

CHAPTER-I: BACKDROP FOR AUDIT

1.1 Why did we select working of the Excise Department for review ?

We ranked the operations of the Excise Department against commonly used criteria for selection of audit areas for performance review. The details of our assessment is at Appendix. Our assessment revealed that Excise Department did not rank high in terms of financial materiality of the revenue generated and financial risk. However, the Department emerged as ‘high priority’ in terms of significance and visibility of its operations, operational risks and estimated audit impact. Our overall assessment revealed that working of the Excise Department was a ‘high priority’ area for audit.

1.2 What were the main objectives of our audit?

We undertook the review to ascertain what internal controls exist and whether these are functioning effectively, particularly with regard to:

- Identification of key risks to the achievement of the Department’s objectives and management of such risks;
- Demand and collection of excise revenue leviable under the various Acts and Rules administered by the Excise Department;
- Enforcing provisions of the Acts and Rules effectively to prevent production, transportation and consumption of illicit/harmful spirituous preparations;
- Allotment and utilisation of resources efficiently to carry out the responsibilities entrusted to the Department; and
- Effective implementation of objectives envisaged in the annual abkari policies of the Government.

1.3 What was the audit framework used to conduct our review?

As our audit focus was on the functioning of internal controls in the Department, we conducted our audit against the COSO¹ framework of internal controls, which is an internationally established and accepted control framework. According to the COSO framework, the following are the five elements of an effective internal control system:

- Control environment – This provides a foundation for all other control elements. It is the responsibility of the top management of the Department to establish the control environment through measures such as adopting consistent policies, ensuring timely action to implement the policies, ensuring availability of employees, making available updated manuals to guide work, tacking timely and strict action against violations and initiating measures to strengthen systems.

¹ Committee of Sponsoring Organisations.

- Risk assessment – The management must clearly identify strategic objectives of the Department, risks to achieving such objectives and measures to manage such risks.
- Control activities – These are the policies, procedures and practices that enable the Department to achieve objectives
- Information and communication – This entails establishing systems for assimilating financial, operational and compliance information and passing on such information to those who need it.
- Monitoring – This covers day-to-day monitoring of activities as well as periodic assessment of activities through internal audit and/or external evaluation.

1.4 What was the criteria against which audit was conducted?

The functioning of the Excise Department was compared against the audit criteria listed below and incorporated within the COSO control framework explained in para 1.3:

- Rates of taxes/duties and the provisions contained in various Abkari Acts/Rules.
- Abkari policy of the Government.
- Standards and specifications fixed by the Government for various spirituous preparations.
- Instructions issued by the Department.

1.5 How did we select our audit sample?

We selected samples from all the three geographical zones. Six out of the 14 divisions and a minimum of 25 *per cent* of the circles, from the six identified divisions, were selected by simple random sampling using the audit software IDEA². Twenty five *per cent* Ranges from the selected circles and a minimum of 25 *per cent* of the distilleries in the selected divisions were also selected. In addition, three major border check posts³, the Commissionerate of Excise and the bonded ware houses of the Kerala State Beverages Corporation (KSBC) (FL-9 Licence⁴) in the selected districts were also selected. The units selected are detailed below:

Zone	Division(Two from each Zone)	Circle	Range
South Zone	Thiruvananthapuram	Neyyattinkara	Neyyattinkara
	Alappuzha	Alappuzha	Alappuzha
		Mavelikkara	Mavelikkara
Central Zone	Thrissur	Vadanappally	Chavakkad
		Wadakkencherry	Kunnamkulam
	Palakkad	Chittor	Chittor
		Alathur	Alathur

² Interactive Data Extraction and Analysis

³ Amaravila, Manjeswaram and Walayar

⁴ Foreign Liquor 9 - Licence for possession and supply of foreign liquor in wholesale

Zone	Division(Two from each Zone)	Circle	Range
North Zone	Kozhikode	Kozhikode	Feroke
	Kasargod	Kasargod	Kasargod

1.6 What was the scope of audit and audit methodology?

We conducted the review during January to May 2011 mainly through scrutiny of files and records at the selected units and by collecting information from other Government agencies like the Kerala State Mental Health Authority, the Directorate of Health Services, the Chemical Examiners Laboratory, Thiruvananthapuram, and the State Crime Records Bureau. Our audit team also physically observed the functioning of the border checkposts. The review covered a five year period from 2006-07 to 2010-11.

1.7 What was the nature of consultation with the Government in the conduct of the review?

Before taking up the review, we organised an entry conference in January 2011 with the Secretary (Taxes), wherein the scope and methodology of audit was discussed. The Secretary assured us full co-operation in the conduct of audit. On behalf of the Indian Audit and Accounts Department, we acknowledge the co-operation of the Kerala State Excise Department, the Chief Chemical Examiner and the State Crime Records Bureau in providing necessary information and records for audit. The Report was sent (August 2011) to the Department/Government and an exit conference was held on 31 October 2011 with the Additional Secretary, Taxes Department wherein the key audit findings and recommendations were discussed. The response of the Government during the exit conference and on other occasions has been suitably incorporated in the Report.