

CHAPTER IV Internal Control Management

Internal control is broadly defined as a process effected by an entity's management, designed to provide reasonable assurance regarding the achievement of objectives of effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations. A strong internal control mechanism not only acts as deterrence but also mitigates the chances of fraudulent activities and aids the management in achieving its intended objectives. Audit verified criteria such as adherence to the prescribed procedures, Internal/Special audits, system of data management, accounting and internal reporting to assess the effectiveness of internal controls and found the following deficiencies:

- Inadequate monitoring of Internal/Special Audit (Para 4.1);
- Absence of time limit for Issuance/adjudication of SCNs (Para 4.2);
- Mismatch in MIS reports and data as per Customs EDI system (Para 4.3);
- Other Irregularities (Para 4.4).

4.1 Inadequate monitoring of Internal/Special Audit

As per Paragraph 7.10 of FTP 2015-20, a Risk Management System (RMS) shall be in operation, wherein every month, the computer system in the DGFT headquarters, on random basis, will select 10 *per cent* of cases, for each RA, where benefit(s) have already been granted. Such cases shall be scrutinized by an Internal Audit team, headed by a Joint DGFT, in the office of respective Zonal Additional DGFT. The team will be responsible to audit claims, not only for its own office but also the claims of all RAs falling under the jurisdiction of the Zone. The respective RAs may also, either on the basis of the report from Internal/External Audit Agency or *suo-moto*, reassess any case, where any erroneous/ineligible payment has been made/claimed. RAs will take necessary action for recovery of payment along with interest at the rate of 15 *per cent* per annum on the recoverable amount.

Para 4.07 (ix) of FTP further specifies that DGFT or any person authorised by him may conduct audit of the manufacturer pertaining to AAs issued under Self-Ratification Scheme. Such audit may be conducted based on RMS within three years from the date of issue of authorisation. Sub-para (x) further states that DGFT or any person authorised by him may initiate a special audit, considering the nature and complexity of the case and revenue of government, if he is of the opinion at any stage of scrutiny/enquiry/investigation that the norms have not been claimed correctly or excess benefits have been availed.

It was seen in nine RAs (Ahmedabad, Bengaluru, Chandigarh, Jaipur, Hyderabad, Ludhiana, Panipat, Vadodara and Visakhapatnam) that no internal audit or special audit was conducted, despite having cases under Self-Ratification Scheme.

It was seen in Mumbai and Pune RA that Internal audit is being conducted by PAO from MoF which is not under the administrative control of DGFT and whose scope is different from that of the 'RMS' based internal audit. No information regarding special audit was furnished by RA Mumbai and Pune.

RA Bengaluru, Hyderabad and Visakhapatnam were not aware that such mechanism exists with RAs for conducting internal audit of AA cases. No information on conducting of Internal/special audit was given by CLA Delhi despite request/reminders issued in this regard.

Availability of manpower for conducting internal/special audit was reviewed and it was seen that no separate posts exist or manpower allotted for internal/special audit in RA Bengaluru, Mumbai and Kochi and shortage of staff was observed from RA Mumbai, Pune, Chennai and Kochi.

DGFT stated (February 2021) that all RAs have been instructed to conduct Internal/Special Audit and Internal audit is in progress or schedules prepared at the field level. DGFT further stated (July 2021) that no separate Internal Audit Wing has been formed at DGFT Headquarters and no separate strength specified for conduct of internal audit at RAs/CLAs, however, some RAs have formed their Audit Wing. Internal audit of DGFT Headquarters is conducted by PAO team formed by CCA, DoC.

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

Recommendation No. 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.

DGFT stated (February 2021) that all RAs have been directed to conduct Internal audit and also Special Audit wherein AAs are issued under self-ratification/declaration by carrying few test checks.

Progress in this regard would be monitored in subsequent Audits.

4.2 Non-monitoring of conditions of authorisations and EO fulfillment by RAs

FTDR Act 1992 was introduced with effect from 7 August 1992 to provide for the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India. Section 13 read with section 11 of the FTDR Act, 1992, empowers the adjudicating authority to impose penalty for violation of any of the conditions of the licence or failure to fulfill EO after issuing SCN under Section 14 of Act *ibid*.

Audit reviewed the mechanism instituted for RAs to see whether the conditions of licences and fulfilment of EO by AHs were complied with by checking whether the list of SCN/Adjudication orders are duly maintained, time taken for issuing SCN/Adjudication and also whether any recovery mechanism is put in place.

It was observed in audit that no time limit had been prescribed in the Act for issuance of SCN and subsequent adjudication. In the absence of a specific timeline for issuance of SCN/Adjudication order, RAs are not bound to take penal action in case of any violation of the conditions of licence or failure to fulfill EO, thereby resulting in inordinate delay in issuance/adjudication of SCNs as illustrated hereunder:

(i) In RA Mumbai, time taken to issue SCNs in 1,074 Authorisations during the period from 2015-16 to 2018-19 ranged from two to 17 years. In 396 cases, PHs were held, factsheet prepared but no adjudication orders were issued despite lapse of two to three years. In other cases, even after issue of SCNs, the proceedings of hearing and conclusion of proceedings did not happen periodically. Audit test checked 25 sample cases in RA Mumbai and Pune and found no significant reasons for delay in issue of SCNs and their adjudication. As per EDI data, RA Mumbai had adjudicated 374 SCNs during 2015-16 to 2018-19 and imposed a penalty of ₹432.26 crore. Two sample adjudication files checked in audit involved ₹46 crore penalty imposed in January/February 2018 and the cases are pending before Appellate Authority.

(ii) In RA Bengaluru, 949 SCNs were issued during the period from 2015-16 to 2018-19, out of which only 51 cases could be adjudicated (5.37 per cent) involving penalty of ₹824.17 lakh. However, no recovery could be made till date.

(iii) In RA Hyderabad, 229 SCNs were issued in respect of 229 AAs; however, none was adjudicated. Further scrutiny revealed that 228 SCNs (out of total 229 SCNs) were issued in 2018-19 for defaults pertaining to 2001-02 to 2017-18. RA took upto 17 years for issuing SCNs.

(iv) In RA Jaipur, eight SCNs were issued during the period covered in review with delay ranging from 67 to 981 days. Only six SCNs were adjudicated with delays ranging from seven months to six years. However, no recovery (out of ₹29.00 lakh penalty) could be made, till date, in any of the cases.

(v) SCN/Adjudication register was not properly maintained in RA Cuttack, Jaipur and Kolkata.

(vi) Details of SCNs issued or Adjudications made were not furnished by three RAs (Ahmedabad, Delhi and Vadodara).

DGFT stated (February 2021) that steps are being taken to resolve the issue and strengthen the institutional mechanism and ascribed reasons like shortage of manpower for the delay.

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

Recommendation No. 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.

DGFT stated (February 2021) that ECA Division has issued (January 2021) Model Guidelines and timelines to all RAs for Adjudication Proceedings under FTDR Act, and also referred to the new IT system being put in place for comprehensive monitoring of adjudication proceedings.

Progress in this regard, would be watched in subsequent Audits.

4.3 Mis-match in MIS reports and data as per Customs EDI system

The MIS report of DGFT provides valuable inputs for assessing the operational aspects/performance/workload of RAs. RAs are required to collate various information viz., details of various applications processed, cases referred to NCs, EO monitoring, SCNs/Adjudications, Court cases, Sanctioned strength and PIP which are compiled by the Statistics Division on the basis of inputs received from various sections of the RA. Monitoring by DGFT is on the basis of MIS reports submitted by RAs.

Review of MIS reports submitted to DGFT when compared with Customs EDI data revealed inconsistencies in three RAs as detailed below:

In RA Mumbai, cross-verification for the period from FY 01 to FY 17 revealed mismatch in 956 cases of un-redeemed licences, 331 cases of SCNs issued and 1,287 cases of SCN not issued. Besides, there is a shortcoming in the MIS-4 report as it does not exhibit age-wise analysis of pendency of SCNs/Demand notices issued and reasons for their pendency.

Similarly, in RA Pune, the mismatch in un-redeemed cases was 85 for the period from FY 09 to FY 19. Details of pendency of SCNs are not reported in MIS reports submitted to DGFT. When ascertained, it was stated that 59 SCNs are pending for periods ranging from 1 to 2.5 years.

In RA Jaipur, numbers of AAs and CIF value thereon for the period from 2015-16 to 2018-19, maintained at RA were not tallying with the MIS report sent to DGFT, with variance of 43 AAs involving CIF value of ₹540.86 crore.

RA Jaipur, accepting the observation, corrected the current MIS-4 report in January 2020. However, reasons for mismatch of data in earlier MIS reports were not adduced.

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 defaulters.

DGFT stated (February 2021) that the facility of eodc.online provides the database interface and that steps are being taken to resolve the issue and strengthen the institutional mechanism.

Recommendation No. 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.

DGFT stated (February 2021) with the new IT system being introduced (1 December 2020), the scheme is now paperless wherein online reports would be generated with 100 per cent accuracy and there is no question of mismatch or non-maintenance of master register.

Progress in this regard would be watched in subsequent Audits. Details of action taken on the basis of information collated from MIS reports may be intimated to Audit.

4.4 Other irregularities

4.4.1 Non-maintenance/updation of Master Register

Rule 4.44 (a) of HBP 2015-20 stipulates that RAs shall maintain a proper record in a Master Register indicating starting and closing dates of EOP and other particulars for effectively monitoring the EO so that timely action could be initiated against the defaulter AH.

Audit observed during the period of audit that the Master Register was not maintained in five RAs (Cuttack, Delhi, Panipat, Patna and Varanasi) and not properly updated in other five RAs (Hyderabad, Indore, Jaipur, Kanpur and Visakhapatnam).

A case is highlighted in RA Hyderabad where fulfillment of EO was not being monitored effectively even though Master Register was maintained both in physical as well as in the Computer systems (LEMIS). In 93 out of 1,343 unredeemed AAs, where EOP had lapsed, no exports were made even though

the AHs imported duty free goods with duty forgone of ₹309.67 crore in these cases. In four instances, no communication was made with the AHs in this regard. In one case, the excess imports were noticed only at the time of redemption of AA. Besides, the amendment orders for revalidation/ extension /enhancement/invalidations were not updated in the Master Register.

DGFT stated (February 2021) that the online module eodc.online monitors the EO status whereby details of pending cases can be checked. Now all the EODCs are system generated which can itself serve as Master Register.

In the absence of a Master Register during the period 2015-16 to 2018-19, RAs neither had any mechanism to determine fulfillment of EO till documents were submitted by AHs nor RAs could ask for details for fulfillment of EO from AHs. Further, RAs were not in position to take action such as refusing further licences, enforcing conditions of licence or initiating penal action with recovery of duty/interest in the absence of such requisite records. The online functionalities were stated to be implemented only from 1 December 2020 and this will be reviewed in subsequent audits.

4.4.2 Non-monitoring for import of precious metals by nominated agencies

Para 4.94 of HBP stipulates that four/five star export houses may apply online to RAs, for issue of Nominated agency certificate. Sub-para (b)(iii) stipulates that RAs which issues Nominated agency certificate shall monitor the performance of such certificate holders based on half yearly returns as per Appendix-4M of HBP to be filled by such agencies. RAs will also inform DGFT about non-filers and also take appropriate action within 30 days for the suspension/cancellation of the nominated agency certificate. DGFT headquarters can also review the performance of Nominated Agencies, whenever necessary.

RA Bengaluru issued nominated agency certificate to M/s. X Exports (a star house exporter) involved in imports/exports of gold bars/medallions. However, RA failed to report DGFT about non-filing of half-yearly returns or initiate appropriate action for suspension/cancelling of the nominated agency certificate.

4.4.3 Inadequate monitoring of cases referred to NC

Monitoring of cases referred to NC is being done by RAs and MIS-3 report in this regard is required to be forwarded to DGFT Headquarters on monthly basis. MIS-3 report is a product group-wise list of pending cases related to no-norms category which are referred to the NCs by RAs for finalization of norms. It is compiled by the Statistics Division on the basis of inputs received from various sections. It is not generated automatically from the EDI system of DGFT.

In RA Kochi, the statistical information relating to AAs referred to NCs were not available and MIS-3 report submitted to Headquarters was shown as Nil on the

ground that the AHs have directly sent the application for fixation of norms to NCs, indicating ineffective monitoring of AA cases referred to NCs.

DGFT stated (February 2021) with the new IT system (1 December 2020), delay in issue of EODC by RAs would be resolved. Policy Circular 23 (May 2019) stipulates forwarding of required documents directly to NCs by the applicants for AAs issued under self-declaration when SION does not exist and therefore cases referred to NCs were shown as Nil.

The intent of the Policy Circular *ibid* was to bridge the time lag between online application and receipt of documents by NCs and therefore applicants were allowed to forward the required documents directly to NCs. As AAs are issued by jurisdictional RAs, Audit is of the view that RAs should reflect AAs referred to NCs in their MIS-3 report and the same needs to be monitored by DGFT.

Conclusion

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.

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.

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 defaulters.

Recommendations

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.

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Dated: 28 OCT 2021


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