

**Table – 2.1: Results of audit**

(` in crore)

<b>S1. No.</b>	<b>Categories</b>	<b>No. of cases</b>	<b>Amount</b>
1.	Performance Audit on “Implementation of VAT (including IT Audit of VATIS)”	1	27.89
2.	Allowance of Excess Input Tax	107	13.11
3.	Non-levy/Short levy of Interest and Penalty	92	4.59
4.	Short levy of tax on works contract	45	13.74
5.	Short levy of tax under CST Act	89	10.46
6.	Incorrect exemption of taxable turnover	19	2.08
7.	Short levy of tax due to application of incorrect rate of tax	43	3.20
8.	Under-declaration of VAT	34	2.75
9.	Other irregularities	423	9.87
	<b>Total</b>	<b>853</b>	<b>87.69</b>

During the year, Department accepted under-assessments and other deficiencies of ` 37.42 crore in 309 cases. Of these ` 32.59 crore involving 113 cases were pointed out by Audit during the year 2014-15. An amount of ` 0.87 crore was realised in 63 cases during the year.

“Implementation of VAT (including IT audit of VATIS)” involving ` 27.89 crore and a few illustrative cases involving ` 9.24 crore are discussed in the following paragraphs.

## **2.4 Performance Audit on “Implementation of VAT (including IT audit of VATIS)”**

### **2.4.1 Introduction**

The Andhra Pradesh Value Added Tax Act (AP VAT Act) was introduced in 2005 to provide for and consolidate the laws relating to levy of value added tax on sale or purchase of goods in the State. It replaced Andhra Pradesh General Sales Tax Act, 1957 (APGST Act). Rules supporting AP VAT Act, known as Andhra Pradesh Value Added Tax Rules (AP VAT Rules) were also introduced in the same year. The Commercial Taxes Department uses an IT system known as Value Added Tax Information System (VATIS) to aid the implementation of the Act in the State.

### **2.4.2 Organisational setup**

Commercial Taxes Department (CTD) is under the purview of the Principal Secretary, Revenue Department at the Government level. At Commissionerate level, Commissioner of Commercial Taxes (CCT) is the head of the Department and is assisted by Additional Commissioners, Joint Commissioners (JC), Deputy Commissioners (DC) and Assistant Commissioners (AC). Divisional offices at field level are headed by the DCs and are assisted by the ACs, Commercial Tax Officers (CTO), Deputy

Commercial Tax Officers (DCTO) and Assistant Commercial Tax Officers (ACTO).

There are 117 assessing offices functioning under the administrative control of the DCs consisting of 13 Large Taxpayer Units<sup>4</sup> (LTUs) headed by ACs and 104 circles headed by the CTOs.

### **2.4.3 Audit Objectives**

The Performance Audit was conducted to

- \* assess the adequacy of systems in place to ensure compliance with legal provisions relating to registration, scrutiny of records and cancellation of registration of the dealers;
- \* assess the effectiveness of the system of assessments; and
- \* evaluate adequacy of IT Policy and relevant controls.

### **2.4.4 Scope, Sources of Audit Criteria and Methodology**

Performance Audit on Implementation of Value Added Tax (including IT Audit of VATIS) covers the period from 2011-12 to 2013-14 and was conducted from September 2014 to May 2015. The performance of the Department was benchmarked against the following audit criteria:

- APVAT Act and Rules, 2005
- VAT Audit Manual<sup>5</sup> issued by the Government of AP and
- Orders/notifications issued by the Government/Department from time to time
- Citizen's charter 2012

For conducting this Performance Audit, out of the 13 LTUs and 104 circles, two LTUs<sup>6</sup> and 13 circles<sup>7</sup> were selected by simple random sampling method. IT audit of VATIS for the period from April 2011 to March 2014 was also conducted as part of the Performance Audit. Data related to selected sample (15 units) was extracted from the centralised data provided by the CCT and was analysed using IDEA software. The general controls and application controls were evaluated with reference to audit objectives.

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<sup>4</sup> Large Taxpayer Units have under their jurisdiction 25-50 dealers of each Division selected on the basis of criteria like tax payments, complexity of transactions, etc. as decided by the CCT.

<sup>5</sup> The Department revised manual during 2012.

<sup>6</sup> DC(CT) Kurnool and DC(CT) Nellore,

<sup>7</sup> Adoni-II, Akividu, Ananthapur-II, Bhimavaram, Chilakaluripet, Chittoor-I, Hindupur, Kurupam Market, Morrispet, Peddapuram, Tadepalligudem, Rajam and Vinukonda.

## **2.4.5 Acknowledgment**

Audit acknowledges co-operation extended by the Department in providing server data, records and other necessary information. The entry conference was held on 2 December 2014 with the Special Commissioner (CT) and Departmental officers in which the Department was appraised of the scope and methodology of audit. An exit conference was held on 30 October 2015 in which the audit results and recommendations were discussed with the representatives of the Department and the Government. The Government was represented by the Special Chief Secretary while the Department was represented by the CCT. Responses of the Government and Department have been suitably incorporated in the Report.

## **Audit Findings**

### **Adequacy of systems for compliance**

CTD is responsible for ensuring that eligible dealers in the State are registered and are paying appropriate tax. Provisions have been made in the VAT Act, Rules and Manuals to protect the interests of the Government revenue as well as to streamline the processes. Registration of dealers provides the basis for controlling the VAT dealers.

The registered dealers are mandatorily required to submit their returns and supporting documents. These form the basis for calculation of the tax liability/ITC of the dealers by CTD.

Cancellation of registration can be done on the request of the dealer or by CTD if certain legal provisions have been violated by the dealer. In such cases, audit is to be conducted by the CTD to ensure that the Government revenues are protected.

### **2.4.6 Non-conducting of street surveys for identifying new dealers**

Section 17 of the APVAT Act, 2005 provides that every dealer other than a casual dealer shall be liable to be registered in accordance with the provisions of the Act. It further provides that dealers having turnover more than ` 7.5 lakh but less than ` 50 lakh should get registered as 'Turnover Tax' (TOT) dealer and dealers with turnover more than ` 50 lakh should invariably be registered as VAT dealers. With a view to identify such dealers who are liable to be registered and pay tax but have remained unregistered, street survey is an important tool. Appendix V of the VAT Audit Manual prescribes conducting of street surveys to identify and ensure registration of dealers. However, neither any procedure nor a periodicity has been prescribed.

Audit observed that street surveys had not been conducted in any of the 13 selected circles during the period covered under audit. In the absence of any such surveys CTD deprived itself of the opportunity of detecting the eligible unregistered dealers and bringing them under the tax net. However, there is no other enabling provision in this regard. The matter had earlier been

raised in the Report of Comptroller and Auditor General of India (Revenue Receipts) for the year ended 31 March 2009.

The matter was referred to the Department (September 2014 and May 2015) and to the Government (October 2015). The Government stated (December 2015) that circular instructions were issued to the Deputy Commissioners (CT) of all Divisions in the State to allot street survey programmes to ACTOs in the Circles under their jurisdiction in order to identify and register dealers who are to be registered as VAT/TOT dealers.

However, copy of the circular instructions was not provided to Audit and during the course of audit the CTOs had stated that no street surveys were conducted during the period covered under audit.

#### **2.4.7 Absence of penal provisions resulted in non-compliance**

##### **2.4.7.1 Non-filing of VAT 200A and VAT 200 B returns**

According to Section 13(6) of APVAT Act, Input Tax Credit (ITC) for transfer of taxable goods outside the State otherwise than by way of sale was to be allowed for the amount of tax in excess of four *per cent*/five *per cent*<sup>8</sup>. As per Section 13(5), no ITC is to be allowed if inputs are used for manufacture of exempt goods. As per Rule 20 of AP VAT Rules, dealers to whom Sections 13 (5) or (6) apply, are to file VAT 200A returns monthly and VAT 200B returns annually. These returns give the breakup of the transactions which are required for correct calculation of ITC eligibility in the case of interstate transfer of goods/manufacture of exempt goods. However, there was no provision for imposing any penalty for non-submission of these returns.

During the course of audit, in 12 circles<sup>9</sup> it was noticed (December 2014 to May 2015), from VATIS data analysis that in 9,450 cases dealers had effected transfers of taxable goods to their branches outside the State, sold exempt goods within the State and claimed ITC amounting to ` 666.50 crore during the period 2011-14. Unlike VAT 200, there was no provision in VATIS for online submission of VAT 200A and VAT 200B returns and the manual copies were also not made available to Audit. In the absence of these returns, correctness of ITC claims could not be checked. The AAs could not insist on compliance as there was no penal provisions in the Act/Rules.

The matter was referred to the Department (August 2015) and to the Government (October 2015). Government stated (December 2015) that online filing of VAT 200A and VAT 200B has been made mandatory in VATIS from June 2015. For the previous period, it is stated that if any irregularities were noticed during the course of audit, demands were being raised. However, it does not ensure the corrective measures taken in all the cases pointed out by Audit, as all cases are not selected for VAT audit. Further, Government has not addressed the issue of penal provisions for non-compliance.

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<sup>8</sup> Tax rate revised from four to five *per cent* from 14 September 2011 vide Act No. 11 of 2012.

<sup>9</sup> CTOs- Adoni-II, Akividu, Ananthapur-II, Bhimavaram, Chilakaluripet, Hindupur, Kurupam Market, Morrispet, Peddapuram, Rajam, Tadepalligudem and Vinukonda.

#### **2.4.7.2 Non-filing of financial statements**

Para 5.12 of VAT Audit Manual prescribes mandatory basic checks on figures reported by VAT dealers in their monthly VAT returns, and comparison of the figures with those recorded in certified financial statements to detect under-declaration of tax, if any. As per Rule 25(10) of AP VAT Rules, every VAT dealer whose annual total turnover is more than ` 50 lakh shall furnish, for every financial year, the financial statements certified by a Chartered Accountant, on or before 31 December subsequent to the financial year to which the statements relate.

Audit noticed (September 2014 to May 2015) in nine circles<sup>10</sup> from the data available in VATIS for the years 2011-14 that in all 7,942 cases<sup>11</sup>, VAT dealers (who had a turnover of more than ` 50 lakh during the financial year) did not submit the audited financial statements. Neither had the dealers complied with the provisions under Rules nor did the AAs insist for submission of financial statements. In the absence of certified financial statements, CTD cannot check whether the turnover disclosed in the returns are correct unless the dealers are selected for audit.

There was a provision under section 14(1-B) of Andhra Pradesh General Sales Tax Act 1957, to levy penalty on non-submission of financial statement duly certified by the Chartered Accountant. In the AP VAT Act, these provisions were dispensed with, owing to which the AAs could not insist on compliance.

The matter was referred to the Department (between September 2015 and October 2015) and to the Government (October 2015). The Government stated (December 2015) that though filing of certified financial statements is mandatory as prescribed under the Rules, compliance with the statutory stipulation, by most of the dealers has not been satisfactory. In order to overcome the difficulties in enforcing the filing of audited financial statements, an amendment incorporating a penal provision in the APVAT Rules, 2005 was being contemplated. The AAs had been directed to obtain certified financial statements for the earlier periods from the defaulting dealers and returns cross-verified with them.

#### **2.4.8 Effectiveness of the system of assessment**

During the course of audit of the two DC(CT) offices and 13 circles, test check of files and VATIS data analysis, cases of short/non-levy of taxes due to incorrect allowance of ITC, adoption of incorrect rate of tax, incorrect declaration of taxes and non-levy of penalty and interest on belated payment of taxes etc. were noticed. The cases are discussed in following paragraphs.

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<sup>10</sup> CTOs- Adoni-II, Akividu, Ananthapur, Chilakaluripet, Chittoor-I, Hindupur, Peddapuram, Rajam and Tadepalligudem.

<sup>11</sup> One case means one financial year for which tax was to be assessed.

#### 2.4.8.1 Non-levy of interest and penalty on belated payments

As per Section 22 (2) of APVAT Act, in case of delayed payment of taxes, dealers have to pay interest at 1.25 *per cent*<sup>12</sup> per month on tax due for the period of delay from the prescribed or specified date for its payment. Further, according to Section 51(1) of AP VAT Act, where a dealer fails to pay tax due on the basis of the return submitted by him by the last day of the month in which it is due, he shall pay penalty of 10 *per cent* of the amount of tax due.

During the course of audit it was noticed in two DC(CT) offices<sup>13</sup> and 13 circles<sup>14</sup> (September 2014 to May 2015) that the AAs had not levied interest and penalty in respect of 42 dealers, though they had paid tax with the delay ranging from five days to 340 days. The total non-levy of interest and penalty works out to ` 65 lakh.

#### 2.4.8.2 Adoption of incorrect rate of tax

As per Section 4(1) of AP VAT Act, every VAT dealer shall pay tax on every sale of goods, at the rates specified in the Schedules. During the course of audit, in two circles<sup>15</sup> Audit (December 2014 to April 2015) noticed from the returns and records for the period from 2011-12 to 2013-14 of two dealers that they had adopted the rate of tax as four/five *per cent* on the sales turnover of ` 9.03 crore, whereas the purchase orders, against which the sales were made, indicated that the goods sold were water storage tanks and steel structures, on which tax at the rate of 12.5/14.5 *per cent* was leviable. The AAs did not check the returns and sales records of the dealer. This resulted in short payment of tax of ` 1.61 crore.

#### 2.4.8.3 Under-declaration of purchase tax

As per Section 4(4) of APVAT Act, every VAT dealer, who purchases taxable goods from unregistered VAT dealers shall pay tax at four *per cent* on the purchase price of such goods, if the goods are (i) Used as inputs for goods which are exempt from tax under the Act; (ii) Used as inputs for goods, which are disposed of otherwise than by way of sale in the State.

In Akividu circle, Audit noticed (April 2015), that owing to inadequate scrutiny of returns, the AAs did not notice the non-payment of purchase tax by four dealers during 2012-13 and 2013-14. The dealers had purchased paddy amounting to ` 37.42 crore from un-registered dealers and derived taxable sales (` 42.47 crore) of rice and exempt sales (` 79.25 lakh) of husk. However, they had not paid proportionate purchase tax on paddy which was used for making exempt sale of husk. This resulted in non-payment of purchase tax of ` three lakh.

<sup>12</sup> One *per cent* of tax due up to 14 September 2011 and 1.25 *per cent* from 15 September 2011 per month.

<sup>13</sup> DC(CT) Kurnool and DC(CT)Nellore.

<sup>14</sup> CTOs- Adoni-II, Akividu, Ananthapur-II, Bhimavaram, Chilakaluripet, Chittoor-I, Hindpur, Kurupam Market, Morrispet, Peddapuram, Tadepalligudem, Rajam and Vinukonda.

<sup>15</sup> CTOs- Ananthapur-II and Peddapuram.

#### **2.4.8.4 Variations between the figures of returns and financial statements**

Audit noticed in DC(CT) Kurnool (October 2014), that the AA did not notice that there were variations between the sales turnovers as per the financial statements and those reported in VAT returns by two dealers. In all the cases the sales turnovers as per financial statements were more than those reported in VAT returns for the year 2012-13. There was under-declaration of turnover by ` 34.92 crore resulting in short payment of tax of ` 1.73 crore. This indicates absence of proper scrutiny of returns and cross linking with the financial statements submitted by the dealers<sup>16</sup>.

#### **2.4.8.5 Incorrect claim of ITC**

As per Section 13(1), no ITC shall be allowed on tax paid on the purchase of goods specified in Schedule VI. Provisions under Sections 13(5) and 13(6) stipulate restrictions on claiming ITC. As per Rule 20 of the AP VAT Rules, a VAT dealer making taxable sales, exempt sales and exempt transactions of taxable goods shall restrict his ITC as per the prescribed formula<sup>17</sup>.

Audit noticed in five circle offices<sup>18</sup> (November 2014 to April 2015) from VAT 200, VAT 200A and VAT 200B returns of seven dealers for the years from 2010-11 to 2013-14, that these dealers were making exempt sales, taxable sales and/or exempt transactions of taxable goods and Schedule VI goods but ITC was claimed without applying the prescribed formula for restrictions. This resulted in excess claim of ITC of ` 1.07 crore.

#### **2.4.8.6 Under-declaration of tax under works contract**

As per Section 4(7)(a), every dealer executing works contracts shall pay tax on the value of goods at the time of incorporation of such goods in the works executed at the rates applicable to the goods under the Act. As per Section 13(7) of the Act, VAT dealers paying tax under Section 4(7)(a) of the Act can claim ITC at 75 per cent (90 per cent till 14 September 2011) of the related input tax. Rule 17 of AP VAT Rules specify the methods in which the turnover and ITC of works contractors are to be calculated and taxes levied. In two circles<sup>19</sup> Audit noticed (March and April 2015), from VAT 200 returns of four works contractors that they had paid tax incorrectly, instead of arriving at tax due as per the provisions under Rule 17. This resulted in under-declaration of tax of ` four lakh.

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<sup>16</sup> As per section 2(35) of Act, 'Tax period' means a calendar month. As per section 20 of the Act read with Rule 23 of AP VAT Rules, every VAT dealer shall file a return within 20 days after the end of the tax period. Further, the return so filed shall be subject to scrutiny to verify the correctness of calculation, application of correct rate of tax and input tax credit claimed therein and full payment of tax payable.

<sup>17</sup>  $A*B/C$ , where A is the input tax for common inputs for each tax rate, B is the taxable turnover and C is the total turnover.

<sup>18</sup> CTOs- Adoni-II, Chilakaluripet, Hindupur, Peddapuram and Vinukonda.

<sup>19</sup> CTOs- Chittoor-I and Peddapuram.

#### **2.4.8.7 Under-declaration of turnover by Bar and Restaurants (Hoteliers)**

As per Section 4(9)(c) of the Act, every dealer, whose annual total turnover is ` 1.5 crore and above shall pay tax at the rate of 14.5 *per cent* of the taxable turnover of the sale or supply of goods, being food or any other article for human consumption or drink, served in restaurants, sweet-stalls, clubs, any other eating houses or anywhere whether indoor or outdoor or by caterers. Section 2(39) defines ‘Total Turnover’ as the aggregate of sale prices of all goods, taxable and exempted, sold at all places of business of the dealer in the State.

In Chilakaluripet and Ananthapur circles Audit noticed (December 2014 to May 2015) that three dealers running bar and restaurants declared the turnover during the period from 2011-12 to 2013-14, at less than ` 1.5 crore and paid VAT at five *per cent* on the sale of food only. However, annual total turnover of the dealers including the liquor sales as per the data obtained by Audit from Andhra Pradesh Beverages Corporation Limited was more than ` 1.5 crore per annum and the dealers were liable to pay tax at 14.5 *per cent*. Under-declaration of turnover by excluding the liquor sales, resulted in under-declaration and short payment of VAT to the tune of ` five lakh. The AAs did not check the correctness of turnover declared by the dealers though they had been registered as ‘bar and restaurant’. Out of three cases, in one case at Ananthapur-II circle, VAT audit was conducted but Audit Officer (AO) did not notice the omission and levy appropriate tax.

#### **2.4.8.8 Under-declaration of tax on hire charges**

In terms of Section 4(8) of the Act, on every VAT dealer who transfers the rights to use goods taxable under the Act for cash, deferred payment or other valuable consideration, tax is to be levied at the rates specified in the Schedules, on the total amount realised or realisable for such transfer.

In Kurnool Division and Peddapuram circle, Audit noticed (April and October 2015) that four dealers did not declare the hire charges of lorries amounting to ` 14.01 crore collected during the years 2009-10 to 2012-13 in their sales turnover. The AA did not notice non-payment of VAT on omitted sales turnover due to inadequate scrutiny of returns, resulting in non-levy of tax of ` 2.02 crore. Though out of the four cases, in two cases of Peddapuram circle VAT audit was conducted, the Audit Officer did not notice the omission and levy appropriate tax.

All these observations were referred to the Department (September and October 2015) and to the Government (October 2015). The Government stated (December 2015) that the concerned AAs had already initiated action for revising the assessments in accordance with the objections raised by Audit.

#### **2.4.9 Non-levy of interest on belated payment of deferred sales tax**

Under ‘Target 2000 sales tax incentives scheme’ promulgated by the State Government in 1996, industrial units were allowed deferment of sales tax to the extent of incentive limit as mentioned in Final Eligibility Certificate



(FEC). When AP VAT Act was introduced, all industrial units availing tax holiday or tax exemption on the date of commencement of the Act were to be treated as units availing tax deferment under Section 69 of the Act. As per Rule 67 of AP VAT Rules, the repayment of deferred tax was to commence after the completion of the deferment period. In case of non-remittance of deferred sales tax on the due dates under the ‘Target 2000 sales tax incentives scheme’, interest at 21.5 *per cent* per annum was to be paid as per the conditions mentioned in the FECs.

In four circles<sup>20</sup> Audit noticed (September 2014 to April 2015), from tax deferment records that nine dealers had paid deferred tax amounting to ` 51 lakh with delay<sup>21</sup>, on which they were liable to pay interest at the rate of 21.5 *per cent* per annum. However, Department did not levy interest of ` 19 lakh on belated payments.

The matter was referred to the Department (August 2015) and to the Government (October 2015). The Government stated (December 2015) that the concerned AAs had already initiated action for levying interest in accordance with the observation made by Audit.

#### 2.4.10 VAT Audits

As per para 5.12 of the VAT Audit Manual, every Audit Officer (AO) shall exercise the basic checks prescribed such as verification of the purchase particulars, comparison with the financial statements, verification of payment of output tax etc., and enclose these particulars along with the audit files. Para 5.12.4 and Appendix VIII of the VAT Audit Manual on “examination of annual accounts” prescribes verification of the financial statements of the dealers so as to review any disparities between the details available in the VAT returns submitted by the dealer and his financial statements for that period.

VAT audits cover only around 10 *per cent* of dealers every year which may not be sufficient to prevent leakage of revenue. No norms have been prescribed for conducting minimum number of VAT audits in VAT Audit Manual. The details of VAT audits conducted during the period from 2011-12 to 2013-14 in the erstwhile combined State of AP are as follows:

Year	Total no. of registered dealers	Audits completed	Percentage of audits with respect to dealers	Revenue from VAT audits ( in crore)
2011-12	1,89,945	18,947	9.97	493.78
2012-13	2,30,381	23,468	10.19	823.55
2013-14 (upto Dec. 2013)	2,78,693	14,080	3.05	863.67

<sup>20</sup> CTOs- Adoni-II, Akividu, Morrispet and Peddapuram.

<sup>21</sup> ranging from 28 days to 2096 days.

Audit reviewed VAT audit files and observed the following system and compliance deficiencies which reflect on the quality/insufficient checks being carried out in VAT audits.

#### **2.4.10.1 Non-completion of VAT audit before cancellation of registration**

As per Rule 14(4) of AP VAT Rules 2005, every VAT dealer whose registration is cancelled under this rule shall pay back ITC availed in respect of all taxable goods on hand on the date of cancellation. In the case of capital goods on hand on which ITC has been received, the ITC to be paid back shall be based on the book value of such goods on that date. The VAT Audit Manual clearly prescribes several guidelines for selecting units for audit. It is laid down in the Manual that if a dealer applies for cancellation, an audit should be conducted to ascertain the correctness of ITC availed by the dealer and only after completion of audit, the cancellation was to be done.

During the course of audit it was noticed (October 2014 to May 2015) in eight circles<sup>22</sup> for the period from 2011-14 that CTD did not audit 1,685 dealers before the cancellation of their registrations owing to which the correct ITC to be recovered from such dealers could not be checked. The self-assessments made by the dealers in the VAT 200 returns would be considered deemed to have been assessed due to not auditing them. Thus protection of revenue was not ensured in these cases.

The matter was referred to the Department (September and October 2015) and to the Government (October 2015). The Government stated (December 2015) that instructions had been issued to the DCs (CT) to ensure that revenue due to the Government is realised by conducting audits, if the dealers had availed ITC or they had tax liabilities to be discharged. They also stated that guidelines would be formulated in this regard. However, CTOs Chittoor-I and Peddapuram had intimated (March and April 2015) that VAT audit could not be conducted due to insufficient staff.

#### **2.4.10.2 Non-receipt of records after audit**

The CCT issued circular instructions<sup>23</sup> to DCs to authorise audits to any officer of the Division not below the rank of DCTO. After completion of audits, audit files were to be transferred to the circles where the dealers were registered for further action to collect taxes, penalty and interest. Further, CCT issued instructions<sup>24</sup> to DCs to ensure that the demands raised according to the audits were taken into account by the relevant circle.

During the course of audit of eight circles<sup>25</sup> (October 2014 to May 2015), VAT audit records in respect of 1,771 cases for the period 2011-14 were called for by Audit. However, the Department could produce only 704 audit

<sup>22</sup> CTOs- Adoni-II, Akividu, Ananthapur-II, Chilakaluripet, Chittoor-I, Hindupur, Peddapuram and Tadepalligudem.

<sup>23</sup> CCTs Ref. No. B.II(2)/122/2006 dated 04 October 2006.

<sup>24</sup> No.BV(3)/120/2008 dated 16 April 2008 (Appendix XVIII of VAT Audit Manual).

<sup>25</sup> CTOs- Adoni-II, Akividu, Ananthapur-II, Chilakaluripet, Hindupur, Rajam, Tadepalligudem and Vinukonda.

files. For the remaining 1,067 audit files, it was observed that those were not received in the respective jurisdictional circle offices after completion of VAT audit. Due to non-receipt of the audit files, the compliance of the assessments finalised could not be ensured. Monitoring of the demands raised cannot be done by the respective CTOs in the absence of documents.

After Audit pointed out the cases, the AAs stated that the matter would be brought to the notice of DCs for necessary action.

The matter was referred to the Department (September and October 2015) and to the Government (October 2015). Government accepted the observation and stated (December 2015) that all the AOs were being directed to ensure that files in respect of the audits completed, were sent to the concerned Circles/LTUs promptly. DCs (CT) had also been directed to monitor and ensure that delays were avoided. Disciplinary action would be initiated against the officials responsible for delays if they were abnormal.

#### 2.4.10.3 Improper maintenance of VAT audit files

It was observed (October 2014 to May 2015) during test check of 2,098 cases in two DC(CT) offices<sup>26</sup> and 13 circles<sup>27</sup> that there were several omissions in the audit files as indicated in the following table.

Sl. No	Type of omission	No. of cases (percentage)
1.	Audit officers did not enclose the checklist	969 files (46.19 per cent of the test checked cases)
2.	P&L account was not enclosed	672 cases (32.03 per cent)
3.	Purchase particulars were not enclosed	942 cases (44.90 per cent)
4.	Returns were not available	808 cases (38.51 per cent)
5.	Details of G.I.S data were not available	1,717 cases (81.84 per cent)
6.	Non-verification of filing of statutory forms	1,653 cases (78.79 per cent)
	<b>Total</b>	<b>2,098</b>

Due to the above mentioned omissions, Audit could not verify the accuracy of the assessment/penalty orders.

The issues were brought to the notice of the AAs (between October 2014 and May 2015). They replied that the matter would be brought to the notice of concerned DCs(CT).

The matter was referred to the Department (September and October 2015) and to the Government (October 2015). No specific reply was received from the Government.

<sup>26</sup> DC(CT) Kurnool and DC(CT) Nellore.

<sup>27</sup> CTOs- Adoni-II, Akividu, Ananthapur-II, Bhimavaram, Chilakaluripet, Chittoor-I, Hindupur, Kurupam Market, Morrispet, Peddapuram, Rajam, Tadepalligudem and Vinukonda.

#### 2.4.10.4 Leakage of revenue due to non-compliance with provisions

As per para 5.12 of the VAT Audit Manual, every AO shall exercise the basic checks prescribed such as verification of the purchase particulars, comparison with the financial statements, verification of payment of output tax etc., and enclose these particulars along with the audit files.

VAT audit is the final stage of scrutiny for finalisation of assessment. A scrutiny of VAT audit files revealed that deficient exercise of checks during VAT audit resulted in short levy of tax due to incorrect adoption of rate of tax, incorrect restriction/allowance of ITC, incorrect determination of taxable turnover, short/non-levy of penalties and interest as discussed in the following points.

- \* Audit noticed (September 2014 to May 2015), in DC(CT) Kurnool and eight circles<sup>28</sup> from VAT audit files of 19 dealers that turnovers reported in their VAT 200 returns for the period from 2006-07 to 2012-13 did not tally with those reported in financial statements. During the course of VAT audit, the AOs did not notice this issue. This resulted in short levy of tax of ` 1.06 crore that could have been prevented if the audit checks had been mandatorily followed.
- \* In four circles<sup>29</sup> (December 2014 to May 2015), Audit observed from VAT audit files of six dealers that the AOs, while finalising the assessments for the period from 2008-09 to 2013-14, allowed incorrect rate of tax/exemption on taxable turnovers. This resulted in non-levy of tax of ` 11.15 crore.
- \* Audit noticed (September 2014 to February 2015) in two circles<sup>30</sup> from the VAT audit files of two dealers that, during the period from 2005-06 to 2013-14 the dealers had paid tax after due date i.e. 20<sup>th</sup> of succeeding month of the month of return. However during the course of VAT audit, the AOs did not levy interest on belated payment of taxes. This resulted in non-levy of interest of ` 13 lakh.
- \* Audit noticed (September 2014 to May 2015) in two DC(CT) offices<sup>31</sup> and seven circles<sup>32</sup> from VAT audit files of 15 dealers that AOs levied tax on turnover under-declared by the dealers during the financial years from 2008-09 to 2013-14. However, penalty of ` 90 lakh was not levied/short levied.
- \* Audit noticed (May 2015) in CTO Chilakaluripet from an audit file of a dealer that he had purchased cotton amounting to ` 5.33 crore from unregistered dealers and derived taxable sales (` 8.47 crore) of cotton

<sup>28</sup> CTOs- Adoni-II, Ananthapur-II, Chilakaluripet, Chittoor-I, Kurupam Market, Hindupur, Morrispet, Rajam.

<sup>29</sup> CTOs- Ananthapur-II, Chilakaluripet, Hindupur and Rajam.

<sup>30</sup> CTOs- Adoni-II and Chilakaluripet.

<sup>31</sup> DC(CT) Kurnool and DC(CT) Nellore.

<sup>32</sup> CTOs- Adoni-II, Akividu, Ananthapur-II, Chilakaluripet, Chittoor-I, Hindupur and Kurupam Market.

lint and exempt sales (₹ 3.22 crore) of hank yarn during the period 2009-10 to 2012-13. However, the dealer had not paid proportionate purchase tax on cotton which was used for making exempt sale of hank yarn. The AO during the VAT audit did not levy purchase tax of ₹ six lakh.

- \* In Chittoor-I circle, it was noticed (March 2015) from the VAT Audit files of two dealers of textiles and fabrics (to be taxed at five *per cent* or at one *per cent* if dealer opted to pay under composition) for the year 2012-13, that both the dealers did not pay any tax by incorrectly declaring the sale of textile and fabrics as exempt sale. However, the AO allowed exemption instead of levying tax at five *per cent*. This resulted in non/short levy of tax of ₹ 25 lakh.
- \* In seven circles<sup>33</sup> (September 2014 to March 2015) it was noticed from VAT audit files of 12 dealers that the dealers were engaged in exempt sales/exempt transactions along with taxable sales and were to claim ITC proportionately. However they had claimed full/excess ITC during the years 2008-09 to 2013-14. This was not observed in VAT audit by AOs which resulted in incorrect allowance of ITC amounting to ₹ 4.61 crore.
- \* In Chilakaluripet circle (May 2015) it was noticed from the audit files of three dealers that they were engaged in exempt sales/exempt transactions along with taxable sales and were to claim ITC proportionately. However they had declared full/excess ITC during the years 2007-08 to 2012-13 and claimed refunds. While conducting refund audit the AO did not restrict the ITC which resulted in excess allowance of refund amounting to ₹ 23 lakh.
- \* As per Section 4(7)(e) of AP VAT Act, if any dealer having opted for composition, purchases any goods from outside the State and uses such goods in the execution of works contracts, he shall pay tax at the rates applicable to the goods under the Act and the value of such goods shall be excluded (from the turnover) for the purpose of computation of turnover on which tax by way of composition at four *per cent* is to be paid. In DC(CT) Kurnool Division (October 2014), Audit observed from VAT audit file that a dealer had opted to pay tax under composition and purchased goods from outside the State during the years 2009-10 to 2010-11. The dealer incorporated such goods in the works and was liable to pay tax at the rates applicable. However during the course of VAT audit, the AO finalised the assessment under non-composition instead of levying tax on interstate purchase under composition and arrived at incorrect tax due. This resulted in short levy of tax of ₹ 94 lakh.
- \* In the office of DC (CT) Kurnool and six circles<sup>34</sup> (September 2014 to May 2015) it was noticed from VAT audit files of nine dealers for the

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<sup>33</sup> CTOs- Akividu, Ananthapur-II, Bhimavaram, Chilakaluripet, Hindupur, Tadepalligudem and Vinukonda.

<sup>34</sup> CTOs- Akividu, Ananthapur-II, Chittoor-I, Kurupam Market, Morrispet, Tadepalligudem.

period from 2006-07 to 2012-13 that the AOs arrived at taxable turnovers under works contract incorrectly by allowing ineligible deductions and adoption of incorrect rate of tax resulting in short levy of tax of ` 41.61 lakh.

- \* As per Section 13(7) of the Act, VAT dealers paying tax under Section 4(7)(a) of the Act can claim ITC at 75 per cent (90 per cent till 14 September 2011) of the related input tax. From VAT audit files for the period from 2008-09 to 2012-13, in respect of four dealers, in three circles<sup>35</sup> (December 2014 to January 2015) it was noticed that AOs assessed incorrect tax on works contracts due to allowing excess ITC in contravention of the prescribed provisions. This resulted in short levy of tax of ` 15 lakh.
- \* As per Rule 16(1)(b) of AP VAT Rules, ITC shall only be claimed on receipt of the tax invoice. Under Section 55(2) of the AP VAT Act, any VAT dealer who issues a false tax invoice or receives or uses such tax invoice, knowing it to be false, shall be liable to pay a penalty of 200 per cent of the tax evaded. Audit noticed (April 2015) in Adoni-II circle, from VAT audit file of a dealer that the dealer made purchase of vegetable oil from various dealers and submitted tax invoices with waybills for claiming ITC. Audit crosschecked the details of the transactions mentioned in invoice and waybills. It was observed that as per the waybills, the quantity of oil transported through each waybill ranged from 11,110 kg to 22,610 kg. Verification of vehicle registration numbers mentioned in the waybills from the website of Transport Department of Andhra Pradesh revealed that those vehicle numbers belonged to autorickshaw, goods carriage, trailers etc. through which such large quantities could not be transported. The AO neither disallowed claim of ITC amounting to ` 20 lakh on fictitious way bills and invoices nor levied penalty as per the provisions mentioned above. Not verifying the details during audit resulted in incorrect allowance of ITC and non-levy of penalty of ` 60 lakh.

From the cases mentioned above it is clear that the VAT audits conducted did not ensure compliance with Rules.

The issues were brought to the notice of the Department (September and October 2015) and to the Government (October 2015). The Government stated (December 2015) that the AAs had already initiated action for levying interest/penalties or for revising the assessments in accordance with the objections raised by Audit.

#### **2.4.11 Internal audit**

Department does not have a structured Internal Audit Wing that would plan and conduct audit in accordance with a scheduled audit plan. Internal audit is organised at Divisional level under the supervision of Assistant Commissioner

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<sup>35</sup> CTOs- Ananthapur-II, Hindupur and Kurupam Market.

(CT). Internal Audit Report is to be submitted within 15 days from the date of audit to the DC(CT) concerned, who would supervise rectification work.

**2.4.11.1** During the course of test check of the two DC(CT) offices and 13 circles (September 2014 to May 2015) it was observed in DC(CT) Kurnool and seven circle offices<sup>36</sup> that in three circles<sup>37</sup> internal audit was not conducted for 2012-13 and 2013-14 and report for the year 2011-12 had not been received. In three circles<sup>38</sup> internal audit was conducted for the year 2013-14 but reports were not issued. In remaining two offices<sup>39</sup> internal audit had not been conducted for the year 2013-14. From the above it is evident that the internal audit mechanism was not effective during the period covered under Performance Audit.

The matter was referred to the Department (September 2014 to May 2015) and to the Government (October 2015). The Government stated (December 2015) that instructions had been issued by DCs(CT) to AC(CT) (Audit) in the Division to concentrate on internal audit. CTO (Audit) should concentrate only on internal audit and AG audit. DCs (CT) of all Divisions had also been directed to ensure that backlog in the completion of annual internal audit be cleared within the time prescribed by the Department.

**2.4.11.2** As per para 4.96 of the Manual, the allocation of audit cases should be recorded on a computerised listing in divisional and circle offices with date of allocation, date of audit and date of finalisation. A watch register is to be maintained for monitoring the details of audit in each office.

It was noticed that the watch registers with details of authorisation of VAT audits were not maintained in DC(CT) Kurnool and four circle offices<sup>40</sup> without which the information on the status of audits authorised and completed could not be verified. There was a risk of duplicate or erroneous authorisation of VAT audits in the absence of the watch registers. Audit noticed (December 2014 to January 2015) that in cases of 10 dealers in Ananthapur-II circle and nine dealers in Hindupur circle, VAT audits for same period were authorised during 2009-10 and 2011-12 to two different AOs in each case.

The matter was referred to the Department (September and October 2015) and to the Government (October 2015). The Government stated (December 2015) that from September 2012, audits are being allotted to the AOs through VATIS. The risk of duplicate or erroneous allocation of audits, as pointed out by Audit is not possible through the above computerised programme and hence there was no need for maintaining a watch register in each office separately. However, Audit noticed instances of erroneous authorisation made after September 2012, which is indicative of failure/non-implementation of monitoring system through VATIS.

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<sup>36</sup> CTOs- Adoni-II, Akividu, Ananthapur-II, Bhimavaram, Chilakaluripet, Chittoor-I and Hindupur.

<sup>37</sup> CTOs- Adoni-II, Ananthapur-II and Hindupur.

<sup>38</sup> CTOs- Akividu, Bhimavaram and Chilakaluripet.

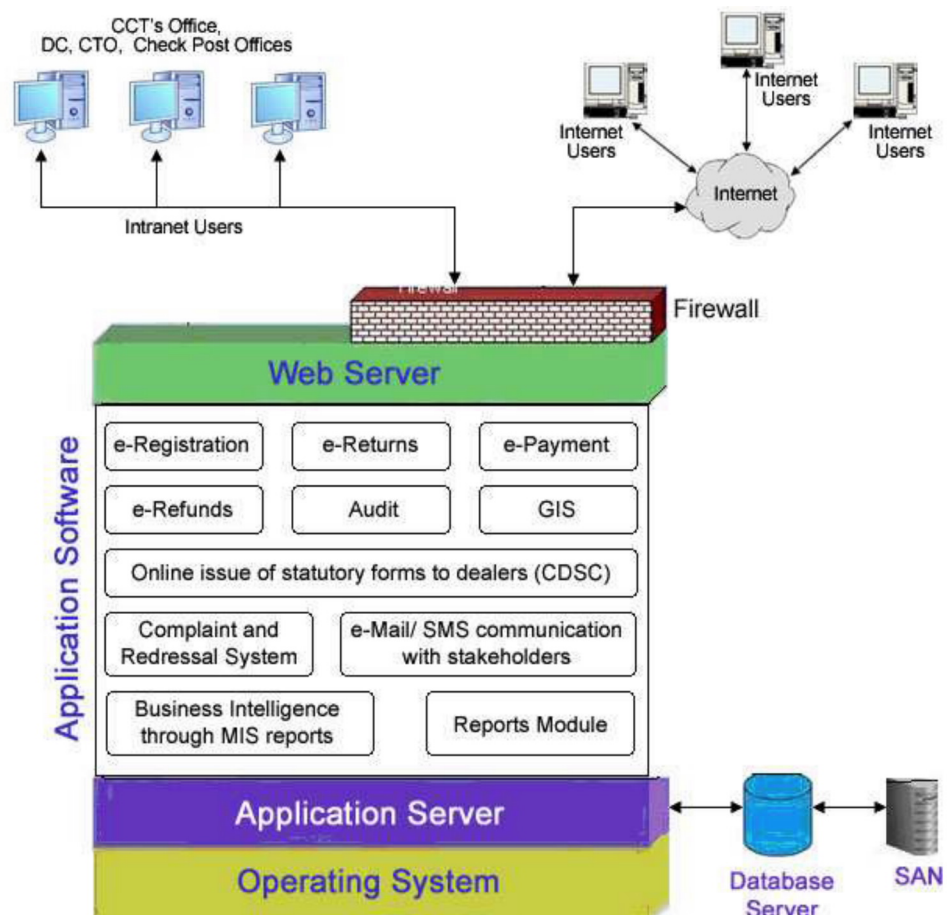
<sup>39</sup> DC(CT) Kurnool and Chittoor-I.

<sup>40</sup> CTOs- Adoni-II, Akividu, Ananthapur-II and Hindupur.

## IT Audit of VATIS

### 2.4.12 Adequacy of IT policy and controls

CTD has been using Information Technology (IT) since 1989 and VATIS came into existence along with introduction of AP VAT Act in 2005. The original VATIS was developed in centralised architecture by Tata Consultancy Services Limited (TCS) and field offices were connected to the Central Data Centre located at the office of CCT. Processes relating to dealer registration, VAT/TOT returns, VAT audit and assessment, and Goods Information System (GIS) that monitors interstate transactions etc., were computerised under this. To improve the response time of the system as a part of the realigned focus of the CTD, reengineering of VATIS was conceived. It was to extend departmental services (Service Oriented Architecture) to the dealers through multiple media like Internet, e-Seva and citizen service centres (CSC). The re-engineered VATIS has modules like e-Return, e-Registration, online issue of Statutory Forms and Complaint/Feedback system. The functional architecture of VATIS is as shown below:



### FUNCTIONAL ARCHITECTURE

The application has been built using Windows servers (database and application servers) with SQL Server and .NET framework. All the offices are interconnected through intranet using AP State Wide Area Network



(APSWAN) and other stakeholders are connected to the application via internet for obtaining services.

Audit conducted IT audit of Registration, Return, Audit, Payments, Refunds and Complaint / Feedback modules of VATIS application for the period April 2011 to March 2014. Data related to selected sample (15 units) were extracted from the centralised data provided by the CCT and was analysed using 'Interactive Data Extraction and Analysis (IDEA)'. The general controls and application controls were evaluated with reference to Audit objectives.

The audit revealed deficiencies in the system relating to planning and use of IT application, mapping of business rules, access controls, data capture and validations, data integrity and system security issues etc., as mentioned in the succeeding paragraphs.

#### **2.4.12.1 Lack of documented IT policy**

Information Technology Policy ensures support of computing and communication resources to the Department in order to achieve compliance with requirements and effective use of resources, duly addressing the risks in the best possible way. The IT policy needs to be prepared without ambiguity and approved by Senior Management. It has to meet the needs of CTD.

CTD does not possess an IT Policy that addresses the issues of using IT resources in accordance with applicable rules and objectives. Implementation of VATIS with the objectives of developing single core application was embarked upon<sup>41</sup> (August 2010) to take care of all the core tax functions, providing functionality as per the guidelines of the Government, offering quality service to the departmental staff as well as the dealers and to facilitate interface with other Government Departments. However due to the lack of a documented policy addressing the alignment of requirements and implemented services, Audit could not check if the objectives had been completely achieved.

Government contended (December 2015) that the software was developed by involving a core group of senior officers, field representatives and certain members of the trade and that the user requirements were thoroughly explained to the software vendor. As the requirements were ever evolving, no emphasis was placed on formulation of a watertight IT policy. However, it is now proposed to prepare a broad IT policy for the Department.

#### **2.4.13 VATIS Implementation**

The implementation of re-engineered VATIS began in February 2012 and the system switched over to maintenance mode from May 2013. Though CTD has accepted all the modules after testing, Audit found some deficiencies relating to development approach, data migration and processes covered under VATIS including lack of mapping of business rules, data inconsistencies etc., which

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<sup>41</sup> Date of Request for Proposal (RFP).

have not been addressed even after two years of implementation. These are given below:

#### **2.4.13.1 Piecemeal approach adopted in developing the new VATIS software**

An agreement was concluded with LGS Global Ltd in April 2011. LGS was to start project implementation within 230 days of entering into contract. Request for proposal (RFP) for the purpose of re-engineering VATIS was issued in August 2010 by the Government and upon evaluation of the bids received. The implementation, however, began 10 months after agreement i.e. from February 2012. The timeline was extended initially up to September 2012 and then to April 2013. The new software (re-engineered VATIS) development model was changed from originally planned waterfall approach (all changes at once) to iterative (module wise replacement) to save cost. Meanwhile, a module for registration of dealers was developed in parallel by Centre for Good Governance (CGG) which as per the orders of CCT (March 2011) was implemented in all Divisions by June 2011. This was replaced by the registration module of the reengineered VATIS (February 2012).

Delivery of different modules took place on different dates from February 2012 (Registration module) to April 2013 (email/SMS for communication with Stakeholders). The developers were required to develop software in accordance with the System Requirement Specifications (SRS) and User Requirement Specifications (URS) which are to be frozen before implementation in order to ensure that development process is completed within timelines specified.

Audit observations pertaining to the contract for reengineering VATIS and its implementation revealed the following:

- \* System Requirements Specifications (SRS) document was prepared by the developer after implementation of all the modules (April 2013). This shows that the project was started without identifying the requirements of CTD and involving user groups which resulted in the creation of a system which did not meet the requirements of the Department. For example, as stated earlier in para 2.4.7.1, additional returns of VAT 200A and VAT 200B required for restricting the ITC were not being obtained from the dealers. Neither was there any provision for online submission of these returns. Audit observed that no requirement was projected with regard to this in the RFP, though filing of these additional returns is mandatory. Absence of facilities to automatically generate notices/reports also corroborates the fact.
- \* CTD had supplied (January 2013) IT related infrastructure to its branch offices without conducting requirement study, which is essential as different circle and divisional Offices handle varying quanta of work and manpower. The nature of transactions dealt with by them are different. It was noticed in audit that the number of systems supplied to branch offices were not as per strength of operating ACTOs, DCTOs, CTOs and DCs.

- \* The Department conducted module-wise testing<sup>42</sup> of the application internally and gave acceptance to the developer in a phased manner along with implementation of the modules from February 2012 to April 2013 (final acceptance). Out of all the tests conducted before acceptance of the system, documentation exists only for the validation tests conducted by the developer. Audit also noticed that validation tests were conducted after implementation of the modules like audit, payment and registration. A stable production environment requires appropriate testing infrastructure. Before going for implementation of computer application, test data needs to be removed from the production database. It is observed that test cases were not separated (August 2014) from production data even though final acceptance had been given more than a year ago. These show that standard software development and testing practices were not followed.
- \* Change Management process enables improvement of an organisation's performance in relevance to the changes brought in to the existing system. Change management documentation ensures chronological recording of the changes adopted and becomes knowledge base for future changes to be made. Audit observed that workflow issues have not been documented and change management documentation was not produced to Audit in spite of repeated requests. No third party or security audit was conducted during the period 2011-2014 for VATIS.

The Government stated (December 2015) that reengineering of VATIS was taken up after an in-depth analysis of the defects in the then existing system. The documentation like SRS etc. was submitted formally by the developer at a later stage. Supply of infrastructure was made based on requirements projected by the field staff. With regard to testing and change management processes, currently there are only two test Taxpayer Identification Numbers (TINs) in operation to test the live problems of dealers. A third party<sup>43</sup> had also been roped in to test the VATIS application.

However, evidence of conducting a requirement assessment and formulation of an implementation plan based on these details was not given to Audit. Further, it is desirable that the test data, pertaining to earlier period, be deleted from the live database. No relevant reply for lack of change management documentation was given.

#### **2.4.13.2 Incomplete data migration and inadequate data capture**

In the case of tax Departments like CTD, maintenance of legacy data is critical. It was observed that the data that was ported from the previous version of the VATIS was not in line with the new table structures. It was found that after migrating the data to the re-engineered VATIS from old VATIS, the data

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<sup>42</sup> Login functionality with credentials, User Navigation, Data Entry and validation, APVAT Act specifications, Dates validation etc.

<sup>43</sup> Standardisation Testing and Quality Certification Directorate (STQC), Government of India.

columns of the re-engineered VATIS were left empty or filled in with universal data values, as no corresponding data value or column existed in the old VATIS. Thus due to ineffective data migration, CTD has to simultaneously maintain two databases, portals and associated infrastructure. It also necessitates users to hop through different portals and databases for report generation which is cumbersome to users.

Audit also observed that though it is mandatory to capture PAN, it was not captured with registration data of 230 dealers out of 15,971 active VAT dealers and 3,160 dealers out of 7280 active TOT dealers in the period 2011-14. Therefore, the data migration and data capture were not effective.

Government replied (December 2015) that the old data was not ported to avoid burden on the server and as the time periods cannot be taken up for assessment. However, the Department promised to take a decision on the same soon. Further, Department had also stated that even for missing PAN cases, the PAN capturing field has been made mandatory once a dealer logs into the system.

However, as CTD still has to maintain two databases and portals, and to build up a continuous history of dealers, it would be desirable to integrate them.

#### **2.4.13.3 Lack of portability of data from Debt Management Unit portal**

Before reengineering of VATIS, the departmental users were obtaining details pertaining to the demands of arrears by accessing the data residing on a separate Debt Management Unit portal (DMU). An observation on lack of reliable data in DMU portal had featured in Para 2.5.4 of the Report of Comptroller and Auditor General of India (Revenue Sector) for the year ended March 2014.

It was found in audit that the data of arrears from DMU portal was not directly ported to the re-engineered VATIS but was re-entered into the application manually. As the DMU data itself was not found reliable, reentering of such data into new VATIS requires assurance that the data entered is rectified while reentering. However, no certification was obtained either from Department officers concerned or from any third party service provider. The officials now cross check data existing in old VATIS/DMU with the data entered in new VATIS and also manual records of demand, collection and write off pertaining to the period before 2006 to arrive at arrears. This again necessitates users to hop through three different data groupings. This reveals lack of planning in data migration and porting.

The matter was brought to the notice of Government (October 2015). However, no specific reply was given (January 2016).

#### **2.4.14 Processes covered under VATIS**

An analysis of data and application of VATIS revealed that VATIS was not being fully utilised by CTD, either due to non-incorporation of Rules/procedures or due to lack of data/awareness. None of the processes has

been completely automated. Business rules like advance rulings and court judgments are not being mapped into system. The observations made are mentioned below:

#### **2.4.14.1 Registration**

When a dealer is applying for registration with CTD, the application must have adequate provisions for capturing important details like PAN of the dealer, the address and contact details, principal activities of the dealer and principal commodities he deals with.

A study of the registration module of the reengineered VATIS revealed that though application forms for registration as VAT dealer (VAT 100) or TOT dealer (TOT 001) could be filed online during the audit period, all the supporting documents still needed to be sent through post along with print outs of filled application forms. VATIS also allowed dealers to mention a maximum of only five principal activities and five principal commodities while applying. An analysis of data in respect of the 15 sample offices for the period 2011-14 revealed that the commodity details captured was 'others' in 3,538 cases (dealers registered before reengineered VATIS) out of 19,454 total VAT dealers. Eight such cases were registered under reengineered VATIS. Commodity wise reports cannot be generated in the absence of proper commodity classification. The details of commodities being dealt with by dealers are necessary to calculate tax liability and to monitor the transactions relating to evasion prone commodities.

Government replied (December 2015) that under APVAT Act 2005, only "principal commodities" are to be mentioned in the VAT application for registration while CST registration application mandates mentioning of all commodities that the dealer deals in as it is linked to 'C' forms.

It is incorrect to assume that the dealers can deal in only five principal commodities or have only five principal activities. The VAT application may be revised to bring it in line with CST application to ensure better monitoring of dealers.

#### **2.4.14.2 Returns**

As stated earlier, VAT 200A and 200B returns could neither be filed online nor could the details be entered in VATIS during the audit period. The calculation of tax liability/ITC claim thus require the dealer to manually file the return and the AA to manually account for the adjustments to be made on exempt transactions/sales.

VAT 200 returns also do not have commodity-wise data and details of sales/purchases (e.g. TIN of the dealer to whom a commodity was sold or from whom a commodity was purchased) but only tax rate-wise data.

Currently, from the data in VAT 200 returns, it is possible to check only if tax had been paid on the amounts declared by the dealer under each rate. There is no mechanism to capture commodity wise sales or purchases to verify whether

the dealer was dealing only in goods for which he was registered, whether the commodity was classified under the correct Schedule and whether the taxes were paid accordingly. There is no mechanism to verify if there is any disparity in sales claimed to be made by a dealer, say A to another dealer B as neither A nor B has to disclose the buyer/seller details in their monthly returns. Thus, e>Returns module of VATIS does not support cross checking of sales and purchases.

It was also observed that wherever revised returns were filed and payments made, the ledgers of the dealer and the payment status reports were showing a mismatch due to the Returns module not being updated even if Payment module was updated.

Government accepted (December 2015) audit findings and stated that provision for filing of additional returns and for cross-checking of sales and purchases have been made in the software.

#### **2.4.14.3 Implementation of automatic notice and report generation**

VATIS does not alert users to convert TOT dealers to VAT dealers based on turnover. Though it was part of RFP, automatic notice and reminder generation, and their delivery through email and SMS is not fully implemented. Interest and penalty on belated/non-filing of returns or belated payment of tax is not automatically calculated. It is left to the assessing authority to manually scrutinise the returns and related documents and levy the demand.

An analysis of payment and dealer details available in VATIS package revealed that in 16,006 cases of delayed submission of returns in Andhra Pradesh, penalty and interest amounting to ` 28.17 crore was not realised during the period 2011-14. This could have been avoided by automating notice generation at least in cases of belated payment/filing of returns.

It was also observed that 611 out of 19,093 active dealers who were registered before March 2011 in the sample offices did not file monthly returns and total number of such pending returns is 7,383 as on August 2014. Penalty at the rate of ` 2,500 for each instance of non-filing was to be charged.

Analysis of data in VATIS package also revealed that both mobile and telephone numbers were not captured for 1,043 out of 15,971 active VAT dealers. For 782 out of 15971 active VAT dealers and 1,687 out of 7,280 TOT dealers records, bank account number was not captured. For 505 out of total 19,454 VAT dealers and 105 out of 15,971 active VAT dealers email-id was not captured. Lack of these data would hamper the efforts of CTD to automate notice and reminder generation.

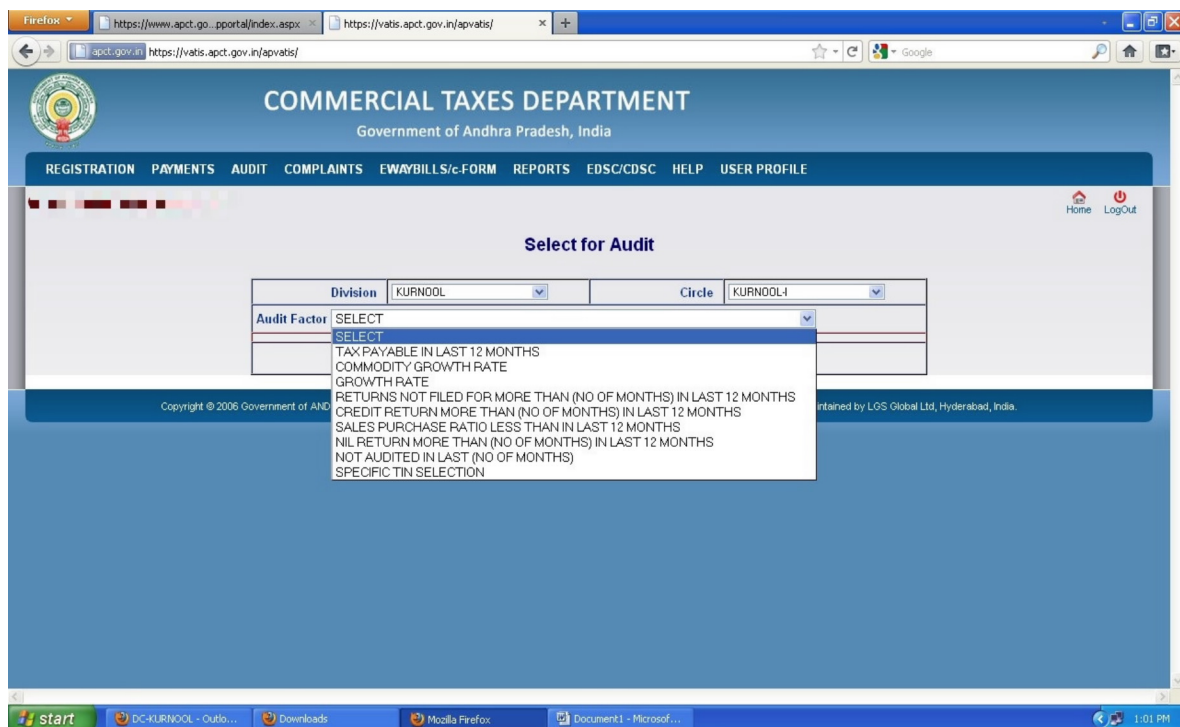
Government replied (December 2015) that dealer turnover reports are available in the MIS report module of VATIS which can be used to identify TOT dealers who need to register themselves as VAT dealers. Government has initiated steps to implement automatic generation of notices for interest and penalty and has proposed implementation of automatic generation of SMS

and email alerts. Steps to levy penalty for not filing monthly returns had been initiated.

#### 2.4.14.4 Audit

VAT Audit Manual being currently used by CTD was brought out in June 2012 five months after the implementation of reengineered VATIS which began in February 2012. Audit module was accepted and implemented from September 2012. A comparison between the Manual and the Audit module revealed the following:

- \* While the VAT Audit Manual gives 15 criteria for selection of dealers for general audit, only four of these have been mapped to VATIS Audit module.



While the Audit Manual clearly stipulates that top six per cent of the VAT dealers excluding LTU VAT dealers are to be audited every 12 months in each Division, data available in VATIS package clearly shows that in 13 circles covered under the sample nearly 78 per cent of top 100 dealers who came under jurisdiction of the offices were not audited during 2013-2014.

Selection parameter wise breakup (as available in VATIS) of 1,529 audit authorizations in sample offices for the period April 2013 to March 2014 as recorded in VATIS is tabulated as follows:

Selection parameter	Audit cases
Nil return more than (no. of months) in last 12 months	1
Commodity growth rate	7
Returns not filed for more than (no. of months) in last 12 months	Nil
Sales purchase ratio less than in last 12 months	424
Credit return more than (no. of months) in last 12 months	50
Not audited in last (no. of months)	705
Growth rate	28
Specific TIN selection	133
Tax payable in last 12 months	181

This table clearly shows that audits were not selected based on parameters provided in the Manual. Selection of 133 dealers based on 'Specific TIN selection' (total 8.70 *per cent* of audit selections) shows that discretionary powers were exercised for selection of dealers for audit.

- \* VAT Audit Manual also calls for Specific Audit in (a) cases resulting from other audits where audit officers have identified evidence of serious fraud or based on information provided by intelligence and other agencies which require in-depth investigation and (b) cases where there is evidence of inter-state fraud or international fraud or investigation involving more than one Division should be passed on to CIU / Enforcement Wing at Headquarters.

In VATIS audit module data captured/ processed pertaining to tax declared, waybills usage, check post data, belated registrations, revised returns and interest amounts payable are not furnished as inputs for selection for specific audit. Thus business requirements have not been mapped to implementation in VATIS package for specific audits.

- \* Only active user\_ids with designation of DC or above can authorise VAT Audits as per business rules. An analysis of data relating to authorisations in VATIS package revealed that in four cases, authorisation of audit of dealers coming under the sample offices was done by users whose user-ids were not present in user master table. In 1,627 cases out of 3,209 audits conducted (September 2012 to March 2014) of dealers in the sample offices it was observed that audit inspection details had been entered by junior assistants, instead of the officers who conducted audit. These show that logical access controls are not in place in case of audit authorizations and entry of data relating to audit inspections.
- \* In 24 cases among the cases where audit inspection conducted during the period from September 2012 to March 2014 in the sample offices



resulted in additional demand. However, the additional demand amounts were posted to tables but no specific reason was assigned to the additional demand. VAT audit inspection details were also not available in another 19 cases (for the three month period from January to March 2014) in audit inspection table indicating inspection details were not uploaded. These show that the Audit module is not being utilised effectively by CTD.

- \* VATIS also does not provide results of VAT audit to CST assessment. Thus a dealer can escape declaring his true turnover by declaring certain turnovers as relating to CST during VAT assessment and not declare it at the time of CST assessment, leading to loss of revenue to the Government.
- \* In 225 out of 697 cases where additional demand was raised due to audit during September 2012 to March 2014 in the sample offices, it took more than 90 days to complete assessment after serving notice. This delay may result in assessments getting time-barred.
- \* In 13 cases relating to the sample offices in the period from September 2012 to March 2014, it was observed that VAT audit of dealers were done by same officers consecutively against the instructions<sup>44</sup> of CCT.
- \* It was observed that cancelled dealers are not being audited as per VAT Act and only 209 out of 1,152 cancelled cases (from September 2012 to March 2014) in the sample offices were audited.

Government, while accepting (December 2015) that all the criteria prescribed was not mapped, stated that more criteria were being added. Steps to reduce discretionary powers of the officers were taken by categorizing the dealers into Large Tax Payers Units (LTUs) and High Tax Cases (HTCs). While accepting rest of the observations made, it was stated that the audit module of VATIS will be redesigned after taking inputs from the field officers.

#### **2.4.14.5 Refund**

Currently, a dealer who is eligible can apply for refund of ITC while filing the monthly returns. Audits are usually conducted before authorization of refunds to verify the claims. This is done manually as it involves cross-verification of sales/purchase particulars with CTOs under whom the dealers having business transactions with the dealer claiming the refund are registered. Details are entered in Refund module only after refund is authorized. Even the voucher for refund payment is generated manually. There is no provision for capturing voucher number and date of generation of voucher in the module. Audit test checked the data relating to refunds of the 15 sample offices where refunds had been authorized as per the VATIS package. A cross-verification of the manually maintained refund registers with VATIS data revealed that in five sample offices<sup>45</sup> there was mismatch in the number of refunds. There were 26

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<sup>44</sup> CCT's Ref.No. B.II(2)/122/2006 dated 4 October 2006.

<sup>45</sup> DC(CT) Kurnool, CTOs- Chilakaluripet, Hindupur, Kurupam Market and Rajam.

cases in two offices<sup>46</sup> where corresponding register entries were not available though entries had been made in VATIS and in 12 cases<sup>47</sup> in which there were no corresponding entries in VATIS though refunds had been made as per the refund registers.

Government stated (December 2015) that a revamped online refund system was under development.

#### **2.4.14.6 Grievance redressal**

An analysis of entries of the table ‘CCRS\_FEEDBACK’ in VATIS package relating to complaints received revealed that in 58 out of 445 complaints entered in VATIS from January 2013 to March 2014 relating to erstwhile combined State of AP, complaint details like the officer to whom complaint was addressed was not captured. Due to the faulty design of the form which allows such critical data to be omitted, these complaints could not be allocated to anyone for resolution.

Government replied (December 2015) that these features were incorporated in the revised web portal of the Department.

#### **2.4.15 Data validation problems**

Audit observed while test-checking the data relating to sample offices that data validation checks that were supposed to be incorporated in the system were either not incorporated or incorrectly incorporated resulting in the following inconsistencies:

- \* VATIS captures invoice details for the goods transported aboard motor vehicles passing through the State, i.e. for vehicles with origin and destination of goods in other States. The movement type assigned in VATIS for such vehicles is ‘3’. It was observed in 29 cases registered with Integrated Check Post (ICP) Naraharipeta that though the transit passes issued were with type ‘3’, the consignee details pertain to the State of AP (TIN beginning with 28). It was also observed that out of these 29 dealers, 25 dealers’ TINs do not exist in the VATIS database and in the remaining four cases, the consignee dealers were registered only under APVAT Act (without CST registration). This indicates that the GIS module of the VATIS is ineffective in preventing such cases where there are chances of evasion of tax.
- \* It was also observed that there were five records in ‘PAYMENT\_DTL’ relating to the sample offices in the period covered under audit where ‘tax period from’ was later than ‘tax period to’.
- \* For 85 out of 15971 active VAT dealers of sample offices, starting date of tax liability (first tax period date) was not within 30 days from approved registration date (RC-effect date).

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<sup>46</sup> CTOs- Chilakaluripet and Rajam.

<sup>47</sup> DC(CT) Kurnool, CTOs- Kurupam Market and Hindupur.

In reply, the Government stated (December 2015) that it was proposing to validate the consignee and the consignor details with TINXSYS database with regard to issue of transit passes. For other observations relevant replies were not given.

#### **2.4.16 Inadequate data capture**

Registration data of VATIS indicate status of the dealer as 'REGD' (Registered) and 'CNCL' (Cancelled) basing on the status of the dealer's registration. Dates of Registration or Cancellation were also captured to indicate changes in dealer's status from active status to cancelled status. Audit observed in cases of cancelled dealer's data that the 'registration effective to' date was not recorded in 1,152 cases out of 4,726 cancelled dealers among 15 sample offices during the period covered under audit. Out of these cases, 209 cancellations were done after the introduction of re-engineered VATIS. This indicates that data capture is incomplete.

The Government replied (December 2015) that the "registration effective to date" field is captured in the cases of reactivation of cancelled dealers.

The reply is not tenable as the field has to be captured in all cases of cancellation to monitor misuse of statutory forms.

#### **2.4.17 Non-compliance with Citizen's charter**

The timeframe fixed for issue of registration certificate to the applicants (when pre-registration visit is required) is 24 days from application date excluding application date. In two cases of new registrations (out of 122 in sample offices in 2013-14) done with pre-visit requirement, Audit noticed that registration took more than 24 days.

As per Citizen's Charter of CTD, registration of dealers not requiring pre-visits is to be completed within six days of application. Audit observed from VATIS package that during the year 2013-14, registration of 126 VAT dealers not requiring pre-visit by the registering authority (out of 5,993 registrations in sample offices) took more than six days which is not in line with the Citizen's charter.

In reply (December 2015), it was stated that instructions were given to officers concerned for issuing registration certificate within the time prescribed and action would be taken in respect of the cases in which delays took place.

#### **2.4.18 IT Security, monitoring of outsourced services and business continuity**

Security policy defines how an organization plans to protect physical and Information Technology (IT) assets that include servers, systems, software and data. For any IT system, it is important that sufficient measures be taken to ensure smooth functioning of critical functions even if disasters occur. This is especially so for a system like VATIS, which supports the CTD, the main revenue-earning wing of the State.

It is observed that risks associated with data and content management are not being adequately addressed. Outsourced service providers facilitate services of portal, and backup recovery issues and facility management services and CTD has not yet evolved a mechanism to maintain and manage data as per required retention period of CTD. There is no security policy drafted but for the items listed in System Requirement Specifications.

RFP 7.2 of annual maintenance contract (AMC) and facility management (FM) services prescribes maintenance of details of problems and issues related to application/database/network failures and time taken to resolve them at branch offices/data centre chronologically through an automated tracking solution implemented by service providers. However CTD is yet to furnish details to Audit. In the same R.F.P, clause 3.2.1.1 stipulates virus protection services to IT infrastructure of the Department. However log of antivirus updating on client machines in branch offices was not available, leaving Audit with no assurance as to whether they were being updated. This indicates that performance of outsourced technical team (HCL) is not being monitored.

Backup activity of reengineered VATIS data and related information is being done at central office. However, Audit found that in all the sample offices backup of branch office's assessment documents, notices, vakalat filings and other important documentation was neither done locally (CTO office) nor at central office as VATIS does not have a mechanism to backup these orders and documents. Thus, VATIS has only a superficial amount of data when compared to the physical documents available in unit offices.

Presence of disaster recovery site in the same city or geographical proximity does not address risks like earthquakes. It was observed that only one disaster recovery site is located that too within three km radius of main site which is not sufficient to ensure business continuity. From these, it is clear that the disaster preparedness of CTD is not adequate.

In reply, it was stated (December 2015) that backup activity cannot be done at local level. It was also stated that the security mechanism was in place both at the data centre and client level. No specific reply was also given on the issue of non-monitoring of the performance of security mechanism and outsourced technical team was given.

Backup of important documents like assessments and vakalat files needs to be taken in order to ensure business continuity.

#### **2.4.19 Training and change management**

Training policy and implementation of the same is critical to inculcate awareness among users of IT infrastructure when new systems are introduced to ensure smooth transition. It is observed that CTD has no training policy. Audit also observed that user manuals have not been provided to local offices.

RFP stipulates Change requests maintenance. However it was found that Change Management documentation was not available either with CTD or

developers. Lack of change management documentation can cause problems with business continuity.

It was replied (December 2015) that steps were afoot to create a training facility, with adequate systems to provide periodic training for field officers with hands on computer training. With respect to change management, it was stated that documentation for changes in tax rates and relevant dates were available.

The reply to change management documentation was limited to updating of the tax rates or master tables but was silent on process change documentation, which is important for business continuity.

#### **2.4.20 Conclusion**

Audit found that CTD was not insisting on filing of returns. The level of scrutiny of records was inadequate as was evidenced by non-levy of penalty/interest on non-filing of returns and belated payments. The selection of dealers for audit remains mostly discretionary. The checks prescribed were not completed and the documentation was inadequate in assessment files. Integration of various modules in and with VATIS was still incomplete. There was no assurance regarding integrity of data as there are problems associated with data migration as well as logical access controls. Filing of returns had not yet fully been made available online and a lot of critical data was still being maintained at local offices which have no backup.

#### **2.4.21 Recommendations**

- \* Built in provisions for automatic scrutiny of returns when they are filed and generation of penalty/demand notices in cases of non-filing and belated payments be introduced.
- \* Audit file tracking system may be integrated with VATIS so that the progress can be monitored. The checklist for the checks prescribed may also be integrated.
- \* Data in VATIS needs to be purged of inconsistencies and module integration taken up in a time-bound manner.