

Executive Summary

Income Tax Department (ITD) is subjected to Internal Audit of assessment and accounting functions. Internal audit of assessment work in ITD is undertaken by the Additional Commissioners of Income Tax (Addl. CsIT), Special Audit Parties (SAPs) and Internal Audit Parties (IAPs) of ITD and internal audit of accounting and financial matters is undertaken by Internal Audit wing of Principal Chief Controller of Accounts (Pr. CCA) of Central Board of Direct Taxes (CBDT).

Internal Audit of assessment functions in ITD has evolved over the years and has assumed significance as an independent function with no overlapping between assessment and audit functions. A new Internal Audit System was introduced in ITD with effect from 1 June 2007 providing for a separate audit structure in the ITD to perform the audit work assigning well defined roles to various authorities for effective functioning and management of Internal Audit. The roles of Supervisory Authorities have been defined in Central Board of Direct Taxes (CBDT) Instruction Number 3 of 2007 and Number 15 of 2013.

We conducted Performance Audit on “Functioning of Internal Audit in Income Tax Department” with the objective to derive the following assurance (a) whether Internal Audit is effective in providing reasonable assurance to the CBDT and Senior Management regarding achievement of objectives relating to compliance, assessment and other inter-related activities, as determined by CBDT; (b) whether internal audit is playing an effective role in enhancing the quality of assessments and (c) whether there is effective and efficient follow-up mechanism of internal audit findings and recommendations.

We covered the work done by the Internal Audit wing of ITD and of Pr. CCA, CBDT during the financial years 2010-11 to 2013-14 and up to the date of audit (December 2014). We also examined the control issues relevant to CIT (Audit) charges and monitoring mechanism at the level of DIT (Audit) as well as Regional Supervisory Authorities administering the CIT (Audit) charges. We held Entry Conference with CBDT in September 2014 wherein we explained audit objectives, scope of audit and main areas of audit examination. We also held Exit Conference with CBDT in June 2015 to discuss the audit findings and recommendations vis-à-vis the Ministry’s reply.

Present report outlines audit planning and execution; audit communication, reporting and follow up of Internal Audit objections and performance assessment of Internal Audit of ITD in Chapters II, III and IV respectively. The Internal Audit by Pr. CCA, CBDT covering issues related to planning, reporting,

follow up and settlement of Internal Audit objections and its performance have been brought out in Chapter V of this report.

Audit findings have been summarised in the succeeding paragraphs. We have also summarised Audit Recommendations at the end of Executive Summary besides giving at the end of each Chapter.

a. We found that Action Plan was not prepared in 17 CIT (Audit) charges. The Audit Manual, 2011 has not prescribed a standard format for drawing up of Action Plan at field level. We found that the planning is constrained as information of auditable cases is not being received from administrative CsIT on monthly basis. We noticed that list of auditable cases were not received on a regular basis in 19 CsIT (Audit) charges from administrative CsIT under Pr. CCsIT/CCsIT of 12 regions. The Register of Auditable Cases is not being maintained in 12 CsIT (Audit) charges. As database relating to selection of auditable cases based on prescribed norms is not being maintained, the coverage of high risk cases in Internal Audit could not be ascertained (*Paragraphs 2.2 to 2.6*).

b. We noticed that out of 7,00,398 cases assigned, Internal Audit examined only 5,73,457 cases resulting in shortfall in coverage of 1,26,941 cases. The practice of selection of high risk units is not in place. We could not ascertain whether there is any quality control mechanism in place to prevent raising of prima-facie incorrect or repetitive objections (*Paragraphs 2.9, 2.10 and 2.12*).

c. We observed that the internal audit memos were not issued timely in seven CsIT (Audit) charges. Internal Audit Reports are not being drawn up for issue to administrative CsIT in timely manner in 15 regions. We found that there were delays in initiation of remedial action in 6,172 cases (13 regions) and delays in completion of remedial action in 1,640 cases (10 regions). We noticed 73 cases involving tax effect of ₹ 134.10 crore in six regions where Internal Audit objections were settled without proper reply or completion of remedial action (*Paragraphs 3.2 to 3.7*).

d. Inadequate follow up of Internal Audit objections resulted in time barring of 1,553 cases involving tax effect of ₹ 392.65 crore in 11 CsIT (Audit) charges. Intra-Departmental Meetings were not held for follow-up and settlement of internal audit objections (*Paragraphs 3.8, 3.11*)

e. The annual target of audit of minimum number of cases, as prescribed by the CBDT, was not met by Additional CsIT (Audit), Special Audit Parties (SAPs) and Internal Audit Parties (IAPs) in certain jurisdictions during 2010-11 to 2013-14. Although the Central Action Plan of CBDT sets target at 100 per cent for settlement of pending audit objections within a timeframe of

four months, the Internal Audit objections pertaining to earlier years were still pending. As on 31 March 2014, 10,960 major audit objections and 13,353 minor audit objections were still pending. There were significant shortages in deployment of IAPs for Internal Audit and staff deployed under Addl. CIT, SAPs and IAPs in different charges during 2010-11 to 2013-14. The Officers engaged in Internal Audit were frequently transferred within a year (*Paragraphs 4.2 to 4.4, 4.6 to 4.11*).

f. We noticed that the IAPs of Pr. CCA (CBDT) did not conduct audit of RTI, Systems Audit, e-payment Audit and Refund Audit as per the scope outlined by the CBDT. The shortfalls in audit coverage ranged from 10 to 774 units during FYs 2010-11 to 2013-14 on account of acute shortage of manpower. We noticed instances of delays in issue of IRs and in receipt of replies post issue of IRs (*Paragraphs 5.3 to 5.5*)

g. During FYs 2010-11 to 2013-14, out of 4,921 units to be audited, only 1,213 units (24.65 per cent) were audited leaving 3,708 units (75.35 per cent) unaudited. The rate of settlement of paras was very low. During FYs 2012-13 and 2013-14, only 902 paras and 1,320 paras respectively were settled. As on 31 March 2014, there were 13,184 audit paras pending for settlement (*Paragraph 5.10*).

During the course of audit and after issue of draft Report, CBDT has undertaken initiatives to further streamline the monitoring and control of Internal Audit. CBDT has added functionality in the AST module to generate MIS on auditable cases for dissemination to the respective CIT (Audit)/ DIT (Audit) by CsIT (CO) across the country in November 2014. The annual target of cases to be audited by Addl. CsIT has been reviewed and revised from 50 cases to 150 cases in order to ensure selection of top 100 cases of administrative CIT charge in May 2015. The Central Action Plan for the first quarter of 2015-16 has outlined timeframe for key result areas of CsIT(Audit) charges viz., formulation of Internal Audit Plan, number of cases to be audited by Internal Audit, frequency of meetings for settlement of Internal Audit objections, organisation of Training/Seminar by Pr. CCIT/CCIT, maintenance of Ledger Cards by Pr. CsIT/CIT and review of performance as per Interim Action Plan for 2015-16. Further Pr.CIT/DIT(Audit) has issued (June 2015) detailed instructions to all Pr. CCsIT and CsIT(Audit) outlining action to be taken in view of the findings brought out in this Performance Audit Report.