

## **CHAPTER-VII**

### **FOLLOW UP REPORT ON PREVIOUS AUDIT RECOMMENDATIONS**

## CHAPTER-VII: FOLLOW UP AUDIT

### 7.1 Follow up audit on the audit recommendations pertaining to the Performance Audit on “Transition from Sales Tax to VAT (featured in the CAG’s Audit Report for the year ended 31 March 2009)”

#### *Highlights*

➤ Out of the 26 audit/PAC recommendations, the Department accepted 21 recommendations, out of which, the Department had completed action on eight recommendations while in case of five, the Department had initiated action but it was yet to be completed. In case of remaining eight recommendations, the Department had failed to take any action or partially taken action despite accepting them.

#### *Para 7.1.4*

➤ The Department stated that three checkgates were computerised while steps were being taken for setting up of integrated checkgates. Audit verification, however, revealed that only two checkgates were fully interlinked while in case of the third checkgate, the modem was damaged and the same had not been replaced.

#### *Para 7.1.4.2*

➤ It was observed that that the Taxation Department was yet to create a database of dubious/risky dealers. This resulted in continued loss of revenue due to evasion of tax by unscrupulous dealers as is being pointed out by audit year after year.

#### *Para 7.1.4.7*

➤ It was observed that the number of cases scrutinised was very low compared to the number of dealers. However, the Department did not prescribe targets for completion of scrutiny by STs stating that the same was not feasible.

#### *Para 7.1.4.10*

➤ The Department had prepared the VAT Manual for audit assessments. However, the Department did not fix a criteria for selection of dealers to provide for flexibility while making such selections.

#### *Para 7.1.4.12*

➤ It was observed that the Taxation Department had not prescribed any mechanism for cross-verification of dealers’ records with other departments such as Income Tax, Central Excise *etc.*, in order to detect evasion of tax. Although the Department had issued instructions to the STs to cross-verify the records of doubtful dealers with the Central departments, the STs were yet to comply with the instructions.

#### *Para 7.1.4.16*

### **7.1.1 Introduction**

Performance Audits (PAs) are essentially means to improving public sector performance and accountability and this can be achieved through implementation of the recommendations contained in the PAs. Consistent and systematic follow up by the audit with the department towards implementation of the recommendations will contribute significantly towards improving the efficiency in the functioning of the various Government departments.

A follow up audit was carried out with regard to the action taken on audit recommendations relating to the PA on “*Transition from Sales Tax to VAT in Meghalaya*” pertaining to the Taxation Department. The PA was featured in the Audit Report for the year ended 31 March 2009 and was subsequently discussed by the Public Accounts Committee (PAC) in May 2011, following which, the PAC brought out its 37<sup>th</sup> Report (presented to the State Assembly in September 2011) containing additional recommendations for implementation by the State Government.

### **7.1.2 Audit Objective**

The main objective of conducting the follow-up audit was to assess the progress of the Taxation Department towards implementing the accepted audit recommendations of the PA on “*Transition from Sales Tax to VAT in Meghalaya*” and the recommendations made by the PAC.

### **7.1.3 Audit Scope and Methodology:**

The follow-up audit was conducted between June 2015 and October 2015 and the audit process involved issue of questionnaire to the Taxation Department and the Meghalaya Legislative Assembly and review of the replies including holding discussions with the officers of the Taxation Department. In cases where the Department has assured that action has been taken in line with the audit/PAC recommendation, necessary verification was made. The follow-up audit report has been prepared & finalised after incorporating the replies and the feedback provided during discussions.

### **7.1.4 Audit Findings:**

The PA on “*Transition from Sales Tax to VAT in Meghalaya*” suggested 24 recommendations to be implemented by the Taxation Department. On the basis of audit findings/recommendations, the PAC, while agreeing to the Audit recommendations, made two additional recommendations to be implemented by the Department. Out of the 26 audit/PAC recommendations, the Department accepted 21 recommendations for taking necessary corrective actions.

Of the 21 accepted recommendations, the Department had completed action on eight recommendations while in case of five recommendations, the Department had initiated action but it was yet to be completed. In case of

remaining eight recommendations<sup>9</sup>, the Department had failed to take any action or partially taken action despite accepting them.

Action taken by the Taxation Department and audit verification of the same are discussed in the following paragraphs.

#### **7.1.4.1 Reconciliation of Revenue collected (Para No. 2.2.6.2)**

##### ***Status of recommendation: Implemented***

In the earlier Performance Audit it was observed that there was no reconciliation carried out by the Taxation Department with the Accountant General (A&E) resulting in wide variation between the revenue figures booked by the Department and that booked by the AG. Accordingly, it was recommended that suitable guidelines be issued by the Government, for making it mandatory for the controlling offices to carry out reconciliation as per the extant orders.

The Department accepted the audit recommendation and had started the process of quarterly reconciliation of revenue figures with the AG (A&E) from the quarter ended June 2015. Audit verified the same and found it to be in order and the effect of implementation of the recommendation will be seen during next audit.

However, reasons for not doing the same for the last seven years was not explained.

#### **7.1.4.2 Computerisation of the Taxation Department and the check gates and their interlinking (Para No. 2.2.7.1)**

##### ***Status of recommendation: Partially implemented***

It had been observed that the software modules under VAT were yet to be developed while the checkgates had not been computerised and interlinked with the Commissionerate. Accordingly, it was recommended that the Government may expedite interlinking of the check posts and develop the software modules.

It was verified during follow-up that all the remaining software modules such as e-payment, online issue of road permits/declaration forms, e-registration of dealers *etc.*, had been made operational and were fully functional. The Department had taken steps to interlink three major checkgates *i.e.*, Byrnihat, Umkiang and Dainadubi. The Department further stated that steps were being taken for setting up of integrated checkgates and till date, there were no plans to interlink other checkgates due to low volume of trade.

Audit verification, however, revealed that only two checkgates were fully interlinked while in case of the third checkgate, *i.e.*, Dainadubi, although a

<sup>9</sup> Action Not Taken in respect of **six** recommendations.  
Action Partially Taken in in respect of **two** recommendations.

Very Small Aperture Terminal (VSAT)<sup>10</sup> satellite communications system had been installed and was functional, the checkgate did not have net connectivity as the modem was damaged and the same had not been replaced. Furthermore, the plan to set up integrated checkgates was in cold storage, as the Transport Department, which was the nodal Department, was yet to initiate action for acquisition of land for setting up of checkgates.

*The Department may coordinate with the Transport Department to prioritise the setting up of integrated check gates.*

#### **7.1.4.3 Creation of manual (Para No. 2.2.7.2)**

##### ***Status of recommendation: Implemented***

It was observed that the Taxation Department did not have a VAT Manual and accordingly, it was recommended that the Government may expedite the preparation of the VAT Manual.

The Department stated that the VAT manual had since been prepared and approved by the Government. Audit verified the same and found that the VAT manual was in place and was being used by all the departmental officers for assessment, scrutiny *etc.*

#### **7.1.4.4 Completion of assessments under the repealed Acts (Para No. 2.2.7.3)**

##### ***Status of recommendation: Implementation in progress***

Audit observed that the Department had not fixed a time limit for completion of assessments under the erstwhile Taxation Acts as result of which, there were a lot of pending assessments under the Repealed Acts and accordingly, it was recommended that the Government may consider prescribing specific timeframe for completion of the assessments under the Repealed Acts.

The Department stated (September 2015) that the pending assessments under the Repealed Acts had been drastically reduced from 79,398 in March 2009 to 10,917 in July 2012. The Department also stated that up-to-date report was being sought from all unit offices and it was expected that the pending assessments would further decrease.

Audit observed that while the time limit of completing all the assessments by December 2011 was not adhered to, the Department made some progress in bringing down the pending cases of assessments from 99,643 to 10,917 as of July 2012 in respect of 10 out of 15 unit offices. The status of pending assessments could not be verified in any of the unit offices.

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<sup>10</sup> VSAT is a satellite communications system that serves home and business users. A VSAT end user needs a box that interfaces between the user's computer and an outside antenna with a transceiver. The transceiver receives or sends a signal to a satellite transponder in the sky. The satellite sends and receives signals from an earth station computer that acts as a hub for the system.

While appreciating the fact that the Department had been able to significantly reduce the number of pending assessments under the Repealed Acts in addition to carrying out scrutiny/assessments under the VAT Act, it is further recommended that the Department may ensure completion of all the pending assessments. Further, if the GST Act is adopted, the Department would have to keep provisions for completion of assessments under VAT as well before moving to GST. Moreover, in all cases, prescribed time limit should be adhered to.

**7.1.4.5 Carrying forward of the Database of all the dealers under the repealed Acts and confirmation of the securities provided by them (Para No. 2.2.8.1)**

***Status of recommendation: Implemented***

Audit observed that many of the dealers under the Repealed Acts did not carry forward their business under the VAT, which indicated evasion of tax by such dealers. Accordingly, it was recommended to investigate the turnover of such dealers and levy tax, interest and penalty as per the provisions of the MVAT Act. The PAC further recommended that the Department may update the database on a continuous basis so as to reduce the scope for tax evasion.

The Department stated (September 2015) that all the dealers who migrated from Repealed Acts to VAT reflected the stock carried forward during the transition period. Audit verified the same and found that in all cases checked during regular transaction audits, the dealers were actually carrying forward the stock from the Repealed Acts to VAT.

**7.1.4.6 Periodic analysis of dealers below the threshold (Para No. 2.2.8.3)**

***Status of recommendation: Implemented***

Audit observed that there was no system for periodic scrutiny of the dealers to see if such dealers had crossed the threshold limit of ₹ 1 lakh and were liable for registration. Accordingly, it was recommended that the Government may consider prescribing a system for periodic verification of books of accounts of dealers to detect cases of dealers crossing the threshold limit.

The Department stated (September 2015) that a Survey team was put in place which regularly inspected the business activities of dealers to see if any of the dealers had crossed the threshold. Based on the efforts of the team, 24 dealers had been compulsorily registered by the ST, Nongpoh during the last three years. The fact that such dealers could be identified only after institution of a Survey Team corroborates audit opinion that a system was needed for detection of unregistered dealers.

**7.1.4.7 Database of dubious/risky dealers (Para No. 2.2.8.4)**

***Status of recommendation: Action yet to be taken***

The PAC had recommended that a database of risky/dubious dealers be created based on their past history of fraud/concealment *etc.*, and make the same available to the next audit along with action taken against them.

It was observed that that the Taxation Department was yet to create any such database of dubious/risky dealers. This has resulted in continued loss of revenue due to evasion of tax by unscrupulous dealers as is being pointed out by audit year after year.

*It is therefore reiterated that the Department may expedite the process of preparation of the database, which will help in keeping a watch on the business activities of such dealers.*

**7.1.4.8 Deficiencies in the forms for submission of returns (Para No. 2.2.9.1)**

***Status of recommendation: Implemented***

It was observed that the Department had not prescribed any form for submission of returns by dealers who did not opt for payment of composite tax. It was accordingly recommended that the Government may prescribe the monthly/annual return forms for the general dealers.

The Taxation Department acted on the recommendation and amended Rule 30 of MVAT Act by prescribing quarterly returns for the general dealers.

**7.1.4.9 Mechanism to monitor filing of returns Para (No. 2.2.9.2)**

***Status of recommendation: Implementation in progress***

It was observed that there was no system for monitoring the timely submission of returns by dealers. It was accordingly recommended that the Government may take appropriate steps for regular monitoring of timely receipts of the returns and prompt action against the defaulters.

The Taxation Department had instructed all the STs to maintain registers for monitoring submission of returns by dealers. Audit verification revealed that the field offices were yet to maintain such registers. As such, the field offices had no control mechanism in place to detect timely submission of returns. This resulted in non-submission of returns and non-payment of tax by unscrupulous dealers who had subsequently closed down their businesses in the State resulting in loss of revenue to the State exchequer<sup>11</sup>.

*It is therefore reiterated that the Department may expedite the process of creating a monitoring mechanism to check timely submission of returns.*

<sup>11</sup> Instances have been pointed out in the Audit Report for the year ended 31 March 2014.

**7.1.4.10 Scrutiny and verification of returns (Para No. 2.2.9.3)**

***Status of recommendation: No action taken***

It was observed that the number of cases scrutinised was very low compared to the number of dealers and there were no provisions also for submission of reports by STs to the Commissionerate showing the number of cases scrutinised *vis-à-vis* the prescribed target. It was accordingly recommended that the Government may take immediate action to fix norms quantifying the number of scrutiny to be completed by each ST during a particular period including a mechanism for monitoring the compliance of such orders.

The Taxation Department stated (September 2015) that prescribing targets for completion of scrutiny by STs was not feasible. The Commissioner of Taxes (COT) had however directed all the STs to speed up the process of scrutiny. The Department also stated that no further action could be taken.

*It is reiterated that the Department may look into the possibility of fixing a realistic target for scrutiny for STs, with a view to evaluating the performance of the STs against such targets.*

**7.1.4.11 Result of scrutiny of the returns conducted by audit (Para No. 2.2.9.4)**

***Status of recommendation: Implementation in progress***

Audit observed several mistakes in scrutiny due to absence of proper guidelines. Accordingly, it was recommended the Government may consider issuing guidelines, prescribing the points to be checked while scrutinising the returns. The PAC also recommended that the Department may complete scrutiny of the returns of the remaining dealers at the earliest and to take appropriate action accordingly in order to check the concealment of the taxable turnover of the dealers.

The Taxation Department stated that the COT had directed (August 2015) all the STs to speed up the process of scrutiny and submit a status report on the same. Further reply was awaited.

It was observed that the Department was yet to issue any guideline or checklist prescribing the points to be seen while carrying out scrutiny. This resulted in detection of several cases of mistakes in scrutiny by audit year after year.

*It is therefore reiterated that the Department may issue guidelines for scrutiny of returns by the STs.*

**7.1.4.12 Tax Audit (Para No. 2.2.10)**

***Status of recommendation: Partially Implemented***

It was observed that neither any percentage had been fixed for tax audit nor had the criteria for selection of dealers been prescribed. It was accordingly recommended that the Government may prescribe the criteria, timeframe

and percentage of the dealers and frame the VAT manual so that the audit assessments could be started.

The Department stated (September 2015) that the VAT Manual had already been approved and was in place. As regards fixing criteria for selection of dealers, the Department stated that such a criteria could not be fixed ostensibly to provide for flexibility while making such selections and hence no further action was required to be taken.

*The reply is not acceptable as fixation of criteria for selection of dealers is essential in order to bring the element of transparency in the selection process.*

#### **7.1.4.13 Input Tax Credit (Para No. 2.2.11)**

##### ***Status of recommendation: Action not taken***

It was observed that in the absence of a system of cross-verification of the records of selling dealers there were cases of irregular allowance of Input Tax Credit (ITC). Accordingly, it was recommended that the Government may prescribe a system of cross verification of the records of the selling dealers on a random basis before allowing the ITC. They may also consider amending the format of the returns to provide for the particulars of the goods in the form.

The Department stated that the present system of scrutiny of returns based on the statement of purchases supported by tax invoices together with other documents prescribed under MVAT Rules was sufficient and no further action was required to be taken. The Department communicated the same to the PAC as well.

*Considering the fact that VAT was in a nascent stage in 2008-09 (the period of the PA) and as the VAT system has matured over the last few years, the Department has been able to successfully carry out scrutiny based on the system prescribed.*

#### **7.1.4.14 Deficiencies in the provision relating to goods taxable at the first point (Para No. 2.2.12.2)**

##### ***Status of recommendation: Implemented***

It was observed that due to deficiencies in the MVAT Act pertaining to sale of liquor which was taxable at the first point of sale, there was loss of revenue. The PAC recommended that Section 44 of the MVAT Act may be amended in order to rectify the deficiencies in the provisions pertaining to goods taxable at first point of sale.

The Taxation Department amended Section 44 of the MVAT Act in March 2012.

*No further action is required.*

**7.1.4.15 Irregular grant of incentives to exempted industrial units (Para No. 2.2.14)**

***Status of recommendation: Implemented***

It was observed that there was loss of revenue due to grant of ITC to industrial units which were availing benefits under the Meghalaya Industrial Remission Scheme. It was accordingly recommended that the Government may review the issue and consider retrospective amendment of the provisions of the industrial schemes.

The Department stated (September 2015) that the Industrial Remission Scheme had been amended retrospectively with effect from July 2009 by withdrawing the benefit of ITC to industrial units which were getting benefits under the Industrial Scheme. The notification was further modified<sup>12</sup> through another notification dated August 2012.

*Audit verified the same and observed it to be in order. No further action required.*

**7.1.4.16 Deficiencies in the provision for cross verification of the records of other departments like Central Excise, Income Tax Department, etc. (Para No. 2.2.15)**

***Para 2.2.15.1 Status of recommendation: Implementation in progress***

**A** It was observed that there was loss of revenue due to absence of a system for monitoring the goods passing through Meghalaya and bound for other States. It was accordingly recommended that the Government consider a mechanism for effective monitoring of the vehicles carrying goods meant for other States passing through Meghalaya to arrest this problem.

The Taxation Department stated (September 2015) that the Act and Rules were sufficient to address the issue of goods in transit passing through Meghalaya and bound for other States. The COT further directed (June 2015) the ST of the Enforcement Branch (EB), Shillong to ensure that there was no offloading of goods in Meghalaya while in transit. Audit verification revealed that the ST, EB had been successful in detecting few cases of irregular offloading of goods while in transit and realised appropriate tax and penalty from the defaulters.

***Para 2.2.15.2 Status of recommendation: Action not taken***

**B** It was observed that the Taxation Department had not prescribed any mechanism for cross-verification of dealers' records with other departments such as Income Tax, Central Excise *etc.*, in order to detect evasion of tax. It was recommended that provisions be made in the MVAT Act for cross-

<sup>12</sup> *The new notification provided for the date from which the previous notification would come into effect.*

verification of the dealers' records with those of Income Tax, Central Excise etc.

The Department stated that instructions had been issued<sup>13</sup> (June 2011) to the STs to cross-verify the records of doubtful dealers with the Central departments. Audit verification revealed that the STs were yet to comply with the instructions.

*It is reiterated that the COT may take up the matter with the STs to ensure that all doubtful cases are cross-verified with Central departments before completion of scrutiny/assessments etc. In this regard, submission of a periodical report may be prescribed for all the STs in order to ensure compliance.*

#### ***Para 2.2.15.3 Status of recommendation: Implemented***

**C** It was observed that the Department had not issued instructions for verification of the declaration forms from the centralised database system called TINXSYS. It was accordingly recommended that the Department may issue instructions to all the STs to verify the details of declaration forms in TINXSYS before allowing exemption /concessional rate of tax.

The Taxation Department stated (September 2015) that instructions had been issued to all STs (January 2013) to use the TINXSYS to verify the authenticity of declaration forms before carrying out assessments.

*Audit verification revealed that the STs were complying with the order and results of such verifications were available in the case records of the dealers. Audit further reiterates that the COT may direct the STs to submit periodical information pertaining to the number of declaration forms verified by the STs so as to eliminate the possibility of assessments without verification of details.*

<b><i>7.1.4.17 System of sending the details of works contract/purchases by the works/buying Departments to the Taxation Department (Para No. 2.2.16.1)</i></b>
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#### ***Status of recommendation: Implementation in progress***

It was observed that the Works/buying Departments failed to share details of work contracts/purchases with the Taxation Department resulting in evasion of tax by contractors/suppliers. It was accordingly recommended that the Government may prescribe a system for periodic verification of the records of the works/buying departments by the STs in order to detect cases of non/short deduction of tax at source. The PAC further recommended that legal action may be taken against few departments in order to set a deterrent for others.

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<sup>13</sup> *The COT directed all the STs to ascertain the returns of turnover submitted by dealers to the Central departments with those submitted to the Taxation Department.*

The Department stated (September 2015) that despite issuing instructions time and again to all administrative departments of both Central and State Government to deduct tax at source from the bills of contractors and suppliers, the same was not complied with by the departments. The Department had requested the Government to clarify if sanction was needed to prosecute the Drawing & Disbursing Officers of the erring departments under Section 90 of the MVAT Act.

*It is again reiterated that the Department may convene a meeting at the highest level with all the Works/buying departments in order to ensure that they comply with the instructions to deduct tax at source. Further, the Taxation Department may bring the issue of non-compliance by the erring departments and sanction of DDOs' prosecution under the MVAT Act before the PAC.*

**7.1.4.18 Bar on purchase/engagement from/with unregistered dealers by buying departments (Para No. 2.2.16.2)**

***Status of recommendation: Action not taken***

It was observed that there was no bar on buying departments from awarding works contracts/supply contracts to unregistered dealers. It was accordingly recommended that the amendment be made in the Act/Rules by banning the Government departments from entering into works/supplies/contracts with unregistered dealers.

The Taxation Department was yet to intimate any action taken in this regard. This resulted in loss of revenue due to non-registration of dealers undertaking works contracts as has been pointed out in the Report on the theme "Deduction of tax at source" to be featured in the Audit Report for the year ended 31 March 2015.

*Since the MVAT Act already provides for registration of dealers, the Taxation Department may issue notification/public order directing all works/buying departments to ensure that no works/supply contracts are awarded to unregistered dealers.*

**7.1.4.19 Internal Control (Para No. 2.2.18)**

***Status of recommendation: Action not taken***

It was observed that the Department did not have adequate internal controls to regulate its functioning. It was accordingly recommended that mechanism for internal control including internal audit be strengthened.

The Department did not take any action on the matter stating that the instructions issued by the COT to the field offices from time to time were adequate. The Department also stated (September 2015) that as the audit of the taxation offices was undertaken both by Audit as well as the Examiner of Local Accounts, no additional internal audit wing was required.

Audit observed that in the absence of any internal audit, the Department had no mechanism to monitor its own functioning and benchmarking the performance of its different wings and field offices. This has resulted in huge under recoveries of revenue as detected by audit year after year due to lapses in the functioning of the field offices which could have been avoided had there been an internal monitoring mechanism in place.

*It is therefore reiterated that the Department may consider the possibility of setting up an internal audit wing to address the various lapses in the functioning of field offices.*

#### **7.1.5 Conclusion**

The fact that the Taxation Department had completed the implementation of eight recommendations with implementation in progress in another five indicated willingness on the part of the Department to address the issues detected by audit. In cases where the Department had not taken any action or partially taken action, the following course of action is suggested:

- the Department may coordinate with the Transport Department to prioritise the setting up of integrated check gates;
- the Department may ensure completion of all the pending assessments and also keep provisions for completion of assessments under VAT as well before moving to GST in future;
- the Department may expedite the process of preparation of the database which will help in keeping a watch on the business activities of unscrupulous dealers;
- the Department may expedite the process of creating a monitoring mechanism to check timely submission of returns;
- the Department may look into the possibility of fixing a realistic target for scrutiny for STs, with a view to evaluating the performance of the STs against such targets;
- the Department may issue guidelines for scrutiny of returns by the STs;
- the Department may provide for fixation of criteria for selection of dealers for audit assessment in order to bring the element of transparency into the selection process;
- the COT may take up the matter with the STs to ensure that all doubtful cases are cross-verified with Central departments before completion of scrutiny/assessments etc. In this regard, submission of a periodical report may be prescribed for all the STs in order to ensure compliance;
- the COT may direct the STs to submit periodical information pertaining to the number of declaration forms verified by the STs so as to eliminate the possibility of assessments without verification of details;
- the Department may convene a meeting at the highest level with all the Works/buying departments in order to ensure that they comply with the

instructions to deduct tax at source. Further, the Taxation Department may bring the issue of non-compliance by the erring departments and sanction of DDOs' prosecution under the MVAT Act before the PAC;

- the Taxation Department may issue notification/public order directing all works/buying departments to ensure that no works/supply contracts are awarded to unregistered dealers; and
- the Department may consider the possibility of setting up an internal audit wing to address the various lapses in the functioning of field offices.

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