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## Audit of Receipts

Audit of receipts (Direct Taxes, and Indirect Taxes) was entrusted to the C&AG, on consent basis, by the Government even prior to the enactment of C&AG's (DPC) Act, 1971. The audit of Central Excise was taken up in 1959. Even though 'a memorandum of understanding of the audit of Income Tax Receipts and Refunds' was agreed to in March 1960 by the then C&AG, A.K. Chanda, and Secretary to Government of India, A.K. Roy, regular audit of Income Tax receipts and refunds commenced from 1 April 1961<sup>1</sup>. With the enactment of C&AG's (DPC) Act, 1971 however, specific provision exists in Section 16 thereof for C&AG to audit all receipts. Thus, the statutory duty of C&AG to audit all receipts of the Governments of the Centre as well as States and Union Territories, and his power therefor are now fully formalized, and established.

The history of auditing receipts by C&AG has been a long and interesting one. In many respects, audit of receipts or revenue Audit, as it was known previously, presents a fascinating Chapter in the history of the development of SAI India's auditing system. For long, audit was mostly concerned with Government expenditure only, albeit the audit of customs receipts and departmental receipts like Public Works and Forests was in vogue even from earlier years, much before Independence. Customs audit was entrusted to Auditor General in 1913. With the passing of Government of India Act, 1919 the duties and powers of Auditor General were prescribed in the Statutory Rules under the Act known as the Auditor General's Rules, 1926. Under this (Rule 12), audit of the Customs revenue was entrusted to the Auditor General, which was adopted in the Government of India (Audit and Accounts) Order, 1936 promulgated under the Government of India Act, 1935. The Audit of receipts of Public Works and Forests was initially conducted by the respective

Departments themselves, but subsequently it was carried out by the Auditor General as part of his audit of these two departments, as is the position today.

Article 151 of the Constitution requires C&AG to audit the 'accounts' of the Union and the States. The expression 'accounts' naturally incorporates not only expenditure but also receipts. Dr. Gauri Shankar, who is often referred to as the architect of the revenue audit in the IA & AD, writing about the genesis of present Revenue Audit System, confirms<sup>2</sup> that during the time of Shri Mavalankar, the first Speaker of Lok Sabha, a resolution was passed in the Speakers' Conference requesting the Auditor General to take up the audit of receipts in a comprehensive manner and report the results of such audit to Parliament separately. The Central PAC also endorsed this recommendation. Despite these strong recommendations, the first C&AG, Narahari Rao, could not take up the audit of revenue receipts because in his view 'the department did not have the necessary expertise to audit revenue'. He felt it would take some time to acquire necessary skills for conducting revenue audit. The Speakers' Conference and the PAC, of course, took note of it even as PAC was of the view that Auditor General was bound by the Constitutional mandate to audit the receipts of the Union in terms of Article 151 of the Constitution. A.K. Chanda who succeeded Narahari Rao made sincere efforts to organize Revenue Audit Branch, but it was during the time of A.K. Roy, who succeeded Chanda, that a separate Revenue Audit setup was created in the office of the C&AG to be fully manned by Audit personnel except for Gauri Shankar who was seconded from the Income Tax Department.

The bold initiative of A.K. Roy to have a separate Revenue Audit setup manned by the Audit personnel (barring, of course, the sole exception of Gauri Shankar) rather than by officers taken on deputation from the Revenue Department, has been lauded as a reflection of Roy's confidence in the Departmental officers' capabilities<sup>3</sup> which was the result of his insight of the intricacies of such an audit, having been earlier, Member, Central Board of Revenue and subsequently Chairman of the Board and eventually Revenue Secretary. The department could not have had a better person than him to organize revenue audit. His approach in building up this wing of Audit consisted of three elements: (1) the expertise needed for auditing revenue receipts could be built "inhouse" by special training inputs and skill development, (2) he started initially with "pilot audits" whose reports were vetted at the Headquarters, and (3) he borrowed the services of a competent and experienced

officer of the Indian Revenue Service whose abilities he knew having seen him during his tenure in the Board of Revenue. The officer concerned (Gauri Shankar) was eventually inducted into the IA&AS with appropriate seniority.

Gauri Shankar took the help of a couple of dedicated and competent officers of the IA&AD to devise a Manual on the audit of revenue receipts. Initially, the Inspection Reports on the audit of Income Tax were received in Headquarters and after vetting, they were issued to the concerned Income Tax Office(s). The auditing technique adopted was itself unique. Audit would take up the Income Tax assessment files and carry out a de-novo assessment exercise to test whether the assessing officer had correctly assessed the tax due. Initially, a small percentage of completed assessments were examined to see whether 'any leakage of revenue arising from negligence, collusion, mis-application and non-application of law relating to revenues'<sup>4</sup> was involved. Audit will base its case on the legal framework, by pointing out the legal deficiencies and infirmities in the assessment. These legal defects related to 'settled question of law by Supreme Court or High Courts'<sup>5</sup>. An interesting case, quoted in this context related to audit examination of the exemption given by an executive notification to interest earned on Government Securities held by rulers of the princely states, which was objected on the ground that the relevant exemption was no more valid after the enactment of new Constitution. The draft Audit Para was sent to the Central Board of Revenue where the Chairman asked for the opinion of Law Ministry who confirmed the view of the audit. The revenue implication for this objection was Rs. 500 to Rs. 600 crore, a significant amount those days. This paragraph boosted the image of revenue audit.

It is remarkable that the Audit Department took up full-fledged audit of receipts in 1959 (for Central Excise) and 1961 (for Direct Taxes) whereas customs audit was being done by the C&AG from earlier times. The significance of these dates will be apparent from the fact that it was only in 1959 in 3<sup>rd</sup> Congress of INTOSAI at Rio de Janeiro that a mention of the subject of receipt audit was made for the first time. At that time, Receipt Audit 'partook of the nature of audit of expenditure in approach, detail and presentation'<sup>6</sup>. Further, 15 years later, INTOSAI in its 8<sup>th</sup> Congress, (Madrid, 1974) proclaimed 'that receipt audit should cover assessment and not only collection, legality and not only regularity and demand access of audit to all fiscal documents including individual tax files'.<sup>7</sup> As R.S. Gupta says 'it is much more than a mere coincidence that the great Indian experience in designing and working a most comprehensive

audit of receipts fell between these two dates—rather years ahead of 1974 declaration of INTOSAI'.<sup>8</sup>

It would be pertinent here to say that revenue audit was not merely a unique exercise in building an expertise in an entirely new field of audit, which had no precedent; at another level, the Audit Department faced even more difficult problems. This was the problem of 'Audit vs. Administration' which was one of the familiar local audit problems in the initial days. The hostility to the revenue audit by Income Tax, Central Excise and Customs Departments was perhaps understandable. First, the assessing officer surely would have felt that an outsider and a 'novice' had come to question his assessment, which was a quasi-judicial function. The second reason perhaps was that the PAC, which was taking keen interest in the Revenue Audit Reports, made the department to explain hard for their lapses pointed out in audit. The assessing officers thought that they were in real danger career-wise due to the strictures from PAC.

The next C&AG S. Ranganathan, the seasoned administrator that he was, made sincere attempts to get the administration rid of these feelings, when addressing the Commissioners of Income Tax in 1969, he said that audit should be held as an ally of the administration and not a 'sterile and carpic critic' and went on to say that a defect in the assessment pointed out by audit, should not necessarily result, on that account, the officer being considered incompetent or corrupt. The revenue department had to view the officer's performance in its totality. He conveyed these remarks to the top management and said that rather than go after leather hunting, it was more important to make improvements in the quality of assessment and collection of taxes<sup>9</sup>.

Beginning in 1961, in such circumstances, Direct Taxes Audit made smooth and quick progress. This was the branch of audit where audit systems and procedures were meticulously manualised. Then there was always a centralized experienced command at Headquarters, as far as technical guidance was concerned. The skill development was a key factor. And soon the stamp of audit efficiency on Income Tax, other Direct Taxes and Customs and Central Excise was clearly visible. Even as both Chanda and Roy pleaded for a strong Internal Audit for Income Tax and Central Excise and Customs Department, and the assessment cases to audit were given after the Internal Audit had vetted them, several deficiencies in application of law and assessment were still detected by Audit. This speaks of the high level of knowledge and auditing skill of the Audit Department that even from such a highly filtered sample of tax

assessments, they could find out mistakes in assessment of significant financial implications.

The Receipt Audit Wing came to be known as one of the most well-organized wings of Headquarters. This is due to several reasons, the most important of which is the fact that Revenue Audit is basically concerned with Tax Laws, Rules and Regulations and the Case Laws decided by the High Courts/ Supreme Court. Thus, the information base for Audit is precisely defined. With regard to availability of records (a perennial problem in many offices), an added advantage in Receipt Audit is that Audit gets all the records and documents concerning an assessee in a single file.

#### DEVELOPMENTS IN TAX AUDIT SYSTEMS AND PROCEDURES

The Revenue Audit Manual drafted under the leadership of Gauri Shankar in early sixties remains the main source book of Revenue Audit. There have been, as is often the case, additions to the material to cope with either new kinds of taxes or meet some new developments. But overall, the principles and procedures laid down in the original Manual retain their validity. That is a tribute to the meticulous planning for the Manual and its details shown by the original author(s). A third edition of the Manual was brought out in 1990. As Audit is always evolving with changes and developments in law, rules etc., so the Audit of Receipts also underwent this evolution.

It has always been said of Income Tax audit that 'general is more important than the particular', enforcing the view that it is the systems approach that counts in Income Tax audit. And yet, the methodology of conducting a check of the individual assessments to ascertain the 'general' position, forms an important part of the audit process. As R.S. Gupta, a veteran of Income Tax Audit states 'Since all individual assessments to tax under a tax law are controlled by the same legal provisions of substance and procedure, an error of interpretation or procedure is likely to have implications of a much wider nature than just an under-assessment in a particular case... The approach of receipt audit was, ... to use individual cases as a starting point of enquiry into the working of tax laws, rules and procedures in relation to whole segment of tax administration'<sup>10</sup>.

Audit Methodology in Tax Audit used by India is unique in many ways and has now been adopted by many countries including Canada. Some others find it hard to adopt for lack of adequate

'Mandate'. The Receipt Audit Manual of IA&AD has been suitably adopted by several South East Asian countries.

#### SYSTEM APPRAISALS IN AUDIT OF DIRECT TAXES

Way back in 1977, LIMA declaration of Guidelines on Auditing Receipts, brought out by the INTOSAI, emphasized that Tax audits should cover not only testing the legality and regularity but also examining the organizational efficiency of tax collection with a view to suggesting improvements in the legislation and in its enforcement.

Similarly, Bali Seminar of ASOSAI in 1988 examined the subject, and recognizing the socio-economic implications of Taxation, recommended that 'To evaluate the effectiveness of Tax measures, the audit may include review of the systems used in Government for monitoring and evaluating the realization of such goals. Further, the impact of Tax rebates and concessions should also be examined in the audit'.

As part of performance audit system that was developing in SAI India from mid 1960s, system appraisals in Direct Taxes started appearing in the Audit Report on Revenue Receipts from 1973-74 onwards. Such reviews/ system appraisals have featured every year in the Receipt Audit Reports except for the years 1979-80 and 1980-81.

Topics for reviews/ system appraisals are selected in consultation with the direct taxes wings of the field offices. Generally, interesting topics, which have greater impact on the revenue receipts, are selected. In system appraisals, implementing mechanism of the Income Tax Department is also reviewed.

After a topic for review is finalized, selected field offices conduct pilot studies. On the basis of these pilot studies and feedback received from the selected field offices, guidelines, containing detailed audit checks and checklists for conducting the review and collection of related data, are issued by the Headquarters office to the field offices. Before 1990s, guidelines were issued directly by the Headquarters office without any pilot study by the field offices but in the early 1990s, pilot study system was introduced. Zonal workshops are held for review parties including concerned group officers to discuss threadbare the problems/ bottlenecks and audit strategies. Field offices finalize the draft review keeping in view the guidelines and discussions held during workshops and send it to Headquarters office. Headquarters office, after going through the review material received from the field offices, prepares the review report, which

finally appears in Audit Report after its approval by the Comptroller and Auditor General.

C&AG's reviews and appraisals on direct taxes have been highly commended by PAC, and others. These are also extensively covered by Media. There are several instances when, based on these reviews, Govt. has introduced changes in the Law, Rules, Procedures etc.

#### PERFORMANCE AUDIT GUIDELINES AND RECEIPT AUDIT

Applicability of Performance Auditing Guidelines to the realm of Receipt Audit was discussed following C&AG's remarks on the Action Plan of RA-INDT section for 2005-06 where he minuted that 'Director General (Performance Audit) may be consulted on the two reviews for March 2006'. The discussion was in the context of the fact that tax audits are primarily legality and regularity audits as emphasized in Lima Declaration of Guidelines on auditing receipts. At the same time, receipt audit, as already pointed out, also examines the system and efficiency of tax collection machinery. Looking at these facts, the C&AG had remarked that while compliance audit should not be diluted, Performance Audit guidelines should be followed to the extent possible. Additional Dy. C&AG (RA), in the context of above orders of the C&AG, amplified in a note to him that in line with these directions, receipt audit would keep in mind the methodology and basic features enumerated in Performance Auditing Guidelines like strategic planning, selection of topics for review, documentation, entry and exit conferences, defining of audit objectives, audit findings, audit conclusions and audit suggestions etc. These features are now part of Performance Audit of Receipts.

#### RECENT DEVELOPMENTS IN DIRECT TAXES

*Audit Planning – Risk Based Approach:* A major change that has taken place during the last few years is that in Revenue Audit also, like in other audits, much greater emphasis is being placed on Risk Based Audit Planning. This is in line with the objectives of the Perspective Plan 2003-2008 of the Audit Department, which emphasizes improving the quality and impact of audit by adopting best international practices. Moving towards a risk based approach to audit namely, using risk analysis and statistical samplings in local audit was in line with the above goal. With a view to further refining Audit methodology in Direct Taxes and for better results, the Headquarters asked the field offices in August 2003 to create an independent database of high risk assesses from various sources as

detailed in the annexure to Headquarters letter. This database was to be used for selection of cases for local audit and these were to be audited 100 percent and were to be updated every year. Subsequently, Headquarters issued detailed guidelines on risk analysis and statistical sampling in local audit of Direct Taxes on 1 July 2004. It was emphasized in the preamble to these guidelines that while 100 per cent scrutiny of assessments which are already being selected in audit will be continued, emphasis would be on streamlining the selection of cases/ units and assessments completed in summary manner. This method of selection of units and assessment records based on risk analysis and statistical sampling and audit checks were to be adopted by field offices for the Audit Plan of 2006–07. This document now sets about at one place the basis for audit planning in Direct Taxes Audit. Towards this objective, statistical sampling techniques have been redefined in an attempt to capture the high-risk areas of Direct Tax auditing. The objectives of new Audit Plan framed on this basis are: (i) to select the auditee units and thereafter assessment records in the selected units in a scientific manner during local audit of Direct Taxes, (ii) to derive an assurance that the audit findings are correct with a certain level of confidence, and (iii) to attempt an extrapolation of results from such sample audit to the total population (assessments) and make a comment on the 'performance'.

The system of risk analysis and statistical sampling in Local Audit was applied for the first time from 1 July 2004 by audit offices in four Metro cities (Mumbai, Delhi, Chennai and Kolkata) and by other offices from 1 October 2004.

These instructions are in line with the current best practices of the Audit Department to carry out the audit on the basis of the perceived risk profile of the entities. The document, therefore, has categorized the units on the basis of inherent risk factors and control risk factors as High (H), Medium (M) and Low (L) risk areas. Accordingly, weights have been attached to each parameter. The periodicity of audit of a particular unit will be decided on the basis of this categorization. The application of the risk analysis will be both for planning of the audit units and subsequently for selection of assessment records. For both of these, detailed instructions are contained in this document. This new approach and its implementation is reviewed every year in a workshop where the experience of field officers in implementing the Risk Based Audit is discussed and based on the shared inputs, improvements/

modifications are carried out in the document detailing Risk Based Audit approach and guidelines. For the Audit Plan 2006–07 therefore, a revised set of guidelines was issued. The instructions also emphasized on the creation of an independent data bank of assessments cases, assesses and other issues pertaining to audit jurisdiction of each field office involving all 'high risk' assesses. The updation of this data is to be done each year during the conduct of audit of a unit.

It would be relevant to mention here that use of statistical sampling techniques was debated and discussed in the XVIII conference of the Accountants General held in January 1991 and thereafter in May 1991 the C&AG emphasized the need for introduction of random sampling method in selection of assessment cases for audit after some pilot audits in a few wards to consider the viability of such a procedure. The Audit Department introduced a Statistical Random Sampling Method (SRSM) for selection of cases for audit. Detailed stepwise instructions on to how to go about this was mentioned in the circular of May 1991. The circular also suggested that the officers and staff should be familiarized with the system and it was also suggested that the new method should be closely observed for three months in implementation and thereafter evaluation of the effectiveness and viability of the new procedure should be carried out in the Headquarters. This would indicate that Audit Department was conscious of the use of statistical random sampling method from 1991 itself; but what has been introduced from 2004 is a fairly comprehensive and integrated technique of risk analysis and statistical sampling for audit planning and assessment of cases. Another advantage now is that the sampling model is prepared by Direct Taxes Wing in consultation with the in-house specialist who is an officer of Indian Statistical Service.

*Computerization and IT Audit:* Direct Taxes Wing has been making efforts to increasingly use more and more computer applications and IT based techniques for its internal working as also in the field audit of the auditee units; for example, in the risk based audit plan, a good deal of work is done through computers like selection of units, etc. In its internal working, the wing has been successful in 'Work flow Automation' as far as audit report work is concerned. All the draft paragraphs along with key documents are uploaded from field offices online and they are dealt with in Headquarters through 'omnidocs'. After the receipt of material in computer by the data entry operator from the field, the same passes through

various levels upto ADAI (RA) for examination and approval of PD (DT)/ ADAI (RA) in a completely paperless environment online system. The printout is obtained only for the approved draft paragraphs for issue to the Ministry.

IT Audit made its foray in the real sense in Receipt Audit for the first time in 2005 when it carried out performance audit of Assessment and Information System, which was included in Direct Taxes Report of C&AG of 2006. The review was carried out using CoBiT framework of the IT Governance Institute which was adopted by the C&AG of India Even before this, in the year 2000 when C&AG conducted a review of Voluntary Disclosure of Income Scheme, 1997. The audit methodology adopted required preparation of specially designed input sheets containing about 100 fields which was used by field audit staff to collect information, and additional information was extracted from the folders of the declarants on to notepads for eventual computerization. Thus, extensive use of computers was made for scanning 12 lakh input sheets to convert the information into a database for analysis through the computer. Today, Direct Taxes (Receipt Audit wing) is fully geared to conduct IT audits concerning direct taxes assessments as well as their schemes.

#### AUDIT REPORT (RECEIPTS)

Subsequent to the introduction of regular audit of Income Tax in 1960–61, the first Report on Revenue Receipts was brought out in Chapter-VII of Union Government Audit Report (Civil), 1962. The Chapter covered audit comments on Customs Audit, Central Excise Audit and Income Tax Audit. This first Report on Revenue Receipts dealt with subjects like significant variations between budget estimates and actuals in Income Tax, cases of income escaping assessments, cases containing mistakes in assessing total income due to negligence, arrears of tax, demands etc. The entire Report covering audit comments on Income Tax, Central Excise, Customs duties receipts consisted of 22 pages only. From 1963, however, the C&AG introduced a separate Audit Report on the Revenue Receipts where one Chapter (Chapter IV) was devoted to Direct Taxes. From 1971–72, separate Audit Reports on Direct Taxes were presented. The Report on Direct Taxes was bifurcated into two volumes from 1999–2000. The present format<sup>11</sup> of the audit report on direct taxes volume-I (other than Performance Audit) has the following chapters:

- (i) Chapter-I includes information on the arrangements for audit of direct taxes and mentions the result thereof;

- (ii) Chapter-II incorporates important statistical information on the tax administration;
- (iii) Chapter-III mentions issues arising out of the test check of assessments of corporation tax;
- (iv) Chapter-IV deals with results of test check of income tax assessment;
- (v) Chapter-V highlights the results of test check of other Direct Taxes viz. wealth tax, gift tax, interest tax and expenditure tax assessments.

The change brought about in the Audit Report from the year 1993–94, when a new Chapter-II on Tax Administration was introduced, will rank as a very important induction from many angles. This Chapter captures important data on the various aspects of the working of Income Tax Department including tax recovery machinery, refunds etc. The wealth of data given in this Chapter has proved, in the eyes of experts, a real boon to the cause of better tax management because of their acceptability by Tax Department and their willingness to act on them. In this, no doubt, the guidance of PAC works as a great catalyst because eventually it is the keen and close questioning of PAC that brings out the best answers to the various issues thrown up by Audit Report.

From materiality angle, there has always been a floor level money value, which a Draft Para has to satisfy for being considered as a Para for eventual inclusion in the C&AG's Audit Report. The floor level of these money values has kept changing (rising) with the passage of time. For the Audit Report 2005–06, this was as given below for different taxes and for Metros and Non-Metros.

Area	Corporate Tax	Income Tax	Other Director Taxes
Metros	Rs. 10 lakh	Rs. 5 lakh	Rs. 50,000
Non-Metros	Rs. 5 lakh	Rs. 2 lakh	Rs. 30,000

Metros include: Mumbai, Delhi, Chennai, Kolkata and for special reasons Ahmedabad also.

#### QUALITY OF MANPOWER AND TRAINING ASPECTS

High quality and expertise of the staff working in the Income Tax Receipt Audit (ITRA) have always been recognized within as well as outside the Department, including by the PAC and the Income Tax fraternity. The CBDT gave recognition to this in the early nineties by including the SOG (RA) Examination as a qualification for acting

as 'Authorized Representatives' before Income Tax Officials in assessment proceedings, etc., under the Income Tax Rules, as is applicable for lawyers, chartered accountants and former income tax officials etc. Apart from granting due recognition to the quality and standard of the Departmental Examination held by the C&AG, this decision opened up an opportunity for the retired officials of the IA&AD, with adequate experience and qualification, to seek a second career after leaving the department. It would also act as an incentive for the ambitious officials of appropriate seniority to acquire the Receipt Audit qualification and expertise through self-development.

However, with significant and far-reaching developments taking place in the field of taxation policy, it is imperative that audit upgrades its technical expertise and auditing skills consistently. The Bali declaration of ASOSAI had strongly stressed the need for specialized training to Tax Auditors when it said 'Tax Audit is a specialization which requires thorough knowledge of the relevant Laws and Regulations. SAIs should provide intensive and frequent training for tax auditors taking advantage of the training facilities available in their local tax department's training institutions as well as those with other SAIs'<sup>12</sup>. The key to the strong foundation for Direct Tax audit was the rigorous training inputs and hands on practice given to selected staff at the base level (Section Officers and Audit Officers) in the late fifties and early sixties. There is some vacuum of expertise being felt now at that level. Interaction with the Senior Officers in the department indicated that their perception was that manpower quality was a worrying factor. In that context, training becomes a key input in the RA Wing. While there has been no drastic structural reforms in the training system, the wing is trying to meet the challenge by intensifying its existing training systems, which is done at 3 levels—an inhouse training programme conducted in each AG office, training programmes at RTIs and finally training programmes for IA&AS Officers at National Academy of Direct Taxes at Nagpur (in line with ASOSAI recommendations quoted above).

Besides, every year zonal workshops (2 or 3) on important topics are organized. These workshops mostly have a vertically integrated participation of officers from AAOs upwards to Accountants General level. These workshops are more "audit report oriented". Other than these, short workshops of the duration of a day or two are organized on specific and relevant topics of importance by the Headquarters where mostly outside experts act as faculty. A third development

towards the improvement of manpower quality was revamping of SOGE Revenue Audit Examination system in 2006 on the basis of the recommendations of a committee set up for the purpose. The new syllabus emphasizes objective type questions to test the practical knowledge of the candidates on the taxation matters.

#### ROLE AND IMPACT OF C&AG'S RECEIPT AUDIT IN THE EYES OF EXPERT COMMITTEES

The subject of role and impact of receipt audit has been discussed in two important committees that were set up by the Government of India on the tax reforms. The first one called Tax Reforms Committee chaired by Professor Raja J Chelliah (popularly called Chelliah Committee Report) extensively discussed the role and impact of C&AG's audit of Income Tax and Central Excise. The Committee acknowledged that receipt audit by C&AG 'had played important role in ensuring accountability and helping the Tax Department identify lapses and mistakes which could be rectified as well as avoided in the future'. The report specifically paid compliments to the C&AG's audit personnel who do 'painstaking work towards the fulfillment of the responsibilities placed on the shoulders of the C&AG by the Constitution'.

Having said that the Committee proceeded to review what it called some problems and consequences 'which in fact tend to militate against the long term growth of the economy and the growth of revenue itself as well as impose hardship on the assessee'. Some of the more important aspects rather complaints examined by the Committee related to audit raising too many objections with several of them not of very significant revenue implications. Many of these eventually get dropped from the audit reports or not accepted by the Board. This results in adverse implications for the assessee. Audit contests the Board's interpretation of the law; audit places excessive emphasis on the revenue aspect in individual cases rather than emphasizing on the adequacy of laws, rules, systems and procedure; audit pays little attention to cases of over pitched assessments and finally in the context of Central Excise, the report pointed out another complaint namely, audit parties often visit factories not only to check documents but also to verify stocks etc. which is in the nature of investigation work. The Committee was especially concerned about visit of audit parties to factories of small-scale producers. The Committee while recognizing the important role of external audit, stressed that difference of opinion between the department and audit

should not result in an audit phobia developing in tax collecting mechanism, which often resulted in high-pitched assessments in favour of revenue. However, the Committee did not give any recommendation on the plea of department that audit should not visit the Central Excise units for checking of the records.

The other important report that has come out recently (2002) is the report of Task Force on Direct-Indirect Taxes whose Chairman was Dr. Vijay L Kelkar. The Committee also discussed audit related issues concerning mostly Indirect Taxes. The two main recommendations made by the Committee concerning Indirect Taxes (Custom and Central Excise) were that there should be instructions by the CBEC to the effect that where an audit objection runs counter to its own instructions/ circulars no protective duty demand need be issued. This should however be complimented by evolving a mechanism to settle the objection with the C&AG at the earliest. The Committee also recommended exchange of officers on deputation between the two departments.

Kelkar Committee also raised the issue of visit of C&AG's staff to Central Excise assessee units i.e. the manufacturing premises. The Committee was of the view that since Central Excise Officers, as part of their duty visit the manufacturing units for internal audit purposes, there was no need for a repeat visit for the same job by the C&AG's officers. In Committee's view, this upsets the work programme of taxpayers and reportedly, 'it is also undesirable as it increases interface and give rise to unhealthy practices'. The Committee's interpretation was that C&AG is not authorized to visit the taxpayers both on the customs as well as Income Tax side. Hence, the Committee recommended that Rule 22 (3) of the Central Excise Rules 2002 may be amended to exclude reference to audit party deputed by the Comptroller and Auditor General of India.

Under the current provision of Central Excise Rules, Central Excise audit parties are allowed access to the records of excise duties paid on manufactured items and since these records are maintained in the premises of the manufacturing units of the auditee, it follows that the access to the audit party is available at these manufacturing units. This provision was necessitated when, in the late nineteen sixties, system of self-removal procedure was introduced. As brought out earlier, this question was debated and discussed in the Raja Chelliah Committee Report also and significantly, the Committee did not make any recommendation about Audit Parties visiting or not visiting the Auditee Units. When the matter again surfaced in 2002, courtesy Kelkar Task Force, the C&AG took up this matter

strongly in November 2002 with the then Finance Minister asking him not to accept such a recommendation. Subsequently, he also wrote to C.S. Rao, Revenue Secretary on the subject pointing out the serious adverse implication of this recommendation.

#### AUDIT FOCUS IN DIRECT TAXES FROM 2000 ONWARDS

The focus areas in the audit of direct taxes gets influenced naturally according to the changes in the Act, Rules and procedures. Both transaction audit themes and audit appraisals and reviews are influenced by these changes. The materiality as well as impact on the revenues is a guiding factor and the selection is now based on risk perception of the auditee. The major developments in taxation have also shaped the current Audit focus, which is now attempting to carry out audit of certain new taxes for the first time. These future audits would include:

- ❖ Fringe Benefit Tax introduced in the Budget 2004/2005
- ❖ Securities Transaction Tax, 2005
- ❖ International taxation

Globalization and policies like allowing FDI in certain areas of economic activity in varying percentages and opening hitherto banned sectors to Foreign Companies, have brought up new challenges for Tax Department and in turn for Audit too. The new issues that will concern Income Tax audit in this context relate mostly to the International Taxation area and therefore special attention and special training programmes for these audits needs no emphasis. The department has already moved in this regard and is currently engaged in developing a new system design to audit these taxes. A feedback on the exposure draft on such auditing is being taken from the field offices. Currently, IA&AD is looking at issues of Transfer Pricing. It is still at a nebulous stage.

First set of assessment is yet to be done in respect of the two new issues viz. Fringe Benefit Tax introduced in the Budget 2004/2005 and Securities Transaction Tax, 2005.

A review of the focus areas of audit during the past 5–6 years has thrown up following system reviews as far as Direct Taxes is concerned:

1. Areas with high risks:
  - ❖ Assessment of private schools, colleges and coaching centers,  
(Audit Report No. 13 of 2004)
  - ❖ Assessment of Sports associations/institutions and sports personalities  
(Audit Report No. 8 of 2007)
2. Growth sectors in the economy
  - ❖ Review on audit of assessments in select sectors: companies in cement, automobiles and Textiles sectors,  
(Audit Report No. 12A of 2002)
  - ❖ Review on assessment of selected companies in the selected sectors of computer software, automobiles and ancillaries, steel and trading  
(Audit Report No. 8 of 2007)
3. Exemptions/ deductions
  - ❖ Review on efficiency and effectiveness of administration and implementation of selected deductions and allowances under the Income Tax Act  
(Audit Report No. 13 of 2005)
  - ❖ Expenditure on eligible projects or schemes- Section 35AC of the Income Tax Act, 1961  
(Audit Report No. 12A of 2002)
4. Specific schemes
  - ❖ Operation of the scheme of taxation of companies under special provisions of the Income Tax Act  
(Audit Report No. 13 of 2004)
  - ❖ Status of improvement of efficiency through the Restructuring of the Income Tax Department  
(Audit Report No. 13 of 2005)
  - ❖ Efficiency of summary assessment scheme and process of selection of cases for scrutiny.  
(Audit Report No. 7 of 2006)
  - ❖ Review on effectiveness of search and seizure operations  
(Audit Report No. 7 of 2006)

## INDIRECT TAXES

*Customs Audit:* Customs Audit unlike other branches of Receipt Audit i.e. Direct Taxes and Central Excise, as already detailed, has a long history. This was one of the audits, which was entrusted to Audit Department from 1 May 1924. However, in its modern version,

Customs audit came along with audit of other individual taxes from the year 1959. The audit findings on Customs receipts were contained in a separate volume of C&AG's Audit Report on 'Indirect Taxes – Customs' upto the year ending March 2004. Audit Reports on Customs, Central Excise and Service Tax have been clubbed into one volume for Transaction audit findings and another volume for Performance Audit from the Audit Report, 2006. Hence, the nomenclature of the report for the year ending 31 March 2005 changed to Union Government (Indirect Taxes—Customs, Central Excise and Service Tax) (Transaction Audit) and Union Government (Indirect Taxes—Customs, Central Excise and Service Tax) (Performance Audit).

Customs receipts have been a major source of revenue in the Indirect Taxes but after the economic liberalization of 1991 and the consequent rationalization of custom tariff, the peak customs duty has gradually come down which has impacted the growth of customs receipts. However, it still remains a formidable source of income and is likely to have a better share in the overall resources because of the current economic boom where imports are growing fast.

The Customs audit techniques are the same as have been discussed in the paragraphs above—it is assessment based for transaction audit purposes and performance based for systems reviews. The system reviews of Customs (as also of Central Excise Audit) have been highly rated for their deep analysis and have helped the administration in course correction and tax policy as would be reflected in the section devoted to Audit Report findings in this Chapter.

*Significant Developments in Customs Audit:* In the year 1992, the monetary value of draft audit paragraphs to be proposed for Audit Report (Custom Receipts) was fixed at Rs.50,000. However, in the year 1998–99 this limit was raised to Rs.1 lakh and for the Audit Report for the year 2006–07 this was further enhanced to Rs.5 lakh.

Technical Inspection of Customs Audit Field Offices was introduced in the year 1999–98. This inspection is done by the Customs Audit Team of the Headquarters and is different from the inspection done by the Director of Inspection from the Headquarters. Generally, every year, two field offices are inspected.

In the field of audit reporting some important developments were:

- ❖ An analytical para depicting excess/ short-fall of actual customs receipts vis-à-vis budget estimate on a 4-year timeframe was

introduced in Chapter I of the Audit Report for the year 1999–2000 for the first time.

- ❖ Individual cases where recoveries had already been made at the instance of audit were incorporated in the Total Under Assessment (TUA) para in the Audit Report for the year 1999–2000 for the first time. It is a standing practice now.
- ❖ Online audit through the CR Audit Module (NIC) was introduced at CRA, Chennai in the year 2002–03. The NIC Module was developed for internal use of customs department which was not suitable for C&AG's audit process. Hence, CRA Chennai, developed its own module to query the history database provided by the department, periodically. This module was extended to all major field offices with a proper server-client architecture. A training course was also conducted at RTI Chennai on the use of the software module.
- ❖ From the year 2003–04 a para on functioning of Internal Audit in the customs department was introduced in the Audit Report (Customs). Like other functional departments of C&AG, in Customs audit also, a system of measurement of effectiveness of audit (matrix) was introduced in the year 2003–04 to adjudge the contribution of the field audit offices in terms of the money value of the paragraphs.
- ❖ From the year 2004–05 a system of 'Entry Conference' and 'Exit Conference' between the representatives from the Ministry and Audit was introduced in the case of performance audit in terms of performance audit guidelines applicable to all the functional groups.
- ❖ In a case of participatory audit, the Audit Department carried out a review on non-realization of Foreign Exchange (for the Audit Report 2000–01) with active cooperation from the RBI and authorized dealers.
- ❖ The powers of the AO/ Sr.AO, Group Officers and AG/ PD for dropping the objections was revised in the year 2002–03 as under:

Sr AO/ AO	Upto Rs.10, 000
Group Officer	Rs.10, 000 to 50,000
AG/ PD	Full powers

- ❖ The Perspective Plan of IA&AD for 2003–08 as adopted by the Accountants General Conference held in 2003 and as approved by the C&AG is currently under implementation in the Customs Audit Wing. The system of preparing self-learning packages

on various topics for receipt audit was introduced in the year 2003–04.

*Central Excise Audit:* Audit of Central Excise duties started on entrustment basis in the year 1959–60. A separate report of C&AG on Central Excise Audit was introduced from the year 1971–72. It contained two chapters and 52 paragraphs, of which 37 were effective paragraphs- 21 on Central Excise and 16 on Customs. The first review on Central Excise revenue appeared in 1976–77 on 'Iron and Steel and products thereof'. The Audit Reports on the Indirect Taxes were produced in two volumes in 1995–96—one on the Central Excise and the other one on Customs. The Audit Report on Customs was later merged with Audit Report on Central Excise in 2006 as already stated.

Prior to 1997–98, the monetary limit of draft audit paragraphs proposed for inclusion in the Audit Report (Central Excise) was Rs.2 lakh. However, in the case of 5 major field audit offices located at Mumbai, Calcutta, Hyderabad, Ahmedabad and Lucknow, it was fixed at Rs.5 lakh. This limit was raised to Rs.10 lakh from Audit Report 1997–98 onwards. In the case of Service Tax, the money value for draft audit paragraphs was fixed at Rs.5 lakh from Audit Report 2000–01 onwards.

Central Excise Audit Offices, like Customs Audit Offices also undergo technical inspection. There is a system of selection of units for audit on the basis of computerized audit plan and statistical sampling in the audit plan was introduced from 2005–06. The Plan has provision for implementing statistical sampling in non-computerized assessee units. The draft paragraphs to the Headquarters are dispatched online from October 2005. In terms of the Perspective Plan, various offices are completing the specific projects or goals like creating electronic data base, revision of audit manual (revised manual issued to all offices).

*Visit of Audit Officers to Assesse Premises for Checking the Records:* Rule 173 (G) (6) of the Central Excise Rules 1944 provides that every assessee shall, on demand make available to the central excise officer or the audit party deputed by the Commissioner or Comptroller and Auditor General of India, records including the Cost Audit Reports, IT Audit Reports and other records for audit purpose. However, new Central Excise Rules notification of 1 March 2001 effective from 1 July 2001 had no provision to enable audit parties of C&AG to carry out the checks of assessee records in their premises.

The new Rule 21 had provided access to these premises only to officer empowered by the Commissioner, which meant his own staff. The then Dy. C&AG took up the matter strongly with the Secretary Revenue, Ministry of Finance in April 2001 reasoning with him that it was necessary for audit parties to carry out a sample check of accounting and other records of manufactures mostly to obtain assurance regarding adequacy and operation of controls in the central excise revenue collection system. He, therefore, requested the Secretary to get suitable provisions incorporated in the new Central Excise Rules.

The Ministry of Finance responded by issuing notification in June 2001 where it duly incorporated the above provision in Section 22(3) of the Central Excise Rules for making relevant records available to audit parties by the assessee.

In earlier part of this chapter, where the Reports of two expert committees have been discussed, we have discussed this subject as reflected in their Reports. It would be relevant to mention, however, that in 2006, the Government of India have authorized the C&AG audit parties to carry out a check of the assessee records relating to service tax also. This practically amounts to the same kind of powers to audit in relation to checking of records as are available to them under Rule 22(3) of the Central Excise Rules, in relation to audit of Central Excise.

#### SETTLEMENT OF AUDIT OBJECTIONS

Though there was a system of periodic meetings on this subject between Commissionerates and the C&AG's field offices dealing with the Central Excise audit, over the past few years these were not being held regularly. The Central Board of Excise and Customs issued fresh directions in August 2006, conveying the following decisions:

- ❖ The jurisdictional Dy. Commissioner Incharge of Central Excise/ Service Tax division may have a meeting with Senior AO/AO of the Local Accountants General immediately after audit by CERA party is over—this probably was more in the nature of the exit meeting on the conclusion of audit.
- ❖ Monthly meetings were to be held between the Joint/ Additional Commissioners audit with Senior DAG/DAG of the local AG office. This meeting was to take place at the stage of Statement of Facts which is a prelude stage to the draft paragraph.

- ❖ The Commissioners of Central Excise or Service Tax would review the outcome of the above meetings and should also hold quarterly meetings with local Accountants General/ Pr. Directors of Audit with a view to settle the issues before these are converted into draft audit paragraphs/ audit paragraphs.
- ❖ Finally, the zonal Chief Commissioners of Central Excise were to take meetings with the local AG or Pr. Directors of Audit twice a year to review the foregoing arrangements and the results therefrom.

The detailed orders on such meetings were contained in CBEC letter of 4 November 1996. It is obvious that the interactive process between the Central Excise and the Audit had been formalized for quite sometime but reiteration of the instructions in 2006 have been timely and effective.

A new activity in this interactive process is the monitoring of the recovery of dues which have been adjudged as payable to the Government with regard to the cases or paragraphs that appear in the C&AG's Audit Reports. This monitoring mechanism started from the Audit Reports of 2006. The results of recovery were to be furnished to the Accountants General or Principal Directors for every quarter by the 15 of the each following quarter.

A consolidated Report on All India basis for each quarter was also to be furnished to Principal Director (Indirect Taxes) of the office of C&AG. These Reports are compiled separately for Customs, Central Excise and Service Tax. These instructions were also applicable from the Audit Reports of 2006 onwards. For earlier Audit Reports on Indirect Taxes, the instructions reiterated that action was to be taken in accordance with the law and without delaying and let up but these old recoveries were not to be included in the quarterly Reports mentioned above.

The C&AG on the basis of these instructions of the CBEC addressed all the field offices dealing with the audit of Indirect Taxes in October 2007 on the above lines including frequency of such meetings. In particular, it emphasized on the exit meeting of the CERA party incharge with the jurisdictional Assistant or Dy. Commissioner concerned; Group officer incharge of CERA to have monthly meeting with Dy. Commissioner Central Excise and discuss cases given in the Statement of Facts and Accountants General/ Principal Directors to review the results of above meetings and quarterly meeting with local Commissioners of Central Excise as also with Chief Commissioners. All these meetings were also to take

stock of the monitoring of the quarterly meetings on recovery of central excise duty and service tax on the basis of audit paragraphs.

The procedure outlined above would apply *mutatis mutandi* to customs audits also.

#### AUDIT REPORTS ON NON-TAX REVENUE

An important development was the presentation of a separate audit report on non-tax receipts of the Union Government titled 'Union Government (Non-tax Receipts) No.9 of 2006' which was placed in Parliament on 15 December 2006. This was the first ever-exclusive report for non-tax receipts. The audit report was brought out at the initiative of C&AG V.N. Kaul.

As non tax revenues have historically been inelastic and exhibit very low levels of buoyancy, widespread reform measures in the form of improving the mechanisms for administration, implementation and recovery of user charges and tariffs of various services provided by the government are required to be put in place to increase collections. Owing to the growing share of the non tax receipts in the total revenues of the Union Government, it was decided to compile a separate audit report.

The report has six Chapters including the introductory chapter which provides a trend analysis of non tax receipts accruing to the Union Government. The other chapters dealt with Receipts of the Department of Telecommunications, an appraisal of the system of levy and collection of fees by the Registrar of Companies, a study of some aspects of receipts at Badarpur Thermal Power Station which was set up by the Ministry of Power in 1967 and till recently managed by the NTPC, until its formal transfer of ownership to the latter. One chapter was devoted exclusively to the receipts of the Department of Space and another to the major receipts from the Department of Atomic Energy. The emphasis in the report, in the words of C&AG was towards assessing the efficacy and effectiveness of the systems in place for maximizing revenue collection and the adequacy of internal controls in the departments.

An interesting aspect of this report is that this report was prepared in a very short period by a small team of 3 officers at Headquarters led by PD (DT). It is creditable that this report, the first of its kind, brought out the revenue potential available in areas other than direct and indirect taxes. The report is also noteworthy for the fact that extensive use of IT skills was made specially in the case of auditing of Registrar of Companies where analysis of

computerized data was done using Computer Aided Audit Techniques (CAATs) and Interactive Data Extraction and Analysis (IDEA 2001).

### STATE RECEIPTS

The issue of audit of Sales Tax Receipts was taken up by the C&AG with the State Governments and the Government of India in regard to Union Territories in early 1961. The State Governments issued orders entrusting the audit of Sales Tax Receipts and refunds to the C&AG between 1961 and 1968. The MP Government issued orders for audit of Excise Receipts and refunds (June 1964), UP, Union Territory of Goa, Daman and Diu (1960). In the year 1971, Audit of Mining Receipts (Bihar), Motor Vehicle Tax Receipts (Orissa), Tamil Nadu and Mysore, Agricultural Income Tax Receipt (Orissa) were entrusted. Entertainment Tax in Mysore, Electricity duty in Orissa were entrusted from April 1967. These were also entrusted by Tamil Nadu (September 1968), Mysore (April 1967), UP (1966). Since then, State Receipts Audit has made significant progress in all directions.

#### *Audit Reports*

At the beginning of 1990, separate Audit Report on State Receipts was being brought out by Accountants General in Andhra Pradesh, Kerala, Punjab, Haryana, Bihar, Tamil Nadu, Rajasthan, Orissa, Gujarat, Madhya Pradesh, Himachal Pradesh, West Bengal, Assam, Maharashtra, Uttar Pradesh and Karnataka and in 12 States viz. Goa, Pondicherry, Tripura, Nagaland, Sikkim, Arunachal Pradesh, Jammu and Kashmir, Mizoram, Meghalaya, UT Chandigarh, Dadra and Nagar Haveli, Andaman and Nicobar Islands, Minicoy and Lakshadweep Islands and Daman and Diu, Delhi and Manipur in a chapter on the Civil Audit Report. As of March 2007 three more States Chhattisgarh, Jharkhand and Delhi are having separate Audit Reports totaling 19 and in 12 States with one UT Chandigarh, the results of Audit of Receipts form a chapter in the Civil Audit Report.

Sales tax used to constitute the most important tax source of receipts for majority of the States, till replaced by Value Added Tax recently. In Audit also, sales tax audit paragraphs dominated the State Audit Reports on receipts. Some of the important developments that took place in the sales tax audit during the years 1990–05 are enumerated below:

- ❖ In 1998, C&AG fixed the following floor ceilings for audit of Sales Tax Assessments. Assessments below the limits prescribed shall not be audited without Headquarters approval.

States	Gross Turnover below which no audit to be done	Gross turnover above which all cases to be audited by Senior most members of party
<b>Group A</b> Andhra Pradesh, Karnataka, Gujarat, Maharashtra, Tamil Nadu, West Bengal & UP	Rs. 75 lakh	Rs. 5 crore
<b>Group B</b> Bihar, Haryana, MP, Rajasthan, Punjab & Delhi	Rs. 50 lakh	Rs. 2.50 crore
<b>Group C</b> Assam, HP, Orissa, Goa, Pondicherry, J&K, all NE States, Kerala and Union Territories.	Rs. 10 lakh	Rs. 50 lakh

- ❖ The minimum monetary value of Draft Paragraphs for inclusion in the Audit Reports (Receipts) was Rs.20,000 till Audit Reports 1990–91. From 1990–91 onwards, the minimum value was raised to Rs. 30,000 for each paragraph for some large States. The limit however, did not cover cases involving mis-appropriation, fraud or violation of statutory provisions etc. ADAI (RA) prescribes the minimum monetary value of draft paras every year for each State. For Audit Report 2006–07, the minimum monetary value of draft paragraphs was Rs. 5 lakh for large States and Rs. 2 lakh for other States.

State Excise constitutes the next big revenue earner in most of the States.

The instructions prior to 1996 were that, in cases where recovery of money covered by an Audit para has been effected and no system failure was involved, the paragraph may not be included in the Audit Report. In 1996, instructions were revised stating that such paragraphs having money value of Rs.1 lakh and above for large States and Rs. 75,000 for other States may be included in the Audit Reports as individual paragraphs.

In January 1997, Headquarters issued detailed instructions to the Accountants General on Receipt Audit Reports. One of the important requirements conveyed was that Receipt Audit Reports of State Governments must include, as far as practicable, Audit paragraphs relating to all types of receipts raised by State, which will make the reports truly representative of the entire spectrum of revenue activities of the State, instead of merely being a compendium of isolated objections.

In June 2003, the format of Chapter-1 of the Audit Reports on Revenue Receipts was revised, effective from Audit Reports for the year 2002–03 onwards. The new format contains highly useful trend analyses of revenue receipts, which give time series analysis of 5 years' revenue realizations. This analysis is to be done separately for tax revenue and non-tax revenue. Another paragraph would analyze and comment on follow up measures taken by the Government on commitments made in the Finance Minister's Budget Speech, MOU with Government of India, Mid-term fiscal plan, Finance Commission's observations etc. Some of the illustrative items listed in the relevant instructions referred to critical fiscal and economic issues pertaining to the States, measures for rationalization of tax structures, appraisals of resource mobilization efforts etc.

A separate section was to be devoted for analysis of budget preparation. The analysis was to be based on study of the government files. Another section was devoted to the variation between budget estimates and actuals. As mentioned above, a time series analysis of GSDP and receipts for a five-year span would also be included in the Reports, in a tabulated form which will cover percentage growth of GSDP, percentage growth of tax and non tax receipts, buoyancy in receipts in percentage terms and receipts as percentage of GSDP. Analysis of collection and cost of collection was also to be done carefully. Similarly, collection of sales tax per assessee was to be provided to indicate the efficiency of the tax collection. An intelligent analysis of arrears of revenue was also required, as also arrears in assessments. A separate section on evasion of tax, write off, waiver and refunds was to be made. There was also a section where failure of senior officers to enforce accountability and protect the interest of the Government was to be recorded. Details of Departmental Audit Committee meetings and response of Departments to draft audit paragraphs was also to be included in separate paragraphs as also follow up on Audit Reports.

In August 2003, in an important decision, C&AG desired that all cases of audit observations accepted by State Government should be tabulated in the relevant chapters of the State Revenue Receipts Report in the same manner as is done in the case of C&AG's Audit Report on Union Government Direct Taxes. C&AG also prescribed a matrix containing weight for different parameters under different groups to assess audit effectiveness of Receipt Audit Reports. This matrix is to be sent along with bond copy of the Audit Report by the concerned AG.

In line with C&AG's observations, instructions were issued in August 2003 for evaluation of the Internal Audit Systems in the revenue administration of State Governments, beginning with the Receipt Audit Report 2002-03. Internal Audit System of Sales Tax was selected for evaluation, initially.

#### BIENNIAL AUDIT PLAN

From the year 2003-04, a revised format of biennial audit plan was prescribed. This was more or less corresponding to the structure of Audit Report described above. The biennial audit plan had many interesting sections namely critical issues in Government Revenues and tax administration and also statistical information on revenue receipts, etc.

#### AUDIT REVIEW COMMITTEE FOR COMPREHENSIVE APPRAISAL OF STATE RECEIPTS

In February 2005, in an important decision, the C&AG of India approved constitution of a State Level Committee for the State Revenue Reports, to be called Audit Review Committee, for comprehensive appraisal of State Receipts. This Committee will primarily devote itself to discuss issues relating to comprehensive audit appraisals or reviews of any tax or non-tax revenue of the State Government. The idea was that such appraisals contain a number of instances of control failures, etc. and therefore it was important that these were discussed with the Government before inclusion in the Audit Report. The mechanism evolved in this case is similar to the one obtaining on the State Commercial side. The Committee members are the AG who undertook the concerned appraisal as Chairman, another AG of a neighbouring State holding charge of Receipt Audit as an expert member, and Government to be represented by the Secretary of the respective Department, with the Group Officer incharge of State Receipts as member secretary. There was a provision for a Headquarters nominee also attending meeting if the concerned ADAI so desired. The procedure for Committee meetings were also detailed—it will go into merits and de-merits of the points of audit findings and evidence (key documents) which are the basis of audit opinion may be produced before the Committee by both the sides. In the case of dis-agreement by Government, a written reply should be given by them which shall be considered for incorporation in the final appraisal after due verification, as is the present practice.

Feed back received suggests that the system is proving effective in promoting meaningful interaction between audit and administration leading to firm audit conclusions.

The State Revenue Audit Wing was following 'Style Guide' to ensure uniformity of the drafting/ reporting style of Audit Reports.

#### FOLLOW UP ACTION

The C&AG desired in 1991 that a uniform practice be followed by all states regarding follow up action on Audit Reports and directed all Accountants General that States PAC Secretariats may be requested to follow the provisions applicable to the Central Audit Reports, as regards vetting of Action Taken Notes by Audit.

#### IMPORTANT AUDIT PARAS AND REVIEWS ON RECEIPT AUDIT

##### (A) DIRECT TAXES

C&AG's reviews and appraisals on direct taxes have been highly commended by the various stakeholders. Some of the important audit appraisals and reviews that appeared in Audit Reports during the period 1990–2006 are the following:

(i) Mistakes in assessments completed under Summary Assessment Scheme (1990–91), (ii) Computerization in the Income Tax Department (1991–92), (iii) Functioning of Investigation circles (1992–93), (iv) Administration of Tax Deduction Account Number (1993–94), (v) Interest, penalties and prosecutions (1993–94), (vi) Summary Assessment Scheme and Accounts under section 44 AB of the Income Tax Act, 1961 (1995–96), (vii) Deductions in respect of profits and gains from newly established industrial undertakings after a certain date (1996–97), (viii) Export incentives and deductions in respect of profits retained for export business (1997–98), (ix) Tax deduction at source under Section 194 C and 194 E of IT Act (1997–98), (x) Assessment of search cases made on or after 1 July 1995 under Income Tax Act, 1961 (Block Assessment) (1998–99), (xi) Voluntary Disclosure of Income Scheme, 1997 (1998–99), (xii) Kar Vivad Samadhan Scheme, 1998 (1999–2000), (xiii) Private Banking Companies and Non Banking Financial Companies (2000–01), (xiv) Private Hospitals and Nursing Homes (2000–01), (xv) Implementation of selected judgments of Supreme Court (2001–02), (xvi) Assessment of companies in the select sectors of Pharmaceuticals, Food Processing, Paints & Varnish and Cigarettes

(2001–02), (xvii) Assessment of business of civil construction (2002–03), Assessment of private schools, colleges & Coaching centers (2002–03), (xviii) Some aspects of non resident taxation with reference to Double Taxation Avoidance Agreements (2003–04), (xix) Status and adequacy of follow up action in selected post-VDIS assessments (2003–04), (xx) Efficiency of summary assessment scheme and process of selection of cases for scrutiny (2004–05), (xxi) Effectiveness of Search and Seizure operations (2004–05).

*Functioning of Investigation Circles (Paragraph 2.1 Report No. 5 Of 1994):* A review was carried out in audit and report brought out in 1994 in C&AG's Audit Report on Revenue Receipts—Direct Taxes to evaluate the post-search and seizure performance of the Department, specially investigation circles and analyze the efficacy of the existing system. The report acknowledges a number of constraints faced by audit including extreme reluctance by the Department to part with the relevant records specially appraisal reports. Resultantly, a large number of appraisal reports were not produced to audit. The rules provide that prosecution would be launched for certain defaults like willful attempt to evade tax, false statement in verification etc. Audit gathered that out of the 6,462 cases that were scrutinized by the investigation circles, prosecution proceedings were initiated in just 173 cases during the period 1988–89 to 1992–93. Apparent conclusion therefore was that department could not establish any tax evasion in majority of cases.

Audit discovered that in 3,712 cases (which was 35.88 per cent of 10,348 cases i.e. the number of cases where final assessments were completed), no concealed income was detected or established.

The regular assessments were unduly delayed although, Action Plan was proposed for each financial year. Apparently, the objective of quick follow up action was not achieved after the search and seizure operation. The regular assessment scrutiny revealed wide variations in the income estimated in orders passed under section 132(5) that is the appraisal report prepared after the search and seizure and income finally settled. The differences were staggering as indicated by data below:

Rs.13.54 crore determined initially in regular assessment was reduced to 93.02 lakh and against the tax of Rs.2.82 crore, the final determination of tax was only Rs.42 lakh. More importantly, the quality of assessments in investigation circles was also poor going by the decisions of Appellate authorities.

Similar reviews were printed subsequently in Report No.12 of 2000 (Paragraph 3.1) and Report No.7 of 2006 (Chapter II).

*Review on Summary Assessment Scheme*<sup>13</sup>: Summary Assessment Scheme was introduced first time in 1970 to be effective from 1 April 1971 and inserted as Section 143(1) of the Income Tax Act, 1961. Since then, the scheme has undergone a number of changes and some of the provisions originally contained under section 143(1) have been amended. Audit had conducted a review of Summary Assessment Scheme in 1987–88 where its major conclusions were that:

- ❖ Expectations of the scheme had not been fully realized;
- ❖ Frequent dilution of the scheme by raising income/ loss limit and reduction in tax rates had not promoted greater voluntary compliance by the tax payers;
- ❖ Contrary to Board's claim that the scheme had not been abused, audit found substantial tax evasion by the assesses due to loopholes in the scheme; and
- ❖ Finally, the assessment, monitoring and control machinery had not proved effective.

PAC discussed this report and made recommendations on the Audit Report in their 173 Report. The Committee, inter-alia, made a strong criticism of the Ministry's instructions issued in August 1987 'for stoppage of all action on audit findings in summary assessment cases'. It also called for a relook into the effectiveness of the scheme preferably by reputed experts and not by the concerned Ministry/ CBDT. It also recommended that uniform set of instructions on the scheme be issued at the commencement of every assessment year and also no changes be made thereafter to these instructions. Audit had reviewed the scheme on two more occasions after 1987–88. First in 1991 Report, Audit reviewed Action Plan of the department for the year 1988–89 and subsequently in Audit Report 1997 C&AG again reviewed summary assessment scheme. The gist of both these reviews was that despite the Board's instructions to reduce pendency of assessments, the overall pendency of assessments continued to remain very high.

In the backdrop of the above developments, the review in C&AG's Report of 2006 was conducted. The thrust areas of Audit examination were:

- ❖ Position of pendency/ efficiency of disposal
- ❖ Ambiguity and inconsistency in initiating remedial action on audit observations especially where assessment was completed after prima facie adjustments were done away with, with effect from 1 June 1999
- ❖ Extent of mistakes/wrong availment of exemptions, concessions, reliefs in summary assessments
- ❖ Effectiveness of internal audit in audit of completed summary assessments
- ❖ Adequacy of follow up action on the recommendations of PAC on earlier audit findings
- ❖ The rationale and methodology of selection of cases for scrutiny in the period covered under the review

In Summary, audit examination was on rationale, scope and actual implementation of summary assessment scheme and an evaluation of its implications on revenues. Alongwith this, Audit also attempted to examine the methodology of selection of cases for scrutiny. Broadly, audit findings were as below:

- (i) The disposal of summary cases as a percentage of disposable cases of the department was 90.69 per cent, 71.88 per cent and 77.16 per cent during the years 2002–03, 2003–04 and 2004–05 respectively. The corresponding percentages of disposal of scrutiny cases was 43.51 per cent, 52.41 per cent and 51.83 per cent respectively for these years.
- (ii) Audit test check revealed various types of mistakes as a result of which the assesses availed non-entitled benefits involving a revenue of Rs.390.51 crore (in a sample check of 64,755 summary assessment cases for the period 2002–03 to 2004–05). The department accepted audit observations in 210 cases, which had a tax effect of Rs.69.62 crore but did not accept audit view on 627 cases with a revenue effect of Rs.135.11 crore on the usual ground that assessments had been completed in summary manner.
- (iii) The Board has not prescribed any time schedule either for initiating proposals for selection of cases for scrutiny or for issue of instructions to field formations in this regard. A large number of non-corporate assesseees were out of purview of random selection for scrutiny for the years 2002–03 and 2003–04. Even though the Finance Minister in his Budget Speech for the year 2003–04 had promised

immediate abolition of existing discretion based system of selection of returns for scrutiny to be replaced by a computer generated intelligent random selection (only 2 per cent of the returns for annual scrutiny), several categories of cases were still being selected manually even in 2004–05. Moreover, the number of returns selected for scrutiny was less than even 2 per cent of the total assessments in 2003–04 as well as 2004–05. Overall, number of assessments completed after scrutiny assessed as a percentage of total assessments due was less than 1 per cent in all the years under review.

Audit gave its recommendations on the basis of their study (and this is one of the features of the present performance audit system of the C&AG). Some of these were:

- (i) The summary assessment scheme should be got studied by an Expert Group with the objective of finding ways to reduce the quantum of revenue foregone as a result of assessee availing non-entitled benefits due to the scheme.
- (ii) The Government should make a clear statement on its position with respect to powers of assessing officers and take remedial action in summary cases as a result of audit observations specially after 1 June 1999 when prima facie assessments were done away with by a suitable amendment to the law. However, the amendment did not clearly provide whether assessing officer could rectify mistake apparent from record under section 154 in summary assessment cases in the light of those circulars of 1999. The result is an ambiguity leading to inconsistency in the departmental action on the issue of initiating remedial action on audit observations relating to summary assessments specially those, which were completed after 1 June 1999. This needs to be remedied.

Audit also recommended that Government may review its chain system of internal control and make it more effective.

#### (B) INDIRECT TAXES

Gist of some important Audit Report Paragraphs and their impact on Customs Receipts is given below:

*1997 Report on Customs Receipts:* Had featured 2 systems appraisals viz. i) 100% Export Oriented Scheme and ii) Gem and Jewellery units under Export Processing Zones. The highlights of the reports were-

- ❖ Misuse of the scheme by the Gem and Jewellery units in Export Processing Zones resulted in loss of substantial revenue and non-fulfillment of stated objectives viz. boosting exports and improving foreign exchange earnings.
- ❖ Deficient internal control in tax administration of 100 per cent Export Oriented Units led to a loss of revenue of over Rs.549 crore.
- ❖ Audit detected a loss of revenue of Rs.114 crore due to various factors like incorrect classification, grant of inadmissible exemption, etc. in its test audit.

*Audit Report of 1998 (for the Financial Year 1996–97):* There was one review on Export Processing Zones (EPZ) and 184 paragraphs of non/ short levy of Customs duty amounting to Rs.4108 crore. Out of this, lax control mechanism in tax administration of EPZ scheme accounted for a loss of revenue (with interest) of Rs. 2943 crore.

*C&AG's Report on Customs Duties for the Year Ending March 1999 (10 of 2000):* It has a very interesting system appraisal on Export Promotion of Capital Goods scheme. The scheme administered by the Ministry of Commerce was meant to provide import of capital goods at concessional customs duty with an export obligation equal to three times the CIF value of imports to be achieved within four years from the date of import. The review revealed that the licensees could achieve only 77 per cent of the total export obligation. In the bargain, the Customs Duty concession of Rs.247 crore became infructuous. The Ministry of Commerce in an unusual move notified a blanket amnesty scheme to the defaulting firms by extending the period of export obligation to March 2001. This was against the opinion of Law Ministry and Finance Ministry had not issued any corresponding Customs notification. Resultantly, the defaulters were being penalized by way of recovery of duty and interest.

*Report for Year Ending March 2000, (10 of 2001) and 11 of 2001 on Customs and Central Excise and Service Tax:* In the review on 'Kar Vivad Samadhan Scheme' applicable to both Customs and Central Excise cases, Audit commented on the failure of the scheme to realize its objectives of declodging tax administration and raising revenue of some significance (on Customs duty); similarly, this scheme on the Central Excise side failed in its objective and benefited only

undeserving cases. While the Government realized Rs.400 crore from the scheme, it lost Rs.624 crore which was forgone by way of abatement of 50 per cent of outstanding dues. For Customs part, realization was Rs. 124.89 crore and revenue forgone was Rs. 179.40 crore. The balance amount relates to Central Excise and Service Tax.

Audit noticed a number of irregularities in a scheme for levy of duty on the basis of production capacity on certain products of iron and steel and also in implementation of scheme leading to loss of revenue. Finance Minister while presenting 2000–01 Budget admitted that the scheme did not work and scrapped the scheme. The earlier system of levy of duty on Ad Valorem basis was restored. A similar para was printed in Audit Report 10 of 2002 in regard to processed fabrics and the scheme had to be denounced restoring Ad Valorem rates of duty.

*Report on Customs Duty for the year ending March 2001 (10 of 2002):* C&AG carried out a systems appraisal of Customs Departments' computerized System called Indian Customs Electronic Data Interchange System (ICES), which envisaged acceptance of customs documents and exchange of information with other agencies involved in international trade electronically. The salient points of this audit were that the project was far from completion even after 9 years and estimates were poorly formulated while the selection of VSAT technology proved imprudent. Audit also commented upon inadequate security policy as a result of which a fraudulent payment of drawback of Rs.1.95 crore in Delhi Customs House was noticed.

*Audit Report for the year ending March 2002 (No. 10 of 2003):* The Report contained 2 systems appraisals and 213 paragraphs involving non levy/ short levy of Customs Duty of Rs.4423.86 crore. The systems appraisal on 'Non disposal/ delay in disposal of seized, confiscated and detained goods' highlighted inter-alia loss of revenue of Rs.29.62 crore and blockage of revenue of Rs.773.95 crore and sale of arms/ ammunition to MPs/ VIPs at extremely low prices.

*Audit Report for the year ending March 2004 (No. 10 of 2005):* This report contains a review on working of Inland Container Depots (ICDs)/ Container Freight Stations (CFSs) – 71 ICDs/ CFSs were examined of which 43 were public and 28 private entities. The audit objectives in this study were to seek an assurance that (i) imported goods received at ICDs and export goods cleared/ dispatched therefrom had been properly accounted for; (ii) revenue due to the Government viz. duty on lost/ pilfered goods, unclaimed/ un-cleared goods and

cost of customs staff posted at ICDs had been recovered in time; and (iii) there was no failure of systems/ procedure, lack of monitoring or leakage of Government revenues due to non-compliance of codal provisions prescribed for working of ICDs.

The audit findings in this case revealed that customs revenue of Rs.2400 crore remained unprotected against risk of loss, pilferage etc. due to non/deficient execution of bond/ bank guarantee by custodians (for import cargo storage), by carriers for trans shipment of export cargo, non-renewal of bank guarantee and insufficient insurance coverage.

Unclaimed/ uncleared/ confiscated goods worth Rs. 287.96 crore were lying undisposed.

Test check revealed absence of system of reconciliation of containers.

Recovery of duty of Rs.23.57 crore plus interest of Rs.3.14 crore on account of failure to re-export of 2404 containers that were imported without payment of duty was pending.

It was also noted that there was no mechanism to monitor the realization of foreign exchange and ensure the correctness of export incentives of Rs 681 crore paid on such exports. This was due to the fact that the Customs Department was not forwarding GR Forms to Reserve Bank of India.

The report has a system review on 'Recovery of arrears of revenue' where audit had analyzed this issue on the basis of a study of record of 36 Commissionerates for the three-year period 2000–2003 covering 8 States.

Broadly, the findings were:

The Rule Position: Section 12 of Customs Act, 1962 provides that except as otherwise provided in the Act or any law, customs duties are levied at such rates as may be specified. Normally, these duties are to be paid within 5 days. The Act also provides that customs duties that have either not been levied or paid or have been short levied or short paid may be demanded by issue of a notice. If the confirmed amount is not paid within 3 months and there is no stay from an appellate authority, recovery proceedings are initiated.

Audit observed that recovery proceedings had not been initiated by the department, despite no pending appeals in 1844 cases involving Rs. 127.79 crore. Thus, 69 per cent of pendency lay with the department. Although there were 7345 cases of defaulters, certificate action under section 142 (c) (i) and (ii) was initiated by the department in 932 and 2415 cases only involving Rs.70.06 crore

and Rs.200.64 crore respectively. Against this, District Authorities could only recover Rs.0.71 crore and Rs.9.79 crore respectively. In 12 Commissionerates, no case was even referred to the District Collector. Delays in initiating action by the department were numerous and delays ranged between 1 to 15 years in certificate action and 3 to 10 years in intimation of action by the department to the district authorities. Department broadly agreed with the audit view and said that change in approach and strategy would address the shortcomings. In 835 cases involving Rs.307.40 crore, provisions of Attachment of Property Rules were not invoked.

Audit also detected pending unconfirmed demands involving duty of Rs. 2278.13 crore in 2 Commissionerates.

In general, audit conclusion was that failure of system and weak monitoring were the major causes for the arrears. Audit noticed inaction and delayed action under the provisions of the Act even as statutory framework provided for solutions. Similarly, tardy action to issue certificate, to recover personal penalties or attach property was evident. As a result, arrears doubled in the last two years.

#### CENTRAL EXCISE

*Audit Report for the year ending 31 March 1996:* The significant audit findings in the Report were:

- ❖ 46770 cases involving duty of Rs.12730.62 crore were pending finalization with different authorities at the close of financial year 1995–96. Rs.2709 crore were the short collection of duty on account of various factors like short levy/ non-levy of duty, inadmissible exemption, excess Modvat Credit and incorrect classification, etc. The report suggested the need for strengthening the controls in the Department.
- ❖ In an interesting case noted in audit, interest of Rs. 1630 crore was not demanded from an assessee while confirming demand of duty pertaining to the period 1983 to 1987.
- ❖ Rs. 100 crore were lost by Department due to fixation of lower tariff value of aerated water and inconsistent criteria in the classification of prickly heat powder by the CBEC.

*Audit Report for the year ending 31 March 1997:* This Report contained two Performance Audits viz. (i) Modvat Credit on Capital Goods, and (ii) on Soap and Detergents.

It had 374 paragraphs. The review on Modvat Credit on Capital Goods brought out incorrect avilment of credit of Rs. 250 crore. The pendency of the cases was huge—50687 cases having a revenue

implication of Rs. 56395 crore including 31157 cases involving Rs. 22600 crore.

*Audit Report for the year ending 31 March 1998:* In this Report on Central Excise Receipt for the same period, the aggregate financial implication was Rs. 22769 crore representing 221 paragraphs featured individually or grouped together and one review on "Delay in finalization and collection of demand". The system appraisal depicted a poor picture of the Department. For want of adequate action, it could not realize Rs. 5270 crore confirmed demands till March 1998 with interest of Rs. 2317.72 crore. There were instances of non-finalization of adjudication cases within 6 months, loss of revenue duty of Rs. 58 crore for not raising the demands in time, etc.

*Audit Report on Central Excise and Service Tax for the year ending March 1999:* The highlight of this Report was the appraisal of Service Tax. This appraisal is significant not only because it was first review on audit of Service Tax, which had completed four years since it was introduced, but in many ways, this review was very different from other reviews, which C&AG had conducted. Perhaps for the first time the C&AG ventured into a discussion of merits and de-merits of certain policy aspects like fixation of rate of tax, inadequate and staggered coverage of services and omissions in covering certain sectors, which audit thought, were more taxable. In that sense, this review marks a watershed in C&AG's Audit Reporting.

Audit pointed out that poor collection of Service Tax was due to inadequate coverage of services. On the basis of Audit recommendation, Government appointed a Committee and 10 more services were brought under the Service Tax net in 2002 Budget. The input services used in the output services were also brought into Service Tax net.

*Audit Report for the year ending March 2003:* This Report on Indirect Taxes pointed out department's failure to stop revenue leakage of Rs. 1328.18 crore on determination of assessable value under new section 4. Similarly, a review of Call book depicted poor performance of the Department in incorrect/ unauthorized transfer of cases to call book, cases kept pending for want of clarification from the Board, non-vacation of stay etc. that involved revenue of Rs.5712.21 crore. In an interesting case, the C&AG in the test check of records found that 10 assesses were allowed exemption on the pan masala containing tobacco which was in contravention of the notification (which allowed exemption only if pan masala did not contain tobacco) resulting in loss of revenue of Rs.81.78 crore. Similarly, the report pointed out

two unauthorized exemptions not covered by exemption notification which resulted in loss of revenue of Rs. 54.34 crore.

This report also contains a para where audit was able to establish simultaneous availing of Cenvat/ Modvat credit on capital goods and depreciation under Income Tax Act by Numaligarh Refinery Limited. Audit contended that the availment of credit amounting to Rs.51.67 crore was incorrect because the company was paying minimum alternative tax (income tax) on the basis of book profit calculated after charging depreciation on capital goods and the fixed assets were exhibited at their cost inclusive of duty availed. The Ministry accepted the objection.

A similar para in this report concerning a car manufacturing company also pointed out Modvat credit of Rs.14.79 crore on capital goods whereas they had claimed a revenue expenditure of Rs.354.33 crore in their Profit and Loss Account for the year ended March 2000 and this included amount of Modvat credit taken on capital goods. Due to non disclosure of this fact, the audit contended that company was liable to pay Rs. 14.79 crore in addition to duty of Rs.14.79 crore and with interest of Rs.10.72 crore up to January 2003. The Ministry admitted this objection also and said that necessary action to recover the amounts including penalty had been taken.

(C) STATE RECEIPTS AUDIT  
ACCOUNTANT GENERAL (AUDIT) PUNJAB

- ❖ For manufacturing spiced country liquor, the plain spirit is redistilled after adding flavours and spices. There was no provision in the State Excise Act, 1914 or the Rules made thereunder for allowing wastage of spirit that may occur in the process of redistillation. The loss of excise revenue due to wastage occurred in the process of redistillation and allowed by the department was pointed out by Audit. The Government amended Rule 101—A which before substitution provided wastage allowance for spirit, in storeroom (2 per cent) bottling operation (1.5 per cent) and bottled spirit room (1 per cent). The amended notification dated 26 June 1999 made provision for wastage in redistillation at the rate of one percent. Although in making these amendments no reference to audit observation was given, it was apparent that these were made as a result of audit objection.

(Paragraph 4.3 of Audit Report for the year ended March 1996)

- ❖ Audit had been objecting through local audit reports to non-levy of interest and penalty on delayed payment of installments of license fee. There was no provision for levy of interest and for penalty for late payment of installments of license fee for vends for sale of liquor in the Excise Act/ Rule/Policy. Government moved in the matter and in the Excise Policy for the year 2005–06 made a provision for the year 2005–06 onwards for levy of interest @ 1 per cent per month to be calculated on daily basis in addition to penalty not provided earlier.
- ❖ Audit had been pointing out through local audit reports about non-levy of stamp duty on agricultural land and rural residential property transferred to 'wife' by an owner. The Punjab Government remitted in December 2001 stamp duty in case of transfer of agricultural land and rural residential property in favour of son, mother, daughter, widow etc. but did not mention 'wife'. Audit impact is visible from the fact that Punjab has now included 'wife' with effect from December 2001 vide notification issued in November 2006.

PRINCIPAL ACCOUNTANT GENERAL (AUDIT I)  
MAHARASHTRA, MUMBAI

- ❖ Review on Internal Control on claims relating to branch transfer of goods to and from the State of Maharashtra to other States brought out deficiencies in Sales Tax assessments viz:
  - (i) Non accountal/short accountal of goods received from other States by branches/agents.
  - (ii) Acceptance of claim relating to branch transfer in the absence of prescribed declaration form(s)/dispatch proof.
  - (iii) Acceptance of invalid/incomplete declaration forms.
  - (iv) Acceptance of photocopies of declaration forms.
  - (v) Allowing interstate transactions as branch transfer (without tax).
  - (vi) Allowing consignment sales to agents in other state though not registered in the other state under the Central Sales Tax (CST) Act.
  - (vii) Admitting branch transfer claim even though the branch to which goods are transferred were not registered in the other State.

The above matter was discussed in PAC in August 2006. Accordingly, in view of the audit observations and recommendations

of PAC, the provisions of Rule 9(b) of CST, Mumbai Rules 1957 were revised and circular issued by the Commissioner of Sales Tax on 10 November 2006 issuing specific instructions in respect of Branch Transfer Transactions.

(Paragraph 2.2 of Audit Report for the year ended 31 March 1999)

- ❖ Non-recovery of incentives from closed units—A test check in seven divisions revealed that out of 224 closed units, 190 eligible units which had availed incentives of Rs.74.30 crore were either closed, disposed off or had stopped manufacturing activities during the period from 1985 to 1987 which was within operative period of agreement. Even though the cumulative sales tax incentives of Rs. 74.30 crore availed by 190 units and the quantum of incentives by 34 units were forthwith recoverable with interest/ penalty, no effective and timely steps were taken to recover the amounts. There are two types of units, namely; (a) units availing sales tax incentives by way of exemption, and (b) units availing sales tax incentives by way of deferral. The units availing incentives by way of exemption are assessed to nil tax during currency of their eligibility and entitlement certificates and no tax demand is raised. Even if such unit closes before expiry of the operative period of the agreement, since there are no sales tax arrears assessed on such unit, the sales tax authorities cannot proceed to recover the incentives availed. It becomes incumbent for the implementing agency to take cognizance of the fact of closure of the unit before expiry of the operative period of the agreement and proceed to take consequential action such as cancellation of the eligibility certificate and recovery of the Sales Tax incentives as provided in the agreement, eligibility certificate and the scheme. In respect of (b) above, cancellation of eligibility certificate immediately after closure has to be done by the implementing agency before any action is initiated by the Sales Tax Department. The concerned implementing agencies were given information about the closure of the units. Principal AG also sent a copy of the draft review to Government of Maharashtra on 10 September 1998. The Government set up a High Power Committee under the chairmanship of Secretary (Industries) and Commissioner and Principal Secretary (Financial Reforms) as members in September 2003 to monitor the closed units and recover availed incentives from such units. (Paragraph 2.3.7 of Audit Report for the year ended March 1998).

## NOTES: CHAPTER-6

<sup>1</sup> R.K. Chandrasekharan, op. cit. Vol.-II (page 639&640)

<sup>2</sup> Appendix LI to the Public Accounts Committee First Report 1951-52

<sup>3</sup> Dr. V. Gauri Shankar in his article on 'Revenue Audit- Some Reflections', Golden Jubilee Commemorative Volume' National Academy of Audit & Accounts, Shimla 1950-2000 has put it thus "He did not agree (very rightly as subsequent events showed) that it required special expertise which the Audit Department could not possess for auditing revenues"

<sup>4</sup> Dr. V. Gauri Shankar, 'Revenue Audit—Some Reflections', Golden Jubilee Commemorative Volume 1950-2000 National Academy of Audit & Accounts, Shimla

<sup>5</sup> Dr. V. Gauri Shankar, op. cit.

<sup>6</sup> Dr. R.S. Gupta: 'Development of Receipt Audit' "Golden Jubilee Commemorative Volume 1950-2000 National Academy of Audit & Accounts, Shimla

<sup>7</sup> ibid

<sup>8</sup> ibid

<sup>9</sup> R.K. Chandrasekharan, Op. Cit- Vol.-II (page 649)

<sup>10</sup> Dr. R.S. Gupta, op. cit.

<sup>11</sup> This Format is as per Audit Report for the year ending March 2005 which is titled as "The Report of the Comptroller and Auditor General of India, for the year ended March 2005—Union Government (Direct Taxes) No.8 of 2006.

<sup>12</sup> 'Bali Declaration' at 4th Assembly and 3rd International Seminar of ASOSAI June 6-11, 1988 Bali, Indonesia

<sup>13</sup> Report of the Comptroller and Auditor General of India, for the year ended March 2005—Performance Audit—Union Government (Direct Taxes) No. 7 of 2006

## LIST OF KEY EVENTS

9 May 1991	Instructions issued regarding selection of cases for audit of direct taxes assessments using statistical random sampling.
1993-94	Commencing from 1993-94 Audit Report, a chapter on Tax Administration was included in Audit Report.
1997-98	Introduction of Technical inspection of Customs Audit field parties by a team from C&AG.
11 November 2002	C&AG wrote to Finance Minister asking him not to accept recommendation of Kelkar Task Force that audit parties should not visit premises of tax payers.
August 2003	C&AG desired that all audit observations accepted by State Government should be tabulated in the relevant chapters of the State Revenue Receipt Report.
August 2003	Field offices instructed to create database of high risk assesses.
2002-03	Online audit through the CR Audit Module (NIC) inaugurated at CRA Chennai.
1 July 2004	Headquarters issued detailed guidelines on risk analysis and statistical sampling.
February 2005	C&AG approved constitution of a state level Committee for the State Revenue Reports to discuss issues relating to comprehensive audit appraisals/reviews.
October 2005	Online dispatch of Draft Paragraphs from field offices to Headquarters (Indirect Taxes Wing) commenced.
8 December 2006	Empowering CERA parties of C&AG to have access to the commercial records of the service Tax assesses through notification of 2 November 2006.
15 December 2006	The first ever-exclusive Audit Report on non tax receipts of the Union Government presented in Parliament.
October 2007	Instructions issued on periodic meetings of Audit with Central Excise and Customs authorities.

## DOCUMENTS

## 1

No. 801/RA/INDT/CE/577-2004/ST/Tech  
Dated 08.12.2006

To  
All Pr. Accountants General/Accountants General/Pr. Directors  
(Dealing with Central Excise and Service Tax)  
As per mailing list

Sub: Notification No. 29/2006-Service Tax dated 2<sup>nd</sup> November 2006  
empowering CERA parties of C&AG to have access to the commercial  
records of the Service Tax assesses

Sir/Madam

I am directed to enclose herewith a copy of Notification No. 29/2006-Service Tax dated 02.11.2006, wherein Rule 5 of Service Tax Rules, 1994, has been amended to the effect that every assessee shall make available, at the registered premises at all reasonable time, records as mentioned in sub-rule (3) of Rule 5, for inspection and examination by the Audit Party deputed by the C&AG of India for your information.

2. Upto the Budget 2006-07, ninety six services were covered under Service Tax net and there is possibility that in near future more services may be brought in Service tax net. Therefore, it is imperative that a comprehensive data base of registered assesses of Service Tax as per annexure "A" (copy enclosed) may be prepared Commissionerate wise and sent to Headquarters since this exercise is an essential pre requisite for selection of units for effective control of Audit including risk based audit approach.
3. Revenue on account of Service Tax which was around Rs. 23000 crore for the year 2005-06 and is expected to grow steadily and there may be need of additional manpower to conduct the audit of registered assesses of Service Tax. Therefore, it is requested that requisite manpower in addition to manpower already existing for Central Excise audit may be worked out as per annexure "B" (copy enclosed) and furnished for further scrutiny and examination at Headquarters.
4. All information should be sent in soft copies (CD/Floppy) also.

Yours faithfully

Sd/-

(C. Nedunchezian)

Director (Customs and Central Excise)

Encl: As above.

DO No. 6(23)-B(R)/2006  
February 12, 2007

Dear Shri Kaul,

Thank you for your letter No. 3/NTR/22-2006 dated December 29, 2006 enclosing the audit Report on Non-Tax Receipts of the Union Government (No. 9 of 2006) covering five Ministries/Departments.

2. This is indeed a welcome initiative. The coverage of the issues in the report and the respective recommendations highlighted the need for the concerned Ministries to put in place effective tracking and recovery mechanisms and gear up their reviews to maximize revenue non-tax collections and tighten their internal supervisory controls. Recognizing the importance of this contribution, a meeting of the concerned Financial Advisers was convened under the Chairmanship of the Finance Minister during the course of which the Financial Advisers were asked to take corrective action based on the recommendations contained in the Report.

Yours sincerely  
Sd/-

(Ashok Jha)  
Finance Secretary

Shri Vijayendra N. Kaul,  
Comptroller and Auditor General of India,  
10, Bahadur Shah Zafar Marg,  
New Delhi

## GLOSSARY OF ABBREVIATIONS

CBDT	Central Board of Direct Taxes
CERA	Central Excise Receipt Audit
CIF	Cost, Insurance and Freight
CoBiT	Control Objective for Information and Related Technology
EDI	Electronic Data Interchange
FDI	Foreign Direct Investment
GSDP	Gross State Domestic Product
ICD	Inland Container Depot
ITRA	Income Tax Receipt Audit
NBFC	Non Banking Financial Company
NIC	National Informatics Centre
NTPC	National Thermal Power Corporation
SOGE (RA)	Section Officer's Grade Examination (Revenue Audit)
SRMS	Statistical Random Sampling Method