Chapter III

Effectiveness of Internal Audit

3.1   Introduction

Internal Audit is one of the main compliance verification mechanisms in the Central Excise department in the era of self assessment and is undertaken under Rule 22 of Central Excise Rules, 2002. The Internal Audit function involves selection of assessee units on the basis of risk parameters and scrutiny of records of the assessee in a uniform, efficient and comprehensive manner in accordance with the audit standards. For this purpose, the Central Board of Excise and Customs has laid down detailed guidelines in the form of the Central Excise Audit Manual (CEAM), 2008 for audit of Central Excise, which prescribe detailed processes for conduct of audit.

3.2   Organisational Set-up

The Central Excise department was restructured in October 2014. Before restructuring, Internal Audit was conducted by an Audit Cell in each Commissionerate, headed by an Additional/Joint Commissioner.

After the restructuring, separate Audit Commissionerates were created under the supervision of Directorate General of Audit (DG Audit). Each Audit Commissionerate is assigned jurisdiction over assessees, associated with two or three executive Commissionerates.

The Directorate General of Audit, Customs and Central Excise, New Delhi (headed by Director General) with its seven zonal units at Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Mumbai, each headed by an Additional Director General, is required to ensure the efficient and effective implementation of the audit system (based on EA 2000 Methodology) and also to evolve and improve audit techniques and procedures through periodic review.

In the restructured set-up, Audit Commissionerate comprises of a headquarters, similar to an Executive Commissionerate and subordinate offices, called Circles, similar to Divisions. Each Circle is headed by a Deputy/Assistant Commissioner and comprises of Audit Groups equivalent to the Range offices which have Superintendents and Inspectors.

3.3   Audit Objective

The objective of this audit was to verify the extent of compliance of the Internal Audit Commissionerates with the laid down:-

- Rules/manual/norms/ guidelines and

- Mechanism for the follow-up of audit findings and rectificatory action thereof.

3.4   Audit Criteria

The sources of audit criteria include the provisions/ guidelines in the following Act, Manuals and Circulars of the department:-

a)   Rule 22 of Central Excise Rules, 2002
b)   Central Excise Audit Manual, 2008
c)   Manual for Quality Assurance Review, 2007
d)   Notifications, Circulars, Instructions, Guidelines etc issued by the CBEC from time to time

3.5   Scope, Coverage and Audit Methodology

There are 124 executive Commissionerates and 45 Audit Commissionerates all over India, out of which, total 15 Audit Commissionerates were selected for the purpose of Audit.

We examined the Assessee Master Files (AMF), Internal Audit files (IAF), Audit Planning Register (APR) and Audit follow-up register (AFR) etc., for the period 2012-13 to 2014-15 available with selected Audit Commissionerates and Executive Commissionerates.

3.6   Non-Production of Records

During audit, we requisitioned 750 Assessee Master Files, out of which we received 565 Assessee Master Files. We requisitioned 1125 Internal Audit Files, out of which we received 1039 Internal Audit Files. Further, five Commissionerates[21] did not produce APR, AFR for the whole period. In the absence of these records, we are not in a position to comment on extent of compliance by the Internal Audit wing of the department with the laid down procedures.

3.7   Audit Findings

We found instances of non/incomplete maintenance of Assessee Master Files, Audit Planning Register, Audit Follow up Register etc. Further, during scrutiny of sample Internal Audit Files, we noticed, lack of documentation of Desk Review, Audit Plan and Verification Report. The observations are discussed in succeeding paragraphs.

---

[21] Chennai Audit I, Cochin Audit, Hyderabad Audit, Bhubaneswar Audit and Kolkata Audit II

3.8   Desk Review and Conduct of Field Audit

3.8.1   Assessee Master File

As per chapter 9 of Central Excise Audit Manual (CEAM), 2008, Risk-based audit requires a comprehensive data base for profiling each taxpayer, so that risk factors, relevant to a taxpayer, may be identified in a scientific manner and audit planned and executed accordingly. A comprehensive data base of assessees is an essential pre-requisite for selection of units as well as for undertaking preliminary Desk Review and for effective conduct of audit. As per the CEAM, 2008 this information has to be collected and kept in a separate file for each assessee, called Assessee Master File (AMF). The AMF is to be prepared and updated by the Audit cell in the Commissionerate. The Audit Cell would be responsible for the data management, updation and upkeep of the AMF. This file should invariably be   created for each assessee. If not already done, it may be done immediately, in any case, before conduct of next audit.

A list of documents as indicated in Annexure A (Registration application, copies of past three years returns, copy of past three years audits, cost audit/tax audit report and financial statements of past three years) & Annexure B (Details of goods manufactured and exempted, production details, duty payment and issue of SCN of past three years and details of litigation) of the manual is to be kept in each AMF. The AMF is to be maintained both as a hard copy as well as in electronic form.

During the Audit by CERA, it was observed that the required database of the assessees for risk assessment, is not being maintained, as evidenced from the observations mentioned below.

- Though there were 62,993 registered assessees under 14 Commissionerates[22], AMFs were created in respect of only 11,184 assessees (17.75 per cent) for the period 2012-13 to 2014-15**.** Patna Audit Commissionerate did not intimate the total number of assesses.
- Out of sample of 565 AMFs in selected Commissionerates, 545 files were not complete and did not have all the documents mentioned in Annexure A/Annexure B of the CEAM, 2008.
- In nine Commissionerates[23], the AMFs had been maintained/ updated only after selection of units for Internal Audit.

---

[22] Bangalore CX Audit (Bangalore I, II,III), Pune Audit-I, Kolkata Audit-II, Chandigarh Audit, Bhopal Audit I, Bhopal Audit II (Raipur), Chennai Audit I (Chennai I & III) , Cochin Audit, Ahmedabad Audit-II, Jaipur Audit, Hyderabad Audit, Bhubaneswar Audit, Delhi Audit-I and Lucknow Audit

[23] Ahmedabad Audit-II, Jaipur Audit, Chandigarh Audit-II, Hyderabad Audit, Bhopal Audit II, Bangalore CX Audit, Kolkata Audit-II , Pune Audit-I and Lucknow Audit

- In all selected Commissionerates AMFs had not been maintained in electronic format as prescribed in the CEAM, 2008.

When we pointed this out (October 2015 to January 2016), the Ministry admitted the facts (December 2016) in all the cases and reported shortage of manpower in newly created Audit Commissionerates, as the main reason for the same. All the Commissionerates noted the audit observation for future compliance. Bhubaneswar Audit Commissionerate further stated that after formation of Audit Commissionerate, the risk factor is calculated centrally by the DG, Audit and made available to all Audit Commissionerates which are relied upon for selection of units for auditing.

In view of practical constraints expressed by almost all the Commissionerates in maintaining AMFs for all the assessees and response of Bhubaneswar I Commissionerate regarding role of DG Audit in calculating risk scores of assessees centrally, the Ministry needs to evolve a practical way of risk profiling of assessees by Commissionerates which will capture the localised risk and can be used in combination with centralised risk scoring done by DG Audit.

3.8.2 Inadequate Desk Review/Audit Plan/ Verification Report with Working Papers

As per para 10.4.1 of CEAM 2008, Desk Review is the first phase of the audit programme. The idea is to gather as much information about the assessee as possible before visiting the unit. In Desk Review, major items to be examined includes Assessee Master File, Trial Balance, Annual Financial Statements (P&L and Balance Sheet), results of last audit, availing of exemptions, returns filed with other authorities like Sales Tax, Income Tax etc. Analysis of this information for preparation of Desk Review and results of the same should be submitted to the Deputy/Assistant Commissioner (Audit) for approval. Further as per para 10.4.14 of CEAM, 2008, Audit Plan containing the exact formulation of issues selected for detailed examination in respect of every assessee and should be finalised after approval by Additional Commissioner/Joint Commissioner (Audit). This is to be prepared in the form of Annexure H of the CEAM, 2008[24]. The audit party conducts the verification (at the assessee premises) by checking the points mentioned in the Audit Plan and the auditor should prepare a "Verification Paper", as prescribed in Annexure I of the CEAM, 2008[25] outlining the audit checks in the Audit Plan, verification done on each check and auditor's observations in brief.

---

[24] Format of Annexure H is Subject, Specific Issue, Source Document, Back-up Document, Coverage Period and Selection Criteria

[25] Format of Annexure I is Date of verification, Name of the auditor verifying the issue, issue in brief, Ref. No. of Audit Plan, Documents verified, Brief account of the process and extent of verification, Auditor's observation and conclusion in brief, Quantification of revenue, if any and Documents relied upon

To assess the compliance of above three procedures viz. Desk Review, Audit Plan and Verification Report, Audit conducted a test check of 1039 assessee audit files in 15 Audit Commissionerates of central excise and found inadequate documentation in 166 files, in nine Commissionerates[26]. Summary of the observation is given below:

- Desk Review was not found attached or poorly prepared in 53 Internal Audit files in six Commissionerates[27].

- Audit Plan was not found attached or not prepared as per the prescribed format of annexure H of CEAM, 2008 in 81 Internal Audit files in four Commissionerates[28].

- Verification Report was not found attached as mandated in annexure I of CEAM, 2008 in 121 Internal Audit files, in eight Commissionerates[29].

Some of important observations are as under:

- In Cochin Audit Commissionerate (including Cochin, Calicut and Trivandrum executive Commissionerates), we noticed that in 34 out of 67 test checked files, working papers were not prepared. In these cases, the Audit Parties merely prepared a note titled 'Desk Review' indicating the dates of audit and the general areas proposed to be examined during the audit and some basic data like Balance Sheet, Profit and Loss Account, ER-1 returns etc. without any analysis of these records. As Working Papers were not prepared, there was no evidence that there was proper examination of the various financial statements, calculation of various financial ratios and conduct of trend analysis. This indicated that no proper Desk Review was conducted in these cases, affecting the preparation of good quality Audit Plans.

- In Kolkata Audit II Commissionerate, we noticed that out of 51 test checked files, summary result of Desk Review were not available in 6 files, Audit Plan was not available in one file and verification papers were not available in 34 files.

- In Patna Audit Commissionerate (including Patna, Ranchi I & II and Dhanbad executive Commissionerates), we noticed that out of 75 files

---

[26] Cochin Audit, Bangalore CX Audit, Chandigarh Audit, Hyderabad Audit, Kolkata Audit II, Lucknow Audit, Patna Audit, Pune Audit I and Jaipur Audit.

[27] Cochin Audit, Chandigarh Audit, Bangalore CX Audit, Kolkata Audit II, Lucknow Audit and Jaipur Audit.

[28] Cochin Audit, Chandigarh Audit, Kolkata Audit II and Patna Audit.

[29] Cochin Audit, Chandigarh Audit, Hyderabad Audit, Kolkata Audit II, Lucknow Audit, Patna Audit, Pune Audit I and Jaipur Audit.

test checked, Audit Plan in 45 were not in accordance with the Annexure H of the Manual.

- In Lucknow Audit Commissionerate (including Agra, Kanpur, Lucknow and Allahabad executive Commissionerates), we noticed that out of 75 files test checked files, in nine files, Desk Reviews were not attached and in 39 files, verification papers were not available.

When we pointed this out (October 2015 to January 2016), the Ministry accepted the audit objection in all the cases and stated that (December 2016) necessary rectification measures have been taken/will be taken in due course.

3.8.3   Lapses Not Detected by Internal Audit Parties

Lapses not detected by the Internal Audit detected in Central Excise Revenue Audit (CERA) by CAG of India subsequently

In 7 cases in three audit Commissionerates[30], CERA audit, conducted subsequent to Internal Audit, detected lapses/irregularities involving revenue of ₹ 86.18 lakh which had not been detected by the Internal Audit of the Commissionerate. The observations relates to non/short payment of duty, irregular availing of CENVAT Credit, short payment of interest etc.

The Ministry in its reply (December 2016) accepted the audit objection in six cases and did not furnish reply in one case.

Poor Desk Review and audit planning adversely affected the quality of Internal Audit. Further, due to non availability of Verification Report and working papers, proper accountability of Internal Audit party cannot be ensured.

3.9   Monitoring of Internal Audit Process

3.9.1   Maintenance of Audit Planning Register (APR)

As per para 12.3.1 of CEAM 2008, the Audit Planning Register[31] is to be maintained in the prescribed format. It will facilitate in ensuring: (i) all units allotted to an Audit Group have been audited; and (ii) wherever audit has been completed, the Audit Reports are issued in time and it will also ensure that if audit of any unit could not be taken up, the same can be included in the schedule for the subsequent period.

---

[30] Bhopal Audit II, Hyderabad Audit and Patna Audit

[31] Format of Audit Planning Register is Sl. No., Name of Unit, IAP No., Propose Month of Audit, Actual date of Audit, Submission of DAR to Audit Cell, Audit Report No, Date of Issue etc.

We observed in nine Commissionerates[32], that the APR was not maintained according to CEAM, 2008 and entries such as date of submission of Internal Audit Report (IAR) to audit cell, Audit Report number and date of issue of IAR were not filled up. Consequently, it was not possible to monitor, from these registers, whether the audit reports were issued on time.

In Chennai I and III Commissionerates, the planning files/registers for the three years (i.e. 2012-13 to 2014-15) were not produced to Audit. Hence, the maintenance of the registers could not be ascertained.

When we pointed this out (October 2015 to January 2016), the Ministry accepted the facts and stated that (December 2016) now the register is being maintained properly, as per new audit manual.

3.9.2   Maintenance of Audit Follow-up Register

As per clause 12.1.3 of CEAM, 2008, the details of audit reports discussed by monitoring meeting, the decision taken in the meeting and the further follow up action should be entered in the Audit Follow up Register[33] (maintained in the format given in the manual), as soon as the audit report is approved. A monthly abstract should be put up by Audit cell to Additional/Joint Commissioner (Audit) by 10th of the following month in the format given the manual.

We observed in nine Commissionerates[34] that most of columns were not filled up in the Audit Follow up Registers.

The 'Monthly Abstract of Audit Follow up Register' was not being prepared/ submitted to Addl. / Joint Commissioner (Audit) in four Commissionerates[35].

When we pointed this out (October 2015 to January 2016), the Ministry accepted the facts and stated that (December 2016) now the register is being maintained properly as per new audit manual.

---

[32] Delhi Audit-I, Bangalore Audit I, Jaipur Audit, Chandigarh Audit, Lucknow Audit, Patna Audit, Cochin Audit, Bhopal-II, Pune Audit-I

[33] Format of Audit Follow up Register is AR No., Name of Assessee, Range and Division, Reg. No. of Assessee, Period of Audit, Date Audit, IAP No., Para No., whether accepted by MCM, duty involved, Spot Recovery, Recovery other than spot recovery before issuance of SCNs, Division file No. SCN No. & Date, Amount in SCN, Reason of closure of para & date of closure of para.

[34] Ahmedabad Audit-II,   Chandigarh Audit, Lucknow Audit, Patna Audit, Pune Audit-I, Delhi Audit-I, Bhopal II , Hyderabad Audit, Chennai Audit I

[35] Lucknow Audit, Patna Audit, Delhi Audit I, Pune Audit-I

3.9.3   *Submission of Draft Audit Report (DAR)*

According to Para 12.1.3 and Para 12.2.1 read with Board's circular dated 16 February 2000[36], the draft Audit Report should be finalised within the time frame envisaged i.e. within 20-25 days of the commencement of audit in the assessee's Unit in standardized format (*Annexure N* of the manual) along with enclosures to Audit Cell for considering in Monitoring Meeting. Auditor should submit draft Audit Report to the Assistant Commissioner / Deputy Commissioner (Audit), with all enclosures for examination and vetting.

We observed in eight Commissionerates[37] that out of 497 test check files, there was delay upto three months, in respect of 122 draft audit reports and there was delay of more than three months, in submission of 43 draft audit reports.

Few cases are illustrated below:

- In Kolkata Audit II Commissionerate, in case of M/s Young India Prestress Pvt. Ltd., the DAR was submitted with the delay of 241 days.
- In Dhanbad Executive Commissionerate, in case of M/s BCCL., the DAR was submitted with the delay of 193 days.
- In Chandigarh Audit Commissionerate, in case of M/s Amritsar Crown cops (P) Ltd., the DAR was submitted with the delay of 331 days.

When we pointed this out (October 2015 to January 2016), the Ministry accepted the audit objection and stated (December 2016) that the delay in submission of draft audit report was due to delay in receipt of documents/replies or non-cooperation by the assessees.

3.9.4   *Evaluation of Audit Reports*

Clause 12.2.4 of CEAM 2008, provides that the monitoring committee meeting (MCM) shall also evaluate the working of audit group in respect of each audit. The scoring of audit report and working papers should be carried out by the Commissioner and Addl. Commissioner/Joint Commissioner (Audit). As instructed in Ministry's circular No. 514/10/2000-CX dated 16 February 2000, the scoring committee should score the audit report and the working papers with a view to evaluate the standard of the audit conducted as per Annexure-O of the manual.

We observed in eight Commissionerates[38], that out of a total 580 Internal Audit files, no scoring had been done in 434 files (74.83 per cent). In three

---

[36] No.514/10/2000-CX

[37] Delhi Audit I, Bangalore CX Audit, Lucknow Audit, Patna Audit, Kolkata Audit II, Chandigarh Audit, Cochin Audit and Pune Audit-I

[38] Jaipur Audit, Bangalore CX Audit, Chennai Audit-I, Delhi Audit-I, Kolkata Audit-II, Lucknow Audit, Patna Audit and Cochin Audit

Commissionerates[39], no scoring had been done in any of the Internal Audit files examined.

When we pointed this out (October 2015 to January 2016), the Ministry accepted the facts and stated that (December 2016) the audit comment is noted for future compliance.

In the absence of scoring of Audit Reports, quality of Internal Audit cannot be evaluated.

3.9.5   *Finalization and Issuance of Final Audit Report*

As per para 12.2.3 of EA 2000, based on the decision of the MCM, the draft Audit Report should be finalised by the Audit Cell within fifteen days from the date of MCM.

We observed in all selected Commissionerates that out of 1039 test check files, there was delay upto three months in respect of 356 final audit reports and delay of more than three months, in issue of 121 final audit reports.

Few cases are illustrated below:

- In Delhi Audit I Commissionerate, in case of M/s Trimurti Fragrances Pvt. Ltd., the delay was of 206 days. Further, it was also noticed that in 19 files, date of MCM was not mentioned and in one file the date of issue of inspection report was not mentioned. In two files, inspection reports were not available.
- In Kolkata Audit II Commissionerate, out of the selected sample, FARs could not be found on record in any file. Based on the decisions in the MCMs, none of the DARs were found to have been actually converted into FARs.
- In Cochin Audit I Commissionerate, in case of M/s Kancor Ingredients Ltd., the delay was of 589 days in issuing the Final Audit Report, after the conclusion of audit at the assessee's unit.

When we pointed this out (October 2015 to January 2016), the Ministry accepted the audit objection and stated (December 2016) that the delay in finalization of draft audit reports was for want of recovery particulars in respect of the observations accepted by the assessees or compliance of queries raised in MCM committees.

Improper maintenance of Audit Planning and Follow up Registers have direct impact on effective watch on Internal Audit process. Further, non maintenance of timeliness in issuance of FAR to the assessee does not reflect well on the image of the department.

---

[39] Delhi Audit I, Jaipur Audit and Kolkata Audit II

3.10 Miscellaneous Issues

3.10.1 Audit of Units Under Computerized Assisted Audit Programme (CAAP)

Central Board of Excise and Customs has taken several initiatives in the past to introduce "e-governance in the department. Computer Assisted Audit Programme (CAAP) is an electronic tool, meant to carry out audit verifications of assessee's electronic business records more comprehensively to meet the objectives of EA-2000. Computer Assisted Audits (CAAs) involve examination and analysis of business (private) records that are maintained electronically. Result Framework Documents (RFD) circulated by DGICCE vide D.O.F No. 503/32/2007/Pt-II dated 05 July 2012 stipulates that all mandatory units are to be audited through CAAP.

We observed in Jaipur Audit Commissionerate, that out of total 464 mandatory units, only 21 units of Central Excise were audited under CAAP during the year 2014-15.

When we pointed this out (December 2015), the Ministry stated (December 2016) that CAAP training for Officers is being organized regularly.

3.10.2 Wrong Depiction of Figures/ Information in Monthly Performance Report (MPR)

We observed the following discrepancies in MPR of Delhi Audit-I Commissionerate for the months of December 2014 and January 2015:-

- In Annexure 7 of MPR of December 2014, amount of closing balance of para was shown as ₹ 94.56 crore instead of ₹ 92.58 crore.
- Annexure 7 (Para B) of MPR of December 2014, showed Nil paras in closing balance instead of correct figure of three paras amounting to ₹ 1.77 lakh.
- Annexure 7 (Para B) of MPR of January 2015, showed Nil paras in closing balance instead of correct figure of three paras involving ₹ 2.83 lakh.

When we pointed this out (November 2015), the Ministry admitted the facts and stated (December 2016) that the discrepancies observed have been rectified and actual figures are being reflected in the prescribed reports. The inadvertent error is regretted.

3.11 Conclusion

Risk based audit has been adversely affected due to non/ incomplete maintenance of Assessee Master Files in most of the cases. Poor Desk Review, audit planning and non-documentation of Verification Reports raise questions on the work done by IAP. Further, Draft Audit Reports are being

finalised with significant delay and no monitoring of the timelines is being carried out. Poor maintenance of records by a wing which is the backbone of the compliance verification mechanism, reflects poorly on the functioning of the department.