

**PERFORMANCE AUDIT ON
EXPORT PROMOTION CAPITAL GOODS SCHEME**

**Report of the
Comptroller and Auditor General of India
for the year ended March 2011**

**Union Government
(Indirect Taxes - Customs)
(Performance Audit)
No. 22 of 2011-12**

Laid on the table of Lok Sabha and Rajya Sabha on ... 2000 दिवासर 2001

TABLE OF CONTENTS

	<i>Contents</i>	<i>Page</i>
	<i>Preface</i>	<i>(iii)</i>
	<i>Executive summary</i>	<i>1</i>
<i>Chapter 1</i>	<i>Introduction</i>	<i>3</i>
<i>Chapter 2</i>	<i>Verification of applications</i>	<i>6</i>
<i>Chapter 3</i>	<i>Fixation of Export Obligation</i>	<i>11</i>
<i>Chapter 4</i>	<i>Licences issued to ineligible applicants and defaulters</i>	<i>15</i>
<i>Chapter 5</i>	<i>Import and installation of capital goods and progress report of export obligation fulfilment</i>	<i>20</i>
<i>Chapter 6</i>	<i>Redemption of EPCG authorisations</i>	<i>28</i>

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 observations included in this Report have been selected from the findings of a performance audit on 'Export Promotion of Capital Goods Scheme' carried out during the year 2010-11.

The results of our audit along with recommendations are contained in this Report.

Executive summary

We conducted a performance audit on the 'Export Promotion Capital Goods Scheme' (EPCG) to evaluate the adequacy of the provisions of Foreign Trade Policy, Customs Act and related instructions and to assess their proper implementation in issue of authorisation under the scheme, post issue monitoring of authorisation and redemption of authorisation after completion of the export obligation (EO) periods. The aim was to see that the scheme was being effectively and efficiently implemented and there were no loopholes in the scheme being taken undue advantage of.

The Director General of Foreign Trade (DGFT) issued 89,000 licences between the year 2000 and 2008 of which 63 per cent were issued from Mumbai, Delhi, Coimbatore, Chennai and Bengaluru.

Total revenue forgone on this scheme from 2005-06 to 2009-10 was ₹ 38,188 crore.

The total revenue implication of this audit report is ₹ 3,154.87 crore.

Our major findings are:

- Under EPCG Scheme, the licences issued have to be monitored over an eight year period through many prescribed checks. We observed that authorisations were issued without complete set of documents prescribed and post verification of declarations was usually not done by Regional Licencing Authorities (RLAs) in violation of DGFT's instructions. We recommend that DGFT should prescribe a time-bound schedule for carrying out the prescribed checks and monitor the implementation of this control mechanism.

(Paragraph 2.1)

- We found that Post Issue Audit Wings (PIAW) were not operational in most places except Mumbai. The DGFT should ensure that the PIAWs become operational in the RLAs within fixed time frame for better internal control.

(Paragraph 2.2)

- We found cases of incorrect fixation of average export obligation. We recommend that the DGFT should examine the matter, reiterate the exact method of calculation of average EO and take remedial action in cases of incorrect fixation.

(Paragraph 3.1)

- We found many cases of incorrect fixation of specific export obligation due to calculation mistakes. We recommend that the calculations of EO should also be covered in the test check by Post Issue Audit Wing.

(Paragraph 3.2)

- We observed that authorisations were issued against refusal orders by granting abeyance orders by RLAs without authority. We recommend that the DGFT should issue instructions to stop the issue of abeyances and investigate the basis on which the RLAs had given themselves the discretion to issue abeyance orders.

(Paragraph 4.2)

- We found that neither the RLAs had instituted any system to monitor the receipt of installation certificates of the imported capital goods nor the Customs department initiated any address verification in most of the locations. We recommend that as authentication of the licensee premises is an important check to verify at any time that the imported capital goods were installed and operated at the declared location, Board may examine alternate methods similar to the ones followed by Credit Card Companies/Banks etc. such as periodically calling for copies of utility bills containing the address of the licensees.

(Paragraph 5.2)

- We observed that there was lack of monitoring at the redemption stage. The RLAs were not tracking the receipt of redemption applications on the due dates i.e. on completion of eight years from date of issue of licence. We also observed that there was substantial delay in finalisation of applications for redemption. We recommend that the process of monitoring of the receipt of redemption applications on due dates and their processing thereafter, upto the issue of export obligation discharge certificate (EODC), should be automated.

(Paragraph 6.1)

Chapter 1 Introduction

1.1 EPCG Scheme: The background

The Export Promotion Capital Goods (EPCG) Scheme is one of the earliest export promotion schemes presently in operation. It was introduced on 1st April 1992. The scheme grants licences to exporters to import capital goods at a concessional rate of customs duty. The licencees have to fulfil an export obligation (EO). This means that they have to export a prescribed quantity of goods related to the capital goods being imported under the scheme, within a prescribed number of years from the date of issue of licence.

As the general duty rates on imports fell over time, the concessional rates were also revised downwards. The export obligation on new licencees was reduced substantially in 2004 and the basis for calculation of EO was changed from the CIF value of imports to quantum of duty saved.

The Ministry of Finance statistics showed that the total revenue forgone on this scheme from 2005-06 to 2009-10 was ₹ 38,188 crore. The DGFT intimated that 89,000 licences had been issued between the year 2000 and 2008 of which 63 per cent were issued from Mumbai, Delhi, Coimbatore, Chennai and Bengaluru.

1.2 Process of EPCG Authorisation

The scheme is administered by the Regional Licensing Authorities (RLAs) under the Director General of Foreign Trade (DGFT), Ministry of Commerce. The provisions governing the EPCG Scheme are contained in Foreign Trade Policy (FTP). Detailed procedural aspects are available in the Handbook of Procedures (HBP) notified by Director General of Foreign Trade under Ministry of Commerce and Industries. For being eligible for grant of an authorisation, an applicant must possess, inter alia, a valid IEC¹ code, a nexus certificate showing the production relationship between the machinery to be imported and the items to be exported towards fulfilment of export obligation. The application for licence is to be submitted to the RLA as specified under the Handbook of Procedures of the Foreign Trade Policy. The RLA verifies the information on the application and is required to issue the authorisation, known as EPCG licence, within three days. The applicant is thereafter referred to as authorisation holder or licencee.

¹ Importer Exporter code

As the scheme involves forego of substantial customs revenue, certain responsibilities relating to the monitoring of fulfilment of export obligations (EO) are vested with the Customs Department. The licence issued by the RLA should be submitted thereafter by the licensee to Customs for registration followed by execution of bond and Bank Guarantee. The jurisdictional Commissioner of Customs has to do random verification of some of the authorisations registered at his port to check the correctness of addresses mentioned in the authorisation. On discharge of export obligation, the licensee makes an application of redemption to the Regional Licensing Authority concerned. The RLA issues an Export Obligation Discharge Certificate (EODC) to the Authorisation holder and sends a copy of the same to the Customs Authority with whom the Bond and Bank guarantee had been executed.

In case, the licensee fails to fulfil the prescribed export obligation, he has to pay the customs duty foregone plus interest. The RLA may initiate penal proceedings against the authorisation holder for failure to fulfil the conditions prescribed.

1.3 Audit Objectives

The review was conducted to assess whether:

- A. the Regional Licensing Authority conducts due verification of documents and declarations mandatorily submitted by the IEC holder with the applications.
- B. the export obligation is fixed correctly taking into account the duty saved and the previous three years' exports.
- C. the licensing authorities ensure that licences are not issued to defaulters and ineligible applicants
- D. the RLA/ Customs Department ensure that the capital goods have been imported within the prescribed time limit, have been installed and the licensee submits reports on the progress in fulfillment of export obligation.
- E. the EPCG authorisation is redeemed timely and after verifying the discharge of export obligation.

1.4 Scope and methodology of Audit

As the period allowed for fulfillment of export obligation is eight years, we checked two sets of licences – those that have been issued after April 2007 and another set issued prior to March 2003 for which redemption would be due by March 2011. We conducted the audit in 12 JDGFT Offices² (RLAs) which had issued the highest number of licences. They

² Regional Licencing Authorities at Ahmedabad, Bengaluru , Chennai, Coimbatore, Delhi, Ernakulum, Hyderabad, Kolkata, Ludhiana, Madurai, Mumbai and Pune.

were located in nine states³. These RLAs have issued a total of 52,114 licences. We selected a sample of 1814 current licences i.e. issued after April 2007, which was the basis for scrutiny of the first four audit objectives. In some cases we used the entire sample and in other cases, subset of the entire sample, as per requirements of the audit procedures. For the last audit objective on redemption of licences, we selected 461 licences in which redemption was due as the period of EO was over and another 421 licences which had already been redeemed.

We also covered 22 Customs Commissionerates⁴ linked to the selected RLAs. We carried out physical verification of the installation of machinery imported under the scheme at the premises of 224 licencees. The audit was conducted from December 2010 to March 2011.

1.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and Ministry of Commerce and Industries and their field formations in providing necessary information and records during the conduct of this audit. The objectives, scope and audit methodology for the review was discussed in entry conference held on 8 December 2010 with both the Ministries. The draft report was issued to both the Ministries in July 2011. The audit findings and recommendations were discussed in an exit conference held on 7 September 2011 with both the Ministries. The written responses, from the Ministries wherever received, have been appropriately incorporated in this report.

³ Andhra Pradesh, Tamil Nadu, Delhi, Gujarat, Karnataka, Kerala, West Bengal , Maharashtra and Punjab,

⁴ Kandla, ICD Ahmedabad, Mundra, Ahmedabad Air Cargo, Cochin, Air Cargo Hyderabad, ICD Hyderabad, Kolkata (Sea) Port, Kolkata (Air), ICD Bengaluru, Bengaluru Air, ICD Patparganj, ICD Tuglakabad, NCH, New Delhi, NCH- Mumbai, Mumbai (Air), JNCH, Tuticorin (sea) , Tuticorin (St Johns'), Chennai (Sea), Chennai (Air) and Ludhiana.

Chapter 2

Verification of applications

We scrutinized whether the RLAs were ensuring that the applications for grant of licences were submitted in a complete form and the declarations submitted with applications were verified to be correct.

2.1 Submission of mandatory documents by applicants

In terms of paragraph 5.2 of HBP⁵, the holder of an IEC may submit an application for an EPCG authorisation in specified form (ANF5A) along with mandatory documents. These, inter alia, include certificate from Chartered Engineer establishing nexus between the manufacturer's export product and the capital goods proposed to be imported, certificate from Chartered Accountant stating exports made by the applicant in the preceding three years and registration-cum-membership certificate (RCMC) from the concerned Export Promotion Council.

The applicant is also required to declare that none of its proprietor/partners/directors are attached to any firms that have been defaulters with DGFT and give the details of unrealised foreign exchange pending beyond six months.

2.1.1 We found that RLAs at Andhra Pradesh, Maharashtra, Delhi, West Bengal and Kerala have devised checklists to ensure that the mandatory documents were filed along with the applications. RLAs at other states did not have any checklists. Out of 52,114 authorisations in nine states, we test checked 1814 cases and found 49 cases where licences were issued without obtaining valid documents. The break up is given below:

State	Number of authorisations issued from April 2007 to Sept 2010	Number of cases scrutinised	Number of cases of issue without obtaining valid documents	Whether any checklist was used
(1)	(2)	(3)	(4)	(5)
Maharashtra	14444	560	Nil	Yes
Delhi	8867	267	Nil	Yes
West Bengal	3510	108	1	Yes
Kerala	723	23	Nil	Yes
Tamil Nadu	11949	383	44	No

⁵ Hand Book of Procedures (HBP)

State	Number of authorisations issued from April 2007 to Sept 2010	Number of cases scrutinised	Number of cases of issue without obtaining valid documents	Whether any checklist was used
Andhra Pradesh	3014	147	Nil	No
Karnataka	4054	134	4	Yes
Punjab	4457	136	Nil	No
Gujarat	1821	56	Nil	No
Total	52114	1814	49	

We found that the authorisations issued mostly had a complete set of documents. The proportion of exceptions was not significant except in Karnataka and Tamil Nadu.

- At RLAs, Coimbatore, Madurai and Chennai in Tamil Nadu, out of 383 licences (duty saved ₹ 769.75 crore) examined, 44 licences (11 per cent) with duty saved amount of ₹ 170.69 (22 per cent) crore were issued with invalid RCMCs. This included 16 cases where the RCMCs submitted had expired; 20 licences valuing ₹ 74.75 crore where the RCMCs did not mention the export products of the applicant; seven licences with CIF value of ₹ 5.55 crore where RCMCs were issued for an indefinite period. In one licence with CIF value of ₹ 71 lakh, the RCMC was issued by the Synthetic & Rayon Textiles Export Promotion Council, Mumbai which was not the appropriate authority. The appropriate authority was the Cotton Textiles Export Promotion Council, Mumbai since the Export commodity was 'cotton yarn'. RLA, Coimbatore in their reply stated that RCMC is to be valid on the date of application only and not on the date of issue of authorisations. Audit scrutiny revealed that the RCMC submitted by the licencees in the cases pointed out by audit were valid upto 31 March 2007, whereas the applications for the licences were received after 31 March 2007.
- In RLA, Bengaluru, Karnataka, three licences were issued without the requisite CAs certificate and one licence without obtaining the nexus certificate. The CIF value of these cases was ₹ 63.03 crore. RLA, Bengaluru accepted the audit observation and stated that action has been taken to call for the documents from the licencees.

Our findings indicated that there was a high degree of compliance in submission of complete set of documents. We had observations in four RLA offices where the scrutiny of application is required to be strengthened. As a good practice, all RLAs could use a checklist as being done by five RLAs, as stated earlier.

2.2 Verification of declarations made by applicant

DGFT had issued an instruction in January 2000 under which a Post Issue Audit Wing (PIAW) was required to be constituted in all RLAs for the purpose of test audit of five percent of the licences issued for ensuring the veracity of documents submitted along with application for EPCG authorisation (ANF5A).

The documents submitted by the applicant provide third party authentication of its identity and activities and act as an in-built check prior to issue of authorisation. Therefore, the DGFT introduced a system to establish their veracity through a sample check.

We ascertained that in spite of the passage of eleven years, the PIAW had not been constituted in any of the RLA Offices except Mumbai. Even in Mumbai, where PIAW is functional, out of 11,249 licences issued during 1 April 2007 and 30 September 2010, the department selected 475 licences (4.2 per cent) for random checking of the veracity of the declaration made in the authorisation application. The verification is carried out by issuing references to various authorities requesting verification and confirmation of documents within 30 days. Out of 475 cases, in more than 50 per cent cases (248), no response was received.

The RLA, Mumbai replied (May 2011) that the 'no response received (NRR)' cases were not disposed unless the replies were received from the concerned authorities.

RLA, Hyderabad replied that due to shortage of manpower, PIAW verification become difficult. Therefore, 100 per cent verification is not feasible. Such verification is required only in the cases of doubtful applicants who had come to their adverse notice, especially on Proprietary and Partnership firms.

Reply of the RLA is not acceptable as the DGFT instruction dated January 2000, PIAW was required to be constituted in all RLAs for the purpose of test audit of five per cent of the authorisations issued ensuring veracity of documents submitted along with the application for authorisation.

In the course of our scrutiny, we detected instances of incorrect declarations by applicants. We also found that there were no procedures in place in the RLA offices to verify these aspects.

- Paragraph 5.7 of Foreign Trade Policy 2009-14 stipulates that in case of domestic sourcing of capital goods, export obligation shall be reckoned with reference to notional customs duties saved on FOR (Free on road) value.

In RLA, Ahmedabad, eight applicants (13 licences) declared the duty saved amount on capital goods sourced from domestic suppliers by considering only countervailing duty (CVD) whereas the notional customs duty was also required to be included as per paragraphs 5.6 and 5.7 of FTP. This was not verified by the RLA and resulted in short fixation of EO by ₹ 19.31 crore. The RLA

accepted the observation and stated that no specific procedure has been prescribed in the Foreign Trade Policy (FTP) for applying correct rates. However, RLA assured that necessary corrections would be carried out after obtaining details from the concerned parties. Reply of the RLA that no procedure has been prescribed in the FTP is contradictory to the provisions of paragraphs 5.7 of FTP.

- In RLA, Ludhiana we found from the scrutiny of the balance sheets/export records that there were six licencees whose exports were much higher than declared as they had not included indirect/deemed export in their declarations. In the absence of any system for verification of export figures given in the declarations, the average export obligation was fixed short by ₹ 55.54 crore in the above mentioned six cases.

On being pointed out (February 2011), the RLA, Ludhiana replied that since there were no stipulations in the Foreign Trade Policy/Procedures to carry out verification of documents/statements of previous exports submitted by the applicant in their application, this was not done.

- It was observed in RLA, Ernakulum that in one case, RCMC submitted along with the application was invalid on the date of application. The RLA had not taken any action to obtain valid RCMC which is a mandatory document. In four other cases, the actual FOB value of exports from the Kochi port exceeded the declared FOB value (Form ANF5A). Cross-verification of one of these licencees (M/s Kitex Childrens Wear Ltd) indicated that the declared value furnished by the unit in ANF5A was the figure from bank realization certificate, i.e. the payments received in foreign currency which was lower than the actual exports through Kochi port. The reasons for the difference in remaining cases had been called for from the JDGFT.
- As per declaration in ANF5A form, format of application, the applicant has to declare details of past export where foreign exchange realisation is pending beyond six months. Such declaration needs to be authenticated by a certificate from a Chartered Accountant. We found that in eight cases (five in RLA, Kolkata, one in RLA, Ludhiana and two in RLA, Bengaluru), the applicants, while applying for EPCG authorisation, declared that no amount was pending realisation beyond prescribed time period for the earlier exports made by them. However, the statements of unrealised foreign exchange issued by RBI showed that total export proceeds of ₹ 16.88 crore had remained unrealised against the IEC numbers of these applicants. The Ministry of Commerce, Enforcement guideline dated 29 April 1998, clarified that under Rule 7 (1) (f) of the Foreign Trade (Regulation) Rules, 1993, licencees can be refused to an applicant who is or was a managing partner in a partnership firm or is or was a Director of a private

Limited Company having controlling interest, against which any action is for the time being pending. It directed that a list of the Directors and partners of the firms against which action was pending was to be prepared and referred to at the time of considering grant/renewal of a licence.

We found that such reference list of persons as per the Enforcement guideline was not being maintained by the RLAs. Even the Denied Entities List (DEL) available on the DGFT website did not carry the PAN identity of individual directors/ partners. Thus, over a thirteen year period, the department have not put in place any mechanism to adhere to the guidelines. In the absence of any data to link directors etc. of applicant firms to the directors of firms on whom action was pending, it was not possible for us to ascertain and establish whether there were any such cases amongst the test checked applications.

- We found one application at JDGFT Ernakulum, where the name of one of the directors of an applicant firm, M/s. BPL Mobile Communications Ltd, Ernakulum was also the same as the name of a director of M/s BPL Ltd, Palakkad, a company that had been placed on the Denied Entity List by the DGFT since 2006. The applicant firm was issued five EPCG licences and availed duty benefit of ₹ 3.38 crore. In this case, there was adequate indication for the RLA to enquire whether the two directors were the same person and withhold/ cancel the authorisation if this were the case. However, in the absence of any post verification mechanism, no enquiry was made.

Our findings indicated that wrong declarations by the applicants are a real risk and requires deterrence. Since the RLAs have to issue the licences within three days, it is not practicable that the irregularities pointed out by us could have been detected by them in this short time frame. However, the DGFT had issued instruction in 2000 to cover this risk through post verification by PIAW wings to detect wrong declarations. In the absence of any post verification, there is no deterrence mechanism against wrong declarations in the applications which are resulting in short fixation of export obligations.

Recommendation 1: DGFT's instructions on post issue verification have been largely ignored by the RLAs. The DGFT should prescribe a time-bound schedule and monitor the implementation of this control mechanism.

The DGFT in their reply stated (August 2011) that the Head of Office of each of the RLAs has been directed to ensure implementation of the monitoring mechanism and send a report to the DGFT on monthly basis.

Chapter 3

Fixation of export obligation

The EPCG Scheme permits a licensee to import capital goods at a concessional duty rate who, in turn, has to fulfil an Export Obligation. The total export obligation consists of two parts, specific and average, which has to be achieved over eight years. The specific EO imposed on an authorisation holder was equivalent to five times the duty foregone under FTP, 2004-09, which was revised to eight times under FTP 2009-14. The average EO is the arithmetic mean of exports of the same and similar products, made in previous three years by the authorisation holder. We scrutinised the fixation of average export obligation and specific export obligation and we found irregularities in their fixation in 143 and 26 cases respectively.

3.1 Fixation of Average Export Obligation (AEO)

In December 2004, the DGFT had issued a clarification marked to all RLAs that for calculation of average EO, the aggregate FOB value of exports in the three preceding years was to be divided by the actual number of years of export.

3.1.1 In our sample of 1814 licence files, there were 95 cases where the licensees had declared exports for less than three years preceding the licensing period. We scrutinised the method of calculation of average EO and found that the DGFT's instructions were not followed in 94 out of 95 cases. Since the applicants had declared exports for only one or two previous years in these cases, the average should have been calculated dividing by one or two respectively. However, the average was calculated dividing by three. Only RLA, Ernakulum had done the calculation correctly in the sample scrutinised. The wrong calculation resulted in short fixation of average EO by ₹ 1,082.34 crore as tabulated below:

State	No. of application with less than 3 years' prior export	No. of cases with wrong calculation where under declaration of export noticed	Average EO fixed lower by (₹ In crore)
Tamil Nadu	12	12	7.38
Punjab	6	6	42.56
Maharashtra	32	32	162.08
West Bengal	8	8	18.48
Kerala	1	Nil	Nil
Karnataka	3	3	61.30
Gujarat	3	3	19.82
Delhi	15	15	730.53
AP	15	15	40.19
Total	95	94	1082.34

- The JDGFT Kolkata admitted (March 2011) short fixation of average EO by ₹ 18.48 crore in the eight cases pointed out and informed that all eight licences were being recalled on top priority for necessary corrective action.
- The JDGFT Ludhiana admitted three out of six cases pointed out and replied (Feb 2011) that the average EO had been refixed. For the remaining three cases, it stated that the average export obligation was fixed correctly in view of the decision taken at the Open House Meeting organised under the chairmanship of Commerce Secretary on 1 June 2010. It further stated that it had also been decided that a policy circular had to be issued for uniform practice in all zones. However, this had not been issued thereafter.
- The RLA, Hyderabad stated (March 2011) that wherever average export obligation had been fixed wrongly, the cases would be corrected under intimation to audit.
- The RLA, Mumbai, has refixed AEO in eight cases and similarly, RLA, Pune have refixed AEO in eight cases.

Recommendation 2: *The DGFT should examine the matter and reiterate the exact method of calculation of average EO as almost all the selected RLAs had adopted a method other than what was specified in 2004. Moreover, such licences should be identified in a time bound manner and the average EO refixed. This may be co-ordinated and monitored by DGFT.*

The DGFT in their reply stated (August 2011) that the DGFT is already seized of the matter and a circular in this regard is again being issued to ensure uniform method for calculation of AEO.

In our opinion, only issue of a circular to adopt uniform method for calculation of AEO is not sufficient. RLAs may also be instructed to identify the cases where AEO had been fixed wrongly and remedial action should be taken in those cases.

3.1.2 We also examined the remaining 1719 (1814-95) files in our sample and found another 49 exceptions in which errors and inadequate scrutiny by RLAs resulted in short fixation of average EO by ₹ 1,832.67 crore. A few illustrations are given below:

3.1.2.1 In three licence files in RLA, Mumbai, 11 licence files in RLA, Pune and 10 licence files at RLA, Ahmedabad, there were calculation errors due to incorrect adoption of export values declared in the CA certificates. These errors resulted in short fixation of average export obligation to the tune of ₹ 60.02 crore, ₹ 152.69 crore and ₹ 1,462.44 crore respectively. On being pointed out, RLA, Ahmedabad, Mumbai and Pune accepted the omission and rectified the mistakes by issuing amendment sheets.

3.1.2.2 M/s Uflex Ltd. and M/s Promed Exports Pvt. Ltd. were issued EPCG licences in February 2009 and July 2009 respectively by RLA, Delhi

but the average export obligation was fixed short by ₹ 37.20 crore due to calculation error. The department accepted the observation and amended the average EO in one licence (M/s Promed Exports Pvt. Ltd.) and initiated action in the second case.

3.1.2.3 RLA, Kolkata issued a licence to M/s McNally Bharat Engineering Co. Ltd in June 2008 fixing the average EO of ₹ 40,519 instead of ₹ 405,19,000. The mistake occurred as the words 'in thousands' in the CA's certified export figures was ignored. As a result, the average EO was fixed lower by ₹ 4.05 crore. Reply had not been received from the RLA (October 2011).

3.1.2.4 In 14 licence files in RLA, Pune, the average export obligation was fixed by taking into account the years in which the licensee had not exported, instead of previous three years exports. This resulted in short fixation of average export obligation of ₹ 26.31 crore. RLA, Pune has initiated action to refix AEO in these cases.

3.1.2.5 Exporters with FOB export value over ₹ 7,500 crore are categorised as Premier Trading Houses (PTH). The Foreign Trade Policy 2004-09 provides that PTH shall have an option of fixing average level of exports based on arithmetic mean of export performance in the last five years instead of three years applicable to all other exporters.

We found that the benefit of five year averaging was extended to three licensees in RLA, Mumbai and five licensees in RLA, Pune who were not holding the status of PTH. This resulted in incorrect fixation of average export obligation to the tune of ₹ 61.32 crore and ₹ 28.88 crore respectively. RLA, Mumbai has refixed AEO in all the cases and RLA, Pune has refixed AEO in two cases each.

3.2 Fixation of specific Export Obligation

We found 26 other cases where errors by RLAs resulted in short fixation of specific EO by ₹ 144.51 crore. The cases are illustrated below:

3.2.1 M/s Indian Oil Corporation was issued an EPCG authorisation on 22 July 2008 by RLA, Delhi. The Export Obligation had been fixed at six times instead of eight times of duty saved. This resulted in short fixation of Export obligation by ₹ 76.47 crore. The department accepted the short fixation of EO and enhanced the same accordingly.

3.2.2 As per the provisions of FTP 2009-14, concessional duty of three percent is paid under EPCG Scheme, subject to an export obligation equivalent to eight times of duty saved, to be fulfilled in eight years. In case of Small Scale Industry (SSI) units, the EO is lower, equivalent to six times of duty saved on capital goods imported, provided the CIF value of such imported capital goods under this scheme does not exceed ₹ 50 lakh and total investment in Plant & Machinery after such imports does not exceed SSI limit.

We observed that in eight SSI licence files in RLA, Pune, the export obligation was not fixed at six times but at three to five times the duty saved amount. This resulted in short fixation of EO of ₹ 18.50 crore. Audit scrutiny of another five licence files in RLA, Pune revealed that the licencees had exceeded the total investment limit for SSI on plant and machinery after import of the capital goods. The export obligation was however fixed at six times the duty saved amount instead of eight times. This resulted in short fixation of export obligation of ₹ 10.14 crore. Out of these 13 cases, RLA, Pune have refixed EO in four cases.

3.2.3 Another four units were given SSI benefit (six times EO fixation) in RLA, Ahmedabad, despite being ineligible for such exemption as the CIF value of the capital goods proposed to be imported was above ₹ 50 lakh under EPCG Scheme. This resulted in short fixation of EO of ₹ 5.24 crore. There is no module in the system to validate the SSI eligibility conditions like CIF value of capital goods proposed to be imported, total investment in plant and machinery. On being pointed out, RLA, Ahmedabad accepted the observation and rectified the mistake in these authorisations.

3.2.4 In RLA, Ahmedabad, we also observed eight EPCG licences, where the EO was fixed at six times instead of eight times for the reason that the parties claimed the EO at six times of duty saved on the ground that it was an SSI unit. We observed that these units were in fact not falling in the category of SSI unit. This resulted in short fixation of EO of ₹ 34.16 crore. The RLA accepted the observation and rectified the mistake in these cases.

Except where mentioned, replies were awaited as on October 2011.

In conclusion, we found a total of 168 cases (9.3 per cent) out of 1814 in which errors in calculation resulted in short fixation of export obligation by ₹ 3,060 crore. Such errors indicate a lack of professionalism in approach and should be arrested by taking deterrent action.

Recommendation 3: *In view of the large number of incorrect calculations, it is recommended that the calculations of EO should also be covered in the test check by PIAW and the DGFT should ensure that the PIAW become operational in the RLAs within fixed time frame.*

The DGFT in their reply stated (August 2011) that DGFT circular guiding RLAs to adopt uniform method of computing annual average export obligation is being issued and, therefore, the test check of Post Issue Audit Wing (PIAW) for this purpose will hardly be required. DEA & CAG are also auditing EPCG files.

The reply of the DGFT is not acceptable as checks by any external agency do not absolve the normal functioning of departmental internal control mechanism in any manner. Test check by PIAW would enhance the calculation accuracy and mitigate the risk of authorisation being issued with incorrect AEO and EO. PIAW, being their internal control mechanism for post issue verification of the authorisation issued, should ensure the correctness of the authorisation issued.

Chapter 4 ***Licences issued to ineligible applicants and defaulters***

We scrutinised whether the RLAs were exercising checks to ensure that licences are not issued to defaulters or to applicants not eligible for the benefits of the scheme. In the following instances, we found that licences were issued in contravention of provisions.

4.1 Licences issued to ineligible applicants

We came across 26 licences that were not scrutinised properly and were issued to three licencees who were not eligible to avail the benefits of the scheme.

- M/s. OPG Energy (P) Ltd. Chennai, a Company involved in power generation, was issued eight licences between November, 2003 and August, 2008 by JDGFT, Chennai for import of capital goods involving duty concession of ₹ 6.02 crore. Instead of imposing the export obligation on M/s. OPG Energy, who availed the EPCG benefit, the liability of fulfilling EO was imposed on 18 other industries which were consumers of electricity generated and transmitted by the Company. The EPCG licences issued were irregular as there was no captive consumption of electricity by the licencee for the manufacture and export of any goods. Moreover, the foreign trade policy did not provide for grant of EPCG licence to one entity and discharge of export obligation by other entities.
- We noticed that two entities, M/s Simplex Concrete Piles (India) Ltd. and M/s Gammon India Ltd., providing civil construction services to power projects in India, were issued 18 licences by RLA, Chennai for import of construction equipments for CIF value of ₹ 211.87 crore involving duty concession of ₹ 66.66 crore under deemed export category. We observed that the licences issued were irregular as the provisions of 'deemed export' in terms of paragraph 8.1 of FTP apply only to supply of goods and not to rendering of services. Thus, the entities were ineligible for grant of EPCG licence. We further noted that the DGFT, HQ certified the nexus in both cases subject to free foreign exchange realisation (FFE). However, the licences were redeemed without examining whether FFE realisation had been achieved.

4.2 Issue of EPCG licences to licencees against whom refusal orders were issued

As per the provisions of Rule 7 of the Foreign Trade (Regulation) Rules, 1993, the licensing authority may for reasons to be recorded in writing, refuse to grant or renew a licence for various reasons which include failure to produce any document called for by the licensing authority. The order issued by the licensing authority under this provision is termed as Refusal Order (RO).

Guidelines for Maintaining the Denied Entities List, dated 31 December, 2003 issued by the Enforcement division of the DGFT provides that entities who are issued Refusal orders for not fulfilling Export obligation should be issued a demand notice and should be placed in the Denied Entities List if the demand is not complied with. The Denied Entities List also debars the licensee from getting any fresh licence from any other licensing authority. Entities can also be placed in this list in cases of fraud/mis-declaration and as a result of adverse findings by investigating agencies.

4.2.1 We observed that RLA, Mumbai had issued four EPCG licences with CIF value of ₹ 6.53 crore to M/s Pioneer Embroideries Ltd. during the currency of a refusal order (RO) which was issued in September 2008 and had not been withdrawn upto July 2011.

We scrutinized the files to ascertain how the licences were issued despite the RO. We found that the licensee had been issued an EPCG licence earlier, in 2003. Since he did not submit the proof of block wise export obligation in respect of this licence, the RLA issued a Demand Notice (October 2007) directing the licensee to submit the documents evidencing fulfilment of EO within 15 days from the date of receipt of the notice.

As the licensee failed to comply with the directions in the Demand Notice, the RLA issued a refusal order on 10 September 2008. The licensee replied to the refusal order stating that it had made exports of ₹ 4.58 crore in the year 2004-05 and requested for grant of abeyance for a period of 60 days. Although the documents were not produced in support of this statement, the RLA issued an abeyance on 18 September 2008 for a period of one month as the licensee had reported some exports. After conclusion of abeyance period, the licensee came in the Denied Entities' List from 18 October 2008 as he had not fulfilled the commitment to furnish the documents showing the block-wise exports.

The licensee again applied for and was granted an abeyance by the RLA on 9 January 2009 for a period of one month. Thereafter, the licensee applied for a fresh EPCG licence which was granted by the RLA on 16 January 2009. The licensee was then reverted to DEL from 9 February 2009 as he continued to default on the submission of the documents showing blockwise EO.

The RLA granted another abeyance on 02 March 2009 for one month after the licensee submitted export details upto year 2005. During this abeyance period, he was granted another three EPCG licences. Thereafter, he again reverted to DEL for non-submission of evidence of fulfilling the entire blockwise EO.

In this manner, though there was a refusal order which debarred him from getting any fresh licence, the licensee was given four EPCG licences by way of abeyance orders. The details are tabulated below:

Period of Abeyance	Number of EPCG Licences issued during the Abeyance Period	CIF value of the EPCG Licences issued during the Abeyance Period (₹ In lakh)
09.01.2009 to 10.01.2009	1	534.82
02.03.2009 to 02.04.2009	3	118.64
Total	4	653.46

4.2.2 We found that there were another 22 licensees who had been issued refusal orders but 319 EPCG licences were issued to them during the currency of the ROs by issuing abeyance orders. The CIF value of the 319 licences was ₹ 3,828.91 crore. The grant of licences in this manner was a very serious irregularity as the RLAs had taken on discretionary powers for issue of abeyance orders which was not provided for in the rules. This violated the control exercised over defaulters through Refusal Orders.

On this being pointed out, the RLA stated that the abeyances to Refusal Orders were granted for the purpose of issue of fresh licences in deserving / genuine cases. The reply was not acceptable because the RLAs were not empowered to grant any abeyances. Moreover, M/s Pioneer Embroideries could not be described as a 'deserving or genuine' case as it had remained a defaulter from September 2008 to date (July 2011).

4.2.3 We observed the use of abeyance orders in a similar manner during test check in RLA, Ahmedabad. A refusal order was issued to M/s RaajRatna Metal Industries in October 2007 for not submitting documents showing fulfilment of export obligation and was withdrawn on 16 March 2011 after fulfilling the obligation. The licensee was granted 23 EPCG licences between April 2008 and October 2010 i.e. during the currency of the RO.

As in the case of RLA, Mumbai, cited above, the 23 EPCG licences were issued by issuing abeyance orders. The CIF value of these 23 licences was ₹ 100.73 crore. Table 4 shows the number of these licences issued during the abeyance periods.

Period of Abeyance	Number of EPCG Licences issued during the Abeyance Period	CIF value of the EPCG Licences issued during the Abeyance Period (₹ In lakh)
1/4/08 to 30/4/2008	1	22.90
8/5/08 to 7/8/08	7	8690.28
18/8/08 to 17/11/08	3	81.58
25/11/08 to 24/2/09	2	79.84
28/7/09 to 27/9/09	2	146.87
26/10/09 to 25/12/09	1	23.60
30/12/09 to 15/1/10	3	71.40
21/1/10 to 20/3/10	1	27.99
9/6/10 to 8/10/10	3	928.86
Total Licences	23	10073.32

In these cases we observed that in addition to the 23 EPCG licences, the licensee was also issued 124 DEPB licences and 24 Advance licences by way of abeyance orders.

We found four other licensees against whom refusal orders were issued, but 58 EPCG licences had been issued in the same manner through abeyances.

The RLA, Ahmedabad replied (May 2011) that refusal orders are issued with a view to keep exporters under pressure to ensure compliance and at the same time abeyance circulars are issued so that their (licensee's) economic activities are not stopped as otherwise it would result in severe/serious consequences for the economy/ generation of revenue/ employment. Hence, fresh licences are issued to defaulting firms during the abeyance period. It was also stated that in many cases, LEMIS (EDI system) put the licensees in DEL list as soon as export obligation period of 18 months was completed, without taking into account the extended total export obligation period of 36 months as provided in Foreign Trade Policy for fulfilment of Export obligation.

The replies of these two RLAs that abeyance orders are issued for deserving and genuine cases and for continuance of economic activities are not acceptable. If there was such a requirement relating to sustenance of revenue generation, employment etc., it should have been brought to the notice of the DGFT/ Ministry of Commerce to review the rules and make changes at policy level to regulate the issue in the manner found appropriate. The FTR Rules provide that RLA can issue RO to a defaulter and withdraw the same when he ceases to be a defaulter. The ROs also debar such defaulters from getting any other licences. The rules do not provide for the RLA to use any discretion and grant interim relief by issuing abeyance orders. For the numerous licensees in respect of whom abeyances were given against the ROs, it created a situation where the defaulter licensees were approaching the RLAs repeatedly for fresh licences and the RLAs were granting the same through abeyances although they were not empowered to do so under the rules.

The reply regarding the LEMIS software indicated that the RLAs should have communicated matter to DGFT for updating of relevant changes in the system.

Recommendation 4: - *The DGFT may issue instructions to stop the issue of abeyances and investigate the basis on which the RLAs had given themselves the discretion to issue abeyance orders. The DGFT may also review and remove those licencees from the DEL, which had been included because information had not been updated in the software. DGFT may also institute a control to ensure that the changes in FTP are updated on the LEMIS system within a prescribed time frame.*

The DGFT in their reply stated (August 2011) that whenever there is some default in fulfilment of EO, the firms are put in DEL so that in future licences are not issued to them. However, in the interest of Export Promotion, in case of regular exporter in the event of submission of evidence of fulfilment of EO, abeyance is granted so that their business activities do not suffer. Abeyance is granted for a limited time only to put pressure to get their cases redeemed. They also stated that these abeyance orders were issued under the power vested to the adjudicating and other authorities in terms of section 17(3) of the Foreign Trade (Development and Regulation) Act, 1992 which inter alia provides that 'every authority making any adjudication or hearing any appeal or exercising any powers of revision under this Act shall have the power to make such orders of an interim nature as it may think fit and may also, for sufficient cause, order the stay of operation of any decision or order'. Further they stated that it is ensured that the Public Notice/Notification is uploaded on EDI system as soon as the same is sent to Government Press for Publication.

The reply of the DGFT is not correct as there is no provision in the Policy or related rules to issue abeyance order and the provision quoted by the department is not applicable as these cases cited by us were neither adjudication of any show cause notices nor hearing of any appeals preferred by the aggrieved party. The issue of abeyance orders in a discretionary manner is not a transparent process as it is not regulated by any norms. The practice of putting licencees in DEL, taking them out, putting them back again and so on makes the DEL totally farcical as licencees know that they can approach the RLAs and get abeyances. The reply also did not indicate if DGFT had reviewed and removed licencees wrongly included in the DEL due to delays in the past, in updating changes in FTP on the LEMIS system.

Chapter 5

Import and installation of capital goods and progress report on export obligation fulfilment

After issue of EPCG authorisation, the licensee is required to submit the authorisation to the Customs authority at the designated port, where the capital goods are scheduled to be imported, along with request for registration. After execution of bond and Bank Guarantee with the Customs department, the licence gets registered. We scrutinised 588 licences, which were registered in the ports situated at the same station as that of issuing RLAs, out of our sample of 1814 licences test checked and found that there were no delays in the process of registration.

After registration, the licensee can import and install the capital goods and use them for generating exports which would be counted towards his EO. The RLAs/ Customs authorities are required to monitor the imports and installation.

5.1 Monitoring of imports by RLAs

As per Paragraph 2.12 of HBP, the import of capital goods should be completed within three years from the date of issue of EPCG licence, failing which the licence becomes invalid.

We found that the RLAs did not have any system to monitor whether the imports were being completed within the prescribed three years, in respect of all licences. There were 572 licences in our sample of 1814 licences that had been issued between April 2007 and March 2008. The imports should have been completed in these cases as more than three years had passed (upto March 2011). We found that the details of import of capital goods against 301 licences (53 per cent) were not available in the licence files as tabulated below. The RLAs had not initiated action on these cases to verify the completion of import.

RLAs	Period	No. of licences issued during 2007-08	Details of import of Capital Goods not available in file
Kolkata	2007-9/2011	27	17
Ludhiana	Do	39	31
Hyderabad	Do	41	40
Ernakulum	Do	7	2
Coimbatore	Do	70	13
Chennai	Do	55	3
Bengaluru	Do	49	0

RLAs	Period	No. of licences issued during 2007-08	Details of import of Capital Goods not available in file
Ahmedabad	Do	11	1
Delhi	Do	72	72
Madurai	Do	20	11
Mumbai & Pune	Do	181	111
Total		572	301

The high level of exception showed that this is an area of concern and is required to be monitored closely. Reply was received from RLA, Hyderabad who stated that as on date there is no online system or otherwise for confirmation regarding the date of completion of import of capital goods by the EPCG licensee and this information is also not communicated by the Customs Department. This aspect hinders monitoring which is therefore done manually. The reply highlighted an instance of lack of coordination with Customs department. Since all import details are on the Customs EDI system, a data interface would ensure that RLAs get the requisite import data against the licences issued.

5.2 Monitoring of submission of Installation Certificates by RLAs

Paragraph 5.3.1, of the HBP provides that the authorisation holder shall produce to RLA a certificate of installation of capital goods from concerned Jurisdictional Central Excise Authority/independent Chartered Engineer. The certificate has to be furnished within six months from the date of completion of import.

Submission of the Installation Certificate (IC) is a control mechanism in the scheme to ensure that Capital goods imported under the scheme are used for the intended purpose by the intended beneficiary. The Department of Revenue had stated in 2008 that Certificate from Central Excise authorities is an inbuilt safeguard mechanism in the EPCG Scheme.

We found that the RLAs had not instituted any system to monitor the receipt of ICs. Out of 1814 cases checked, in 1542 (85 per cent) cases involving CIF value of ₹ 5,99,861.21 crore, we found that the ICs were not available in the licence files. In another 25 cases where ICs were submitted, we found that the certificates were deficient as the most crucial detail i.e., the date of installation of the imported machinery was not mentioned. The details are tabulated overleaf:

RLAs	Period	Total no. of licences audited	No. of cases in which installation certificate was not submitted	CIF value (₹ in crore)	No. of ICs not mentioning date of installation
Kolkata	2007-Sept 2011	108	91	2376.94	7
Ludhiana	do	136	117	1006.28	13
Hyderabad	do	147	146	565.74	Nil
Ernakulum	do	23	8	168.07	Nil
Coimbatore	do	193	190	2135.63	Nil
Chennai	do	135	78	1012.43	Nil
Bengaluru	do	134	50	119.14	Nil
Ahmedabad	do	56	34	577.60	4
Delhi	do	267	267	588990.12	Nil
Madurai	do	55	52	407.86	1
Mumbai and Pune	do	560	509	2501.40	Nil
Total		1814	1542	599861.21	25

The RLAs had not initiated action in any of these cases. RLA, Pune agreed that the ICs were not available in the licence files and stated that remedial action would be taken to safeguard revenue. RLA, Delhi stated that the licencees were submitting ICs but they were not placed in the licence file due to heavy workload. The RLAs of Coimbatore, Ludhiana and Hyderabad stated in reply that licencees submit the installation certificate at the time of redemption. The replies indicated that the monitoring of installation within six months had been virtually dispensed with and a key control had been totally diluted. The RLAs, Madurai and Mumbai stated that ICs have been called for and submitted by authorisation holders. RLA, Bengaluru accepted the audit observation and assured necessary corrective action. RLA, Ernakulum informed that in seven cases, the IC has been called for and in another case the licencee surrendered the unutilised authorisation, which has been cancelled. RLA, Rajkot accepted the audit observation.

5.3 Random Verification of addresses by Customs

The CBEC issued Circular No. 5/2010 in March 2010, directing the jurisdictional Commissioner of Customs to randomly verify for some of the authorisations issued under EPCG Scheme registered at their port to check the correctness of the addresses shown in the authorisation. It specified that this was important as the scheme required the installation of the capital goods.

We found that the Customs Department had not initiated any address verifications at any location, except at Hyderabad, even after one year from the date of circular i.e. till March 2011.

In Hyderabad, in 20 cases out of 218 cases registered between April 2010 and January 2011 with jurisdictional ports, the Customs Commissionerates had sent letters addressed to Central Excise Commissionerate for verification of addresses. Only in respect of two cases the addresses mentioned by the licensee had been confirmed. The verification reports had not been received by the Customs Commissionerate for the other 18 cases.

While responses of the Commissionerates were awaited at most places, the Assistant Commissioner, ICD Sabarmati stated that verification of the licences would be done during the validity period. The Commissioner of Customs (EP), New Customs House, Mumbai replied (June 2011) that the verification of addresses has now been started and the Commissionerate at Nhava-Sheva informed opening of register for recording of verification of addresses from March 2011.

Our findings showed that the address verification of licencees is yet to be initiated and needs to be taken up on priority.

Recommendation 5: As authentication of the licensee premises is an important check which makes it possible to verify at any time that the imported capital goods are installed and operated at the declared location, Board may examine alternate methods similar to the ones followed by Credit Card Companies/Banks etc. which periodically call for copies of utility bills containing the address.

The DGFT in their reply stated (August 2011) that excise authorities check the premises of the authorisation holder, therefore alternate method viz. calling of utility bills will add to the transaction cost of the exporter and is, therefore, not required.

The reply of the DGFT is not acceptable as authentication of licensee premises is an important check and calling for utility bill periodically from the exporters as an alternate inexpensive method may be appropriate. Reply of the MOF is awaited.

5.4 Physical Verification of Installation

Since we found a high degree of non compliance by the authorisation holders in submitting ICs, we undertook physical verification of installation of a small sample of 234 licences. This was done with the assistance of Central Excise commissionerates. Out of the 234 installations verified by us at ten RLAs⁶, we found that the machines had not been installed in seven cases and the machines had been installed in premises other than that mentioned in the licences in another seven cases as tabulated overleaf:

⁶ RLAs at Ahmedabad, Bengaluru, Chennai, Coimbatore, Delhi, Ernakulum, Hyderabad, Kolkata, Mumbai, and Ludhiana

RLAs	No. of installation verified	No. of correct installation	No. of installation in other premises	No. of installation not found in the premises
Chennai	45	40	5	Nil
Kolkata	12	9	1	2
Ludhiana	33	30	0	3
Delhi	2	2	0	0
Ernakulum	6	4	0	2
Hyderabad	21	20	1	Nil

The exceptions pertained to five RLAs. All installations were found to be correct at the other five RLAs. Two illustrations of wrong installation/non installation are given below:

(i) M/s Apollo Ziper India Ltd. imported capital goods worth ₹ 62.78 lakh on 4 December 2008 through Kolkata (Sea) port under EPCG authorisation for which duty amounting to ₹ 18.14 lakh was foregone. We conducted physical verification on 5 April 2011 of installation at the licensee's declared premises and found that the machinery was lying in stock and not installed even after lapse of 28 months from the date of import.

(ii) M/s JMC Garments Ltd was issued an EPCG authorisation from RLA, Kolkata for import of capital goods. Capital goods valuing ₹ 88.77 lakh were imported by February 2010 and duty foregone was ₹ 14.11 lakh. During physical verification of installation of capital goods imported under EPCG authorisation conducted on 7 April 2011 under EPCG authorisation, we found that the capital goods were installed at another factory of the authorisation holder at Baruipur, West Bengal instead of the factory at APC Roy Road, Kolkata. Installation certificate had not been submitted.

Our findings indicated that there was a risk of non-installation/wrong installation of the capital goods imported under EPCG but both the Customs Department and the RLAs were oblivious to this risk and had virtually non-operationalised the prescribed control system.

5.5 Registration of imported vehicles

The scheme provides for import of vehicles by the hospitality industry. The imports are required to be registered as tourist vehicles. In these cases, the registration was similar to the installation of capital goods.

In 2008, the Department of Revenue, Ministry of Finance had brought to the notice of the Commerce Ministry several irregularities noticed in case of import of vehicles under the EPCG Scheme. The DGFT subsequently issued a circular in May 2008 by which the Customs authorities were required to endorse the Bills of entry while clearing vehicles imported under the scheme so that they had to be registered as 'tourist vehicles'.

The circular further directed that in all past cases where redemption was due till 30 June 2008, such EPCG licencees would have to get the vehicles registered as tourist vehicle by 31 August 2008. RLAs were directed to monitor and ensure compliance. The directions under the circular were also incorporated in the FTP 2009-14 in paragraph 5.2.

We found that the RLAs did not have any mechanism to monitor the receipt of the registration certificates. Of 101 cases scrutinised by us in RLA, Pune, Mumbai, Hyderabad, Chennai, Delhi and Coimbatore, where EPCG authorisations had been issued for import of motor vehicles, we found that mandatory registration certificates were not submitted in 83 cases as tabulated in Table below.

RLA	Year in which licences issued	Number of Licences audited	No. of Registration certificate submitted	No. of Registration where certificate not submitted
New Delhi	2007-08	38	2	36
	2008-09			
	2009-10			
Mumbai	2007-08	41	11	30
	2008-09			
	2009-10			
	2010-11			
Pune	2007-08	10	2	8
	2008-09			
	2009-10			
	2010-11			
Hyderabad	2008, 2009	2	0	2
Chennai	2007-08	9	2	7
	2008-09			
	2009-10			
Coimbatore	2008-09	1	1	0
Total		101	18	83

No action was, however, initiated by the RLAs concerned. Except in 11 cases in Mumbai and two cases in Pune, the Customs department also did not endorse the Bill of Entry as mandated. Therefore, the control introduced to track intended use of concessional duty imports of motor vehicles was not being exercised and we were unable to gather assurance on the end use of the imported vehicles for the intended purpose.

RLA, Hyderabad informed that registration certificates have been obtained from the firms. RLA, Pune has called for the registration certificates from the authorisation holders and RLA, Mumbai stated that registration certificates would be insisted at the time of redemption.

5.6 Progress reports for fulfilment of export obligation

Paragraph 5.9 of the HBP prescribes that the licensee shall submit to the RLA concerned, by 30th April every year, a progress report on fulfillment of export obligation. RLA may issue partial EO fulfillment certificate, subject to proportionate fulfillment of EO.

The provision enables the RLAs to monitor the fulfillment of export obligation on a regular basis through the progress reports. We found that the RLAs had not instituted any system to monitor the receipt of progress reports. We scrutinised 743 licences issued prior to April 2004 at 12 RLAs⁷. In 543 out of 743 checked, i.e. in 73 per cent cases involving CIF value of ₹ 3,085.69 crore, we found that the progress reports were not available in the licence files and in another 87 cases progress reports were submitted belatedly i.e. after 30th April. Our findings showed that the RLAs were not monitoring the progress of EO fulfillment.

The RLA, Mumbai replied (May 2011) that at the time of applying for fresh licence the applicant gave details of EPCG authorisations held and the percentage of fulfillment of EO. Further, if any violations were noticed the authorisation holders were directed to pay the customs duty along with interest and in the event of failure thereof, cases were taken up for adjudication.

The RLA, Hyderabad stated (March, 2011) that it was not feasible to know the due date of submission of progress reports in the absence of provision in the system. The Ernakulum RLA, office replied that the Master Register tracked the receipt of progress reports of EPCG licences. We observed that while the Register was being maintained, it was not being used to carry out such monitoring. The replies indicated that the RLAs were aware of shortcomings in the monitoring mechanism but initiative had not been taken to address the problem. There is a clear need to develop a monitoring system and given the huge number of licences, it has to be an automated solution.

The RLA, Ludhiana stated that although there is provision for submission of progress reports, there is no provision in the Policy/Procedures for taking penal action against the exporters for not complying with this requirement and the licensees submit the complete details at the time of redemption. RLA, Delhi gave a similar reply and further stated that block-wise EO is checked at the time of redemption. The replies indicated that the RLAs were agreeable to not doing any monitoring during the eight year obligation period and postpone all their responsibilities to the redemption stage. Moreover, the reply regarding provisions was not correct as paragraph 5.17 of the HBP (2009-14) provides for penal action in case of failure to fulfil any condition of authorisation.

⁷ RLAs at Ahmedabad, Bengaluru, Chennai, Coimbatore, Delhi, Ernakulum, Hyderabad, Kolkata, Ludhiana, Madurai, Pune and Mumbai.

In our opinion, the issue of non submission of progress reports and installation certificates is far more significant than mere non compliance to instructions by licencees. The findings indicate complete dilution of monitoring of licencees after issue of licences till redemption. Both the RLAs and Customs authorities have virtually abrogated their responsibility for any monitoring of licences after they are issued. They have not initiated any measures, although the monitoring can largely be achieved through automation and linkage of RLA data to the EDI data of Customs.

Recommendation 6: *DGFT and CBEC should co-ordinate their effort to monitor installation of capital goods and progress reports. This would include identifying automated solutions and using the EDI data of Customs. Penal provision should also be introduced for non-compliance.*

The DGFT in its reply stated (August 2011) that installation of capital goods is monitored by excise authorities and fulfilment of EO is done by DGFT which has a monitoring mechanism laid down in paragraph 5.9 of the FTP. It was also stated that EDI in DGFT is actively engaged in automation. Reply of the MOF is awaited.

The DGFT being the issuing authority for EPCG licences, cannot transfer the entire responsibility of monitoring of installation to excise authorities. The excise authorities verify the installations but the DGFT is required to track and obtain the verification reports.

The reply did not indicate whether an interface was being built up with the customs EDI system. It also did not comment on our recommendation for introducing penal provisions in cases of non-compliance.

Chapter 6

Redemption of EPCG authorisations

As per paragraph 5.13 of HBP Vol I, EPCG authorisation holder shall submit to the concerned RLA, an application in ANF5B (statement of Export for redemption of EPCG authorisation) along with documents prescribed therein. On being satisfied with declarations made in the ANF5B, the RLA shall redeem the licence by issue of an Export Obligation Discharge Certificate (EODC) to the authorisation holder and send a copy to customs authority with whom Bank Guarantee /letter of undertaking has been executed.

We reviewed the process of redemption in the selected RLAs by reviewing a sample of 461 licence files where the redemption was due as export obligation period had expired and another 431 licence files where the licences had been redeemed. Our findings are given below:

6.1 Inaction by RLAs on non-receipt of redemption applications

We have commented on the lack of monitoring of installations and progress of export obligation etc. in the earlier parts of this report. Some RLAs had informed us that all requirements were taken care of at the time of redemption. However, we observed that lack of monitoring was also evident at the redemption stage. The RLAs were not tracking the receipt of redemption applications on the due dates i.e. on completion of eight years from date of issue of licence. We examined 461 EPCG authorisations issued prior to March 2003 by eleven RLAs, for which the period for EO fulfilment was over and redemption was due. We found that redemption applications were available on file only in 51 cases and the EO period was extended by the RLAs in 40 cases.

Redemption applications were not available in the remaining 370 licence files. RLAs had not taken any action in 284 cases (62 per cent of the sample of 461), issued 86 SCNs and referred 13 cases to the customs department. The customs department had initiated action in 87 cases on their own. The details are tabulated overleaf:

RLA	No. of unredeemed lics. Audited	EO (₹ in crore)	Duty saved (₹ in crore)	No. of licences				
				EO Period extended	Redemption application not on file	SCN issued by RLA	Reference to Customs by RLA	Action taken by Customs Deptt
Ernakulum	23	62.03	15.30	5	18	4	13	14

RLA	No. of unredeemed lics. Audited	EO (₹ in crore)	Duty saved (₹ in crore)	No. of licences				
				EO Period extended	Redemption application not on file	SCN issued by RLA	Reference to Customs by RLA	Action taken by Customs Deptt
Chennai	54	1227.34	101.72	10	44	10	0	19
Coimbatore	75	825.29	31.37	12	63	4	0	38
Madurai	14	59.93	2.07	2	12	4	0	6
Delhi	63	1096.28	62.79	3	42	23	0	1
Ludhiana	33	103.29	6.11	4	29	11	0	0
Hyderabad	52	195.29	15.32	0	52	5	0	0
Bengaluru	60	538.67	8.58	0	41	7	0	9
Mumbai	10	538.67	34.06	1	9	0	0	0
Ahmedabad	34	280.92	27.04	0	32	14	0	0
Kolkata	43	127.96	11.55	3	28	4	0	0
Total	461	5055.67	315.91	40	370	86	13	87

Our findings showed that in majority of cases, although the redemption applications were not available, the RLAs had failed to take any action.

RLA, Delhi replied that cases are monitored licensing year-wise and SCNs had been issued in all licences of 2002. They also stated (March 2011) that since the eight years period of EO is available till March 2011 and the firm has the facility of availing extension upto another four years, SCNs in such cases shall be issued only if the firm does not apply for extension.

The reply was not acceptable because extension, if any, had to be sought by the licensee before expiry of the EO period of eight years. The RLA was not required to wait for four years in anticipation of an extension request. Moreover, monitoring licences year wise was not appropriate as EO period was counted from the day of issue of licence and not as per year of licencing.

RLAs, Hyderabad and Rajkot accepted the audit observation. RLAs, Coimbatore, Ernakulum, Madurai and Mumbai initiated corrective action. RLA, Bengaluru assured necessary action for effective monitoring.

6.2 Receipt and disposal of redemption applications

We checked the action taken by RLAs in those cases where the licencees had submitted the redemption applications.

Paragraph 5.13 of HBP Vol I also provides that the Regional Authority shall act on redemption applications within 30 days. Shortcomings, if any, shall be pointed out in one go. The issue of final discharge certificate/rejection shall be completed within a period of 90 days from date of receipt of initial request.

In order to ensure that the disposal of redemption applications takes place within 90 days, it would necessarily entail that the RLAs maintain the date wise record of the receipt and disposal of redemption applications. We found that most of the RLAs had not kept proper record of the receipt and disposal of redemption applications. Consequently, they were not able to furnish the statistics of the number of redemption applications received and those that were pending for disposal during the period covered in the review.

Only RLAs, Ernakulum and Ahmedabad were able to provide the year wise details of applications. However, although they were able to furnish the statistics, the Redemption application registers maintained by them did not have the date of receipt of redemption application. Therefore, they were not in a position to monitor whether the disposal was taking place within the prescribed 90 days.

Since the receipt and disposals were not maintained properly, there was a risk that there would be delays in issuing the EODC. In the absence of proper centralised records, we scrutinised the timeliness of issue of EODC from 431 redeemed licence files.

6.3 Delay in finalisation of redemption applications

6.3.1 We observed that out of 431 redeemed licences test checked in the various RLAs, In 193 cases (44.7 per cent) there was a delay in finalisation of applications for redemption.

In 62 cases at RLAs at TN, Kolkata, Karnataka, AP, Gujarat, Kerala and Delhi, the delay was more than one year. The delay in these cases was reckoned from the date of submission of requisite documents called for till the date of redemption by the RLA. They included 10 cases in RLA, Kolkata, in which the applications for redemption submitted between November 2006 and December 2010 had not been disposed off till March 2011 pending verification of declarations submitted by the licencees.

The delays were attributable to both the RLAs and licencees. For instance, RLA, Delhi initiated the processing of five applications after a delay of one to two years. In eight applications, the deficiency memos were issued after a delay of two months to three years. In 18 applications the licencees had delayed the replies to deficiency memos.

RLA, Ahmedabad furnished a reply, stating that licencees are not complying the deficiencies pointed out at one go and due to oversight of the staff, processing of the applications are delayed. Acute shortage of staff was also mentioned.

RLA, Ernakulum stated that the delay was due to need for further verification.

In our opinion, the absence of a proper centralised record makes proper monitoring impossible and there is no way to identify long pending cases to initiate any review or prioritise action.

The RLAs, Bengaluru and Hyderabad accepted the observation and assured necessary corrective action.

6.3.2 The delay in redemption and issue of EODC is not just a procedural shortcoming and has a much larger implication. Under the EPCG Scheme, exports made against EPCG authorisations, which have not been redeemed, shall not be added up for calculating the average export obligation in a subsequent EPCG licence issued to the same licensee. This implies that there is an inbuilt incentive for the licensee to keep his licences unredeemed for the maximum period as it will help him, through lower fixation of average EO, in case he applies for future EPCG licences. For example, in RLA, Delhi, we observed that in 16 cases, though the export obligation was fulfilled by the licensee within one to three years of issue of authorisation, the application for redemption was only filed after eight years. We have also pointed out in the previous paragraph that in a large majority of cases, the licensees are not submitting applications for redemption at the end of eight years i.e. the outer limit for fulfilling export obligation.

Therefore, it is imperative that a proper monitoring system should be introduced to speed up the redemption process and to ensure that the redemption is not getting unnecessarily delayed.

Recommendation 7: *It is recommended that the process of monitoring of the receipt of redemption applications on due dates and their processing thereafter, upto the issue of EODC, should be automated.*

The DGFT while accepting the recommendation replied (August 2011) that as regards automation of process for receipt and disposal of application for issuance of EODC against EPCG Authorisations, EDI is seized of the matter.

In our opinion the data obtained through computerisation should be used as an effective tool for better monitoring of finalisation of redemption applications timely.

Summary of findings for the performance audit

Under Export Promotion Capital Goods (EPCG) Scheme, the licences issued have to be monitored over an eight year period through many prescribed checks. We found that after issuing licences, the Regional Licencing Authorities (RLAs) were not exercising any of the key controls like post verification of declarations, verification of addresses, monitoring of installation, monitoring of progress of achieving the export obligation (EO) and monitoring of receipt of redemption applications at the conclusion of the EO period. Consequently, the degree of compliance to

various requirements and the conditions of the scheme was very low. This abrogation of responsibility for the entire duration of the period of EO could not be an acceptable practice and is required to be corrected. In view of the large number of licences and long currency of eight years of the EO period, monitoring various aspects through manual processes was not practicable. Therefore, we recommend that an automated monitoring system should be implemented by the Director General of Foreign Trade in a time bound manner. This system should have an interface with the customs Electronic Data Interchange (EDI) system for access to import and export data that would be required to exercise some of the key controls and should be effectively used for better monitoring and exercising of controls.

New Delhi

Dated :7 December 2011



(SANDHYA SHUKLA)

Principal Director (Customs)

Countersigned



New Delhi

Dated :8 December 2011 Comptroller and Auditor General of India

(VINOD RAI)