

Chapter VI: Monitoring, evaluation and control

The DCs, Developers and Units have largely stated in their response to our survey that, monitoring was adequate. However, based on the evidence gathered by audit, we conclude that this is the weakest link in the whole scheme of SEZs. Developers and unit holders were almost left un-monitored, in the absence of an internal audit set-up. This posed a huge risk for revenue administration. The inadequacies in the performance appraisal system of SEZs, compounded by lack of Internal Audit, facilitated developers to misrepresent facts to the tune of ₹ 1150.06 crore which remained undetected as there was no mechanism to cross verify the data given in the periodical reports with the original records. Further, there was no system to monitor the exemptions given on account of Service Tax, Stamp Duty etc. Consequently, a reliable estimate of the magnitude of the total tax concessions provided, could not be made.

SEZ online system is a Database Management system and a life line for working of SEZs. DoC does not have any IS Strategic plan for the Database Management System of the SEZs in the country because the entire database management system project, its maintenance and the strategic management control have been outsourced to NSDL. Thus, a critical IS system is not internally monitored nor has any committee been formed to adequately monitor the system as required in a typical IS organisation. Approval of an important stakeholder i.e DoR was also not taken with regard to the revenue administration function of the system.

In view of the complete outsourcing of the project and its maintenance activities, the strategic control of Service Level Agreements review, source code review and performance audit of the IT infrastructure and application needs to be mandatorily with the Government. Accordingly, separate and specific SLAs are required to be reviewed and aligned.

6.1 Monitoring and Evaluation

Considering the wide array of exemptions and concession extended to Developers/Units under various Central and State statutes, existence of a robust monitoring and evaluation mechanism will ensure that the SEZs function as intended.

Internal Audit arrangements

Though the Act was introduced several years ago, and considerable concessions are extended to the developers, there is no structured internal audit mechanism in the MOC&I to assist in oversight of the functioning of

SEZs. Absence of a structured internal audit arrangement is fraught with the risk of undetected misrepresentation of facts by developers which cannot be left to the jurisdictional Commissionerates dealing with Direct and Indirect Taxes administration.

In response to a query in this regard, DC, SEEPZ, Maharashtra while agreeing with the audit view stated (January 2014) that creation of an internal audit arrangement would supplement the existing monitoring mechanism but opined that this needs to be decided by MOC&I as it was a policy matter.

Audit is of the opinion that the department may institutionalize a system of internal audit of the establishments under MOC&I dealing with SEZs and SEZs/units.

System of Monitoring and evaluation

Annual monitoring on the functioning and performance of the units in the SEZs is carried out by the Unit Approval Committee (UAC). The performance of the units/Developers is being monitored annually through the Annual Performance Reports (APRs) in case of Units and Half-yearly/Quarterly returns in case of Developers. Based on such review, the DCs inform/suggest to the Department of Commerce, corrective measures to enable the defaulting units to fulfill their obligations as per SEZ Act/Rules. For any violation, the DC is empowered to initiate action under the Foreign Trade (Development and Regulation) Act, 1992, which includes issue of show cause notice (SCN), levy of penalty, cancellation of the Letter of Permission (LOP), etc. The applicable customs duty forgone on such violations is to be recovered by the revenue department.

6.1.1 Inadequate Monitoring Mechanism

The primary objective of SEZ Scheme as per the SEZ Policy is to serve as growth engines to promote Exports, Investment and to generate Employment. Section 3 of SEZ Act read with Rule 3 of SEZ Rules prescribes the procedure for establishing SEZs wherein the Developer has the option of directly applying to Board or through the State Government. Various details like project report, exports projections, investments, projected employment are required to be submitted in the application, based on which the approval is granted.

As approvals are granted based on these commitments/projections, monitoring of the SEZs should logically be pegged to these parameters. We noted that performance of Developers/Units is monitored by UAC at the zonal DC Level and not at BoA Level. Further, the details of projections made by Developers are not available at DC level. Monitoring is based on Form E

(QPRs/HPRs) submitted by Developer as per Rule 12(7) read with 22(4) and 15 of SEZ Rules wherein no columns are prescribed for projected figures of Exports, Investment and Employment. Hence, monitoring of actual performance vis-à-vis projected figures promised by the developer in Form A is not being done at all. Consequently, the Ministry will not be able to measure the pace of performance against the expected deliverables at any given point of time. Further, it was observed that no time limit was prescribed for submitting the HPRs/QPRs by Developers.

State-wise deficiencies in monitoring and evaluation are tabulated below:

State	Name of the SEZ	Deficiencies in monitoring
Rajasthan	RIICO	Failure to file HPRs/QPRs, a mandatory requirement
Tamilnadu	J Matadee FTWZ	Failure to file Chartered Engineer's Certificate on utilisation of Duty Free Goods, a mandatory requirement
Gujarat	Diamond and Gems SEZ (Sur SEZ)	Failure to file HPRs/QPRs, a mandatory requirement
	M/s Adani Port & SEZ Ltd.	Diversion of duty free goods from SEZ to non SEZ areas was not reported in the HPRs. Developer paid duties amounting to ₹ 19.39 crore along with interest of ₹ 2.39 crore. Short payment of ₹ 84.06 lakh on VAT/CST and education cess of ₹ 5.01 lakh on indigenously procured cement was made. Further interest was paid on customs but not on VAT/CST. However, these issues were not monitored.

6.1.2 Review of Annual Performance Reports (APRs)

Rule 22(3) of SEZ Rules, 2006, stipulates that SEZ units shall submit Annual Performance Reports in Form I, to the Development Commissioner. Rule 54 read with annexure I states that the annual review of performance of unit and compliance with the conditions of approval shall be done by the Unit Approval Committee on the basis of APRs which needs to be certified by an independent Chartered Accountant and submitted before the end of the first quarter of the following financial year. Monitoring of performance is done by UAC based on APRs and the Units with Negative NFE for 1st and 2nd year are to be kept on watch list. SCN needs to be issued at the end of 3rd year and penal action is to be initiated at the end of 5th year.

Our observations arising out of the review of the state wise APRs are tabulated below:

Nature of irregularity	% of States selected	States involved	Remarks
Failure to file APRs	28.57	Andhra Pradesh, Rajasthan, Gujarat and Tamilnadu	178 units involving 261 cases
Delay in submission of APRs	78.57	Andhra Pradesh, Rajasthan, Gujarat, Maharashtra, Karnataka, Tamilnadu, Kerala, West Bengal, Uttar Pradesh, Madhya Pradesh and Chandigarh	Delay ranged from 1 to 72 months in 1318 cases
Submission of revised APRs	7.14	Chandigarh	Though there was no provision in the extant rules, in 11 cases involving 3 units APRs were revised which were

Nature of irregularity	% of States selected	States involved	Remarks
			accepted by the DC
Uncertified APRs	21.42	Andhra Pradesh, Rajasthan and Gujarat	14 Units involving 17 cases
Non/Short reporting of DTA sales in APRs	28.57	Andhra Pradesh, Maharashtra, West Bengal and Karnataka	₹ 98.50 crore of DTA sales Non/short reported in APRs by 23 units in 26 cases
Failure to initiate against Units with negative NFE	14.28	Gujarat	No action against M/s Terram Geosynthetics in Mundra SEZ Gujarat even though the unit had a negative NFE of ₹ 98.35 lakh at the end of five years. Even SCN was not issued.
		Karnataka	No SCN was issued in M/s Quest Global in Karnataka for having negative NFE of ₹ 88.81 lakh at the end of three years.

In response, DC, VSEZ while accepting the audit observation stated (September 2013) that appropriate action would be initiated against the erring units.

6.1.3 No provision for monitoring duty free indigenous procurement

Rule 22 (3) of SEZ Rules stipulates submission of Annual Performance Report (APR) in the Form prescribed wherein the NFE calculation is to be reported and monitoring of the Units is to be done by UAC Committee based on the APRs submitted by the Units. Further, PAC in its 62nd report has emphasised the need for accounting of duty free supplies of indigenously procured goods while monitoring the performance of the units.

We noted from a scrutiny of APRs that complete transactions/ working of the units were not being captured in the APRs and information involving foreign exchange alone needs to be reported thereby leaving out transactions viz. duty free supplies of indigenous procurement of raw materials, capital goods, building materials, etc, since the format prescribed does not provide for capturing these particulars. Scrutiny of 121 Units located in Andhra Pradesh, Madhya Pradesh, Maharashtra, Tamilnadu, Kerala, Karnataka, Rajasthan and West Bengal indicated that the units made DTA purchase of material worth ₹ 89,792.01 crore involving duty exemption of ₹ 10,576.41 crore which was not accounted for in the APRs of the respective units. Consequently, the same could not be monitored by the UAC as there was no enabling provision in the SEZ Acts/Rules in this regard.

In case of M/s Charisma Jewellery Pvt. Ltd, SEEPZ SEZ, Mumbai, the Unit made procurements from offshore banking unit amounting to ₹ 4.68 crore and did not report it in their APRs by treating it as indigenous procurement. Since procurement from offshore banking unit is a case of inter unit transfer,

the same should have been considered as import for the purpose of calculating NFE which was overstated by ₹ 4.68 crore.

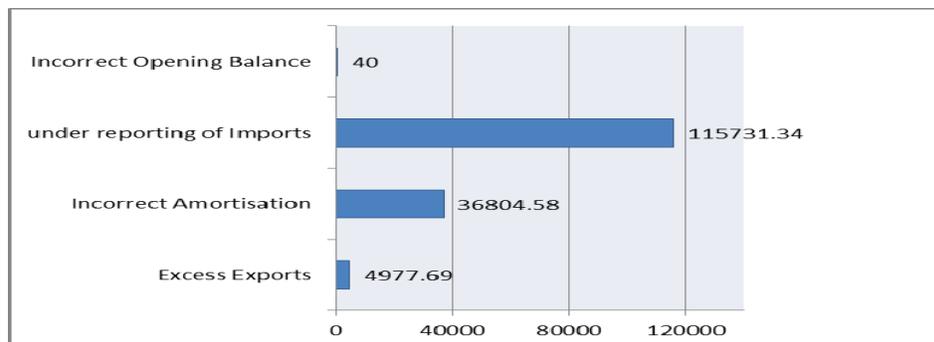
Department replied (September 2013) that APRs were devised to capture all transactions that impinge upon NFE calculation.

The reply is not tenable as the fact remains that APRs are the sole mechanism for monitoring of the Units. In the absence of provision to capture all financial data of the SEZs, comprehensive monitoring could not be done.

6.1.4 Verification of data in APRs

As per the Rule 54 of SEZ Rules 2006, every unit in a SEZ has to maintain proper accounts, and submit APR in prescribed format (Form I) to the DC duly certified by a Chartered Accountant. This data is important as it serves as the basis for verifying whether the units have indeed achieved the required positive NFE and also as a monitoring mechanism to ensure that the units are functioning as intended under the applicable policy and rules. However, the SEZ scheme relies mainly on self-certification and does not require the APRs to be supported by other statutory documents like annual accounts, customs records, income tax (IT) returns, bank realisation certificates (BRC) etc. This facilitated few units to provide incorrect /inconsistent data in their APRs. The NFEs derived on the basis of this inconsistent data cannot be relied upon.

Results of our correlation of data furnished by the units in their annual performance reports with data available in the annual accounts, customs records, IT returns, etc., indicated that 21 units located in Andhra Pradesh, Gujarat, Kerala, West Bengal and Uttar Pradesh had reported excess NFE to the tune of ₹ 1150.06 crore. This modus operandi was through under/non reporting of imports, exports prior to commencement of production, incorrect amortization of Capital Goods, etc., which led to excess reporting of NFE in the APRs as depicted below:



Further, as per Rule 22 (3) of SEZ Rules, the Units are required to provide details of outstanding Export proceeds in their APRs. We observed that the

information on unrealised exports proceeds was not furnished in any of the APRs submitted. Cross-verification with Annual Accounts and outstanding Bank Reconciliation Statements revealed unrealised exports to the tune of ₹ 5,386.19 crore to be realised in respect of 110 Units located in Andhra Pradesh, Gujarat, Rajasthan, Kerala, West Bengal, Tamilnadu, and Uttar Pradesh.

Incidentally, all these APRs were duly certified by Chartered Accountant for the veracity of facts and figures reported in it.

As monitoring of Units is based solely on the information contained in the APRs, hence due diligence is expected both from Units in reporting of facts and figures and Chartered Accountants in certifying the same.

A typical case of failure in monitoring excess reporting of NFE/Exports is discussed in Box 15.

Box-15: Failure in monitoring excess NFE/Exports

In case of Solar Semiconductors an SEZ Unit in FAB City Hyderabad wherein imports were under reported by ₹ 1129.30 crore is resulting in excess reporting of NFE by ₹ 1129.30 crore. Further, there were outstanding export proceeds to be realised to the tune of ₹ 48.34 crore which was not reported in APR and the same was not monitored and action taken.

In the case of M/s Euro Trousers, an SEZ unit in KASEZ, Gujarat, department did not take action even though the CA had given adverse remarks in the APR of 2009-10 and 2010-11 that the unit was a branch office of its foreign entity and had major forex transactions. However, the details of outstanding export proceeds were not produced to audit.

MOC&I vide its Instruction (41 dated 13th November 2009) stated that the Units claiming negative NFE on account of foreign exchange fluctuation need to submit a certificate from the authorised bank to the UAC. A unit in SURSEZ, Gujarat (M/s. Raj International) reported negative NFE of ₹ 13.43 lakh and ₹ 1.33 crore in their APR for the year 2010-11 and 2011-12 respectively. The reason attributed for negative NFE was due to Foreign Exchange fluctuation. However, no certificate was adduced in this regard from the authorised bank in contravention to the instruction issued by MOC&I.

Finally, the widespread loopholes noted in the manner in which APRs are filed by the Developers/Units raise doubts regarding the completeness, authenticity and reliability of the information used for managing the database maintained by the Ministry of Commerce for various purposes. This

also calls for a review of the entire monitoring structure to plug the deficiencies pointed out which will not only streamline the system but also plug the revenue leakages taking place in the existing set up.

Audit is of the opinion that for effective monitoring of unrealised export proceeds, APRs need to be captured accordingly.

In reply to paragraphs 6.1 to 6.1.4, DoC stated (11 June 2014) that the findings of Audit have been noted and shared with all Zonal Development Commissioners for compliance. The findings of Audit will be taken into account while reviewing the SEZ policy.

DoC may intimate the outcome of the review of the SEZ policy to audit.

6.2 SEZ Online

As a part of the e-Governance initiative, Ministry of Commerce (MOC) entered into an agreement with NSDL Database Management Limited (NDML) in Sep-2009 for establishing and managing a nationwide integrated solution for administration of Special Economic Zones (SEZ) of India along with Infosys. SEZ Online is a total integrated solution which facilitates speedy processing of various transactions that SEZ Developers, Co-Developers, Units, EOUs and Deemed Exporter have with SEZ administration.

The layered architecture of the application was aimed at future extensibility, scalability and maintainability of the application. The application is accessed by MoC, DCs and Users (Developers/Units) using their respective modules meant for this purpose.

The envisaged benefits of the system are as under:

- Online clearance of imports and exports and consequent reduction in Operational Cost and Turnaround Time
- Reduction in Compliance Cost
- Faster Clearance including applications
- Improvement in efficiency and transparency in Service to End Users
- Availability of Repository of all transactions / interactions with DC's Office
- System to act as a Dashboard and MIS for MOC and DCs

We requested MOC&I for an online access (view facility only) of the system, but the same was not provided. The following audit findings are made based on the results of analysis of electronic data and other paper version of the documents provided by the Ministry.

- a) DoC does not have any IS Strategic plan for Database Management System of the SEZs in the country because the entire project, its maintenance and the strategic management control have been outsourced to NSDL. Thus, such a critical IS system is not internally monitored nor has any committee been formed to adequately monitor the system as required in a typical IS organisation.
- b) Approval/consent of an important stakeholder in DoR was also not taken with regard to the revenue administration function of the system.
- c) It was also observed that there was no HR (Human Resources) management policy for recruitment, capacity building, skill upgradation of manpower required to strategically manage and monitor a critical revenue sensitive system.
- d) Audit is of the opinion that in an IS organisation a critical application like SEZ Online with massive revenue implication requires a regular audit of the database, OS, infrastructure, application hardware for:
 - I. IT security audit
 - II. Malware analysis
 - III. Source code review
 - IV. Application configuration review
 - V. ICT infrastructure configuration review
 - VI. Application-OS-hardware-network performance reviews
 - VII. Vulnerability assessment and penetration testing (VAPT)
 - VIII. Analysis of system generated logs for application change management
 - IX. Web application security (WAS) assessment
 - X. Validation of the patches deployed and protocol functionality
 - XI. Analysis of SLA (Service Level Agreement) indicators and the tools to monitor and calculate the SLA indicators
 - XII. Review of technology deployed to ensure continuity of IT system
 - XIII. IT Act Compliance
 - XIV. National Cyber Security Policy compliance

In view of the complete outsourcing of the project and its maintenance activities, the strategic control of Service Level Agreements review, source code review and performance audit of the IT infrastructure and application needs to be mandatorily with the Government. Accordingly, SLAs may be reviewed and aligned.

- e) **Not all users are onboard** : As per Rule 78 (E-filing) of Chapter VIII, Miscellaneous, of “The Special Economic Zones Rules, 2006” (as amended up

to 31.08.2010), every developer and unit shall file applications and returns electronically on the Special Economic Zone online system, within a period of one month of the system being commissioned. However, as per the e-update of SEZ Online system (October 2012) as many as 170 SEZs out of 392 are registered with SEZ Online and only 119 of them had commenced transacting.

f) General Controls:

i) **Access privileges not restricted ideally:** The roles and privileges for customs/DC officials should be based on 'Need-to Know' basis. In the event of change in the incumbency, if any, the roles and privileges should be updated by Admin at the DC level. However, it was observed in Hyderabad that even after transfers, assessment and other files of the previous incumbent were being shown as pending with the Official concerned.

ii) **Conflict in the duties performed:** Owing to manpower shortage, there was an overlap in the roles performed by the Specified officers and the Authorized Officers. This is fraught with the risk of conflict in duties performed. In view of this, there should be appropriate compensating controls to address this residual risk.

iii) **Need to restrict roles and privileges to functional area:** Roles and privileges need to be restricted to functional area of operation. It was seen that users can access the system from any place. AOs sitting in one place can do assessment of all the SEZs.

g) Deficiencies in System Designing: Notwithstanding the fact that the system was initiated over two years ago, many business rules are yet to be integrated into the system. Consequently, they were being performed manually or were being maintained as standalone systems as discussed below:

i) According to the system in place invoices are based on international commercial terms (INCOTERMS) which are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC) that are widely used in international commercial transactions or procurement processes. We noted that during assessment the Customs officials were entering the type of Invoice (as system captures only CIF/FOB/CI/CF Invoice types) manually based on which duty assessment is done in case of Imports or DTA Sales. Assessment of duty was being done based on Customs and Central Excise Tariff. However, this was not integrated into the system and assessment was being done manually.

ii) Anti-Dumping Duty (ADD) is levied under sub-section (5) of section 9A of the Customs Tariff Act, 1975 to protect the domestic industry. We noted that although data required for levying such duty has already been captured in the System (viz., country of origin, price, etc.), ADD was being calculated manually wherever applicable.

iii) One of the objectives of the system was to have electronic database on the performance of the SEZ units and the duty/ tax exemptions that was provided to the SEZ units. However, we noted that there was no provision in the system to capture the Service Tax exemptions availed by the Units/Developers. The interest of the Government could have been at least saved had the value of exemption availed on service Tax been entered in the BLUT (Bond cum Legal Undertaking).

iv) We noted that there was no facility for e-payment of duty in respect of DTA sales as available in ICEGATE. SEZ online system was not linked to ICEGATE or Bank portals. For instance, SEZ units, located in Sriperumbudur or Chengalpattu, situated at the outskirts of Chennai (i.e. more than 35 Kms.) have to make duty payments through DD/Cheque at Air Cargo Customs, Meenambakkam, Chennai due to lack of e-payment facility. Similarly, due to lack of linkage with ICEGATE the movement of goods to and from the SEZ could not be watched through the Customs Houses located all over India. The Import General Manifest /Export General Manifest details are captured manually and fed into the SEZ online module which, if linked to the ICEGATE, could be gathered automatically without manual intervention.

v) No reconciliation of accounts could be carried out by the PAO with the Banks as far as the revenue earned from SEZ is concerned.

vi) One of the objectives of the system was to serve as a data repository for SEZs. However, there was no provision to store the data prior to 2010 and hence Ministry has to depend on the manual system to give information putting a question mark on the completeness and reliability of the database in use.

vii) Processes like approval of SEZ, its notification, extension of approval if any, investment, employment, land, de-bonding, calculation of duty to be paid on such de-bonding etc. were yet to be made functional and integrated into the system.

viii) One of the vital MIS tool (reports) was not made functional. In the Export Module, no provision was made to capture data pertaining to Onsite locations.

h) Service Level Agreement: The Service level Agreement between DOC and NDML needs to be reviewed in view of the following:

i) Although the ownership of database lies with DOC, strategic management control of the vital data is left with the private vendors. How the risk associated with this has been mitigated is not known.

ii) No time schedule was given for the functionalities (SEZ A1 to A27 in Administrative Module, C1 to C6 in customs module) to be developed. Since signing of SLA (September 2009), most of the functionalities could not be developed viz., interface with ICEGATE, MIS reports, etc.

iii) No provision was made for reviewing the application with regard to the adequacy of business processes covered and the correctness of business rules mapping. Similarly, no provision was made to review the SLA except for pricing of the fees to be charged by NDML.

iv) Assessment Functionality with provision of Duty Payment through payment gateway was not mentioned in the SLA even though online payment option for all the charges of MDML is available in SEZ Online system.

v) Clause 5.5 of the SLA promises to switch over to a Disaster Recovery Site in shortest possible time in the event of disaster in the primary test. However, no specified time limit, description of Back up site (Hot/Warm/Cold) is agreed upon.

vi) Clause 5.7 specifies that NDML will obtain ISO 27001 certification for SEZ Online System with distinct policies for data management and Security. Whether the certification was acquired is not known.

vii) Clause 6 deals with ownership of hardware, software and data. It is seen that software is not to be transferred to DOC even after the termination of the agreement.

viii) Clause 8.1 promises operational uptime of 97 per cent. However, no performance metrics or measurement tools (throughput/response time/downtime) are agreed upon and further nothing is mentioned about non-fulfilling of the promised operational uptime.

ix) Clause 8.2 stipulates maintaining of single shift telephonic support desk. Although the system is online, it still has the archaic telephonic support desk. A proper support desk handling Incident and Problem management in line with ITIL Framework and features like escalating the critical problems to the apex authorities needs to be put in place. Response times also need to be agreed upon.

x) It has been observed that NDML is charging ₹ 200 for each transaction in SEZ online system apart from one time registration of ₹ 50,000 and annual maintenance charges of ₹ 20,000 per year whereas the transaction cost for the similar data was ₹ 66 in the ICES.

xi) SLA needs to be reviewed in view of newer concepts like Application Performance Management which provides a means for measuring and analyzing an application's quality of service as experienced by the end-user. With this perspective, an end-to-end view of performance can be obtained across all components including application, desktop, network and server on a per user, per application, per transaction, or per business process basis.

i) **Data Analysis:** the year-wise data received from DOC in respect of Imports, Exports and DTA Sales/Purchases were analyzed and the findings are given below:

Imports:

S/No.	Financial Year	Total Number of Cases	Duty forgone (₹ in crore)	No. of instances of Null/Zero values of Duty forgone
1	2010-2011 (12/10 to 3/11)	212534	3106.23	6325
2	2011-2012	543050	9937.80	11736
3	2012-2013	684041	16909.12	6346

- Blanks or gaps were observed in row no.128344 in 2010-2011 and row no.564386 and 190099 in 2012-13.
- Zero/Null IGM in 36630 cases out of 212534(2010-2011).
- 7663 cases in 2010-11 where country of origin and port of shipment are different. Individual cases need to be checked to see whether Anti-Dumping duty is levied wherever, applicable.
- 160 cases of imports of wastes and scraps in 2010-2011 (Rule 18(4)(a) restricts recycling of plastic wastes and scraps).
- 139 cases in 2010-11 where Invoice No. was zero/dots (lack of Input validation Controls).
- 36581 cases in 2010-2011 where the nature of transaction was given as "Others" and items like Diamonds, Labels were imported without having any duty forgone.
- Invoice Type: FOB (103998 cases in 2010-11 but details of insurance and freight was not given in few cases); CF (7746 in 2010-11 but insurance not given in few cases) and CI (11840 in 2010-11 but freight details not given in some cases). When invoice is in FOB/CI/CF actual

incidence of freight and insurance is to be loaded or in the absence of details Freight at the rate of 20 per cent and Insurance at the rate of 1.125 per cent is to be added to the FOB value to arrive at the CIF Value. This aspect needs to be checked.

DTA Purchases:

S/No.	Financial Year	Total Number of Cases	Duty Forgone (₹ in crore)	No. of instances of Null/Zero values of Duty forgone
1	2010-2011 (12/10 to 3/11)	21433	4.86	18113
2	2011-2012	139218	107.83	103206
3	2012-2013	266206	2658.94	116038

- Duty forgone amount stated above cannot be relied upon with such huge number of null/zero value cases (18113 in 2010-11, 103206 in 2011-12 and 116038 in 2012-13).
- Blank entries observed at row no.146395, 146396 and 240538 in the year 2012-13 for the same party.
- Lack of Input Validation control in Invoice date field where dates of 2001 and 2005 are also allowed to be entered (Data entry error as other details are for 2011 but invoice date is given as 2001).
- Instances of purchase of Waste/Scrap from DTA.
- Duty Forgone on supplies on Consignment/Free of cost basis not captured.
- Duty Forgone is not captured in some cases where nature of transaction is "others" (1329 records in 2010-11).

DTA Sales

S/No.	Financial Year	Total Number of Cases	Duty forgone (₹ in crore)	No. of instances of Null/Zero values of duty forgone
1	2010-2011 (12/10 to 3/11)	47342	423.13	6116
2	2011-2012	143144	980.22	17624
3	2012-2013	211094	2278.65	23799

- Blank entries at row no. 35053 in 2010-11, 75502, 42750 and 41442 in 2011-12 and 59344, 59363 and 60135 in 2012-13 (in 2011-12 same party M/s Gupta Associates).
- Zero Duty Clearances (6116 in 10-11, 17624 in 11-12 and 23799 in 12-13) needs to be analyzed further and item details and classification

need to be cross checked. Certain items like Insulin, Solar modules, Contraceptives are exempted. A unit in the DTA producing/clearing same final product would also clear these goods at 'nil' rate of duty, but would have suffered duty on inputs used in the manufacture of these products. This puts the DTA units under a comparative disadvantage .

- Duty forgone is given as nil in some cases where Nature of Transaction is "Free of Cost" (220 cases) and "Consignment" (5711 cases) with item details like diamond, capital goods, plastic hangers etc.

Exports:

S/No.	Financial Year	Total Number of Cases	Exports (₹ in crore)	No. of instances of Null/Zero values of Duty forgone
1	2010-2011 (12/10 to 3/11)	248538	45113.54	112
2	2011-2012	486749	100759.69	244
3	2012-2013	583488	151208.02	83

- Exports through SEZs for the year 2012-13 as per SEZ online data was ₹ 151208 crore whereas the exports for the same period was given as ₹ 476159 crore (MOC&I Annual report and BoA Minutes).
- 169 entries in 2012-13 with export value blank/dot/zero.
- 2824 entries in 2012-13 are shown to be exported to India.
- 11415 entries in 2012-13 were exported in Indian Rupees.
- 7 entries with Negative FOB value in 2010-2011 (inadequate input validation control).

DoC in their reply (June 2014) stated that SEZ Online System is still under implementation and on Live Testing Stage and the audit observation will be taken into consideration by the DoC, in consultation with the DoR.

Final outcome may be intimated to audit.

j) Production of Records: The following documents were not produced to audit:

- I. Details of fees charged by NDML as per SLA was not provided to audit.
- II. SLA between NDML and M/s Infosys (vendor) was not produced to audit.
- III. Details of vulnerability assessment and penetration testing along with application security assessment are stated to have been produced;

however, only copy of code review certificate dated 10th December 2013 was produced to audit.

DoC in their reply (June 2014) stated that the available records were produced and other records shall also be made available in due course of time.

Reply is not acceptable to audit because no reason for non availability of records with the auditee was furnished to audit. These records could have been produced to audit during the period between issue of the draft report (27 April 2014) and furnishing of DoC's reply (14 June 2014) to the draft report.

To sum up, the system could not be utilized optimally even after two years of the system going live (October 2011) with much functionality to be rolled out completely. This calls for a review of the progress made and the service level agreements with NSDL so as to expedite the system development in all respects in a time bound manner to realize the full potential of the objectives with which the system was embarked upon.

DoC in their reply (June 2014) stated that the Advice/Comments of Audit shall be duly taken into consideration before the portal is independently functional after the ICEGATE integration is done. The Department will ensure the streamlining of all the shortcomings of SEZ Online System noticed by the DoC, DoR or any other participating Ministry /Department before the system is in place on standalone basis.

As no targets were suggested by DoC for integration of the portal with ICEGATE, it is suggested that a specific time line may be drawn up for completion of the project.

6.3 Other Compliance Issues

Various other compliance issues (17 issues) amounting to ₹ 17.96 crore noted in various states are indicated in Appendix 5:

DoC in their reply (June 2014) stated that the matter is being examined for further necessary action and shared with all Zonal Development Commissioners for compliance.

DoC may intimate the final outcome to audit.

6.4 Stakeholders' feedback

As a part of our review and based on a need expressed by MOC& I during the Entry Meeting (22 October 2013), it was felt necessary to have direct inputs from the principal players in the SEZ scheme viz., Developers, Units within

SEZs and the Development Commissioners to elicit their feedback on various issues concerning functioning of SEZs in the country.

With the intended objective, we selected a sample of 91 Developers, 532 Units and 9 Development Commissioners spread over 11 States/UT¹⁸ out of the audit sample for our survey by issuance of questionnaires containing questions on various aspects relating to formal/in-principle approvals, notification, and subsequent business activities carried out by the Units in the Special Economic Zone. In response, 39 Developers (43 per cent of 91 developers), 173 Units (33 per cent of 532 units) and 9 Development Commissioners have responded to our Survey Questionnaire.

In response to our survey questionnaire (Appendix 6), it has been observed that majority of the Developers/units expressed satisfaction in obtaining approvals from BoA/UAC, sanction of claims/concession, and process of de-notification and exit from SEZ, including grievances redressal. However, the redressal mechanism for grievances is not efficient. A fixed time frame is required for getting approval from BoA, submission of documents and setting up of single window clearance mechanism in each State. SEZ units also felt that operating in DTA has become more beneficial as compared to operating in SEZs after withdrawal of exemption for MAT and DDT for the SEZs. Signing of more Free Trade Agreements by India enabled Indian exporters outside the SEZs to import duty free inputs which acted as a disincentive for exporters operating within SEZs. Export benefits to the SEZ units have considerably reduced vis-a-vis DTA units. Global recession and end of tax holiday were attributed to be the main causes for shortfall between projections and actual. This was followed by other reasons such as, too many restrictions, lack of infrastructural facilities and cumbersome land acquisition processes. SEZs opted for de-notification mainly because of infrastructure facilities and growth in domestic market, poor global market, excessive restrictions, end of tax holiday and introduction of MAT.

The experience of Development Commissioners in respect of issues flagged to BoA, addressing the issues related to Developers/Units by members of UAC and adequacy of information furnished by Developers/Units in APR/QPR for effective performance of Units are satisfactory. About 12 per cent DCs agreed that Single Window Clearance mechanism is not very effective. 56 per cent of the DCs expressed that concession/exemption granted to SEZs are

¹⁸ Andhra Pradesh, Chandigarh, Delhi, Gujarat, Haryana, Karnataka, Maharashtra, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal

sufficient, whereas, 12 per cent disagreed with them. Frequent changes in fiscal policy, lack of interest, contiguity norms and non-recognition of SEZ as public utility etc were felt to be the reasons for bottlenecks in functioning of SEZs.

The details of the sample and responses received are given in Appendix 6.

FIEO and PHDCCI expressed the views of the exporters and industry where acquisition of farmland for establishing SEZs was considered a very important issue. The other issue is related to the concentration of SEZs in the districts that are relatively more industrialized or situated in sea connected States, which creates regional imbalances and income inequality. Moreover, different land requirement criterion for setting up a SEZ in different sectors also creates concentration of SEZ in specific sectors. This is evident from the fact that 60 per cent of the SEZs in India are comprised of IT based products and services sector and it is considered that SEZs in India has become an attractive area for information technology firms to avail tax incentives by shifting to the zones from domestic tariff areas.

With regard to the overall functioning of the SEZs, getting permission from the custom authorities for procuring/exporting materials/services and getting sanction of claims viz. rebate, CST etc. were considered to be the major difficulties. Non existence of single window clearance system widely and lack of clarity in certain procedures viz. exit from the SEZ results in operational inefficiency for a SEZ. The major change which is observed is change in SEZ developers/units pessimistic attitude towards the SEZ concept in India. This is on account of enhancing several export incentives for the exporters operating within DTA which finally acted as a disincentive for the exporters operating within SEZ. PHD Chamber believes that operating in DTA area has become more beneficial as compared to operating within SEZs.

The essence of the stakeholders response is given in the box below.

Box-16

- Single Window Clearance has not integrated all the clearances and therefore it was not serving the intended purpose. Absence of state level Acts adds to this problem.
- Minimum Alternative Tax (MAT) and Dividend Distribution Tax (DDT) seem to be acting as impediments in the growth story of SEZs which was evident from the magnitude of de-notifications.
- IT/ITES Sectors have an edge over other sectors due to availability of skilled manpower and plug and play facilities.
- It is now beneficial to work out side SEZs, in the DTA, for greater fiscal benefits.

Recommendation: *In addition to specific monitoring measures, internal audit needs to be conducted and internal controls both in the manual and online*

system need to be strengthened while retaining the strategic control of the SEZs database management system with MOC&I.

7. Conclusion

Audit observed that MOC&I has not prescribed any measurable performance indicators in line with its objectives and functions, for the real socio-economic benefits for citizens and the State. The SEZ policy and procedures were not directed towards involving all the states. There were no time limits for each stage of the SEZ life cycle for bench marking.

The system of according extensions without appropriate corrective measures or deterrent action, led to de-notification and diversion of the land for commercial purposes which necessitates review of the system being followed.

The Statement on revenue loss on account of various tax sops to SEZs presented along with Budget every year is not comprehensive as it does not consider concessions given on account of Central Excise and Service Tax. Income tax Act, 1961 does not provide for timely remittance of foreign currency; there was also no mechanism for capturing, accounting and monitoring of ST forgone, either by Development Commissioners or the jurisdictional ST Commissionerates. There is no provision to recover duty forgone on inputs utilised for manufacture of finished products on clearances of such exempted goods in DTA as it is done in EOUs. The tax administration's (direct taxes and indirect taxes) failure to process many cases of undue tax claims amounting to ₹ 1654 crore questions the robustness of the tax scrutiny process in place. Further, concessions under State statutes viz., Stamp Duty, VAT, CST, etc could not be quantified in the absence of any monitoring mechanism.

The modest achievements of SEZs in the country are a contribution from a few SEZs operating in a few developed States. Many of these SEZs were established in the EPZ regime between 1965 and 2005. Many SEZs in the country remained at approval/notification stage which is reflected by the fact that per cent of operational to notified zones is only 38.78 per cent. Considering the significant shortfalls in achievement of the intended socio-economic objectives by all the sectors of SEZs, there is an urgent need for the Government to review the factors hindering the growth of non-operational and under-performing zones.

Monitoring and internal audit needs urgent attention in the whole scheme of SEZs. Strategic control of the SEZ online database management system has been outsourced to a private operator NSDL. In the absence of an effective internal audit set-up, Development Commissioners, Developers and unit

holders are loosely monitored. This posed a huge risk for revenue administration as well as the growth impetus of the nation.

DoC agreed with the audit conclusions and admitted (June 2014) that Government of India introduced the SEZ Act, 2005 to make SEZs an engine for economic growth, supported by a quality infrastructure and complimented by an attractive fiscal package, at the Centre and the State levels. SEZs have tremendous growth potential, however, number of bottlenecks which have come in the way of SEZ growth need to be addressed, such as; adverse impact on development of SEZs due to imposition of MAT and DDT; non applicability of export promotional benefits of FTP to SEZs. There were difficulties in acquiring land for establishing contiguity in the SEZ for setting up large SEZs consequent upon the enactment of the LARR Act, 2013. Multiple permissions from State/Central Authorities for master plan and environmental clearance at various levels due to non-delegation of powers to DCs and UACs also hindered the growth of SEZs.

Audit is of the opinion that there is a need to relook at the policy framework and its implementation for better outcome.

New Delhi
Dated : 28 July 2014


(Nilotpal Goswami)
Principal Director (Customs)

Countersigned

New Delhi
Dated : 30 July 2014


(Shashi Kant Sharma)
Comptroller and Auditor General of India