

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

for the year ended March 2011

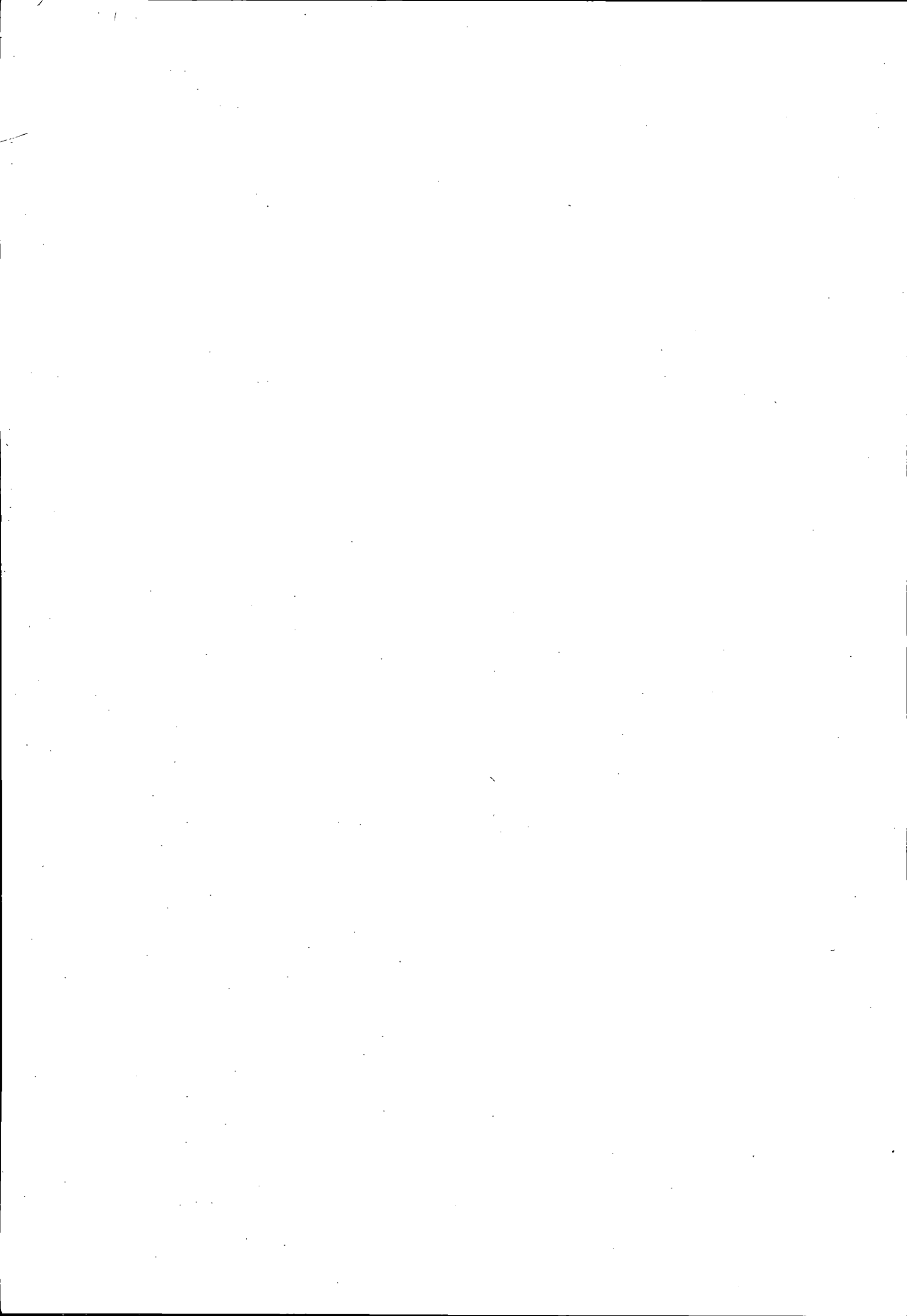
**Union Government
(Indirect Taxes – Central Excise and Service Tax)
(Performance Audit)
No. 25 of 2011-12**

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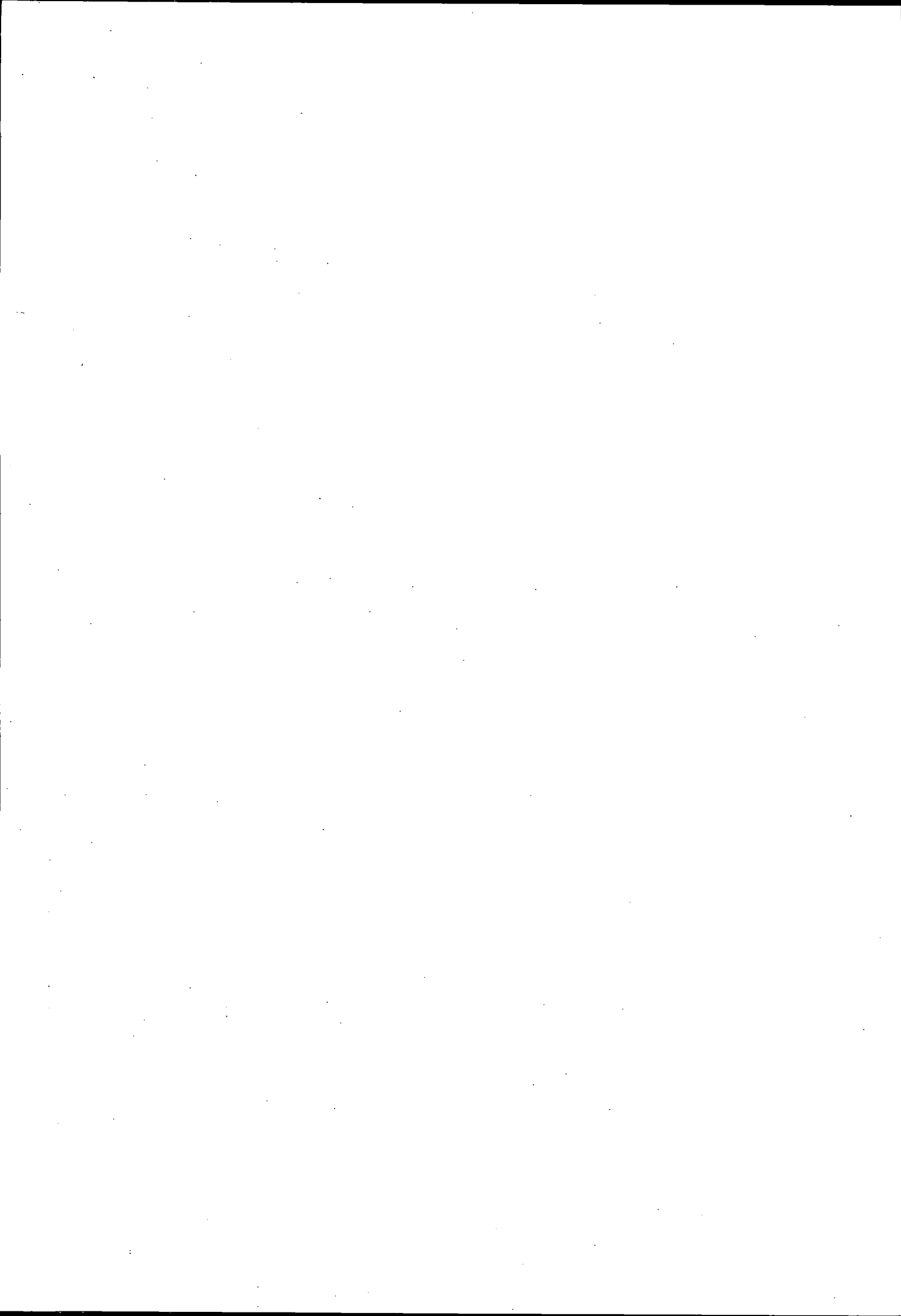


PREFACE

This Report for the year ended March 2011 has been prepared for submission to the President of India under Article 151(1) of the Constitution of India.

Audit of Revenue Receipts – Indirect Taxes of the Union Government is conducted under the Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. The Report presents the results of audit reviews and appraisals of receipts under indirect taxes (Central Excise and Service Tax).

The observations included in this Report have been selected from the findings of performance audit carried out during the year 2010-11. The results of our audit alongwith recommendations are contained in this Report.





EXECUTIVE SUMMARY

We conducted a performance audit on working of Commissionerates, Divisions and Ranges. Our sample comprised 46 commissionerates, 95 divisions and 204 ranges. We evaluated whether the measures to broaden the service tax base, the monitoring mechanism for registration of assesseees, the receipt and scrutiny of returns, the internal audit process, the issue of show cause notices and the review of call book cases were adequate and adhered to by the department.

Our key findings and related recommendations are given below: -

- We were informed by 17 out of 35 test checked commissionerates that they had not carried out the procedures as prescribed by DGST in its action plan for broadening the tax base. We found that different practices were being followed by different commissionerates. We recommended that the Board should issue comprehensive guidelines to remove ambiguities. We also recommended that as a long term measure, the Board may identify sources from where information can be imported electronically into ACES, to form an intelligence gathering system to identify potential taxpayers.

(Paragraph 2.2)

- We had identified 1959 service providers in the last five years Performance Audit Reports, who were unregistered, but prima facie, were liable to register and pay service tax. We found that the department had verified only 337 and consequently, 151 service providers were made to register. We recommended that the verification and follow up action may be ensured in the remaining cases in a time bound manner.

(Paragraph 2.2)

- We observed delays in issuing registration certificates and in acceptance of surrender certificates. We recommended that suitable monitoring mechanisms may be put in place to prevent such delays.

(Paragraph 3.2)

- We found delays in the post facto verifications of registration and recommended that the department may monitor the time taken for post facto verification of registration applications.

(Paragraph 3.3.1)

- The process of preliminary scrutiny has been automated as one of the modules of the ACES system. We recommended some MIS reports that may be generated by the ACES system to monitor the process.

(Paragraph 4.2.2)

- We found that detailed scrutiny of Central Excise and Service Tax Returns were being done only in very few ranges or divisions. We recommended that detailed scrutiny of returns (selected on prescribed risk parameters) by ranges and of high monetary value by AC/DC/JC/ADC be ensured.

(Paragraph 4.3)

- We observed that the work of maintenance of assessee master file had not been completed by the audit wings of most of the commissionerates. We recommend that the preparation of Assessee Master Files for each assessee may be completed in a time bound manner.

(Paragraph 5.2)

- We found that the non-mandatory units were selected, by and large, only on the basis of revenue collected and recommended that the ACES module for internal audit, which is operational, may be implemented in a time bound manner so that multiple parameters can be used for the risk based selection of non-mandatory units.

(Paragraph 5.3)

- We found that in ten commissionerates, non-mandatory units were audited at the cost of mandatory units. We recommended that this practice may be curtailed and reduction in audit coverage due to staff shortages may be distributed across mandatory and non-mandatory units.

(Paragraph 5.5.2)

- On test check of 46 commissionerates for central excise and service tax, we observed that there was no centralised record of all the cases which required issue of SCN and recommended that centralised record of all cases where SCNs are likely to be issued, may be maintained and monitored by the commissionerates to ensure that SCNs are actually issued wherever required.

(Paragraph 6.2)



CHAPTER I - INTRODUCTION

1.1 Introduction

The levy, assessment and collection of central excise duties and service tax are administered by the Central Board of Excise & Customs (CBEC), which is a part of Department of Revenue, under Ministry of Finance, Govt. of India. The total central excise and service tax collections in the last three years (2007-08 to 2009-10) were ₹ 3,35,215 crore and ₹ 1,70,663 crore respectively.

The Central Excise Department has 98 central excise commissionerates and seven¹ exclusive service tax commissionerates which report to Chief Commissioners heading 23 zones. Most of the central excise commissionerates also deal with work relating to service tax in their jurisdiction.

Each commissionerate is headed by a Commissioner, who is assisted by Additional /Joint commissioners and Deputy/Assistant commissioners, whose duties and functions include internal audit of the assessee units through the internal audit parties, adjudication of cases corresponding to their monetary limit and monitoring the collection and assessment functions of the divisions and ranges. The Divisional officers of the rank of AC/DC perform the function of granting registration, adjudication upto their monetary limit and supervision and control of assessment done by ranges. The function of the lowest level office, headed by Range Officer (Superintendent) are scrutiny of assessments, taking steps towards broadening of tax base in co-ordination with divisions, drafting show cause notices, registration functions etc. The range officers are assisted by inspectors. In this performance audit, we have examined the control mechanisms in ranges, divisions and commissionerates, pertaining to five critical areas of functioning.

1.2 Audit objectives

The performance audit was conducted to seek assurance that:

- (i) the prescribed mechanism to broaden the tax base, by identifying service tax providers and bringing them under the tax net, was being complied with
- (ii) the registration certificates were being issued in a timely manner and prescribed verification checks were being carried out
- (iii) control over assessments was being exercised by conducting prescribed scrutiny of returns

¹ One Mumbai ST commissionerate was bifurcated into two commissionerates Mumbai ST-I and Mumbai ST-II with effect from 1 March 2010 taking the total of exclusive service tax commissionerate to seven.

- (iv) the Internal Audit process was in conformity with the prescribed norms/guidelines
- (v) issue of show cause notices and review of call book cases were being done in a timely manner

1.3 Scope and Coverage

For conducting the performance audit, we selected 46 commissionerates, 95 divisions functioning under the selected commissionerates and 204 ranges functioning under the selected divisions. Our selection included 28 commissionerates where both central excise and service tax records were examined, 11 commissionerates where only central excise records were examined and seven Commissionerates where only service tax records were examined. In effect, we covered 39 commissionerates while auditing central excise records and 35 commissionerates while auditing service tax records.

Similarly, out of 95 divisions, we examined both central excise and service tax records in 35 divisions, only central excise records in 36 divisions and only service tax records in 24 divisions. In effect we covered 71 divisions while auditing central excise records and 59 divisions while auditing service tax records.

In the similar manner, out of 204 ranges, we examined both central excise and service tax records in 39 ranges, only central excise records in 97 ranges and only service tax records in 68 ranges. In effect we covered 136 ranges while auditing central excise records and 107 ranges while auditing service tax records.

1.4 Acknowledgement

We had an entry conference with the officers of Ministry of Finance and CBEC on 29 December 2010 where the audit objectives and scope of the performance audit were discussed. The audit recommendations and some of the audit findings were discussed in an exit conference held on 25 November 2011 with the officers of the Ministry. We acknowledge the cooperation extended by the Ministry of Finance and the field formations in providing the necessary information and records during the conduct of this audit.

1.5 Areas covered in the review

In this review, we had covered five areas of examination and the review was conducted to seek assurance on the adequacy of and adherence to the internal control system in the selected five areas. Accordingly the review has been structured giving a separate chapter for each of these five areas.



2.1 Introduction

Broadening of tax base is necessary to ensure growth of revenue. With increasing reliance on voluntary compliance, it becomes important for the department to put in place an effective mechanism for collecting information from various sources to identify persons who were liable to pay tax but had avoided to pay so as to bring them into the tax net thereby broadening the tax base. This is especially applicable for service tax, where new services are regularly being brought under the tax net.

An action plan was drawn by the Director General of Service Tax² and circulated to Chief Commissioners on 26 May 2003, under which the field formations were required to obtain information: -

- (a) on unregistered service tax providers from yellow pages, service providers' associations, newspaper advertisements, regional registration authorities and websites like Indiamart.com.
- (b) from Banks about property which may be covered under architectural/consulting engineer services.
- (c) from Municipal corporations and major assesseees including PSUs and private sector organisations regarding various services being availed by them and to obtain details of such services providers including their addresses.
- (d) from major hotels, auditorium, banquet halls, conference hall about convention services and event management service providers.
- (e) by making discrete market enquiries.
- (f) by collecting intelligence and conducting field surveys.

As these instructions clearly outlined the various items of work required to be performed by field formations, we used them as criteria while examining the efforts for broadening the tax base.

2.2 Efforts for broadening the tax base

We enquired as to what measures had been taken by the commissionerates towards broadening of tax base of service tax assesseees in pursuance of the specific items of DGST action plan. It was informed by 17 commissionerates³ out of 35 test checked commissionerates that they had not carried out these procedures for broadening the tax base.

² The Directorate General of Service Tax was constituted in 1997 to ensure that proper establishment and infrastructure could be created under different central excise and service tax commissionerates to monitor the assessment and collection of service tax.

³ Ahmedabad ST, Patna, Ahmedabad III, Panchkula, Bangalore ST, Kolkata ST, Nagpur, Bhopal, Mumbai ST, Delhi ST, Bhubaneshwar I, Bhubaneshwar II, Jaipur II, Jaipur I, Guwahati, Goa and Jamshedpur

Six commissionerates⁴ intimated that the items of work prescribed by DGST were carried out. However, they intimated that the results of such efforts were not available with them. Visakhapatnam I Commissionerate stated that items of works prescribed by DGST for broadening the tax base were being carried out but it was difficult to co-relate number of registrations made with any particular measure. However, the total number of registrations achieved, from a combined application of these measures, was also not furnished.

The remaining eleven commissionerates⁵ stated that items of work prescribed by DGST were carried out, as a result of which 1412 new assesseees were registered.

The reply given by some commissionerates for not doing items of works prescribed by DGST were as follows: -

Mysore Commissionerate stated that the work of survey and intelligence to broaden the tax base were conducted mainly by the Preventive Wing of the Division. Delhi ST and Pondicherry Commissionerates intimated that department organised *Melas* to spread awareness among the new assesseees.

The replies did not appear to be correct as the measures prescribed by DGST were different from anti-evasion and spreading awareness.

Delhi ST Commissionerate and ST division, Jaipur, under Jaipur I commissionerate stated that the DGST instructions were no longer applicable. The Cochin Commissionerate intimated that the functions and duties of service tax officers were standardised vide CBEC instructions of July 2007 and broadening of tax base was not a part of the work assigned to the Ranges and it was the Divisions' responsibility to carry out surveys and identify third party sources etc. Kolkata ST commissionerate intimated (June 2011) that action had been initiated by them in this direction from February 2011.

The replies indicate lack of clarity about measures to be taken by the Commissionerates. The measures prescribed by DGST had not been rescinded till date. Moreover, in the exit conference for a previous performance audit⁶, the Board intimated (June 2011) about a set of measures that are being taken by Commissioners to identify unregistered service providers. They coincided closely with the measures that had been prescribed by DGST in 2003. Therefore, there appeared to be varying interpretations of the exact role of the commissionerates in identifying unregistered assesseees. The matter was required to be clarified by the Board.

While conducting audits in the past, we had used similar procedures as prescribed by the DGST in its action plan and additionally gathered information from the income tax returns. We could identify 4503 service providers, who were not registered. These findings had been incorporated in

⁴ Hyderabad II, Hyderabad III, Raipur, Pune III, Chennai ST and Noida

⁵ Dibrugarh, Vadodara II, Mysore, Cochin, Indore, Chandigarh I, Coimbatore, Pondicherry, Lucknow, Meerut I and Ludhiana

⁶ Performance Audit on Service tax on Banking and other Financial Services (March 2010)

earlier performance audit⁷ reports. We had reported that prima facie, they appear to be unregistered assesseees and had recommended that the department verify these cases.

A total of 1959 out of 4503 unregistered service providers identified in the earlier PA reports were in the jurisdiction of some of the selected divisions and ranges of 35 commissionerates, where we conducted this review. We asked the commissionerates to indicate the action taken to verify these 1959 cases. Compilation of the information furnished by the commissionerates showed that only 337 cases (17 per cent) were verified and 151 assesseees of the verified ones (45 per cent) were registered. The action taken on the remaining 1622 cases (83 per cent) was not indicated. Cochin, Delhi ST, Chandigarh-I and Mumbai ST Commissionerates did not provide requisite information regarding verifications carried out.

The success rate of 45 per cent showed that these measures had a good potential to identify more assesseees but were being largely neglected.

2.3 Fixation of targets by commissionerates and monitoring through submission of reports

The DGST instructions provided for submission of a fortnightly report by the divisional offices to the Commissioners and by the Commissioners to the Chief Commissioners regarding efforts made for increasing the tax base. The report had to specially cover areas such as surveys conducted and outcome thereof, data base maintenance, meetings with the service provider associations etc.

The selected commissionerates reported that no fortnightly reports were being submitted regarding efforts to broaden the tax base. The selected commissionerates also reported that no targets were fixed for the measures required to be taken for broadening the assessee base.

2.4 Response to earlier audit recommendations

In our earlier Performance Report on Service tax on Business Auxiliary Services (March 2008), we had recommended that inter-governmental and inter-departmental co-ordination was required to be strengthened to ensure that the registered assesseees providing services pay the applicable service tax. Agreeing in principle to these recommendations, the Board had stated (November 2008) that a number of steps had been taken to streamline and strengthen the procedure for conducting surveys including constitution of a

⁷ (i) Manpower Recruitment Agency's Services and Security Agency's Services (March 2005)
(ii) Management Consultant's Services, Scientific or Technical Consultancy Services, Technical Testing and Analysis Services and Technical Inspection and Certification Services (March 2006)
(iii) Rent-a-cab Scheme Operators' Services, Photography Services and Health Club and Fitness Centre Services (March 2007)
(iv) Business Auxiliary Services (March 2008) and
(v) Construction Services (March 2009).

committee to identify third party sources, directions to its field formations to identify and locate the unregistered service providers from internet sites, setting up of help centres and issue of modus-operandi circulars to disseminate relevant knowledge to the field formations. It had also stated that inter-governmental and inter-departmental co-ordination was achieved through regular interactions with Income Tax and State Sales Tax departments through Regional Economic Intelligence Committee meetings. We examined the implementation of these measures in the test checked commissionerates.

2.4.1 Setting up of help centres

While the Board had intimated that help centres would be set up, as explained in the previous paragraph, we observed that they were set up only in thirteen⁸ out of 35 commissionerates. We sought this information from Mumbai ST Commissionerate in February 2011 and again reminded in April 2011 but it did not intimate the action taken.

2.4.2 Intergovernmental and interdepartmental co-ordination through regional economic intelligence committee meetings

We observed that Regional Economic Intelligence Committee meetings were not held in eight commissionerates⁹. The committee was not even set up in four¹⁰ of these eight commissionerates. Mumbai ST commissionerate did not provide the requisite information. Such meetings were held in the 26 remaining selected commissionerates. Out of these 26, seven commissionerates¹¹ stated that REIC meetings did not have broadening of tax base on their agenda. Another 11 commissionerates¹² did not indicate whether this issue had featured in the discussions of the REIC. Only eight commissionerates¹³ indicated that following measures relating to broadening of tax base were taken up because of these meetings: -

- Five service providers were identified by Income Tax department for having unaccounted income. Based on this information, the central excise department (preventive wing) wrote to field formations, to verify whether they fell in the category of service tax assesseees or not.
- Details were sought from the Income Tax Department, of persons who had received brokerage and commission in land deals.
- Cross linking of details of service tax returns in respect of commercial coaching & education institutions for the year 2007-08 & 2008-09 with details in Income Tax department.
- Cases of service tax on coaching and training institutes reviewed.

These efforts were in line with the instruction issued by the Board and were required to be replicated in other commissionerates.

⁸ Jaipur-I, Jaipur II, Kolkata ST, Cochin, Bhubaneshwar I, Chandigarh I, Ludhiana, Chennai, Coimbatore, Pondicherry, Panchkula, Meerut I and Ahmedabad-III

⁹ Dibrugarh, Guwahati, Nagpur, Jamshedpur, Mysore, Goa, Pune III and Coimbatore

¹⁰ Dibrugarh, Guwahati, Goa and Cochin

¹¹ Chennai ST, Kolkata ST, Lucknow, Noida, Meerut I, Jaipur I and Bhopal

¹² Ludhiana, Hyderabad III, Visakhapatnam I, Bhubaneshwar I, Bhubaneshwar II, Ahmedabad III, Vadodara II, Ahmedabad ST, Panchkula, Patna and Hyderabad II

¹³ Raipur, Indore, Jaipur II, Cochin, Bangalore ST, Pondicherry, Delhi ST and Chandigarh-I

2.5 Conclusions

We found that there was lack of clarity about who had the primary responsibility for doing this work, the ranges, the divisions or the preventive wings in the commissionerates. We had pointed out in our five earlier performance audit reports that identification of potential assessees required a more focused approach. The Board had indicated in exit conferences for earlier performance audits that staff shortages in service tax wing was one of the primary causes for not taking up this work in a more intensive manner. However, even with shortages, the available manpower could be utilised to work on smaller samples. But this initiative was virtually not being taken up at all. The commissionerates had not even verified the cases where we had pointed out entities who, prima facie, appeared to be potential assessees as there was a high percentage of confirmation in the few cases that were checked.

Recommendation No. 1

- *The Board may prescribe a deadline for commissionerates to verify cases already pointed out by us in the earlier Performance Audit Reports. It may also fix targets for doing such verifications and issue comprehensive guidelines for this work to remove ambiguities and contradictions.*

The Board stated in the exit conference that it had directed the field formations to ensure that the verifications are done expeditiously. To monitor this, each Chief Commissioner would give a status report on extent of compliance in their Zone by first week of March 2012 to DG (Service Tax) who would submit a report to the Board by end March 2012. It was also stated that the Board was directing the field formations that similar verifications in future may be completed by Commissioners within eight weeks of receipt of intimation/DRs/PARs.

Recommendation No. 2

- *As a long term measure, the Board may identify sources from where information can be imported electronically into ACES, to form an intelligence gathering system on potential taxpayers.*

The Board stated in the exit conference that as of now, there was no mechanism in ACES whereby information/data could be imported electronically, from external databases, into ACES. Therefore, other mechanisms would continue to be used by field formations as intelligence gathering tools on potential tax payers. We reiterate that this may be considered as a long term goal and examined again, as and when the ACES system becomes fully operational.

Recommendation No. 3

- *The Board may prescribe an effective monitoring mechanism to identify potential assessees and get them registered.*

The Board stated in the exit conference that it had issued comprehensive instructions for broadening of tax base, including creation of a special cell in each commissionerate to identify potential assessees.



CHAPTER III - REGISTRATION

3.1 Introduction

Section 6 of the Central Excise Act, 1944, read with Rule 9 of the Central Excise Rules, 2002 provides that any person who is engaged in manufacture or production of any specified goods included in the first and second schedule to the Central Excise Tariff Act, 1985 shall get himself registered. The application for registration, in Form A1, has to be submitted in duplicate to the jurisdictional divisional officer.

Similarly, Section 69(1) of the Finance Act, 1994 and Rule 4 of the Service Tax Rules cover registration of service providers. The application for registration is required to be made in Form ST-1 to the jurisdictional superintendent of central excise/service tax within 30 days of levy of service tax on such service or in case of an existing taxable service, within 30 days of the commencement of provision of such service.

For both central excise and service tax, the registration certification has to be granted by the department within seven days of filing of an application. These processes are carried out through a centralised, web based software application known as Automation of Central Excise and Service Tax (ACES). This application is connected through MPLS¹⁴ network which automates various processes of central excise and service tax and gives complete end to end solution under various modules. Any assessee can register with the Department online, can file online returns, claims, permissions & intimations. The system tracks its status and the assessee gets online messages.

Online applications for registration are processed by the divisions/ ranges and registration certificates are issued through the system. In the case of central excise registrations, the divisional officers (AC/DC) mark the cases on-line for post facto physical verification of premises and other details given in application, by the concerned Range Officers.

We scrutinised 2817 central excise registration cases in 69 divisions under 39 commissionerates and 7584 service tax registration cases in 58 divisions under 35 commissionerates.

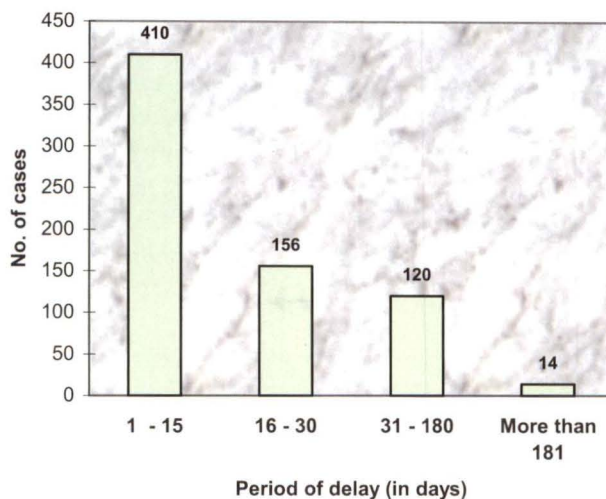
We observed instances of delays in issuing registration certificates and conducting post-verification, non-conversion of temporary registration numbers and delays/ shortcomings in the processing of applications for surrender of registrations such as non-availability of verification reports and lack of monitoring. Detailed findings are given below: -

¹⁴ **Multiprotocol Label Switching (MPLS)** is a mechanism in high-performance telecommunications networks that directs data from one network node to the next based on short path labels rather than long network addresses, avoiding complex lookups in a routing table. The labels identify virtual links (*paths*) between distant nodes rather than endpoints. MPLS can encapsulate packets of various network protocols.

3.2 Delay in issuing registration certificates

We observed that in 700 (25 per cent) out of 2817 cases in 35 central excise commissionerates, there were delays in issuing registration certificates. The delays are depicted below: -

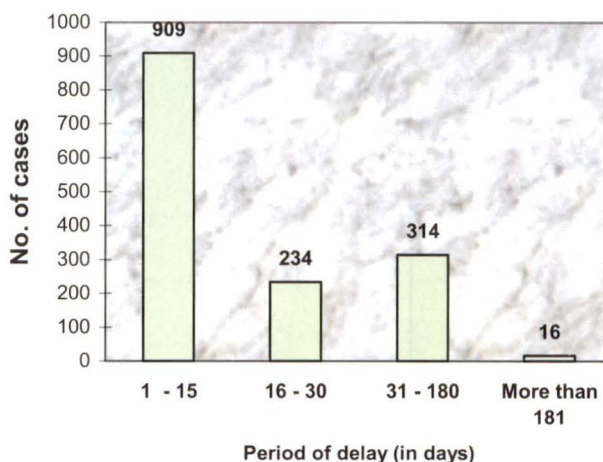
Delay in issue of Registration Certificate (CX)



The top five commissionerates where delays in grant of central excise registration certificates were noticed were Noida: 80 (out of 169), Indore: 74 (out of 159); Ludhiana: 63 (out of 200), Bhubaneswar I: 33 (out of 93) and Pune III: 29 (out of 238).

We also observed delays in issue of service tax registration certificates in 1473 (19 per cent) out of 7583 in 28 commissionerates, as depicted below:

Delay in issue of Registration Certificate (ST)



The top five Commissionerates where delay in grant of service tax registration certificates were noticed were Chandigarh I: 477 (out of 739); Patna: 230 (out of 233); Raipur: 80 (out of 191); Bhubaneswar II: 67 (out of 157) and Ahmedabad ST: 57 (out of 261).

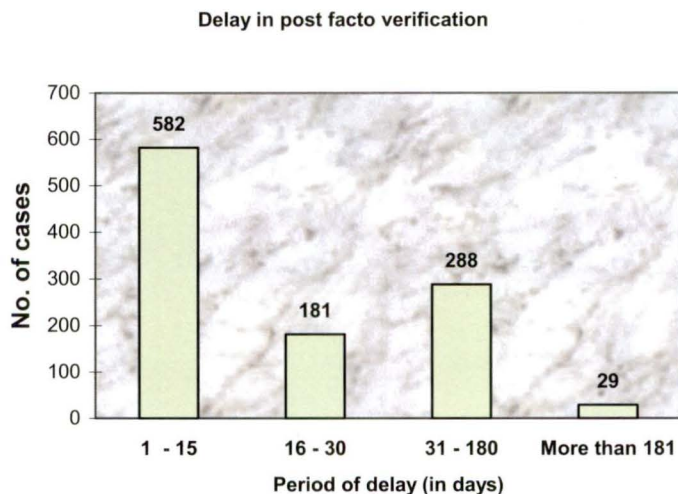
The department stated that delays occurred due to improper functioning of ACES system, non-submission/ delayed submission of complete records by the assessee, delay in verification of assessee's premises, heavy workload, connectivity failures and other administrative reasons. While the administrative and operational constraints cited could cause some delays, they did not explain the cases where delays were in terms of months.

3.3 Post facto verification

In the case of central excise assessee, after the issue of registration certificate, post facto verification is to be conducted by range officers to check that the premises mentioned in the application for registration are genuine and intended for purposes for which the application has been made. As per provisions, the range has to do the verification within five working days of the receipt of the duplicate copy of the application for registration.

3.3.1 Delays and omissions

We observed that ACES was not generating a report showing the date of forwarding the duplicate copy of the application from the division to the range for post facto verification and date of receipt of verification report, which would enable the divisions to monitor delays. For our sample of 2817 cases, we ascertained the delays in post facto verification from the manual records. We found 1080 cases in 29 commissionerates where, there were delays in the post facto verifications. The details are depicted below:



The divisions stated that the delays were due to late submission of required documents by the assessee, submission of illegible documents, documents not signed by the authorised persons and unavailability of assessee to verify the premises when the range officers were visiting. While such operational problems would always cause some delays, they could not explain the substantial number of cases where the delays were in terms of months. We also observed that in 68 cases in nine commissionerates¹⁵, the post facto

¹⁵ Guwahati-7, Raipur-6, Indore-1, Ludhiana-11, Jaipur I-8, Gurgaon-12, Patna-16, Lucknow-6 and Noida-1

verifications were not done. Another sixteen cases in three commissionerate¹⁶ were not sent by the divisional officers to concerned ranges for post facto verification. The reasons for not conducting the post facto verifications had not been intimated (November 2011), though called for.

3.3.2 Negative verification reports

We scrutinised the action taken by the divisional offices on the negative verification reports sent by the range offices.

3.3.2.1 We found in one case in Balasore division under Bhubaneswar I commissionerate, the range Superintendent had stated in his verification report that the assessee was operating from two separate premises which were part of the same factory but separated by a public road. This required the approval of the Commissioner.

When we pointed this out (March 2011), the department replied that assessee resubmitted the ground plan which showed the factory premises as continuous and not separated by any road or canal. Thus, approval of Commissioner was not required.

The reply of the department is confusing. The resubmitted ground plan which was forwarded to us is only for plot 650, which was mentioned as one of the two premises separated by a road. Thus, plot 650 is continuous but the reply does not mention the other part of the factory which is separated from plot 650 by a road. The reply is not consistent with the verification report and the matter has to be examined further.

3.3.2.2 In another case, the range officer stated in his post verification report that some machinery had not been installed and it was recorded that the registration certificate should be deferred. The division did not initiate any action on the negative verification report.

The Jaipur II Commissionerate replied (October 2011) that since the assessee started using its machinery later on, no action was taken regarding registration already generated by the system. The reply did not explain why the registration was not deferred initially, on receipt of negative report.

3.3.2.3 In two cases in Division VIII under Delhi II Commissionerate, negative verification reports were submitted by the range offices and subsequently after issue of SCN, Registration Certificates were cancelled, on file. However, the cancelled registrations remained active in ACES. During the Exit Conference, the Department agreed that the cancellations had not been updated on ACES.

A suitable reporting mechanism may be developed to monitor whether action is taken on negative verification reports.

3.4 Conversion of temporary registration numbers to PAN based registration numbers

We scrutinised whether the temporary registration numbers, allotted to registrants when they did not have PAN numbers, had been converted to 15

¹⁶ Patna: 9, Ahmedabad III: 1 and Jamshedpur: 6

digit PAN based registration numbers as per departmental instructions. We noticed from the database of registered service providers that in Patna Commissionerate 2283 (18 per cent) out of 12887 service providers were issued temporary registration, which were still to be converted into 15 digit PAN based Registration Numbers. In another four commissionerates¹⁷, 47 temporary central excise registrations were not converted to PAN based registration numbers. Similarly, 348 temporary service tax registration numbers were not converted to PAN based numbers in six commissionerates¹⁸.

Since most of the commissionerates had completed the process, the remaining cases were required to be converted to PAN based numbers, on priority.

3.5 Surrender of Registration Certificates

As per notification No. 35/2001 (NT), dated 26 June 2001 and Rule 4 (7) of Service Tax Rules, 1994, every registered person, who ceases to carry on the operation for which he is registered, shall de-register himself by making a declaration in the specified form and deposit his registration certificate (RC) with the Superintendent of central excise. While applying for surrender of registration, a declaration has to be furnished by the registered person to the effect that there are no government dues or demands pending against him as on the date of surrendering the registration. The Superintendent of central excise has to ensure that the assessee has paid all amounts due to the Central Government under the provisions of the Act, and the rules and the notification issued there under, and thereupon cancel the registration. Our scrutiny of the applications for surrender of central excise and service tax registration certificates, revealed shortcomings which are detailed below:

3.5.1 Central Excise

3.5.1.1 We found that in four certificates in Jalandhar division under Ludhiana Commissionerate, the verification reports on clearance of pending demands and/ or 'no dues certificates' were not found in the relevant files. Therefore, there was no assurance that certificates had been approved for surrender after verifying that the surrendering assessee had paid up all their dues.

The Ludhiana Commissionerate intimated (October 2011) that verification in one case was earlier conducted by range office but the report had been received now. As regards the other units, jurisdictional range officers have reported that verification had been done and no dues were pending against the units.

The reply did not explain whether such verification reports were available and if so, why were they not placed in the files concerned.

3.5.1.2 In Bangalore III Commissionerate, we observed that all the applications submitted by assesseees for surrender of RCs under ACES, had been kept pending since November 2009. The department did not take any action for disposal of the applications. We also observed that although DC

¹⁷ Patna, Pondicherry, J & K and Bangalore III

¹⁸ Mysore, Raipur, Panchkula, Bhubaneswar II, Chennai ST and Pondicherry

(Audit) was directed to take up the audit before cancellation of RC, the verifications had not been completed even after the expiry of 17 months.

3.5.1.3 In Raipur division under Raipur Commissionerate, we could not ascertain the position of surrendered RCs as division was not able to produce any centralised record used by them to monitor such cases. In reply, the Divisional Officer stated that the position could not be ascertained as ACES system was not generating any MIS reports related to surrendered registrations. Same reply was given by the Deputy Commissioner of Rourkela II Division in Bhubaneswar II Commissionerate. These divisions were required to monitor surrendered cases, if necessary, manually, as done by other divisions till such time that the requisite MIS reports were provided in ACES.

3.5.2 Service Tax

3.5.2.1 Out of fourteen application of surrender of registration received in Service Tax Division, Jaipur in Jaipur I Commissionerate, ten surrender application received during April 2009 to January 2010 were still pending for verification even after lapse of two years and in remaining four applications, department stated that efforts were being made to trace the record (October 2011).

3.5.2.2 In Division-III of Kolkata ST Commissionerate, applications for surrender of registration certificates were accepted in 180 cases during 2009-10 on the basis of reports from ranges. However, the range reports did not give any details of the extent and nature of the verification. In Division-I under the same commissionerate, no records relating to surrender of registration certificates were produced to us.

The department stated (June 2011) that as no in-depth verification of dues was possible, they only examined whether any SCN was pending against assesseees. Such a verification process was quite inadequate and there was risk that tax/duty could remain unpaid for business transactions carried out in the periods before and immediately after surrendering the certificates.

3.5.2.3 In Delhi ST Commissionerate, 56 assesseees applied for surrender of Registration Certificates, with requisite documents, in their respective ranges between March 2009 and March 2010. However no action had been taken on these applications. Division III of Delhi ST Commissionerate stated that (February/March 2011) the applications had not been processed because the assesseees had not furnished the documents till date. It was also stated that the process of verification for any pending demand is carried out only after print out of the surrender application filed on line is received. During the Exit Conference, the department stated that the surrender applications were accepted, only if these were filed through ACES; the assesseees who had submitted applications manually, had to apply through ACES and e-mails had been sent to all the applicants whose surrender applications were pending in the ranges for acceptance. The replies were not acceptable. The applications were lying unprocessed for more than one year and could not be kept pending indefinitely. They had to be finalised so that recoveries, if any, could be made from the assesseees.

3.5.2.4 In Pune III Commissionerate, the department had not accepted all the 1649 surrender applications received between 2008-09 and January 2011 for want of verification of pending demands. The department is required to carry out the requisite verifications and issue demands, if any. Further delays could lead to demands becoming time barred.

3.5.2.5 In Bangalore ST and Mysore Commissionerates, we sought the number and details of assesseees, who had applied for surrender of RCs during the period of audit. The commissionerates were unable to ascertain the figures from the ACES as MIS report had not yet been designed and they had not kept manual records either. Therefore, there was no monitoring mechanism for the receipts and disposals of the applications.

Recommendation No. 4

- *Suitable control mechanisms may be put in place so as to prevent delays in granting registration certificates and accepting surrender of registration certificates.*

The Board stated in the exit conference that it had instructed Commissioners for periodical monitoring of these areas of work and for the Chief Commissioners to take stock of the actions taken.

Recommendation No. 5

- *The department may monitor the time taken for post facto verification of registration applications. Appropriate MIS report may be generated in ACES.*

The Board stated in the exit conference that it would be instructing field formations for periodical monitoring of this area of work so that delay, if any, would not be on account of any slack in departmental actions/functioning. It also stated that a comprehensive MIS to assist senior officers was under development by Systems Directorate and would include appropriate reports.



4.1 Introduction

The CBEC introduced self assessment in respect of central excise in 1996 and in respect of service tax in 2001. With the introduction of self assessment, the department also provided for a strong compliance verification mechanism with three important prongs—Scrutiny of Returns/ Assessments, Audit and Anti-Evasion. The crucial role of scrutiny of assessments was highlighted in the Report of the Task force on Indirect Taxes, 2002, which stated that "It is the view that assessment should be the primary function of the Central Excise Officers. Self assessment on the part of the taxpayer is only a facility and cannot and must not be treated as a dilution of the statutory responsibility of the Central Excise Officers in ensuring correctness of duty payment. No doubt audit and anti-evasion have their roles to play, but assessment or confirmation of assessment should remain the primary responsibility of the Central Excise Officers".

In the exercise of powers conferred under Rule 12(3) of Central Excise Rules, 2002 and Rule 5A of the Service Tax Rules, 1994, the Board has laid down detailed guidelines for scrutiny of returns as contained in the two return scrutiny manuals both for Central Excise returns (ER1 and ER3) and Service Tax returns (ST3). The scrutiny of returns is in two stages: The purpose of preliminary scrutiny of returns is to ensure arithmetic accuracy of the duty computation, completeness (permanent account number, description of the item, registration details of the unit etc) timeliness (timely submission of the return and timely payment of duty) and identification of stop filers and non filers. The detailed scrutiny of assessment is done for selected returns on the basis of risk parameters to ensure the correctness of assessment (correctness of classification, valuation and Cenvat credit). The preliminary scrutiny has been largely automated through the Automation in Central Excise and Service Tax (ACES) system and according to the Manual for Scrutiny of Service Tax Returns, 2009 (Para 1.2B), this would release manpower for detailed manual scrutiny which then would become the core function of the range.

4.2 Preliminary scrutiny

Before implementation of ACES system, all the returns received by the Superintendent are to be scrutinized within three months of the date of receipt of returns. Under ACES, filing of returns and preliminary scrutiny is done by the system and discrepancies are marked for review and correction on an observation sheet generated by the system. The returns marked for review are to be validated in consultation with the assessee and re-entered into the system.

4.2.1 Implementation and functioning of ACES

We ascertained the degree of implementation of ACES in the commissionerates so as to ascertain whether automated preliminary scrutiny through ACES would free up time for the ranges to attend to other important items of work, as envisaged. The test checked 46 commissionerates intimated that ACES had been implemented in all their subordinate ranges except for six ranges under Dibrugarh Commissionerate, one range (Kamptee) under Nagpur Commissionerate and one range (Begusarai) under Patna Commissionerate where implementation is being delayed due to non-receipt of Broadband from BSNL and other technical problems.

We found that out of the 196 test checked ranges where ACES was implemented, there were functional problems in 112 ranges. The problems cited by various ranges included interruption in connection (Bankipur-I range and Darbhanga range in Patna Commissionerate, 10 ranges under Jaipur I & II commissionerates and 3 ranges of Raipur Commissionerate), lack of infrastructure including absence of power backup (3 ranges in Raipur Commissionerate), non-allotment of user-id and password (Service Tax Cell Nagpur), frequent link failure (12 ranges in Kolkata III, IV and V and 4 ranges in Kolkata ST Commissionerate), slow system response time (8 ranges in Delhi II Commissionerate), power supply of insufficient capacity (four ranges in Bangalore ST commissionerate), non-installation of hardware (four ranges in Bangalore III & Mysore Commissionerates), etc.

The Deputy Commissioner, ST Cell, Nagpur stated (October 2011), that user-id and password had been allotted to the concerned group superintendent and operations would start shortly.

The Kolkata IV, V and ST commissionerate accepted that there were frequent link failures.

The Range Superintendent (Begusarai) stated (May 2011) that persuasive effort was being made to ensure Broadband connectivity at the earliest.

4.2.2 Preliminary scrutiny using ACES

The ACES system has to carry out the checks prescribed for preliminary scrutiny and to prepare an observation sheet in which all the returns having errors are listed, with details of errors and are marked for further review and correction by the range superintendents.

We found that the ACES was not generating MIS Reports of returns submitted with delay and statement of assessees who had delayed the payment of duty. These two shortcomings were also not being indicated in the observation sheets being generated for review and correction.

4.2.2.1 Identification of delayed Returns and delayed payment of duty

We observed, through manual scrutiny, that in three ranges under Pondicherry Commissionerate, 41 per cent of 435 returns had been filed belatedly. We also found substantive delays (extending up to 303 days) in returns filing in three ranges in Goa Commissionerate, three ranges in Nagpur Commissionerate and one range in Bhubaneswar II Commissionerate.

In three ranges in Nagpur Commissionerate, in Vadodara-II Commissionerate-Group VIII and in Ahmedabad-ST Commissionerate-Range XII, we found delayed payment of duty in 17 returns on which interest was due. Ranges at Nagpur intimated that it had recovered the interest in two cases. After introduction of online filing, the cases of belated filing can be identified by ACES through a suitable MIS report, so that the ranges could take suitable action on these cases.

4.2.2.2 Non-filers

In response to our recommendations in earlier Audit Reports, the Ministry had stated that identification of non-filers and stop filers of returns would be implemented through the ACES project.

We found that any report showing list of non-filers was not being generated by ACES (September 2011). We did not find evidence that detection of stop filers by investigating the non-filers was taken up as a concerted effort.

4.2.3 Preliminary scrutiny of returns done manually

In 45 ranges although ACES was implemented, preliminary scrutiny was done manually and we found the following shortcomings:

4.2.3.1 Three Central Excise ranges in Meerut I, three ranges in Lucknow, three ranges in Nagpur, three ranges in Noida Commissionerates, four service tax Ranges in Guwahati and Dibrugarh Commissionerate, four ranges in Meerut I and Noida Commissionerate and four groups in Chennai ST Commissionerate intimated that the preliminary scrutiny of returns had been done. However, we found that the check list prescribed¹⁹ were either not attached with the scrutinized returns or were not signed by range officers. The unsigned checklists did not have any observations. Thus, we were unable to get adequate assurance that the returns had actually been checked. Lucknow and Nagpur Commissionerates intimated (March and April 2011) that returns were scrutinized but not signed due to oversight. This implied that nobody could be held accountable if any errors were found in the process of scrutiny.

4.2.3.2 We found that Panchkula Commissionerate had not conducted manual scrutiny of returns according to the Manual for Scrutiny of Service Tax Returns, 2009 and similarly Delhi III Gurgaon and Delhi IV Faridabad Commissionerates had not done the scrutiny according to Manual for Scrutiny of Central Excise Returns, 2008.

The Panchkula Commissionerate admitted (June 2011) the audit observation and stated that on receipt of Manual in October 2010 proforma of monthly reports have been changed as per the manual.

The Faridabad Commissionerate stated (June 2011) that manual scrutiny was carried out before implementation of ACES.

The Gurgaon Commissionerate stated (January 2011) that preliminary scrutiny was being carried out as per conventional method. It further stated (June 2011) that the erstwhile instructions applicable to scrutiny of Manual Returns are not applicable in respect of returns filed under ACES. The replies were not correct as revised method of preliminary scrutiny was introduced by the

¹⁹ in Annexure 2.1 of the Manual for the scrutiny of Central Excise returns 2008

Manual for Scrutiny of Central Excise Returns, 2008 and was operational during the period covered under review. The scrutiny under ACES has also been derived from this manual. Therefore, the commissionerates were required to do the scrutiny either manually as per revised manual or under ACES. However, they were doing neither and following the manual scrutiny that was operational before introduction of the revised Manual for Scrutiny of Central Excise Returns, 2008.

4.2.3.3 In four ranges in Bangalore ST Commissionerate, although ACES was functional, preliminary scrutiny was being done manually. The returns were being filed online but the observation sheets generated by ACES were not being reviewed and action was not being taken.

4.2.3.4 In four ranges in Patna Commissionerate, only about 19 per cent ST-3 returns were scrutinized against the norm of 100 per cent.

4.2.3.5 In four ranges in Jamshedpur Commissionerate, two ranges in Raipur Commissionerate and two ranges in Chandigarh I Commissionerate, preliminary scrutiny of ST returns was not done at all.

4.2.4 Monthly report on returns received and scrutinised

As per the manuals for the scrutiny of central excise and service tax returns, a monthly report has to be submitted by the Range Officer to the jurisdictional Assistant/Deputy Commissioner of the Division regarding the number of returns received and scrutinized.

We ascertained that in 42 ranges under 12 commissionerates no monthly reports were submitted by range officers of central excise and in 49 ranges in 16 commissionerates no monthly reports were submitted by range officers, in service tax. The information on returns scrutinized was also not being submitted in any other form. Therefore, this work was not being monitored through this prescribed report in these ranges.

In 35 central excise ranges in 12 commissionerates and 21 service tax ranges in nine commissionerates, while the prescribed report was not prepared, the information relating to preliminary scrutiny was submitted through MTR.

Under ACES, the range Superintendents have to fill up observation sheets depicting the action taken on the returns, marked by the system for review and correction. An appropriate MIS report was required to be generated by ACES to enable the monitoring of the action taken by the Superintendents. Such a report would serve the same purpose as the monthly reports being submitted manually at present.

4.2.5 Scrutiny of returns for which preliminary scrutiny was done by department

4.2.5.1 Central Excise

Out of 22601 returns scrutinised by the department, we test checked 1421 returns and found errors in 88 returns (6 per cent). These errors were not detected by the department. They included returns with incomplete challan numbers, date and BSR (code indicating bank branch) codes not mentioned, abstract of current account not filled or wrongly filled, invoices issued during the month not mentioned, wrong accounting code on challan for duty and cess,

challan not enclosed, column of cenvat credit availed & utilised not filled properly, non-payment of interest on differential duty, non-reversal of Cenvat credit etc. Illustrative examples are given below:

i) In Begusarai range, we observed that an assessee (M/s Carbon Resources Pvt. Ltd.) had submitted two manual returns for the month of October 2009 signed by two different persons/authorities. Figures of productions and closing balance of final product in those returns did not match. The two returns did not carry any comments to explain the reasons for submission of two returns.

ii) In one range under Bhubaneswar I Commissionerate, M/s Tata Steel Ltd., Chrome ore beneficiation Plant, Sukinda Chromite Mines deposited ₹ 4.35 crore as duty towards short shipment of goods cleared for export. The interest leviable on delay in payment was neither paid by the assessee nor demanded by the Department. In reply, the Range Superintendent reiterated that duty of ₹ 4.35 crore was paid due to short shipment but did not explain why interest was not paid.

4.2.5.2 Service Tax

We test checked 938 service tax returns already scrutinized and found 44 errors (5 per cent) undetected by the department. The errors included use of incorrect accounting heads on challans, non imposition of penalty for delayed filing of returns and challans not available with ST-3 returns. Two illustrative examples are given below:

i) M/s Orbit Motors (P) Ltd, an authorised service station in Rourkela service tax Range availed and utilised cenvat credit of ₹ 1.73 lakh during October 2009 to March 2010 on service tax paid on transportation charges during the relevant period. Since the input service credit was not in relation to providing output service, credit so availed and utilised was irregular. Range Superintendent stated that action would be taken after verification.

ii) Test check of 20 ST-3 returns already checked by range II of Panchkula Division revealed that challans amounting to ₹ 6.69 lakh were not found attached with ST-3 returns of 11 assesseees.

4.3 Detailed scrutiny

4.3.1 Detailed scrutiny by Ranges

As per Board's circular dated 11 May 2009, once ACES is implemented, returns would be automatically listed in descending order of risk and submitted to Commissioner for selection.

This function was not found operational and the system was not selecting any returns for detailed scrutiny as per Board's circular. To a query raised by us, only 12 ranges²⁰ out of 136 reported that detailed scrutiny of central excise

²⁰ Mallapur and Nacharam – II in Hyderabad III Commissionerate, Range-II, Bilaspur in Raipur Commissionerate, Division III, AR-I of Vapi Commissionerate, Rajgangpur in Bhubaneswar II Commissionerate, CE R-II, LDH-I and CE R-III, JLD in Ludhiana Commissionerate, IA, IB and IIIA in Pondicherry Commissionerate, Chinhat II and Aliganj in Lucknow Commissionerate.

returns was being done. Similarly, only nine ranges²¹ out of 107 reported that the detailed scrutiny of service tax returns was being done.

In eight ranges, we examined 28 ST-3 returns which had already been scrutinised by the department but did not find any deviations. Range III D of Pondicherry Commissionerate intimated that they had done detailed scrutiny of 390 returns but provided only four cases for our scrutiny. While comparing the ST3 returns with the financial statements (as prescribed in the scrutiny manual), we found prima facie evidence of understatement of value of services provided in all the four cases which resulted in short payment of service tax of ₹ 25.79 lakh. The details are tabulated below:

Table No. 1

(Amount in lakh of rupees)

| Name of Assessee | Taxable Service | Gross receipt as per Financial statements | Gross Receipt as per ST 3 return | Difference in taxable value | Service tax short paid |
|----------------------------------|-------------------------------------|---|----------------------------------|-----------------------------|------------------------|
| M/s Magic Hour Films Private Ltd | Photography Service | 155 | Nil | 155 | 16 |
| M/s Manakular Motors-Service | Authorised Service Station Services | 223 | 205 | 18 | 02 |
| M/s Mertho Constructions | Works Contract Services | 974 | 815 | 159 | 07 |
| Shri A.Srinivasa Rao | Audit & Consultation Fees Services | 153 | 140 | 13 | 01 |

For the case enumerated at Sl. No. 1 in the above table, the department have intimated (April 2011) recovery of service tax of ₹ 52.41 lakh alongwith interest of ₹ 4.52 lakh for the financial years 2008-09, 2009-10 and 2010-11.

We observed that very few cases were subjected to detailed scrutiny and it was a matter of concern that one range was unable to find all the errors even in these small samples. Appropriate corrective action was required to be taken.

4.3.2 Detailed Scrutiny by AC/DC/JC/Addl. Commissioner

As per para 2.1A.10 and 2.1A.11 of Manual for the Scrutiny of Central Excise Returns, 2008, every six months, the Deputy/Assistant Commissioner in charge of the Division has to scrutinise the returns of units paying annual PLA revenue between ₹ 1 crore to ₹ 5 crore and the Additional/Joint Commissioner has to scrutinise the returns of units paying annual PLA revenue of over ₹ 5 crore. Wherever necessary, they can requisition the concerned documents from the assessee. The report on the scrutiny shall be sent to the Commissioner latest by the 15th of the next month.

²¹ Service Tax Group I, Service Tax Group II and Service Tax Group V in Hyderabad III Commissionerate, Group-VIII in Vadodara II Commissionerate, Group X in Mumbai ST-I Commissionerate, STR I Jalandhar in Ludhiana Commissionerate, Rajgangpur and Rourkela ST in Bhubaneswar II Commissionerates, Range IIID of Pondicherry Commissionerate.

The AC/DC of only seven²² out of 71 divisions reported that the returns of units paying annual PLA revenue in the range of ₹ 1 crore to ₹ 5 crore were being scrutinised. However, we found²³ that largely it was done only on the basis of the returns without calling for any additional information/records from the concerned assessees. Therefore, it was akin to preliminary scrutiny. The Hyderabad III Commissionerate did not furnish any information in this regard.

The Additional/Joint commissioners in three²⁴ out of 39 commissionerates reported that the returns of units paying annual PLA revenue above ₹ 5 crore were being scrutinised and only in one case the additional commissioner of Raipur Commissionerate found a discrepancy and took action.

4.4 Test check of returns not scrutinised by the department

We scrutinised 960 returns in central excise and 500 returns in service tax where the department had not done either preliminary or detailed scrutiny and found errors in 208 and 195 returns respectively. The errors included instances of misclassification, wrong adjustment of tax/duty, non-reversal of cenvat on clearances of exempted goods, excess/incorrect availing of cenvat credit, incorrect availing of input service credit, non-payment of interest on reversal of cenvat credit, incorrect accounting of secondary and higher education cess etc. Some illustrative cases are given below:

4.4.1 M/s Morarjee Textiles Ltd, Butibori under Nagpur Commissionerate was engaged in manufacturing of textiles fabrics falling under chapters 52 and 53 of the Central Excise Tariff. During detailed scrutiny of its return for the period October 2009 to March 2010, the service tax credit details were called for. We found that the assessee had reversed cenvat credit of ₹ 27.68 lakh vide entry No. ST/1239 dated 1 November, 2009 against CERA observation raised in September, 2009 for “Non-payment of amount equivalent to the Cenvat credit attributable to input services used in manufacture of exempted goods”. Thereafter, the assessee availed credit of equivalent amount vide entry No.1833 dated 19 March 2010 under the narration “Amount Credited on A/c of Stock declaration which is debited vide entry No.1239 dated 1 January 2009”. It was evident that the assessee had wilfully quoted a wrong date and given a misleading and factually incorrect narration to hide the fact that it was availing credit which had been reversed against a previous audit objection of CERA. On this being pointed out (March 2011), the Range Superintendent accepted the observation (March 2011) and reported recovery of amount of ₹ 27.68 lakh. However, penal action was awaited (November 2011) for making false entries to avail inadmissible credit.

The same assessee had received input services and paid the service tax on these input services using cenvat credit account which was not permissible. Thereafter, it availed cenvat credit for the amounts paid out of cenvat credit, which was also irregular. The department had objected to the irregular payment from cenvat credit account and issued SCNs. Demand of ₹ 61.93 lakh had been confirmed and one demand of ₹ 21.19 lakh raised in July 2010

²² Hyderabad H, Bilaspur, Raipur, Ludhiana I, Jalandhar, Lucknow II and Noida Division V

²³ In Bilaspur & Raipur divisions

²⁴ Raipur, Ahmedabad III & Ludhiana

was pending adjudication. However, the department had not objected to the irregular availing of credit which was required to be reversed, with interest. Reply of the department was awaited (November 2011).

4.4.2 In Darbhanga range in Patna Commissionerate, an assessee (M/s Hazi Umal Biri Udyog) had made delayed payment of excise duty for the months of October 2009, November 2009 and March 2010. The accounting codes of duty and cess mentioned in GAR-7 challans were also not correct.

In reply, the department stated that objection was related to a small biri manufacturer who was hardly literate and prone to such mistakes. However, the concerned assessee has been requested for compliance (August 2011).

4.4.3 In Bettiah range in Patna Commissionerate, M/s Tirpuati Sugar Ltd., cleared 86409 quintal of sugar in November 2009 and paid sugar cess, education cess and secondary and higher education cess of ₹ 13.45 lakh against ₹ 23.20 lakh payable. This resulted in short payment of cess amounting to ₹ 9.75 lakh.

In reply, the department stated that the matter is being looked into and steps for recovery of duty will be taken if objection was found correct (July 2011).

4.4.4 We scrutinised 120 returns in Pune-III and ST Mumbai-I Commissionerates that had been marked for review and correction by ACES but had not been reviewed by the ranges. We found discrepancies in 26 returns. Nine of these returns involved delayed filing of return and four returns involved delayed payment of duty. We also found short payment of duty in six returns of Pune III involving ₹ 17.36 lakh and seven returns of ST Mumbai I involving ₹ 9.94 crore. In Pune III commissionerate out of short payment of ₹ 17.36 lakhs, department intimated the recovery of ₹ 8.22 lakh. Some illustrative cases are mentioned below:-

4.4.4.1 Scrutiny of ST3 returns of M/s India Bulls Real Estate Co. P Ltd (for April to September 2010) and M/s Gammon Infrastructure Projects Ltd (for April to September 2010) in Mumbai ST I Commissionerate revealed that they received ₹ 34.73 crore and ₹ 12.21 crore respectively for providing exempted services but had not maintained separate accounts of inputs (as declared in column 5A(c) of their returns). Hence, they were liable to pay amount equal to 6 per cent of the value of exempted services i.e. ₹ 2.08 crore and ₹ 73.23 lakh respectively as per provisions of Rule 6(3) of Cenvat Credit Rules, 2004.

4.4.4.2 In two returns of M/s Gammon India Ltd and M/s Rediffusion Dentsu Young & Rubicam Pvt. Ltd. (for April to September 2010) in Mumbai ST I Commissionerate, it was observed that there was mismatch of service tax payable of ₹ 30.45 crore and the service tax paid of ₹ 23.35 crore, as per figures shown in the ST 3 returns. The large difference of ₹ 7.10 crore was not examined by the department although the returns had been marked for review and correction. We pointed it out in April 2011. Reply was awaited (November 2011).

4.4.5 In Patna Commissionerate, under Bankipur-I range, we detected short payment of ₹ 26.25 lakh due to wrong calculation of service tax at the rate of 10 per cent instead of applicable rate of 12 per cent, during the

scrutiny of ST-3 return of M/s Scorpion Express Pvt. Ltd., Patna, for the period October 2009 to March 2010.

4.4.6 The service tax return for the period from October 2009 to March 2010, of M/s Seeta Sponge Iron Ltd., registered under GTA service in Kalunga –I Range in Bhubaneswar II Commissionerate, did not have any challans enclosed for tax paid and the column for details of service tax was also left blank. It was not possible to know whether service tax of ₹ 4.27 lakh had been paid or not. This omission was not detected by the range. On being pointed out by us, the range superintendent replied that the matter would be investigated.

4.4.7 The Bangalore ST Commissionerate had not carried out any detailed scrutiny. We called for records, as specified in the Service Tax Returns scrutiny manual and carried out the detailed scrutiny for 148 returns of 74 assesseees. We detected errors in returns of 30 assesseees amounting to ₹ 4.13 crore. Two illustrative cases are given below.

4.4.7.1 Rule 3 of the Service Tax (Determination of Value) Rules provides that the value of taxable service shall include non-money consideration where such consideration is received.

M/s Digicomp Complete Solution Ltd, in Bangalore ST Commissionerate, providing services to a foreign firm, M/s Compel Electronics, imports material that is supplied free of cost by M/s Compel. The assessee treats these free imports as inputs and takes cenvat credit of CVD paid. Since they are received free of cost from the service receiver, they are in the nature of additional non-money consideration and their value should be added to the valuation of taxable service as provided in Rule 3 of the Service Tax (Determination of Value) Rules. Non-inclusion of the value of the free imports has resulted in under valuation leading to short payment of service tax of ₹ 17.15 lakh (2008-09 & 2009-10), which is recoverable alongwith interest. Department is also required to assess the short payment in earlier years.

4.4.7.2 M/s Globe Detective agency under Bangalore ST Commissionerate, is rendering security services in India to foreign clients. The income from providing these is classified as "Educational Testing Income (ETS)" in the financial statements. The assessee has not been paying service tax on ETS, treating it as Export of service. This is irregular as the services are being provided within the country and service tax is payable. The non-payment of service tax works out to ₹ 7.36 lakh for the year 2009-10 which is recoverable with interest. When we pointed this out, the department issued (May 2011) a show cause notice assessing the short payment of ₹ 34.88 lakh for 2009-10 and earlier periods.

The illustrative cases related above involve revenue implication of ₹ 14.92 crore. They underline the importance of carrying out preliminary and detailed scrutiny in the prescribed manner to detect and correct discrepancies and errors in the returns.

4.5 Reconciliation of payment of Central Excise Duty and Service Tax indicated in Returns

Since the duty/ tax is paid at banks and the returns are submitted to the ranges, the payment details shown in returns are required to be reconciled with the payments received at banks, to guard against the risk of fraudulent declaration of payment of tax and to ensure correct accounting. Upto March 2007, the Chief Accounts Officers (CAO) in the commissionerates did the reconciliation of tax / duty paid. They received assessee-wise payment details from divisions, who in turn compiled them from the details prepared by their subordinate ranges from the returns submitted. The CAO would also receive soft copy of assessee-wise payment details from the Pay and Accounts Officer (PAO). Thereafter, the CAO had to reconcile the payment details submitted by the divisions with the details furnished by the PAO.

CBEC implemented the “Electronic Accounting System in Excise and Service Tax (EASIEST)” from 1 April 2007. Under this system, the assesseees pay central excise / service tax at banks through challans and the banks enter payment details on EASIEST. The payment data generated by the banks is maintained by NSDL (under an MOU with CBEC), who transfer the data to the CBEC servers. EASIEST data is also sent to Pay and Accounts Officers (PAO) for reconciliation of payments. The system is administered by the Director General (System), CBEC, New Delhi, who is assisted by the National Informatics Centre (NIC).

While filing returns, assesseees give details of challan numbers through which they pay tax / duty. As per circulars dated 13 March 2007 and 31 August 2009, the manual reconciliation by the CAO was done away with and the ranges are supposed to reconcile the payments by linking the challan numbers listed in the returns with the challan numbers of the payments actually received in banks and uploaded on the CBEC server.

We ascertained that in 92 ranges, reconciliation was not done either through the ACES and EASIEST i.e. electronically. In 26 ranges it was done manually, as per the earlier practice. Only in 66 ranges the reconciliation was done electronically.

We did a test check of the challans attached to a sample of 20 returns in the ranges where the reconciliation *was done* through EASIEST. We observed that there were no discrepancies except in Pondicherry Commissionerate where 18 out of 20 test checked challans had been accounted wrongly by showing different duties clubbed under a single head and in Jaipur I Commissionerate, where 68 challans could not be found on EASIEST system.

Where reconciliation *was not done*, we test checked 20 returns of central excise and 20 returns of service tax by reconciling the challans with the challan details available from EASIEST on the CBEC server at <https://cbec.nsd.com/EST/>. The errors detected as described below, underlined the requirement of carrying out the reconciliation of challans for proper accounting of revenue.

4.5.1 Central excise

4.5.1.1 In Bettiah range under Patna Commissionerate, details of 16 challans for the month of February 2010, amounting to ₹ 74.87 lakh, of M/s M. P. Chini Industries were not found on EASIEST.

In reply, the department intimated (July 2011) that the matter was under examination and in case of fraud or non-payment is detected, action would be initiated to safeguard the Government revenue.

4.5.1.2 In Faridabad Commissionerate 66 challans were checked and the details of 12 challans amounting to ₹ 47.04 lakh were not found. In five challans involving an amount of ₹ 5.34 lakh, details such as Bank branch code, Challan number and date of deposit etc. were neither recorded in the challan nor in ER-I returns. Therefore, they could not be matched on EASIEST.

4.5.1.3 In Gurgaon Commissionerate, 53 challans were checked and the details of eight challans amounting to ₹ 15.20 lakh were not found. In another 27 challans amounting to ₹ 39.19 lakh, Bank branch code was not recorded. Therefore, the challans were not traceable on the EASIEST system.

4.5.1.4 In Jajpur Road I range under Bhubaneswar I Commissionerate, one challan was not found in EASIEST.

4.5.1.5 In one range in Pondicherry Commissionerate, we observed that in 12 challans, payment was made clubbing different duties under one single head which resulted in wrong accounting.

4.5.2 Service Tax

4.5.2.1 In Division I of Mumbai ST I Commissionerate, details of nine challans of two assesseees were not available in EASIEST. When we pointed this out, the department replied that the tax amount has been paid by the assesseees as verified from physical challans.

4.5.2.2 In Raipur Commissionerate, out of 40 challans, details of four challans were not available in EASIEST.

4.5.2.3 In three ranges (Jajpur road-I, Dhenkanal-II and Balasore service tax) under Bhubaneswar-I Commissionerate details of 12 challans were not available in EASIEST. Similarly in Kuarmunda range under Bhubaneswar-II Commissionerate, details of six challans were not available in EASIEST. Superintendents, Dhenkanal-II, Jajpur road-I and Kuarmunda replied that reconciliation of challan would be made and intimated to audit.

4.5.2.4 In Pondicherry Commissionerate, in one Service Tax Group, out of total population of 1199 challans a Sample of 30 cases was taken up and it was noticed that in 20 remittances, payment made was shown in one head instead of exhibiting separately under ST, EC, SHE Cess.

Recommendation No. 6

➤ *The following MIS reports may be generated by ACES and corrective action taken:*

- *list of non-filers - which may be investigated to detect stop filers*
- *returns submitted with delay – suitable penalty may be imposed*

- *assesseees who had delayed the payment of duty - prescribed interest may be imposed*
- *details of returns marked by the system for review and correction but corrective action not taken.*

The Board stated in the exit conference that the Systems Directorate had informed that in ACES there is a functionality to generate a report called 'assessee-wise detailed report', both in Central Excise and Service Tax, giving information whether assessee is filing return in ACES or not. It also stated that the comprehensive MIS, under development in ACES, would generate reports suggested by us.

Recommendation No. 7

- *The function of detailed scrutiny may be implemented in all the ranges. Till such time that ACES does not do the sample selections of returns, the samples may be selected manually, as prescribed in the scrutiny manuals. It may also be ensured that AC/DC/JC/ADC may conduct the detailed scrutiny of high monetary value returns as prescribed in the returns manual.*

The Board stated in the exit conference that it was reiterating extant instructions and directing the Commissioners to monitor implementation of this area of work. The Chief Commissioners were being asked to take stock of the actions taken.

Recommendation No. 8

- *The challan details submitted online and manual returns may be reconciled with the challan details captured through EASIEST. Such a process would become fully automated when all returns are submitted through ACES.*

The Board stated in the exit conference that with effect from 1 October 2011, all the CE and ST returns are mandatorily to be filed electronically. It was also stated that even otherwise, the Range Officer had to verify TR-6 challans with data of actual payment as per serial No. 27 of Annex 4.1 of Manual of Scrutiny of Central Excise return.



CHAPTER V - EFFECTIVENESS OF THE INTERNAL AUDIT PROCESS

5.1 Introduction

Internal audit is one of the main compliance verification mechanism in the department, which involves selection of assessee units on the basis of risk parameters and scrutiny of records of the assessee to ascertain the level of compliance with the prescribed rules and regulations. Internal Audit is empowered, under Central Excise and Service Tax Rules, to access the records of the assessees at their registered premises. Every commissionerate has an Audit cell, manned by an Assistant/Deputy Commissioner and auditors and headed by an Additional/Joint Commissioner and this cell prepares co-ordinates and monitors the audit plan. The audit is done by a set of internal audit parties (IAP) consisting of Superintendents and Inspectors.

The Board has laid down detailed guidelines in the form of Audit manuals for audit of central excise and service tax units, which prescribe detailed processes for conduct of audit. We evaluated five main processes prescribed in the manuals.

5.2 Maintenance of Assessee Master File

Risk-based audit requires a comprehensive data base for profiling each taxpayer, so that risk factors relevant to a taxpayer may be identified in a scientific manner and audit planned and executed accordingly. A comprehensive data base of assessees is an essential pre-requisite for selection of units as well as for undertaking preliminary Desk Review, for effective conduct of audit. As per the audit manuals, this information has to be collected and kept in a separate file for each assessee called Assessee Master File. As per chapter 9 of Central Excise Audit Manual, 2008 and para 6.1 of the Service Tax Manual, 2003, the Assessee Master File is to be prepared and updated by the Audit cell in the commissionerate. A list of documents as indicated in Annexure A (Registration application, copies of past three years returns, copy of past three years audits, cost audit/tax audit report and financial statements of past three years) & Annexure B (Details of goods manufactured and exempted, production details, duty payment and issue of SCN of past three years and details of litigation) of the manual is to be kept in each assessee master file.

We observed that this work had not been completed by most of the commissionerates and the information related to Assessee Master Files was not reflected in the monthly reports submitted by the Audit Cell to the Commissioner. The details are given below:-

5.2.1 Central Excise

Fifteen²⁵ out of 39 test checked commissionerates reported that the master files were created for all assessees. We test checked 20 assessee master files in each of the 15 commissionerates (300 files) and found that in eight commissionerates²⁶, the test checked files were kept according to manual. In the remaining seven commissionerates²⁷, 117 out of 140 files were found incomplete as items such as organisational chart of the unit, copy of declaration of the latest list of the records furnished by assessee, cost audit/tax audit reports etc. were missing. The absence of these records hamper the selection process of the units for audit and the desk review processes where the units have already been selected for audit.

Coimbatore, Pondicherry, Bhubaneshwar II, Cochin and Lucknow Commissionerates reported that they had created master files for all the mandatory units (to be audited every year) and some of the non-mandatory units. We test checked 20 assessee master files each in four commissionerates and seven files that were produced by Bhubaneshwar II Commissionerate. We found that in Coimbatore Commissionerate, the test checked files were kept according to manual. In the other four commissionerates, 48 out of 67 files were found incomplete.

Fourteen commissionerates²⁸ reported that the assessee master files were not created even for all mandatory units. We requisitioned, for test check, 20 assessee master files, from each commissionerate from amongst the files that were created. We found that in three commissionerates (Indore, Pune III & Thane II), the test checked files were prepared according to manual. However in nine commissionerates 145 out of 180 files were found incomplete. Bhubaneshwar I Commissionerate produced only 5 files instead of 20 and all of them were incomplete. Bhopal Commissionerate did not produce any files for scrutiny so we were unable to verify quality of maintenance of files. Patna and Goa Commissionerates reported that assessee master files had not been created. Kolkata III, IV and V Commissionerates reported that a register was maintained for recording the names of assessees and revenue paid by each of them. This register was considered as 'assessee master file/profile' and used for selecting units to be audited and also for conducting preliminary desk review. Separate files were not maintained for each assessee.

Kolkata V commissionerate intimated (June 2011) that on being pointed out by us, it had initiated action in this regard. However Kolkata III and Kolkata IV Commissionerate stated (June 2011) that it was not practically possible to maintain the master files. This was not consistent with our findings. Many of the test checked commissionerates had already created a large bank of master files which showed that the task was practically feasible.

²⁵ Hyderabad II & III, Visakhapatnam I, Dibrugarh, Delhi II, Jamshedpur, Bangalore III, Mysore, Ahmedabad III, Vadodara II, Vapi, Chandigarh I, Ludhiana, Jaipur I & II

²⁶ Hyderabad II & III, Visakhapatnam I, Delhi II, Mysore, Ahmedabad III, Vadodara II and Vapi

²⁷ Dibrugarh, Jamshedpur, Bangalore III, Jaipur I & II, Chandigarh I and Ludhiana

²⁸ Indore, Pune III, Thane II, Raipur, Nagpur, J & K, Belapur, Meerut I, Noida, Faridabad, Gurgaon, Bhubaneshwar I, Bhopal and Guwahati

5.2.2 Service Tax

Twelve commissionerates out of 35 test checked reported that the master files were created for each assessee. We test checked 20 assessee master files in each commissionerate (240 assessee files) and found that in eight commissionerates²⁹ the test checked files were kept according to manual. In four commissionerates³⁰, 79 out of 80 assessee files were found incomplete as items such as copy of the list of accounts maintained by the taxpayer, copy of service specific profile, cost audit/tax audit reports etc. were missing.

Seven commissionerates³¹ reported that they had created master files for all the mandatory units and some of the non-mandatory units. We did a test check of 20 assessee master files in each commissionerate (140 assessee files) and found that in Coimbatore Commissionerate the test checked files were prepared according to manual. In Cochin and Panchkula Commissionerate all 40 files were found incomplete. In Bhubaneshwar II Commissionerate three files were found incomplete and another 17 files requisitioned by us had actually not been created. Lucknow, Indore and Bhopal Commissionerates did not produce any files so we were unable to verify the maintenance of files.

Ten commissionerates³², reported that the assessee master files were not created even for all mandatory units. We requisitioned, for test check, 20 assessee master files, from each commissionerate from amongst the files that were created. We found that in Pune III commissionerate, the test checked files were kept according to manual. In Delhi ST Commissionerate, four out of 20 files were found incomplete. Bhubaneshwar I Commissionerate and Bangalore ST Commissionerate produced three and five files respectively instead of 20 files and all the files produced were found incomplete. In Pondicherry Commissionerate 19 out of 20 requisitioned files were not created. In remaining five commissionerates, all 100 files were found incomplete. Mumbai ST Commissionerate did not produce any file for examination.

In Patna, Nagpur, Chandigarh I, Kolkata ST and Goa Commissionerates, no assessee master files were created.

The Kolkata ST Commissionerate stated (June 2011) that henceforth assessee master files would be maintained for top 100 assessees.

Our findings showed that 463 (59 per cent) out of 780 files of Central Excise and 442 (66 per cent) out of 665 test checked files of Service Tax were either not created or were maintained in an incomplete manner. We also observed that the status of creation of assessee master files was not included in the MTR (Monthly Technical Report) or any other reports submitted to the commissioner. Therefore, this activity was not being properly monitored. Consequently, the selection of units for internal audit was not being done on various risk parameters as prescribed in the manuals.

²⁹ Hyderabad II & III, Visakhapatnam I, Ahmedabad ST, Ahmedabad III, Vadodara II, Ludhiana and Mysore

³⁰ Dibrugarh, Chennai ST and Jaipur I & II

³¹ Coimbatore, Bhubaneshwar-II, Cochin, Lucknow, Bhopal, Panchkula and Indore

³² Bangalore ST, Jamshedpur, Delhi ST, Pune III, Mumbai ST, Pondicherry, Meerut I, Noida, Bhubaneshwar I and Guwahati

5.3 Selection of units for audit

As per para 10.1.1 and 10.1.2 of Central Excise Audit Manual, 2008 and as per para 5.1.4 of Service Tax Audit Manual, 2003, the audit cell of each commissionerate is to maintain an updated list of all registered assessees. The list is segregated into two categories - mandatory units and non-mandatory units. The units in the non-mandatory category are to be selected for audit on the basis of risk assessment using prescribed criteria.

While an elaborate selection procedure was prescribed in the manual, we found that in actual practice, the non-mandatory units were selected, by and large, only on the basis of revenue collected. Details are furnished below:

5.3.1 Central Excise

As per para 10.1.2 of Central Excise Audit Manual, 2008, DG (Audit) is to compute the risk for all the non-mandatory units in a centralised manner, called rupee risk, every year and circulate the list of assessees in each slab of non-mandatory category by 15th April. On the basis of this list, the Audit Cell is to prepare an annual list of assessees to be audited during the year.

It was reported by 39 test checked commissionerates of central excise, that none of them received the list of assessees from DG (Audit).

As per para 10.1.3 of Central Excise Audit Manual, 2008, while selecting the units, local risk parameters provided as per para 3.1.7 of the Central Excise Audit Manual are to be applied and the units rearranged accordingly. The reasons for such rearrangement are to be recorded. The selection of units for audit is done by Deputy/Assistant Commissioner (Audit), which is approved by Additional/Joint Commissioner (Audit).

In nine commissionerates,³³ the data/information for local risk parameters was maintained as per the manual and also applied in arranging the audit priority of the units. Cochin Commissionerate did not furnish any information in this regard. In remaining 29 commissionerates the selection was done primarily on the basis of revenue with one or two additional criteria and not in the detailed manner as envisaged in para 3.1.7 of the Central Excise Audit Manual.

5.3.2 Service Tax

As per para 5.1.3 of the Service Tax Audit Manual, 2003, the units in the non-mandatory category are to be selected for audit on the basis of risk assessment taking into account local risk parameters prescribed in para 5.1.5 and 5.1.4 of the manual, *ibid*.

In 13 commissionerates³⁴ the data/information for local risk parameters was maintained as per the manual and also applied in arranging the audit priority of the units. The Cochin and Kolkata ST Commissionerates did not maintain/furnish any information in this regard. Mumbai ST and Bangalore ST Commissionerates reported that they could not audit all mandatory units, hence no non-mandatory units were audited and the need to apply these risk

³³ Guwahati, Dibrugarh, Nagpur, Indore, Jaipur I, Meerut-I, Ahmedabad III, Coimbatore and Pondicherry

³⁴ Guwahati, Dibrugarh, Nagpur, Mysore, Meerut I, Bhubaneswar II, Ahmedabad ST, Vadodara II, Ahmedabad III, Chandigarh I, Ludhiana, Jaipur I and Pondicherry

factors did not arise. In remaining 18 commissionerates³⁵ the selection was done primarily on the basis of revenue with one or two additional criteria and not in the detailed manner as envisaged in para 5.1.4 of the Service Tax Audit Manual.

5.4 Audit Planning

As per para 10.1.5 of Central Excise Audit Manual, 2008 and 5.2.1 of Service Tax Audit Manual, 2003, the quarterly schedule of allocation of units to each audit party is done with the approval of Additional Commissioner/Joint Commissioner (Audit).

5.4.1 We found that in central excise as well as service tax, majority of the commissionerates prepared quarterly schedules with the approval of proper authority. In some cases the schedules were approved with different periodicity.

5.4.2 Prior to actual conduct of audit, the IAPs are required to

- gather as much information about the assessee as possible and analyse this information which is called “Desk-Review” and the same should be submitted to the Deputy/Assistant Commissioner (Audit) for approval. This is provided in para 10.4.1 of Central Excise Audit Manual, 2008 and 6.2 of Service Tax Audit Manual, 2003,
- prepare an “Audit Plan” approved by Additional Commissioner/Joint Commissioner, containing the exact formulation of issues selected for detailed examination in respect of every assessee. This is to be prepared in the form of Annexure H & F as per para 10.4.14 of Central Excise Audit Manual, 2008 and 6.4 of Service Tax Audit Manual, 2003
- prepare a “Verification Paper”, as prescribed in Annexure I & E of the respective manuals, outlining the audit checks in the Audit Plan, verification done on each check and auditor’s observations in brief.

To assess the compliance to these three procedures, we did a test check of 20 assessee audit files each in 37 commissionerates of central excise and seven and eleven files produced by Bhubaneswar I and Lucknow Commissionerates respectively (total 758 files). Similarly, in service tax, we did a test check of 20 assessee audit files each in 33 commissionerates and five files that were produced by Bhubaneswar I Commissionerate (total 665 files). Lucknow Commissionerate did not furnish any files in respect of service tax.

We observed that

- for 60 central excise audits (eight per cent) and for 78 service tax audits (12 per cent), the desk review papers were not prepared.
- For six central excise audits (0.8 per cent) and for 43 service tax audits (six per cent), the audit plan was not prepared.
- For 115 central excise audits (15 per cent) and for 144 service tax audits (22 per cent), the verification papers were not prepared.

³⁵ Hyderabad II, Hyderabad III, Visakhapatnam I, Lucknow, Noida, Chennai ST, Coimbatore, Patna, Goa, Raipur, Pune III, Bhopal, Indore, Bhubaneswar I, Jamshedpur, Jaipur II, Panchkula and Delhi ST

5.5 Execution of audit plan

5.5.1 Audit Plan Registers

As per para 12.3.1 of Central Excise Manual, 2008, and para 9.5.1 of Service Tax Audit Manual, 2003, a register of units planned for audit in the prescribed format is to be maintained to monitor the different stages of execution of the audit and ensure that all units allotted to an Audit Group have been audited and wherever audit has been completed, the Audit Reports have been issued on time.

We observed that the Audit Plan Registers were not maintained according to manual and did not reflect whether all planned units had been audited and whether audit reports had been issued timely.

In 11 commissionerates,³⁶ the register was maintained according to manual. However, in 28 commissionerates³⁷, it was not maintained according to manual and entries such as date of submission of IAR to audit cell, Audit Report No and date of issue of IAR were not filled up. Consequently, it was not possible to monitor, from these registers, whether the audit reports were issued on time. In Bangalore III, Cochin and Kolkata III, IV & V Commissionerates we observed that APR contained details of only those units which were actually audited. Consequently, it was not possible to monitor, through the register whether all units allotted to a particular group had actually been audited. The APR was not produced for examination by Jamshedpur Commissionerate.

The department admitted the facts in Goa, J & K, Pondicherry, Bangalore III, Lucknow, Meerut I and Noida Commissionerates and stated that it was noted for future compliance. The reply was awaited from the remaining commissionerates (November 2011).

Similarly, in service tax in 12 commissionerates³⁸ the register was maintained according to manual. However, in 21 commissionerates³⁹ it was not maintained according to manual and entries such as date of submission of IAR to audit cell, Audit Report No, date of issue of IAR were not filled up. The APRs were not produced for examination by Jamshedpur and Delhi ST Commissionerates.

The department admitted the facts in Goa, Pune III, Pondicherry, Lucknow, Meerut I and Noida Commissionerates and stated that it was noted for future compliance. Kolkata ST Commissionerate informed that they had taken rectificatory measures. The reply was awaited from the remaining commissionerates (November 2011).

³⁶ Ahmedabad III, Bhubaneshwar II, Coimbatore, Delhi II, Dibrugarh, Guwahati, Jaipur I & II, Mysore, Vadodara II and Vapi

³⁷ Bangalore III, Belapur, Bhopal, Bhubaneshwar I, Chandigarh I, Cochin, Faridabad, Goa, Gurgaon, Jamshedpur, Hyderabad II & III, Indore, J & K, Kolkata III, IV & V, Lucknow, Ludhiana, Meerut I, Nagpur, Noida, Patna, Pondicherry, Pune III, Raipur, Thane II & Visakhapatnam I

³⁸ Ahmedabad III, Vadodara II, Ahmedabad ST, Bangalore ST, Mysore, Jaipur I & II, Panchkula, Guwahati, Dibrugarh, Bhubaneshwar II & Coimbatore

³⁹ Nagpur, Kolkata ST, Cochin, Lucknow, Noida, Meerut I, Chandigarh I, Bhubaneshwar I, Mumbai ST, Pune III, Patna, Chennai ST, Pondicherry, Hyderabad II & III, Visakhapatnam I, Raipur, Bhopal, Indore, Ludhiana and Goa

5.5.2 Audit Coverage

We found that in ten commissionerates, non-mandatory units were audited at the cost of mandatory units. This situation prevailed for both central excise and service tax.

5.5.2.1 Central Excise

Of the 39 test checked commissionerates, 34 commissionerates furnished figures of the units due, planned, audited and the shortfall during 2009-10, as depicted below:-

Table No. 2

| Categorisation of unit | Slab of annual duty (PLA + Cenvat) | Total number of units | Number of units due for internal audit as per the frequency prescribed | Number of units planned | Number of units audited | Shortfall | Short fall in per centage |
|--|------------------------------------|-----------------------|--|-------------------------|-------------------------|-----------|---------------------------|
| Category A (mandatory) 100 per cent to be audited | More than ₹ 3 Crore | 3809 | 3809 | 3785 | 3110 | 675 | 17.8 |
| Category B (non-mandatory) 50 per cent to be audited | Between ₹ 1 Crore to 3 Crore | 4032 | 2016 | 2164 | 1879 | 285 | 13.1 |
| Category C (non-mandatory) 20 per cent to be audited | Between ₹ 50 lakh to ₹ 1 Crore | 3846 | 769 | 1046 | 943 | 103 | 9.8 |
| Category D (non-mandatory) 10 per cent to be audited | Less than ₹ 50 lakh | 25025 | 2503 | 2125 | 1669 | 456 | 21.5 |
| Total | | 36712 | 9097 | 9120 | 7601 | 1519 | 16.7 |

The remaining five commissionerates⁴⁰ did not furnish the details. The foregoing table reveals that the short fall percentage is higher in the case of mandatory units compared to category B & C (non-mandatory) units. Number of non-mandatory units planned was greater than units due in category B & C, whereas for mandatory units it was lower than the requirement.

Instances where greater emphasis placed on the audit of non-mandatory units at the cost of mandatory units are depicted below:-

(a) In Belapur Commissionerate 191 mandatory units were planned and only 83 units (43 per cent) were audited. At the same time the Commissionerate planned 177 non-mandatory units and audited 166 units (93 per cent) thereby giving priority to audit of non-mandatory units.

⁴⁰ Goa, J&K, Thane II, Jamshedpur and Cochin

(b) In Pune III Commissionerate 254 mandatory units were planned and only 65 (26 per cent) were audited whereas against 172 non-mandatory units planned, 120 units (70 per cent) were audited.

(c) In Thane II Commissionerate 111 mandatory units were planned and 90 units audited (81 per cent) whereas 235 units of Category C & D were audited against 199 units due.

(d) In Jamshedpur Commissionerate out of 65 mandatory units, only 31 (48 per cent) were audited whereas 81 non-mandatory units of D category were audited against only 42 units due. Thus, non-mandatory units were audited at the cost of mandatory units. The Commissionerates, in their replies stated that shortfall in audit was due to (i) non-receipt of relevant documents from the assesseees for desk review, (ii) request of the units for postponement of audit, (iii) seizure of documents by preventive wing, (iv) closure of units, (v) shortage in man power.

The reasons furnished in the replies could not justify large shortfalls in audit cited above. For items (i) to (iv), the parties can be redeployed for auditing other assesseees, which were due but could not be planned because of shortage of man power. Giving shortage of man power as a reason for short fall in audit was against the concept of audit planning, where units would be planned for audit based on man power.

5.5.2.2 Service Tax

Of the 35 test checked commissionerates, 30 Commissionerates furnished figure of units due, planned, audited and shortfall during 2009-10, as depicted below:-

Table No. 3

| Categorisation of unit | Slab of annual duty (PLA + Cenvat) | Total number of units | Number of units due for internal audit as per the frequency prescribed | Number of units planned | Number of units audited | Shortfall | Short fall as per percentage of units planned |
|---|------------------------------------|-----------------------|--|-------------------------|-------------------------|-----------|---|
| Category A (mandatory) 100 per cent to be audited | More than ₹ 50 lakh | 5148 | 5148 | 3441 | 2589 | 852 | 24.7 |
| Category B (non-mandatory) 50 per cent to be audited | Between ₹ 25 lakh to 50 lakh | 4434 | 2217 | 1158 | 944 | 214 | 18.5 |
| Category C (non-mandatory) 20 per cent to be audited | Between ₹ 10 lakh to ₹ 25 lakh | 12260 | 2452 | 1453 | 1210 | 243 | 16.7 |
| Category D (non-mandatory) two per cent to be audited | Less than ₹ 10 lakh | 306847 | 6137 | 2868 | 2183 | 685 | 23.8 |
| Total | | 328689 | 15954 | 8920 | 6926 | 1994 | 22.4 |

The remaining five commissionerates⁴¹ did not furnish the details. The foregoing table reveals overall shortfall of 22.4 per cent. The short fall percentage was highest in the case of mandatory units. Only 67 per cent of mandatory units were planned out of which 24.7 per cent of units remained unaudited which meant that effectively only 50.3 per cent of mandatory units were audited.

We found that seven Commissionerates⁴² placed greater emphasis on the audit of non-mandatory units at the cost of mandatory units. Three cases are detailed below:-

- a) In Jamshedpur Commissionerate, only 10 (20 per cent) mandatory units were audited against 51 due where as 167 units of category D were audited, although only 42 were due.
- b) In Chandigarh I Commissionerate, 92 mandatory units were planned and only 59 (63 per cent) were audited whereas in category B & C, 167 units were planned against only 117 units due and 160 were audited.
- c) In Nagpur Commissionerate, 39 category A units were planned against 102 units due and only 10 (10 per cent of due) were audited. While only 48 non-mandatory units were due in category B & C, 114 were planned and only 22 units (45.8 per cent of due) were audited. Therefore, both during planning and execution, greater preference was given to coverage of non-mandatory units.

We also observed that there was scope for rationalization in the deployment of personnel. For example, Bangalore ST Commissionerate was not able to conduct audit of all mandatory units while Mysore Commissionerate was auditing even the non-mandatory units much beyond the units due as per frequency norms. Similarly, Chennai ST Commissionerate was not able to include all mandatory units in audit plan whereas Coimbatore and Pondicherry Commissionerates were auditing non-mandatory units beyond frequency norms.

The Commissionerates, stated in reply that shortfall in audit was due to (i) non-receipt of relevant documents from the assesseees for desk review, (ii) request of the units for postponement of audit, (iii) assesseees not available, (iv) closure of units, (v) shortage in man power.

The reasons furnished in the replies could not justify large shortfalls in audit cited above. For items (i) to (iv), the parties can be redeployed for auditing other assesseees, which for due but could not be planned because of shortage of man power. Giving shortage of man power as a reason for short fall in audit goes against the basis concept of audit planning where units should be planned for audit based on man power.

⁴¹ Goa, Kolkata ST, Delhi ST, Jamshedpur & Cochin

⁴² Jamshedpur, Cochin, Bhubaneshwar I, Nagpur, Chandigarh I, Chennai ST and Ahmedabad ST

5.6 Reporting

5.6.1 Monitoring Committee Meetings

As per para 12.2.2 and 12.2.3 of Central Excise Manual, 2008, and as per para 9.2.1, 9.2.2 and 9.3.1 of Service Tax Audit Manual, 2003 all draft audit reports are to be discussed and approved by the Monitoring Committee headed by the Commissioner. We found that the monitoring committee meetings were held on a regular basis and all reports had been issued after approval by the committee.

5.6.2 Nil Reports

We observed that in 15 central excise commissionerates and 11 service tax commissionerates, the nil reports were substantially above the average for the test checked commissionerates.

5.6.2.1 Central Excise

The test checked commissionerates reported that the total number of reports issued in 2009-10 were 9420 out of which 1280 (14 per cent) were nil reports. Out of these 1280 reports 262 related to mandatory units and 939 related to non-mandatory units. The position in respect of 79 reports could not be ascertained.

In 25 commissionerates, the percentage of Nil report was between 2 and 15 per cent, in four commissionerates⁴³ it was between 16 and 25 per cent and in 10 commissionerates,⁴⁴ it was between 26 and 49 per cent.

5.6.2.2 Service Tax

We ascertained that the total number of reports issued in 2009-10 were 9110 out of which 1241 (14 per cent) were nil reports. Out of these 1098 reports, 233 related to mandatory units and 798 related to non-mandatory units. The position in respect of 67 reports could not be ascertained.

In 21 commissionerates⁴⁵ the nil report percentage was between one and fifteen per cent. In ten commissionerates⁴⁶ it was between 17 and 29 per cent.

The statistics given above showed that the nil reports averaged at 14 per cent in both central excise and service tax. They were above the average in 15 central excise commissionerates and 11 service tax commissionerates. The high variations were required to be analysed by the department.

In paragraph 5.3, we have pointed out that selection of non-mandatory units was being done only on revenue basis and not on other risk parameters as prescribed in paragraph 10.1.3 of Central Excise Audit Manual and paragraph 5.1.3 of Service Tax Audit manual. This could be a contributory factor for the large number of nil reports for non-mandatory units.

⁴³ Raipur, Kolkata IV, Delhi II & Cochin

⁴⁴ Patna, Mysore, Lucknow, Kolkata III, Dibrugarh, Goa, Guwahati, Chandigarh I, J & K and Hyderabad II

⁴⁵ Chennai ST, Jaipur I, Nagpur, Hyderabad II, Hyderabad III, Guwahati, Indore, Ahmedabad III, Visakhapatnam I, Raipur, Noida, Kolkata ST, Delhi ST, Panchkulan, Goa, Pune III, Bhubaneswar I, Bangalore ST, Jaipur II, Cochin and Ahmedabad ST

⁴⁶ Meerut I, Lucknow, Mysore, Vadodara II, Chandigarh I, Bhubaneswar II, Bhopal, Jamshedpur, Dibrugarh and Coimbatore

Recommendation No. 9

- *We recommend that the preparation of Assessee Master Files for each assessee may be completed in a time bound manner. The timelines may be monitored by Commissioners through monthly reports submitted by the Audit Cells*

The Board stated in the exit conference that it agreed with the recommendation and intimated that the Director General (Audit) would examine the matter and prepare a comprehensive report for the Board's consideration.

Recommendation No. 10

- *We recommend that the ACES module for internal audit, which is operational, may be implemented in a time bound manner so that multiple parameters can be used for the risk based selection of non-mandatory units.*

The Board stated in the exit conference that the DG, Systems and DG, Audit would examine the matter and report jointly, by 31 January 2012, on the quantum of work involved and the reasonable time frame by which the operational module can be implemented in central excise and service tax formations. Based on this, and other relevant considerations, Board would issue appropriate instructions.

Recommendation No. 11

- *We recommend that MIS reports may be designed in ACES in the format of the Audit Plan Registers to monitor whether all planned units had been audited and whether audit reports had been issued timely.*

The Board stated in the exit conference that the comprehensive MIS being developed by Systems Directorate would include such information.

Recommendation No. 12

- *We recommend that the reduction in audit coverage due to staff shortages may be distributed evenly across mandatory and non-mandatory units. The practice of auditing larger number of non-mandatory units at the cost of mandatory units may be curtailed.*

The Board stated in the exit conference that the DG, Audit had addressed a letter dated 22 November 2011 to Chief Commissioners drawing their attention to the prescribed norms for audit of mandatory and non-mandatory units as well as to the observations of the Audit and similar findings in the Department's Quality Assurance Review of Commissionerates for the year 2010-11. The Chief Commissioners had been asked to ensure that the audit of such type of units was conducted as prescribed.



CHAPTER VI - SHOW CAUSE NOTICES AND CALL BOOK CASES

6.1 Introduction

Section 11A of Central Excise Act, 1944 for Central Excise and Section 73 of the Finance Act, 1994 for Service Tax provide for issue of Show Cause Notice (SCN) when any duty of excise/ service tax has not been levied or has been short-levied or short-paid or erroneously refunded.

6.2 Maintenance and updating of SCN control register

We observed that there was no uniform practice of maintaining a centralised record to monitor issue of SCNs and their follow up.

On our test check of 46 commissionerates for central excise and service tax, we noticed that there was no centralised record of all the cases which required issue of SCN. Once issued, SCNs were monitored through different records such as 335J Register, Draft SCN Register, SCN movement register, SCN issue register etc. Consequently, there was a monitoring system once SCNs were issued but nothing to ensure that SCNs had been issued in every case of detection of non-levy, short-levy etc. wherever required. Since there was no centralised record, we had to restrict our examination to ascertaining whether SCNs were being issued in all cases, as required by the instructions of the Board, in respect of the observations raised by audit parties (CERA) of the CAG during 2008-09. We found instances where SCNs were not issued and reasons for not doing so were not found on record, as detailed below.

6.2.1 In Patna Commissionerate, we observed that Bettiah central excise range did not initiate the process to issue SCN in one CERA observation (involving ₹ 1.07 lakh) relating to M/s Harinagar Sugar Mills Limited. Similarly, the service tax range I, Bankipur did not initiate the process of issuing SCNs in one para relating to M/s Neelkamal Steel Pvt. Ltd., Patna and three paras relating to M/s Bharti Airtel Ltd., Patna involving a total amount of ₹ 58.93 lakh, pointed out by CERA.

In reply the department intimated (August 2011) that SCN of ₹ 1.07 lakh and ₹ 1.50 lakh had now been issued in respect of M/s. Harinagar Sugar Mills Limited and M/s. Neelkamal Steel Pvt. Ltd., respectively. On the three paragraphs of ₹ 57.43 lakh related to M/s. Bharati Airtel Ltd., it was intimated (August 2011) that the amounts involved in the three cases were included in SCNs issued during January 2010 to March 2010.

6.2.2 In four selected central excise ranges under Nagpur Commissionerate, out of 93 paras issued by CERA, action was taken only in 43 paras either by way of issue of SCN or otherwise and in remaining 50 paras, no action was taken. In respect of service tax, we observed that SCN

had not been issued from eight months to twenty months in nine cases detected by CERA/ IAP/ Preventive Branch.

6.2.3 In two selected divisions under Bhubaneswar II Commissionerate, against 23 CERA objections involving ₹ 14.78 crore, SCNs were issued only in two cases.

6.3 Call Book cases

The Board's circular dated 14 December 1995 provides that the following four types of cases that are pending adjudication are to be transferred to the Call Book.

- Cases in which the Department has gone in appeal to a quasi judicial or a judicial authority.
- Cases where injunction has been issued by Supreme Court/ High Court etc.
- Cases where audit objections are contested.
- Cases where the Board has specifically ordered the same to be kept pending and to be entered into the call book.

Once transferred to the Call Book, the cases are not to be included in the list of cases pending adjudication. The cases in the call book are to be reviewed every month to identify any cases that are to be taken out of the call book and adjudicated. We found instances where these provisions were not adhered to, as detailed below:

6.3.1 Cochin Commissionerate issued four show cause notices to an export oriented unit, DC Mills, Alapuzha, during 2005 to 2009, based on an internal audit objection for non-payment of jute cess amounting to ₹ 49.56 lakh. The commissionerate sought clarification from the Board and transferred these cases to the call book. The Commissionerate did not received any reply from the board (November 2011). As these SCNs did not fall in any of the four categories of cases mentioned in Circular dated 14 December 1995, the transfer of the cases to call book was not in order. They were required to be taken out of the call book and added to the list of cases pending adjudication.

6.3.2 During scrutiny of cases transferred to call book in central excise Division, Alwar, we observed that SCN No V (85)01/Dem./2009 and SCN No. V (76 & 74)13/Dem/09 were issued on the basis of observations of CERA. The Department agreed to both the objections. However, both the cases were transferred to call book in the month of January 2010, without the approval of the competent authority i.e. the Commissioner. The reasons for the unauthorized transfers to the call book were not intimated to us (November 2011).

6.3.3 In Belapur Commissionerate, we found four instances, where cases were not taken out of Call Book leading to long delays in adjudication. The cases are described below:

- a. A SCN issued to M/s IOC Ltd. in April 2000, on the basis of CERA objection, was kept pending in Call Book even after the observation was closed by us in November 2005. It was taken out of Call Book and adjudicated only in October 2009.
- b. A SCN issued to M/s Singh Scrap Processors was taken out from Call Book (April 2008), three years after decision of CESTAT (February 2005) and adjudicated after another year (June 2009). There was a total delay of more than four years after the CESTAT judgment.
- c. A SCN issued (February 1998) to M/s. Joglekar Refabrication and Ceramic Pvt. Ltd. was removed from the Call Book (February 2009), ten years after the acceptance of CEGAT order (September 1999).
- d. A SCN issued (February 2000) to M/s Balmer Laurie & Co. was kept pending in call book for more than four years even after the decision of Supreme Court in 2005.

6.4 Cases remanded by Commissioner (Appeals)

The Finance Act, 2001, amended Section 35A (3) of Central Excise Act, 1944, relating to the powers of Commissioner (Appeals). It provided that “The Commissioner (Appeals) shall after making such further enquiry as may be necessary pass such order as he thinks fit just and proper, confirming, modifying or annulling the decision or order appealed against”. The Supreme Court, in its decision in the case of MIL India Limited, held that the power of the Commissioner (Appeals) to remand had been taken away by the amendment in Finance Act, 2001. On the basis of the above judgment, the Board, in its Circular dated 25 July 2008, affirmed that the powers had been withdrawn to speed up adjudication process because on remand, cases were pushed back to the starting point.

We observed that even after the issue of the above circular by the Board, six cases had been remanded back by Commissioner (Appeals), Cochin. In all these cases, the decisions were accepted by the Cochin Commissionerate during review. As the remand orders were in contravention of the provisions and instructions of the Board, the department could have filed appeals against them instead of allowing the adjudication process to revert to the starting point. The reasons for non-compliance with the provisions had not been intimated to us (November 2011).


Recommendation No. 13

- *A centralised record of all cases where SCNs are likely to be issued, may be maintained and monitored by the commissionerates to ensure that SCNs are actually issued. In the automated environment of ACES, the same record could be used to monitor subsequent stages of action taken.*

The Board stated in the exit conference that all cases detected need not necessarily lead to issuance of show cause notice but it was important that

every detection either results in timely issue of SCN or other appropriate action, as deemed fit by the competent authority. In this regard, it was stated that the Board was consulting field formations on the extant monitoring mechanisms and based on feedback, would take the appropriate action.

New Delhi
Dated : 9 December, 2011


(SUBIR MALLICK)
Principal Director
(Central Excise and Service Tax)

Countersigned

New Delhi
Dated : 9 December, 2011


(VINOD RAI)
Comptroller and Auditor General of India

Glossary of terms and abbreviations

| Abbreviated form | Expanded form |
|------------------|--|
| AC | Assistant Commissioner |
| ACES | Automation of Central Excise and Service Tax |
| ADC | Additional Commissioner |
| APR | Audit planning register |
| BSNL | Bharat Sanchar Nigam Limited |
| BSR | Basic statistical return |
| CAG | Comptroller and Auditor General of India |
| CAO | Chief Accounts Officer |
| CBEC | Central Board of Excise and Customs |
| CEGAT | Customs, Excise and Gold (Control) Appellate Tribunal |
| Cenvat | Central value added tax |
| CERA | Central excise receipt audit |
| CESTAT | Customs, Excise and Service Tax Appellate Tribunal |
| CVD | Countervailing duty |
| DC | Deputy Commissioner |
| DGST | Director General of Service Tax |
| DR | Draft Report |
| EASIIEST | Electronic Accounting System in Excise and Service Tax |
| EC | Education cess |
| E-MAIL | Electronic mail |
| ETS | Education testing service |
| GTA | Goods Transport Agency |
| IAP | Internal audit party |
| IAR | Internal audit report |
| JC | Joint Commissioner |
| Ltd. | Limited |
| MIS | Management information system |
| MOU | Memorandum of understanding |
| MPLIS | Multiprotocol label switching |

| Abbreviated form | Expanded form |
|------------------|--|
| MTR | Monthly technical report |
| NT | Non-tariff |
| PAN | Permanent account number |
| PAO | Pay and Accounts Officer |
| PAR | Performance Audit report |
| PLA | Personal ledger account |
| Pvt. | Private |
| RBI | Reserve Bank of India |
| RC | Registration certificate |
| REIC | Regional economic intelligence committee |
| SCN | Show cause-cum-demand notice/Show cause notice |
| SHE | Secondary and higher education |
| ST | Service Tax |