

Chapter II: Audit Mandate, Products and Impact

2.1 Authority of the CAG for audit of receipts

Article 149 of the Constitution of India provides that the Comptroller and Auditor General of India (CAG) shall exercise such powers and perform such duties in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament. Parliament passed the Comptroller and Auditor General's DPC Act (CAG's DPC Act) in 1971. Section 16 of the CAG's DPC Act, authorises the CAG to audit all receipts (both revenue and capital) of the Government of India and of Governments of each State and Union Territory having a legislative assembly and to satisfy himself that the rules and procedures are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed. Regulations on Audit & Accounts, 2007 (Regulations) lay down the principles for Receipt Audit.

2.2 Examination of systems and procedures and their efficacy

2.2.1 Audit of receipts includes an examination of the systems and procedures and their efficacy mainly in respect of:

- a. identification of potential tax assessees, ensuring compliance with laws as well as detection and prevention of tax evasion;
- b. exercise of discretionary powers in an appropriate manner including levy of penalties and initiation of prosecution;
- c. appropriate action to safeguard the interests of the Government on the orders passed by departmental appellate authorities;
- d. any measures introduced to strengthen or improve revenue administration;
- e. amounts that may have fallen into arrears, maintenance of records of arrears and action taken for the recovery of the arrears;
- f. pursuit of claims with due diligence and to ensure that these are not abandoned or reduced, except with adequate justification and proper authority.

2.2.2 To achieve the above, we examined the assessments completed by the Income Tax Department (the ITD) in the financial year 2018-19. In addition, some assessments which were completed in earlier years were also taken up for examination.

2.2.3 The ITD undertakes scrutiny assessments in respect of a sample of returns filed by the assessee as per the Income Tax Act, 1961. The income tax returns (ITRs) are selected for scrutiny through Computer Aided Scrutiny Selection (CASS) on the basis of parameters identified and pre-defined by the ITD. These cases are then closely examined in respect of claims of deductions, losses, exemptions etc. to arrive at the correct assessments to ensure that there is no evasion of taxes. The assessee is given the opportunity to substantiate his claim with evidence, failing which the assessing officer (AO) makes the assessment as deemed appropriate. The work of processing, completion and rectification of assessment order in respect of scrutiny cases is done by the AO in the Assessment Information System (AST)/Income Tax Business Application (ITBA) module. AST/ITBA undertakes calculation of tax, calculation of interest under various sections of the Act, time barring checks etc. In the case of scrutiny assessments, rectification, appeal effect orders, figures are data-fed to the system by the AOs based on the orders. The payments made by the assessee in respect of TDS/TCS and advance tax etc. are auto populated from Form 26AS and OLTAS application respectively.

2.2.4 Incidence of errors in assessment

We audited 1,888 out of a total of 6,249 assessment units of the ITD during FY 2019-20 and issued 16,193 audit observations (Inspection Report level audit paragraphs). On further analysis, we observed that around 6.14 *per cent* of scrutiny cases, which we examined, had errors. Interestingly, we found mistakes in 805 assessments which Internal Audit had already checked. Table 2.1 below gives the details while *Appendix-2.1* gives the details field audit office wise.

Table 2.1 Analysis of Incidence of errors in assessment checked by audit during 2019-20				
Total no. of assessments completed in units selected for audit	Total no. of assessments checked in audit	Total no. of audit observations raised in audit	No. of cases which Internal Audit had already examined	Audit observation raised after audit of cases by IAP (<i>in per cent</i>)
3,47,937	2,63,340	16,193	805	4.97

Source: MIS and CAG's SAI System and its interface with the ITD's ITBA.

2.3 Analysis of Draft Audit Paragraphs

We issue significant and high value cases noticed in audit to the Ministry for comments before inclusion in the Audit Report as per provisions of Regulations 205 to 209. We give a time frame of six weeks to the Ministry to offer their comments on cases issued to them before their inclusion in the Audit Report.

We have included 577²⁷ high value cases involving a tax effect of ₹ 12,893.13 crore in Chapters III and IV of this Report. Table 2.2 shows category wise details of these cases and sub-category-wise details are given in Appendix-2.2. Chapters III and IV bring out details of errors in assessments in respect of Corporation Tax and Income Tax respectively.

Table 2.2: Category-wise details of errors of high value cases						
Category	CT		IT		Total	
	No.	Tax Effect	No.	Tax Effect	No.	Tax Effect
(₹ in crore)						
a. Quality of assessments	134	818.92	166	325.66	300	1,144.58
b. Administration of tax concessions/exemptions/ deductions	157	2,938.67	18	33.45	175	2,972.12
c. Income escaping assessments due to errors	51	8,606.78	29	32.61	80	8,639.39
d. Overcharge of tax/interest	14	112.16	09	24.88	23	137.04
Total	356	12,476.53	222²⁸	416.60	578	12,893.13

2.3.1 Quality of Assessments – Excess or irregular refunds/interest on refunds

We noticed irregularities emanating from excess or irregular refunds or interest on refunds caused by computing errors, not considering the refund already issued/adjusted, excess computation of interest on refund, etc. Errors noticed in this category during FY 2016-17 to FY 2018-19 as brought out in the Compliance Audit Reports of the past three years along with findings of the current year Audit Report (2019-20) are summarised in Table 2.3 below.

Table 2.3: Excess or irregular refunds/interest on refunds								(₹ in crore)	
Assessment	Audit Report for the year ended								
	March 2017		March 2018		March 2019		March 2020		
	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	
CT	6 ²⁹	50.35	4 ³⁰	30.98	5 ³¹	1114.29	6	24.08	

During FY 2019-20, these irregularities were highest (where ever 'highest' is mentioned, it is only with reference to the total tax effect and not in relation

27 One DP is having observation on both under assessment and over assessment for two AYs, hence considered as two cases in other places of the Report.

28 221 IT cases issued to Ministry. One DP is having observation on both under assessment and over assessment for two AYs, hence considered two cases. Thus, total count is 222.

29 Karnataka and Maharashtra

30 Maharashtra.

31 Karnataka and Maharashtra

to the number of cases) in Pr. CCIT-Karnataka (56 per cent) and Pr. CCIT-Mumbai (32.2 per cent).

2.3.2 Administration of tax concessions/exemptions/deductions– Irregularities in allowing depreciation/business losses/capital losses etc.

We noticed irregularities related to incorrect allowance and set-off of business losses, capital losses and unabsorbed depreciation, incorrect allowance of depreciation etc. The nature of such irregularities included:

- (i) incorrect allowance of set-off of brought forward business losses and unabsorbed depreciation where no loss in respect of earlier assessment years (AYs) was available,
- (ii) adoption of incorrect figures viz. earlier years' business loss adopted as returned loss in current AY,
- (iii) incorrect allowance of carry forward of business loss although ITR for the said AY was filed after due date of filing of return, and
- (iv) double deduction on account of depreciation etc.

Such irregularities occurred due to non-correlation of assessment records which indicates failure of the AOs in applying due diligence and to comply with the law. Irregularities noticed in allowance of depreciation/business losses/capital losses etc. during FY 2016-17 to FY 2018-19, as brought out in the Compliance Audit Reports of the past three years along with findings of the current year Audit Report (2019-20) are summarised in Table 2.4 below.

Assessment	Audit Report for the year ended							
	March 2017		March 2018		March 2019		March 2020	
	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect
(₹ in crore)								
CT	81 ³²	1,144.10	66 ³³	1,796.86	75 ³⁴	2,655.15	87	1,017.28
IT	9 ³⁵	24.41	7 ³⁶	9.19	14 ³⁷	21.29	11	27.83

32 Andhra Pradesh & Telangana, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Maharashtra, Odisha, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal

33 Andhra Pradesh & Telangana, Assam, Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Odisha, Rajasthan, Tamil Nadu, UT Chandigarh, Uttar Pradesh and West Bengal

34 Andhra Pradesh & Telangana, Bihar, Delhi, Gujarat, Madhya Pradesh, Karnataka & Goa, Kerala, Maharashtra, Odisha, Rajasthan, Tamil Nadu and West Bengal

35 Bihar, Jharkhand, Rajasthan, Kerala, Odisha and Maharashtra

36 Bihar, Delhi, Rajasthan, Maharashtra and West Bengal.

37 Andhra Pradesh & Telangana, Bihar, Delhi, Madhya Pradesh, Kerala, Maharashtra, Rajasthan, Punjab, Jharkhand and West Bengal

In respect of Corporation Tax, these were highest in Pr. CCIT-Karnataka (30.3 per cent) and Pr. CCIT-Mumbai (26.19 per cent) during FY 2019-20.

In respect of Income Tax, these irregularities were highest in Pr. CCIT, Karnataka (44.25 per cent) during FY 2019-20.

2.3.3 Administration of tax concessions/exemptions/deductions - Incorrect allowance of business expenditure

We noticed irregularities related to incorrect allowance of ineligible claims of business expenditure viz. capital expenditure, unpaid claims and provisions deemed as unascertained liability etc. Errors in incorrect allowance of expenditure noticed during FY 2016-17 to FY 2018-19, as brought out in the Compliance Audit Reports of the past three years along with findings of the current year Audit Report (2019-20) are summarised in Table 2.5 below.

Table 2.5: Errors noticed in allowance of business expenditure								
Assessment	Audit Report for the year ended							
	March 2017		March 2018		March 2019		March 2020	
	(₹ in crore)							
	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect
CT	50 ³⁸	478.67	48 ³⁹	875.47	49 ⁴⁰	764.39	40	187.75

During FY 2019-20, irregularities on this account were highest in Pr. CCIT-Andhra Pradesh (32.3 per cent) and Pr. CCIT-Delhi (20.3 per cent).

2.3.4 Income escaping assessment due to errors – Irregularities under special provisions including MAT/Tonnage Tax etc.

We noticed irregularities related to errors in levying tax under special provisions of the Act due to:

- (i) errors in computation of book profit,
- (ii) not considering the expenditure disallowed under normal provisions for computing book profit,
- (iii) not considering the specified expenditure for computing book profit,
- (iv) tax levied under normal provisions instead of special provisions, etc.

Errors noticed under special provisions of the Act during FY 2016-17 to FY 2018-19, as brought out in the Compliance Audit Reports of the past three

38 Andhra Pradesh & Telangana, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, Odisha, Rajasthan, Tamil Nadu and West Bengal.

39 Andhra Pradesh & Telangana, Karnataka, Kerala and Maharashtra.

40 Andhra Pradesh & Telangana, Bihar, Delhi, Gujarat, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Maharashtra, Odisha, Tamil Nadu and West Bengal.

years along with findings of the current year Audit Report (2019-20) are summarised in Table 2.6 below.

Table 2.6: Errors under special provisions									
Assessment	Audit Report for the year ended								
	March 2017		March 2018		March 2019		March 2020		
	(₹ in crore)								
	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	No. of errors	Tax Effect	
CT	1 ⁴¹	2.06	28 ⁴²	100.43	22 ⁴³	447.85	8	234.18	

During FY 2019-20, these irregularities were highest in Pr. CCIT-Delhi (92.4 per cent).

2.4 Response to Audit

2.4.1 We elicit response from the audited entities at different stages of audit. As per provision of Regulations 193 on completion of field audit, we issue the local audit report (LAR) to the ITD for comments.

CBDT's instruction No. 07 of 2017 lays down the Standing Operating Procedure to handle receipt/revenue Audit Objections superceding the instruction No. 09 of 2006, instruction No. 16 of 2013 and circular No. 08 of 2013.

The Audit Regulations 202 and 203 require the establishment of systems and procedures to ensure adequate, constructive and timely action on audit observations included in Inspection Reports/Audit Notes and establishment of audit committees for monitoring and ensuring compliance and settlement of pending audit observations. The Department's efforts to ensure that replies to audit are sent in the prescribed period have not been satisfactory.

2.4.2 Table 2.7 below depicts the position of number of observations included in the LAR issued during FY 2017-18 to FY 2019-20 and replies received thereto and observations accepted (as on 31 March of the respective FY).

41 Maharashtra

42 Andhra Pradesh & Telangana, Delhi, Gujarat, Karnataka, Maharashtra, Odisha, Rajasthan, Tamil Nadu and West Bengal.

43 Andhra Pradesh & Telangana, Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu and West Bengal.

Financial Year	Observations raised	Reply received		Reply not received	Percentage of observations accepted (where replies received)	Percentage of reply not received
		Observations accepted	Observations not accepted			
2017-18	24,502	3,983	2,882	17,637	58.02	71.98
2018-19	21,533	3,357	2,743	15,433	55.03	71.67
2019-20	16,330	2,412 [#]	3,252	10,666	42.58	65.32

1,409 Observations accepted and remedial action taken; 1,003 Observations accepted but remedial action not taken

2.4.3 Table 2.8 below shows the position of pending observations.

Period	Corporate Tax		Income Tax		Other Direc Tax		Total	
	No.	Tax Effect	No.	Tax Effect	No.	Tax Effect	No.	Tax Effect
								(₹ in crore)
Upto March 2018	17,009	60,579.88	15,352	12,308.13	1,540	167.03	33,901	73,055.04
March 2019	5,786	29,540.84	7,072	9,158.15	235	668.73	13,093	39,367.72
March 2020	3,004 ⁴⁴	17,041.39	4,102	1,802.87	77	3.77	7,183	18,848.03
Total	25,799	1,07,162.11	26,526	23,269.15	1,852	839.53	54,177	1,31,270.79

The accretion in pendency in replies to audit findings each year has resulted in accumulation of 54,177 cases involving revenue effect of ₹ 1,31,270.79 crore as of 31 March 2020.

2.4.4 We issued 577⁴⁵ high value cases to the Ministry and CBDT during August 2020 to December 2020 seeking their response within six weeks of receipt of the same. However, we received replies from the Ministry/CBDT only for 43⁴⁶ high value cases (July 2021). Out of these cases, remedial action was completed in 400 cases (69.20 *per cent*) having a tax effect of ₹ 2,952.55 crore (22.90 *per cent*), remedial action was initiated in 91 cases (15.74 *per cent*) involving a tax effect of ₹ 644.51 crore (5.0 *per cent*) and remedial action was neither initiated nor completed in 86 cases having a tax effect of ₹ 9,296.07 crore. Table 2.2 shows category wise details of these cases (sub-category-wise details are given in Appendix-2.3).

Non-production of records

2.4.5 As per Section 18 of C&AG's (DPC) Act, 1971, Audit has a right to call for any record or document to which its duty extends. Further, Regulation 185 of Regulations on Audit and Accounts, 2007 provides that the Officer in charge

44 Observations become pending after six months of issue of the observations;

45 One DP is having observation on both under assessment and over assessment for two AYs, hence considered as two cases in other places of the Report.

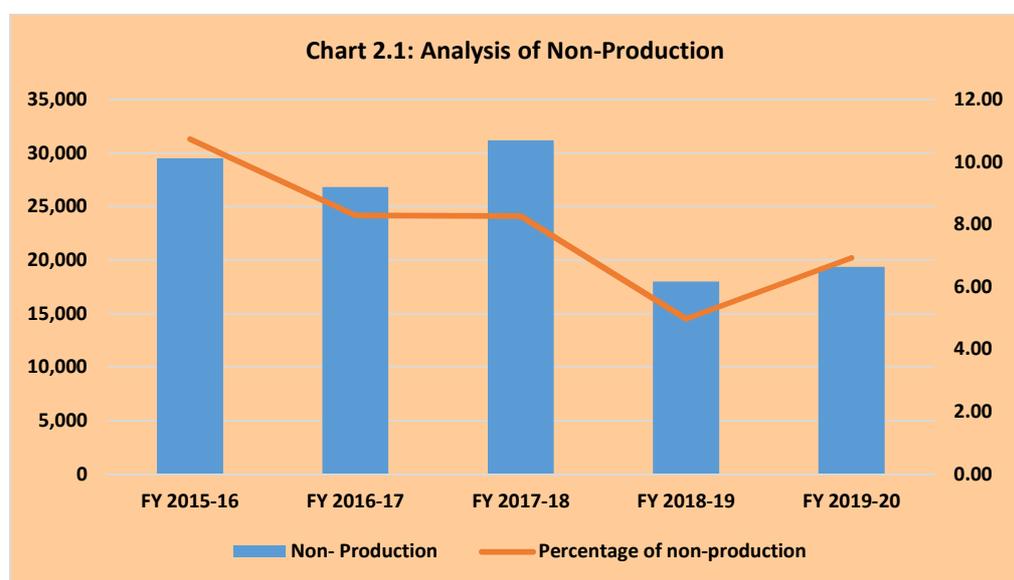
46 29 cases pertains to Chapter III (Corporate tax) and 14 cases pertains to Chapter IV (Income tax)

of the auditee unit shall comply with requests of Audit for information and records as complete as possible and within the specified time.

CBDT's instruction no. 07 of 2017 lays down Standing Operating Procedure to handle receipt/revenue Audit Objections superseding the instruction no. 09 of 2006, instruction no. 16 of 2013 and circular no. 08 of 2013.

As per para 8.1.2 of Audit Manual of the ITD, the AO shall supply the assessment and other records, as requisitioned by the LAP. If it is not possible to make available any particular record requisitioned, the AO shall communicate the reasons for the same to the LAP in writing with prior approval of the PCIT and such records shall invariably be produced to audit at the next audit cycle.

2.4.6 Notwithstanding above, the ITD did not produce 19,484 out of 2,79,939 records⁴⁷ (6.96 per cent) requisitioned during FY 2019-20. The non-production of records to Audit is a recurring phenomena as detailed in Chart 2.1 below.



Appendix 2.3 shows the details of non-production of records during FY 2017-18 to FY 2019-20. Non-production of records has increased significantly in Pr. CCIT-Tamil Nadu, Pr. CCIT-Gujarat, Pr. CCIT-NER, Pr. CCIT-Odisha and Pr. CCIT-Kerala FY 2019-20 over the previous year.

Table 2.9 below shows details of records not produced to audit pertaining to same assessees in three or more consecutive audit cycles.

Table 2.9: Records not produced to Audit in three or more audit cycles	
States	Records not produced
a. Tamil Nadu	1,479
b. Odisha	9
Total	1,488

⁴⁷ Includes 20,413 records not produced in earlier years and requisitioned again during current audit cycle

In FY 2019-20, 1,488 records pertaining to same assessees in two states were not produced to audit in last three or more consecutive audit cycles.

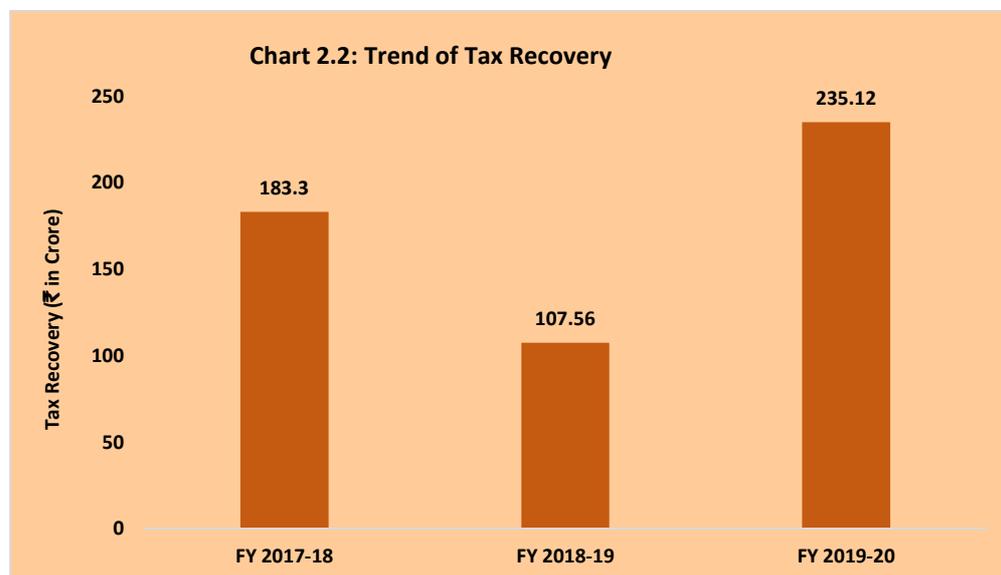
Recommendations

It is recommended that

- *The Ministry/CBDT may enforce the laid down system with instructions that PCIT/CIT(Audit) may take suitable action against defaulters.*
- *Provisions of the Audit Regulations need to be observed in letter and spirit by the ITD.*
- *Timely submission of replies either for acceptance or non-acceptance of the paras may also be ensured so as to prevent the outstanding paras from becoming time-barred for remedial action.*

Recovery at the instance of Audit

2.5 The ITD takes remedial actions to rectify the mistakes pointed out by the Audit during compliance audit and performance audit. The ITD made recoveries from demands raised to rectify the mistakes. Recoveries made during FY 2017-18 to FY 2019-20 is given in Chart 2.2 below:



The ITD recovered ₹ 525.98 crore in the last three years from demands raised to rectify the errors in assessments that we pointed out. This includes ₹ 235.12 crore recovered in FY 2019-20.

