaited (December 2001).

(e) Advance licensing scheme

In terms of Para 128 of Handbook of Procedures 1992-97 Vol.I, if the export obligation is not fulfilled both in terms of quantity and value, the licence holder of both VABAL and QBAL shall, for regularisation, pay :

- i) to the customs authority, customs duty on the unutilised imported material along with interest at the rate of 24 per cent per annum thereon;
- ii) to the licensing authority a sum which is equivalent to the CIF value of unutilised material imported and a sum equivalent to the short fall in export obligation.

In addition, if the holder of a duty free licence under the scheme violates any conditions of the licence, a penalty in terms of Section 11(2) of F.T.(D&R) Act, 1992 was also leviable.

(i) 13 Quantity based advance licences (QBAL) were issued to 13 exporters between October 1993 and January 1997 by licensing authorities at Bangalore, Madurai, Mumbai and New Delhi for duty free import of goods valued at Rs.6.31 crore against prescribed export obligation of Rs.9.37 crore. Against the import of goods worth Rs.4.20 crore, the licensee could export goods worth Rs.2.57 crore in four cases. In the remaining nine cases, the licencees could not make any exports. This resulted in shortfall of Rs.4.42 crore in export obligation. The licencees were liable to pay; (i) Rs.1.76 crore towards customs duty on the unutilised material and interest of Rs.1.99 crore thereon, (ii) Rs.3.05 crore as the sum equivalent to the unutilised imports and Rs.4.42 crore equivalent to the shortfall in export obligation.

On this being pointed out (between May 2000 and February 2001), the Ministry in two case reported (July/August 2001) recovery of Rs.7.70 lakh and the department in other two cases reported (March 2001) that action has been initiated against two importers for recovery. Replies in the remaining cases are awaited (December 2001).

(ii) In another QBAL issued to M/s. ABB Ltd. by licensing authority at Bangalore, the licensing authority while redeeming the licence calculated shortfall in export obligation as Rs.1.77 lakh instead of Rs.16.85 lakh resulting in short surrender of 'SIL' to the tune of Rs.30.17 lakh.

On being pointed out (August 2000), the Jt. DGFT stated (March 2001) that the importer had since surrendered 'SIL' for Rs.30.17 lakh.

9.2 Irregular DTA sales

Sale in Domestic Tariff Area (DTA) is permissible by a 100% EOU if the value addition achieved is not less than the minimum specified for the item in the Exim Policy. Further, as per Note 3 under Para 119 of Exim Policy 1992-97, in the case of projects where the investment in land, building, plant and machinery exceed Rs.200 crore, the value of goods shall be amortised.

(a) M/s. Balmer Lawrie Freight Containers Ltd., a 100% EOU in Madras Export Processing Zone (MEPZ) Chennai was engaged in manufacture and export of freight containers. During the period from September 1995 to March 1996 and April 1996 to March 1997, the unit achieved value addition of (-)12.47 per cent and 15.73 per cent against the prescribed minimum value addition of 27.3 per cent. The unit had effected DTA sales for a value of Rs.15.42 crore on payment of concessional customs duty of Rs.4.69 crore during September 1995 to March 1997.

As the unit failed to achieve the prescribed value addition, the DTA sale was irregular. Therefore, the unit is liable to pay differential customs duty of Rs.4.69 crore and interest of Rs.1.52 crore (upto March 2001).

On being pointed out (January 2001), the Ministry stated (November 2001) that the unit had met the minimum requirement of export obligation and NFEP for the total export obligation period of five years as per the policy guidelines of February 2001.

The reply of the Ministry is not tenable as the unit had not achieved the prescribed value addition for the years/period despite taking into account actual raw material consumed and amortisation of capital goods imported.

(b) M/s. Bata India Ltd., a 100% EOU with an investment of Rs.5.12 crore in plant and machinery etc. in Madras Export Processing Zone (MEPZ), Chennai was permitted (August 1994, October 1995) to effect DTA sales for a total value of Rs.1.41 crore during August 1994 to September 1995. The unit could achieve value addition of (-) 27.59 per cent against the prescribed minimum value addition of 30 per cent. However, the unit had effected DTA sales for a value of Rs.2.04 crore during October 1994 to December 1995 on payment of concessional customs duty of Rs.0.83 crore.

As the unit could not achieve the prescribed minimum value addition, the DTA sales was irregular. Therefore, the unit is liable to pay differential customs duty of Rs.0.83 crore and interest of Rs.0.93 crore upto March 2001.

On being pointed out (December 2000/March 2001), the Ministry justified (November 2001) the value addition adopted on the ground that as per Exim Policy, the value of capital goods should be amortised for calculating value addition.

The reply of the Ministry is not tenable as amortisation is permissible only where the investment in land, building, plant and machinery exceeds Rs.200 crore which is not so in the instant case.

(c) M/s. Tata Ceramics, a unit in Cochin EPZ was permitted (December 1991) manufacture and export of "Bone china table wares". The unit started its commercial production on 1 April 1995. As against the prescribed minimum NFEP of 20 per cent, the unit could achieve only minus (-) 90 per cent NFEP as on 31 March 1998. However the unit effected DTA sales for a total value of Rs.1.26 crore made during 1995-96 to 1997-98. As the unit could not achieve the prescribed NFEP, the DTA sale allowed was incorrect and as such the differential duty of Rs.48.41 lakh is recoverable.

On this being pointed out (March 2000), the Ministry reported (August 2001) recovery of the short levied amount.

(d) In terms of notification No.8/97-CE dated 1 March 1997 as amended, the finished products, rejects and waste and scrap produced or manufactured in a hundred per cent Export Oriented Unit wholly from indigenous raw materials are allowed to be sold in Domestic Tariff Area at concessional rates of duty. However, the benefit of the concessional rate of duty cannot be extended to those EOUs which produce goods both from indigenous and imported raw materials.

M/s. Bata India Ltd., a hundred per cent EOU in Chennai manufacturing and exporting 'Leather shoes' made from both indigenous and imported material had cleared their products in DTA availing exemption under the notification dated 1 March 1997. Audit scrutiny revealed that the unit is not maintaining any separate account for indigenous and imported material in respect of goods processed/cleared in DTA/exported. As such the duty exemption granted on the DTA sale was irregular and the differential duty of Rs.70.32 lakh on the DTA sale needs to be recovered.

The matter was reported in October 2000/March 2001, reply from the Central Excise Department is awaited (December 2001).

9.3 Availment of excess DEPB credit

DGFT policy circular No.19 (RE-2000/2001) dated 28 July 2000 clarifies that the DEPB benefit for export of "MS Galvanised Sheets/Strips" shall be granted as per the entry at Sl. No.363 of the list. Further it clarified that remedial action should be initiated in cases where DEPB benefit was granted against the entry No.91 for prior exports.

(a) DEPB credits were granted in seven licences issued during 1997-98 for export of 'Galvanised coils' against the entry at Sl.No. 91 instead of entry at Sl.No.363 resulting in excess DEPB credit of Rs.4.69 crore.

On being pointed out (August 2000), Dy. DGFT in respect of one DEPB licence stated (May 2001) that goods earlier classified under Sl.No.91 are to be taken to Sl.No.363 for the exports effected on or after 1 April 2001 as the entry at Sl. No.91 has been deleted in the Exim Policy 2001-2002 effective from April 2001 only.

The reply is not tenable as Policy circular dated 28 July 2000 and dated 11 September 2000 clarified that recovery of excess DEPB credit availed by the exporters in the past against export of goods under Sl.No.91 of Engineering Group was also to be effected.

Reply in respect of remaining six DEPB licences is awaited (December 2001).

(b) The rate of credit allowable under Duty Entitlement Pass Book (DEPB) Scheme in respect of processed, preserved and frozen headon/headless Shrimps was reduced from 10 per cent to 5 per cent of FOB value with effect from 1 April 2000 vide Public Notice No.1(RE-2000)/1997-2002 dated 31 March 2000.

Eight DEPB licences under Jt. DGFT, Visakhapatnam, exported processed, preserved and frozen headon/headless shrimps of FOB value Rs.6.31 crore during April 2000, on which a credit of Rs.63 lakh was allowed instead of Rs.31.50 lakh (5 per cent of FOB value) resulting in excess credit of Rs.31.50 lakh.

This was pointed out in February 2001. No reply was received (December 2001).

9.4 Other cases

In 11 other cases, non levy of duty due to non fulfilment of export obligation and incorrect levy of duty on DTA sales amounting to Rs.91.15 lakh were pointed out as detailed below. Mistakes in nine cases were accepted by the department.

(Rupees in lakh)			
Sl. No.	Nature of irregularity	Amount objected	Whether accepted by deptt./Ministry
1.	Incorrect regularisation of shortfall in export obligation	26.07	Yes
2.	Excess imports	12.26	Yes
3.	Non adherence of IO norms	10.08	--
4.	Non fulfilment of export obligation	9.01	Yes
5.	Inadmissible DTA sales	6.84	No
6.	Non fulfilment of export obligation	6.54	Yes
7.	Non fulfilment of export obligation	6.39	Yes
8.	Non fulfilment of export obligation	5.37	Yes
9.	Non fulfilment of export obligation	3.81	Yes
10.	Non fulfilment of export obligation	2.56	Yes
11.	Non fulfilment of export obligation	2.22	Yes
	Total	91.15	

CHAPTER 10 : OTHER TOPICS OF INTEREST

10.1 Irregular removal of warehoused goods

In terms of Section 72(1)(b) of Customs Act, 1962, where any warehoused goods have not been removed from a warehouse at the expiry of the period for which permitted to be warehoused under Section 61, the full amount of duty chargeable on such goods together with all penalties, rent interest and other charges becomes payable. If the owner fails to pay the amount so demanded, the warehoused goods can be detained and sold by the proper officer. It has been judicially held by the Supreme Court in the case of *M/s. Kesoram Rayon Vs. Collector of Customs, Kolkata* {1996 (86) ELT 464 (SC)} that "Where the goods have been allowed to be cleared after expiry of the warehousing period, the removal of such goods should be treated as 'Improper removal' and the rate of customs duty payable should be at the rate applicable on the date on which the permitted warehousing period came to an end".

(a) *M/s. Mardia Chemicals Ltd.*, was permitted in March-April 1996 to deposit imported power generation plant in private bonded warehouse owned by him. The bonding period of warehouse was to expire in March 1997 but an extension upto February 1998 was allowed to the exporter. Request of the owner for further extension was rejected by the Chief Commissioner (March 1998) making the importer liable to pay duty leviable on warehoused goods and interest thereon as on 1 March 1998. In the event of failure to pay duty and interest, goods were liable to be sold by the proper officer.

Audit scrutiny revealed that neither had the importer paid duty and interest nor the department had initiated action under Section 72 of the Act for sale of goods to realise Government dues. This resulted in non recovery of duty of Rs.7.58 crore and interest of Rs.4.67 crore upto March 2001.

On being pointed out (August 2000), the department stated (February 2001) that a show cause notice for payment of duty and interest was issued to the importer in September 2000 and adjudication proceedings were in process.

(b) The permitted warehousing period of two uncleared consignments of 1697.536 and 630.214 tonnes of 'Paraxyline' expired in August and November 1997 respectively. The department issued notices to *M/s. SVC Superchem Ltd.* under section 72(1) in November 1997 and November 1999. The Ministry turned down the importer's request for waiver of interest and instructed (June 1998) recovery of Government dues immediately. However, the Commissioner extended (May 1999) the warehousing period upto June 1999. Any removal thereafter would tantamount to an improper removal. Yet the goods were allowed to be cleared (March 2000) at 'NIL' rate of duty

on a DEEC licence issued in February 2000 i.e. after the expiry of the extended warehousing period. This resulted in non collection of duty of Rs.2.92 crore and interest of Rs.2.57 crore upto March 2001.

On being pointed out (September 1999), the department confirmed (June 2000) that goods were cleared under DEEC Scheme at nil rate of duty. However the fact remains that the importer was not entitled to use a DEEC licence issued in February 2000 for a consignment whose extended warehousing period had come to an end in June 1999.

(c) The warehousing period in respect of five consignments of various imported goods expired in June 1998 and the Department allowed their clearance from the warehouse in September 1998 on payment of duty at the rate in force on the date of clearance instead of at the rate prevailing on the date of expiry of the warehousing period. The clearance at the lower rate resulted in loss of revenue to the extent of Rs.11.74 lakh including interest of Rs.4.24 lakh.

On being pointed out (September 2000), the department stated (March 2001) that the importer (M/s. India Foils Ltd.) was asked to pay the short levied amount.

10.2 Uncleared goods not disposed off

According to Section 48 of Customs Act, 1962, if any goods brought into India are not cleared for home consumption or warehoused or transhipped within thirty days from the date of unloading thereof at a customs station or within such further time as the proper officer may allow or if the title to any imported goods is relinquished such goods may after notice to the importer and with the permission of the proper officer be sold by the person having the custody thereof.

(a) Between November 1998 and October 1999, M/s. Essar Oil Ltd., Jamnagar who was also the custodian of the goods filed fifty five bills of entry at a customs house, for home consumption of capital goods involving a duty of Rs.84.28 crore. Though duty on imported goods was assessed between November 1998 and October 1999, it was neither recovered nor the goods cleared till May 2001. Action had also not been initiated under Section 48 of the Act *ibid* to realise Government dues.

On this being pointed out (January 2000), the Commissioner of Customs, Ahmedabad stated (June 2000) that the goods were not cleared by the importer due to financial difficulties. It was further stated (July 2001) that the Custodian was served with final notice to clear the goods on payment of duty by 30 June 2001.

Final outcome of the case is awaited (December 2001).

(b) 14 consignments of various goods viz. components, Chemicals, oil etc with revenue implication of Rs.43.93 lakh warehoused in Delhi Commissionerate during 1986 to 1997 remained uncleared after the expiry of the warehousing period.

On being pointed out (January 2001), the department stated (June 2001) that action has been taken to dispose the goods. In an auction held on 6 June 2001, bids in 11 cases were accepted by the department.

10.3 Delay in recovery of revenue due to inaction by department

Section 59 of Customs Act, 1962 provides that the importer of any goods specified in sub-section (1) of Section 61, which have been entered for warehousing and assessed to duty under section 17 or 18, shall execute a bond binding him to a sum equal to twice the amount of duty payable on such goods.

18 bonds executed by M/s. Central Warehousing Corporation Ltd. and seven other importers during 1987-88 to 1997-98 in Central Warehousing Corporation Ghaziabad under Meerut Commissionerate became time barred but neither the goods warehoused were removed nor duty amounting to Rs.3.26 crore including interest recovered.

On this being pointed out (August 2000), the department stated (December 2000) that auction notices had since been issued in 12 cases involving duty of Rs.1.30 crore. Further developments were awaited (December 2001).

10.4 Non realisation of penalties/fines

In terms of Sections 112(i) and 114(i) of the Customs Act, 1962, any person who imports or exports goods which are liable to confiscation under Sections 111 or 113 of the said Act, shall be liable to a penalty in the case of goods in respect of which any prohibition is in force under this Act or any other law for the time being in force. Moreover, in terms of Section 142 of Customs Act, 1962, the proper officer of Customs is empowered to recover the outstanding amount payable to the Government.

(a) Scrutiny of records of three Customs Commissionerates (two in West Bengal and one in Delhi) revealed that penalties amounting to Rs.13.06 crore in 1234 cases imposed under Section 112 and 114 during January 1984 to October 2000 remained outstanding for realisation. The department had not taken any action to recover the amount.

On being pointed out (between January 2000 and March 2001), the department stated (December 2000 and July 2001) to have initiated action and/or referred for certificate action in respect of 846 cases and recovered Rs.3.41 lakh in nine cases.

(b) In Custom House, Vishakapatam it was revealed that an amount of Rs.19.49 lakh imposed as personal penalties in 26 cases and adjudicated during the years 1986, 1990 and 1992 remained unrealised.

On being pointed out (November 2000), the department confirmed (March 2001) that an amount of Rs.10.32 lakh was pending in 19 cases and stated that efforts are being made for realisation of arrears.

10.5 Non levy/short levy of anti dumping duty

In terms of notification Nos.169/94-Cus. dated 20 September 1994, 36/98-Cus. dated 26 June 1998, 81/98-Cus. dated 27 October 1998, 107/99-Cus. dated 24 August 1999, 39/99-Cus. dated 26 April 1999, 28/2000-Cus. dated 16 March 2000, 44/2000-Cus. dated 17 April 2000, 78/2000-Cus. dated 26 May 2000, 104/2000-Cus. dated 21 July 2000 and 115/2000-Cus. dated 31 August 2000, specified goods imported into India from China, Taiwan, Japan and Germany attract anti dumping duty as prescribed therein.

21 different consignments of these goods were imported by M/s. Rippal Traders, Ahmedabad and eight others through five major Custom Houses without levying anti dumping duty or levying at the rate lower than that prescribed in the notification. When the short collection of duty of Rs.2.31 crore was pointed out, the department/Ministry admitted mistakes in eight cases involving Rs.1.72 crore and reported recovery of Rs.75.70 lakh in five cases. Replies in remaining cases are awaited (December 2001).

10.6 Non realisation of Merchant over time (MOT) charges

In terms of Section 36 of Customs Act, 1962 read with Regulation 3 of Customs (Fees for rendering services by Customs Offices) Regulations, 1968, fee is leviable for any services rendered on Sunday or on any holiday observed by the customs department or on any other day after the working hours by customs officers on a request made by any person on that behalf.

Review of Merchant Over Time register of a Custom House revealed that MOT charges against the services rendered by the departmental officers were not assessed and levied regularly. On being asked (October 1998 and October 1999) to review all such cases,

the department (July 2000) stated that the total amount of MOT charges leviable for the period from January 1997 to October 1999 amounting to Rs.52.74 lakh was recovered.

10.7 Non levy of special excise duty

As per Second Schedule to the Central Excise Tariff, special excise duty is leviable on goods classifiable under Central Excise Tariff heading 4012.19/4011.90 on an ad valorem basis.

28 consignments of 'Retread aircraft tyre' and seven consignments of 'Aircraft tyres and pneumatic tyres' were imported by M/s. Jet Airways India Ltd. and two others through Air Customs, Mumbai during April 2000 to September 2000 were assessed under Central excise Tariff sub heading 4012.19/4011.90 respectively. The goods were charged to special excise duty on additional duty levied instead of on an ad valorem basis or 'NIL' rate of SED. This resulted in short levy amounting to Rs.37.88 lakh.

On these being pointed out (between August and December 2000), the department/Ministry reported recovery of Rs.35.58 lakh in respect of 35 consignments.

10.8 Delay in disposal of confiscated goods

In terms of Section 110 (1A) of the Customs Act, 1962, the Central Government is empowered to dispose off the seized goods as listed in notification No.31/86-Cus. dated 5 February 1986 having regard to the perishable nature of any goods, depreciation in the value of the goods with passage of time, constraints of storage space, valuable nature etc.

A consignment of 'Computer parts' seized in June 1993 and confiscated in March 1996 was assessed at Rs.15.74 lakh in January 1997. However, the goods were disposed off for Rs.2.71 lakh in May 1998. The lack of timely action by the department to dispose off the goods resulted in loss of Rs.13.03 lakh.

On being pointed out (April 2000), the department (September 2000) justified the delay due to following of due procedure before sale of goods. The reply is not tenable as the period of nearly five years taken by the department in disposal of goods after seizure was not justified.

10.9 Other cases

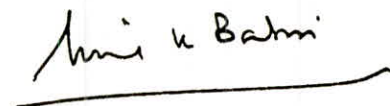
In 10 cases, Audit pointed out irregularities involving Rs.88.21 lakh as detailed overleaf. The department accepted objection in nine cases (duty effect of Rs.83.68 lakh) and reported recovery of Rs.37.90 lakh in five of these cases.

(Rupees in lakh)

Sl. No.	Subject	Amount objected	Amount admitted	Amount recovered
1.	Non realisation of supervision charges	16.29	16.29	--
2.	Non levy of cess	14.56	14.56	14.56
3.	Application of incorrect rate of duty	11.89	11.89	--
4.	Application of incorrect rate of duty	8.99	8.16	2.09
5.	Non recovery of establishment charges	7.78	7.78	7.78
6.	Excess payment of drawback	7.51	7.51	7.51
7.	Excess payment of drawback	7.03	7.03	--
8.	Short levy of interest	5.96	5.96	5.96
9.	Non levy of surcharge	4.50	4.50	--
10.	Delay in assessment of duty on ship stores	3.70	--	--
	Total	88.21	83.68	37.90

10.10 Miscellaneous

374 other objections involving duty of Rs.83.69 lakh were also pointed out. The department has accepted all the objections and reported recovery of Rs.83.69 lakh of the amount.



New Delhi
Date 13 February 2002

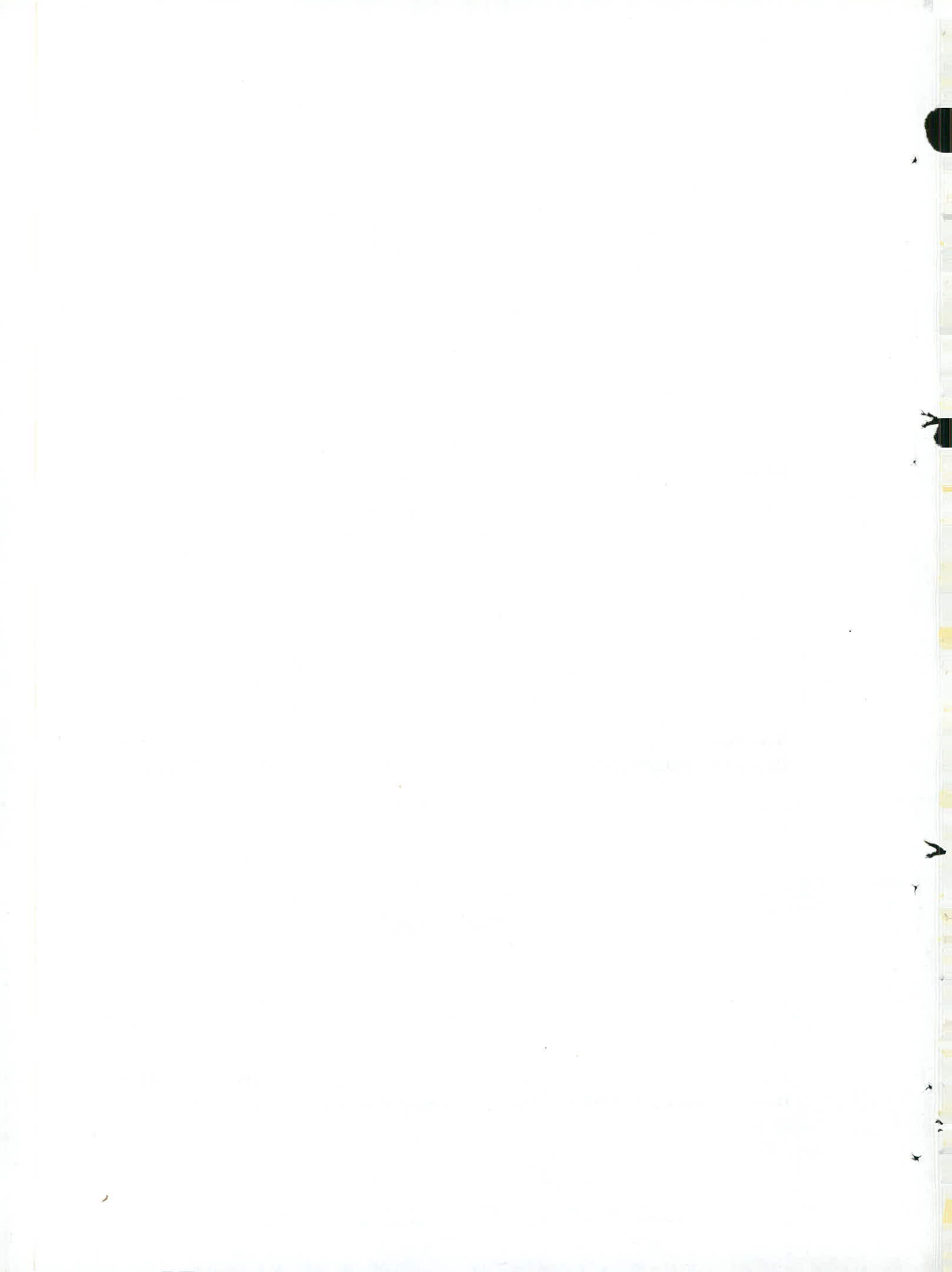
(S.K. BAHRI)
Principal Director (Indirect Taxes)

Countersigned



New Delhi
Date 13 February 2002

(V.K. SHUNGLU)
Comptroller and Auditor General of India



Annexure I**{Refer to Paragraph Number 2.7 (a) (vii)}**

Name of customs locations	*Documents proposed to be handled	No. of documents actually handled in					
		1998-99		Per cent 1999-00		Per cent 2000-01	
Kolkata Air Customs	Bes 62500	29970		31552		32224	
	SBs 62500	47546		51216		54316	
	Total 125000	77516	62.0	82768	66.2	86540	69.2
Kolkata sea customs	Bes 62500	36221		36680		NA	--
	SBs 62500	57962		59052			
	Total 125000	94183	75.4	95732	76.6		
Chennai Air Custom	Bes 62500	95280		110149		118497	
	SBs 100000	108582		122567		121140	
	Total 162500	203862	125.5	232716	143.2	239637	147.5
Chennai Sea custom	Bes 62500	74713		93869		76398	
	SBs 150000	125088		159348		191237	
	Total 212500	199801	94.0	253217	119.2	267635	126.0
Cochin sea custom	Bes 7500	10055		10088		8193	
	SBs 25000	40209		38315		45765	
	Total 32500	50264	154.7	48403	149.0	53958	166.0
Hyderabad Air Custom	Bes 7500	13857		15680		16297	
	SBs 25000	10095		15453		14141	
	Total 32500	23952	73.7	31113	95.8	30438	93.7
Tuticorin sea custom	Bes 7500	9698		14153		14731	
	SBs 25000	66955		74130		91671	
	Total 32500	76653	235.9	88283	271.6	106402	327.4
Vizag sea custom	Bes 12500	4129		4528		4012	
	SBs 50000	8778		9408		8975	
	Total 62500	12907	20.7	13936	22.3	12987	20.8
Bangalore Air custom	Bes 62500	91960	100.4	103891		123294	156.5
	SBs 62500	33595		58657		72287	
	Total 125000	125555		162548	130.0	195581	
Trivandrum Air custom	Bes 7500	NA	--	6793		5537	
	SBs 25000			43538		33342	
	Total 32500			50331	154.9	38879	119.6
Ahmedabad (ICD)	Bes 7500	865		976		1251	
	SBs 25000	13533		19447		23700	
	Total 32500	14398	44.3	20423	62.8	24951	76.8
Mumbai Air Customs	Bes 175000	322980		262112		NA	NA
	SBs 250000	324669		353476			
	Total 425000	647649	152.4	615588	144.8		

*Calculated for 250 days in a year with reference to the estimation of documents handled per day

Annexure-II

(Refer to paragraph 3.3)

Sl. No	Scheme under which export has been made	Details of action to be initiated
1.	Drawback	Rule 16A of the Drawback Rules provides for the recovery of the proportionate drawback originally paid relating to the unrealised export sale proceeds along with interest at 24%, deeming that drawback has never been allowed.
2.	EOU/EPZ	As per provisions of para 9.5 and 9.6 of Exim Policy 1997-2002, "Units were under obligation to ensure value addition/net foreign exchange earnings as a percentage of exports". In the Exim Policy 1992-97, the value addition was to be calculated with reference to the foreign exchange realised, whereas in the Exim Policy 1997-2002, for calculating Net foreign exchange performance (NFEP), the word 'realised' has been dropped
3.	DEEC	Para 7.25 of Hand Book of Procedures Volume I 1997-2002 makes it obligatory on the licensee to submit to the concerned Regional Licensing Authority (RLA) the Bank certificate of export and realisation of foreign exchange in the form at Appendix 25 or Appendix 14-B in case of deemed export. Prior to April 1995, licences were redeemed only after submission of Bank Realisation certificate (BRCs) evidencing realisation of export proceeds. This issue was examined by an Inter Ministerial Committee and after consultation by the Ministry of Commerce with the Department of Economic Affairs and RBI, it was decided that since the RBI was the authority for monitoring realisation of export proceeds, the requirement for submission of BRCs was discontinued from April 1995. However consequent to the PAC's observation, in their 24 th Report (1997-1998) (Eleventh Lok Sabha) the decision was again reviewed and the requirement of BRCs for fulfillment of Export Obligation was reintroduced from 13 April 1998.
4.	DEPB	In terms of Para 7.37 of Exim Policy and Para 7.48 (b) of HBP Volume-I 1997-2002 read with notification No.34/97-Cus dated 7 April 1997 credit under pre-export DEPB shall be offset within a period of twelve months from the date of issue of DEPB licence. In the event of failure to produce evidence of export, Custom House shall enforce recovery of credit with 24 per cent interest per annum. Interm of para 7.38 of HBP Volume-I DEPB credit on post-export basis shall be allowed without insisting on the realisation of export proceeds. However if the export proceeds are not realised within six months or such extended period as may be allowed by RBI, the DEPB holder shall pay in cash an amount of credit obtained against such exports. From 8 June 1998, the policy provides for recovery of the credit granted with 24 per cent interest by the licensing authority.
5.	EPCG	Para 6.13 of HBP Volume-I (1997-2002) provides for submission of a certificate from the Bank evidencing exports and realisation in freely convertible currency.

Foreign Exchange Regulation Act & Rules, also provides for repatriation of the value of exported goods through Authorised Dealer on due date for payment or within six months from the date of shipment whichever is earlier. Failing which penalty is leviable.