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Chapter 1: INTRODUCTION

1.1. Purpose:

1.1.1 The purpose of the Excise Audit Manual is to outline the principles and policies of audits conducted under the Central Excise Act and the Rules framed there under.

Guidelines provided herein are intended to ensure that:

- the Central Excise audits are carried out in a uniform, efficient and comprehensive manner, adhering to stipulated principles and policies; and
- the audit standards (as contained in Chapter 5 of this Manual) are observed while conducting the audit.

1.1.2 It is recommended that the Standard Audit Programme, Working Papers, previous Audit Reports, Participant Manual and Board's instructions issued from time to time etc. may be studied for the detailed instructions on Central Excise Audit.

Standard Audit Programme (contained in Part II) is a self-contained and systematic outline of procedures to be followed by an Auditor to conduct a Central Excise audit.

Audit Report and Working Papers (contained in Part III) are elaborate documentary records of an audit conducted by the Auditor.

Participant Manual is a document prepared by the National Academy of Customs, Excise and Narcotics for the participants undergoing training course on Central Excise audit to familiarize themselves with the Audit Manual and principles, standards and objectives of Audit.

1.2 Scope:

1.2.1 The manual covers subjects that are related to principles, policies and special issues pertaining to conduct of a Central Excise audit. For detailed audit steps or audit procedures, Parts II and III of this Manual may be referred to. The manual does not deal with legal interpretations and rulings on excise matters.

1.2.2 The manual does not contain the answers to all the problems that may arise in the day-to-day audit work. In such cases, the auditor has to apply his mind, keeping in view the spirit of the principles and policies

outlined in the manual. If needed, he may seek guidance from the supervisory officer.

1.3. Amendments

1.3.1 Future changes in the Central Excise Act and the Rules framed thereunder, administrative policies and procedures may require changes to this Manual. The experience gained during the conduct of audit would also necessitate its periodic updating to maintain its utility.

1.3.2 The users are welcome to provide suggestions for the improvement of this Manual and to make its scheme and contents more useful. Suggestions may be forwarded to the Directorate General of Audit through Jurisdictional Commissioners.

Chapter 2: AUDITOR'S RESPONSIBILITY AND AUTHORITY

2.1. Definition of Auditor:

2.1.1. Auditor means 'a Central Excise officer entrusted with the responsibility of conducting audit'. It includes an Assistant Director (Cost).

2.2 Role of the Auditor:

2.2.1 While conducting audit, the Auditor is required to carry out his duties with utmost sincerity, integrity and diligence. The Auditor has immense responsibility in detection of non-compliance, procedural irregularities and leakage of revenue due to deliberate action or ignorance on the part of the assessee. At the same time, the Auditor should keep in view the prevalent trade practices, the economic realities as also, industry and business environment in which the assessee operates. Therefore, the Auditor should take a balanced, scrupulous and rational approach while conducting the audit. Besides, the auditor is expected to play a key role in promoting voluntary compliance amongst the assessees. During the course of the audit if certain technical infractions, without any revenue implications, arising due to bonafide oversight or ignorance of the assessee, are noticed, the assessee should be guided for immediate correction. Such cases should also be mentioned in Working Papers discussed in Part III. The auditor should also apprise the assessee of the provisions of section 11A (2B) of the Central Excise Act and section 73 of the Finance Act, 1994 (for Service Tax) and encourage him to take advantage of those provisions in order to avoid disputes and litigation.

2.2.2 The audit process should be transparent so that all the findings are intimated to the assessee and an opportunity is given to the assessee to give his explanation before an objection is finalised and consequential action is initiated.

2.2.3 The Auditor should take into account the explanation from the assessee regarding all points of dispute before taking the final view. If necessary, the Auditor should contact his supervising Asstt. / Deputy

Commissioner to ensure that the views taken by him are consistent with the law and the latest instructions.

2.2.4 An Auditor is responsible for conduct of audit and should endeavour to take a final view on all issues raised by him during that audit. The Auditor should document all his findings in the Working Papers so that a record of steps leading to an audit point is available. **The Working Papers for each of the step should be filled as soon as that step is completed.** They should be 'speaking documents' that clearly explain why a particular area was included in the audit plan as well as the basis for arriving at every objection that goes into the Draft Audit Report after audit verification. The documentary evidence which has been relied upon in coming to a certain conclusion should invariably be cited.

2.3. Dealing with the Public:

2.3.1 The objective of the Central Excise Department is to collect correct amount of duties levied under the Central Excise Law in a cost effective, responsive, fair and transparent manner and also to maintain public confidence in the system of tax collection. This should be reflected in the Auditor's conduct and attitude. The auditor should bear in mind that he is one of the critical channels of communication between the department and the assessee after the liberalisation of procedural controls.

2.3.2 The Auditor should establish and maintain a good professional relationship with the assessee. The Auditor should recognise the rights of the assessee, such as, the right to impartial, uniform and transparent application of law and the right to be treated with courtesy and consideration. All law-abiding assessee stand to gain from such audit in as much as: -

- (a) They will be better equipped to comply with the Central Excise Law and Procedures;
- (b) The preparation of prescribed returns and self-assessment of Central Excise duties will be better focussed, correct and complete;

- (c) The scrutiny of business accounts and returns submitted to various agencies, in the course of audit will remove any deficiencies in their accounting and internal control systems;
- (d) The disputes and proceedings against them would be substantially reduced or even eliminated.

2.3.3 The auditor should be tactful to gain the goodwill and confidence of the assessee. Where there is lack of co-operation, or deliberate failure to provide information and records by the assessee or in case of other exigency, the Auditor should inform his superiors and follow it up by a written report, if necessary.

2.3.4 Confidentiality should be maintained in respect of sensitive and confidential information furnished to an Auditor during the course of audit. All records submitted to the audit parties in electronic or manual format, should be used only for verification of levy of excise duty or for verification of the tax compliance. These shall not be used for any other purposes without the written consent of the assessee. Maintaining the confidentiality is necessary to secure the trust and co-operation of the assessee.

2.4. Auditor's Authority under the Central Excise Law:

2.4.1 There is no separate cadre known as 'Auditor' under the Central Excise Law. The departmental audit is conducted by the Central Excise Officers and all the powers vested in the Central Excise Officers under the Act and Rules are available to the officers conducting the audit. Thus, the Auditor is also a 'proper officer'.

2.4.2 Most of the statutory documents and records that were earlier maintained under the Central Excise rules have been dispensed with. Therefore, the Auditor, for conducting audit, has to mainly rely on the records maintained by the assessee in the ordinary course of business. Under sub rule (2) of rule 22 of Central Excise Rules, 2002 the assessee is required to furnish a list in duplicate of the following:

- (i) all the records prepared and maintained for accounting of transactions in regard to receipt, purchase, manufacture, storage, sales or delivery of the goods including inputs and capital goods, as the case may be;
- (ii) all the records prepared and maintained for accounting of transactions in regard to the payment for input services and their receipt or procurement
- (iii) all the financial records and statements including trial balance or its equivalent.

Sub rule (3) of rule 22 of Central Excise Rules, 2002 further provides that the assessee, on demand shall make available the following documents for scrutiny to the audit parties:

- a) the records maintained or prepared by him in terms of sub rule (2);
- b) the cost audit reports, if any, under Section 233 B of the Companies Act, 1956 (1 of 1956); and
- c) the Income Tax Audit reports, if any, under Section 44 AB of Income Tax Act, 1961 (43 of 1961).

2.4.3 Therefore all records maintained by the assessee for accounting of transactions in regard to receipt, purchase, manufacture, storage, sales or delivery of the goods including input, capital goods and input services are to be furnished on demand by the auditor, whether maintained manually or in a computerised manner. The assessee is also required to submit all financial records and statements including trial balance or its equivalent to the audit parties. In addition, the assessee is required to provide production records like daily production slips/statements, production register, dispatch registers, challans etc. which are maintained by them for their internal control and which would help the auditors verify the information in their books of accounts. Where an assessee maintains or generates his records on computer, he should provide these records to the auditor in electronically readable format like Compact Discs, pen drives etc. after due authentication.

2.4.4 Like any other officer of Central Excise, the auditor is empowered to access any registered premises for carrying out verifications and checks for conduct of audit when authorised by the Commissioner under rule 22 of the Central Excise Rules.

Chapter 3: AUDIT SELECTION

3.1 Audit by selection:

3.1.1 Given that audit is an activity requiring substantial, high-quality human resources and the large assessee base, it is impossible to subject every assessee to audit each year. Moreover, mere emphasis on coverage of more number of units obviously dilutes the quality of Audit. Proper selection of units for audit is extremely important as it permits deployment of the existing administrative resources for achieving optimal audit results. Selection of units for audit, which is also referred to as 'work load selection', means selection of units to be audited during a specified period depending upon the available administrative resources.

3.1.2 Notwithstanding the above principle, there are certain types of units (depending on criteria such as the quantum of annual duty payment), which are to be audited mandatorily every year. The remaining units are to be subjected to audit by selection. But the selection of units cannot be arbitrary. It should be based on certain principles. The units for such selective audit should be identified on the basis of assessment of the risk potential to revenue. This process is known as Risk Assessment.

3.1.3 The Audit selection guidelines, therefore, would apply to the non-mandatory units. The concept of risk assessment is an essential feature of audit selection. This method involves identification of certain risk parameters, which are broadly of two types:

- (i) Benchmark Ratio based risk parameters; and
- (ii) Stand alone risk parameters.

Category (i) covers risk parameters based on benchmark ratios, which study the quantitative deviation of an individual assessee's parameters from the industry norm. The extent of deviation of the ratio for the individual unit from the benchmark ratio for the industry as a whole is used to arrive at a quantitative assessment of 'rupee risk', which gives a systematic and reasonable projection of possible extent of non-compliance by the assessee. In working out the benchmark ratio, it

would be necessary to classify the units into various industry groupings and further each grouping into sub-groupings on the basis of turnover (for e.g. big, medium or small).

3.1.4 Category (ii) covers stand alone risk parameter. Under this, the individual ratio of the assessee is compared at successive points of time for the same unit without calculating the ratio for the industry as a whole. Thus, for example, this can relate to the difference between the amount of input CENVAT credit availed divided by the value of dutiable clearances (including export clearances under bond) for the previous year and the year before the previous year.

3.1.5 Risk ratios by themselves do not help in the comparison of risk across units/ assessees owing to differences in their size or scale. The same risk ratio represents a higher risk for a unit having a larger turnover or paying more revenue than it does for a unit with a smaller turnover or revenue. As such, risk ratios are required to be converted into 'rupee risk' for a meaningful comparison. Once this has been done, the units are arranged in descending order of rupee risk for each Commissionerate in order to facilitate selection. In the normal course, units with a higher rupee risk should be audited on priority over those with lower risk.

3.1.6 The exercise for selection of units for audit should be carried out for the entire year at the beginning of the financial year. For this purpose, the Directorate General of Audit would compute the risk ratios (as well as the rupee risk) for all non-mandatory units in the country in a centralised manner each year. The menu of risk parameters to be used for conducting this exercise would be drawn up with the approval of the Director General. The menu would be confidential and the Directorate would ensure that it is balanced so that all material areas of risk are represented. The Directorate would also devise the methodology for the calculation of each risk parameter, its relative weight in the menu as also the composite rupee risk for individual units. The Commissionerate-wise list of non-mandatory units alongwith their rupee risk computation would be sent to the Commissioners by the Directorate either electronically or on a suitable medium such as Compact Discs, latest by

the 15^h April each year. This would enable the Commissionerates to draw up their audit schedule for the first quarter in a timely manner.

3.1.7 Method of selection of units based on risk assessment: Once the rupee risk calculations for non-mandatory units are received in the Commissionerate, the following steps are to be undertaken sequentially for the selection of units:

- Preparation of updated list of all registered units of the Commissionerate falling under different duty slabs (i.e. above Rs. 3 crore, between Rs. 1 crore and 3 crore, between Rs. 50 lakhs and 1 crore and below Rs. 50 lakhs).
- Preparation of updated list of all Export Oriented Units (EOUs).
- Deciding upon the maximum number of audits that can be carried out in different duty slabs in non-mandatory categories taking into account:
 - (i) The instructions of Board,
 - (ii) The available audit man-power, and
 - (iii) Available audit man-hours after conducting the mandatory audits.
- Reordering the selection of units (as given by the Directorate General of Audit in descending order of rupee risk) by applying Local Risk parameters, if necessary. Local risk parameters, which may vary from one Commissionerate to another and from one commodity to another are illustrated below:
 - a) High duty paying units;
 - b) Units availing high percentage of CENVAT or showing fall in revenue but increase in CENVAT;
 - c) Units undertaking expansion or diversification entailing one time excessive availability of CENVAT credit in respect of Capital goods.
 - d) Units producing evasion-prone/high duty final products;
 - e) Units having bad track record with the department;
 - f) Units manufacturing goods on job work basis;
 - g) Manufacturer of consumer durables particularly having MRP based assessment.
 - h) Units manufacturing both dutiable and exempted goods.
 - i) Duty paying SSI units whose value of clearances remain just below the threshold level for the last few years;

- j) Units manufacturing items like Molasses whose distribution is controlled.
 - k) Units undertaking job on Turnkey basis.
 - l) Units, which have been subject to merger or amalgamation recently.
 - m) Units selling goods through related/associated units.
 - n) Unit where assessable value shows a downward trend or production is stagnant or falling.
 - o) Units in respect of which important legal changes from Excise angle have taken place.
 - p) Units also engaged in Trading of similar goods.
 - q) Units referred to audit as a result of the scrutiny of their monthly/quarterly returns
 - r) Units availing high amount of rebate of Central Excise duties
- Identification of Reference Units. (As explained in para 10.1.4, these are the units with very low or negative risk-value with out any local risk factor. The Audit of such selected units helps in ascertaining the efficacy of risk parameters used for selection in a particular period.)
 - Preparation of final annual lists of units selected for audits by applying the prescribed risk parameters together with local risk factors.

3.1.8 Commissionerates should achieve the audit targets by suitably enhancing the audit manpower. However, if it is not possible to cover all such units due to manpower constraints, priority should be given to the units in the category of mandatory audits (i.e. units paying annual duty (cash + CENVAT credit) of above Rs. 3 crore). The selection of non-mandatory units should be made in descending order of their risk perception for each category (i.e. below Rs. 50 lakhs, between Rs. 50 lakhs and Rs. 1 crore, and between Rs. 1 crore and 3 crore of annual duty payment in cash and from CENVAT credit taken together) keeping in view the available manpower, the number of units in each category and Board's instructions.

3.1.8 As regards Export Oriented Unit s (EOUs), a total of 500 such units are required to be audited each year on an all-India basis. In effect, therefore, each Commissionerate would audit about 5-6 units per

annum. The parameters for selection of these units would be prescribed by the Directorate General of Audit.

3.2 Allocation of units for Audit:

3.2.1 As detailed in paras 6.4.1 and 6.4.2, an "Audit Cell" in the Audit Branch of the Commissionerates shall be responsible for planning and allocation of audits to audit parties. It shall also coordinate the monitoring and evaluation of audits. Once the units are selected for audit, they should be allocated among the available audit parties. Allotment of units for audit should be done for a quarter so as to give enough time for auditors to prepare background material and familiarise themselves with the units.

3.2.2 For such allocation, the Audit Cell should maintain a profile of each Auditor on the computer which should also mention the expertise, if any, of the officer. Educational background of the Auditor, background in accountancy, his experience in the department in various fields, his expertise, and his previous postings would be relevant for the allocation of audit work. It must be ensured that an officer who has been Superintendent or Inspector in-charge of the same factory in the preceding 5 years is not detailed for auditing the unit.

A profile of each auditor will be maintained by the 'Audit cell' in computer comprising inter alia the following information:

1. Name of the officer.
2. Designation.
3. Experience in the Department.
4. Professional qualification, if any.
5. Experience in Central Excise Range or Divisional office (in years).
6. Whether undergone training in audit.
7. Experience in audit wing.
8. Number of major audit points raised by him on his own (to be taken from Working Papers) in his career. Amounts involved in such cases.
9. Any commendation/awards, rewards, etc. received.

Each auditor should furnish a self-appraising resume containing the above information immediately upon joining the audit section, which

should be upgraded on yearly basis so long as the officer continues to be posted in the Audit Branch.

3.2.3 Officers, when posted to the Audit Branch for the first time, should invariably be sent for training in EA 2000 and financial accounting so that they have the basic skills to handle audit work. Compulsory in-house training programmes could also be organized in the Commissionerates for the benefit of new entrants to the Audit Branch soon after the annual transfers. Efforts should be made to arrange special training programmes for major industrial sectors in the jurisdiction of a Commissionerate so that auditors have the necessary specialization and sufficient number of auditors specializing in major industries are available.

3.2.4 Deputy/Asst. Director (Cost) should be associated with all major audits, involving valuation issues. Wherever the Commissionerate has no Deputy/Assistant Director (Cost), the Chief Commissioner (CE) of the zone should make his services available to such Commissionerate.

3.3. Deployment of Auditors:

3.3.1 Normally, officers selected and posted to the audit section should be allowed to continue to function in the audit wing for a minimum period of three years.

3.3.2 The formation of audit parties is a critical component of audit management. Apart from ensuring that officers with the requisite qualifications, skill and experience are posted to Audit Branch, Commissioners should also ensure that the skill and experience available in Audit Branch is evenly distributed across audit parties and the Audit Cell. As far as possible there should be at least one officer with commerce or accounts background in each party. It is also useful to assign officers with computer skills to each party to deal with units that keep computerized accounts. For efficient functioning of the Audit Cell, officers with computer skills and some prior audit experience are required. Similarly, the skill sets and experience available with an audit

party should govern the size and complexity of audits that it handles. For optimal results, there should be matching of these two factors.

3.3.3 In case of a unit which has been identified as one with heavy workload (as transactions are quite large and heavy), more than one audit party may be deployed at a time and the items of audit work should be specifically assigned to them by the supervising officer.

3.3.4 The composition of an audit party may vary from 2 to 5 officers depending on the availability of officers and the size or complexity of audits in a Commissionerate. An audit party may consist of two Superintendents and two Inspectors may be sufficient to deal with units paying a total duty of Rs. 1 crore to 3 crores per annum. For mandatory units, however, a team of five officers may be required. However depending on the availability of the officers of the aforesaid grades the constitution of an audit party may be modified (e.g. there can be more than one Superintendents in an audit party when sufficient number of inspectors are not available. In that case senior most Superintendent should lead the audit party). The supervising officer of the rank of Assistant Commissioner / Deputy Commissioner must frequently (especially in important and sensitive units) associate with the actual audit and attend to the areas of risks identified during desk-review. All units listed to be audited should be intimated at least 15 days before the commencement of audit verification in their premises. A format of the letter intimating the assessee about the audit and the records/documents to be provided to the auditors has been provided in **Annexure R** of this manual. Every audit party is required to inform the Assistant / Deputy Commissioner (Audit & that of the Division) about their presence in a factory as soon as they reach the factory so as to enable the supervisory officer to contact them whenever necessary.

Chapter 4: CONDUCTING THE AUDIT

4.1 Introduction:

4.1.1 Audit will be conducted as per the Standard Audit Programme in Part II. The Standard Audit Programme enumerates steps for conducting audit in a systematic manner and on sound auditing principles to assess the degree of tax compliance by the assessee and identify specific instances of non-compliance. The Standard Audit Programme includes the format of the Working Papers for different types of audit. It is important that the auditor records all of the steps, in appropriate Working Papers, as he goes along.

4.1.2 The broad principles of EA 2000 audit are:

- (i) Audit will be conducted in a systematic and comprehensive manner.
- (ii) Emphasis will be on scrutiny of records maintained in the normal course of business and would involve the validation of information contained in the assessee's tax returns (ER1 or ER3) with his books of accounts.
- (iii) Audit effort will be based on materiality principle – higher the potential risk, greater the intensity of scrutiny.
- (iv) Recording of all findings.
- (v) Audit is clearly distinct from anti-evasion activity – audit can uncover non-compliance only to the extent of their reflection in the books of accounts. However, there should be close coordination between the working of audit and anti-evasion branches of the Commissionerates. In case audit detects any indications of clandestine/ suppressed production or removal and cannot conclude findings without a proper anti-evasion investigation, the case must be brought to the notice of the Commissioner in a timely manner. The latter should promptly decide whether or not an anti-evasion investigation is called for and initiate action accordingly. If the case is such that investigations may have to cover manufacturing units or other premises lying outside the jurisdiction of the Commissionerate, it may be referred for

investigation to the Director General (Central Excise Intelligence) through the zonal units of the Directorate General of Audit. When doing so, the sponsoring Commissionerate would be required to submit a detailed write-up on the case justifying the need for anti-evasion investigation and the probable modus-operandi.

- (vi) During the audit if it is found that the guidelines in the Standard Audit Programme are in conflict with provisions of the Central Excise Act / Rules / Notifications / Instructions because of changes made subsequent to publication of this Manual, the provisions of Act / Rules / Notifications shall prevail over the guidelines of the programme.

4.2 Period to be covered during audit:

Every audit should invariably cover the retrospective period up to the previous audit by Departmental Audit Party or the last 5 years whichever is less and should extend up to one completed month preceding the date of current audit.

4.3 Duration of audit:

Efforts should be made to complete each audit within the following general time limits:-

- i) Units with annual duty payment (cash + Cenvat credit) above Rs.3 crore (mandatory units) – 10 working days.
- ii) Units with annual duty payment (cash + CENVAT credit) between Rs.1 crore and Rs.3 crore – 7 working days.
- iii) Specified EOUs – 7 working days
- iv) Units with annual duty payment (cash + CENVAT credit) between Rs. 50 lakhs and Rs. 1 crore – 5 working days (out of which normally not more than 3 days for verification in the assessee's unit).
- v) Units with annual duty payment (cash + CENVAT credit) not exceeding Rs. 50 lakhs - 5 working days

The duration, as above, covers the entire period spent on audit of a particular assessee from Desk Review to preparation of report of audit results (i.e. days spent in office as well as in a factory). In exceptional

cases, aforesaid period may be extended with the approval of Deputy/Assistant Commissioner (Audit). Further, in accordance with the requirements of the audit of a particular assessee such duration can suitably be reduced with the express prior concurrence of the Deputy/Assistant Commissioner (Audit) provided the verification as per the Audit Plan is completed in the prescribed manner.

4.4 Overview of the Audit Programme:

4.4.1.A brief overview of the EA 2000 process of audit is given in the succeeding paragraphs.

4.5. Preparing for Audit:

Preliminary or Desk Review.

4.5.1 Upon assignment of an audit, the auditor must do complete preparation before the visit to the unit. This is done in the office and involves reviewing all the information available about the unit, its operations, growth in production and clearances, its revenue growth and trends in payments in cash vis-à-vis CENVAT credit, reasons for selection for audit and possible issues that can be identified at this stage. Perusal of Assessee Profile, Annual Report, Trial Balance, Cost Audit Report and Income Tax Audit Report and comparison of the information reflected in these records vis-à-vis the ER-4 (Annual Financial Information Statement), ER-5 (Return on Input-Output norms) and ER-6 (return on monthly consumption of inputs) wherever filed by the assessee will help the auditor in the preliminary review. Such review would necessarily involve a comparison of the information contained in these records and the regular excise returns such as the ER1 and ER3 filed by the assessee. Any unresolved discrepancies in these returns that may be noticed at the time of scrutiny of returns by the Range Superintendent would also be a useful input for Desk Review.

4.5.2 The auditor should also get the assessee profile and other information from the computer wherever computerized information is available. If the information is incomplete, the same should be entered so

that in due course information becomes complete. Generally, the Trial Balance and Balance Sheet for the period subsequent to the last audit may not be available in the Assessee's Master File. For this purpose, while sending the intimation of audit to the assessee, he may be requested to furnish the Trial Balance of the period of audit.

Gathering Information about Assessee and the Systems followed by him.

4.5.3 At this stage, the auditor gathers information about various activities of the unit like tax accounting, procurement of raw materials, production, marketing, stocks and sales. This information is gathered through discussions with the senior management for which a visit to the business premises of the unit would have to be made by the auditors. An important activity to be completed during this stage is to develop a clear understanding of the manner in which the assessee fetches information from his business records/documents to prepare his Central Excise returns. The reliability/authenticity of this information is tested during "walkthrough" conducted while evaluating internal controls.

Tour of the Premises / Plant

4.5.4. This is used to gather information about the systems. A physical tour provides confirmation of much of the information gathered during previous steps and it also helps resolve issues noted earlier. Often, the tour brings out operations and technical details about inputs used and products/by-products/wastes manufactured, some of which may not have been discussed during the discussions. It provides clues about important aspects of the operations of the unit. If necessary the auditor should speak to the plant manager or supervisor/foreman during the tour.

Evaluation of the Internal Controls.

4.5.5 Internal Controls form a basis for reliability of the company's own accounting records. The evaluation of Internal Controls is necessary for determination of the scope and extent of audit checks required for the assessee.

4.5.6 If the internal controls are well designed and working properly, then it is possible to rely on the books maintained by the assessee. The scope and the extent of the audit can be reduced in such a case. The reverse would be true if the internal controls are not reliable. One of the ways of evaluating internal control is to do a '**walk through**' (as explained in para 11.5.6 of Part II).

Revenue Risk analysis.

4.5.7. Having assessed the reliability of company's accounting records, the next step is to assess the "potential" risk to the revenue. If the risk is low, i.e. accounting records are accurate; the extensive tests may not be required. There are several methods to assess the revenue-risk, such as, comparison of the derived (from financial records) dutiable clearance and tax liability vis-à-vis actual clearance shown and duty paid. Details of these methods are discussed in Standard Audit Programme.

Trend analysis.

4.5.8. This is an important step in assessing a company's accounting records. Analysis of various trends will help highlight unusual situations or abnormal trends. Trend analysis involves comparing operations from year to year and comparing with other units in the same sector.

Illustrative examples of the important trends are:

- a) Trends of production of finished goods (including by-products, scrap etc.).
- b) Clearance of excisable goods for home consumption as well as for export.
- c) Trends in assessable values in current year and a few preceding years.
- d) Value of Sales to related person vis-à-vis to unrelated person.
- e) Movement of goods on job work in terms of quantity over a period of time vis-à-vis total production (in quantity).
- f) Ratio of total duty paid to taxable manufacturing turnover over the years.

- g) The ratio of CENVAT credit availed to the total duty paid over the years.
- h) Trend of clearances of excisable goods without payment of duty say e.g. to EOUs, UN Organisations etc.

Developing the Audit Plan.

4.5.9 This is one of the most significant steps in the audit programme. The auditor should assess all the information gathered so far and develop a plan to examine detailed records related to the areas where material problems are indicated or foreseen.

4.5.10 The Audit Plan should be documented in the Working Papers. It should be consistent with complexity of the unit, materiality, problems and risk factors identified up to this point and the reasons for selection of the unit for audit in the first place.

4.5.11 The draft Audit Plan should be submitted for approval of Addl. / Joint Commissioner (Audit) and the audit should be undertaken only after such approval.

4.6 Verification:

4.6.1 This is the detailed verification as per Audit Plan. Entry in the working paper must be made for each item of the Audit Plan. At the end of each entry in working paper, auditor must indicate objections and findings. If any of the planned verifications is not conducted the reasons thereof must be recorded.

4.6.2 Audit objections raised must be fully supported by documentary and legal evidence. This will greatly help in explaining and discussing the objections with the assessee and other follow up action.

Reviewing results with the Assessee.

4.6.3 It is important that the auditor informs the assessee of all the objections before preparing draft Audit Report. The assessee must have the opportunity to know the objections and to offer clarifications with supporting documents. This process will resolve potential disputes early and avoid unnecessary disputes.

Summarising Audit Findings.

4.6.4. This step involves putting together all of the audit findings in one place to be placed in the audit file. Where necessary, important objections and findings must be reviewed with the immediate supervisor before discussing them with the assessee.

Informing the Divisional Deputy/Assistant Commissioner of major audit points.

4.6.5 If the audit party detects a major audit points involving short levy / short payment, which requires immediate attention of the jurisdictional officers including time-bound proceedings for recovery of the dues, the head of the audit party should, as a measure of abundant caution personally discuss the issue with the Divisional Deputy/Assistant Commissioner This may be done immediately after completion of the audit of the unit to bring all such points to the notice of the Deputy/Assistant Commissioner in-charge of the Division.

Compliance of Audit objections.

4.6.6 Where the assessee is in agreement with the audit findings, in part or in full, the auditor must request that payments be made promptly to stop accrual of interest. Voluntary compliance should be encouraged so as to avoid protracted legal wrangles. Attention of the assessee may be invited to sub section (2B) of Section 11 A of the Central Excise Act, 1944. Wherever the assessee agrees to make a payment under section 11A (2B), he may be requested to furnish a letter in the format at **Annexure S**.

Future Compliance.

4.6.7 This is the final step before the auditor leaves the assessee's premises. The auditor must discuss with the assessee, steps to improve compliance including systemic improvement and modifications in the legal arrangements. The brief summary of the discussions and the views of the assessee must also figure in Working Papers.

Reporting.

4.6.8 The draft Audit Report needs to be completed at this stage after the auditor has recorded all the findings against each of the detailed audit steps. All the Working Papers must be included as attachments to the final Audit Report.

4.7 Audit Follow up:

4.7.1 After the submission of the Audit Report along with the Working Papers, -

- The Superintendent in-charge of the audit team should discuss the major audit points with Assistant/Deputy Commissioner audit. After preliminary discussion the action points should be identified by the audit team.
- The Audit Report should be submitted for evaluation to the Audit Cell (please refer to para 6.4.2).
- The Audit Cell should evaluate the Audit Report and score each report as per the instructions of the Board. (Circular No. 514/10/2000 – CX. dt. 16.2.2000).
- This Cell, headed by the Commissioner, during its monthly meetings should review the Audit Reports for final acceptance (or non-acceptance) of the audit points. Thereafter the draft Audit Report would be finalised by the Audit Cell.
- The minutes of the meeting of the Audit Cell should clearly state the required action to be taken in respect of each of the audit points.
- The Audit cell should update the Assessee Master file based on the information available in the Audit Report.
- The audit section should maintain Registers of Audit Planning and Audit Follow-up in prescribed format (details given in para 12.3.1 and 12.3.7) until the closure of the audit point either by issue of a show cause notice and recovery of dues or by non-acceptance of the audit point by the Audit cell.

Chapter 5: AUDIT QUALITY AND STANDARDS

5.1. Definition:

5.1.1. 'Audit Standards' in the context of Central Excise Audit is defined as:

“The minimum level of performance of the audit, consistent with established departmental instructions/ procedures, accepted professional audit techniques and procedures generally accepted by accounting profession so as to measure the level of tax compliance as required under the Central Excise Act and the Rules. These are the standards that a competent auditor would follow while conducting an audit.”

“Audit Standards” are necessary for achieving the desired quality and goals of an audit. In other words, audit quality would be judged in terms of adherence to these standards.

5.1.2 This manual and the other documents mentioned in Chapter 1 aim at ensuring the minimum levels of performance during the conduct of audit. Therefore, the standards laid down in these documents should be strictly adhered to. The methods and procedures used in achieving the standard level of performance for conducting an audit must also be clearly indicated in the audit Working Papers. The findings and the conclusions of the Audit Report are required to be supported by evidence and rationale clearly brought out in the Working Papers.

5.2 Ensuring adherence to standards

5.2.1 The basic responsibility for ensuring that audit standards are adhered to by the auditors is that of the jurisdictional Commissioner of Central Excise. However, the Directorate General of Audit would play a very important role in judging whether and to what extent the prescribed standards are actually being met through an institutionalized system of Quality Assurance Reviews. Every Central Excise Commissionerate would be subjected to such reviews periodically. The reviews would provide feedback to the Commissioners and Chief Commissioners so as to enable them to take corrective action in case gaps are detected. At the national level, the outcome of these reviews would be evaluated by the Directorate

General of Audit from the point of view of carrying out any policy changes or legislative amendments that may be necessary for better compliance with standards.

5.3 Audit Quality Elements and Audit Standards

5.3.1 The methodology for conducting these reviews is contained in the Quality Assurance Review Manual published by the Directorate General of Audit. For the details on the audit quality elements, standards and their explanation the QAR Manual should be referred. According to the QAR Manual, Audit Quality would be judged on the basis of the nine elements mentioned below.

Each of the elements is roughly aligned with a step or stage of the audit process.

1. Selection of units for audit
2. Preliminary Review or Desk Review.
3. Evaluation of Internal Controls.
4. Audit Planning.
5. Audit Verification.
6. Technical Issues.
7. Working Papers, Audit Report, and Follow up.
8. Professional Conduct.
9. Timeliness.

Standards have been fixed for each of these elements.

1. Selection of units for audit

a. Objective:

Mere emphasis on coverage of more number of units obviously dilutes the quality of Audit. Selection of units for audit in a scientific manner is extremely important as it permits the efficient use of audit resources viz. manpower and skills for achieving effective audit results. To the extent such selection is based on risk, it leads to deployment of audit resources where they are most needed i.e. in the audit of less compliant units. Such selection is finally subject to the availability of administrative resources.

b. Standards:

1. Updated list of all the registered units and EOUs in the Commissionerate should be maintained.
2. The list must be segregated into various slabs of duty payment as per the current threshold limits for audit prescribed in the Manual or Board's instructions.
3. Annual list of units to be audited should have been prepared with mandatory and non-mandatory units separately where non-mandatory units should be arranged on the basis of rupee risk circulated by DG (Audit) coupled with Local Risk Parameters.
4. A quarterly schedule of audits should have been prepared out of the list of units to be audited, based on workload analysis i.e. the availability of audit teams.
5. The selection of non-mandatory units (for preparing quarterly schedules) should invariably be done on the basis of rupee risk circulated by DG (Audit) coupled with local risk parameters, if any. Reference units should also be included.
6. A profile of every auditor working in the Audit Branch must be maintained.
7. Units appearing in the quarterly schedule should have been allotted to audit teams/ parties by matching their size or complexity with the experience and skill level of the audit parties.

2. Preliminary / Desk Review:

a. Objective:

Before commencing the audit of any assessee, complete preparation is done in the office and it involves reviewing all the information available about the unit, its operations, reason for selection for audit and possible issues that can be identified at this stage. Perusal of Assessee Profile, Annual Report, Trial Balance, Cost Audit Report and Income Tax Audit Report by the auditor are the pre-requisites in the preliminary review/Desk review. For this purpose the auditor needs to get the assessee profile and other information about the assessee. The Desk review lays emphasis on gathering data about the assessee, his operations, business practices and an understanding of the potential

audit issues, understanding his financial and accounting system, studying the flow of materials, cash and documentation and run tests to evaluate the vulnerable areas. The preliminary review assists in development of logical audit plan and focus on potential issues.

b. Standards:

- For conducting the Desk Review an updated Assessee Master file including Profile of every registered assessee must be maintained.
- The preliminary/Desk Review must:
 - Include the reason why this particular assessee was selected for audit.
 - Include a review of information available about the assessee both in Excise returns and in financial statements including related information such as industry sector profile, rulings, latest law and Board's Circulars instruction
 - Include Revenue Risk Analysis
 - Include Trend Analysis
 - Result in a summary of observations and follow-up items

3. Evaluation of internal controls:

a. Objective:

The objective of internal controls review is to assess whether the assessee has reliable systems and controls in place that would produce reliable accounting/ business records. This assessment would be used by the auditor to decide the extent of verification required and even focus on areas with unreliable or missing controls. It should be noted that this review must be commensurate with the size of operations. A small assessee might have little in terms of internal controls where as a large assessee would have sophisticated internal controls in place. Most medium to large companies have ERP systems in place, which account for all transactions from entry of raw material to clearance of final products. Auditors must have a look at these systems and more relevantly determine whether the Excise duty based software is integrated to the main ERP system or is running parallel to the main ERP. If the internal controls are well designed and working properly, then

it is possible to rely on the books maintained by the assessee. The scope and the extent of the audit can be reduced in such a case. The reverse would be true if the internal controls are not reliable.

b. Standards:

The internal controls review:

- Should have been preceded by a tour of the premises and interview for a proper understanding of the internal controls and systems in place
- Must review assessee documentation and software programme regarding accounting systems and controls there in available with the assessee.
- Must examine controls and perform a walk-through of
 - General and Tax Accounting
 - Sales and Other revenues
 - Purchases/ Stores/ Production
 - Other parts of operations where applicable
 - Conclusions and observations based on the synthesis of information obtained.

4. Audit Plan

a. Objective:

The objective of preparing an audit plan is to outline a logical series of review and examination steps that would meet the goals and standards of an audit in an efficient and effective manner.

b. Standards:

Audit Plans must meet following standards:

- It must conform to the format prescribed in the Audit Manual.
- Audit Plan must be consistent with the complexity of the audit:
- Audit Plan is consistent with the reason(s) for selection, including prior audit issues.
- Audit Plan must be linked to and based on the preliminary/desk review and internal control review
- The audit plan must consider large, unusual, or questionable items.
- Audit plan must consider assessee's commodity specific issues.
- Audit plan must be internally consistent, precise and complete. It should point out the scope and areas of enquiry, the period under

probe, the quantum of test sampling and the documents to be scrutinized.

- The Audit plan should be approved by Senior officer.

5. Audit Verification

a. Objective:

The objective of audit verification is to perform verification activities and document them in order to obtain and record audit evidence. The verification techniques must be appropriate to audit objectives identified in the audit plan.

b. Standards:

Audit verification must include:

- Verification of all issues appearing in the Audit Plan.
- Appropriate and adequate audit techniques like ABC analysis
- Audit tests that are consistent with the internal control evaluation
- Use of indirect tests as appropriate
- Verification of any new issues that the auditor may have come across, but not included in the Audit Plan.
- Must address the AC/supervisor's comments and referrals from other Commissionerates, if any.
- Preparation of verification paper in the prescribed proforma.

6 Technical issues:

a. Objective:

It is important that in an audit, the objections that are raised are technically correct and stand up against scrutiny or challenge. Law being open to interpretation, it may be difficult to test the technical correctness of all objections. However, it should be correct to the extent that any professional auditor, working with and having access to the same research material would likely come to the same conclusion. It also means that the auditor must demonstrate, in writing, the research and reasoning used to base his/her application of legislation, policies and jurisprudence.

b. Standards:

An audit must be technically correct or supported as per following standards:

- The Central Excise Act, the Central Excise Rules, jurisprudence and other applicable acts, regulations and directives are applied properly
- All objections should be technically correct and relevant
- Amounts of duty detected should be supported and fully explained in the working papers and/or audit report
- An audit should make referrals to other departments where applicable

7. Working Papers, Audit Report and Follow up:

a. Objective:

The objective of this standard is to ensure all audit documentation, which includes reports, working papers and correspondences, are complete, accurate and of professional quality.

b. Standards:

Working papers should support the audit effort and results. They should:

- be clear, concise, legible, organized, indexed, and cross-referenced;
- disclose the audit trail and techniques used in the examination of each significant item;
- support the conclusions reached and cover all queries raised; and
- include audit evidence (e.g., copy of a financial statement, an invoice, a contract, a bank statement, a job-work agreement, etc.) to support the assessment.
- link results to supporting working papers, e.g. the objections identified in the working papers must agree with the summary of audit results or statement of audit objections and the audit report.
- Audit reports need to be clear and disclose all material and relevant information.
- Follow up Action

8. Professional conduct.

a. Objective:

All dealings with the assessee and its staff should be professional and courteous in accordance with the policies of Excise and the Citizen's Charter.

b. Standards:

- The assessee must be fully informed of the audit process.
- The assessee must have enough time to prepare for audit.

- The assessee must be given a timely response for requested information.
- The assessee must be given an explanation for all audit objections.

9. Timeliness

a. Objective:

An audit needs to be carried out in a timely manner, both from departmental perspectives and from assessee perspectives. Delays are costly, both to the assessee and the department.

b. Standards:

- Audit should be planned and scheduled in such a way as to avoid major interruptions.
- Audits should be completed within a reasonable time.
- There should be no undue delays in finalizing an audit.
- Audit time should be commensurate with the complexity of the audit.

Chapter 6: AUDIT MANAGEMENT

6.1 Introduction:

6.1.1. Audit management requires planning, organising, directing and executing the audit process as well as the provision of resources necessary for it. Structurally & functionally this is to be undertaken at two levels – apex level and local level. In order to monitor, co-ordinate and guide the effective implementation of new audit system, the Board has set up Directorate General of Audit as the nodal agency. At the local level, management of audit is entrusted to the Commissionerates supervised by Chief Commissioners.

6.2 Management at the Apex Level:

6.2.1 The Directorate General of Audit with its 7 zonal units at Ahmedabad, Mumbai, Delhi, Bangalore, Kolkata, Chennai and Hyderabad is to provide a focal link between the Commissionerates (who actually run the audit process) and the Board on all audit-related matters. The Directorate does not conduct any primary audits on its own. On the one hand it aids and advises the Board in policy formulation and on the other it guides and provides functional direction in planning, co-ordination, supervision and conduct of audits at the local level. It is responsible for the codification of the audit process in the form of Manuals and their regular updating in the light of any changes that may have taken place either in Central Excise or Service Tax law and procedure or in audit policy itself. It is also required to run a centralised Risk Management programme so as to enable Commissionerates to select non-mandatory units for audit on the basis of their respective rupee risk couples with local risk parameters, if any. Operating the Risk management programme involves the identification of risk parameters, their amalgamation into a risk matrix, the calculation of rupee risk of individual assesseees or taxpayers, the timely circulation of these risk calculations to the Commissionerates and the periodic evaluation of the efficacy of risk parameters. The Directorate is also required to strategise

at the macro-level and set broad priorities for the audit programme each year.

The Directorate General collects and compiles data on audit results achieved by the Commissionerates, analyses them and provides suitable feedback to the Commissionerates as well as the Board.

With the help of its zonal units the Directorate General of Audit has to regularly monitor the conduct of audit in accordance with letter and spirit of EA 2000 and interact with Chief Commissionerates and Commissionerates for eliminating the deficiencies and improving the performance. For this purpose, it is required to run the Quality Assurance Programme wherein it defines “quality”, sets standards and measures the performance of individual Commissionerates vis-à-vis these standards. Under this programme, it also evaluates the ‘enabling environment’ for optimum audit performance and provides feedback to the field formations in this regard.

EA-2000 audits are very knowledge-intensive and presuppose that the auditor has complete knowledge about the assessee’s business, activities and compliance behaviour. As such, the Directorate is required to identify the data needs of auditors and the location of sources from where it can be fetched and made available. For keeping auditors updated on the types of non-compliance, the Directorate General of Audit and its zonal units have to examine the various types of irregularities detected during the audits every month and circulate the major detections on all India basis for immediate corrective or preventive actions in all the Commissionerates in the country.

Another important area of work for the Directorate is the identification of training needs of auditors and officers handling audit related work and coordination with the Directorate General of Training for the fulfilment of this need. It is also required to assist the Directorate of Training in the preparation of appropriate training material.

The Directorate General of Audit is required to nurture, monitor and grow the Computer Assisted Audit Programme (CAAP) so as to enhance the ability of the audit system to deal with assessees and taxpayers that work predominantly in a soft environment.

This Apex body is also to co-ordinate with the external agencies as well as other formations within the Department. This is necessary both for procurement of data relevant for audit (e.g. with Directorate General of Systems) as well as for evolving a coherent compliance strategy (for instance, Directorate General of Central Excise Intelligence) through the coordinated working of audit and anti-evasion.

One of its important tasks is to suggest measures to improve tax compliance to the Board and to gauge the level of assessee satisfaction with the EA-2000 system. It is also required to interact with select assessees and trade associations for improving tax compliance.

The zonal units of the Directorate General (Audit) are to build up data comprising of commodity/industry profiles reflecting the peculiarities in accounting system, procedures, movement of goods and vulnerability to evasion etc. with a view to suitably advising the Commissionerates. Directorate General (Audit) with its zonal centres would act as co-ordinating and supervising agency, with an important functional role in the audit of multi locational units, related or inter connected units, and companies formed as a result of merger or amalgamation.

6.2.2 The Directorate General of Systems Data Management makes available ER1/ER2/ER3 data at national level to Directorate General (Audit) and on that basis the apex body circulates the list of units identified on the basis of risk parameters (in descending order of rupee risk).

6.3 Role of the Chief Commissionerates:

6.3.1 The office of Chief Commissioner is not an operational formation for the actual conduct of audit, but it provides an important link between the D. G. Audit and the Commissionerates of the Zone. The role of this office in the over all management of audit is as follows:

- i. Collection, compilation and analysis of the data received from Commissionerates in standard formats and communication of the

same to the respective Zonal Additional Director General (Audit) and to Directorate General (Audit).

- ii. Review of the audit performance of Commissionerates
- iii. Dissemination of information pertaining to audit to the Commissionerates.
- iv. Ensuring that follow-up action is taken by the Commissionerates on the basis of feedback provided by D.G. (Audit) after Quality Assurance Review
- v. Ensuring that the services of a Computer Assisted Audit Programme centre, if located in the zone, are available to all Commissionerates in the zone and the officers trained in CAAP techniques are retained for a sufficiently long tenure
- vi. Effective deployment of Assistant/ Deputy/ Joint Director (Cost) posted within the zone for audit as and when required.
- vii. Monitoring the training for auditors and the officers of the zone in techniques of excise audit , accountancy and CAAP.

6.4 Management at local level:

6.4.1 Management of audit at local level should be handled by the Audit Section in the Commissionerate. The Audit Section should function under the regular supervision of Additional/Joint Commissioner (Audit) and consist of Deputy/Assistant Commissioner (Audit) and a select team of auditors having sufficient field experience, well versed in the audit techniques and having knowledge of computer applications. Within the Audit Section the Commissioner should constitute an “Audit Cell” which will be entrusted with functions distinct from conducting primary audits viz., Planning, allocation, co-ordination of Monitoring and Evaluation of Audits.

6.4.2 The functions of Audit Cell are, -

1. Planning of Audit:

- (i) To maintain a database of available manpower resources for effective deployment.

- (ii) To maintain data of units to be audited mandatorily and others to be audited on the basis of risk analysis.
- (iii) Selection of unit on the basis of: -
 - a. Risk parameter,
 - b. Board's guidelines, and
 - c. Available manpower.
- (iv) Maintenance of assessee master file (details in Standard Audit Programme in Part II).
- (v) Planning the audit schedule in such a way so as to make optimum use of available resources.
- (vi) Ensuring proper desk review before commencement of audit.
- (vii) Ensuring audit follow-up.

2. Co-ordination of Monitoring of Audits.

For monitoring of audits the Commissioner should call a meeting, which should normally be held once a month. The meeting should be headed by the Commissioner and should be attended by the Audit Cell, Supervisory Officers of the Audit Teams, the concerned Divisional Deputy/Assistant Commissioner where required. The meeting should examine the sustainability of each audit objection and set out the future action points in the circulated minutes, which would be drawn and forwarded to the concerned field-officer alongwith the copy of relevant Audit Report. It should also examine the overall working of the audit system and identify the areas requiring special attention including training requirement.

3. Performance appraisal and Quality Assurance:

For achieving some of the aforesaid objectives, the Audit Cell should also simultaneously put up the Working Papers on each audit for monthly evaluation and scoring. The emphasis of the scoring system would be on conduct of audit in accordance with the norms laid down in this Manual and the Working Papers, and also the results achieved. The Scoring system divides the entire process of audit into five parts: (i) preparation of the Audit Plan; (ii) conduct of audit; (iii) revenue points raised (major objections and their quality); (iv) realisation of revenue; and (v) issues relating to future compliance by the company. A greater responsibility, therefore, rests on the senior officers to duly assess the reports and bring

out the strength and weaknesses of the Audit Reports. Such regular appraisal would help in steering the audit into areas, which are the core of the new audit system by making good the deficiencies noticed. The scores of each team in different areas of audit should be reviewed every quarter. If the quarterly average in a specific field is found to be below 60 marks, immediate re-training of the concerned auditor for the subject should be organised. The cell should discreetly gather views from the trade/industry regarding the system of audit. Standard feedback format should be designed by the cell for this purpose. The conclusions of the cell should be an input for taking responsive measures. This cell should prepare a comprehensive report highlighting the areas needing training and quality improvement.

6.4.3 Role of Senior Officers:

I. Commissioner:-

A. Infrastructure

1. Training: Assess the training needs of the auditors and organise regular training programmes.
2. Posting: Post skilled and experienced officers to the audit section.
3. Infrastructure: Look into the infrastructural requirements of the audit section and take action as required.
4. Vehicle: Provide vehicles to audit parties during audit.
5. Data Capture: Ensure that the Excise Returns (ER 1, 2, 3, 4, 5 & 6) data is captured on the system in a comprehensive and timely manner. Ensure that Copies of ER 4, 5 & 6 returns are available with audit in timely manner
6. Co-ordination between return scrutiny and audit: Ensure that the returns filed in the range/division are duly scrutinised and the results conveyed to audit in a timely manner.

B. Audit Process

7. Selection: Devise strategy to prioritise audits by applying local risk parameters.
8. Profiles & Registers: Ensure that assessee profiles and registers are maintained and updated regularly.

9. Monitoring Committee: Hold regular monthly meetings of monitoring committee to review the objections raised by the auditors and to finalise the objections.

C. Co-ordination between Audit & Anti-Evasion

10. Co-ordinate between audit and anti-evasion sections for quick action wherever required.
11. Timely intervention in cases where the audit process becomes ineffective owing to non-cooperation by assessees.

D. Follow up, Performance Appraisal & Feedback

12. Interact with senior management of the assessees in cases of major detections to persuade them to make voluntary payments.
13. Review the performance of the auditors and take steps for improvement.
14. Interact with the major taxpayers in order to obtain feedback on the audit system.
15. Take remedial measures on performance appraisal of the audit section (conveyed as Audit Performance Index gradings by D. G. Audit every quarter) and the findings of the Quality Assurance Review by DG (Audit).

II. Additional/ Joint Commissioner (Audit):

1. Co-ordination, planning and overall management of the audit branch.
2. Formation of the Audit Parties and Audit Cell.
3. Organizing training programmes for auditors.
4. Final selection of non-mandatory units to be audited during the year on the basis of risk assessment.
5. Approving the Audit Plan after ensuring that all the steps have been completed.
6. Scoring and evaluation of Audit Reports.
7. Reviewing the follow-up actions and maintenance of records/registers in audit section.
8. Interacting with senior management of the factories paying annual PLA revenue of over Rs. 5 crores at the stages of Audit Plan and post audit discussion whenever such factories are taken up for audit.

9. Ensuring timely submission of Quarterly audit reports and other reports.
10. Interacting with the officers of DG (Audit) during the Quality Assurance Review.

III. Deputy/Assistant Commissioner (Audit):

1. Co-ordination, planning and day to day management of audit section.
2. Ensuring preparation/updating of assessee master file and ensuring that the copies of all the returns and documents are available.
3. Organising training programmes for the auditors.
4. Formation of Audit Parties and Audit Cell.
5. Preparing the list of non-mandatory units to be audited during the year on the basis of risk assessment.
6. Preparation of audit schedule with dates for each unit.
7. Supervision and approval of each of the steps leading to preparation of Audit Plan.
8. In select cases, interviewing the officers of the assessee during visit for preparing Audit Plan.
9. Visiting the units and suitably participating in the conduct of audit as frequently as possible especially in sensitive factories.
10. Scrutinising the Verification Report and the draft Audit Report.
11. Discussion with the assessee regarding audit objections and persuading the assessee to pay the dues.
12. Ensuring the maintenance and upkeep of all records and registers.
13. Ensuring the submission of Quarterly audit reports and all other reports in timely manner.
14. Taking followup action on final audit reports and ensuring minimal pendency of confirmed audit paras.
15. Interacting and assisting the officers of DG (Audit) during the Quality Assurance Review.

IV. Divisional Officers:

1. Provide data to audit branch to build up data base. (Please refer to Chapter 9 on Assessee Master File).
 2. Timely submission of copies of ER4, ER5 & ER6 to the audit branch.
 3. Discussions with auditors on audit findings prior to preparation of Audit Report.
 4. Taking follow-up actions on audit objections.
 5. Suggestions regarding selection of units for audit.
 6. Ensure that the returns filed in the range/division are duly scrutinised and the results conveyed to audit in a timely manner.
- V. Assistant Commissioners/Deputy Commissioners in-charge of other Sections in Headquarters.
- i. The details of orders-in-original passed by ACs/DCs accepted/appealed against may be submitted once in a month to the Audit Cell for their information.
 - ii. Important CESTAT decisions specially on appeals filed by the department before the CESTAT should be brought to the notice of the audit cell on a quarterly basis.
 - iii. The technical branch would ensure that copies of general circulars are sent to audit cell and important notifications, which have a bearing on the department's work, are highlighted.
 - iv. Give to the audit cell every month details of all show cause notices issued.
 - v. The anti evasion branch must give the details of all upto date important detections to Audit Cell.
- 6.4.4 Computer Cell, Hqrs. Office would,-
- a. make available the assessee profile in the SERMON package to the Audit cell.
 - b. make the ER-1/ER-2 data available to the audit system on a monthly basis.
 - c. also generate trend analysis reports in respect of units in the Commissionerates for use by the Audit Cell.

Chapter 7: GUIDELINES FOR AUDIT IN SPECIAL SITUATIONS

7.1 Multi-location or Inter-connected Units:

7.1.1 Definition

Following are the examples of multi-location or inter-connected units:

it would cover only:

- i. A single manufacturer having more than one manufacturing unit for similar goods; or
- ii. Two or more manufacturing units, which are “related persons” in terms of section 4 of the Central Excise Act, 1944.

7.1.2 IDENTIFICATION OF UNITS:

For units at category (i) the headquarters of the Directorate General of Audit would generate the list of assessees by using the SERMON database, with the following exclusions

- (a) Registered depots/ dealers bearing the same PAN number.
- (b) Any group of such units located entirely within the jurisdiction of the same Commissionerate (i.e. having the same location code), they would not be treated as MLUs.

The preliminary list would be generated by the 15th of April in each financial year and circulated on CD or any other electronic media to the Zonal ADGs. It would have the following details.

- A. ECC No.
- B. Name of the Unit.
- C. Location Code.
- D. Name of the Commissionerate.
- E. Address of the Unit (registered premises)
- F. Address of the Head Office (where it is different from the registered premises)
- G. Total Central Excise revenue in the preceding financial year.

Since data available in SERMON does not separately flag or recognize “related” units, it would not be possible to identify category (ii) units in this manner. These would have to be identified by the respective

Commissionerates on the basis of scrutiny of their financial records at the time of audit. The Commissionerates would be asked to henceforth maintain a database of units in their jurisdiction that have transactions with “related” persons either within the Commissionerate or outside.

7.1.3 **PRELIMINARY SELECTION OF UNITS:**

In the normal course, the preliminary selection of units for coordinated/ simultaneous audit would be done by 31st April of each financial year. There would be a two-pronged system of selection of units for audit. Units falling within category (i) would be selected by the zonal units. They would select **not more than five groups of units for coordinated audit per annum from this category**. For this purpose, the jurisdiction of each ADG would extend only to those units whose corporate office or Head Office is located in his jurisdiction. The selection would be based on the following criteria:

- (i) Units manufacturing sensitive or evasion prone commodities or commodities showing an adverse revenue trend;
- (ii) Groups having one or more units in Commissionerates where the area-based exemption is available; or
- (iii) At random.

For units falling under category (ii), the initiative for selection would have to come from the jurisdictional Commissioner. For these units too the location of the Head Office or the Corporate Office would be the criterion for deciding which ADG would handle the coordinated audit. The reasons for selection of such units could be:

- (i) non-availability of all records relevant for Central Excise audit in the registered/ factory premises;
- (ii) the centralization of some important business function such as purchases, booking of business or sales in the Head Office; or
- (iii) any other, to be communicated by the Commissioner in writing to the concerned ADG.

7.1.4 **FINAL SELECTION – ESSENTIALITY TEST**

The final selection of groups for the year would be based on an essentiality test to be applied by the zonal unit. No unit would actually be

taken up for coordinated/ simultaneous audit unless it passes the essentiality test. It would be meaningful to subject the units in a group to coordinated/ simultaneous audit only if the nature of relationship between them or between them vis-à-vis the Head Office is such that it would not be possible to verify issues material for Central Excise audit through “stand-alone” audits as for instance where some critical business function is centralized in Head Office. A coordinated / simultaneous audit would also be required where some critical business records are maintained in the Head-Office or financial statements such as the Balance Sheet or Profit and Loss Statement are not available unit-wise but for the company as a whole. The existence of these circumstances is likely to have an impact on the unit’s compliance with Central Excise law (e.g. valuation of goods, availment of CENVAT credit etc.). These issues would not be evident and would, therefore, require examination by the Zonal ADG. For this purpose, the zonal units would be required to obtain information from the units selected on a preliminary basis in a standardized questionnaire. A copy of the same is at **Annexure U**. The Zonal Unit would approach the corporate office or the Head office of the selected unit for filling up this questionnaire. If needed, the concerned ADG could arrange a meeting between his team and the management of the auditee company for this purpose. The advantage of such interaction would be that the evaluating team would clearly understand the issues involved. Based on the feedback given by the team and the responses in the questionnaire, the ADG would decide whether or not a simultaneous audit is warranted in a particular case.

7.1.5 **SCHEDULING OF MULTI-LOCATION UNIT AUDITS:**

Unlike the present scheme, where the audit of units forming part of a MLU is coordinated, in future, it is proposed to schedule the audit of all units in a group **simultaneously**. Only units that pass the essentiality test would be scheduled for simultaneous audit. The zonal ADGs would prepare a quarterly schedule of MLU audits (for all four quarters of the year simultaneously) latest by 31st of May of the financial year. These audits should **invariably be scheduled in the last week of every quarter**. In order to minimize the chances of a clash between the normal

audit schedules prepared by the Commissionerates and these, each Commissionerate would earmark the last week of every quarter for such audits and should accordingly keep one audit team free for the purpose. As Commissionerates would have the names of the selected units in advance, it should be ensured that they are not included in the normal audit schedule of the Commissionerate for that year. In case any of the units of the group have already been audited during the current audit cycle, the ADG would have to decide whether there is a need to include it in the MLU audit.

7.1.6 **PREPARATION OF AUDIT PLAN:**

The concerned Commissioners should ensure that the audit team that is assigned the audit of unit(s) in his jurisdiction completes the Desk Review and prepares the draft Audit Plans at least three weeks prior to the verification date. A copy of the draft Audit Plan duly approved by the Joint/ Additional Commissioner (Audit) alongwith the Working Papers and extracts of the note-sheet portion of the audit file should then be sent to the coordinating ADG. It should be ensured that calculations done as part of the ratio analysis, trend analysis or revenue risk analysis are also sent.

On their part, the zonal unit should obtain the consolidated balance sheet, Profit and Loss Statement and other financial documents of the company from the Head Office/ Corporate Office for scrutiny. They should also use the information contained in the company's response to the questionnaire and that gathered during the interview with their management to clearly understand the role played by the Head Office in the conduct of business by individual units, the strength of internal controls, the availability of records in Head Office and the strength of internal controls. On this basis, the zonal unit should prepare its own draft audit plan for the Head Office/ Corporate Office. Once the audit plans for all the units forming part of the group are received the ADG should convene a meeting with representatives (one per team) of each audit team for finalization of audit plans. This would also be an opportunity for the ADG to explain the nature of relationship between the constituent units and common issues to be verified during the audit.

Similarly the audit teams of the Commissionerates may have identified certain issues that would need to be verified from the records / documents maintained at the Head/Corporate Office. The final audit plan for each unit would be approved by the ADG after the meeting and returned to the audit team.

7.1.7 AUDIT VERIFICATION & PREPARATION OF DRAFT AUDIT REPORTS

Any verification in the Head Office/ Corporate Office would be done by an audit team deputed directly from the zonal unit by the ADG while the individual manufacturing units would be covered by audit teams of the respective Commissionerates.

The audit teams should remain in contact with the zonal ADG when conducting verification so that any new issue detected at the time of verification can be quickly conveyed to the other audit teams. It should be the responsibility of the respective Additional / Joint Commissioner of the Commissionerate that each issue of the audit plan is verified by the audit team and findings recorded. As objections would eventually have to be raised against the individual units (and not the Head Office), the zonal ADG should send a copy of the verification report of the Head Office/ Corporate Office to each of the Commissionerates for finalizing their audit report. A copy of the verification report and the draft audit report of each unit should be sent to the ADG for record.

The Draft Audit Report of each unit would be finalized in the same manner as other audits i.e. by the Monitoring Committee headed by the Commissionerate.

7.1.8 QUARTERLY REPORTS AND MONITORING

Although the results of audits conducted in a coordinated manner would be included by the Commissionerates in their Quarterly Audit Reports, the zonal units should compile the results of MLU audits separately for each quarter and send it to headquarters latest by the 15th of the month succeeding that quarter.

7.2 Export Oriented Units.

7.3.1 The frequency for the audit of Export Oriented Units has been given in para 3.1.8 above.

7.3.2 While conducting the audits of EOUs, the auditors should examine the following issues in addition to the usual checks:

1. Whether approval of Board of Approval/ Development Commissioner / prescribed authority has been obtained; whether unit has become operational during validity of the letter of the approval; whether the items of manufacture and rejects conform to such approval;
2. Whether a unit actually has the manufacturing capacity as per the scale of production declared and approved in LOP by Development Commissioner.
3. Whether benefits of Customs/ Central Excise exemptions have been availed only on admissible items listed in the notifications; whether the goods imported/ indigenously procured duty free are required and conform to the declaration submitted to the Development Commissioner and are actually used for the manufacture/processing of export goods; whether such goods are available in the factory or otherwise accounted for;
4. Whether goods covered under all the CT-3 forms issued during the period of Audit have been received and duly accounted for; whether such duty free goods are properly declared in terms of description, value and quantity; and whether the capital goods, raw materials, components, etc. have been used within the prescribed period;
5. Whether any goods are imported in CKD condition in violation of the Foreign Trade Policy;
6. Whether there is any un-authorized removal of goods for job work;
7. Whether permission for DTA sales has been obtained and if so whether the details of foreign exchange earnings and utilisation, supplied to the Development Commissioner tally with the records of the unit; and whether the conditions of exemption notification are satisfied;

8. Whether, the goods under DTA sales have been correctly valued in terms of Customs Act read with Customs Valuation Rules and instructions issued by the Board; whether the DTA sale is within the prescribed limit and made on the basis of actual physical exports (and not deemed exports);
9. Whether excess DTA sales are effected at concessional duty by inflating the FOB value of exports.
10. Whether duty on DTA sales is short-paid by under-invoicing the value or mis-classification.
11. Whether the facility of partial conversion of DTA unit into EOU is being misused. Such misuse is possible, firstly, when the duty free capital goods or raw materials etc. are used by a non-entitled unit i.e. the DTA unit. Secondly, duty free imported goods may be diverted to the DTA unit and also the production of the DTA is shown as the production of EOU for obtaining concession which can easily be done especially, when two units shares common facilities and where they may not be under continuous Customs or Excise supervision.
12. Whether there is any fudging and concealing of non-fulfilment of conditions and non-fulfilment of export obligation by resorting to large scale inter-unit transfer; whether goods are removed against proper advance release orders and the material has reached the actual destination (Sometimes, EOU furnishes copies of only Shipping Bills as filed, as proof of export even though the goods are not exported under such shipping bills. Careful scrutiny of shipping bills will indicate that no goods have been exported and only shipping bill has been filed {and later withdrawn in some cases});
13. Whether export obligation as prescribed is shown as fulfilled under both EOU scheme and duty exemption scheme by double counting of the same exports.
14. Whether values of exports are being mis-declared for, showing the fulfilment of export obligation incorrectly.
15. Whether re-warehousing certificate has been obtained in case of goods sent for inter-unit transfer or else duty due has been

demanded; and whether goods claimed to have been exported have actually been exported.

16. Whether the CENVAT credit has been availed in accordance with the CENVAT Credit Rules, 2004.

7.4 Units availing Export Benefits:

7.4.1 Units availing the benefit of various export promotion schemes like EPCG Scheme, DEPB Scheme, Drawback, etc. are generally required to give declarations, under various authorities pertaining to non-availment of certain facilities (like CENVAT credit) under Central Excise Law. The auditor in such cases shall keep this point in view at the time of making Audit Plan, and also conduct the verification thereof.

Chapter 8: INTRODUCTION

8.1 The Standard Audit Program enumerates steps for conducting audit in a systematic manner and on sound auditing principles to assess the degree of tax compliance by the assessee. Therefore, it is important that the auditor should adhere to all the steps detailed herein thereby ensuring that all relevant areas are examined for compliance.

8.2 The auditor has to conduct the audit by scrutinizing all the records of the assessee maintained for his business. It is, therefore, of utmost importance that details of all the records maintained by the assessee in the course of his business are known to the auditor. For this purpose the auditor shall ensure supply of all relevant records by the assessee in accordance with his legal authority (Refer para 2.4 of Chapter 2 of Part I).

8.3 Normally the auditor should follow the audit steps sequentially unless there is sufficient reason for deviation. After completing each step the details of the scrutiny conducted and conclusions drawn must be recorded in the relevant Working Paper before proceeding to the next step. This would ensure that no relevant detail is lost sight of.

8.4 The steps detailed in this document are based on sound auditing principles. It is, therefore, necessary that the auditor should be aware of the basic principles of accountancy and auditing. It is recommended that auditor should study books on accountancy specially those explaining the financial records.

8.5 The auditor should also keep himself abreast of the changes in the law and procedures, upto date exemption notifications and instructions issued by the Board from time to time. For this purpose they should keep copies of these documents and should consult the Electronic Library circulated to the departmental officers. In case such provisions or instructions contradict any part of this document, the former should prevail.

8.6 An auditor can verify the level of tax compliance mainly from the records made available to him or facts noticed during the tour of assessee's premises. However, during the course of audit if the auditor has sufficient grounds to suspect any duty evasion, which is beyond the scope of audit to investigate, he should report the matter to the senior officer for taking immediate suitable action. To illustrate, if there are reasonable indications of clandestine removals necessitating extension of enquiry to the consignees, the matter can be better investigated by anti-evasion wing of the Commissionerate.

8.7 The auditor can expect better audit results if he gathers information about the assessee, goods manufactured and general trade practices before conducting the audit. Careful scrutiny of the assessee master file and relevant information available in different sections of the Commissionerate, together with a sincere desk-review would, therefore, be essential.

Chapter 9: ASSESSEE MASTER FILE

9.1 A comprehensive Data Base about an assessee to be audited is an essential pre-requisite for selection of units as well as for undertaking preliminary Desk Review, for effective conduct of audit. A substantial amount of data is already available in the various sections of the Commissionerate starting from the details contained in the Registration Certificate. Some of the data like those contained in annual financial statements keep changing over years. The first step for conducting an effective audit is to collect all relevant information about the assessee from various sources, arrange it in a systematic manner and update it periodically so that the audit can be planned in a result-oriented manner. For this, it is necessary to maintain separate master files for each of the assessees.

9.2 The Assessee Master File should contain all the useful information of an assessee. The information should be in the form of statistical data as well as in narrative form. This file should be useful not only for the future audits, but also as a ready reckoner for the other purposes, such as for reply to the Parliament Questions and generating Management Information System (MIS) reports.

9.3 The Audit Cell would be responsible for the data management, updating and upkeep of the Assessee Master File. This file should invariably be created for each assessee. If not already done, it may be done immediately, in any case, before conduct of next audit.

9.4 The master file should be updated periodically after completion of each audit. The Audit Report, duly approved during the audit monitoring meeting, should be filed properly in the Audit Cell along with all the audit Working Papers. The copies of documents listed in **Annexure A** should also be kept along with the Audit Report. Some of these documents have to be collected from the assessee during the course of audit, while others are to be procured from the department.

9.5 The audit party should also furnish certain relevant information in the proforma, as in **Annexure B**, for electronic data entry by the Audit Cell. Initially, the auditor should carry a blank proforma of this Annexure, fill it up during the course of audit and submit it to audit cell with the Audit Report for data entry. For subsequent audit of the assessee, the auditor should take along a print out of the filled **Annexure B** for updating during the course of audit. The audit cell should periodically incorporate these changes in its database.

9.6 The Audit cell should maintain the Assessee Master File in two forms i.e. (a) hard copies of certain documents and (b) information in electronic format. All the hard copies of the documents should be placed in a separate file for each assessee, which should be allotted a unique serial number after a due entry in the file opening register of the Audit cell. The hard copies of the documents should be placed in the same order as they appear in **Annexure A**. The documents of one type should be placed in a chronological order with the oldest document at the back and the most recent document at the front (e.g. old and recent Audit Reports should be arranged in this sequence).

9.7 The hard copies of the documents should be maintained for a period of 5 years. Documents older than 5 years should be stripped/removed, unless they are relevant to any current proceedings. The disposal of any of the stripped documents should be done with the approval of the Deputy/Assistant Commissioner of Audit.

9.8 The Audit cell should allot a separate electronic folder to each assessee in the computer and make all the entries pertaining to that assessee in that folder only. The information provided by the audit party in **Annexure B** should be entered in the said folder. The date of the first entry of the proforma should be entered at the top of the first page of the proforma along with the name of the officer compiling the data. Normally, the folder should be updated after every subsequent

audit. However, the Audit cell, on a quarterly basis, should update the information that changes periodically. At the initial stages, most of the information would be available in the form of hard copies and the updating has to be done manually. Progressively, the information would be maintained in electronic format with automated data transfer through networking system and could be automatically updated.

9.9 When revised information in **Annexure B** is received from the audit party, the information should be updated accordingly. The date of last updating should be mentioned at the appropriate place on the first page of the proforma.

9.10 Keeping in view the security of the information, the hard copies should be made accessible only if the information contained therein is not available in the electronic format. In any case, the file containing the hard copy should not be taken out of the Audit cell unless permitted by the head of the Audit cell and after due entry in the file movement register. The information contained in these files would, however, be available to all the officers for any legitimate official purpose.

9.11 The electronic data should be kept in properly secured format so that it can be altered or modified only by the authorized officer of the Audit cell. The data should, however, be accessible to all the concerned officers.

Chapter 10: PREPARATION FOR AUDIT

The principles for selection of units for audit have been indicated in Chapter 3 of Part I.

10.1 **Actions to be taken by the Audit Cell for selection of units for audit.**

The annual audit exercise begins with Audit Cell undertaking the following steps:

10.1.1. The Audit Cell of each Commissionerate should maintain an updated list of all the registered assessees (including Export Oriented Units) in the Commissionerate as on 31st March of the preceding financial year. The activity of selection and allocation has to be carried out during April of each year.

10.1.2 The list of units should be segregated into categories - mandatory and non-mandatory category. The non-mandatory category should be further broken down in to separate lists according to the various slabs of duty payment as per the latest instructions of the Board regarding threshold limits for audit. The lists should be prepared on the basis of revenue data of the preceding financial year. The existing Board's instruction regarding threshold limits and periodicity of audits in different categories are as under:

- (i) All units paying annual revenue (Cash + CENVAT over Rs. three crores - to be audited every year.
- (ii) The units paying duty (Cash + CENVAT) between Rs. 1 crore and Rs. 3 crores in a financial year – to be audited once in 2 years.
- (iii) The units paying duty (Cash + CENVAT) between Rs. 1 crore and Rs. 50 lakhs - to be audited once in 5 years.
- (iv) 10 % of the units with an annual revenue yield (Cash + CENVAT) of below Rs. 50 lakhs - to be audited every year.

The units in the non-mandatory category are to be selected on the basis of risk assessment. D. G. (Audit) would circulate the list of assessees in each slab of non-mandatory category by 15th April of each year. The list arranged in the descending order of rupee risk would contain the name and registration number of the assessees and the rupee risk.

10.1.3. The Audit Cell should prepare an annual list of assessees to be audited during the year by picking up units from the above lists. While selecting the assessees from non-mandatory category the officers should apply the local risk parameters. A list of local risk parameters is available in para 3.1.7 of the CEAM and can rearrange the assessees in list provided by DG (Audit). The reasons for such rearrangement should be recorded.

10.1.4 The annual list so prepared should then be broken down into quarterly list by applying the Work Load Analysis technique. This is a technique by which the Audit Cell calculates and estimates the number of units that can be audited in the Financial year and each quarter. A simple formula has to be used by working out the number of working days and the norms for number of days for each category of audit, existing number of units and the number of auditors/audit parties available in the Commissionerate. It also enables the senior officers in charge of IAD to increase or decrease the number of parties.

10.1.5 The final stage of selection is the preparation of quarterly schedules. After preparation of the quarterly list the Audit Cell is required to allocate the unit(s) to the different Audit Parties, by taking into account the profile of the auditors. The allocation has to be carried out methodologically with due approval of Additional/Joint Commissioner in-charge of audit. While preparing the schedule care should be taken to ensure that all units to be audited mandatorily during the year are fully covered. As regards the non-mandatory units, a schedule of units to be audited should be prepared in such a manner that the high-risk units are placed at the top. This will ensure that in the event of time overrun in conducting some of the audits, only the low risk units are left unaudited. The list should also contain 5 % of Reference Units i.e. units that show low risk as per the list circulated by DG (Audit). This would in judging Such schedules should be made well in advance so as to ensure that all units listed to be audited receive the intimation atleast fifteen days before the commencement of audit. In case the units have related units, interconnected units, and separate Head office etc. (multi-location units), located within the

Commissionerate or outside the jurisdiction of that Commissionerate, the audit schedule should be made in the manner laid down in paras 7.1.3, 7.1.4 and 7.1.6 above.

10.2 **Auditors Profile.** Profile of each of the auditor posted in the IAD should be available in the Audit Cell. The format and contents of the profile is provided in para 3.2.2 of the Central Excise Audit Manual. Auditors profile facilitates effective deployment of units to auditors by taking into account appropriate skill levels, training, educational background etc.

10.3 **Allocation of audits amongst the audit parties:** The audit schedule should also mention the Group No. of the audit party to conduct audit of a particular unit. The allocation of the audit of a unit to a particular group should be done carefully depending upon the experience and specialisation of the auditors, e.g. in case of an audit involving scrutiny of complex accounting documents, auditors with Commerce background should be selected. Besides, the services of Assistant Director (Costs) should also be utilised effectively. Similarly, for audit of units maintaining accounts in electronic format, a computer-savvy audit team should be preferred. If the situation demands, the audit parties can be reconstituted as per the needs. It must be ensured that the team members of the audit party are fully trained for conducting audit in accordance with the guidelines in this manual.

10.4 **Action to be taken by the auditor:** Once the audit schedule, with team allocation, is finalised, the action shifts to auditors. The auditor should have adequate time to complete the preparation for audits to be conducted as per the quarterly audit schedule. It must be kept in mind that the outcome of all steps, (as listed below) prior to preparation of Audit Plan, would culminate in an Audit Plan. Therefore, the auditor should record each step in the relevant working paper before taking next step.

- (a) Assessee's profile.

- (b) Nature of business operations.
- (c) Assessee Master file.
- (d) Rupee risk and local risk factors.
- (e) Selection.

Preliminary or Desk Review

10.4.1 This is the first phase of the audit programme done in the office. The idea is to gather as much relevant information about the assessee and its operations as possible before visiting the unit. A good Desk Review under the supervision of senior officers is critical to the drawing up of good Audit Plan.

10.4.2 The auditor should immediately refer to the Assessee Master File (**Annexures A and B** refer). Study of the Assessee Master File could throw up important points, which may merit inclusion in the Audit Plan. In addition, the auditor should also obtain the latest Trial Balance Sheet, Tax Audit Report, Annual Financial Statement, Cost Audit Report or any such document prepared or published after last updating of Assessee Master File. From the scrutiny of these documents, certain points may further emerge for inclusion in the Audit Plan. The auditor should also incorporate the result of any parameters brought to light by risk analysis into the desk review for pin pointing specific issues for scrutiny during audit. An illustrative list of important areas to be scrutinized from the audit angle is given at **Annexure C**.

10.4.3 From the Assessee Master File, Trial Balance and Annual Financial Statements (Profit & Loss Account and Balance Sheet) it is possible to work out important financial ratios. The said ratios should be compared with the ratios of earlier year and wherever significant variation is noticed, these areas may be selected for audit verification. It may be kept in mind that any adverse ratio is only an indicator for verification of such an area and there may be valid reasons for the same. Therefore, only on the basis of such an adverse ratio, a point for verification can be selected. An illustrative list of important ratios is given at **Annexure D**.

10.4.4 At this stage, the auditor should also take into account the following facts, -

- (i) The reason for selection of a unit (to give an idea about potential problems).
- (ii) Results of last audit/ audits.
- (iii) Anti evasion profile and any such action in progress, if any.
- (iv) Availment of any conditional, full or partial exemption.
- (v) Special benefits availed under various export promotion schemes.
- (vi) Pricing and marketing patterns in case of ad valorem rates.
- (vii) Returns filed with State sales tax, Income tax Department, Banks and such agencies.
- (viii) Industry specific reports submitted to various Departments.
- (ix) Units having large imports.

10.4.5 Some of the other documents which auditor would find useful for carrying out Desk Review are listed under **Annexure `E**. Documents which need to be perused while formulating the Audit Plan and conducting the subsequent verification are given at **Annexure M**. The auditor should go through the same at the Desk Review stage as well.

Revenue Risk Analysis:

10.4.6 Risk Analysis is a method of identifying potential revenue risk areas by employing modern techniques. It can be carried out by (i) reconciling various specific financial data, comparing it with different business accounts/documents, (ii) deriving certain data and comparing with the actual figures of the financial document & (iii) comparing the key data figures of the unit with the average all industry figure of similar kind (if available) or part figures of the same assessee. For example, excise duty payment shown in the returns can be reconciled with that shown in the financial accounts. Further, from the reconciled figure of excise duty payment, assessable value of the sales can be worked out. This can then be compared with the sales figure shown in financial records. The difference, if any, must be analysed. The unit assessable value of the assessee can be compared with that of another assessee manufacturing the same item. This method would give an idea whether the valuation and duty calculation system of the assessee is high/low risk area.

An illustrative example is annexed as **Annexure F**

Trend Analysis:

10.4.7 Trend analysis is a type of computational support needed for the analysis preparatory to planning, by analysing historical data and working out future projections. Historical data is analysed to discover patterns or relations that would be useful in projecting the future production, clearances and values etc.

10.4.8 For audit purposes either absolute values or certain ratios are studied over a period of time to see the trend and the extent of deviation from the average values during any particular period.

10.4.9 The auditor can study the trend of following data.

1. Gross operating profit vis-à-vis sales. Whenever the Gross profit has either declined or remained constant despite increase in production and sales, a detailed study may have to be undertaken to see whether there is any undervaluation. Conversely, an abnormal increase in gross profit without commensurate increase in the sale value may indicate suppression of clearance and sale or undervaluation
2. CENVAT as a percentage of either PLA or the total duty paid. Large variations in such ratios merit detailed examination.
3. Trends of production of finished goods as well as scrap.
4. Trends of production of dutiable goods vis-à-vis exempted goods.
5. Clearance of excisable goods for home consumption as well as for export.
6. Value of sales to related person vis-à-vis total sales.
7. Movement of goods on job work in terms of quantity over a period of time vis-à-vis total production (in quantity).
8. Input-output ratio as reflected in ER-5 return for last 3 years.

10.4.10 The summary results of Desk Review, alongwith the completed Working Papers, should be submitted to the Deputy/Assistant Commissioner (Audit) for approval and guidance, if any.

Gathering information about assessee and his internal systems:

10.4.11 Before start of audit verification, the auditor should know the functioning of various areas, like marketing, production, purchase, stores

and accounts. Such information can be gathered from the heads of various sections of the assessee during a brief preparatory visit to the unit before verification. However, in case of assessees paying annual revenue (Cash + CENVAT) below Rs. 3 crores, the Assistant/Deputy Commissioner (Audit) may decide whether this visit could be combined with audit verification keeping in mind the size and complexity of the unit or prescribed duration norms. The auditors should also go through the working papers prepared in the last audit in order to acquaint with the broad procedures followed by various sections of the assessees as part of the Desk Review. The auditors may fix appointment with various section heads and during discussions the overall functioning of the unit can be found out and at the same time officers of the company can also explain various procedures adopted by them. Various types of records maintained for internal control purpose and reports generated by the units can also be found out by the auditors during discussions. Any important happenings like fire or natural calamity, introduction of new products, overall scenario of industry, new marketing techniques, new discounts, action of competitors etc. can also be found out by the auditors.

Points noticed during desk review can also be enquired at this stage. Generally, the discussion with the senior management should be handled by the senior members of the audit party at the level of Assistant / Joint Commissioner because it requires tactful handling of senior officers of the company. However, questioning should not take the role of interrogation and it should be restricted to fact finding. For this purpose, a sample questionnaire has been prepared for discussion in the areas like purchase, sales, stores, tax accounting, job work given in **Annexure J**. However auditors may add more questions depending upon the nature of the industry.

10.4.12 At this stage, the audit team should also determine the sections/ parts / departments of the unit, which it intends to tour. In case, the assessee is not forthcoming with the required information during the visit to factory, the auditor should himself make a systemic study of the assessee and fill up the relevant Working Papers. The

auditor should start with an overview of the assessee's business and organisation. This should be followed by a detailed review of various sub systems, with special attention to those having impact on the tax liabilities (i.e., raw material receipt storage & issue; sales & purchase accounts; production records; finished goods issue and despatch etc.). Assessee maintains number of accounts and documents and also files number of returns with other departments. A general review of all these documents would give the auditor a broad view of the activities of the assessee.

10.4.13 **Scrutiny of Annual Financial Information Statement (ER-4)**

ER-4 return is required to be filed every year by the assesseees who are paying PLA revenue of more than Rs. one crore. This return contains various information regarding raw material purchase and consumption, sale of excisable and non-excisable goods, sale of exempted goods, sale of trading goods, various other income received by the assessee, CENVAT credit availed etc. The information given in this return is very important because this information need to be compared with the information available in the financial statements like Profit & Loss account, Balance Sheet and Notes to the Account. Some of the information is required to be compared with the periodic returns filed by the assessee. The detailed verification for various items given in the ER-4 is given in **Annexure M**.

Audit Plan

10.4.14 Audit Plan is the most important stage before conduct of audit. All the previous steps are actually aimed at preparation of a purposeful Audit Plan. Therefore, it is important that all previous steps are completed and the relevant Working Papers of each of the steps filled up before commencing its preparation. By now, the auditor is in a position to take a reasonable view regarding the vulnerable areas, the weak points in the systems, abnormal trends and unusual occurrences that warrant detailed verification. Certain unanswered or inadequately answered queries about the affairs of the assessee may also be added to this list.

10.4.15 Audit Plan should be a detailed plan of action, preferably in a standard format. The Audit Plan should be consistent with the

complexity of the audit and the reasons for selection of specific issues for audit. It must specify, -

1. Subject: - For example availment of exemption, valuation, CENVAT etc.
2. Specific Issue to be verified: - Under this column, the auditor should mention the precise issue pertaining to the subject. For example, discounts passed on to the buyer, utilisation of inputs for repair/re-processing, etc.
3. Source Document/ Information to be verified: - documents/information reflecting or having a bearing on payment of Central Excise duty, to be verified. For example Central Excise Invoice showing a particular discount and original invoice under which CENVAT credit is taken.
4. Back-up Document: The documents to be examined to check the correctness of the information contained in the source document. The method of examination may also be specified under this column. For example commercial invoice, customer ledger, discount policy documents, price circulars, etc. reflecting the said discount.
5. Period of coverage: - Normally, the coverage will be for the whole of the audit period. However, the auditor may cover a specific extended past period after recording reasons and obtaining permission from senior officer.
6. Selection Criteria: - In case, the volume of documents for verification is very large, the auditor may adopt sample verification after recording reasons for the same. In such a case, the sample selection techniques should be spelt out in the Working Papers. The sample should be chosen in such a way that it is a true representative of the whole.
7. Verification Serial Number: It is the paragraph number of the Verification Paper showing the result of verification conducted by the auditor (please see para 11.4 of this section and heading S. No. 15 in Working Papers in Part III of this Manual). Verification Paper is part of Working Paper for a distinct record of each issue identified in Audit Plan as actually verified during Audit.

10.4.16 The Audit Plan must be discussed with the Deputy Commissioner / Assistant Commissioner (Audit) and should be finalised after approval by the Additional/Joint Commissioner (Audit).

An illustrative example for filling in the Audit Plan is annexed as **Annexure H**.

Chapter 11: AUDIT VERIFICATION

11.1 Audit verification is done on the lines of the Audit Plan for checking the correctness of tax payment by the assessee. While conducting the verification, the auditor should try to determine whether the apparent weaknesses in the internal control system of the assessee has led to any loss of revenue. He should also identify the procedural infractions on part of the assessee, which are recurrent in nature and which may obscure a vital fact. During the process, he must cross check the entries made by the assessee in various records and note discrepancies, if any. In all cases involving discrepancies or unexplained variations in trend-ratios, the auditor should make detailed enquiries regarding the cause of the discrepancies and their revenue implication. Illustrations in this behalf are given in **Annexure G**.

11.2 The auditor should examine the documents submitted to various Government departments/agencies like Customs, Income Tax, Sales Tax, Banks, etc. by the assessee. This should be used in cross verification of the information filed by the assessee with the Central Excise department. For example, examination of sales tax returns with other relevant factory records can help the auditor in ascertaining the clearances and discharge of duty.

11.3 The audit verification is not a mechanical process. This gives maximum opportunity to the auditor to go through the assessee's records in his unit. Therefore, auditor may come across a new set of information or documents, not earlier known, during any of the earlier stages. Further, while examining an issue, the auditor may come across a fresh issue also requiring detailed examination. In such a situation, the auditor should go beyond the scrutiny envisaged under the Audit Plan after obtaining the approval of his Dy. Commissioner/Asst. Commissioner and recording full reasons thereof. Despite audit verification being a structured process, it is flexible enough to accommodate the spot-needs.

11.4 The auditor should conduct the verification in a systematic manner, following the sequence of steps, envisaged in the Audit Plan, as

far as possible. He should also complete the relevant verification paper on completion of each step in format given as **Annexure I** (para 15 of Working Papers). Each verification paper should be given the same serial number, which appears for that issue in the Audit Plan. The issues, which are added later, should normally appear at the end.

While the process of verification for each audit would be unique in terms of Audit Plan, it should involve some general steps as discussed below:

Tour of Premises/Plant:

11.5.1 A physical tour provides confirmation of much of the information gathered during previous steps and it also helps resolve issues noted earlier. It helps the auditor to familiarise himself with the manufacturing processes, identify the intermediate goods, by-products and wastes/rejects and locate activities not declared by the assessee or otherwise escaping notice. During the tour to a particular section, the auditor should physically verify the samples of each of the listed documents maintained in that section. The auditor should be accompanied by one of the senior managers, plant manager and /or the plant foreman and should obtain clarification from them, as necessary, on any issue. During the tour the auditor should go through the ground plan of the factory and process charts to get an overview about the layout and the activity of the unit. The plant tour should cover all areas, from receipt of raw material, through manufacturing process, to the finished goods, storage and the shipping areas. The auditor should ensure that he encompasses each and every aspect necessary for him to complete the Audit Working Papers. Before undertaking the tour to the factory, the auditor should also prepare a Questionnaire to gather information for evaluation of internal controls of the assessee. An illustrative Questionnaire is placed as **Annexure J** for guidance of the auditor though he can modify the same according to the need.

11.5.2 The purpose of this tour is to gather information from the assessee about the various systems followed by him in the areas of purchase, stores, sales, job work, tax reporting etc. This information can be test-checked by conducting walk through.

Evaluation of Internal Controls:

11.5.3 An evaluation of Internal controls helps in formulating a detailed programme of verification of relevant internal controls of the assessee. The level of deficiencies in internal controls would determine the coverage and depth of audit verification required for a particular sub-system in the unit. In this regard, an auditor would normally examine the following:

1. Characteristics of the company's business and its activities.
2. System of maintenance of records and accounts.
3. Identifying the persons handling records for Central Excise purposes.
4. Allocation of responsibilities at different levels.
5. System of internal checks.
6. System of movement of documents having relation to excise assessment.
7. Inter-departmental linkages of documents and information, and
8. System of assessee's own internal audit.

11.5.4 An auditor needs to acquaint himself with the systems of control and documentation in operation. This knowledge is obtained either by discussion with various managers or by going through documents like procedure manuals, organisation charts, job descriptions, flow-charts and records maintained. In the case of first audit, the auditor needs to maintain detailed written record of his observations of the internal control system.

11.5.5 It is essential to test the application of internal controls in practice to judge and form an opinion about how effectively the prescribed procedures are actually followed. This study will enable an auditor to assess the level of compliance and level of reliability of the prevalent internal control system. This is done by selecting a few representative samples from different categories of transactions and examining them in depth, especially with regard to the procedural and control aspects. This test can be carried out on the basis of the

information gathered in the format given in **Annexure J**. The above steps may have to be undertaken by the auditor in the unit of the assessee. Undertaking a 'Walk-through' and conducting ABC analysis during this process would help the auditor to evaluate the system of internal control in a scientific manner.

Walk-through:

11.5.6 'Walk-through' is a process by which the auditor selects any transaction by sampling method and traces its movement from the beginning through various sub systems. The auditor verifies this transaction in the same sequence as it had moved. By this method the auditor can get a feel of the various processes and their inter linkages. It is also useful method to evaluate the internal control system of an assessee. The auditor can undertake walk through process of sales, purchase, excise, account adjustment systems etc. Certain model 'Walk-through' routes are given in **Annexure K**. **Annexure C** gives utility of some of the documents/ registers of the assessee that can be made use by the auditor while undertaking Walk-through process.

ABC Analysis:

11.5.7 It is a known fact that in any field of activity an enormous data is generated and all data is not equally important. In order to filter out the irrelevant or relatively insignificant data, various techniques are applied and ABC Analysis is one of such data management technique. In ABC analysis the whole data population is classified into three categories based on the importance. A-category is the class of data that is most important from the point of view of managing and controlling the same. B-category is the class of data, which should invariably be controlled, but the degree of control is not as intense as for A-category. C-category is the class of data, which has much less revenue-implications and can be controlled by suitable test-checks.

11.5.8 The auditor can apply ABC Analysis specially in case the quantum of data/information to be analysed is voluminous. In such a case auditor can classify them according to their utility towards

potential risk into A, B and C categories. For example while dealing with the issue of CENVAT credit availment, the inputs involving lesser number of documents but higher value of CENVAT credit can be classified as category A documents and subjected to 100% detailed scrutiny. Invoices for other major inputs involving moderate number of documents as also less credit amount can be classified as category B documents and subjected to 100% standard checks. The balance documents pertaining to CENVAT, classified as C category can be subjected to sample test checks. The technique of ABC analysis can also be suitably applied for evaluating the systems of internal controls while carrying out verification.

11.5.9 As a result of the observations and test carried out, the auditor has to evaluate as to how far he can rely on the internal control system. He should assess whether the control procedures as prescribed and applied in practice are effective in preventing or detecting material errors and irregularities in the accounting system. This is essentially a question of a best judgement in a particular situation. If there exist certain errors or infirmities in the system, he should try to adjudge the impact of the same on tax compliance. Based on the evaluation, the auditor will grade the soundness of the level of internal control of each sub-system as “reliable”, “adequate” or “poor”. Thus, evaluation of Internal controls is important as it helps in determining the scope and duration of the audit.

11.6 In case of a EOU, the auditor has to lay special emphasis on verification of documents, registers and returns that are mentioned or filed either to the customs authorities or to the any other authority. Certain useful tips to conduct audit verifications, as well as drawl of Audit Plan, in such units are detailed as **Annexure L**. Similarly, units exporting under various export promotion schemes require special attention. Most of these schemes are available to the manufacturer exporters, only if they do not avail CENVAT credit. Further, the quantum of export benefits depends on fulfilment of prescribed conditions and the export sales price. Sales to DTA also constitute a sensitive area. The auditor should scrutinise the records and returns pertaining to these

schemes for verification of fulfilment of such conditions. The auditor should also verify the actual receipt and utilization of capital goods as well as raw material, imported or procured indigenously at concessional rates of duty under these schemes.

11.7 Apparently, the financial and other documents maintained by the assessee for his private use and in compliance of other statutes are of great importance which may reveal substantial short/non-payments of duty. **Annexure M** provides an illustrative list of such records/documents, as also the relevant information that can be gleaned from them. The auditor may take note of the same during 'Gathering information about the assessee and the system followed by him', and go through them during 'Audit Verification'.

11.8 If the auditor comes across particular type of document apart from the listed documents, which is useful for future audits, he may report the same through proper channel to Directorate General of Audit, New Delhi.

Chapter 12: PREPARATION OF AUDIT REPORT AND FOLLOW UP

Preparation of draft Audit Report:

12.1.1 After completing audit verifications, the auditor should prepare the verification paper (as referred to in the previous chapter). This document should record the results of verification conducted as per Audit Plan. Any additional issue (not mentioned in the original plan) verified/point noticed should also be mentioned. The auditor would then inform the assessee of each of such issues pointing out either short levy or procedural infractions. The initial views of assessee must be recorded in the verification document. Details of spot recoveries and willingness of the assessee to pay short levy should also be recorded. This document would then become the basis of preparing the draft Audit Report.

12.1.2 The draft Audit Report must be prepared in consultation with the Deputy/Assistant Commissioner (Audit), in standardised format as given in the Board's circular No. 514/10/2000 – CX dated 16.2.2000 (copy placed at **Annexure N**). The narration of the objections in the Audit Reports should be concise, to the point and self-contained. Where the objections are based on any circulars, clarification or a Section 37B Order issued by the Board, these should be quoted. Cases in which certain specified conditions are not fulfilled giving rise to objections should be clearly brought out. Similarly, where objections are backed by interpretations as decided by the court judgments or decisions made by the Appellate or Revisionary authorities or supported by technical literature, these should be cited. All objections should be sequentially numbered. The auditor should enclose the following documents alongwith the draft Audit Report:

- (i) Completed Working Papers of all the steps prior to Audit Plan with a summary report.
- (ii) Copy of Audit Plan.
- (iii) Copies of verification papers.
- (iv) Copies of all the documents/evidences in support of the objections, alongwith calculation sheets of the short levy details.
- (v) Copies of relevant documents listed in Annexure A in Part IV.

(vi) Copy of completed proforma as listed in Annexure B in Part IV.

12.1.3 The draft Audit Report should be finalised within the time frame envisaged by Board's Circular dated 16.2.2000, i.e. with 20-25 days of the commencement of the audit in the assessee's unit. Before submitting the draft Audit Report it should be given a unique serial number as follows:

A. R. No./Name of Commissionerate/Name of Division/Year.

Even a nil report should be allotted numbers. A. R. (Audit Report) No. is a running Serial No. to be given for the financial year. This should be obtained from 'Audit Follow-up Register' maintained in the Audit Cell. (see para 12.3.7). The information in columns 1 to 8 in the said Register should be filled up at the time of taking A. R. No. from the Register. The same unique Sr. No. will also be the File No. in Audit Section which will obviate any separate file number for the audit file and will facilitate linking any future correspondence from field formations to the concerned file.

Preparation of final Audit Report:

12.2.1 Auditor should submit draft Audit Report, to the Assistant Commissioner / Deputy Commissioner (Audit) alongwith all the enclosures, for examination and vetting. Thereafter the same, alongwith enclosures, should be submitted to Audit Cell for considering in Monitoring meeting. Please refer to para 6.4.2.

12.2.2 The Audit Cell should organise monitoring meetings periodically during which each of the audit objections/observations would be examined for its sustainability. To facilitate prompt decision, the jurisdictional Divisional and Range officers and the officers from the Technical branch should also attend these meetings to offer their views on the spot. The minutes of each such meeting should be drawn, pointing out the decision on each of the audit objection regarding its sustainability and directions for future action. The objections rejected by the meeting will be treated as closed. Similarly all points of a nil draft Audit Report are treated as closed after their approval by Additional/Joint Commissioner (Audit). Copies of the minutes should

be,- (i) enclosed with the Audit Report, (ii) sent to all officers required to take future action and (iii) kept in the master file.

12.2.3 Based on the decision of the monitoring meeting, the draft Audit Report should be finalised by the Audit Cell within fifteen days from the date of the meeting. In case of a nil draft Audit Report the same should be finalised with the approval of Additional/Joint Commissioner (Audit). The Audit Report alongwith supporting documents should be forwarded to the officer required to take further action. In case the action is required to be taken by the officers of other Commissionerates, the Audit Group will be responsible for sending the communication to the concerned Commissionerate through their Commissioner. This may happen in cases like points relating to Service Tax where service provider may fall in the jurisdiction of other Commissionerate or the assessee also manufactures similar items in a unit falling in other Commissionerate.

12.2.4 The Monitoring Meeting shall also evaluate the working of Audit Group in respect of each audit. The scoring of Audit Report and Working Papers should be carried out by the Commissioner and Addl. Commr./Jt. Commr. (Audit). As instructed in Ministry's Circular No. 514/10/2000-Cx dated 16.2.2000 the scoring committee should score the Audit Report and the Working Papers with a view to evaluate the standard of the audit conducted. Greater emphasis should be placed on the quality of Audit Plan and systematic conduct of audit rather than the quantum of detection of short levy and recovery thereof. The scoring system is not meant for reprimanding any auditor or fixing any responsibility but is aimed at assessing the quality of audit and correcting the shortcomings for future. A copy of scoring sheet as appearing in the said circular is enclosed as **Annexure O**.

12.2.5 Officers required to take action on an objection should forward the copy of the action taken documents (such as copy of SCN) to the Audit Cell. An objection should be closed after requisite action has been taken on it. In case new facts come to the knowledge of officers required to take action on an objection, which may involve re-consideration of findings in Audit Report, they should send their report with supporting material for reconsideration of the matter in the Audit

Cell. But this action must be taken most expeditiously, say within one month of receipt of Audit Report. Only in exceptional cases involving cogent grounds, the views taken in the Monitoring Meetings can be requested for re-consideration.

12.2.6 Each Audit Report should be examined by the Audit cell. Any objection with major revenue implication, objection peculiar to a particular industry or those describing a novel modus operandi should be selected for (i) issue of Modus operandi circular within the Commissionerate, (ii) for communicating the same to the Chief Commissioner's office for circulation within the zone (iii) communicating to Directorate General (Audit) for issue of audit circulars and (iv) communicating to Directorate General of Central Excise Intelligence for information.

12.2.7 On completion of the above procedure the Audit Cell shall place the documents in Assessee Master file (please see chapter 9 and Annexure A) and update the electronic file of the assessee (please see Chapter 9 and Annexure B).

Records to be maintained in the Headquarters Audit Section:

12.3.1. A register of units planned for audit (Audit Planning Register) in the format given below should be maintained in Audit Cell. It will facilitate in ensuring:

- (i) all units allotted to an Audit Group have been audited; and
- (ii) wherever audit has been completed, the Audit Reports are issued in time.

It will also ensure that if audit of any unit could not be taken up, the same can be included in the schedule for the subsequent period.

APR No./Sl. No. of the unit	Name of the unit	IAP No. & Name of the Supdt.	Proposed Month of Audit	Actual dates of visit to unit	Date of submission of report to Audit Cell	Audit Report No.	Date of issue	Remarks
1	2	3	4	5	6	7	8	9

The APR No. and Sl. No. of the unit shall be assigned by the Audit Cell while issuing the Audit Schedule. The Col. Nos. 1 to 3 shall be entered by the Audit Cell at the time of issue of Audit Schedule. The subsequent columns shall also be entered by the Audit Cell on receipt of a monthly Audit Performance Report discussed in ensuring paras.

12.3.2 To enable monitoring of the progress of audit after a unit has been allotted to an Audit Group, it is necessary that all the units included in the Audit Schedule should be entered in the Audit Planning Register and all further action taken should also be entered in this register. As already mentioned in paras 10.5 and 10.6, the Audit Schedule should be issued in each quarter to enable despatch of the advance audit intimation in time and also to plan the audit of large and small assesseees by the Audit Group as per overall convenience of the assesseees. For this purpose, each Audit Schedule should be given a unique Serial No. as follows:

ASR No./Serial No. of the unit/Year.

12.3.3 ASR No. may be given as ASR1/ASR2 and so on for each quarterly Audit Schedule. The Serial No. of the unit will be a running Serial No. starting from No. 1 at the start of the financial year. For example, if 25 units have been planned for audit in the Schedule of the first quarter of the year, the Serial No. of the units will run from No. 1 to 25. If 30 more units have been planned for audit in the next schedule, the Serial No. of the units will run from 26 to 55 and so on.

12.3.4 Monthly Audit Performance Report (Audit Group-wise):

Each Audit Group shall submit a monthly audit performance report by 2nd of each month to the Planning Cell in the following format:

Audit schedule No. / Sl. No. of the unit	Name of the Unit	Proposed month of Audit	Actual dates of visit to unit	Date of submission of AR to Audit Cell.
1	2	3	4	5

AR No.	Date of issue	Amount involved in Audit Paras	Spot recovery during Audit	Reason for non-completion of audit
6	7	8	9	10

Note: Column Nos. 8 & 9 should be filled up only when Audit Report has been approved by the Monitoring Meeting.

Alongwith the said report, an abstract of important audit objections should also be given to the Audit Cell. The said information would be used for preparing quarterly Audit Bulletins.

12.3.5 The Audit Cell shall update the Audit Planning Register based on the reports received from audit group. (Col. No. 4 to 8 of Audit Planning Register). This report will also be used for discussion during monthly meeting of audit officers to evaluate the performance of each Audit Group. In the 1st week of every month, an abstract of Monthly Audit Performance Report for all Audit Groups should be put up to Jt. / Addl. Commissioner in the format given below:

Abstract of Monthly Audit Performance Report:

Audit Group No.	OB of units to be audited	No. of new units planned for audit during the month	No. of audits completed during the month (AR issued)	Balance units for auditing
1	2	3	4	5

Period of Pendency			Total duty involved in objections raised during the month	Amount of Spot Recovery during the month
0 -1 months	1 - 2 months	2 - 3 months		
6	7	8	9	10

Note: (i) Amount in Columns 9 and 10 should be entered only for the units where Audit Reports have been approved in Monitoring Meetings.

(ii) Audit is treated to be completed only when an Audit Report has been issued.

12.3.6 The Commissionerates must have their own mechanism and records for tracking the details of adjudication and further actions like appeals pertaining to the show cause notices issued as a result of the audit objection

12.3.7 The details of Audit Reports discussed by Monitoring Meeting, the decision taken in the meeting and the further follow up action should be entered in the Audit Follow up Register (maintained in the format given below), as soon as the Audit Report is approved.

Audit Follow Up Register:

Audit Report No.	Name and address of the assessee	Range and Division	Registration No. of the assessee	Period of Audit	Dates of Audit (dates of visit to unit)	IAP No. and Name of Supdt.	Para No. and objection in brief for each para	Whether objection accepted by the Monitoring Meeting (yes or no)
1	2	3	4	5	6	7	8	9

Duty involved in each para	Spot recovery during audit	Duty recovered other than spot recovery before issue of SCN	Divisional file No.	SCN No. & date	Amount demanded in SCN	Reasons for closure of para	Date of closure of para	Remarks
10	11	12	13	14	15	16	17	18

Note: (i) Col. No. 1 to 8 shall be entered by Audit Group while obtaining the file number.

(ii) Col. Nos. 9 to 11 shall be entered by the Audit Cell before issue of Audit Report .

(iii) Col. Nos. 12 to 15 shall be entered on receipt of replies from Division.

The following abstract for each month should be put up by Audit Cell to Addl./Jt. Commissioner Audit by 10th of the following month.

Monthly Abstract of Audit Follow-up Register.

Opening Balance		Total No. of units audited during the month (Audit Note issued)	Paras accepted during the month for action		Total No. of Paras closed during the month		Total recovery during the month		Closing balance	
No. of paras	Total Amount involved		No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved
1	2	3	4	5	6	7	8	9	10	11

Period wise pending					
0 – 3 Months		3 – 6 months		> 6 months	
No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved
12	13	14	15	16	17

Note: The quarterly report to be sent to zonal Additional Dir. Gen. (Audit) shall be prepared based on this report.

12.3.7 The quarterly report in the following format is required to be sent to the Zonal Additional Dir. Gen. (Audit).

(A) Details of audits conducted

(Rupees in lakhs)

Name of the Commissionerate	No. of units scheduled for audit	No. of units audited	No. of revenue paras raised	Total short levy detected	Total recovery
1	2	3	4	5	6

(B) Action taken on final Audit Report paras accepted for action:

Opening Balance		Paras accepted during the quarter for action		No. of paras closed during the quarter and reasons					
				SCN issued		Amount recovered and paras closed		Other reasons like closure on merit	
No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved
1	2	3	4	5	6	7	8	9	10

Closing Balance		Period-wise pendency							
		0-3 months		3-6 months		6-12 months		> 1 year	
No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved	No. of paras	Total Amount involved
11	12	13	14	15	16	17	18	19	20

Follow up action on Audit Reports: -

12.4.1 All officers (such as Divisions/range, Headquarters preventive etc.) required to take future actions as per the minutes of the Monitoring meeting, should send a monthly status report of the action taken on the audit objections to the Audit Cell, latest by the 10th of the next month. The same should be used by the Audit Cell for updating the “Audit Follow Up Register” mentioned above. The Audit Cell should prepare monthly report on audit performance and follow up action. The proforma of monthly report on audit performance is given at **Annexure P** while that of the monthly status report is given in **Annexure Q**.

Chapter 13: ENHANCING TAX COMPLIANCE

13.1 The ultimate aim of conducting audit is to increase the level of assessee's tax compliance. Therefore, no audit can be considered to be complete unless the auditor has made all efforts to ensure maximum recovery of short levy before he leaves the premises of the assessee.

13.2 As the current Audit system adopts a transparent methodology, it is necessary that all the audit objections noticed by the audit party are conveyed to the assessee with a view to ascertaining his view point before preparing the draft Audit Report. Accordingly the audit objections should be intimated in writing to the assessee. It should be clarified in such written communication that the same is not in the nature of any show cause notice and is only a part of participative and fact-finding audit scheme under which even the preliminary and tentative audit observations are being shared with the assessee to know his view point. Where satisfactory explanation or evidence is submitted to the auditor, the findings should be revised as necessary after approval of Deputy/Assistant Commissioner (Audit).

13.3 It is the auditor's responsibility to explain all his objections to the assessee and to make all attempts to resolve any disagreements before they are finalised. It is also the auditor's responsibility to make sure that his senior is aware of potential disagreement and the position taken by the assessee.

13.4 The assessee must be advised of his rights and obligations with respect to items in dispute. However it should be pointed out that interest would continue to accrue in terms of Section 11 AB of Central Excise Act, 1944.

13.5 Where the assessee is in agreement with the short levy, as noticed, the auditor should persuade him to pay the duty promptly. The assessee can be informed that on making spot payment he gets the benefit of Section 11 A (2B) of Central Excise Act, 1944 except the cases covered by the Explanation 1 appended thereto.

13.6 Where a substantial amount remains unpaid, because of assessee's disagreement or otherwise, the auditor should attempt to collect any

information that will aid in future collection. This will include bank information, ownership of the assets and receivables, financial liquidity, cash flow situation or any other factor, which may help recovery of duty.

13.7 Before leaving the assessee's premises, the auditor must discuss future compliance issues with the senior management of the unit. Steps the unit management can take to reduce specific errors detected in the audit and to improve compliance and systems should be pointed out. Written or verbal assurances as given by assessee should be recorded in the Audit Report.

13.8 If there is any way the department can assist the assessee to reduce errors and improve compliance, attempts must be made to offer such assistance.

Chapter 14: WORKING PAPERS

INSTRUCTIONS FOR FILLING UP THE WORKING PAPERS

1. Each part of the Working Paper should be filled up on completion of the relevant audit step. The date on which such part is completed and Working Paper filled should be mentioned.
2. The completed Working Papers must be submitted by the audit team with the draft Audit Report (prepared as per proforma given in Annexure N in Part IV) forming the top sheet.
3. Copies of supporting documents/records/evidences referred to in the Working Papers must be annexed at the end. Each copy should be cross-reference to the relevant entry in the Working Paper.
4. The Working Papers form the basis of audit objection. They also show the detailed steps undertaken by the auditor during the preparation for and conduct of the audit. Therefore they should be filled carefully, giving observations and conclusions of the auditor duly supported by evidences/documents, wherever required.
5. The Working Papers should be filled in by the auditors themselves and in no case should be handed over to the assessee for filling them up.
6. Some of the entries appearing in the Annexure in Part IV may appear to overlap with the entries of the Working Papers. It must be kept in mind that SAP and Annexures are only for the reference and guidance to the auditor. Therefore the auditor should fill in the Working Paper taking into account the facts and circumstances of each case and not merely copy out the illustrations given in the Annexures in Part IV.
7. Before the conduct of audit verification, the Audit Plan should be approved and signed by senior officer not below the rank of Additional/Joint Commissioner in charge of audit. During the verification if any issue arises or is noticed the same may be verified after obtaining prior approval of the said senior officer.

Date of Preparation_____

W/P No._____

A. DETAILS OF AUDIT

1. DATE OF AUDIT:
2. DATE OF SUBMISSION OF AUDIT REPORT:
3. DRAFT AUDIT REPORT NO. :
(Pl. see para 12.1.2)
4. DETAILS OF THE AUDIT TEAM:

S. No.	Name of the officer	Designation

B. NATURE OF BUSINESS OPERATION OF THE ASSESSEE

1. Brief description of the main products manufactured in the proforma given below:

Sr. No.	Description of goods manufactured	Tariff Sub-heading	Exemption Notification availed	Rate of duty

2. Details of principal inputs and capital goods used by the assessee.

Details of Principal Inputs/Capital Goods				
S No.	Input Materials/ Capital Goods	Tariff Sub Heading	Exemption Notification	Duty Rate

3. Brief details of the revenue for the last three financial years in the proforma given below:-

Year	Total CENVAT credit availed (in Rs.)			Total duty payment (in Rs.)	
	Inputs (goods)	Capital Goods	Inputs (services)	Cash	CENVAT credit

- C. PRELIMINARY OR DESK REVIEW:
(Please refer para 10.4.1 to 10.4.13)

Date of Preparation _____

1. Give reasons for selection of the unit for audit.

2. The auditor should check whether the Assessee Master File (referred to in Annexure A and B) is available in IAD and whether the same is complete. If not the auditor should complete the same as far as possible from the information available in the office.

Go through the information available in Assessee Master File. Identify and mention (with justifications), the areas or issues which merit inclusion in the Audit Plan. (refer para 10.4.2).

3. Obtain and study other documents illustrated in para 10.4.2 and Annexure C and conduct examinations as illustrated therein . List out the documents studied.

S No.	Name of the document/report *	From Period *	To Period *	Remarks

4. Work out some of the important financial ratios as mentioned in para 10.4.3 and Annexure C. Mention the important indicators, which require to be included in the Audit Plan.

S No	ISSUE DESCRIPTION *	REMARKS

5. Mention changes in the law and rates of duty pertaining to the products manufactured and inputs since previous audit.

6. Mention details of Anti-evasion cases booked in recent past or are in progress and past audit objections, which have not been settled so far, by way of assessee acceptance, adjudication, appeals etc.

7. Give details of important areas (pertaining to the goods manufactured, rate of duty, exemption notification and CENVAT credit availment on inputs/Capital Goods) to be included in the Audit Plan with reasons thereof.

8. **REVENUE RISK ANALYSIS;**
(Please see para 10.4.6 Annexure F in Part IV)

Date of Preparation _____

- (1) Perform the Revenue risk analysis, covering a period of one atleast year or a minimum of one return, for Excise duties payable and paid. The excise duty payable may be derived from the Income Statement in the Profit and Loss Account by excluding non-manufacturing income and the income from exempted manufactured items and applying the excise duty rate. This may be compared with total excise duty paid as per monthly return. Mention results indicating possible problems areas and mention issues to be included in the Audit Plan.

- (2) Perform the revenue risk analysis, covering a period of atleast one year for CENVAT Credits utilization and availment and record your conclusions as to the potential revenue loss. Value of input purchased as per the expenditure statement in the Profit and Loss account may be used for working out CENVAT credit available and compare it with CENVAT credit availment given in the CENVAT return. Mention results indicating possible problems areas and mention issues to be included in the Audit Plan.

9. **TREND ANALYSIS:**
(Please see paras 10.4.7 to 10.4.9 and Annexure G in Part IV)

Date of Preparation_____

- 1) Undertake analysis of trends as illustrated in para 10.4.9 or other trends as deemed relevant. Mention issues to be included in the Audit Plan.

S. No.	Analysis Description	Results of Analysis Performed	Auditor's Remarks

10. GATHERING AND INFORMATION ABOUT ASSESSEE AND THE SYSTEM FOLLOWED BY HIM.
(Please refer to para 10.4.11 and 10.4.12)

Date of Preparation_____

INTERVIEWS

- (1) Person(s) Interviewed, their designation and dates of interview.
-
-
-
-
- (2) Give the gist of interviews specially in respect of
- (i) related ventures, business with these ventures and annual volume of such transactions,
 - (ii) relationships with the unit and its owners / shareholders,
 - (iii) the head office / registered office of the unit, location of its operations and location of its accounting records
 - (iv) whether Company is an ancillary unit or independent unit of production:
 - (v) internal controls in the unit.
 - (vi) any organizational or systemic changes that has occurred since last audit.

Mention issues to be included in the Audit Plan

- (3) Whether the assessee has submitted list of all documents maintained in respect of items mentioned under para 10.4.2 (enclose the list).

11. **FINANCIAL AND TAX ACCOUNTING INFORMATION:**

Date of Preparation_____

- (1) Obtain audited Balance sheet and Profit and Loss Account and trial balance. Review any notes in the Balance sheet / profit and loss account. If unit is a division of a company, check if internal financial statements are prepared for the unit before consolidation with other related units. Work out purchase of raw materials value to sales value of manufactured goods ratio and compare with CENVAT ratio. Obtain a copy of last two reports. Mention issues to be included in the Audit Plan.

- (2) Identify all business activities like sale of manufactured goods, sale of trading goods, non-manufacturing activity like repair, service activities and major source of 'Other Income'. Mention issues to be included in the Audit Plan.

- (3) Compare total turnover as per profit and loss account with the corresponding figures submitted to the department in the returns for three years. Mention discrepancies to be included in the Audit Plan.

SALES INFORMATION:

Date of Preparation_____

- (1) Indicate marketing / clearance pattern in the following proforma:-

Sr. No.	Nature of Sale/Transfer etc	Yes	No	If yes, description of product (s)	*Practice of valuation followed by the assessee.
1.	Sale at the factory gate				
2.	Sale through the depot/distributors /				

	consignment agents / Marketing intermediaries.				
3.	Sale in retail				
4.	Retail Sale Price (Maximum) – Section 4A				
5.	Inter Plant transfer				
6.	Captive consumption				
7.	Clearance to U.N. and other aided projects				
8.	Inputs received and job work done				
9.	Inputs/semi-processed material sent for job work outside.				

* Whether provisions of Section 4 or Valuation Rules, 2000 now has been applied by the assessee who has made the self-assessment. The Valuation section or the specific Valuation Rule invoked may be indicated.

Mention issues to be included in the Audit Plan.

- (2) Examine selected debtor account (customer) to find out any recovery other than shown in sales invoice (Check Debit Note and Journal Vouchers also). Mention issues to be included in the Audit Plan.

- (3) Identify any special situations such as sales to related units, trading activities, commissions, volume discounts, exchanges or trade-ins and imposition of MRP based value for duty. Mention issues to be included in the Audit Plan.

- (4) Identify other revenues as reported in the financial statements (Incomes other than from sales). Mention such other revenues which may form part of the assessable value (for inclusion in the Audit Plan).

PURCHASE INFORMATION:

Date of Preparation _____

Goods

- (1) List major suppliers, goods purchased and indicate annual volume in Rupees. Whether there are purchases from related units? Mention issues to be included in the Audit Plan.

- (2) Examine selected creditor's account (supplier) for each major input to find out any purchase returns, short supply, rejection of goods etc. and its impact on CENVAT credit availment. Mention issues to be included in the Audit Plan.

- (3) Whether the assessee avails any end use based Customs duty exemptions on imported purchases. Mention issues to be included in the Audit Plan.

- (4) Study the purchase details of major capital goods acquired and put to use since last audit. Mention issues to be included in the Audit Plan.

Service Tax

1. List major input services on which credit has been availed

2. Examine selected credits' account for each major input service to verify whether payment has been made prior to availment of credit. Mentioned issues to be included in the Audit Plan

3. Examine whether any input service may have been used in the manufacture of exempted final products. Mention issues to be included in the Audit Plan.

4. Examine whether any taxable services have been received from a service provider located outside India and verify whether service tax due on such transactions if any, has been paid. Mention issues to be included in the Audit Plan.

OTHER INFORMATION:

Date of Preparation _____

- (1) Study the whether any goods are manufactured and captively consumed. Mention issues to be included in the Audit Plan.

- (2) Study whether any manufactured goods are cleared for inter unit transfer, intermediates sent for job work or received for job work. Study the valuation and CENVAT credit availment in such cases Mention issues to be included in the Audit Plan.

- (3) Any other relevant information gathered by the auditor during the course of Gathering information about assessee, and systems followed by him and study of financial documents. Mention issues to be included in the Audit Plan.

Observations of the Auditor on any other issue emerging during Desk Review, that are to be included in the Audit Plan, with reasons thereof.

12. AUDIT PLAN:

(Please see para 10.4.14 to 10.4.15 and Annexure H in Part IV).

Date of Preparation _____

Audit Plan approved by _____

- 1) The Audit Plan must be based on the issues identified in the previous steps as to be verified during the conduct of audit and must be specific in the following format (also given in Annexure H in Part IV):

Sl. No	Subject	Specific Issue	Records / Document Code	Coverage Period	Selection Criteria

13. TOUR OF THE PLANT / PREMISES:

Date of Preparation _____

Tour the plant, accompanied by the appropriate officer of the assessee. Include receipt, storage and other relevant areas of the unit in your tour. Observe operations to confirm information received to date and to note areas that may be vulnerable to non-compliance.

Ask about the number of workers in the plant and number of shift worked. Inquire how many electricity meters are used and obtain meter numbers. If electricity is partly or fully self-generated, full particulars including various uses and sale/diversion outside must be ascertained and examined. Ask if unit resells some of the inputs for which CENVAT is availed. Ask about emergence of any intermediate goods/bye-products and storage and disposal of scrap. Ask about goods either sent out for job work or received for job work.

- (1) i) No. of workers employed. _____.
- ii) No. of shifts running. _____.
- iii) No. of places for dispatch of goods outside the factory.. _____.
- iv) Whether any input is exclusively used in the manufacture of exempted goods. _____.
- v) Whether any input is used in the manufacture of exempted as well as dutiable goods. _____.
- vi) Whether any Capital Goods on which CENVAT credit was availed, are exclusively used in the manufacture of exempted goods. _____.

- vii) Whether any discrepancy of facts noticed between what was made known to the audit team earlier and what was observed during the visit. Details thereof.
- viii) _____
Mention if there are new facts not disclosed earlier, noticed during the tour, which may have relevance to revenue or to the level of assessee tax compliance
- ix) _____
Observe movement of goods from the stage of raw material to the stage of clearance of finished goods alongwith movement of accompanying documents. Mention issues to be verified during conduct of audit.
- x) _____
Gather information about the Internal Control System as illustrated in Annexure E in Part IV by interviewing the section in-charges. Mention issues to be verified during conduct of audit.

- (2) Any other relevant information gathered by the auditor during the course of Tour of the premises. Mention issues to be included in the Audit Plan and verified during conduct of audit.

14. EVALUATION OF INTERNAL CONTROLS

(Please refer para 11.5.3 to 11.5.5 and Annexure J in Part IV).

Date of Preparation _____

- (1) Perform a walkthrough for the Sales / Records maintained for Central Excise. Trace a sample of transactions (all types, including those on Credit) from source documents through to Excise Duty account. Mention any new area need to be included in the Audit Plan or whether the extent of verification of the issue already identified in the Audit Plan needs to be modified.

- (2) Perform a walkthrough of the purchase system (including capital assets). Trace a sample of transactions, of all types, including Credits, from source documents through the Excise duty account. Examine specifically system for purchase, rejection, short supply etc. Mention any new area need to be

included in the Audit Plan or whether the extent of verification of the issue already identified in the Audit Plan needs to be modified

- (3) Perform a walkthrough of any other system (eg. Stores Journal Entries, CENVAT accounting etc.) Trace a sample of transactions of all types from source documents through to the Excise Duty Account. Mention any new area need to be included in the Audit Plan or whether the extent of verification of the issue already identified in the Audit Plan needs to be modified.

- (4) Perform a walkthrough of the process of compiling Central Excise monthly return for one month, tracing from the tax return amounts backwards through to their sources. Check sales as per Sales Account in ledger with value shown in monthly return. Mention any new area need to be included in the Audit Plan or whether the extent of verification of the issue already identified in the Audit Plan needs to be modified.

- (5) Conduct ABC analysis in the following areas and evaluate the soundness of level of Internal Control of each such sub system and grade them as good, acceptable or poor in the following format:

Sub systems:

- i. Sales.
- ii. Purchase.
- iii. Tax Accounting.
- iv. Posting to General Ledger and Journals (specially of high value transactions).
- v. Recording of invoice.
- vi. Recording of cash sales and purchases.
- vii. Credit/debit and their documentation.
- viii. Other expenditures.
- ix. Recording of and availment of CENVAT credit.
- x. Accounting of scrap/wastes.
- xi. Account adjustments.
- xii. Others.

Name of sub	Grade	Problems areas if
-------------	-------	-------------------

system	(good/ acceptable / poor)	any

- (6) Any other relevant information gathered by the auditor during the course of Evaluation of Internal Control. Mention any new area need to be included in the Audit Plan or whether the extent of verification of the issue already identified in the Audit Plan needs to be modified.

15. VERIFICATION:

(Please see Chapter 11 and Annexure K to N in Part IV)

Date of Preparation _____

- (1) Carry out verification as per Audit Plan. The result of verification of each of the issues should be mentioned in the format below (also given in Annexure I in Part IV), whether or not there is any detection of discrepancy/audit point. The issues verified which was not part of original Audit Plan but verified later should be mentioned at the end.

Proforma of a verification paper

1. Date of verification
2. Name of the auditor verifying the issue
3. Issue involved in brief
4. Ref. No. of the Audit Plan
5. Documents verified
6. Brief account of the process and extent of verification
7. Auditor's observation and conclusion in brief
8. Quantification of revenue involved, if any (also give the calculation sheet)
9. Documents relied upon to support the conclusion

Signature of the auditor

Supervisor's remarks and signature.

16. POST VERIFICATION

Date of Preparation_____

- (1) Once the verification, as per the Audit Plan, is complete, all the findings with assessee's agreement/disagreement must be consolidated in Part 2 of the draft Audit Report format (Annexure N in Part IV) and Part C of these Working Papers for presentation to and discussions with the superiors and the assessee. The details of spot recovery made during the conduct of audit should also be mentioned in the relevant column of Part C of these Working Papers.
- (2) All important findings specially those pertaining to non/short payment of duty should be discussed with the assessee and his explanation/clarification with supporting material, if any, should be duly taken into consideration before taking a definitive view. The details in this behalf should be recorded here.
- (3) Indicate information provided and specific actions suggested to the assessee to improve future compliance. Where the assessee is in agreement with the suggestions, request a commitment in writing and include it in the Audit Report. If the assessee is unwilling to give a written undertaking, obtain a verbal commitment. Mention results.

17. SUMMARY OF AUDIT RESULTS

Provide an outline in the following format of all objections, which involve short/non levy of duty, amounts (say under Sec. 11D), irregular availment/utilization of credit, irregular payment of refund and non-payment of interest due. Details of objections of technical/procedural in nature without involving revenue / credit / interests/amounts should also be mentioned. Indicate whether the assessee has agreed to the objections and if so, has made spot payment (if so details thereof).

S. No.	Description of commodity	CETSH No.	Code – audit points	Code – records / document	Assessee acceptance (Y/N/P)	Amount of detection in (Rs. 000)	Amount of recovery in (Rs. 000)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)

Provide details for each Sr. No. in respect of columns (4) to (8) above alongwith Sr. No. of Working Paper and particulars of source document and back-up document.

(4)

(i) _____

(ii) _____

(iii) _____

(5)

(i) _____

(ii) _____

(iii) _____

(6)

(i) _____

(ii) _____

(iii) _____

(Auditor)

Name/Designation

Place: _____

Date: _____

ANNEXURE – A

(Please see Chapter 9)

List of documents to be maintained in hard copy form in the ‘Assessee Master File’

S. No.	Names of the documents/declarations/returns	Departments to supply/from whom to be collected
1	Copy of the application for registration	Range/Division
2	Organizational chart of the unit giving names, designations and telephone numbers of the key persons i.e. M.D. / Directors / Partners / Prop. / CS / CA / Authorised Signatory	Audit Party
3	Copy of declaration of the latest list of the records furnished by assessee under Rule 22(2) of Central Excise Rules, 2002	Division
4	Cost audit / tax audit reports for three years	Audit Party
5	Audit Reports for past three audits alongwith Minutes of excise monitoring meeting and working papers	Audit Cell
6	Audit points raised by CERA in the past three audits	Audit Cell /Division
7	ER-4 Return for the past three years	Range / Division
8	ER-5 & ER-6 Returns for the past three years	Range / Division
9	Copies of Annual Report of the Company or Balance Sheet, Profit & Loss Account for the past three years.	Audit Cell
10	Copies of Trial Balance for the Current year and for the past two years	Audit Cell
11	Assessee Profile in the format given in Annexure B	Range
12	Any other document considered relevant by the Audit Party	Audit Party

ANNEXURE – B

ASSESSEE'S PROFILE

1. Name and Address of the Assessee :
2. Range and Division :
3. Details of Previous Audit :

Internal Audit		CERA Audit	
Date of last Audit	Period covered	Date of last Audit	Period covered

4. Whether SSI Unit, if so, state SSI Notification availed them :
5. List the items assessed under MRP assessment (Section 4A) :
6. Details of goods manufactured and exemption claimed, if any :

S. No.	Description of the Product	Classification	Rate of Duty			Exemption Notfn. No. with Sl. No. (Other than captive consumption Notfn. And Export clearance Notfn.)	Conditions of Notification, if any
			Current year	Previous year1	Previous year2		

7. Whether goods are procured under Central Excise (removal of goods at concessional rate of duty for manufacture of excisable goods) Rules, 2001 or goods are imported under Customs (import of goods at concessional rate of duty for manufacture of excisable goods) Rules, 1996. If yes, please specify name of such product.

8. Production details : (Value in lakhs)

Commodity/Year (indicate the financial years starting with the current financial year)		Production		Clearance for home consumption on duty payment		Clearance for home consumption without duty payment.*		Clearance for export on payment of duty		Clearance for export without duty payment	
		Qty	Value	Qty	Value	Qty	Value	Qty	Value	Qty	Value
Commodity1 (give description)	Year1										
	Year2										
	Year 3										

Commodity2 (give description)	Year1										
	Year2										
	Year 3										
Commodity 3 (give description)	Year1										
	Year2										
	Year 3										

* If required, exemption notification wise details may be obtained from Hqrs. Computer Cell from SERMON data base.

9. Details of duty payment during last three financial years : (Rs. in lakhs)

Year (indicate the financial years starting with the current financial year)	Duty Paid – PLA	Duty Paid – Input credit	Duty paid – Capital goods credit	Duty paid – Service Tax credit	Total duty paid through CENVAT credit	Total duty paid	Percentage of input credit to the total duty
	(a)	(b)	(c)	(d)	(e) [b+c+d]	(f) [a+e]	(g) [b/f] %

10. Details of anti-evasion cases booked (including two cases where only AE-2 have been issued) during last three financial years and current financial year :

S. No.	Issue/Issues involved	Period of Demand	Duty involved	Show Cause Notice No. & Date (if issued)

11. Details of Show Cause Notices issued during last three financial years and current financial year :

S. No.	Show Cause Notice No. & Date	Issue/Issues involved	Amount of Duty involved	Adjudicating authority

12. Details of litigations (Adjudication, Appeals, Court Cases etc.) pending:

S. No.	Issue in brief	Duty + RF + PP = Total Amount Involved	Forum before whom it is pending	Period of pendency before the present deciding authority.

(Range Officer)

ANNEXURE – C

I. Documents required during Desk Review -

1. Annual report and Director's report
2. Profit and Loss Account
3. Balance Sheet
4. Notes to the Accounts
5. Trial Balance
6. Cost Audit Report
7. Manufacturing process chart
8. ER-4, ER-5 and ER-6 Returns

II. Records to be verified in the marketing and sales department -

1. Purchase Orders
2. Price Circulars
3. Delivery Challans
4. Material transfer note
5. Sales book

III. Records to be verified in the stores department -

1. Stores Ledger
2. Job Card/Bill of material
3. Goods Receipt Note (GRN)/Material Receipt Note/Inspection Cum Receipt Report (ICRR)
4. Material Return Note
5. Material Requisition Note and Material Issue Note
6. Badbin Register
7. Physical Stock Verification Statement
8. Job work/Sub-contract Register

IV. Records to be verified in Production department -

1. Manufacturing Process Chart
2. Machine Log Book
3. Laboratory Test Report
4. Weighment Slips

V. Finance & Accounts related records -

1. Ledgers
2. Debit Note
3. Credit Note
4. Journal Voucher

5. Internal Audit Reports
6. Purchase Book
7. Purchase Return Book
8. Income Tax Audit Report
9. Income Return
10. Sales Tax/VAT Return
11. Fixed Assets Register
12. Monthly Stock Statement to Bank

I. Documents required during Desk Review -

Sr. No.	Name of the Record/Document	Relevance of the documents and checks to be done
1.	Annual Report & Director's Report	<p>The Annual Report prepared by a company interalia contains the following:</p> <p>i) Director's Report (ii) Statutory Auditor's Report (iii) Balance sheet and Profit & Loss Account (iv) Financial statements of subsidiary companies, if any.</p> <p><u>Director's Report:</u> This gives information like overall financial results of the company, important happenings during the year and future plans of the company. Some of the important happenings like fire and loss of material in the company, details of new products launched, change in the marketing pattern etc. reported in the report may be useful to the auditor.</p> <p><u>Auditor's Report :</u> These may be reports of Statutory auditor or Internal auditor or C & AG Audit. In the case of statutory audit, a separate report under CARO (Companies Auditor's Report Order, 2003) is required to be given.</p> <p><u>Nature of verification:</u> (i) The Auditor's Report should be studied to find out any qualified/adverse opinion given by the auditors which may have impact on Central Excise liability. For example, Auditor may report that finished goods stock were not reconciled between stock records and Central Excise records or provision for obsolete items have not been made during the year. Tax auditor may like to examine such opinion in detail.</p>

		<p>ii) CARO Report may be studied to find out whether the fixed assets records have been maintained properly or whether physical verification of raw material and finished goods was undertaken and whether any discrepancies were noticed on such verification or whether they company has maintained proper records for unserviceable or damaged goods or not.</p> <p>iii) CARO Report also shows disputed tax liabilities separately for Sales Tax, Customs, Central Excise and Income Tax. Cases booked under Sales Tax or Income Tax may be examined to find out any implication on Central Excise.</p> <p>iv) In the case of Public Sector unit, C & AG report and comment of the company available in the Annual Report should be examined.</p>
2.	Profit & Loss Account	<p><u>Nature of the Account:</u> The Profit and Loss Account shows major items of expenditure and income. This is one of the important documents used during desk review to find out the overall working of the unit. In the main body of the Profit & Loss Account, only major heads of expenditure and income are given and the constituents of these headings are given in a separate annexure. The said annexure should be studied in detail.</p> <p><u>Types of verification:</u></p> <p>(i) Scrutiny of sales: Sales may include sale of manufacturing goods, trading goods, parts and accessories, scrap and export. The trading sales may be verified in detail in order to find out whether CENVAT credit has been availed on such trading goods or whether these are similar to the goods manufactured and sold by the unit or whether these are essential parts of components or accessories of goods manufactured by the unit. Purchase and sales price of such trading goods may also be inquired into in order to rule out the possibility of overvaluing the trading goods in order to undervalue the manufactured goods, if these are supplied to same</p>

		<p>customers.</p> <p>(ii) Other incomes like sale of scrap, insurance claims receipt, profit on sale of fixed assets, commission received, erection and commissioning income, freight and insurance recovered etc. may be examined in detail to find out the exact nature of such incomes and whether these have any bearing on the valuation of the manufacturing goods or whether these are liable for Service tax.</p> <p>(iii) In the expenditure side, the account of raw material purchased or cost of material consumed should be examined in detail. For this purpose, the relevant ledger account may be scrutinized as discussed under the head General Ledger. Ratio of R.M. consumption to sales may be worked out for the reasons given in Annexure 'C'.</p> <p>(iv) Alongwith the Profit & Loss Account, quantitative details of the consumption of major raw materials is also required to be given as per the requirements of the Companies Act. Such quantitative details show the quantity of major raw material consumed and value thereof. Such information may be helpful in working out the input-out ratio. Notes given along with the said schedule should be studied carefully to find out cases of use of material for non-production activities.</p> <p>(v) The expenditure or income of the major heads should be compared with the previous year's amount in order to find out cases of major variations.</p>
3.	Balance Sheet	<p><u>Nature of document :</u></p> <p>Balance sheet is a statement of assets and liabilities of a unit on a particular day. The overall financial health of a company can be determined from the study of a Balance sheet.</p> <p><u>Types of verification</u></p> <p>(i) Study of schedule of Share Capital may reveal if the company is subsidiary company and in case the company is holding company, in that case, the name of subsidiary</p>

		<p>company will be disclosed in the Schedule of Investment. If there are sale/purchase transactions with the holding/subsidiary company, in that case, the valuation of such products needs to be examined in the light of Valuation Rules.</p> <p>(ii) Study of fixed assets schedule may show additions and deductions to the fixed assets during the year. For the deductions made during the year, verification may be made as to whether appropriate excise duty have been paid, if the Cenvat credit was availed in the past.</p>
4.	Notes to the Accounts	<p>These notes are part of the Profit & Loss Account and Balance Sheet. These notes may be inserted by the company as per the requirement of the Companies Act or may be added at the instance of Statutory auditor. These notes are very important to a Tax auditor as these reveal important transactions or the important accounting policies followed by the unit.</p> <p><u>Nature of verification:</u></p> <p>(i) Notes of Significant Accounting Policies may be studied to find out the accounting policy in the areas like revenue recognition or determination of obsolete stock.</p> <p>(ii) Notes on quantitative information on consumption of major raw material, production of the finished goods and purchase and sale of trading goods may reveal number of interesting aspects and the input output ratio may also be studied. Cases of use of raw material for non production purposes may also be noticed from the study of such information. Adjustment for shortages, losses etc. may also be reported in the said information.</p> <p>(iii) Any important transaction/happening during the year like non-reconciliation of accounts of material lying with job worker, major expenditure on research and development, destruction of record and reconstruction of duplicate records may also be noticed from the study of such notes.</p> <p>(iv) As per the Accounting Standard issued by the</p>

		<p>Institute of Chartered Accountant of India, the specified companies are required to disclose transactions with the related parties under the Companies Act as part of the Notes to the Accounts. The said information gives all types of transactions like purchase, sales, payment made or payment received from various related parties by the Company. Such information are very useful to find out the details of the related parties and the type of transactions made by them. If necessary these transactions may be examined in detail. However, the related parties as per the Companies Act may not be considered as 'related person' under the Central Excise Law.</p>
5.	Trial Balance	<p><u>Nature of Document :-</u></p> <p>Trial Balance is a statement showing balances of all accounts in the ledgers as on a particular date. In other words, it is a summary of the ledger account maintained by an assessee. The final accounts, namely, Profit & Loss account and Balance Sheet are prepared from the Trial Balance only. From the Trial Balance, similar accounts are grouped together and these are transferred to the Profit & Loss Account and Balance Sheet.</p> <p><u>Types of verification :-</u></p> <p>i) Familiarization with account coding system and understanding the grouping of sub account under main accounts for the purpose of summarization into Profit & Loss Accounts and Balance Sheet.</p> <p>ii) Main purpose is to select the accounts for further scrutiny as a part of audit plan. Accounts which have a prima facie relevance for Excise duty payment or availment of CENVAT credit or payment of Service Tax need to be identified during Desk review. There might be some of the ledger accounts whose exact nature may not be clear on reading of Trial Balance and these accounts may also be identified for further inquiry during the further course of audit.</p>

		<p>iii) Unusual ledger accounts like Raw Material Loss Account or unusual income accounts may also be noticed in the Trial Balance. However, such accounts will not be reflected in the Profit & Loss Accounts as these accounts are adjusted against other accounts. Such account may be selected for finding of exact nature and detailed scrutiny.</p> <p>iv) Various income accounts (credit balances) available in the Trial Balance like Job Work Income Account, Erection and Commissioning Income Account, Commission Account, Recovery of Freight/Advertisement Charges Account Technical Consultation Income Account etc. should be selected to verify whether these income can be added to the assessable value for payment of Excise duty or whether these are liable for payment of Service Tax.</p> <p>v) Some of the expenditure accounts like Security Service Expenditure Account, Sales Commission Account, Advertisement Expenditure Account, Repairs and Maintenance Account, Royalty Account etc. should also be selected to find out whether service provider has paid Service Tax or not.</p>
6.	Cost Audit Report	<p><u>Nature of document and Nature of Verification :-</u> Refer Annexure: E</p>
7.	Manufacturing process chart	<p><u>Types of Verification :-</u></p> <p>i) Study the process chart to find out whether intermediate/by-product arises attracting Excise duty, specifically in case where final product is exempted.</p> <p>ii) It is useful in determination of classification and availment of exemption.</p>
8	ER-5 & ER-6 Return	<p><u>Nature of Documents</u></p> <p>ER-5 return and ER-6 returns are filed by the assessee paying annual revenue of Rs.1 Crore and above and manufacturing specified commodities. ER-5 is an Annual Return in which assessee is required to provide input-</p>

		<p>output norms for the major finished goods manufactured by them. ER-6 return is filed on monthly basis providing details like opening balance, quantity consumed, cleared as such and quantity of finished goods manufactured. Details of waste and scrap arising during manufacture and cleared/destroyed is also given in the said return.</p> <p><u>Types of Verification</u></p> <ol style="list-style-type: none"> 1) Compare the norms of consumption of inputs as mentioned in the ER-5 with the norms given in the Standard Input-Output Norms (SION) published by the DGFT for different Export Product group as part of the Foreign Trade Policy. 2) Compare the input-output ratio as provided in ER-5 with the input-output ratio worked out as per ER-6. If the consumption of input as per ER-6 is more, as compared to the quantity determined as per ER-5, same needs to be examined during verification. 3) The Notes to the Account annexed to the Balance Sheet and Profit & Loss Account provides quantitative details of consumption of principal raw materials, quantity of major finished goods produced, quantity of input sold as such etc. The auditor should compare the said figure with figures available in ER-5. 4) Compare the Input-Output Norms of the Assessee as given in ER-5 with the other assessees, if any in the Commissionerate manufacturing same products. 5) Study quantity of waste and scrap cleared as percentage of total production with the other units manufacturing similar goods.
9	ER-4 Returns	<ol style="list-style-type: none"> 1. For detailed verification refer Annexure – M. 2. Compare the figures with Profit & Loss A/c. to ensure that information provided in the ER-5 Return matches with financial records.

II. Records to be verified in the marketing and sales departments -

Sr. No.	Name of the Record/Document	Nature of the documents and checks to be done
1.	Purchase order	<p><u>Nature of Document :</u> This document denotes the price and other conditions laid for purchase of goods/sale of goods.</p> <p><u>Nature of Verification:</u> <u>Purchase order placed by Customers:</u></p> <p>(a) To verify the terms and conditions specially with respect to price revision, supply of any material/component by the customer, erection and commissioning charges. The total price charged in the Purchase Order may be compared with the Central Excise invoice to ensure that no extra flow back is received outside the invoice through commercial invoice/debit note.</p> <p>(b) To verify whether excise invoice is raised for full amount as per the Purchase Order or part of the goods are sold as trading goods.</p> <p>(c) Dutiability of clearance of samples, if any, agreed to in the purchase order may be verified.</p> <p>(d) Tax & duty structure agreed upon in the purchase order should be checked with invoices raised for clearance. In case the unit raises a separate commercial invoice, such invoices should be checked for the basic price, duty, taxes, etc. actually collected.</p>
2.	Price Circular	<p><u>Nature of Document :-</u> Most companies issues price circular periodically explaining various conditions of sales like various types of discounts, conditions for providing the discount, recovery of freight, packing charges, interest and other charges.</p> <p><u>Type of verification :-</u></p> <p>i) Study the various elements to be recovered from the customers and whether these are required to be added to the assessable value or not like packing charges, freight charges, handling charges.</p>

		<p>ii) If any discount is given to a class of buyer, the exact nature of such discount may be studied in detail to find out whether the discount is admissible or not.</p> <p>iii) Verify whether any item or benefit is supplied free of cost by the buyer.</p> <p>iv) In case of cum duty prices, the various components forming part of value need to be studied from price circular.</p>
3.	Delivery Challan	<p><u>Nature of Document:</u></p> <p>This document is raised for clearance of all types of goods (finished goods, inputs and other goods) out of the factory. It indicates the description of goods, quantity cleared and receiver of goods. D.Cs may be of two varieties viz. returnable D.C. & Non-Returnable D.C.</p> <p><u>Nature of Verification:</u></p> <p>(a) Check how many series of DCs are issued and which sections are preparing these.</p> <p>(b) Returnable D.Cs are used for movement of job-work materials. D.C. Register should be verified to ascertain whether materials sent for job work has been received back within the stipulated time, if not, whether appropriate duty has been paid or not.</p> <p>(c) Non-Returnable D.Cs are used for clearance of goods, which are not to be received back. Normally it is the practice in the industry to raise D.Cs for sales made and it accompanies the Sales Invoices. Inter unit movement of goods are some times done through non-returnable D.Cs without any invoices resulting in clearance without payment of duty.</p> <p>(d) Verify whether duty has been paid on scrap cleared under N.R.D.C.</p> <p>(e) Replacements/Samples may also be cleared under the cover of NRDC's without invoices.</p>
4.	Material Transfer Note	<p><u>Nature of Document:</u></p> <p>This document is used for inter unit transfer of materials & for inter branches transfers within a unit.</p>

		<p><u>Nature of Verification:</u></p> <p>Valuation adopted for such inter unit transfers need to be checked and whether duty has been paid on such transfers be ascertained.</p>
5.	Sales Book	<p><u>Nature of Document:</u></p> <p>This is used for recording all credit sale of products manufactured/traded.</p> <p><u>Nature of Verification:</u></p> <p>(a) Invoice Numbers mentioned should be sequential and if any number is missing the same has to be examined.</p> <p>(b) Verify how many series of sales invoices are used for sale of goods. Whether excise invoice series and commercial invoice no. series are different.</p> <p>(c) Whether Debit Notes/Journal Vouchers are also entered in the sales register. If yes, whether excise duty is payable on additional considerations received through such Debit Notes/JVs.</p> <p>(d) Sales register normally show excise duty separately. Verify the cases where excise duty has not been paid and find out the reasons thereof.</p>

III. Records to be verified in the stores department -

Sr. No.	Name of the Record/Document	Nature of the documents and checks to be done
1.	Stores Ledger	<p><u>Nature of Document :-</u></p> <p>It contains the details about receipt of various input or consumable, its issue for production and closing balance. It also contains details like results of physical verification, obsolete items, slow moving items and its write off etc. Now a days most of the companies maintains stock records on computer.</p> <p><u>Types of Verification :-</u></p> <p>i) Verify coding system for receipt, issue, stock verification, valuation, input cleared as such, obsolete item and other found in store records.</p> <p>ii) Compare the purchase as per CENVAT documents</p>

		<p>with a receipt in the store records.</p> <p>iii) Compare the issue of the major inputs and find out whether corresponding productions have taken place in those dates. Link with machine log books also.</p> <p>iv) Verify whether any shortage found on physical verification as per store records.</p> <p>v) Verify whether any item written off due to obsolesce.</p> <p>vi) Verify whether any input cleared as such and whether proper duty is paid or not.</p>
2.	Job Card/Bill of Material (BOM)	<p><u>Nature of Document:</u></p> <p>This document shows the total quantity of material required for manufacturing product (e.g. a machine) or a batch of products (e.g. batch in Pharma industry). Based on this document material is drawn from stores.</p> <p><u>Nature of Verification:</u></p> <p>(i) Major inputs required for the production of an item can be identified and input output ratio can be worked out and can be verified with actual production to find out clandestine removal/irregular availment of CENVAT.</p> <p>(ii) Cost of production can be determined and the same can be checked with A.V. of captively consumed goods.</p> <p>(iii) Based on BOM, approximate amount of CENVAT credit available for a product may also be worked out.</p>
3.	Materials Receipt Note/Goods Receipt Note (GRN)/Inspection cum Receipt Report (ICRR)	<p><u>Nature of Document :</u></p> <p>The MRN/GRN is prepared for all goods received in the factory. It shows the details like actual quantity received, quantity as per challan/invoice, quantity short received. It is prepared by the Stores Department. The ICRR is prepared by the quality control department and it shows the quantity accepted, quantity rejected and the reasons for rejection. A number of times these reports may not be physically available as these are maintained in computer systems. But statements may be generated on the request of Auditors for cases where goods have been short received or rejected.</p> <p><u>Nature of Verification:</u></p>

		<p>(i) Check the cases of short receipt and rejected goods and verify whether CENVAT credit has been reversed.</p> <p>(ii) Verify in random cases, whether for CENVAT availed invoices, corresponding GRNs are available or not.</p>
4.	Material Return Note	<p><u>Nature of Document:</u> This document is raised by various departments to return the material to stores or to suppliers.</p> <p><u>Nature of Verification:</u></p> <p>(i) In case CENVAT availed materials are returned to supplier whether appropriate duty has been discharged.</p> <p>(ii) In case MRN is raised by shop floor for rejection of raw material, the CENVAT credit treatment may be examined.</p> <p>(iii) In case MRN is raised by shop floor for rejection of partially processed material, such material should be cleared as manufactured goods on payment of duty irrespective of whether CENVAT was availed on the inputs used in manufacture of partially processed goods or not.</p>
5.	Material Requisition Note (MRN) and Material Issue Note (MIN)	<p><u>Nature of Document:</u> MRN is used by various sections in the factory for requisition of material from stores department. In turn, stores department issue the material on MIN. The MRN & MIN contain code no. of receiving sections, description of material and code no. of material issued, and quantity of material.</p> <p><u>Nature of verification:</u></p> <p>(i) The code no. of all sections should be verified to find out non-production departments, like Repair Departments, Estate Department, Staff Welfare Department Offices. Material issued to these sections may be verified and whether CENVAT credit has been reversed or not be ascertained.</p> <p>(ii) MIN may also be used for adjustment of shortages, stock verification discrepancies, stock issued as scrap, obsolete items etc. There may be separate code no. for such adjustments. CENVAT treatment on such goods may</p>

		<p>be verified.</p> <p>(iii) For inputs cleared as such for sale, inter unit transfer, warranty period supply, MIN may be prepared showing different codes. All such clearances may be examined to verify payment of excise duty.</p>
6.	Bad Bin Register	<p>Where the raw material or components are not in useful condition, they are transferred to Bad Bins. The Auditor should verify the concerned records seeking reversal of credit on such unusable inputs. These goods are also known as obsolete items.</p>
7.	Physical Stock Verification Statement	<p><u>Nature of document:</u></p> <p>The companies undertake periodic stock verification where book stock is compared with physical stock. The statement showing book stock, physical stock and variation is prepared on each such stock verification. Most of the companies undertake quarterly, half-yearly and annual stock verification.</p> <p><u>Nature of verification:</u></p> <p>(i) Stock verification statement should be examined to find out the cases of shortages or excesses. In case discrepancies are not explained, action may be taken either for demanding reversal of CENVAT credit or demanding duty. This statement may also be available in the Cost Audit Report.</p> <p>(ii) On the basis of such statement, stock adjustments are made in the financial records by passing a Journal Voucher. The said JV may also be examined for the adjustments carried out by the unit.</p>
8.	Such contract Register / Job Work Register	<p><u>Nature of Document :</u></p> <p>This register indicates activity sub-contracted outside.</p> <p><u>Nature of Verification :</u></p> <p>(a) To study whether all materials sent outside for job work have been received back within the time stipulated.</p> <p>(b) In case the job worker discharges duty, then valuation of such goods should be examined as to inclusion of any freely supplied material in the value.</p>

		(c) Receipt of scrap generated at job workers premises should be verified.
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IV. Records to be verified in Production department -

Sr. No.	Name of the Record/Document	Nature of the documents and checks to be done
1.	Manufacturing process chart	<u>Types of Verification :-</u> i) Study the process chart to find out whether intermediate/by-product arises attracting Excise duty, specifically in case where final product is exempted. ii) It is useful in determination of classification and availment of exemption.
2.	Machine Log Book	<u>Types of Verification :-</u> An important verification point in walk through of production process. Verify as to how log book are linked to production records. Compare the production details as per log book with production details available in other records.
3.	Lab Test Reports	<u>Nature of Document:</u> This document is used to report testing of inputs and finished goods. <u>Nature of Verification:</u> (a) Test Report may be helpful in ascertaining correct classification. (b) In Chemical/Pharma industry, each lot/batch is tested. The Lab Test Report may be compared with production records to confirm accounting of correct quantity of production.
4.	Weighment Slips	<u>Nature of verification:</u> Tax Auditor should compare the weighment slips with the quantity shown in the invoice on random basis. This will be more useful in cases where the commodity is charged to specific rate of duty.

V. Finance & Accounts related records -

Sr. No.	Name of the Record/Document	Nature of the documents and checks to be done
1.	Ledger	<u>Nature of document:</u>

Ledger is a book where transactions of same nature are grouped together in the form of an account. For example, all transactions relating to excise duty payment may be entered in Excise Duty Payment Account. Ledgers are of three types:

1. Debtor's Ledger: This contains accounts of all debtors (customers). All transactions made with a customer are entered in the individual account of each customer. Details of sales invoices and debit note issued to a customer and payment received from a customer are entered in the customer's individual account.

Types of verification:

(i) Ledger account of the major customers should be scrutinized. In the Customer's account it should be verified as to what are the documents used for recording the sales of the goods. These documents may be sales invoices or debit notes or JVs. If debit note and JVs are also found entered in the customer's account, such documents should be verified to find out the reasons for such recoveries from the customers and whether excise duty has been paid or not.

(ii) If substantial amount of advances are recovered regularly, this may also be verified from customer's account. In such cases, there may be credit balance showing receipt of advance payment.

2. Creditor's Ledger: This Ledger contains accounts of all creditors like suppliers and service providers. Like in the case of Debtor's Ledger, in the case of supplier's account, the details like purchase invoice, debit note or JV may be available in a supplier's account. The debit note or JV might have been prepared for rejection of purchase material or for short receipt of purchase material.

Types of verification:

(i) If the customer's account shows details of debit note or JV, the reasons thereof may be inquired into and whether CENVAT credit has been reversed or not may be

verified.

3. General Ledger : This Ledger contains all accounts of assets, liabilities, incomes and expenses. Scrutiny of this ledger is very important to a Tax Auditor as the income and expenditure accounts have direct impact on availment of credit, valuation of finished goods and payment of excise duty. The General Ledger may contain 100-500 accounts depending upon the size of the company. Therefore, selection of account for scrutiny is an important task for an auditor. For this purpose, accounts should be selected from the Trial Balance which gives names of all the accounts maintained by a unit. Some of the general rules which may be kept in mind while selecting the accounts for scrutiny are given below :

- (i) Credit entries in raw material purchase account
- (ii) Credit entries in expenses account.
- (iii) Income accounts.
- (iv) Unusual account.

Types of verification:

- (i) All the important input purchase accounts may be verified in order to find out whether any rejection of raw material or short receipt of input have taken place and whether CENVAT credit has been reversed or not.
- (ii) Raw material consumption account may also be verified to find out use of raw material for non production purposes and writing off obsolete material or cases of shortages noticed during physical stock verification.
- (iii) Expenditure accounts where recovery of expenses is possible like Packing and Forwarding Expenses Account, Advertisement Expenses Account, Transportation/Freight Charges Account, Sales Expenses Account etc. may be scrutinized in order to find out any recoveries being made from the customer.
- (iv) From the Trial Balance, the income accounts (these accounts will have credit balances) should be selected for scrutiny and the exact nature of such incomes accounts

		<p>should be found out from the study of the documents mentioned in the relevant ledger accounts. Some of these accounts might have direct impact on the valuation of finished goods or it may also affect the Service Tax liability.</p> <p>(v) Unusual accounts as noticed during the study of Trial Balance may also be scrutinized as to find out the exact nature of such accounts.</p> <p>(vi) The tax auditor may verify the Plant and Machinery Account to find out the additions made during the year and the disposal of plant and machinery made during the year. In the case of disposal, whether the appropriate amount of excise duty has been paid or not may be inquired into by the tax auditor.</p> <p>(vii) As far as verification of claiming of depreciation on capital goods is concerned, the verification should be made from the Income tax return filed by the assessee or from the Income Tax Audit Report (3 CD report).</p>
2.	Debit Notes	<p><u>Nature of Documents:</u></p> <p>Debit Note is a statement informing the other party that his account has been debited for the reasons given in the Debit Note. The financial impact of a Debit Note is that the addressee is liable to pay the amount mentioned in the said statement to the person who has issued the Debit Note. In other words, the person issuing the Debit Note is eligible to receive the amount from the addressee. Debit Note may be issued for various reasons like return/short receipt of goods purchased, increase in the rate/quantity of the goods sold, recovery of packing charges, warranty charges, after-sales service charges etc. from a customer. The job worker may raise a Debit Note for value of own material used by him. The principal manufacturer may issue a Debit Note to a job worker for the value of scrap generated during job work process and retained by a job worker.</p> <p><u>Types of Verification:</u></p> <p>(i) Since the number of Debit Notes issued by a unit are generally not very large, therefore all the Debit Notes must</p>

		<p>be studied by a Tax Auditor.</p> <p>(ii) The Debit Note itself shows the reason for its issue and most of the time the supporting documents are enclosed with the Debit Note. Therefore such documents should be studied in detail.</p> <p>(iii) Cases of additional recoveries from the customer or rejection and short receipt of inputs are generally noticed in the Debit Note.</p>
3.	Credit Note	<p>Credit Note is a statement informing the other person that his account has been credited for the reasons mentioned in the Credit Note. The financial impact of issue of a Credit Note is that the addressee is eligible to receive the amount of credit note. Credit Note may be issued for the reasons like return of goods by the customer (sales return).</p>
4.	Journal Voucher (JV)	<p><u>Nature of Document</u> :-</p> <p>JVs are prepared for all adjustments which may not involve direct financial dealings. For example, accounting of raw materials consumed in a particular month, providing of depreciation or making provision for payment of royalty.</p> <p><u>Types of Verification</u>:</p> <p>(i) As most of the adjustments are made at the end of the half year and at the end of the year, therefore, all the JVs for the half year ending month or year ending month (September and March in the case of units following April to March as accounting year) must be verified.</p> <p>(ii) The narration given in the JVs should be studied in order to find out the exact nature of transaction being entered in the books of accounts.</p> <p>(iii) Study of JVs may reveal accounting system followed by a unit. For example, a company following the system of cost centres may account for consumption of raw material for each centre on a monthly basis. In such cases, the raw material consumption by non-production department like construction department or maintenance department may be found out from the study of JVs which is passed at the end of each month. The said JVs may also be useful in</p>

		<p>quantifying the amount of wrong availment of CENVAT credit for entire year as only one JV is required to be examined for each month.</p> <p>(iv) Adjustment entries passed for transferring the balance of one account to another related account may also be found out from the study of JVs. For example, Recovery of Packing and Forwarding Charges Account may be transferred to Packing and Forwarding Expenses account and for this purpose a JV is passed.</p> <p>(v) Some times additional consideration may be collected from customer by issuing a simple letter to the customer (without issuing any debit note or sales invoice). In such cases these transactions are accounted for through JVs.</p> <p>(vi) Similarly, for quantities short received or rejected quantity also the supplier may be compensated by way of intimation and the transaction is recorded through a JV.</p>
5.	Internal Audit Report	<p><u>Nature of Document :-</u></p> <p>This is the report submitted by internal auditors appointed by the company which looks into day-to-day activities and the systems followed by the unit. In the bigger company, it is a mandatory also.</p> <p><u>Types of verification :-</u></p> <p>i) Call for sample audit reports and examine with respect to observations on loss of any input, excess availment of CENVAT credit, collection of additional consideration</p> <p>ii) Verify whether any system changes have been advised and followed by the assessee. In that case for the past period any implication on Excise payment due to a weak internal control needs to be examined.</p> <p>iii) Internal Auditor also reports about stock verification and in case of shortages the CENVAT availment needs to be examined.</p>
6.	Purchase Book	<p><u>Nature of Document:</u></p> <p>This shows credit purchase of raw materials and other inputs.</p> <p><u>Nature of Verification:</u></p>

		<p>(a) To fine out major suppliers</p> <p>(b) It may also show excise duty separately. In that case excise duty recorded in the purchase register may be reconciled with credit availed as per CENVAT return.</p>
7.	Purchase Return Book	<p><u>Nature of Document:</u> This book gives details of goods returned to suppliers.</p> <p><u>Nature of Verification:</u> Verify whether CENVAT credit has been expunged / such goods cleared on payment of duty.</p>
8.	Tax Audit Report	<p><u>Nature of document:</u> As per the provisions of the Income Tax Act, all assessees having a turnover of above Rs.40 lakhs are required to have their records audited by a Chartered Accountant and the Audit Report known as Tax Audit Report is given by Chartered Accountant. The said report is given in the form 3 CD and it is required to be enclosed along with the Income tax return filed by the assessee.</p> <p><u>Nature of verification:</u> Depreciation statement as per the provisions of Income Tax Act enclosed with Tax Audit Report may be verified to confirm the correctness of availment of CENVAT credit on capital goods.</p> <p>(i) As per Clause 22 of the said report, amount of CENVAT credit availed or utilized during the year and its treatment in the Profit & Loss Account and treatment of outstanding CENVAT credit in the account is required to be given. Tax Auditor may compare the said information with the information as per excise records.</p> <p>(ii) As per clause 28, details like opening stock, purchases, sales and closing stock of trading activities and in the case of manufacturing unit quantitative details or principal items of raw materials, finished goods and by-products showing opening stock, purchases, consumption, sales, closing stock, yield of finished goods, percentage of yield and shortages/excesses is required to be given. This information may be used by Tax Auditor to verify the input-</p>

		output ratio. The reasons for excessive shortage/ excesses and whether duty has been paid on the sale of raw material as reported in the tax audit report may be inquired into.
9.	Income Tax Returns	<p><u>Nature of document:</u></p> <p>This return is filed by the assessee with the Income Tax department showing the calculation of income tax on the profit / loss earned by them. The return is filed in the prescribed format and alongwith the return a statement namely computation of income is enclosed.</p> <p><u>Nature of verification:</u></p> <p>In the computation of income statement, a depreciation statement is also enclosed. The said depreciation statement shows depreciation claimed on various assets as per the provisions of Income Tax Act. The auditors should verify whether the value considered for claiming depreciation is inclusive of CENVAT credit availed by the assessee or not.</p>
10.	Sale Tax/VAT returns	<p><u>Types of verification:-</u></p> <p>i) Reconcile the total sales as per Central Excise returns, Sale Tax/VAT returns and financial records.</p> <p>ii) Verify whether any exemption has been claimed from payment of Excise duty and how the same item is being claimed for payment of Sale Tax / VAT.</p> <p>iii) Verify the credit availment on purchases as per VAT returns and compare with CENVAT Credit as per Excise records.</p> <p>iv) Verify the abatements claim in Sale Tax/VAT return and its implication on Excise payment, if any.</p> <p>v) Verify works contract tax payment as per Sale Tax/VAT return and its implication for payment of Excise duty/Service Tax.</p>
11.	Fixed Assets Register	<p><u>Nature of Document :</u></p> <p>This register contains the details of purchase invoice, date of installation, place of installation, addition/deletion to the asset and depreciation charged.</p> <p><u>Nature of Verification:</u></p> <p>(a) Deletion of Assets – Payment of duty on clearance</p>

		<p>needs to be verified.</p> <p>(b) Location – This will help the auditor to know the place of use so that the eligibility of credit can be determined e.g. in case UPS is used in office then such CENVAT credit cannot be allowed.</p> <p>(c) For physical verification, the location may be found out from this register.</p>
12.	Monthly stock statement to bank.	<p><u>Types of verification :-</u> Companies are required to file a stock statement every month to the banks when the stock is hypothecated for loans. In such cases, verify the stock position as per statement given to the bank and the stock position as per company's private and financial records.</p>

ANNEXURE – D

(Please see Chapter 10)

RATIO ANALYSIS OF DATABASE

S. No.	Nature of Ratio / Method of calculation	Utility of the Ratios in Excise Audit-2000	Source Document
1.	Input CENVAT Credit: Total duty payment (PLA + Input credit + Capital Goods credit)	<ul style="list-style-type: none"> i) To identify wrong availment of CENVAT credit ii) To identify under valuation of goods as value-addition should involve adequate difference between the two. iii) To identify removal of goods without payment of duty. iv) To identify claiming of CENVAT credit on inputs used in exempted products. 	Assessee Master File.
2.	Raw Material Consumption Cost : Sales Value	<ul style="list-style-type: none"> i) This ratio shows the part of sales value represented by raw material cost. The balance sales value represents the value addition on account of non-CENVAT elements like wages, overheads, depreciation, interest. ii) Theoretically, this ratio should have a bearing on the ratio of Input CENVAT credit: Total Duty payment (Sl.No.1). iii) If this ratio is lower than ratio at Sl.No.1 or more than previous year's ratio, it may be on account of the following: <ul style="list-style-type: none"> a) Wrong availment of credit like cases of availing value of goods as credit or availment of credit of basic custom duties in case of import or double credit on same document. b) Fraudulent availment of credit like availment of credit without receipt/actual use of input. c) Rejection/return/clearances of input without reversal of credit d) Receipt of inputs and availment of credit but clearances of finished goods without payment of duty. e) Under valuation of finished goods. <p><u>Important points to be considered:</u></p> <ul style="list-style-type: none"> i) Only manufactured goods sales value should be considered. ii) Export value to be excluded from sales value, if export is under bond (if export was on payment of duty, in that case, export value should be included). iii) Exclude the Excise duty + Sales Tax from sales value, if details are available. 	Profit & Loss Account and Notes to the Accounts.
3.	CENVAT availed on Capital Goods purchased during the year: Addition to Plant & Machinery	<ul style="list-style-type: none"> i) Addition to the Plant & Machinery is available from the Fixed Assets Schedule enclosed to the Balance sheet. ii) If this ratio is significantly higher than the ratio of 50% of the rate of duty on Capital Goods (Presently 16%):100, it may indicate wrong availment of credit. (This ratio needs to be verified at the time of audit because at the Desk Review stage the amount of CENVAT credit on 	Balance Sheet & ER-1 Return.

		Capital Goods purchased during the year may not be available as total credit availed will be inclusive of balance 50% credit of capital goods purchased in the previous year).	
4.	Other Income: Sales	i) If this ratio is higher than previous period, it may be on account of the following: a) Under valuation of finished goods by non-inclusion of other incomes like recovery of Advertisement expenses, Packing and Forwarding Expenses in the assessable value. b) Non payment of duty on scrap/rejects/job work. ii) Service Tax liability on Other Income may also be examined.	Profit & Loss Account.
5.	Sales Tax: Sales (including trading Sales).	To compare the abatement of Sales Tax claimed by assessee in case of Cum-Sales Tax prices.	Trial Balance / Profit & Loss Account
6.	Scrap Sales: Sales	If ratio in the current year is lower, it may be on account of the following: i) clearance of scrap without payment of duty ii) Non receipt of scrap from job worker.	Profit & Loss Account/Trial Balance.
7.	Power Consumption/Fuel consumption(Qty): Production Quantity	To identify suppression of production.	Director's Report in Annual Report and Quantitative details of production from Profit & Loss Account.
8.	Sales Value of Trading Goods: Sales value of manufactured goods.	i) To identify clearances of manufactured goods in the guise of trading goods. ii) To identify clearances of essential parts of manufactured goods as trading goods. iii) To identify under valuation of manufactured goods by overvaluing trading goods.	Profit & Loss Account.
9.	CENVAT availed on inputs: Purchase price of Raw material.	i) To identify cases of wrong availing of credit like availing credit of value. ii) Non reversal of credit/payment of duty on inputs rejected/short received/cleared to other units/cleared as spare during warranty period.	Assessee Master File and Profit & Loss Account/Trial Balance.
10.	Quantity of actual production (Nos./Kgs./Lt) : installed capacity	i) To detect suppression of production and clearances	Annual Report and documents pertaining to installed machinery.

ANNEXURE – E

Verification of Cost Audit Report

As per Rule 22(3) of Central Excise Rules, every assessee shall, on demand, make available Cost Audit Reports (CARs) to the officer empowered under sub rule (1) or the audit party deputed by the Commissioner. Cost Audit Reports have been considered as one of the important tool for conducting the Central Excise Audit as it provides quantitative and financial details regarding production, clearance, capacity utilization, input-output ratio, related party transaction, valuation of production alongwith reconciliation of annual turn over with assessable value of excise product as per excise return. However, Audit Officers often do not have authentic information as to which companies are covered under Cost Audit and may fail to access the Cost Audit Reports. Therefore, details in this regard have been obtained from the Ministry of Company Affairs.

Ministry of Company Affairs have prescribed Cost Accounting Record Rules (CARRs) in respect of 44 different industries. Every company belonging to an industry for which rules have been notified (except small scale companies having total turnover of less than Rs.10 Crores) is required to maintain the cost records as per provisions of the Companies Act, 1956.

The Cost Audit is not mandatory for all the companies in respect of which the CARRs have been notified. The ministry of Company Affairs issue specific orders under Section 233 B of the Companies Act for conducting annual audit of cost records of the company in respect of a particular product covered under CARRs through a practicing Cost Accountant. The Ministry has furnished a list of companies covered under Cost Audit Order which is placed on **website <http://210.210.94.179/audit.html>**. Since the list is compiled alphabetically, this will help the Commissionerate to identify the particular company covered under cost audit under their jurisdiction.

The Cost Auditor in his report give the information/details on the cost data for the company as whole as well as in the respect of each plant/unit of the company located at different locations. The Commissionerate may have a benefit of getting the information/details in respect of other plan/unit as well as for the company as a whole in one report which may help the audit officer in intra/inter-firm comparison of various information/details. The details of relevant paras useful for Central Excise Audit are given in the table below:

In case an assessee is not covered under the cost audit, the Audit Officer may examine the Cost Accounting records maintained by them on the pattern of Cost Audit Report. Updated information on CARRs and Cost Audit Orders issued by the Ministry of Company Affairs will be uploaded on the website by this Directorate from time to time (Reference : Letter F.No.381/107/2005 dated 26.10.05 of Adviser (Cost), Officer of the Director General (Audit), Customs & Central Excise, New Delhi.

Annexure Nos. of the Cost Audit Report	Subject	What is to be seen
1- SI.No.5	General Information	Auditors may use this information at time of Desk Review, which may be useful for audit of multi-Locational units. It provides particulars about location of other manufacturing units and the product(s) manufactured by these units.
3	Process of manufacture	It provides in details about the manufacturing process of the product under audit. Various ingredients used in connection with manufacture of the product under reference can also be traced out from the report. Process of manufacture, ingredients used, alongwith end use of the product (such as industrial use/for medicaments/for consumers' use etc.) will help the auditors to ascertain classification of excisable products correctly & precisely.
4.	Quantitative details	It contains details of : <ul style="list-style-type: none"> • Installed Capacity • Capacity enhanced during the period • Total production & Total available quantity • Captively consumed quantity • Quantity sold with break up of Export & domestic clearance • Closing stock of unsold goods Auditors should reconcile this data with Excise Return and major variation (if noticed) should be looked into.
5A	Major input material / components consumed	It helps to ensure correct availment of CENVAT Credit
5B	Std./ Actual Consumption of Input Materials per unit	Auditors may use this information for verifying the end-use of input materials especially in case of E.O.U. It will help auditor to verify whether the assessee has imported raw material more than the requirement was per Standard/DGFT input-output norms. This will enable the auditor to know about disproportionate procurement of material

		imported, which may be lead to diversion in DTA market.
10	Royalty & Technical Know-how Charges	As the information contain is product wise, the auditor may find useful in determining the tax liability of the assessee. Moreover, auditor may go through the source documents about the scope of work and terms of payment to assess the tax-compliance aspect of service tax on Royalty & Technical Know-how.
18B	Written off stock	To check reversal of CENVAT credit availed on written off items. On the basis of the information available here, auditor needs to quantify the amount of CENVAT credit for which reversal of credit is required.
23	Value addition	To check wrong availment of CENVAT credit or under valuation of excisable product.
26	Related party Transaction	To unearth under valuation of excisable product transferred within group companies/related parties.
27	Central Excise reconciliation for the product under reference	This will help to ensure overall tax assessment and tax compliance such as reconciliation of turnover as per annual report and Excise Returns, CENVAT availed & utilized, Chapter Heading wise reconciliation of production and clearance, if duty realized is more than the amount deposited (section 11 D case) etc.
Performa of Cost of Production		It helps to compute assessable value under cost Construction method in terms of Cost Accounting Standard-4, for determining assessable value under captive consumption, related party transaction (Rule 9 provision) etc.
		Particulars of abnormal/non-recurring cost available in the cost audit report may be examined to find out its implication on Excise point of view. Any extra ordinary happening which resulted in excessive use of raw materials or low productivity due to reasons like wastage in trial production, discontinuation of particular model and sale of scrap etc. is also reported in Cost Audit Report. This information may be used by tax Auditor also.

ANNEXURE – F

(Please see Chapter 10)

Revenue Risk Analysis (illustrative example)

Following is a sample format with which such analysis can be performed:

1. Reconciliation of excise duty paid in excise returns with that shown in financial accounts.
2. Applying the rate (if ad valorem) to such reconciled figure of excise duty in financial accounts, the assessable value of sales can be worked out. If the finished goods attract different rate of excise duty, then product wise assessable value of sales needs to be worked out. For this excise duty paid will have to be first broken up product wise.
3. The assessable value of sales in 2 above should be compared with the value of sales shown in financial accounts and the reasons for the difference must be analysed. Possible reasons could be sales which are either exempted or non excisable. Attempts should be made to isolate such sales in the financial accounts and then correlate the results with the figures in excise returns.
4. Similar steps must be carried out for CENVAT credit also. Credit shown in financial records must first be reconciled with that shown in excise returns. Before doing so, it is necessary to understand the accounting treatment of CENVAT credit followed by the assessee.
5. Having reconciled the amount of credit, the value of purchases has to be worked out. As different inputs attract different rate of duty, such exercise may be difficult for all the inputs. In such a scenario, using ABC analysis, approximate purchase value of important inputs can be worked out (from CENVAT account) and then compared with financial accounts with reference to those inputs. The auditor must make a mention of this selective analysis and must mention as to how much purchases in value terms stands covered (say 80%) with the selective approach. For the remaining inputs, an average rate of duty can be worked out and used for comparing the value of purchases so arrived with that booked in financial accounts. Any difference must be looked into and the reasons must be gone into.

Illustrative examples of Revenue-Risk analysis

Illustration A Reconciliation of Sales of M/s ABC Limited:

Clearances (chapter heading wise) as per monthly returns	26762225
Clearances of duty-free goods	1151245
Clearances of non-excisable goods	902578
Total of all the clearances	28816048
Sales as reported in Annual Report/ Trial Balance	42483330
Difference	13667282

Illustration B Reconciliation of duty payments made by M/s XYZ Limited

Total clearances of duty-paid goods	10483330
Duty payable on goods cleared	1402096
Excise duty paid through CENVAT – inputs	1245904
Excise duty paid through CENVAT – capital goods	1888
Excise duty paid in PLA	104304
Total duty paid	1352096
Difference between the duty payable and duty paid	50000

Illustration C Reconciliation of duty paid as per monthly returns and duty recovered

Total duty paid as per P & L account	1352096
Excise duty recovered as per P & L account	1402096
Difference	50000

Explanation for Illustration A: A small scale manufacturer of special purpose machines was availing SSI exemption for the years 2000-01 and 2001-02.

During the audit of the unit for the year 2001-02, it was noticed that they reported a turnover of Rs.4,24,83,330/- in their Annual Report for the year 2001-02. For the purpose of reconciliation, the relevant monthly returns have been studied and the aggregate value of clearances of duty-paid goods chapter-heading wise worked out to Rs. 2,67,62,225/-. The difference between the turnover in the

Annual Report and the monthly returns was attributed by the assessee to exempted goods (Rs. 11,51,245/-) and non-excisable goods such as trading sales etc. (Rs. 9,02,578/-). However, even after considering the said items, a difference of Rs. 1,36,67,282/- remains unexplained. On close scrutiny of the sales register and other records, it came out that the assessee cleared certain quantity of goods in the fag end of the year 2000-01, under delivery challans, but recorded them as sales in the year 2001-02 to further avail the benefit of SSI exemption for the year 2001-02.

Explanation for Illustration B: During the reconciliation of duty payable and paid by a manufacturer of steel tubes, it was noticed that for the year 2001-02, the duty payable is Rs. 14,02,096/- on a turnover of Rs. 1,04,83,330/-, whereas the aggregate of duty paid in PLA and CENVAT is Rs. 13, 52, 096/-. Thus, a difference of Rs. 50,000 is left un-reconciled. On close scrutiny of duty payments it was noticed that they have defaulted in fortnightly payment of duty in the month of March, 2002. As per the rules, for the month of March of any financial year, the assessee is required to pay the duty payable by 31st March of the year. This resulted in the above difference. The duty paid as per the monthly returns and duty recovered as per financial accounts is given as Illustration C.

Explanation for Illustration C: During reconciliation of duty paid and recovered (both as per the data available in the Profit and Loss Account), it was noticed that the amount of duty paid is Rs. 13,52,096/-, whereas the duty recovered from customers is Rs.14,02,096/-. The difference between the two is Rs. 50000/-. The difference arising is due to default in fortnightly payment of duty in the month of March 2002. Thus, it appears that the duty paid recorded in profit and loss account is reconciled with the duty payment particulars as per monthly returns.

Similarly, the difference arising in Illustrations B and C is equal, which can be simplified below:

- (a) The duty payable on goods cleared (on payment of duty) as per monthly returns shall be equal to the duty recovered from the customers (as reflected in profit and loss account) since the customers' accounts are debited immediately on clearance of goods, and not on receipt of the amount.
- (b) The duty paid (on clearances of dutiable goods) as per monthly returns shall be equal to the duty paid as per profit and loss account, subject to the differences of miscellaneous debits such as fines, penalties, duties paid on audit objections etc.

ANNEXURE – G

(Please see Chapter 11)
TREND ANALYSIS

Illustration A:

During the audit of a manufacturer of a bulk drug, trend analysis of raw material consumption ratio has been conducted. The major input utilised in the manufacture of the bulk drug is CS lye, Para Nitro Chloro Benzene (PNCB), Acetic Anhydride etc. As a sample check, the consumption trend of one input namely PNCB (**being the high value material**), in relation to production, has been studied for 3 years. Following is the statistical data:

Year	Consumption (in kgs of PNCB)	Production (in kgs) of bulk drug	Ratio (per one kg of production)
2002-03	2578520	1613292	1.598
2001-02	2371110	1869111	1.268
2000-01	2019000	1859675	1.085

From the above, it appears that the consumption of input is showing increasing trend over a period of three years. In fact, by gaining experience in manufacturing, productivity is supposed to go up. In other words, in a **process industry**, the consumption of inputs ought to show decreasing trend or at least it should remain, more or less, static. However, in the present case, it is showing a negative trend. Further, even when the ratio has been compared with the industry norms (available from other units) it was found to be on the higher side. When the assessee could not furnish the reasons convincingly with substantiation, the matter was referred to Anti-Evasion for further investigation.

Illustration B:

During the course of audit of a biscuit manufacturing unit, a study has been conducted to verify the trend of consumption of packing material with reference to trend of production of goods. It is ascertained that the cost per unit of packing material remained constant. Further, the quantities of packing materials consumed are having different units of measurement, and hence the cost of packing materials (instead of quantities) was taken for conducting the trend analysis. The particular item was selected because, it is directly relatable to the quantity of goods produced and forms major part of the cost of the product. Except for some exceptional items, the trend of consumption of packing material should be more or less in tandem with the trend of production of finished goods. This was done for two years i.e., 2000-01 and 2001-02.

The production of biscuits in 2000-01 is 10,56,248 kgs, whereas it is 11,98,457 kgs in 2001-02. The cost of packing material consumed (as mentioned in profit and loss account) is Rs.42,25,687/- for 2000-01,

whereas it is Rs.46,98,263/- for 2001-02. It appears that the production of the finished goods increased by 13.46%. Whereas, the cost of packing material consumed has increased by 11.18%. Therefore, it is clear that the cost of consumption of packing material is growing at lesser pace which is a sign of increasing productivity. The assessee explained the trend, stating that they reduced the emergence of wastage at various points.

Illustration C:

M/s ABC are manufacturing specialised machinery. These machineries have a longer span of life, therefore, spare parts are required regularly by the customers for the maintenance of these machines. The assessee also undertakes the repair of these machineries in his manufacturing premises. For the clearances of spare parts, the assessee informed that they were reversing the credit on paying the excise duty as per the prevalent law. At the time of audit, the following information were obtained from the study of Profit and Loss Account for the period 2000-2001 and 1999-2000. The figures of 1998-1999 were also available in the Profit & Loss Account of 1999-2000.

I. Duty payment particulars: (Amount in lakhs)

Year	PLA	Input Credit	Capital Goods Credit	Total	% of Input Credit
1998-1999	14	102	5	121	84 %
1999-2000	21	70	8	99	71 %
2000-2001	20	92	9	121	76 %

II. From the annexures to the Profit & Loss Account, the following details regarding sales and other income were compiled.

	1998-99	1999-2000	2000-2001
Sales (excluding Excise duty)	760	600	640
Trading Sales of bought out items	104	90	105
Services charges (Labour job income)	110	355	120
Other income	12	15	10
Total income	986	1060	875

III. Details of value of raw material consumption was also compiled from the Profit and Loss Account. From the details of value of raw

material consumption, the percentage of Raw Material consumption to Sales was also worked out which is also given below:

	1998-99	1999-2000	2000-2001
Value of R. M. consumption	490	380	405
%age of R. M. consumption to Sales	64 %	63 %	63%

III. Trend Analysis: From the above information the following observations were made by the auditor.

- a. The percentage of input credit availment to the total duty payment has been very high.
- b. The input credit availment ratio has been fluctuating from 84 % to 71 % to 76 %.
- c. The company is earning a substantial amount of revenue from trading sale of bought out item and through labour income. In fact, during 1999-2000, the labour job income was more than 50% of manufacturing sales.
- d. The percentage of raw material consumption to the sale value has been in the range of 63-64%.

IV. From the above findings, the following calculations were made in order to find out the correctness of CENVAT credit availment by the assessee.

- i) Assuming that on all raw material purchased by the assessee, they are availing CENVAT credit and the rate of duty on all the inputs was 16 %.
- ii) Based on the above assumption, the total purchase value of inputs, on which the assessee has availed the credit, has been worked out as below. $((\text{input credit}/16) \times 100)$

(Amount in lakhs)		
Year	Input credit availed	Calculated value of the inputs
1998-1999	102	638
1999-2000	70	437
2000-2001	92	575

iii) As against the above mentioned calculated value of inputs, the actual value of raw material consumption as mentioned in para III above is given below

Year	Calculated value of input	Value of raw material consumed
1998-1999	638	490
1999-2000	437	380
2000-2001	575	405

From the above it appears that the assessee has purchased the inputs and availed the credit but these inputs may not have been used in the manufacture of the finished goods.

VI. Based on the above analysis, following areas were selected for study as a part of audit plan.

- (i) Verify all documents where credit availment is more than Rs. 5000/-.
- (ii) Verify stores records to confirm receipt of credit availed inputs (check GRN and store ledgers).
- (iii) Verify use of inputs (check issue slips and Store Ledger).
- (iv) Verify whether credit was availed on inputs which were sold subsequently as 'sale of bought out item'.
- (v) Verify whether credit was reversed on items used in labour jobs.

VII. The audit noticed the following irregularities.

- (i) For sale of bought out items, the assessee had availed the input credit at the time of its purchase but while selling the same, they did not pay excise duty.
- (ii) For various labour jobs undertaken by them, they had used the inputs on which CENVAT credit was availed by them but no reversal of credit was made.

ANNEXURE – H

(Please see Chapter 10)

Note: This is only an illustrative Audit Plan for M/s ABC Paper Mills. Plan for each unit should be prepared based on the specific requirement.

Sl. No	Subject	Specific Issue	Source Document	Back-up Document	Coverage Period	Selection Criteria
1	Classification	Use of non-conventional inputs for manufacture of paper	Classification declaration	1. R M Procurement Register 2. Digester Control sheets/register 3. Lab reports for pulp. 4. Pulp recovery register	For the months: April, July and October 99	All documents
2	Valuation	Turnover Discounts	CE Invoice	1. Commercial invoice 2. General ledger 3. Credit/ Debit notes	Entire Audit period	All invoice serial numbers ending with 5.
3	Valuation	Sale to related person	1. CE Invoice 2. Price declaration	1. Agreements relating to sales 2. Party ledgers 3. Invoices of comparable goods to unrelated buyer	Second quarter of 99.	All invoices pertaining to related buyer
4	CENVAT Credit	Receipt of actual quantity vis-à-vis quantity on which credit taken	1 Input invoices 2 Credit availment register	1. Material receipt note/register 2. Insurance claim documents for transit losses 3. Stores ledger	Entire Audit period	All invoice
5	Credit on Capital goods	Availment of credit in 2 nd year	1 Capital Goods invoices 2 Credit availment register	1. Physical verification of possession and use.	All capital goods on which 2 nd instalment of credit is availed during the audit period.	All invoices

Guidelines for filling in the Audit Plan:

1. Subject: - For example classification, valuation, CENVAT etc.
2. Specific Issue to be verified. Under this column, the auditor should mention the precise issue pertaining to the subject. For Example Discounts passed on to the buyer, Utilisation of inputs for repair/re-processing, etc.
3. Source Document/ Information to be verified: - documents/information reflecting or having a bearing on payment of CE duty, to be verified. For example CE Invoice showing a particular discount.
4. Back-up Document: The documents to be examined to check the correctness of the information contained in the source document. The method of examination may also be specified under this column. For example Commercial invoice, party ledger, discount policy documents, price circulars, etc. reflecting the said discount.
5. Period of coverage: - Normally, the coverage will be for the whole of the audit period. However, the auditor may conduct test verification for specific periods each extending over a short duration.
6. Selection Criteria: - In case, the volume of documents for verification is large, the auditor may adopt sample verification. In such a case, the sample selection techniques should be spelt out. The sample should be chosen in such a way that it represents the whole, uniformly.

ANNEXURE – I

(Please see Chapter 11)

Proforma of a verification paper

1. Date of verification
2. Name of the auditor verifying the issue
3. Issue involved in brief
4. Ref. No. of the Audit Plan
5. Documents verified
6. Brief account of the process and extent of verification
7. Auditor's observation and conclusion in brief
8. Quantification of revenue involved, if any (also give the calculation sheet)
9. Documents relied upon to support the conclusion

Signature of the auditor

Supervising officer's remarks and signature.

ANNEXURE – J

(Please see Chapter 11)

Review of Internal Control System

PURCHASES

1. Whether all purchases are centralised or de-centralised. If all purchases are authorised by few key persons like owner or Managing Director etc, it may require in-depth study of purchases.
2. Whether all the purchases are made only by issue of purchase order and whether different series of purchase order are issued. Also, the issuance of series of purchase order is centralised in the purchase section. Are there any cases where purchases have been made without issue of purchase order?
3. Whether there is a system of authorised Vendor List. If not, what is the system of approving particular vendor? Are there instances where substantial purchases have been made through unauthorised vendors?
4. Whether all goods entering into the factory premises have been entered at the gate and what details are mentioned at the gate Register.
5. Whether Goods Received Note (GRN) is prepared for each goods entered in the factory. Whether separate series of GRN is prepared for goods meant for different section like raw material, capital goods, stationery etc.
6. Whether a separate code number is available for each type of goods and whether the same is entered on the GRN.
7. Whether inspection for physical quantity or technical specification is carried out before the preparation of GRN or afterward and what is the composition of inspection team. Whether report of inspection is documented and whether a separate record is maintained by Inspection Department.
8. Whether rejected goods are stored separately. What is the system of entering the rejected goods/short quantity on the GRN?
9. Whether for purchase returns, debit notes are issued.
10. Whether for rejected goods any set procedure is followed.
11. What is the ratio of purchases made from dealers and manufacturers
12. How and at what stage excise and accounts department is informed about goods short received and rejected. What document is prepared in this connection.
13. Is there any mechanism to reconcile the quantity and value of goods entered in the stores department and as per the purchase register.
14. Whether CENVAT is availed before preparing the GRN or after preparing the GRN. On the goods rejected or short quantity received, whether the CENVAT reversal is

done on each invoice basis or on the monthly basis. If on monthly basis whether it is done on the basis of any statement issued by GR Section.

15. Whether any item supplied free of cost by customer.

SALES

1. What is marketing pattern - is it through depot, stockist, C&F agent related person or directly by assessee.
2. Whether any bought out item also sold by company?
3. How many series of sales invoices are generated in the company? For example there can be different series for excisable goods, export goods, scrap, other items and job work.
4. Whether sales of all different series of invoices is entered in one sales account or in different sales account.
5. Whether different delivery challan/packing slips is prepared for goods cleared from different sections or there is a common series of delivery challan for all type of goods removed from the factory.
6. What is the control mechanism by which security person at the gate ensures that any goods going out of the factory is cleared under a document.
7. Whether removal of all type of goods from the factory is routed through excise section or there are particular types of goods cleared from some other sections. Who authorises for despatch of goods from the factory.
8. Whether any charges for erection/commissioning charged.
9. Whether any materials supplied to customer free of cost.
10. Any amount for marketing expenses, Advertisement, Royalty, Handling Charges, Packing Charges, Warranty, after sales service and Insurance received from customer on invoice or debit notes.
11. Whether sales tax return and excise return are prepared by same person. If different whether any reconciliation is made for the difference in both the returns.
12. Whether excise invoices and sales invoices are same or different. If it is different whether the excise department is informed of variation in both the invoices.
13. Who is authorised to fix the sales price and whether any printed price circulars are issued.
14. Who is authorised to make supplementary sales invoices or debit note for price variation/additional recoveries (advertisement, after sales service, additional packing, insurance, freight, depot charges) and how excise section is informed.

15. Whether clearance figure of ER 1/ER 2 is tallied with sales register on monthly basis and in case of any variation what action is being taken.
16. Whether any goods received for repair etc.
17. Types of discounts given and how are they accounted for in relevant records.
18. Whether customer's account is debited with net amount of sales invoice or gross amount of sales.
19. Is the company engaged in trading activity also? What is the storage place? Whether CENVAT is availed on such trading goods. Are the bought-out items supplied directly to the customer without bringing into the factory? If so whether separate invoice are issued or the value of the same is added in the excise invoice.

STORES

1. Whether receipt in the stores record are shown only after inspection of goods or before inspection.
2. Whether all receipt in the stores is entered only on receipt of GRN or there are some goods where receipt is shown without preparing the GRN.
3. Whether issues are made only on the basis of requisition by production department or any other department.
4. Whether code number of receiving section are entered in the store record. Whether it is possible to verify the issues made to section other than production department like for construction, R&D, sale of input as such and inputs for repairing and reprocessing work.
5. What is the frequency of physical inventory for high value and frequently used items (A category in ABC analysis) whether a report is prepared for stock verification and put-up to management and what is the frequency of reporting?
6. For goods covered by insurance claim what is the procedure for filing the claim. Whether such goods are entered in the store register or these are shown in separate account. Whether any register or report is prepared for all such claims.
7. Inputs sent out for Job Work, what records maintained. Whether scrap is received back or job work price is adjusted.
8. What is the frequency of stock taking of all the items? How difference is accounted for and what reports are prepared.
9. When any goods are found defective in the stores section or it gets damaged in production department, how it is reflected in the stores, whether any separate account or report is prepared for the same.

TAX ACCOUNTING

1. Whether excise duty paid on raw material is shown separately in purchase account at the time of entering purchase invoice or it is shown only at the end of the month.
2. Whether all purchase bills are entered for full value and thereafter for rejected/stock quantity, credit note or sales return invoice is prepared.
3. Whether excise duty, payable on goods cleared, is shown separately in sales account and whether reconciliation is made with the amount of excise duty payable as per ER 1/ER 2 or other returns.
4. For capital goods whether full value including excise duty is debited in the books or net value is shown in the capital goods account.
5. For capital goods which are fully written off like spares for repair etc. whether excise duties deducted from such expenditure account or not?
6. What is the system to check excise duty liability (CENVAT and PLA) as shown in the financial records with the excise records. Whether any reconciliation is made for the differences.

JOB WORK

1. Whether any input/output ratio has been determined for sending the input for job work.
2. What records are maintained for sending the goods for job work and whether the records shows quantity of input sent, quantity of final product to be received, actually received and variation.
3. Whether any monthly or periodic statement are prepared for each job work and at what level the statement are verified for taking corrective action.
4. What is the system of treatment of scrap generated at the job work stage? Whether it is brought back to the factory or it is allowed to be disposed off by the job worker.
5. Whether the finished goods after job-work are being cleared from job-worker's premises.
6. When the goods are not received from the job worker in time what action is taken by the company and what accounting treatment is done for the same.
7. Are there some items, which are directly sent to the job worker without bringing them into the factory and how the same are accounted for in the records of the company.

ANNEXURE – K

(Please see Chapter 11)

Flow chart showing movement of transactions; same route can be followed for walk through process.

I. Sales / Removal of goods

Tender files



Sales order Book -- Sales Performance Chart -- Scrap Register



Marketing files



Price lists



Dealers agreement --- Distributor consignment Agents C & F Agents
Agreements



Weighment slip – Bin Card – Stores Ledger – Non moving stock register
(For finished goods) (For finished goods)



Delivery note – Invoices



Despatch advice

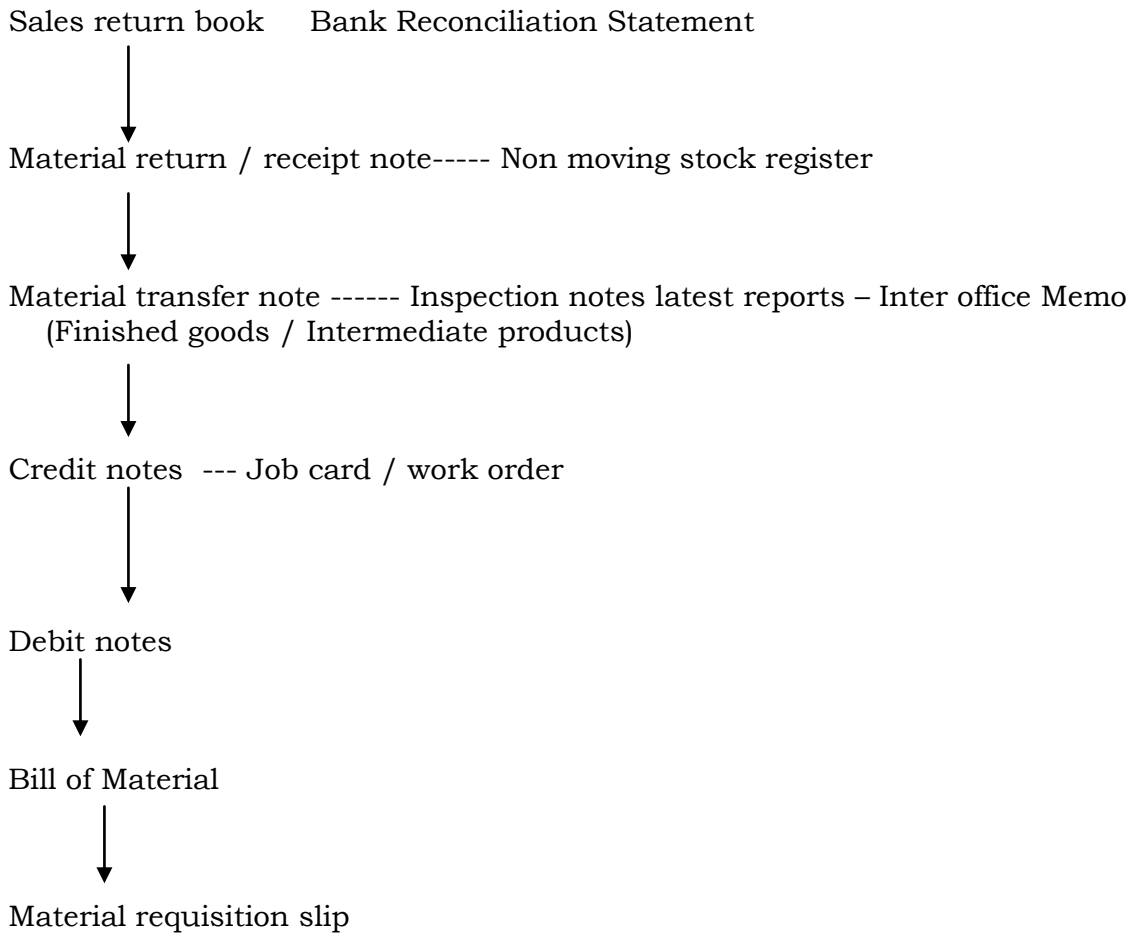


Gate pass – Invoices register

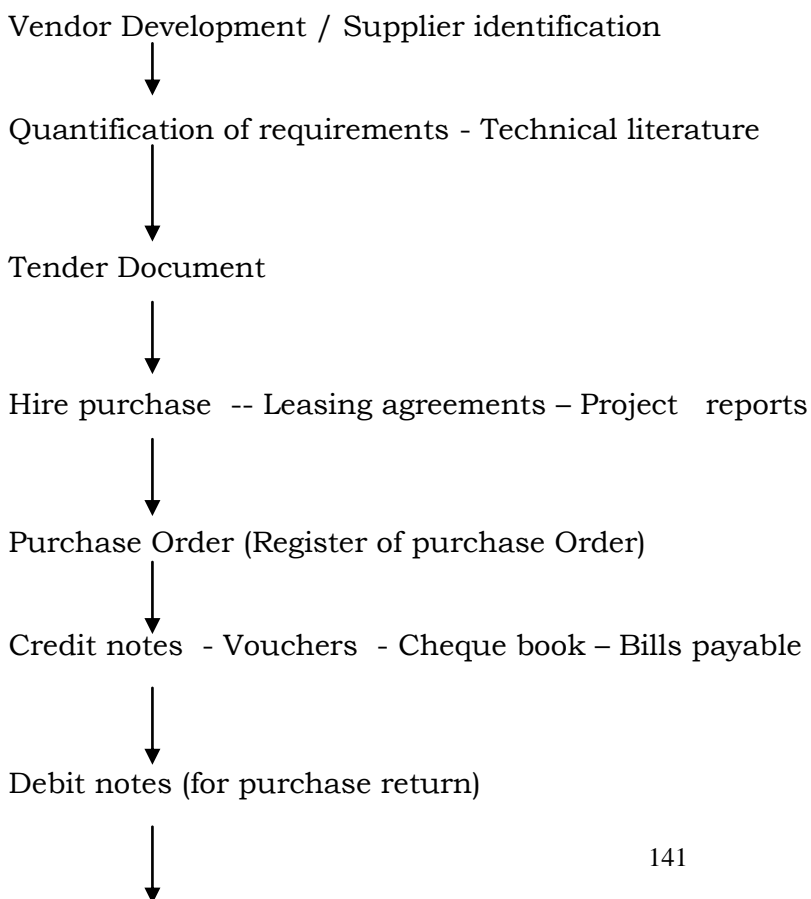


Gate register

II. Sales return



III. Purchases



Purchase book -- Gate register



Purchase Return Book



Gate Register



Material receipt note – Latest report -- Material rejection slip – Bad bin Register



IV. Production - Process Chart

Material Requisition Note - Bill of material – Hire purchase agreements, Lease agreement, Cost Audit report- Cost Register Bin card



Material transfer note / issue slip



Machine logbook --- Fixed Asset register --- Energy Audit report



Job card / work order



Time Card -- incentive card / register/Power generation/Consumption card



Production Slip/Production register

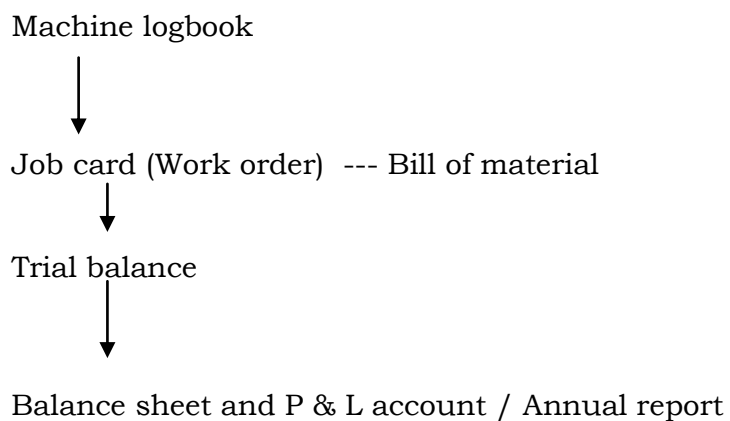


Material transfer note
(Final product)

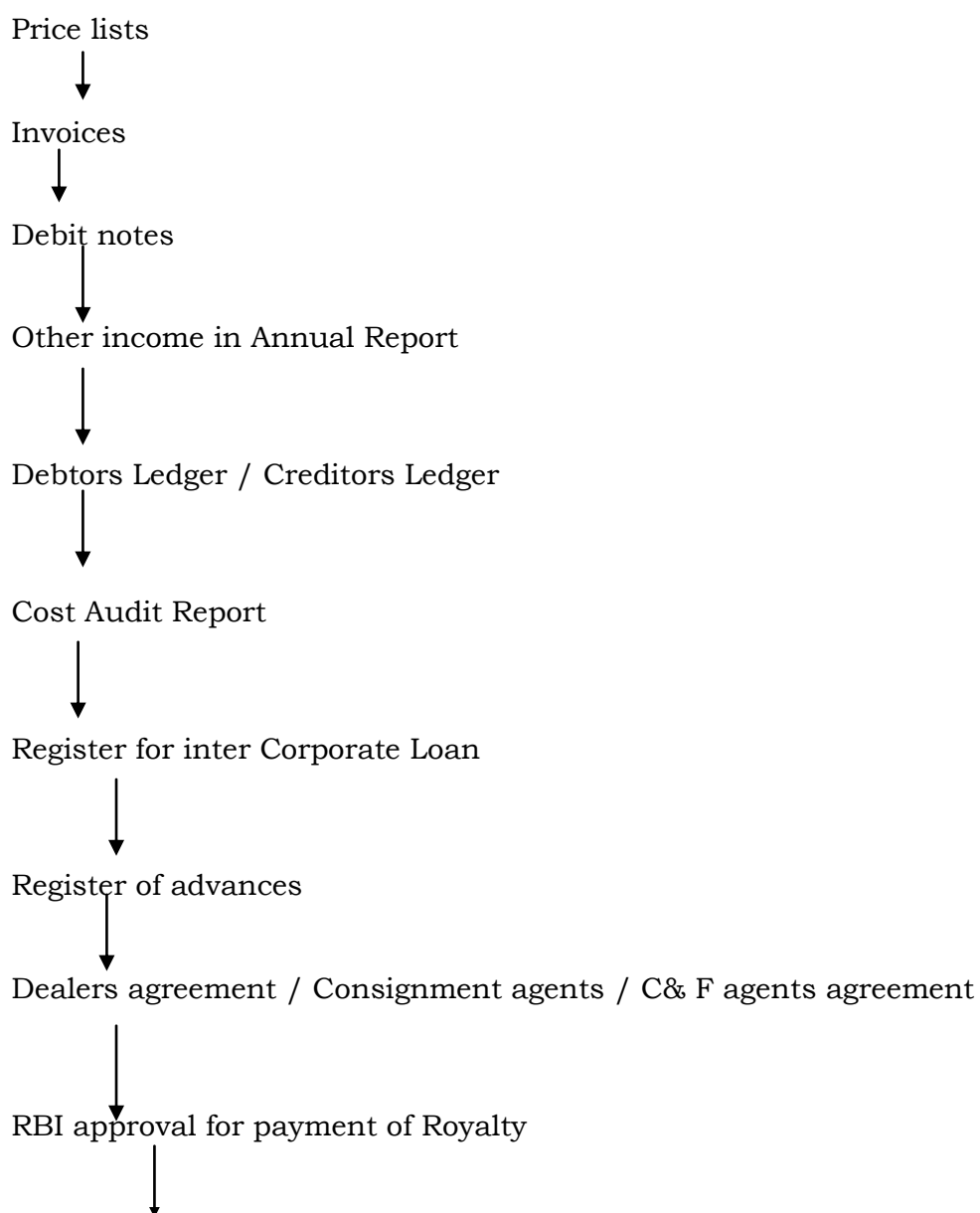
Costing.

Bill of material - cost audit report – cost register – Process chart





V Price determination (Transaction Value)



Bill of Entry Register



Bank reconciliation statement / Bank statement



Marketing files / Sales performance charts



Debit notes



Purchase order placed by buyers / sale contract



Fixed assets in custody of finance given by buyer

VI CENVAT

Gate register



Weighment register/slips



Material receipt note – CENVAT Account --- Loss in Transit – Rejects (CENVAT account)



Lab tests ---- Rejects/ return / debit note



Material transfer –rejected/returned/debit note



Inputs/Capital goods sold/Leased.



Input/Capital goods written off –



Capital goods --- fixed Asset register – Depreciation
Plant register /
I.T. return



Annual report --- Fixed Asset schedules / Depreciation schedules



Credit notes from suppliers



Bill of Material ----- To verify the utility of material / Input in the Manufacture of final Product.



Invoices ----- Input sale / transfer 'assets'
Documents relating to Input / IP transfer to job workers/ Bin cards / stores ledger.

VIII Non dutiable items

Name of the Non dutiable item



Bill of material ---- Cenvat credit availment



Material transfer note (Issue note) – Reversal of Cenvat credit

VIII Classification

Research Development --- Product Development – Product lab



Responsibility for verification of tax liability



Intimation ---- Inter office Memo



Marketing documents including literature.

IX New items produced. Discharge of duty and samples

New items produced.



Intimation



Fixation of value (procedure)



Clearance formality



Discharge of duty.

ANNEXURE – L

(Please see Chapter 11)

GUIDELINES FOR AUDIT OF EOUs INCLUDING EHTP/STP UNITS

Section 3 of the Central Excise Act makes a special dispensation for EOUs and provides that goods manufactured in such units are liable to excise duty equivalent to the aggregate of all customs duties. They are also eligible to a number of exemptions both from customs and excise duties. These exemptions apply to goods procured by such units such as capital goods, raw materials, intermediates and inputs as well as to goods cleared by them viz. finished products, rejects and waste material into the Domestic Tariff Area (DTA). In order to avail of these exemptions, however, these units need to fulfil the conditions prescribed in the relevant notifications. Auditors need to be mindful of these conditions and to clearly distinguish between violations calling for issuance of demands of customs duty and those that involve recovery of central excise duty.

Owing to options available to such units under the EXIM Policy and the nature of goods manufactured, each unit is likely to have a unique pattern of inflow (of duty free or exempted goods) and outflow (of exempted or dutiable goods). To give an example, some units may procure capital goods indigenously claiming excise duty exemption while others may import them free of customs duty. In addition, EOUs are also permitted to send goods out for job work as well as to receive goods from units in the DTA for job work. As a general principle, it may be useful to begin audit of a unit by creating a flow chart that would clearly show these movements so that the nature and extent of duty liability for each movement is clearly identifiable. The following checklist follows this sequence.

Evaluation of Internal Control would be particularly useful in identifying potential risks to revenue for each of these movements. Such evaluation would also throw up risks owing to substitution of imported raw materials, their diversion into DTA and inflation of wastages and rejects – factors unique to EOUs. Depending on the nature of goods being manufactured, auditors may have to use suitable indicators of risk on account of such factors. For instance, in the case of textile processing units procuring fabric (free of duty) it may be useful to compare the weight per square meter of the unprocessed fabric with the weight of the processed fabric being exported.

I Duty free Import under Notification No. 52/2003-Customs dated 31.3.2003 as amended by 5/2007 dt. 15.1.2007 (GE. No. 46)

100% EOUs are permitted to import capital goods, raw materials, office equipment etc. required for manufacture or in connection with packaging and production of export goods. The list of goods permitted for import would depend on the sector (such as aquaculture, agriculture, horticulture, granite production, gems and jewellery or others which include textiles) in which the unit operates. These goods can also be procured free of duty from a customs bonded warehouse. It is critical for auditors to check that the unit maintains proper account of the receipt, storage and utilisation of these goods and has put in place adequate internal systems for this purpose.

In the event of violation of any of the conditions of exemption, customs duty is recoverable on the goods in question. The value of such goods should be ascertained under Section 14 of the Customs Act, 1962. It is important to note that the exemption would continue to apply to goods imported or procured under this exemption even when they are used for the manufacture of goods that are cleared into the DTA as per permission of the Competent Authority (and not exported) as long as the appropriate excise duty is paid on the finished products.

- a) Examine the Bond register with that of Import documents so as to ensure that the goods obtained duty free are covered in the relevant Annexure of the notification.

- b) Check whether the capital goods are installed or otherwise used within one year from the date of importation or procurement or extended period allowed by the Assistant/ Deputy Commissioner, failing which duty together with interest should be demanded.
- c) Similarly, in case of other goods check whether they have been used for intended purposes or re-exported within three years or extended period.
- d) Check whether the unit has the capacity to achieve the volume of production indicated in the LOP or whether a LOP has been obtained for quantities far in excess.
- e) Check whether the goods produced or packaged have been exported within a period of one year or extended period from the date of import/ procurement.
- f) Check that unused goods (including empty cones, bobbins or containers suitable for repeated use) have been exported or cleared for home consumption within a period of one year or extended period. If not, duty together with the applicable interest at the applicable rate should be demanded.
- g) Check whether the unit has achieved positive Net Foreign Exchange Earning. In case it has not been achieved, compute the ratio of unachieved portion of NFEE to positive NFEE. Apply this ratio to the differential duty (duty payable on the goods but for the exemption) to arrive at the duty that would have to be recovered.
- h) Check that the quality of raw materials or components used in the manufacture of the finished (export) product is broadly the same as that imported or procured free of duty.
- i) Ensure that no duty free procured goods are transferred/ sold/ supplied to other units without permission of the Assistant Commissioner/Deputy Commissioner or wherever necessary the Development Commissioner.
- j) Check that the goods taken out of the unit for test, repairs, replacement, calibration, job-work etc. as well as the waste, scrap or remnants are either returned or duly accounted for.
- k) Check that appropriate customs duty has been recovered on such capital goods and other goods (except used packaging materials) that have been allowed to be taken outside the unit, to any other place in India, under paragraph 4 of the notification. In these cases, check that the value of and rate of duty applicable on the relevant dates have been correctly applied. In case of capital goods, check that the depreciated value has been properly worked out.

II Procurement of indigenous goods under excise duty exemption contained in notification no.22/2003-CE. Dt.31.3.2003 as amended by 1/2007 dt.15.1.2007 (GE 31)

Exemption from excise duty is also available to goods brought into a 100% EOU for manufacture or packaging of articles for export. This exemption is similar to notification no.52/2003-Customs in terms of the conditions prescribed. Thus, the same checks, with suitable changes, should be applied in respect of capital goods, raw materials and other goods on which excise duty exemption is claimed.

III Subcontracting, Jobwork:

There are two situations :-

- (1) Sub contract part of their production process.
 - (2) Sub contract part of the product.
- a) Check that the procedure prescribed in Board's Circular No.65/2002-Cus dated 7th October, 2002 as modified by Circular No.26/2003-Cus dated 1st April, 2003 and 29/2003-Cus dated 3.4.2003 is being followed by the unit both in respect of subcontracting or job-work.
 - b) Check whether there was leakage of duty free imported/ indigenous goods to DTA.

- c) Wherever possible, ensure correlation between raw material sent to job workers and processed goods received back.
- d) Check whether there is any substitution of duty free goods by verifying job work registers and challans.
- e) Check the transit document and the register. Verify whether challans are serially numbered for each calendar year.
- f) In case the unit is sending out imported or domestically procured raw materials, components etc. as it is, i.e. without being subjected to any processing in the unit for job work in the DTA, check that revenue is secured through appropriate bank guarantee. This condition is not applicable, however, to status holder EOUs having an unblemished track record.
- g) Check whether goods sent on job work reach back within 90 days from the date of removal/extended period.

IV Inter unit transfer:

- a) Check whether the goods supplied are rewarehoused and the range officer of the receiving unit has issued the rewarehousing certificate.
- b) Verify whether the receiving unit is an EOU/unit in EHTP and its license/LOP is in force.
- c) Check whether duty liability in respect of goods short received or not received has been demanded.

V Exports:

- a) Check whether the proof of export has been received within six months of export. In case of non-receipt check whether show cause notice has been issued demanding duty.
- b) Check third party export as per para 6.10 of Exim Policy read with para 15, Appendix 14I of Handbook of procedures are in order.

VI DTA sales:

Notification No.24/2003-CE exempts all excisable goods manufactured in a 100% EOU from the whole of excise duty [basic, additional (in lieu of sales tax) & additional (textiles and textile articles)]. This exemption is applicable so long as the goods are not brought to any other place in India. In other words, DTA clearances of such goods would be liable to excise duty, unless they are exempt under some other notification.

The highest rate of duty applicable to such clearances is that specified in section 3 of the Central Excise Act viz. the aggregate of all customs duties. The effective rate of duty may, however, be lower – as prescribed in notification no.23/2003-CE. This rate depends on whether the goods under clearance are manufactured out of imported raw materials or exclusively out of indigenous raw materials. Within the second category, the rate of excise duty varies according as the finished goods if manufactured and cleared by a non-EOU are wholly exempt from excise duty or not. For ease of reference, the rates of duty presently applicable to such clearances are set out in the Table below. However, the relevant notification should invariably be referred to while verifying the applicability of these rates since rates have been separately prescribed for some specified items such as cotton fabric, knitted or crotcheted fabrics, gold jewellery, jute yarn etc.

S.No.	Situation	Amount of duty	Notification entry
1	Goods manufactured either	50% of the duty	S.No.2 of

	exclusively out of imported raw materials or a mix of indigenous and imported raw materials	leviable under section 3 or the excise duty leviable on like goods manufactured by a non-EOU whichever is greater	Notification No.23/2003-CE dt.31.3.2003,
2	Goods manufactured wholly from indigenous raw materials - if the finished goods are wholly exempt from excise duty or chargeable to nil rate when manufactured by a non-EOU	30% of the duty payable under section 3 of the Central Excise Act	S.No.4 of Notification No.23/2003-CE dt.31.3.2003,
3	Goods manufactured wholly from indigenous raw materials - if the finished goods are NOT wholly exempt from excise duty or chargeable to nil rate when manufactured by a non-EOU	Aggregate of duties of excise leviable on like goods manufactured by a non-EOU.	S.No.3 of Notification No.23/2003-CE dt.31.3.2003,

- a) Check whether the rates of duty shown in the Invoice(s) have been correctly indicated.
- b) Check whether DTA entitlement as approved by the Development Commissioner and ratified by the Department is in force and is adequate to cover the DTA sales. Also check whether these clearances are in accordance with the provisions of subparagraph (a), (b), (d) and (h) of paragraph 6.8 of EXIM Policy.
- c) Check whether DTA sales of rejects are within the limit of 5% of Freight on Board value of the goods actually exported.
- d) Check whether DTA sales entitlement is availed only if NFEE is positive. If not, full duty may be recoverable.
- e) In case the unit has manufactured/ produced any non-excisable goods that have been cleared into the DTA, check that the duty foregone on inputs (customs duty if inputs were imported and excise duty if they were procured free of excise duty) that have gone into the production of such goods, has been recovered.

VII Destruction of rejected goods/scrap/waste/packing material:

- a) Verify whether all rejected goods/scrap/waste/packing material have been cleared on payment of appropriate duty.
- b) In case the unit declares that these items do not have commercial value and opts for destruction, verify whether the same have been destroyed under supervision of appropriate Departmental officer.

VIII B-17 bond:

- a) Check whether the bond is in force and the Bank guarantee given in terms of Board's guidelines.
- b) Check the balance of bond amount considering 25% of the duty foregone and ensure that the balance is adequate and within limit.

IX Debonding of goods procured duty free:

- a) Check whether depreciation allowed in respect of capital goods is as per the norms stipulated by the Board. For this purpose refer Circular No. 29/2003-Customs dated 3.4.2003 read with Circular 49/2000 dated 22.5.2000.
- b) Check whether the goods intended to be debonded were within the bonding period or within the extended period as permitted by the Chief Commissioner/ Commissioner.
- c) Check whether the duty at appropriate rates prevailing on the day of clearance at the depreciated value in respect of capital goods has been paid and interest at stipulated rates is considered from the date of expiry of the bonding period.
- d) Check whether the designated officer/Development Commissioner has given approval for the debonding of capital goods / raw material etc.
- e) Check whether the duty is paid within two days of approval of the Green Bill of entry and if not interest is calculated at the specified rates as required under sub section 2 of section 47.

X Payment of cost recovery/supervision charges:

- a) Check whether the unit has paid the charges for cost recovery/supervision charges.

XI Others :

- a) Check whether the unit is operating from a hired premises or has obtained capital goods on lease. If yes, greater alertness will have to be exercised while evaluating internal controls and for recoverability of dues, if any.
- b) Verify the action taken on units which have imported capital goods/raw material etc. but not made any significant exports in the past.
- c) Verify whether the procedure adopted for conversion of a DTA unit to EOU is in accordance with the provisions.
- d) Verify whether the DTA unit adjacent to EOU has availed any facility/received any material of/from EOU.
- e) Verify whether the value of goods sold in DTA is comparable to the value of similar goods exported.

Note – The above guidelines are for general convenience of the officers. For actual application, the relevant notifications and paras of EXIM policy should be strictly referred to.

Annexure – M

Indicative list of items to be examined in the ER-4 return filed by the assessee with the details available in Profit & Loss Account, Balance Sheet and ER-1 returns filed by the assessee.

Ref. No.	Particulars sought for	Purpose
3(i)(a) to (c) [ER-4]	Details of expenditure	To compute the ratio of value of CENVATable purchase to Gross sales of excisable goods and to match it with the ratio of CENVAT to Cash duty.
3(ii)(a) & (b) [ER-4]	Item-wise value and quantity of major raw material consumed	(i) Computation of physical input –output ratio. (ii) Co-relation with CENVAT availment. (iii) Computation of unit value of raw material for checking value addition.
3(iii)(a) to (h) [ER-4]	Details of other expenditure Total Freight Advertisement/Sales Promotion Commission paid for sales of manufactured goods R & D Expenditure Wages, Power & Fuel and other expenses (other than (a) to (g) above	To calculate ratio of individual items of expenditure to Gross sales Value to find out possibility of unaccounted sales (e.g. where electricity charges are accounted for in the books but goods produced are removed without accounting for, on comparing the ratio of similar units, variation in ratio may show such cases. The said ratio coupled with trend of freight outward to sale value ratio may also indicate same trend). Also it indicates whether any taxable service received for taking action against service provider.
3(iv)(a) to (c) [ER-4]	Details of goods manufactured from Job worker	To co-relate with valuation and verify whether CENV AT credit provisions are complied with
4(i)	Total Sales value (Gross)	Used in determining all the ratios and derive the value of excise duty payable and match with duty payment in the tax return
4(ii)	Item-wise value and quantity of major finished goods sold	(i) Computation of unit value of finished products for checking value addition. (ii) Computation of physical input output ratio
iii)	Details of trading activity (other than trading of inputs on CENVAT Credit availed and removed as such)	(i) To calculate ratio of Trading Sales Value to gross sales value (chances of clearance of manufactured goods in the guise of trading goods & clearances of credit availed goods as Trading goods) (ii) To ascertain the trend in profit margin of trading goods vis-à-vis goods manufactured by the assessee.
4(iv)	Sales value of Non excisable / exempted goods	To calculate ratio of value of exempted goods to gross sales value.
4(v) & (vi)	Value of goods exported under Bond and/or under rebate	To derive value of dutiable sales and compare with value shown in tax return.
4(vii)	Total value of scrap sales	To calculate ratio of scrap sales value to gross sales value.
4(viii)	Value of inputs on which	To facilitate scrutiny of CENVAT availment

	CENVAT credit availed and cleared as such.	during audit i.e. whether appropriate duty payment made.
4(ix)	Total Sales Tax paid	To calculate ratio of Sales Tax to Excise duty.

4(x)	Details of other incomes as per Profit & Loss A/c	Whether individual elements of other income form part of valuation of goods. Whether appropriate ST has been discharged on' each of the elements under specified service tax category.
4(xi)	Total "Other income" as per Profit & Loss A/c.	To calculate ratio of other income to total sales value. To validate the information Given in 4(x)
4(xii) (a) to (d)	The information on Job Work carried out Whether own raw material/inputs used in manufacture of job work goods. Job Work goods cleared on payment of duty. Total amount of job work received during the financial year.	To ascertain whether Job Work is relevant as a source of risk. To co-relate with valuation and availment of CENVAT credit on inputs. To co-relate with valuation and to study trends in job work income vis-à-vis total sales value.
5	CENVAT Credit details	To co-relate with actual availment of CENV AT credit and to calculate ratio of CENV AT credit availment to total duty payment. The availment and utilization of taxable input service credit would indicate cross sectoral service tax credit trend.

ANNEXURE – N

AUDIT REPORT FORMAT FOR EA-2000

Part-I

1.	Name of the Unit	
2.	Commissionerate/Division/Range in which it is located	
3.	Products manufactured	
4.	Chapter sub-heading	
5.	Main Exemption Notifications availed	
6.	Date of last audit	
7.	Period for which current audit undertaken	
8.	Dates on which audit undertaken	

Part-II

1. Summary of major audit objections from the Working Paper:

Sl. No.	Gist of Objection	Revenue implication, if any	Assessee Agreement, Yes/No if no, reasons for disagreement	Department's conclusions with reasons
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2. Suggestions for better compliance including systemic improvements and modifications in the accounts and internal controls:

Assistant Commissioner/Deputy Commissioner (Audit)

ANNEXURE – O**(please see Chapter 12)**

1.	Name of the Unit	:
2.	Commissionerate/Division	
3.	Range in which it is located	:
4.	Constitution of the Audit Party (with Names and Designation of the Officers)	:
5.	Reference to the Audit Report taken up for this	:
6.	Scoring	:

SCORING SYSTEM FOR EA-2000

Areas	Points (Maximum)	Sl. No. In Working Papers
(a) Quality of Audit Plans	15	Point No. 7
(b) Systematic conduct of Audit with a view to taking an integrated and comprehensive look at the systems especially those which have a bearing on revenue compliance.	50	Points 1 to 6 and 8 (within this evaluation of Internal Control could be assigned 20 point)
(c) Revenue points flowing from finalisation of Audit.	15	Point 9 & 10
(d) Recovery of Audit Assessments	10	Point 11
(e) Suggestion for better compliance including systemic improvements and modifications in the accounting..	10	Point 12
	100	

ANNEXURE – P

**(Please see Chapter 12)
 Monthly report on audit performance.
 (To be prepared by the Audit section)**

Report for the month of _____

Dated _____

Name of supervisor no. of the audit party	Opening balance of audit objections confirmed in FARs	No. of units audited during the month	No. of audit objections accepted in Audit Cell during the month	No. of audit objections closed during the month (FARs)	Total duty involved in the objections during the month	Amount recovered (prior to issue of SCN) during the month	Closing balance of audit objections of FAR
1	2	3	4	5	6	7	8

ANNEXURE - Q

(please see Chapter 12)

Monthly status report.

(To be prepared by the Division/Section concerned)

Report for the month of _____

Dated _____

Openi ng balanc e of FARs.	No. of FARs received during the month	No. of SCNs issued during the month	No. of FARs complied with during the month (other than SCNs)	Total of column 3 & 4	Closin g balan ce of FARs (1+2- 5)
1	2	3	4	5	6

Part B

Age wise Closing Balance of FARs.

Less than 3 months	3 months to 6 months	More than 6 months
6(a)	6(b)	6(c)

ANNEXURE – R

OFFICE OF THE COMMISSIONER OF CENTRAL EXCISE
(OFFICE ADDRESS/ PHONE NUMBER/EMAILETC.

C. No.

Date:

To,

Gentlemen,

Sub: Intimation for conducting Central Excise audit under EA
2000 – reg.

The Internal Audit Party headed by Shri _____,
Superintendent of Central Excise (Audit), IAP No. ____ will take up
the audit of the accounts/records of your unit on _____. It is
requested that the following documents may be furnished
immediately to this office,-

- 1) Copies of Balance Sheet, Trial Balance and Annual Financial Statement for the year 2003-04, 2004-05 & 2005-06.
- 2) Annual returns submitted to the Registrar of Companies, Sales Tax, Income Tax Returns along with Annexures (Form 3 CD) for the financial years 2003-04, 2004-05 & 2005-06.
- 3) Returns if any submitted to Banks/Financial Institutions for the period 2003-04, 2004-05 & 2005-06.
- 4) Cost Audit, Tax Audit and Internal Audit Reports, wherever applicable for the period 2003-04, 2004-05 & 2005-06.

I further request you to extend full co-operation to the Audit party in carrying out the audit. As you are ware, most of the statutory records and documents that were maintained under the Central Excise Rules have been dispensed with. Therefore, the auditors have to mainly rely on the records maintained by the assessee in

the ordinary course of their business for conducting the audit. As per sub rule 2 (iii) of Rule 22 of Central Excise Rules 2002, every assessee is required to furnish all financial records and statements including trial balance or its equivalent. Hence, the auditors may call for the above mentioned records and any other relevant records, documents, returns etc., for their scrutiny. You are therefore requested to keep all the relevant records ready so that the audit can be conducted smoothly.

In case of any difficulty, you can get in touch with the undersigned through the telephone number/fax/email mentioned above.

For voluntary compliance of the Audit objections raised by the Audit parties, there exists a provision under Section 11 A (2B) of the Central Excise Act wherein only applicable excise duty and interest can be paid on the spot and a letter seeking waiver of penalty/show cause notice can be given by the assessee thus leading to better compliance and less litigations (copy of the format enclosed)

The receipt of this letter may please be acknowledged.

Yours faithfully

Additional/Joint Commissioner (Audit)

Copy to,

The Deputy/Assistant Commissioner of Central Excise, Division

The Superintendent of Central Excise, Range.

ANNEXURE – S

**DRAFT OF THE LETTER TO BE WRITTEN BY THE ASSESSEE TO
THE COMMISSIONER OF CENTRAL EXCISE, UNDER SECTION
11 A (2B) FOR AVOIDING PENALTY/SCN**

To,

The Commissioner of Central Excise

Sir,

Subject: Letter given under Section 11 A (2B) for avoiding penalty
and non-issuance of show cause notice – reg.

I/We M/s falling
under the jurisdiction ofrange and
Division state and request as under.

2. As per the provisions of Section 11 A (2B), where any duty of excise has not been levied or paid or has been short levied or short paid or erroneously refunded, the period, chargeable with duty, may pay the amount of duty before service of notice on him under sub section (1) in respect of duty and inform the central excise officer in writing who, on receipt of such information shall not serve any notice under the sub section (1) in respect of the duty so paid;

3. During the course of verification of our records/returns, by the Audit team from the office of Central Excise Commissionerate, it is observed that there is short payment / non levy / non payment of duty/ wrong availment of CENVAT credit on account of issue / issues mentioned as per the Annexure hereto. We have agreed to the points raised during verification/scrutiny and have paid the said amounts of duty/reversed the CENVAT credit of Rs. vide TR 6 Challan No. / CENVAT Register Entry

No..... dated.....

4. In terms of the provisions of Section 11 A (2B) of Central Excise Act, 1944, we request that a show cause notice may not be issued to us in this case and no penalty may be imposed on us as the above short levy/short payment/non levy/non payment/wrong availment of credit are not intentional on our part. We request that the above issues may be treated as closed with this letter since we have complied with the provisions of Central Excise law.

Yours faithfully,

Date:

Place:

(Authorised Signatory)
M/s

ANNEXURE – T

**REPORT OF AUDIT RESULTS FOR ANALYSIS OF RISK PARAMETERS
AND OTHER RISK FACTORS**

(Please read the instructions carefully)

Part A. Preliminary

1. Code - Commissionerate

 2. Name of the assessee

 3. Registration No.

 4. Audit Report No.

 5. Code - Status of the assessee

 6. Total turnover in previous year (inclusive of exports) (in'000'Rs.)

 7. Total Domestic clearance of manufactured goods in previous year (in'000'Rs.)

 8. Total Export clearances including deemed exports in previous year (in'000'Rs.)

 9. R₂ Rupee Risk value Rs. _____
 10. R₃ Rupee Risk value Rs. _____
 11. R₄ Rupee Risk value Rs. _____
- (As provided by DG (Audit))

12. (a) Code – Internal Control

- (i)

 (ii)

 (iii)

(b) Details in case the last two digits of any of the above Code Nos. are 99

- (i)
- (ii)
- (iii)

13. (a) Code – Local risk parameters

(i) (ii) (iii)

(b) Details in case of local risk parameters having code Nos. are LR99

Part B. Details of Audit Paragraphs

Para No. of Audit Report	Description of commodity	CETS H No.	Code – audit objection	Code – Financial records	Amount of duty detection (in Rs.000)	Amount of duty recovery (in Rs. 000)	Assessee's acceptance (Y/N/P)
(I)	(II)	(III)	(IV)	(V)	(VI)	(VII)	(VIII)

INSTRUCTIONS TO FILL UP THE PROFORMAGeneral Instructions:

1. The Report has to be completed for each audit.
2. The proforma should be filled up [except for S. Nos. 4, 12 & 13 (a) and 13 (b)] and submitted to the Planning Cell by the audit party. It should be attached to the draft audit report. The Planning Cell should wait till the finalisation of the report, fill the details of S. Nos. 4, 12 & 13 from its records and transmit to Directorate General (Audit) through email.
3. Please use capital letters only. Each box should be filled with one letter/number only.

Instructions for filling up specific fields:

4. For Commissionerate Code (S. No.1) see list in Appendix A.
5. For name of the assessee (S. No. 2), the assessee's name as appearing in Registration Certificate should be filled in.
6. For Registration No. (S. No. 3) 15 digit PAN based Registration No. should be mentioned. In case the same is not available the 10 digit ECC No. of the assessee should be mentioned in the **first 10 boxes**.
7. The audit report No. (S. No. 4) should be the number allotted to the final audit report as per para 5.2.3 of SAP (Standard Audit Program)

8. The code for Status of assessee (S. No. 5) should be as per Appendix B. The status should be ascertained at the time of conduct of audit.
9. Total turnover of previous year (S. No. 6) should be for the last completed financial year. The turnover should include the values of all elements of business of the assessee such as manufacturing, trading, exports, services etc. Total Domestic clearance of manufactured goods (S. No. 7) includes domestic clearances of all types of goods (whether or not charged to any duty). These figures should preferably be taken from the published records such as Annual Financial Statements, Balance Sheets, Profit and Loss account etc.
10. In S. Nos. 9, 10 and 11 the R₂, R₃, & R₄ Rupee Risk Value should be as per the value shown in DG (Audit)'s letter circulating the list of units. In cases of audit of reference units please fill up all the boxes with 0.xxxxx.
11. For code for Internal Control (S. No. 12 (a)) please see Appendix C. Mention the areas of Internal Control, if any (maximum of 3) in order of their degree of weakness, which in the opinion of the auditor has led to, or in future, may be the causes of poor tax compliance due to reasons such as deficiency in accounting system, reporting, supervisory control and co-ordination with other sub-systems. In case the last two digits of code are 99, please mention in brief the Internal Control issues in boxes provided for it at S. No. 12 (b).
12. S. No. 13 (a), Code for local Risk Parameters, please see Appendix D. In case several such factors were taken into consideration for selecting the unit maximum of three such factors may be mentioned through their codes in order of their importance. In case the code No. is LR99, please mention in brief the details in boxes provided for it at S. No. 13 (b).
13. For column I in Part B, normally the top three paras in terms of quantum of duty detection should be reported in descending order. However, in case the auditor feel that any other audit para, involving lesser quantum of duty detection (including non-revenue procedural paras) is important either because of its uniqueness or possibility of misuse. Such a para can be reported as a deviation to the General Rule. Please mention the para No. as they appear in the audit report.
14. For column II in Part B, description of commodity should be mentioned in not more than fifteen words. In case an audit point involves more than one commodity, the top three commodities may be mentioned. In case the objection pertains to issues relating to excise duty which cannot be identified with any specific commodity(ies), the word 'General' should mentioned. In case the objection pertains to (i) Service Tax, (ii) Customs duty or (iii) Cess, the words 'Service Tax', 'Customs duty' or 'Cess' should be mentioned as the case may be.

15. For column III in Part B CETSH should be mentioned for each of the corresponding description and should be mentioned without a decimal mark between the 4th and the 5th digit. In case the description in previous column is (i) General, (ii) Service Tax, (iii) Customs duty or (iv) Cess, the CETSH should be mentioned as 999901, 999902, 999903 or 999904 respectively.
16. For column IV in Part B, code for audit objection, please see Appendix E. In case there are several issues pertaining to an audit para maximum of three such issues may be mentioned through their codes in order of their importance.
17. For column V in Part B, code for records/documents/reports, please see Appendix F. These refer to the type of records/documents/reports scrutiny of which has led to the genesis of audit point or objection. In case there are several records/documents/reports pertaining to an audit para maximum of three such records/documents/reports may be mentioned through their codes in order of their importance.
18. For column VIII in Part B, mention 'Y' if entire objection under para has been accepted by the assessee, 'N' if entirely rejected and 'P' if the objection has been partially accepted by the assessee.

COMMISSIONERATE - CODES

CODE	COMMISSIONERATE	CODE	COMMISSIONERATE
01	ALLAHABAD	48	KOLKATA-IV
02	MUMBAI-I	49	CHANDIGARH-II
03	AHMEDABAD-II	50	DELHI-II
04	DELHI-I	51	DELHI-III
05	CHENNAI-I	52	HYDERABAD-II
06	SHILLONG	53	HYDERABAD-III
07	VADODARA	54	BHOPAL
08	HYDERABAD-I	55	JAIPUR-II
09	BANGALORE-I	56	LUCKNOW
10	PUNE-I	57	CHENNAI-II
11	NAGPUR-I	58	CHENNAI-III
12	PATNA	59	NOIDA
13	AURANGABAD	60	PUNE-II
14	JAIPUR-I	61	MANGALORE
15	COCHIN	62	PONDICHERRY
16	KOLKATA-I	63	SALEM
17	RAJKOT	64	TIRUNELVELI
18	KANPUR-I	65	CHENNAI-IV
19	CHANDIGARH-I	66	SILIGURI
20	GOA	67	KOLKATA-V
21	BHUBANESHWAR-II	68	KOLKATA-VI
22	GUNTUR	69	KOLKATA-VII
23	AHMEDABAD-I	70	HALDIA
24	MADURAI	71	PUNE-III
25	COIMBATORE	72	NASIK
26	BHUBANESHWAR-I	73	VADODARA-II
27	INDORE	74	DIBRUGARH
28	MEERUT-I	75	VALSAD
29	MUMBAI-II	76	DAMAN
30	TIRUCHIRAPALLI	77	BHAVNAGAR
31	MUMBAI-III	78	LUDHIANA
32	BELGAUM	79	AHMEDABAD-II
33	BOLPUR	80	VISAKHAPATNAM-II
34	KOLKATA-II	81	DELHI-II
35	RAIPUR	82	ROHTAK
36	JAMSHEDPUR	83	MEERUT-II
37	SURAT-I	84	MYSORE
38	VISAKHAPATNAM	85	PANCHKULA
39	SURAT-II	86	GHAZIABAD
40	MUMBAI-IV	87	RANCHI
41	MUMBAI-V	88	THANE-I
42	MUMBAI-VI	89	THANE-II
43	MUMBAI-VII	90	TRIVANDRUM
44	BANGALORE-II	91	TIRUPATI
45	BANGALORE-III	92	HYDERABAD-IV
46	CALICUT	93	JAMMU & KASHMIR
47	KOLKATA-III		

CODE RELATING TO STATUS OF ASSESSEE**List I**

Code No.	Constitution of Business
1	Proprietorship
2	Partnership
3	Registered Company
4	Unregistered Company
5	Trust
6	Society
9	Others

List II

Code No.	Activity of Business
XM	Manufacturer
XM	Warehouse
XD	Depot
XD	Dealer
XE	EOU/ EPZ unit.

Note: The status of assessee is a three-digit code. The first digit will be as per List I and the remaining two digits will be as per List II. E.g. a Depot of an unregistered company would be coded as **4 XD**.

CODES FOR AREAS OF POOR/INADEQUATE INTERNAL CONTROL

S. No.	Code No.	Subject
SALES		
1.	SL 01	To/through related Person
2.	SL 02	Through contract
3.	SL 03	Through depot
4.	SL 04	Through wholesale Dealer
5.	SL 05	Inter Unit Transfer (Local)
6.	SL 06	Inter Unit Transfer (Export)
7.	SL 07	Export
8.	SL 08	Through job Worker
9.	SL 09	Marketing & Sales Promotion
10.	SL 99	Others
PURCHASE		
11.	PC 01	From/through related Person
12.	PC 02	Through contract
13.	PC 03	Through depot
14.	PC 04	Through wholesale Dealer
15.	PC 05	Inter Unit Transfer (Local)
16.	PC 06	Inter Unit Transfer (Import)
17.	PC 07	Import
18.	PC 08	Through Job Worker
19.	PC 99	Others
PRODUCTION		
20.	PD 01	Intermediate Product (captive consumption/for sale)
21.	PD 02	By Product
22.	PD 03	Waste
23.	PD 04	Rejects – Recycled/Waste
24.	PD 05	Packing
25.	PD 99	Others
OVERHEADS		
26.	OH 01	Transportation
27.	OH 02	Electricity
28.	OH 03	Advertisement
29.	OH 04	Telephone / Fax / E-mail etc.
30.	OH 05	R & D
31.	OH 06	Rent
32.	OH 07	Interest
33.	OH 08	Discounts

34.	OH 08	Bad debts
35.	OH 09	Wages, Salaries, Bonus, PPF etc.
36.	OH 99	Others
OTHER INCOME		
37.	OI 01	Service
38.	OI 02	Consultation
39.	OI 03	Design & Engineering
40.	OI 04	On site services / Turnkey activity
41.	OI 05	From bought out goods used at site / supplied with manufactured Goods.
42.	OI 99	Others
ACCOUNTS		
43.	AC 01	Taxes
44.	AC 02	Maintenance of Ledgers/Journals/Balance Sheets/Audit Reports
45.	AC 99	Others
STORES		
46.	ST 01	Inventory - Old Stocks/Just in time stock
47.	ST 02	Issue
48.	ST 03	Consumption
49.	ST 99	Others
OTHERS		
50.	OT 99	Others

Annexure T-4

CODES FOR LOCAL RISK PARAMETERS (NON-REVENUE)

S. No.	Code No.	Risk Parameter
1.	LR01	High revenue paying unit
2.	LR02	New Unit
3.	LR03	Existing unit started manufacturing new product
4.	LR04	Unit in the nature of processing industry
5.	LR05	Unit producing goods prone to evasion
6.	LR06	Unit manufacturing consumer goods
7.	LR07	Unit manufacturing both dutiable and non dutiable goods
8.	LR08	Unit getting the goods manufactured on job work basis
9.	LR09	Unit having substantial activity as job working for others
10.	LR10	Unit undertaking jobs on Turnkey basis
11.	LR11	Unit that have undergone amalgamation or split in the past
12.	LR12	Unit selling goods through related (associated) Units
13.	LR13	Unit selling goods through depots
14.	LR14	Unit engaged in trading of goods that are similar to the manufactured goods
15.	LR15	Unit availing high percentage of CENVAT credit
16.	LR16	Unit which do not exercise the option of availing CENVAT credit
17.	LR17	Unit showing exports a high percentage of the total turnover
18.	LR18	Unit where many irregularities have been noticed during the past audits
19.	LR19	Unit against which a number of anti-evasion cases have been booked during recent past
20.	LR20	Unit showing high percentage of waste, scrap, by product generation
21.	LR21	Small Scale Industry unit that are keeping the clearances just below the threshold levels for last couple of years
22.	LR22	Unit where unit assessable value shows a down trend
23.	LR23	Unit showing stagnant or falling production
24.	LR24	Unit showing high inventory of raw materials or finished goods
25.	LR25	Unit that have recently expanded their production capacity
26.	LR26	Unit showing substantial purchase of Capital Goods in the recent past
27.	LR27	Unit availing special schemes of concessions/incentives under Customs, Excise or Exim Policy
28.	LR28	EOU / EPZ unit
29.	LR29	Unit in respect of which important legal changes from Excise angle (duty rates or procedures) have recently taken place.
30.	LR30	Unit where the management has undergone change recently
31.	LR31	Unit clearing bought-out items with their products without including their price
32.	LR99	Other reasons

TYPE OF AUDIT POINTS WITH THEIR CODES.

S. No.	Code No.	Subject
CLASSIFICATION		
1.	CR01	Improper classification of excisable goods resulting in non-payment-payment or short payment of duty
2.	CR02	Availment of ineligible exemption notification resulting in non-payment or short payment of duty
3.	CR03	Non-fulfilment of condition of exemption notification, resulting in non-payment or short payment of duty
4.	CR99	Classification issues not specified above, resulting in non-payment or short payment of duty
5.	CN99	Classification issues not resulting in non-payment or short payment of duty
VALUATION		
6.	VR01	Under valuation in case of sales through related persons
7.	VR02	Ineligible deduction / discount
8.	VR03	Under valuation in case of goods cleared by job worker
9.	VR04	Depot sales price not adopted or not correctly adopted for valuation
10.	VR05	Sale price from company owned and operated outlets not adopted or not correctly adopted for valuation
11.	VR06	MRP incorrectly declared / not declared for goods falling under Section 4A
12.	VR07	Additional consideration (through cash/account adjustment/debit or credit note etc) of any type not included in the assessable value
13.	VR08	Assessable value for goods for captive consumption improperly worked out
14.	VR09	Under valuation of any type, in case the valuation is on the basis of costing or cost construction
15.	VR10	Subsequent escalation in price
16.	VR11	Assessable value improperly calculated for any other reason
17.	VR12	Under valuation of any type in case the valuation based on contract price
18.	VR99	Under valuation resulting in non-payment or short payment of duty for any other reason
19.	VN99	Valuation issue of any kind not resulting in non-payment or short payment of duty
CENVAT CREDIT ON INPUTS		
20.	IR01	Credit availed without/on short receipt of goods or goods diverted before receipt resulting in wrong availment of credit
21.	IR02	Credit availed without documents / on incorrect or forged documents resulting in wrong availment of credit
22.	IR03	Credit availed on inputs used in manufacture of exempted / non dutiable finished goods, resulting in wrong availment of credit

23.	IR04	Credit availed on damaged / destroyed / written off / not usable inputs, whether or not insurance claimed, resulting in excess availment of credit
24.	IR05	Duty not paid on inputs, on which credit has been taken, removed and sold as such
25.	IR06	Non-payment of amount, equivalent to credit availed, on inputs sent to job worker and not received back
26.	IR07	Credit availed on common inputs used in exempted as well as dutiable goods, involving non-payment of 8% of the price of exempted goods.
27.	IR08	Non-payment of amount equivalent to credit on input lying in stock or in process or used in final products lying in stock while opting for SSI (full exemption)
28.	IR09	Duty debited from CENVAT credit account without sufficient balance
29.	IR99	Ineligible credit availed for other reasons resulting in wrong availment of credit
30.	IN99	Procedural lapses of any kind not resulting in excess availment of credit
CENVAT ON CAPITAL GOODS (CG)		
31.	GR01	Credit availed without/on short receipt of goods; goods diverted before receipt, resulting in wrong availment of credit
32.	GR02	Credit availed without documents / on incorrect or forged documents resulting in wrong availment of credit
33.	GR03	Credit availed on CGs used in exclusive manufacture of exempted / non- dutiable finished goods, resulting in wrong availment of credit
34.	GR04	Credit availed on damaged / destroyed / written off / not usable CGs, whether or not insurance claimed, resulting in wrong availment of credit
35.	GR05	Credit not reversed on CGs sold / removed, resulting in wrong availment of credit
36.	GR06	100 % CG credit availed in the first year of procurement, resulting in wrong availment of credit
37.	GR07	Simultaneous availment of CG credit and depreciation on the CG duty under I T Act, resulting in wrong availment of credit
38.	GR08	Second instalment of CG credit availed without having CG in possession and use, resulting in wrong availment of credit
39.	GR99	Ineligible CG Credit availed for other reasons
40.	GN99	Procedural lapses of any kind not resulting in excess availment of credit
EOUs/ EPZ Units		
41.	ER01	Nonpayment of duty on goods cleared under improper CT-3
42.	ER02	Non-payment of duty on goods imported duty free or cleared under CT-3 and not warehoused in a EOU
43.	ER03	Non-payment of duty on goods imported duty free or cleared under CT-3, warehoused and removed as such thereafter
44.	ER04	Non-payment or short payment of duty on goods cleared to DTA
45.	ER05	Non-payment of duty on goods cleared for exports and diverted to DTA

46.	ER99	Non-payment of duty due to reasons not specified above
47.	EN99	Procedural lapses of any kind not resulting in non-payment or short payment of duty
OTHERS		
48.	OR01	Goods removed without payment of duty
49.	OR02	Duty not paid on samples cleared
50.	OR03	Amounts collected as Excise duty not remitted
51.	OR04	Non-payment of duty by incorrectly claiming a process as not amounting to manufacture
52.	OR05	Non-payment of duty on export goods diverted in local market
53.	OR06	Non-payment of duty on waste and scraps cleared by job worker
54.	OR07	Non-payment of duty on intermediate goods when the final products are fully exempted
55.	OR08	Waste & Scrap generated in the factory not accounted for
56.	OR09	Recurring short payments on issues already detected in the past
57.	OR10	Credit taken in PLA without proper TR 6 Challan
58.	OR11	Duty debited from PLA/CENVAT credit account without sufficient balance
59.	OR12	Service Tax issues
60.	OR13	Customs issues
61.	OR14	Cess issues
62.	OR99	Non-payment or short payment of duty due to any other reasons
63.	ON01	Stock of excisable goods not accounted for not resulting in non-payment or short payment of duty
64.	ON99	Audit points/objections pertaining to procedural lapse of any other kind not resulting in non-payment or short payment of duty

**CODES FOR RECORDS/DOCUMENTS/REPORTS SCRUTINY OF WHICH HAS
RESULTED IN AUDIT PARAGRAPHS**

CODE	RECORDS/DOCUMENTS/REPORTS RELATING TO
RC01	Gate records i.e. Incoming/outgoing materials
RC02	Purchase/material receipts (other than gate records)
RC03	Stock/inventory
RC04	Waste and scrap or rejections
RC05	Issue/consumption i.e. Issue slips, bin cards, etc
RC06	Production i.e. Log books, shop floor records, etc
RC07	Sale or despatch (other than gate records)
RC08	Packaging i.e. Packing slips, etc
RC09	Marketing/sales promotion
RC10	Annual financial statement/balance sheet/P & L Account/Trial Balance
RC11	Cash transactions i.e. Cash book/ledger/day journal, etc
RC12	Debit/credit notes
RC13	Audits of all types except I.T. audit.
RC14	Banks (other than reconciliation records)
RC15	Reconciliation of materials/accounts, etc
RC16	Laboratory tests/quality control
RC17	Relating research & development
RC18	Technical literatures/designs/drawings
RC19	Tender/contracts/pricing
RC20	Tax authorities
RC21	Other authorities
RC22	Other income
RC23	Other expenditure
RC24	Loans/debits/credits
RC25	HRD/personnel
RC 99	Any other issue or activity

ANNEXURE – U

QUESTIONNAIRE FOR CONDUCTING THE ELIGIBILITY TEST BY THE ADDITIONAL DIRECTOR GENERAL (AUDIT)

There are two situations under which units may merit treatment as MLU. These are:

1. Different units under the same management or company manufacturing similar goods e.g. two units of M/s Hindustan Lever manufacturing detergent powder at two different locations.
2. Two or more units that are “related” in terms of the definition contained in section 4 of the Central Excise Act, 1944. This would include units under the same management or company manufacturing goods located at different points in the value chain i.e. the goods manufactured by one unit are inputs/ raw materials for another unit e.g. one unit manufacturing polyester chips and supplying to a sister unit manufacturing polyester yarn.

The questionnaire has been prepared separately for these situations. It is also important to point out that the two categories spelt out above are not mutually exclusive and it is possible that a given unit exhibits some symptoms of each type. In brief, the first step is to reconfirm that the unit is indeed a MLU and if so, why it is one.

The following questionnaire would enable a decision whether the group merits treatment as a MLU:

I. Units manufacturing similar goods:

- (i) Does the company generate unit-wise financial statements such as the balance sheet and the Profit and Loss Statement? If not, what is the mechanism for maintenance and consolidation of accounts? Also, whether unit-wise statements be available in the Head Office/ Corporate Office
- (ii) Whether any of the following business functions are centralized in the Head Office/ Corporate Office:
 - a. Purchase of inputs/ capital goods
 - b. Procurement of input services
 - c. Booking of business/ orders
 - d. Sale of inputs, capital goods, waste and scrap or finished products
 - e. Price-fixation of products
 - f. Scrapping of assets or their write-off
 - g. Any other (pl. specify)

- If so, who in the Head Office is responsible for this function? What are the records/ documents with regard to purchases that are maintained in the Head Office? In what form does information about this activity flow to the constituent units? What are the corresponding records maintained in the units?
- (iii) Do any of the units within the group undertake job-work for any other unit of the group? If so, are there any inter-unit transfers of inputs/ semi-finished goods?
 - (iv) Whether the practices with regard to classification of excisable goods or availment of exemption notification, if any, differ across units for similar products? If so, is there a valid explanation for it?
 - (v) Whether the practices with regard to the method of valuation applied to similar goods different across units? If so, is there a valid explanation for the same?

II. "Related persons":

- (i) Does the sister unit (for whom inputs are being manufactured by the unit being audited) supply any inputs, raw materials, capital goods free of cost?
- (ii) Is the price of the goods being supplied to a sister unit determined independently or by the Head Office/ Corporate Office?
- (iii) Is the pricing done on a principal-to-principal basis?
- (iv) Are the goods supplied by this unit captively consumed by the sister unit or sold as such?

Questionnaire to accompany draft Audit Plan of MLU.

1. What is the big picture of the MLU group? How the unit fits into the definition of MLU or inter-connected unit?
2. What is the connectivity or the relationship making it a MLU?
3. What is the level of control exercised by the Head Office/Central Office? (Extent of interference in the working of each unit under MLU)
4. Is the purchase of raw material centralised and what is the payment policy and accounting treatment? Are any guidelines issued / available? What is the policy regarding return of defective goods and treatment of CENVAT credit availed? Is there any issue that has any bearing to the unit being a MLU? Mention the issue.
5. Have the issues relating to valuation of goods sold to connected/related units checked? What is the valuation policy in respect of goods sold to each other? Is the costing data available for cross checking with other units of the group? Issues like depot sales, Sales to related person, additional consideration, valuation of inter unit

stock transfers, captively consumed goods by related person etc. Has the marketing pattern studied and are there any issues that need in depth study? Whether any bought out items sold and are there any guidelines/policy on the same? Is there any policy/guidelines on discounts and does this issue merit study? Are there any issues bearing on the unit being a MLU? Mention the issues.

6. Whether the issue relating to Warranty of goods studied does it merit further study?
7. Is any physical inventory carried out and any report/statement submitted to Banks and Head Office? Does this issue merit further study?
8. Whether the aspect of Inter unit transfer of CENVAT Inputs checked? Has it any bearing on the unit being MLU?
9. Has the pattern related to CENVAT credit utilisation checked? Is there any issue peculiar to the unit being a MLU that needs in depth study? Mention the issue.
10. Are there any issues relating to sales and distribution that are peculiar to the unit because of it being MLU? Mention the issues.
11. Has the aspect of sale of scrap checked? Are there any policy guidelines for the same? Any important issue identified which has bearing on the unit being MLU? Mention the issue(s).
12. Are there any issues pertaining to Job work that are important and have bearing to the unit being a MLU? Mention the issues.
13. Whether any MIS report pertaining to sales, consumption of raw material, expenses etc. submitted by MLUs to the Head office?
14. Any other issue of any nature that have been identified due to unit being MLU or inter-connected.