EXECUTIVE SUMMARY

Background

The Prohibition and Excise Department (the Department) plays the dual role of enforcing prohibition of arrack and procuring revenue through regulation of Indian Made Foreign Liquor (IMFL) and Toddy. Duty paid on manufacture and the license fee fetched through auction of liquor sales outlets constituted over 94 *per cent* of the revenue receipts of the Department. Though the recent recession had affected several sectors of the economy, liquor trade in the State was on a rise and revenue on this account became the second largest source of the tax receipts of the State. The Excise Revenues increased from ₹ 2,684.57 crore in 2005-06 to ₹ 5,848.59 crore in 2009-10.

Considering the multifarious activities of the Department and the magnitude of revenues handled, a need was felt to review the functioning of the Department with regard to adequacy of the systems and procedures that govern the entire spectrum of licensing, manufacture and sale of liquor and the monitoring mechanism in place, with a focus on levy, assessment and collection of revenue at various stages of the supply chain.

Our audit conducted between September 2010 and January 2011 for the period 2005-06 to 2009-10 involved verification of the records of selected sugar factories, distilleries, excise districts and administrative offices. These units were statistically selected considering their revenue potential and the risk perceived. While comparing the Department's performance against the stipulated norms and best practices followed within the Department, comparison was also made with the best practices followed in other States of the country to the extent available.

The Report

The Report is spread over five chapters. While the first focuses on the Introductory issues, Audit Methodologies and Analysis of Tax incidence, Trends of Revenue etc., the Chapters II, III and IV deal with the audit findings on Manufacture of IMFL, Licensing and Sale of IMFL and Monitoring and Control mechanism, respectively. Chapter V of the Report narrates the Audit Conclusions with suitable Recommendations.

Audit Findings

The findings are summarised below, focus area wise.

Manufacture of Indian Made Foreign Liquor

Distilleries were licensed to produce liquor by charging license fee. Quantum of Excise duty collected is directly linked to the quantum of liquor produced by them. We noted that two distilleries failed to commence/expand production within the stipulated time period, which was neither monitored nor addressed by the Department. Further, none of the State distilleries were able to utilise their licensed capacities to the maximum for manufacture of RS during the period of audit. Increase in production from domestically produced RS would have increased excise duty on IMFL. Distilleries were to pay

additional license fee for additional production but we noted that in three cases the same was not collected from them. Six distilleries checked by us did not maintain fermentable sugar levels of molasses within the prescribed limit of 95 *per cent* as stipulated in the Act, which led to short yield of alcohol and consequent revenue loss in the form of Excise Duty. We noted that during the period of audit, the IMFL distilleries had exceeded their capacity production in the years 2005-06, 2006-07 and 2009-10 using domestically produced RS/imported RS as raw material.

On completion of production, contrary to the norms, nine distilleries did not affix Holograms for identification of goods produced. Though the Government decided to introduce Holographic EAL in place of paper based labels, we noted that this important internal control measure has not been addressed effectively and implemented.

Licensing and Sale

The sales outlets are auctioned biannually and their number remained fixed over a period of time. Their license fee was fixed by raising the fee fetched in the previous cycle by a fixed *per cent* (say 10 or 15 *per cent*) uniformly throughout the State. We noted significant differences between the price fetched in auctions and the value of liquor lifted by the leaseholders and the margins (111 *per cent*) they maintained suggesting a review of the policy to incorporate the element of their sales potential in the license fee fixed before auctioning them. This is on the principle of 'more sales more license fee' and that the Government also gets increased excise revenue on sales. We noted that there was no system of issuing receipts to the customers. We noted from a sample of 20 bottles that 15 *per cent* cases of sale of bottles were not supplied by the Government depot and 35 *per cent* illegal movement of bottles from one outlet to another outlet, which had ramifications in the form of loss of license fee, besides the social issues attached with unauthorised sales. In this backdrop, red flags like outlets located even in small villages fetching record breaking amounts in the auction pointed towards possible crime in future in the form of loose sales and sale through unlicensed outlets. Bars and sales outlets were granted licenses notwithstanding their proximity to religious/educational institutes/National Highways/ Hospitals in violation of Rules.

Monitoring and Control Mechanism

The crime rate in the State, going by the trend of detection, was clearly on a rise. Sale of liquor through unlicensed shops was the most worrying issue with 351 *per cent* rise in the cases detected over a period of five years. The Enforcement Wing's action was either based on a tip-off received from the public or pursuing those cases detected during their routine patrolling operation. The Department booked 2531 offence cases for MRP violations, loose sales and running of bars (for violation of timings and dilution of liquor) and suspended 60 licenses. There was no system of recording complaints received from the public by post and for monitoring them suitably at an appropriate level. We noted several cases of liquor tragedies, which increased since disbanding *Madya Vimochana Prachara Committee*, a committee constituted in 2007 to educate the masses about evils of drinking. The Committee was quite effective during its tenure but it was not renewed.

To address all these challenges, the Department was ill equipped both in terms of the size and the quality of manpower. While the shortages in certain key cadres was certainly a concern, lack of internal audit, absence of supervision targets for inspection of sub-ordinate offices and untrained work force adds to the woes of Enforcement wing in general and crime prevention and detection in particular.

Recommendations

In the last chapter of the report, suitable recommendations are given which would help the Department in generation of additional revenues, prevent leakage of revenue and improve monitoring and control. We recommend that the Government may:

1. monitor closely the manufacture of RS by the State Distilleries commensurate with the licensed capacity.
2. expedite the process of introduction of bar coding system for Excise Adhesive Labels (EALs).
3. consider the factor of sales potential of the sales outlets while determining their upset prices based on the material lifted by them in the previous cycles or alternatively introduce a system of charging additional licence fee for the goods lifted by the outlets beyond specified limits.
4. computerise the entire process of dispatch of liquor bottles from the Distilleries to the marketing depots and to the Sales outlets in order to trace and track their movement using their identification numbers so as to prevent and monitor unauthorised sales.
5. carry out a Statewide review of the liquor shops operating near the Educational/Religious Institutions and hospitals, ignoring the distance limits prescribed in the Act. Enforce condition of grant of license strictly so as to ensure that outlets are not permitted near Educational/Religious Institutions.