

Executive Summary

About this Performance Audit

The objective of the Advance Authorisation Scheme (AAS) is to provide registered exporters with their requirement of basic inputs/raw materials at international prices without payment of Customs duty in India, subject to the condition of export of manufactured goods with specified percentage of value addition. Performance Audit of this Scheme was conducted to ascertain whether the issue, utilization, redemption and implementation of Authorisations by the Directorate General of Foreign Trade (DGFT) and the Customs Department is being done in an efficient and effective manner. Audit also examined the effectiveness of inter-departmental coordination involved in the administration of the Scheme and whether the internal control measures are sufficient to minimize the risks of revenue loss, misuse, etc. Audit covered DGFT, its Regional Authorities (RAs) and related Customs field formations through the Customs Commissionerates concerned.

There are a total of 38 RAs across India wherein 88,157 Advance Authorisations (AAs) involving Cost, Insurance and Freight (CIF) value for imports of ₹7,58,141 crores were issued during the period 2015-16 to 2018-19 covered under the Performance Audit. This audit was carried out between December 2019 and March 2020. Audit selected a sample of 4,048 AA files (4.96 percent) involving CIF value of ₹2,08,126 crores (29.56 percent) for the period 2015-16 to 2018-19 from the 23 major RAs (60.52 percent) out of the total of 38 RAs. Audit also selected jurisdictional Customs field offices where the selected sample cases were registered for effecting duty free imports and exports.

Out of the 4,048 selected cases, 405 AA files involving CIF value of ₹9,906.73 crores pertaining to seven RAs (mainly Mumbai, Ahmedabad and Delhi) were not produced for audit, despite repeated requests/reminders to RAs.

Structure of the Report

This report contains 66 audit observations and 17 recommendations. The performance audit has revenue implication of ₹1,386.80 crore, out of which 44 paras amounting to ₹1291.93 crore were accepted by DGFT/Department of Revenue (DoR), final outcome of action/recovery was awaited in 5 paras amounting to ₹0.24 crore, and 17 paras amounting to ₹94.61 crore were not accepted by DGFT/DoR. Till date, recovery of ₹0.70 crore was made in respect of 8 paras. Similarly, 11 out of 17 recommendations have been accepted by DGFT/DoR; response awaited in respect of five recommendations (R1, R3, R6, R11 and R12) and not accepted in respect of one recommendation (R7).

Chapter I : Overview of Advance Authorisation Scheme

The Scheme is administered by the DGFT while exemption from the levy of Customs duty on imported inputs is allowed by the Central Board of Indirect Taxes and Customs (CBIC), DoR under Ministry of Finance (MoF).

The application for licence is to be submitted to the jurisdictional RAs under DGFT, as specified under the Hand Book of Procedure (HBP). The RA verifies the information furnished in the application and issues the licence, which is then registered with the specified Customs Port for allowing import and export of goods under the licence. The registration is subject to execution of bond, and if necessary, Bank Guarantees (BGs) with the Customs Department. On discharge of Export Obligation (EO), the Authorisation Holder (AH) makes an application of redemption to the RA, who issues an Export Obligation Discharge Certificate (EODC) to the AH and sends a copy of the same to the Customs Department for redemption of bonds and BGs, if any.

AA is issued for inputs in relation to the resultant product based on certain norms such as Standard Input Output Norms (SION) or based on Self-declaration, Self-Ratification Scheme or applicant specific prior fixation of norms, where SION is not notified.

(Para 1.1, 1.2)

Analysis of AA Scheme for the period covered under the PA revealed that the Free on Board (FOB) value of exports increased by 25 per cent from ₹3,03,539 crore in 2015-16 to ₹3,78,808 in 2018-19.

Sectoral analysis of AAs in terms of CIF value showed a declining trend in respect of Gems and Jewellery and Handicrafts from 2015-16 to 2018-19 and significant growth in electronics, textiles, chemicals, leather etc. As of 2018-19, chemical, engineering and plastic sectors accounted for nearly 82 per cent, by CIF value, of the AAs.

Analysis of FOB value fixed in AAs vis-à-vis total physical exports effected during the year revealed that in two sectors, chemicals and plastics, the FOB value for AAs was more than 50 per cent of the total physical exports, as of 2018-19, followed by engineering. In these three sectors, the AA Scheme was an important driver of total sectoral exports.

DGFT implemented mandatory online filing of prescribed documents along with online application for issuance of AAs in May 2019 and has subsequently rolled out a new IT system effective from 1 December 2020 wherein all the prescribed documents (including for redemption) are required to be uploaded online, deficiencies and their responses be handled online and data would be seamlessly transferred to Customs for better monitoring of EODC finalization and making the AA scheme paperless. The period covered during the audit was 2015-16 to 2018-19; therefore, the implementation of these features,

effective May 2019 and December 2020, would be reviewed in subsequent audits.

(Para 1.4, 1.4.1 and 1.4.2)

Summary of Audit Findings

Chapter II : Issuance of Advance Authorisations (AAs)

Audit examined the implementation of facilitation measures introduced for simplifying the process of issuance of AAs by analyzing the data for the period from 2015-16 to 2018-19 and the key features of the automated system. The analysis revealed that the AA Scheme was partially automated with the receipt of application being automated while the process of issue of AAs remained largely manual. The automated system developed for the AA Scheme required, during the period covered in audit, manual intervention, thereby leading to avoidable physical interface and discretion in the hands of authorised officials, resulting in significant delays in issuance of AAs. AAs based on no-norms which are finalized by the Norms Committees (NCs) at DGFT Headquarters remained manual.

65 per cent of AAs issued during the period from 2015-16 to 2018-19 were SION based and the remaining 35 per cent pertained to the no-norms category which are required to be finalized by the concerned NCs; the sample selected for review was accordingly drawn in the same proportion. However, out of the total 1,422 AAs commented in this chapter, 621 AAs were SION based (44 per cent) and the remaining 801 AAs belonged to the no-norms category (56 per cent). Thus, most of the audit issues related to the AAs issued under the no-norms category, even though this constituted only about one-third of the total AAs.

There were acute staff shortages both at DGFT Headquarters and at RAs with substantial accumulated vacancies, which could be adversely impacting the ability of DGFT in ensuring effective implementation and monitoring of not only Advance Authorisation but also other schemes under FTP.

(Para 2.1)

The substantial delay in issue of AAs indicated failure of the automated system in achieving the objective of simplification of procedures and ease of doing business during the audit period of 2015-16 to 2018-19. The process of issuance of AAs though automated, required manual intervention as the mandatory online filing of prescribed documents along with the application could be implemented only in May 2019, whose implementation will be reviewed in future audits. Till then, all the prescribed documents were being submitted physically which defeated the purpose of facilitating an online

system besides resulting in inordinate delays in issuing of AAs despite having prescribed timelines.

(Para 2.2)

Audit reviewed the pendency position of Advance Authorisation applications with the Norms Committees. As on 31st March 2019, the pendency was 5606 which increased to 6044 by 31st March 2020 (7.8 per cent). There were significant delays in fixation of norms beyond the prescribed period of four months, ranging from 4 months to 16 years, as against the time limits of 12 months and 18 months respectively for imports and fulfillment of export obligation. With non-finalization of norms in time, EODC cannot be issued to exporters within the prescribed period, which results not only in blocking of bonds and BGs but also results in increase of non-fulfillment of EO cases. Further, this also delays the initiation of proceedings against the firms by RAs and Customs Authorities for making recovery of Customs duty and interest thereon for default cases, besides penalizing genuine AHs, who are not getting EODCs even after complying with all the stipulated conditions.

(Para 2.4.1 and 2.4.2)

Audit found the implementation of the Denied Entity List (DEL) mechanism, perceived to make the exporters strictly comply with the conditions of licences, to be ineffective with inordinate delay in placing the entities under DEL which ranged upto 8 to 13 years and issuing of multiple abeyance orders. There is no limit fixed for number of abeyance orders that can be issued to an exporter under the extant rules/procedures. Besides, there is no mechanism for the RA to know if the applicant has been penalized under the Customs Act and rules thereunder, as there is no exchange of information about such penalized entities between Customs and DGFT offices. Issue of authorisation is purely on self-declarations of the applicant.

(Para 2.5)

There is no verification of credentials by RAs before issuing multiple AAs, especially to Small Scale Industries (SSI) Units with no past export performance and seeking to make substantial imports beyond its capacity. Further, issuing of new licences to a firm in the absence of non-fulfillment of export obligation of previous AAs in a timely manner defeats the very purpose of the Scheme.

(Para 2.6.1 and 2.6.2)

Chapter III : Implementation of the Scheme

Implementation of the scheme by both the Customs Department and DGFT was examined in audit. Audit also verified whether any institutional mechanism exists for coordination between DGFT and Customs and whether

exchange of information between the two departments is done effectively and in a timely manner.

Allowing duty free imports after the validity period of authorisations or excess imports against licences indicates weakness in the monitoring mechanism in the Customs Licence Utilisation module. Further, the primary purpose of execution of bond is to secure due compliance with rules and procedures as laid in the AA Scheme; it also serves as a collateral security to ensure payment of appropriate duty and interest in cases of non-compliance. Non-cancellation of the bonds in a timely manner, as prescribed in CBIC instructions, not only results in locking up of funds of the genuine AHs but also sends a wrong signal to the trade at large.

(Para 3.1.1 to 3.1.3)

RAs depend on AH to claim for redemption as no mechanism exists with the RAs in the extant system to ascertain the cases where the EO period has expired. Instances of non-monitoring of excess imports, non-compliance with the pre-import conditions and undue extension of Export Obligation Period (EOP) were observed.

(Para 3.2.1.1 to 3.2.1.3)

There is no time limit prescribed in FTP/HBP for seeking revalidation of licences and such requests are sought even after expiry of the validity period of licence. As validity of the licence is specified (12 months from issue date) in Para 2.16 of the HBP and authorisations must also be valid on the date of imports/exports (Para 2.18 of HBP), in audit's opinion any request for revalidation should be entertained within the validity of the licence only.

(Para 3.2.1.4)

RAs do not insist for declaration of all the inputs actually consumed in the manufacture of exported items as required under Appendix 4H/4E. Audit is of the opinion that the practice of considering CIF value of only imported inputs does not reflect the complete picture of value addition. Non-inclusion of value of indigenous supplies, incorrect consideration of GST/Commission/IGST amount and non-declaration of actual imports by AHs were observed in audit, which is fraught with the risk of diversion of duty free imports as well as misuse of the scheme. RAs may ascertain the actual usage of non-declared goods and take appropriate action for disallowing the incorrectly availed exemption.

(Para 3.2.3.1 to 3.2.3.3)

Non-activation of the online facility for redemption/EODC application resulted in delay in issue of EODC and increase in transaction cost and time.

Even though the redemption application were filed online, however, all documents like BEs, SBs, e-BRCs, input and export consumptions and certificates were required to be filed manually during the period of audit 2015-16 to 2018-19. The complete digitization of the redemption process and its integration with licence data would help in reducing the delay and to achieve the benchmark of 15 days set for disposal of redemption applications.

(Para 3.2.6)

In the absence of an effective online Message Exchange Module (MEM), CBIC often had to depend on the AH to ascertain EODC status granted by DGFT. Similarly, DGFT was not aware about the duty payment status for cases where EO period is over but documents have not been submitted. Non-communication of EODC data by DGFT/non-usage of EODC data by Customs authorities results in delay in closure of bonds and increase in pendency.

(Para 3.3.1)

Non-issuance of Show Cause Notices (SCNs) by Customs Department against defaulters and delays in adjudication process indicates weakness in coordination between the two Departments and ineffective utilization of the EDI system or 'eodc.online' of DGFT to ascertain export performance and take concerted action. DGFT should notify DoR about extensions granted to AAs, SCNs/demand notices issued and update its portal regularly thereby facilitating action by Customs in a timely manner.

(Para 3.3.3)

Chapter IV : Internal Control Management

Absence of an effective policy on internal/special audit had contributed to non-monitoring of implementation of the Scheme wherein licences are issued for export of various goods by allowing duty free import of inputs among other functions. Many RAs at field level were unaware of any such mechanism.

(Para 4.1)

Specific timelines should be prescribed in the FTDR Act for issuing of SCNs and adjudication orders so that all cases liable for action should be dealt in the same manner without any prejudice. This would also help to minimize the blockage of government revenue.

(Para 4.2)

MIS reports submitted by RAs are not being adequately monitored/reconciled by the DGFT and non-reporting of vital information is not being pursued with RAs. The delay in initiation of action as well as delay in disposal of demand

notices/SCNs resulted in huge accumulated pendency. No timelines were specified in the FTP and no administrative orders were issued containing instructions to initiate action and escalate legal proceedings against the defaulters.

(Para 4.3)

Recommendations

1. *DGFT/ Department of Commerce should put in place a time-bound plan for filling up of accumulated vacancies with qualified resources, so that it is well equipped to ensure implementation and monitoring of Advance Authorisation and other Schemes, in case DGFT intends to continue with the schemes.*
2. *DGFT may review the manual and automated processes for timely issuance of AAs by ensuring that the online module is realigned to accept only full and completed applications along with all the required documents. The sufficiency of timelines (or otherwise) of such issuance may also be reviewed. Significant delays (ranging from three months to more than two years) in issuing AAs by DGFT vis-à-vis the prescribed timelines of three days defeats the very purpose of the scheme of getting imported items at prevalent international prices as the possibility of fluctuation of prices cannot be ruled out in such extended period.*
3. *With advancement in manufacturing processes and facilities as well as technological upgradations across sectors over time, DGFT should conduct a comprehensive review of the SION notified through HBP Volume-II in 2009.*
4. *With delays in fixation of norms ranging from four months to 16 years (when the time limit prescribed for duty free inputs and exports under the AA scheme is 12 months and 18 months respectively), the Norms Committee (NC) system for the no-norms category is not working effectively and DGFT needs to review the system comprehensively to assess its practicability and feasibility, while minimizing the scope for misuse.*
5. *DGFT may consider prescribing a time limit within which appeals for reviewing NC decisions can be made.*
6. *DGFT may ensure updating of DEL in a timely manner and may review the process of issuing abeyance orders. Further, the DEL should include details of penalties imposed for the prior period, and results of action taken, recoveries made, adjudications, etc. Interest of revenue may be protected in the form of BG either for the duty involved in pending exports before grant of*

abeyance order or full BG for duty involved in respect of fresh licences issued against abeyance orders.

7. *DGFT needs to put in place a mechanism for verifying credentials of exporters before issuing multiple AAs to firms (especially SSI Units with no past export performance) seeking to import/export goods for the first time. Further, DGFT should verify completion of EODCs in respect of earlier AAs, if any, before issuing fresh AAs.*

8. *DGFT may reiterate its instructions to RAs on monitoring of non-furnishing of redemption documents of pending AAs by the AH, before issuing fresh AAs.*

9. *CBIC may consider having an automated alert system for expiry of EO period to ensure appropriate bond renewal/cancellation and obviate the need for depending on AHs for ascertaining EODC status.*

10. *DGFT needs to have an effective mechanism to continuously and regularly monitor EO. Till recently, there was no system to track cases where EOP had lapsed, and RAs depended on AHs to ascertain the EODC status. To minimize possible misuse of AAs, there is a need to have validation checks in the DGFT's EDI system to address possible diversion of imported inputs through substitution of indigenous inputs.*

11. *DGFT should review the procedure for granting revalidation and requests for revalidation should be accepted only within the validity period of the authorisation so that any duty free imports or exports reckoned for export obligation is well within the currency of the authorisation.*

12. *DGFT may insist for complete disclosure in Appendix 4H requiring AHs to declare the "details of all the inputs consumed in the manufacture of exported goods including the indigenously procured inputs and the source of such procurements", for facilitating better monitoring of actual consumption by RAs thereby preventing diversion of duty free imports and misuse of the scheme.*

13. *DGFT should review the procedure for issuance of EODC to meet its prescribed timeline of 15 days by ensuring that the online module is realigned to accept only full and completed applications along with all the required documents.*

14. *DGFT should implement the Message Exchange Module (MEM) across all its RAs for effective and timely exchange of information between DGFT and Customs as well as update the EODC status in its eodc.online website on a regular basis. Periodical meetings may be held in an ongoing manner between DGFT and Customs field formations for timely sharing of information, reconciling the EODC status and recovering the government revenue involved*

in the shape of duty forgone. Appropriate action may be initiated by DGFT/DoR against defaulters for not complying with the Scheme provisions.

15. Internal Audit is an important mechanism for identifying potential areas to improve and hence an effective tool of Internal Control. DGFT should ensure that Internal Audit is appropriately staffed and is being conducted regularly and effectively in its field offices. Further, Special Audit was envisaged specifically for cases wherein AAs are issued under Self-ratification/declaration and therefore should have been carried out in at least a few test cases to act as a deterrent for applicants making wrong declarations.

16. DGFT may consider fixing of time limit for issue and adjudication of SCNs in order to enforce better regulation of the adjudication process in a timely and effective manner.

17. DGFT needs to monitor the MIS reports submitted by RAs and instances of wrong/non reporting may be pursued with RAs. Action may be initiated by DGFT on the basis of information collated from MIS reports.

