

## Chapter III

### Effectiveness of Internal Controls

**3.1** Internal control is an integral process carried out by an entity's management and personnel. It addresses risks and provides reasonable assurance that in pursuit of the entity's mission, the entity is achieving the following general objectives:

- a) executing orderly, ethical, economical, efficient and effective operations;
- b) fulfilling accountability obligations;
- c) complying with applicable laws and regulations;
- d) safeguarding resources against loss, misuse and damage.

**3.2** We noticed that due processes were not followed by departmental officers in certain cases involving revenue of ₹ 116.03 crore. We communicated these observations to the Ministry through 8 draft audit paragraphs. The Ministry accepted (March 2014) the audit observations in 6 draft audit paragraphs and initiated/completed corrective action in 3 cases involving revenue of ₹ 2.57 crore. We have furnished the details of these paragraphs in Appendix IV. The Ministry is yet to respond to 1 draft audit paragraph (March 2014).

### **3.3 Scrutiny of returns**

CBEC introduced self-assessment of Central Excise duties payable in 1996 and for Service Tax in 2001. With the introduction of self-assessment, the department also provided for a strong compliance verification mechanism through scrutiny of returns/ assessments, internal audit and anti-evasion. The crucial role of scrutiny of assessments as highlighted in the Report of the Task force on Indirect Taxes 2002 states "It is the view that assessment should be the primary function of the Central Excise Officers. Self-assessment on the part of the taxpayer is only a facility and cannot and must not be treated as a dilution of the statutory responsibility of the Central Excise Officers in ensuring correctness of duty payment. No doubt audit and anti-evasion have their roles to play, but assessment or confirmation of assessment should remain the primary responsibility of the Central Excise Officers".

Audit observed that scrutiny of returns was a neglected area. Audit detected irregularities in the cases illustrated below which could have been detected had the department conducted the scrutiny as per the prescribed procedures.

### **3.3.1 Failure to detect irregularly availed cenvat credit**

As per Manual of Scrutiny of Central Excise Returns, 2008, the department plays a pivotal role in ensuring correct availing of cenvat credit on inputs, capital goods, and input services in terms of the Cenvat Credit Rules 2004. As per Rule 9(2) of the Cenvat Credit Rules 2004, no cenvat credit shall be taken unless all the particulars as prescribed under the Central Excise Rules, 2002 or the Service Tax Rules, 1994, as the case may be, are contained in the said document.

Range Officer of Range-IV, Howrah West-II Division in Haldia Commissionerate scrutinised some high value input service invoices of M/s Vrinda Engineers Pvt Ltd., on which cenvat credit was availed by the assessee. Audit also scrutinised those invoices and found that two invoices not addressed to any registered premises of the assessee on which cenvat credit of ₹ 18.85 lakh was availed during the month of June 2010. This resulted in irregular availing of cenvat credit of ₹ 18.85 lakh. Despite detailed scrutiny, the department failed to detect the irregularly availed cenvat credit.

When we pointed this out (May 2012), the Commissionerate admitted the objection and intimated (December 2013) SCN was under issue. The Ministry confirmed (January 2014) issuance of SCN to recover the incorrectly availed cenvat credit. However, it did not admit the departmental lapse stating that the irregular availing of cenvat credit could not be detected during scrutiny of periodical returns as the assessee had not submitted these documents to the department with the returns.

The Ministry's contention is not acceptable as the Range Officer had specifically called for the objected invoices (August 2011) for scrutiny and the assessee had furnished the same to the department (September 2011).

### **3.3.2 Irregular payment of duty by wrong utilization of cenvat credit**

As per guidelines contained in para 2.1.1 A(19) of the Manual for the Scrutiny of Central Excise Returns, the departmental officer scrutinising Central Excise returns, is to take action in cases where assessee has not paid duty beyond thirty days from the due date. Rule 8(3A) of the Central Excise Rules 2002, stipulates that if an assessee defaults in payment of duty beyond thirty days from the due date, then he shall pay Central Excise duty for each consignment at the time of removal, without utilizing the cenvat credit till the date he pays off the outstanding amount including interest thereon. In the event of any failure, it shall be deemed that such goods have been cleared without payment of duty and the consequences and penalties as provided in the rules shall follow.

M/s Carbon Resources Pvt. Ltd. Unit-II, Begusarai in Patna Commissionerate made delayed payment of duty for the months of March 2011, October 2011 and March 2012 by more than 30 days. The assessee was required to pay duty in cash for each consignment cleared. However, the assessee utilized cenvat credit of ₹ 12.14 lakh for payment of duty on 18 consignments during the period of defaults beyond 30 days. Such payment from cenvat credit was irregular and recoverable along with interest and penalty.

Department failed to take any action to instruct the assessee to pay duty consignment wise without utilizing the cenvat credit which resulted in irregular utilization of cenvat credit.

While we pointed this out in September 2012, the Ministry admitted the audit objection (March 2014) and intimated the assessee paid the amount of ₹ 12.14 lakh along with interest of ₹ 0.49 lakh. Ministry further stated that instruction had been issued to the field formations to invoke provision of rule 8(4) in case of such defaults.

### **3.4 Internal Audit**

One of the main compliance verification mechanisms in the department is the internal audit which carries out audit at assessee premises by following prescribed procedures including selection of assessee units based on risk parameters and scrutiny of records of the assessee to ascertain the level of compliance with the prescribed rules and regulations. Internal audit is empowered under Central Excise and Service Tax Rules, to access the records of the assessees at their registered premises. The Directorate General of Audit with its seven zonal units at Ahmedabad, Mumbai, Delhi, Bangalore, Kolkata, Chennai and Hyderabad is to provide a focal link between the Commissionerates (who actually run the audit process) and the Board on all audit-related matters. On the one hand, it aids and advises the Board in policy formulation and on the other, it guides and provides functional direction in planning, co-ordination, supervision and conduct of audits at the local level. Every Commissionerate has an Audit cell, manned by an Assistant/Deputy Commissioner and auditors and headed by an Additional/Joint Commissioner and this cell prepares, co-ordinates and monitors the audit plan. Internal audit parties consisting of Superintendents and Inspectors carry out this audit.

We attempted to check the efficiency of the selection process of assessees by internal audit cell of the department and actual audit done by the internal audit parties by verifying some assessee records already audited by the internal audit parties. Few cases are illustrated in the following paragraphs.

#### **3.4.1 Non-detection of undervaluation of excisable goods by Internal Audit**

As per Annexure E of the Central Excise Audit Manual 2008, the auditors are required to verify the Cost Audit Report with a view to ascertain inter alia, whether any related party transaction is made to unearth undervaluation of excisable products transferred within group companies/related parties. Rule 8 read with proviso to rule 9 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 envisages that where excisable goods are not sold by the assessee but are consumed by it or by a related person of the assessee in the manufacture of other articles, the assessable value of such goods shall be one hundred and ten per cent of the cost of production or manufacture of such goods. Further, the Board had clarified (13 February 2003) that the value of goods consumed captively should be determined in accordance with the Cost Accounting Standard (CAS-4) method only.

Audit scrutiny of the records of the assessee M/s. Reliable Autotech Pvt. Ltd. in Nashik Commissionerate, engaged in the manufacture of motor vehicle parts classifiable under Chapter 85 of CETA, 1985 revealed that the assessee had cleared finished goods to its other units in Chakan and Pune during 2008-09 to 2010-11. Audit observed that the assessee did not prepare the required Cost Audit Report (CAS-4) for such clearances as per the above provisions.

When we pointed this out (March 2012), the department intimated (June 2012) that the assessee submitted the cost of production certificate for the years 2008-09, 2009-10 and 2010-11. Differential duty worked out to ₹ 15.34 lakh was paid along with interest of ₹ 4.83 lakh.

The internal audit of the assessee was conducted in March 2011 covering the period up to March 2011; however, the irregularity was not detected by it.

The Ministry admitted the objection (March 2014) and intimated recovery of differential duty of ₹ 15.34 lakh along with interest of ₹ 4.83 lakh. Ministry further intimated that the assessee did not disclose the facts of clearance of excisable goods to their other unit due to which the matter could not be included in the audit plan for further verification.

#### **3.4.2 Non-detection of irregular availing of cenvat credit by internal audit**

As per Annexure E of the Central Excise Audit Manual, 2008, the Cost Audit Report should be verified in order to check the reversal of cenvat credit availed on written off items. On the basis of the information available, auditor needs to quantify the amount of cenvat credit for which reversal of credit is required. Further, as per Rule 3(5B) of Cenvat Credit Rules, 2004, if the value of an input, or capital goods before being put to use on which

cenvat credit has been taken, is written off fully or where any provision to write off fully has been made in the books of account, then the manufacturer or service provider, as the case may be, shall pay an amount equivalent to the cenvat credit taken in respect of the said input or capital goods. The Board vide circulars dated 22 February 1995 and 16 July 2002, clarified that modvat/cenvat credit of duty availed of on inputs/capital goods which were subsequently written off being obsolete or unfit for use was required to be reversed.

Audit scrutiny of records of M/s Mahanagar Gas Ltd., in Mumbai II Commissionerate, engaged in the manufacture of compressed natural gas used as fuel for vehicles and classifiable under chapter 27 of CETA, 1985 revealed that the assessee availed of cenvat credit of duty paid on inputs received in its factory. The trial balance of the assessee for the period 2009-10 and 2010-11 revealed that the assessee had written off obsolete assets and stocks valued at ₹ 1.30 crore lakh for the years 2009-10 and 2010-11. Audit observed that the corresponding credit of duty of ₹ 19.30 lakh attributable to such inputs was, however, not paid back/reversed which was required to be recovered along with interest.

When we pointed this out (July 2011), department admitted the audit objection and intimated (October 2012) that out of ₹ 1.30 crore, ₹ 21.00 lakh pertained to the asset on which no cenvat credit was availed. The assessee reversed the credit of ₹ 12.44 lakh along with interest of ₹ 1.01 lakh.

The internal audit of the assessee for the period up to 2009-10 was conducted in March 2011, but it failed to detect the irregularity.

The Ministry admitted the objection (February 2014) and intimated that SCN for ₹ 21.23 lakh was issued to the assessee. Ministry further stated that missing out some objection during internal audit was coincidental.

### **3.5 Other issues**

#### **3.5.1 Irregular utilisation of cenvat credit**

Rule 20 of Central Excise Rules, 2002 read with notification no. 46/ 2001-C.E. (N.T.) dated 26 June 2001, extends the facility of removal of any excisable goods from factory of production to warehouse without payment of duty for export. CBEC vide Circular No.581/18/2001-CX, dated 29 June 2001, as amended from time to time, has categorically emphasized that goods meant for export can be diverted for home consumption from the warehouse with the permission of the Jurisdictional Assistant / Deputy Commissioner on condition that the clearance shall be effected on invoices prepared under Rule 8 on payment of duty, interest and other charges in cash.

M/s Haldia Petrochemicals Ltd. in Haldia Commissionerate transferred Motor spirit, Benzene, Py gas, etc. to its warehouse. During November 2007, these goods were diverted from the warehouses for home consumption on payment of appropriate duty through cenvat account instead of payment through cash which contravened Board's clarification cited above. Moreover, the assessee did not obtain permission of the competent jurisdictional authority for such diversion of goods. This resulted in irregular utilisation of cenvat credit of ₹ 45.76 lakh which was recoverable with applicable interest.

When we pointed this out (December 2008), the department admitted the objection (February 2012) and intimated that a show cause notice issued in May 2010 for ₹ 56.41 crore for the period April 2005 to December 2009, was confirmed along with imposition of equal penalty in March 2012. Non-adherence to Board's instructions by the departmental authorities on diversion for home consumption of the goods meant for export without prior approval of competent authority, was brought to the attention of the Ministry. The reply of the Ministry was awaited (March 2014).

New Delhi

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