

CENTRAL BOARD OF EXCISE AND CUSTOMS

**CENTRAL EXCISE AND
SERVICE TAX AUDIT
MANUAL 2015**

CESTAM-2015

Directorate General of Audit

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CHAPTER 1

INTRODUCTION

1.1 Purpose:

1.1.1 The purpose of this manual is to outline the principles and policies of audits conducted under the Central Excise Act, 1944, the Finance Act, 1994 and the Rules made there under. Guidelines provided herein are intended to ensure that the audits of Central Excise and Service Tax assesseees and taxpayers are carried out in a uniform, efficient and comprehensive manner, adhering to the stipulated principles and policies.

1.2 Scope:

1.2.1 The manual covers subjects that are related to principles, policies and special issues pertaining to conduct audit of Central Excise and Service Tax assesseees and taxpayers. The manual does not deal with legal interpretations and rulings on Central Excise and Service Tax matters.

1.2.2 The manual does not contain 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, 1944 and the Finance Act, 1994 and the Rules made there under, administrative policies and procedures may require changes to this Manual. Experience gained during the conduct of audit would also necessitate periodic updating of the manual 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 the jurisdictional Principal Chief Commissioners/ Chief Commissioners.

1.3.3 Removal of difficulty

Past guidelines and instructions on the subject stand modified to the extent they are in conflict with these guidelines. Difficulties faced, if any, in the implementation of above instructions may be brought to the notice of DG (Audit) at an early date. The Principal Chief Commissioners and Chief Commissioners are authorized to issue appropriate instructions, to be valid for temporary periods, to remove any difficulty in conduct of audits, which are important from the perspective of augmentation of revenue.

1.4 The Central Excise and Service Tax Audit Manual issues with the approval of the Board.

CHAPTER 2

MANAGEMENT OF CENTRAL EXCISE AND SERVICE TAX AUDIT

2.1 Audit management requires planning and effective execution of the audit process. Structurally and 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 the audit system, the Board has set up the Directorate General of Audit as the nodal agency. At the local level, management of audit is entrusted to Audit Commissionerates, which are supervised by Principal Chief Commissioners/Chief Commissioners.

2.2 Management at Apex level

The Directorate General of Audit, Customs, Central Excise and Service Tax, New Delhi (headed by Director General) with its Seven Zonal Units at Ahmedabad, Bangalore, Chennai, Delhi, Hyderabad, Kolkata and Mumbai (each headed by an Additional Director General) is required to ensure the efficient and effective implementation of the audit system (based on EA 2000 methodology) and also to evolve and improve audit techniques and procedures through a periodic review. With the help of its Zonal units, the Directorate General of Audit regularly monitors Central Excise and Service Tax audits conducted by the Commissionerates to ensure that the coverage of Assesseees/Taxpayers is adequate in number and is reflective of their risk profile and to ensure that these audits are conducted in accordance with the letter and spirit of EA 2000 methodology. To achieve this, the Directorate needs to interact closely with Principal Chief Commissionerates/ Chief Commissionerates to eliminate the deficiencies and to improve the Audit performance of the Commissionerates.

2.2.1 As an advisor to the Board, the Directorate General of Audit is required to suggest measures for enhanced tax compliance, to gauge the level of audit standards and to ascertain the views of the Assesseees/Taxpayers on the existing audit system. It should also interact with select Assesseees/Taxpayers to take a holistic view of the internal audit and to formulate proposals to remove bottlenecks and obviate the scope of irregularities.

2.2.2 The selection of assesseees and taxpayers would be done based on the risk evaluation method prescribed by the Directorate General of Audit. The risk

evaluation method would be separately communicated to the Audit Commissionerates during the month of May / June of every year. The risk assessment function will be jointly handled by National Risk Managers (NRM) situated in the Directorate General of Audit and Local Risk Managers (LRM) heading the Risk Management section of Audit Commissionerates. It helps the Audit Commissionerates in selection of units for audit during the audit year.

2.3 Role of Zonal Principal Chief Commissioner/Chief Commissioner:

2.3.1 The office of the Principal Chief Commissioner/Chief Commissioner is not an operational formation for the actual conduct of audit, but it provides an important link between the Directorate General of Audit and the Audit Commissionerates of the zone. The role of this office in the overall management of audit is as follows:

- i. Collection, compilation and analysis of the data received from Audit Commissionerates and communication of the same to the respective Zonal Additional Director General (Audit) and to the Director General (Audit) wherever specifically asked for.
- ii. Review of performance of the Audit Commissionerates.
- iii. Dissemination of information pertaining to audit to the Audit Commissionerates.
- iv. Resolving problems in implementation of audit system at local level and providing feedback to the Directorate General of Audit.
- v. Ensuring implementation of guidelines, issued by the Directorate General of Audit, as pertaining to the Audit Commissionerates.
- vi. Monitoring the training for auditors and the officers of the zone, in techniques of Central Excise and Service Tax audit and accountancy.
- vii. Arranging assistance and information to officers of the Directorate General (Audit) in regularly examining the conduct of audits and results thereof.
- viii. Posting/allocating the officers with requisite experience and expertise in conducting audits/analysing financial statements, to the Audit Commissionerates, ensuring equitable distribution of officers for improving coverage.
- ix. To take a final decision in cases, other than finalisation of audit objection, where there is difference of opinion between Audit Commissioner and Executive Commissioner.

- x. Also, to resolve issues that may arise between Executive and Audit Commissionerates
- xi. Also, to provide facility of Appraisers for conducting of OSPCA
- xii. Assigning the audit of an assessee / taxpayer, in case of integrated audit, to a particular Audit Commissionerate, within the Zonal jurisdiction, based on payment of Central Excise duty or Service tax whichever is higher.
- xiii. Selection of theme, planning and execution of Theme based Audit .
- xiv. Ensuring that the services of a Computer Assisted Audit Programme Centre are available to all Audit Commissionerates in the zone and the officers trained in CAAP techniques are retained for a sufficiently long tenure.

2.4 Functions of an Audit Commissionerate:

The Audit Commissionerate comprises of the following sections:

i. Planning and coordination section:

To schedule and to provide support in conduct of Monitoring Committee Meetings (MCM); to maintain and to keep a copy of assessee master file and update it in coordination with the audit groups of circles; to maintain records/registers; to submit reports; to look after formation/constitution of audit groups; deployment of officers, matching skills with audit requirement; to maintain database of officers' profile; to monitor training needs of officers; to plan the audit schedule in such a way as to make optimum use of available resources and ensuring proper desk review before commencement of audit etc.,

ii. Administration, Personnel & Vigilance section:

To look after administrative matters, transfer, leave, allowances, budgetary grants, vigilance matters etc.

iii. Technical section:

To attend to draft show cause notices, audit follow up, court cases, and maintain Board's circulars, instructions etc.

iv. Risk Management and Quality Assurance section:

To attend to risk based selection of units, use of third party source of information, to maintain Audit database of units to be audited, to identify themes/issues for audit, to evaluate and scrutinize working papers and to look after the work related to performance appraisal

and quality assurance etc., and to implement the risk based selection advisory received from DG (Audit) and carrying out selection of units after applying local risk parameters.

- v. **Circles:** Actual conduct of audit and subsequent follow up till the logical conclusions of the audit objections approved in MCM by issuance of SCN up to AC/DC level , forwarding of draft SCN of the competency level of above AC/DC along with relied upon documents or by recovery. In case of non-metro cities and in cases where Circles are situated at a distance from Headquarters, one stationary MIS group will look after the work relating to Planning and Co-ordination.

2.5 Role of senior officers of Audit Commissionerate

2.5.1 Commissioner

- i. To ensure selection of assessees/taxpayers, to be audited during the year, on the basis of risk assessment in consultation with the Directorate of Audit, after applying local risk factors.
- ii. To approve the Desk Review and Audit Plan, in respect of top 5 assessees/taxpayers of each audit circle mentioned in the Annual Plan for audit coverage, after ensuring that all the steps have been completed and review of a few draft plans approved by the ADC/JC to ensure quality of audit.
- iii. To hold either circle-wise (or any number of circles together as deemed necessary), Monitoring Committee Meeting (MCM), once a month to take decision about the acceptability of all audit objections and to determine as to whether larger period is invocable in respect of the accepted objections.
- iv. To ensure that MCM is held by using the offline Audit Report Utility and no paper based audit report is prepared. Also to ensure that after the MCM, each Audit Report Utility is uploaded in ACES
- v. To liase with DG (Systems) to ensure that EDW data and ACES data is available to the auditors
- vi. To ensure that requisite follow-up action i.e. recovery, issue of show cause notice is taken.
- vii. To review audit performance and to take steps for improvement.
- viii. To take remedial measures based on the report of audit group on performance appraisal and quality assurance.

- ix. To review the performance and participation of the Additional/ Joint Commissioner and Deputy/ Assistant Commissioner of audit circles.
- x. To interact with the major assesseees/trade associations, to obtain feedback on the audit system.
- xi. To assess the training needs of the auditors and organize training programmes.
- xii. To submit periodical reports to various formations including Zonal ADG (Audit) or Director General (Audit) as prescribed from time to time.
- xiii. To order special audit in terms of Section 14AA of the Central Excise Act, 1944, and Section 72A of the Finance Act, 1994, on his own or on the basis of a reference received from the Executive Commissioner.
- xiv. To send a list containing details of show cause notices issued by the Audit Commissionerate (including Circles), during the month, to each of the Executive Commissionerates, on monthly basis.
- xv. To ensure CAAP audits are conducted in respect of assesseees/taxpayers maintaining records in electronic formats.
- xvi. In cases where further investigation is required, the matter may be forwarded to the Executive Commissionerates with a self-contained note for further investigation and necessary action like recording statements under summons etc.,

2.5.2 Additional / Joint Commissioner

- i. Co-ordination, planning and overall management of the audit sections and circles including supervision of work relating to theme based audit, audit of MLUs/MLSPs etc.
- ii. To approve the desk review and audit plan, in respect of all the large and medium units, other than the top 5 units that are to be approved by the Commissioner, after ensuring that all the steps have been completed.
- iii. To review audit plans approved by the Deputy/Assistant Commissioners of circles, in respect of small units.
- iv. To interact with large assesseees/taxpayers at the time of audit in order to share major audit findings and compliance issues.
- v. To organize training programmes for auditors.
- vi. To review the follow-up action.

- vii. To make correspondence with Executive Commissionerate for follow up of pending audit paras admitted in writing.
- viii. To ensure selection of units for audit as per the risk based list received from DG (Audit) and to provide justification for tweaking the lists.
- ix. To ensure that the Audit Report Utility is used in MCM and the reports are uploaded in ACES and no paper based audit reports are prepared.
- x. To ensure scrutiny of NIL DARs in the audit circle

2.5.3 Deputy/Assistant Commissioners in-charge of Sections of Audit Commissionerate Headquarters

To supervise the work relating to the respective sections of Headquarters viz., Planning and Co-ordination Section, Administration, Personnel and Vigilance Section, Technical Section and Risk Management and Quality Assurance Section and theme audit. To ensure that the Audit Report Utility is used in MCM and the reports are uploaded in ACES and no paper based audit reports are prepared

2.5.4 Deputy/Assistant Commissioners in-charge of Circles:

- i. Co-ordination, planning and overall management of the audit circle.
- ii. To monitor maintenance of assessee master files and registers.
- iii. To approve the desk review and audit plan, in respect of all the small units, after ensuring that all the steps have been completed.
- iv. To interact with assessees/taxpayers at the time of audit in order to share major audit findings and compliance issues.
- v. To issue show cause notices answerable to Deputy/ Assistant Commissioner of the Executive Commissionerate under intimation to Audit Commissionerate Hqrs.
- vi. To prepare and forward draft show cause notices, answerable to Joint/Additional Commissioner and Commissioner, to Audit Commissionerate Headquarters.
- vii. To approve and issue draft audit reports before attending the MCM meeting.
- viii. To issue final audit reports after approval in the MCM meeting.

2.6 Role of Executive Commissionerate:

- i. To represent in MCM;
- ii. To respond to the audit objections, within 15 days of receipt of the minutes of the MCM;
- iii. To provide detailed comments with a justification on the disputed audit paras including the details of Board's Circulars, case laws (if any) or any point of law;
- iv. To attend to the litigation after adjudication proceedings and to defend the order before the appellate fora – viz., Commissioner (Appeals)/ Tribunals/ Courts, with the help of inputs from Audit Commissionerates, wherever required;
- v. To attend to the work related to pre-audit, post audit of refunds, rebates and brand rate fixation of drawback;
- vi. To attend to the work related to CERA;
- vii. To send proposal to the Audit Commissioner, for special audit of an assessee, in terms of Section 14AA of the Central Excise Act, 1944 and Section 72A of the Finance Act, 1994 in deserving cases;
- viii. To pursue recovery of amounts in respect of pending paras admitted by the party (in writing), basing on the reference received from the Audit Commissionerate.
- ix. To carry out investigation and necessary action like recording statements under summons etc in respect of cases forwarded by Audit Commissionerates.
- x. To ensure immediate intimation to the jurisdictional Audit Commissionerates regarding any cases booked/investigation carried out by Anti-Evasion wing of the Executive Commissionerate or by DGCEI and any audit conducted by CERA. A copy of the CERA objection shall also be sent.
- xi. To ensure timely adjudication of show cause notices issued by the Audit Commissionerates.

2.7 Staffing norms for Audit Commissionerate:

- i. Headquarters shall be headed by one Commissioner with the assistance of two Additional or Joint Commissioners and three or four Deputy Commissioners.

- ii. Normally, officers selected and posted to the Audit Commissionerate should be allowed to continue to function in the Commissionerate for a minimum period of two years and maximum of four years.
- iii. 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.
- iv. Each audit circle shall be headed by a Deputy or an Assistant Commissioner
- v. Deputy/Asst. Commissioner of the circles should be associated with all major audits. Senior Officers of the cadre of Joint/Additional Commissioners should interact with the senior management staff of large units before conducting audit. In case of LTUs, the Principal Commissioner/ Commissioner should interact with the management of the unit.
- vi. Audit circle comprises of one stationary audit group (MIS) to look after the work relating to planning and co-ordination section of Hqrs Office, such as MCM, maintenance of Assessee Master Files, processing of draft show cause notices, attending to follow up work etc. and deployment of audit groups for conduct of audit.
- vii. The Audit Groups deployed for audit of large units may comprise of 2-3 Superintendents and 3-5 Inspectors. For medium units, the audit group may include 1 - 2 Superintendents and 2 - 3 Inspectors. For small units, the Audit Group may include 1 Superintendent and 1 - 2 Inspectors.
- viii. Groups for large units, medium units and small units should be in such numbers that the following distribution of manpower deployment in audit groups is achieved.
 - a. 40% of manpower for large units including audits of MLUs, MLSPs and theme based audits
 - b. 25% of manpower for medium units
 - c. 15 % of manpower for small units
 - d. 20% of manpower for planning, coordination and follow up.

2.8 Auditors' Profile:

Profile of each of the auditor posted in the groups should be available in the Audit Planning and Coordination Cell of Circle, in the following proforma.

- i. Name of the officer.
- ii. Designation.
- iii. Experience in the department.
- iv. Professional qualification, if any.
- v. Experience in Central Excise Range / Service Tax formation or Divisional office (in years).
- vi. Whether undergone training in audit.
- vii. Experience in audit wing.
- viii. 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.
- ix. Any commendation/awards, rewards, etc. received.

2.8.1 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 Groups. Auditors profile facilitates effective deployment of auditors to units by taking into account appropriate skill levels, training, educational background of the auditor etc.

2.8.2 The formation of audit groups is a critical component of audit management. The cadre controlling authority in-charge of the Audit Commissionerate shall ensure that the officers with the requisite skill and experience are posted to Audit Commissionerates depending on the availability and other administrative constraints. Audit Commissioners should ensure that the skill and experience available is evenly distributed across the audit groups. 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 MIS section of Audit Commissionerate / Circle, officers with computer skills and some prior audit experience are required. Similarly, the skill sets and experience available with an audit group should govern the size and complexity of audits that it handles. For optimal results, there should be matching of these two factors.

2.8.3 While forming the groups in Service Tax audits, posting of the officers with specialised skills will help achieve better results. For the above purpose, the

services may be divided into groups by aggregating similar services. A suggested list of such groups is provided in **ANNEXURE – ST - XI**. This grouping would facilitate cultivating specialization amongst the Audit Officers and would also lead to uniformity in the type of objections that are raised to particular service providers. Basing on the said grouping, the audit of services pertaining to particular group can be allocated to the specific team(s), depending upon the requirement so that the services of the team which has specialised skills can be optimally utilised. However, Audit teams can be reconstituted in accordance with the local needs.

2.8.4 Officers, when posted to the Audit Commissionerate 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 Audit Commissionerates for the benefit of new entrants soon after the annual transfers. The Audit Commissioner should also ensure to organise special training programmes for major industrial sectors in the jurisdiction of an Audit Commissionerate so that auditors have the necessary specialization and sufficient number of auditors specializing in major industries are available. Officers, who have worked in audit sections earlier, should also be imparted with refresher course on the latest techniques of audit and changes in the statutory provisions, if any.

Chapter 3

AUDITOR'S RESPONSIBILITY AND AUTHORITY

3.1 Definition of 'Auditor':

Auditor means 'a Central Excise officer entrusted with the responsibility of conducting an audit'.

3.2 Role of the auditor:

3.2.1 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 /taxpayer. At the same time, the auditor should keep in view, the prevalent trade practices, the economic realities as also the industry and business environment in which the assessee /taxpayer operates. Therefore, the auditor should take a balanced and rational approach while conducting the audit. Besides, the auditor is expected to play a key role in promoting voluntary compliance by the assessees /taxpayers. During the course of the audit, if certain technical infractions, without any revenue implications, arising due to *bona fide* oversight or ignorance of the assessee /taxpayer, are noticed, the assessee /taxpayer should be guided for immediate correction. Such cases should also be mentioned in working papers. The auditor should also apprise the assessee /taxpayer of the provisions of the Central Excise Act, 1944 and Finance Act 1994 relating to applicability of interest and encourage him to take advantage of those provisions in order to avoid disputes and litigation. The auditor should apprise the assessee /tax payer of the provisions of Section 11A (1) (b) [Section 11 AC (1) (c)] of the Central Excise Act, 1944/Section 73(3) (Section 78(1)) of the Finance Act, 1994 and encourage the assessee /tax payer to make payment of the duty /tax dues before issue of show cause notice.

3.2.2 The audit process should be transparent and all the findings should be intimated to the assessee /taxpayer in writing and an opportunity be given to the assessee /taxpayer to give his explanation before an objection is finalised and consequential action is initiated.

3.2.3 The auditor should take into account the explanation from the assessee /taxpayer regarding all points of dispute, before taking the final view. If necessary, the auditor should contact his supervising Assistant/Deputy

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

3.2.4 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 of his audit 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 of audit should be filled in 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 arriving at certain conclusion should invariably be cited and included.

3.3 Dealing with the public:

3.3.1 The objective of the Central Excise Department is to collect correct amount of duties/taxes levied under the Central Excise /Service Tax 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/taxpayer after the liberalisation of procedural controls.

3.3.2 The auditor should establish and maintain a good professional relationship with the assessee/taxpayer. The auditor should recognise the rights of the assessee/taxpayer, such as, the right to impartial, uniform and transparent application of law and the right to be treated with courtesy and consideration. The auditor should explain that the tax compliant assesseees/taxpayers stand to gain from such an audit in as much as: -

- i. they will be better equipped to comply with the Laws and the relevant Procedures;
- ii. the preparation of prescribed returns and self-assessment of Central Excise duties and Service Tax will be focussed better, correct and complete;
- iii. the scrutiny of business accounts and returns submitted to various agencies, made in the course of audit will remove any deficiencies in their accounting and internal control systems;

- iv. disputes and proceedings against them would be substantially reduced or even eliminated.

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

3.3.4 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 an electronic or manual format, should be used only for verification of levy of excise duty/service tax 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/taxpayer.

3.4 Authority for an auditor:

3.4.1 There is no separate cadre known as 'Auditor' either under the Central Excise Law or under the Service Tax law. The departmental audit is conducted by the Central Excise officers and all the powers vested in the Central Excise Officers under the Central Excise Act, 1944, the Finance Act, 1994 and the Rules made there under are available to the officers conducting the audit. Thus, the auditor is also a 'proper officer'.

3.4.2 The auditor, for conducting audit, has to mainly rely on the records maintained by the assessee/taxpayer in the ordinary course of business.

3.4.3 **CENTRAL EXCISE:** 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.

3.4.3.1 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:

- i. the records maintained or prepared by him in terms of subrule (2);
- ii. the cost audit reports, if any, in terms of Section 148 of Companies Act, 2013.

3.4.3.2 As 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

3.4.3.3 Rule 22 of the Central Excise Rules, 2002 provides that the Commissioner may empower an Officer or depute an audit party for carrying out scrutiny or verification of records of the assessee. The rule also obliges an assessee to make available records for such scrutiny. The statutory backing for rule 22 flows from clause (x) of section 37(2) and the general rule making powers under section 37(1) of the Central Excise Act, 1944. Clause (x) of section 37(2) empowers the Central Government to make rules for verification of records and returns to check the correctness of levy and collection of duty, which, in the present regime of self-assessment would mean verification of correctness of self-assessment and payment of duty by the assessee. It may be noted that the expression “verification” used in the section is of wide import and would include within its scope, audit by the departmental officers, as the procedure prescribed for audit is essentially a procedure for verification mandated in the statute.

3.4.4 SERVICE TAX

3.4.4.1 Service providers of taxable services in the entire country are required to be audited. The relevant enabling provisions for this are, -

- i. Section 65(121) of the Finance Act, 1994 provides that words and expressions used but not defined in Chapter V of the said Finance Act and defined in the Central Excise Act, 1944 or the rules made there under, shall apply, so far as may be in relation to Service Tax as they apply in relation to a duty of excise.

ii. Rule 2(2) of the Service Tax Rules, 1994 lays down that all words and expressions used but not defined in Service Tax Rules but defined in the Central Excise Act, 1944 and the rules made there under shall have the meanings assigned to them in that Act and Rules. [Notification No.2/94-ST, dated 28.06.1994]

iii. The definition of “Central Excise Officer” as contained in the Section 2(b) of the Central Excise Act, 1944 will also apply to the Central Excise officers conducting Service Tax audit and shall also include Service Tax officers. Thus, a Central Excise officer, who is assigned the duties of audit in Service Tax, is the proper officer for conduct of Service Tax audit.

3.4.4.2 The Service Tax Law through the Finance Act, 1994 and Service Tax Rules, 1994 do not prescribe any specific records to be maintained by the assessee/taxpayer. However, Rule 5 of the said Rules deals with records. In this regard the following provisions are relevant:

- i. In exercise of the rule making powers under clause (k) of sub-section (2) of section 94 of the Finance Act, 1994, the Central Government has inserted a new rule 5(A)(2) in the Service Tax Rules, 1994 vide notification no. 23/2014-Service Tax dated 5th December, 2014. This rule, *inter alia*, provides for scrutiny of records by the audit party deputed by the Commissioner. Such scrutiny essentially constitutes audit by the audit party consisting of departmental officers - Refers Circular No. 181/7/2014-ST dated 10.12.2014.
- ii. Verification of records mandated by the statute is necessary to check the correctness of assessment and payment of tax by the assessee/taxpayer in the present era of self-assessment. It may be noted that the expression “verified” used in section 94(2)(k) of the said Act is of wide import and would include within its scope, audit by the departmental officers, as the procedure prescribed for audit is essentially a procedure for verification mandated in the statute - Refers Circular No. 181/7/2014-ST dated 10.12.2014.
- iii. For carrying out integrated audits in exclusive Service Tax Commissionerates, necessary legal enablement has been made in the Jurisdictional Notifications No. 20/2014-ST and 21/2014-ST, both dated 16.09.2014.
- iv. Besides, Rules 9(5) and 9(6) of the CENVAT Credit Rules, 2004 provides for maintenance of records by a provider of output service with respect to receipt and consumption of inputs, capital goods and input services, in addition to

submission of periodical returns prescribed under rule 9(9) to rule 9(11) *ibid*, in respect of credit availed.

3.4.5 SUMMONS: The auditor may issue summons with the approval of Deputy/Assistant Commissioner of Circle, only for the purpose of obtaining records/documents which are necessary for conducting audit, where the assessee/taxpayer is not volunteering to submit the same on the basis of letter issued by the auditor. However, where it is felt necessary that recording of the statement of the taxpayer/assessee is necessary, the Audit Commissioner may forward such cases to the jurisdictional Executive Commissioner, with a self-contained note for taking appropriate/necessary action like carrying out further investigation, issue of show cause notice etc., as deemed fit. In this regard, in case of difference of opinion between the Audit Commissioner and the Executive Commissioner the Principal Chief Commissioner/Chief Commissioner may decide the issue.

Chapter 4

PRINCIPLES OF AUDIT

4.1 The objective of audit of assessee/taxpayers is to measure the level of compliance of the assessee/taxpayer in the light of the provisions of the Central Excise Act, 1944 and the Finance Act, 1994 and the rules made thereunder. It should be consistent with departmental instructions and should make use of professional audit methodology and procedures. The basic principles are:

- i. The audit should be conducted in a systematic and penetrative manner.
- ii. Emphasis should be on the identified risk areas and on scrutiny of records maintained in the normal course of business.
- iii. Audit efforts should be based on materiality i.e. degree of scrutiny will depend on the nature of risk factors identified.
- iv. Recording of all checks and findings.
- v. Audit should normally be distinct from anti-evasion operation in as much as it can detect irregularities only to the extent of their reflection in the books of accounts.

4.2 Standards for conduct of audit:

4.2.1 In keeping with the principles of audit outlined above, audit has to be conducted in a transparent and systematic manner with focus on business records of the assessee and taxpayer and according to the audit plan for each assessee and taxpayer. The assessee and taxpayer participation in the course of audit is also envisaged so that instead of raising purely technical objections (without any revenue implications), substantive issues are also focussed upon.

4.2.2 The auditor should ensure that audit is conducted in a focused manner with optimum utilisation of time and resources available at hand. The auditor must use his judgement and experience to determine the materiality of any discrepancies and/or irregularities observed and decide what action is necessary under the circumstance, for example,

- i. Cumulative effect of small items: An error of one isolated item might be insignificant but the cumulative effect of many individually unimportant items would signify systemic failure. In fact, the relative materiality of an individual item has to be viewed against the net effect on over-all compliance and interest of revenue.

- ii. General or Particular Items: An error made in a particular transaction may be an aberration if it is a stray, single instance but the effect may be material, if it is of recurring nature. Thus frequency of error is of importance.
- iii. Effect in relation to scale of a assessee/taxpayer operation: An error may appear to be small in itself, but may have sizable implication due to the huge scale of operations of an assessee/taxpayer.

4.2.3 Integrated audits:

Coordinated and integrated audit covering two or more duties/taxes for assessee/taxpayer i.e. Central Excise, Service Tax and Customs (OSPCA) having common PAN shall be carried out instead of individual audit for each tax separately, operation of which is detailed in subsequent paras/chapters.

For carrying out integrated audits in exclusive Service Tax Commissionerates, necessary legal enablement has been made in the jurisdictional Notifications No. 20/2014-ST and 21/2014-ST, both dated 16.09.2014.

4.2.4 Period to be covered during audit

Every audit should invariably cover the retrospective period up to the previous audit by the departmental audit group or of the last 5 years, whichever is less and should extend up to the last completed Financial Year preceding the date of commencement of the audit.

4.3 Duration of audit

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

The indicative duration for conduct of Audit that is inclusive of desk review, preparation and approval of audit plan, actual audit and preparation of audit report wherever necessary, for each category would be as under:

- i. LTUs – 8 to 10 working days
- ii. Large taxpayers – 6 to 8 working days
- iii. Medium taxpayers – 4 to 6 working days.
- iv. Small taxpayers – 2 to 4 working days

The above mentioned working days are indicative and applicable for conduct of Central Excise/Service Tax audit covering one year period. In case the audit coverage is for five years, the number of days may be increased to maximum of

16/12/8 days for Large, Medium and Small taxpayers respectively. In other words the number of days for conduct of audit may be increased proportionately, with an increase of 25% of working days for every additional year of coverage. If an integrated audit is to be conducted covering both Central Excise, Service Tax and OSPC audits, especially in case of large units, more number of working days are to be allocated for effective conduct of audit.

4.3.2 The duration, as above, covers the effective number of working days spent by the audit group for the audit of a particular assessee and taxpayer from desk review to preparation of audit report (i.e. days spent in office as well as at the assessee and taxpayer premises). In exceptional cases, the 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 and taxpayer 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 has been completed in the prescribed manner.

4.4 Stage wise action for audit

- i. Preparation/updating of assessee master file containing comprehensive assessee/taxpayer profile.
- ii. Selection of assessees/taxpayers for audit.
- iii. Collection of all relevant documents, data reconciliation statement and reply to questionnaire.
- iv. Desk review on the basis of relevant documents and interview of the assessee/taxpayer.
- v. Formulation and approval of audit plan based on desk review.
- vi. Conducting audit verification on the basis of the approved audit plan.
- vii. Suggestions on correction/improvements to assessee/taxpayer for future guidance.
- viii. Preparation of draft audit report and its submission, along with working papers, to the senior officers.
- ix. Discussion on the draft audit report during MCM and approval of the objections raised therein.
- x. Issue of final audit report with the help of Audit Report Utility (ARU).
- xi. Preparation of Modus Operandi circular to be submitted to the Zonal Additional Director General (Audit) and the Directorate General of Central Excise Intelligence.
- xii. Follow up action, for monitoring the compliance of various points.
- xiii. Ensuring timely issuance of SCNs, wherever warranted.
- xiv. Recovery of revenue detected.

CHAPTER 5

SELECTION OF ASSESSEE/TAXPAYERS FOR AUDIT

5.1 Objective:

Selection of assessees/taxpayers for audit means selection of assessees and taxpayers to be audited during a specified period, taking the available resources into account. Given the large number of registered assessees and taxpayers under Central Excise and Service Tax, it is impossible to subject every assessee/taxpayer to audit each year with the available resources. Further, emphasis placed merely on coverage of more number of assessees and taxpayers would dilute 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. Selection of units for audit based on revenue risk 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. These assessees and taxpayers should be selected on the basis of assessment of the risk to revenue. This process, which is an essential feature of audit selection, is known as 'Risk Assessment'. It involves the ranking of assessees and taxpayers according to a quantitative indicator of risk known as a 'risk parameter'.

5.2 Method of selection based on risk assessment:

The selection of assessees and taxpayers would be done based on the risk evaluation method prescribed by the Directorate General of Audit. The risk evaluation method would be separately communicated to the Audit Commissionerates during the month of May/ June of every year. The risk assessment function will be jointly handled by National Risk Managers (NRM) situated in the Directorate General of Audit and Local Risk Managers (LRM) heading the Risk Management section of Audit Commissionerates. The Risk Management section of Audit Commissionerate would ensure availability of assessee/taxpayer-wise data for a period of last three years, which would facilitate risk assessment and preparation of the list of assessees/taxpayers to be audited in the current year.

5.2.1 Basing on the risk methodology, a list of units will be communicated to the Audit Commissionerates by the NRM, for the purpose of conducting audit for the audit year. The Audit Commissionerates may select the units to be audited in a particular year after reviewing the list forwarded to them by the DG(A), in the

context of local risk perceptions and parameters. The Audit Commissionerate may also select an assessee with low risk score compared to an assessee with relatively high risk score. However, the reasons for such selection should be indicated which would be used as a feedback by the Directorate of Audit for further improvisation of risk factors in future.

5.2.2 The Audit Commissionerates may also select a few units at random or based on local risk perception in each category of large, medium and small units. Feedback on such random selection and results of audit thereof would help in evaluation of parameters used for the process of selection.

5.2.3 After preparation of the annual plan of audit coverage as indicated above, the Audit Commissionerates would also prepare a list of units, in whose cases the risk can be mitigated through a detailed scrutiny of returns and convey the details to the Executive Commissioners for taking necessary action. Selection of such units can be carried out at the Zonal level so that the Audit and detailed scrutiny of returns complement each other. The list of such units and reason for selection should be shared with the Directorate General of Audit.

5.3 Preparation of audit schedule:

5.3.1 Annual plan for Audit Coverage (Audit year being -1st July to 30th June):

- i. The Audit Commissionerate would release an Annual plan by 31st May, indicating the names of assesseees/taxpayers proposed to be audited during the course of the year (period from 1st July to 30th June of the next year) and the month in which the Audit officers would visit the units for verification of records. The Audit coverage (i.e. number of units selected for Audit in a year) may be calibrated with the manpower availability in a Commissionerate. The working strength of officers in Audit Commissionerate would be taken as the basis for calibration.
- ii. In order to ensure adequate coverage, the assesseees/taxpayers shall be categorized into three categories namely large, medium and small units. Given the past experience in detection of non-compliance and recovery of duty through audits, it is suggested that Audit Groups may be deployed to cover large, medium and small units as discussed in Para 2.6.

While deploying officers due care should be taken, so that the staff is proportionately allocated to attend the audit work related to Central Excise Units and Service Tax assesseees/taxpayers based on revenue profile of the Commissionerate.

- iii. The composition of Audit Groups to cover large, medium and small units would be as discussed in chapter 2
- iv. The indicative duration for conduct of Audit that is inclusive of desk review, preparation and approval of Audit plan, actual Audit and preparation of Audit report wherever necessary, for each category would be as discussed in chapter 4
- v. Given that there are around 249 working days in a year, the number of Audits that can be conducted approximately in a year are as follows:
 - a. 31 large units (calculated at 8 days per unit) by one Audit Group
 - c. 42 medium units (calculated at 6 days per unit) by one Audit Group and
 - d. 62 small units (calculated at 4 days per unit) by one Audit GroupThe number of working days for audit are for the purpose of calculations and may vary as per the size of the assessee and the workload involved. The Commissioner can as per the jurisdictional requirement make calculations as per the local requirements and deploy officers accordingly.
- vi. The aforementioned number of Audits could be then multiplied by the number of Audit Groups earmarked for each category to arrive at the total number of Audits that can be conducted by each Audit Commissionerate during the year.
- vii. The manner of deployment of officers as mentioned above and calculation of number of units that can be audited during the year are illustrated below:
 - a) Suppose the working strength of an Audit Commissionerates is 60 Superintendents and 80 Inspectors. The deployment of officers would be: 24 Superintendents and 32 Inspectors would be for large units, 15 Superintendents and 20 Inspectors for medium units and 9 Superintendents and 12 Inspectors for small units and 12 Superintendents and 16 Inspectors in Headquarters, as envisaged at (ii) above. To the extent possible, the manpower distribution amongst the Circles within an Audit Commissionerate

should be proportional to the large, medium and small assessee/taxpayer base in the Circle. In other words, the 24 Superintendents and 32 Inspectors designated for large assesseees/taxpayers would be divided amongst the Circles proportional to the number of large assesseees/taxpayers under each circle. The deployment has to be done in similar manner for medium and small units.

- b) Using the manpower as above, there would be around 10 groups for large units, 12 groups for medium units and 6 groups for small units. The total number of units that could be audited in a year works out to around 310 large units, 504 medium units and 372 small units i.e. 1186 units in all. The Audit Commissioners may exercise necessary reallocation of officers to medium units, if the audit of large units is completed. Thus each Commissionerate can carry out the calculations based on the working strength.
- viii. The criteria for categorizing an assessee /taxpayer as large, medium or small would be (a) annual value of clearances and total duty paid in case of Central Excise and/or (b) value of services rendered and services received (which are dutiable on reverse charge basis) and total Service Tax paid in the case of Service Tax. The threshold limits of value of clearances / value of services for categorizing the units into large, medium and small would be dependent upon (i) the available manpower in the Audit Commissionerate and (ii) the assessee/taxpayer base, turnover and duty paid by each assessee/taxpayer in the jurisdiction of the Audit Commissionerate. It may be noted that threshold limits may vary from one Audit Commissionerate to another Audit Commissionerate in view of varying number of assesseees/taxpayers and quantum of value of clearances / services and duty paid by each assessee/taxpayer. The Audit Commissionerates would obtain the requisite data from EDW / ACES / EASIEST for categorization of assesseees/taxpayers into large / medium / small within their Commissionerate. The categorization would be done based on the methodology prescribed by the Directorate General of Audit. The methodology for categorization would be communicated to the Audit Commissionerates by

Directorate General of Audit during the month of March / April every year.

- ix. The Audit Commissionerates shall consult Zonal units of Directorate General of Audit while finalizing the Annual plan of Audit coverage with the available manpower at the beginning of the financial year. The scheduling can be reviewed half yearly for necessary adjustments, if any. The Directorate General of Audit will also periodically review and revise, wherever necessary, the criteria for categorizing the units into large, medium and small within each Zone / Commissionerate, manpower deployment in each category, composition of Audit Group and number of days required for audit in each category. The review/revision would be done in consultation with the Audit Commissionerates so as to ensure that Audit coverage by officers is made optimal.
- x. Principal Chief Commissioner/Chief Commissioner may allow temporary reallocation / diversion of officers amongst the Audit Commissionerates to ensure adequate Audit coverage of all categories of assesseees/taxpayers falling under the jurisdiction of the zone.

5.4 Integrated audits:

5.4.1 Wherever, the assessee/taxpayer is registered both under Central Excise and Service Tax, integrated audit of both Central Excise and Service Tax may be taken up. Currently, audit is undertaken for each tax separately even though the business and financial records verified during the audit are common for all the three taxes administered by the Board. In order to improve the efficiency of audit process, it has been decided that coordinated and integrated audit covering two or more taxes for assesseees/taxpayers having common PAN shall be carried out. Necessary legal enablement has been provided in the notifications No 20/2014-ST and 21/2014-ST dated 16.09.2014, conferring territorial jurisdiction to the Commissionerates such that Service Tax Audit Commissionerates can audit Central Excise assesseees/taxpayers within a zone and vice-versa. An assessee/taxpayer who is registered under Central Excise, Service Tax and Customs (OSPCA) need not be subjected to three separate audits. The information about various registrations being available, such assesseees/taxpayers would be subjected to a comprehensive audit by the designated Audit Commissionerate. For this purpose the Principal Chief Commissioner / Chief Commissioner will assign the audit of such an assessee/taxpayer to a particular Audit Commissionerate, within the Zonal

jurisdiction, based on payment of Central Excise duty or Service tax whichever is higher. Following the same principle, Customs OSPCA would be also be carried out by the designated Central Excise or Service Tax Audit Commissionerate, in an integrated manner. In case of ACP importers, comprehensive audit is required to be conducted **only** when the said assessee is also selected for audit, based on the risk evaluation method.

5.4.2 Co-ordination of audit of an assessee and tax payer having multiple registrations in the same premises: There may be a special situation, where there are multiple registrations of an assessee / tax payer in the **same premises**, i.e., if a tax payer having a service tax registration falling in the jurisdiction of an exclusive service tax Commissionerate under a Service Tax CC Zone, is also having a Central Excise registration in the same premises, registered with a Central Excise Commissionerate of a different Central Excise CC Zone, both such registrants should be audited simultaneously, coordinated by the CC Zone, in whose jurisdiction, the highest duty/taxpaying assessee/taxpayer falls, irrespective of whether the assessee/taxpayer is covered under risk based selection or not (by exchanging information from desk review to MCM). The auditors from both the PCC/CC Zones may be advised to be involved in the co-ordinated audit.

5.5 Audit of Multi Locational Units (MLUs)/ Multi Locational Service Providers (MLSP)/ ACP importers (OSPCA):

- i. While preparing the Annual plan for audit coverage, instructions contained in **Chapter 9** may be referred to.
- ii. Audit of ACP importers may be conducted as contemplated in the Manual on OSPCA. However, if such an ACP importer is selected for audit under the risk evaluation method in a particular year, a comprehensive audit of Central Excise, Service Tax and Customs OSPC Audit may be conducted.

5.6 Theme based coordinated audits

5.6.1 Theme based co-ordinated audits at all India level would be conducted by the concerned Audit Commissionerates in a coordinated manner. The theme would be selected by the Directorate General of Audit, based on a systematic and methodical risk analysis of internal data of assessee/taxpayer (from ACES and EDW), economic indicators, third party information from tax and other regulatory

authorities and other relevant sources of data. The DGA would also consult trade, industry and manufacturers from time to time, wherever necessary. The theme would be intimated well in advance, say four to six months, to the field formations. Detailed questionnaires would be prepared to serve as guidance to the Audit parties. The dates for such audits would be fixed in advance, say, sometime in December every year, so that they can be blocked by the Commissionerates. The number of such audits will be one or at best two in a year. The selection of theme /issue, coordination and dissemination would be done by DGA in consultation with the field formations.

5.6.2 The theme based coordinated Audits would also be carried out at the Zonal level. The theme for the audit, which could be a sensitive commodity, would be selected at the zonal level and simultaneous and coordinated audit would be carried out within the zone. The number of such audits will again be one or two in a year. The theme for the Audit would be selected based on analysis of data provided by ACES, EDW and relevant third party information identified from time to time. The Principal Chief Commissioner/Chief Commissioner may involve the zonal units of Directorate General of Audit in selection of theme, planning and execution of theme based Audit.

5.7 Selection and Audit of LTUs

In case of LTUs, 80% of the manpower may be used for conducting audits and 20% of the manpower may be used for headquarters functions. The audit group would comprise 2-4 Superintendents and 3-6 Inspectors. The indicative duration for conduct of audit that is inclusive of desk review, preparation and approval of Audit plan, actual audit and preparation of audit report is 8 to 10 working days. Based on the recommended duration, the number of units that could be audited in a year would be 25 LTUs (calculated at 10 days per Audit) by one audit group. The audit groups from LTU Audit Commissionerate's Circles would necessarily conduct the audit of LTUs and wherever additional manpower assistance is required the same can be sought from other LTUs or the jurisdictional Central Excise/Service Tax Audit Commissionerate. Further, audit of the LTU should be conducted in a coordinated manner i.e., the audit of Head Office and group units should be conducted simultaneously. To enable this, the audit dates should be decided in consultation with the LTU. The total number of assessees/taxpayers to be audited and selection of individual assessees/taxpayers for audit would be done as per the risk evaluation method recommended by the Directorate General of Audit.

5.8 Accredited status for deferring frequency of audit

A segment of assesseees/taxpayers, could be given an “accredited” status, similar to the one given in Customs, based on their proven track record of compliance with tax laws and procedures. Such identified assesseees/taxpayers need not be subjected to Audit in every cycle. It has been decided that such units should normally be audited only after 3 years from the date of last audit. The procedure and criteria for accreditation would be communicated separately.

CHAPTER 6

AUDIT - PREPARATION AND VERIFICATION

6.1 Profiling of assessee/taxpayer:

6.1.1 Audit requires a strong database for profiling each assessee/taxpayer so that risk-factors relevant to an assessee/taxpayer may be identified in a scientific manner and audit is planned and executed accordingly. Some of the relevant data has to be collected from the assessee/taxpayer during the course of audit, while the rest is to be extracted from the registration documents and returns filed by the assessee/taxpayer as well as from his annual report, reports/returns submitted to regulatory authorities or other agencies, Income Tax returns, contracts with his clients, audit reports of earlier periods as well as audits conducted by other agencies, (like office of C&AG), etc.

6.1.2 A comprehensive data base about an assessee/taxpayer to be audited is an essential pre-requisite for selection of units as well as for undertaking preliminary desk review and effective conduct of audit. A substantial amount of data is already available in ACES and EDW. Some of the data like those contained in annual financial statements keeps changing every year.

6.2 Assessee Master File (AMF): The first step towards an effective audit is to collect all relevant information about the assessee/taxpayer from various sources, arrange it in a systematic manner so that the audit can be planned in a result-oriented manner. The AMF should contain all the useful information about an assessee/taxpayer, in the form of statistical data as well as in narrative form as required in **Annexure CE-I/ST-I** of this manual. This file should be useful not only for the future audits, but also as a ready reckoner for other purposes, such as for reply to the Parliament Questions and generating Management Information System (MIS) reports.

6.2.1 The Planning and Co-ordination section of Audit Commissionerate Hqrs/ MIS section of the audit circle should collect all relevant information and documents about the assessee/taxpayer from various sources (including the assessee/taxpayer himself), arrange it methodically in the assessee master file and regularly update it.

6.2.2 The hard copies of the documents as listed in **Annexure CE-I/ST-I** should be maintained for a period of 5 years. Documents pertaining to period older than 5 years, should be removed unless relevant to any current proceedings. Disposal of

the documents removed from a master file should be done with the approval of Deputy Commissioner/Assistant Commissioner (Audit).

6.2.3 The Planning and Co-ordination section of an Audit Commissionerate Hqrs/ MIS section of the audit circle should also maintain a separate electronic folder for each assessee/taxpayer and make all entries for that particular assessee/taxpayer in that folder only. The folder should be updated after every subsequent audit. Initially, 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.

6.2.4 The electronic data should be kept in a properly secured format so that it can be altered or modified only by an authorised officer of the audit group. This folder should be protected by a password and should be made available to the officers of audit only with the prior approval of the Assistant/Deputy Commissioner (Audit) in writing. The data should, however, be accessible to all the concerned officers working in Audit Commissionerate.

6.2.5 The AMF of the assessee/taxpayer selected for audit should be handed over to the respective group under an acknowledgement for the purpose of conducting desk review. On completion of the entire process of audit, the audit group should **update** and return the AMF to the Planning and Co-ordination Section/ MIS Section.

6.2.6 It should be ensured that the AMFs are maintained under the direct control of the Dy./Asst. Commissioner in-charge of the circle. On being transferred, the Dy./Asst. Commissioner should handover all the master files to the new incumbent.

6.2.7 The master file should be updated periodically or after completion of each audit. The audit working papers, audit report, duly approved during the audit monitoring meeting, along with the latest documents should be filed properly in a file and the same shall be attached to the Master file folder of the assessee/taxpayer. Scanned/soft copies of the relevant documents should also be kept in the AMF folder.

6.2.8 Keeping in view the security of the information, the hard copies should be made available 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 MIS unless permitted by the Assistant/Deputy Commissioner of the MIS

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.

6.3 Allocation of audits amongst the audit parties:

The audit schedule should also mention the Group No. of the audit group to conduct audit of a particular unit. It must be ensured that the group members of the audit party are fully trained for conducting audit in accordance with the guidelines in this manual.

6.4 Action to be taken by the Audit Group:

Once the audit schedule, with Group allocation, is finalised, the action shifts to audit groups. The group should have adequate time to complete the preparation for audits to be conducted as per the audit schedule. 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/taxpayer about the audit and the records/documents to be provided to the auditors has been provided in **Annexure-CE-II/ST-II** of this manual.

6.5 Working Papers (Annexure – CE-VIII/ST-VIII):

1. 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.
2. 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 in should be mentioned. The working papers should be filled in by the auditors themselves and in no case should be handed over to the assessee/taxpayer for filling them up.
3. The completed working papers must be submitted by the Audit Group with the draft audit report made with the help of audit report utility (ARU).
4. Copies of supporting documents/records/evidences referred to in the working papers must be annexed at the end. Each copy should have a cross-reference to the relevant entry in the working paper.
5. Before the conduct of audit verification, the audit plan should be approved and signed by senior officer not below the rank of

Commissioner/ Additional/ Joint Commissioner/Deputy/Assistant Commissioner of Audit Commissionerate, as the case may be.

6.6 Desk Review

6.6.1 Objective:

The desk review lays emphasis on gathering data about the assessee/taxpayer, 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 a logical audit plan and focus on potential issues.

6.6.2 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/taxpayer and its operations, as much 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. The services of Assistant Director (Costs) allocated to CC Zone may be utilised effectively wherever required.

6.6.3 The auditor should immediately refer to the AMF (**Annexure-CE-I/ST-I refers**). Study of the AMF 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 the last updating of AMF. 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 documents required to be scrutinized from the audit angle is given at **Annexure –CE-III/ST-III**).

6.6.4 All receipts of the taxpayer need to be tested for Service Tax liability. Analysis of exports turnover, turnover of non-taxable and exempted services gives a clear picture of the amounts which were not considered for Tax payment. It also helps to conclude whether such exemptions claimed are proper or not. (Part III (I) of Working papers in Annexure ST –VIII refers).

6.6.5 Cost Accounting Records/Cost Audit:

1. Cost Accounting records are required to be maintained by certain companies *inter alia* by i) whose turnover exceeds Rs. 20 Crores ii) who are listed in any stock exchange as per Companies (Cost Accounting Record) Rules, 2011
2. Cost Audit is required/mandated for applicable companies of CAR Rules and;
 - i) whose turnover exceeds Rs. 20 Crores, which are specified in Table I of order F. No. 52/26/CAB-2010 dated 06.11.2012 of Ministry of Corporate Affairs;
 - ii) whose turnover exceeds Rs. 100 Crores and which are specified in Table II of Order of Ministry of Corporate Affairs, mentioned above and
 - iii) listed companies (For details please refer the website of Ministry of Corporate Affairs at www.mca.gov.in)

For latest amendments and existing norms the Companies (Cost Records and Audit) Rules 2014 may be referred to.

6.6.6 From the AMF, 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-CE-IV/ST-IV**.

6.6.7 Reconciliation of data with third party information: Duty/tax payment shown in the CE/ST returns can be reconciled with that shown in the financial accounts. Further, from the reconciled figure of duty/tax 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/taxpayer can be compared with that of another assessee/taxpayer manufacturing the same item. This method would give an idea whether the valuation and duty calculation system of the assessee/taxpayer is a high/low risk area. A comparative chart of items from financial statement to be

drawn for reconciling the data is annexed as **Annexure-CE- V/ST-V**. The auditor should check the data available in ST-3 returns with other documents such as gross trial balance, Income Tax Returns, Annual Audited accounts, Income Tax Audit report etc. and to carry out a preliminary reconciliation for the purpose of identifying any amount that might have escaped Service Tax.

6.6.8 Revenue Risk Analysis:

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 documents & (iii) comparing the key data figures of the unit with the average of all industry figure of similar kind (if available) or past figures of the same assessee/taxpayer. The result of Revenue Risk Analysis should be filled in the relevant column of working papers.

6.6.9 Trend Analysis:

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.

6.6.10 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. The analysis of trends as mentioned in the relevant table of working papers may be carried out. (refer III 9 of Annexure –CE-VIII/III C of Annexure-ST-VIII)

6.7 Gathering of information of the assessee/taxpayer

6.7.1 Tour of premises/plant:

CENTRAL EXCISE: Before start of audit verification, the auditor should know about 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/taxpayer during the visit to the unit. This is used to gather information about the systems. A physical tour of the unit/premises 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 considered 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. The auditors should also go through the working papers prepared in the last audit in order to acquaint themselves with the broad procedures followed by various sections of the assesseees/taxpayers 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. 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-CE-VI/ST-VI**. However auditors may add more questions depending upon the nature of the industry. The following guidelines should be kept in mind at the time of interview.

- i. Stay in control of the interview.
- ii. Follow a prearranged path of questioning, but be flexible.
- iii. Explain questions clearly and ensure that the question has been understood.
- iv. Listen carefully and observe reactions.
- v. Do not interrupt unless the interviewee appears to be deliberately changing the subject.
- vi. Avoid ambiguous and leading questions.
- vii. Display confidence and put the auditee at ease.
- viii. Summarize the interview at the end and seek clarification if necessary

6.7.1.1 The purpose of the tour is to gather information from the assessee/taxpayer 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.

6.7.1.2 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/taxpayer. An illustrative Questionnaire is placed as **Annexure-CE-VI/ST-VI** for guidance of the auditor though he can modify the same according to the need.

6.7.2 SERVICE TAX: There should be no tour of premises in respect of a service tax assessee. It is only a walkthrough of systems that should be performed.

6.7.3 Evaluation of the Internal Controls.

The objective of review of internal controls is to assess whether the assessee/taxpayer has reliable systems and controls in place that would produce reliable accounting/business records. 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 software being used exclusively for the transactions related to excise/service tax matters is integrated to the main ERP system or is running parallel to the main ERP. This assessment would be used by the auditor to decide on the extent of verification required and to 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/taxpayer might have little in terms of internal controls where as a large assessee/taxpayer would have sophisticated internal controls in place. If the internal controls are well designed and working properly, then it is possible to rely on the books maintained by the assessee/taxpayer. 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. Audit should evaluate the soundness of internal control of sub-systems/areas like sales, purchase tax, accounting etc., and grade them as good, acceptable and poor (refer Part D of working papers)

6.7.3.1 In this regard, an auditor should normally examine the following:

- i. Characteristics of the company's business and its activities.
- ii. System of maintenance of records and accounts.
- iii. Identifying the persons handling records for accounting purposes.
- iv. Allocation of responsibilities at different levels.
- v. System of internal checks.

- vi. System of movement of documents having relation to duty/tax assessment.
- vii. Inter-departmental linkages of documents and information.
- viii. System of own internal audit.

6.7.4 Techniques for evaluation of the Internal Controls.

(a) **Walk-through:** This is a process by which the auditor selects any transaction by sampling method and traces its movement from the beginning through various sub systems to the end. 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 a useful method to evaluate the internal control system of an assessee /taxpayer. The auditor can undertake walk through process of sales, purchase, excise, account adjustment systems etc., certain model 'Walk-through' routes are given in **Annexure-CE-VI/ST-VI**. Similarly, key controls may be examined for recording of all cash transactions: these controls may include scrutiny of numbered cash transaction invoices, daily reconciliation of cash invoices, separation of taxes etc. Undertaking a 'walk-through' and conducting ABC analysis during this process would help the auditor in evaluating the system of internal controls in a scientific manner.

(b) **ABC Analysis:** 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. The ABC Analysis is one of such data management techniques. This technique is particularly useful when auditors are required to scrutinise and examine a large volume of data/documents within a limited time. In ABC analysis the whole data population is classified into three categories (i.e. A, B and C categories) based on the importance, as given below:

- A-category is the class of data that is the 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 far less revenue -implications and can be controlled by suitable test-checks.

The auditor can apply ABC Analysis especially where the quantum of data/information to be analysed is voluminous. In such a case, the auditor can classify them according to their tendency towards potential risk into A, B and C categories.

To give an example, transactions with top five customers/clients of an assessee/taxpayer may alone be taken up for detailed examination by auditors. Similarly while verifying credit utilization by the assessee/taxpayer, documents relating to the receipt/procurement of major inputs may be examined. The technique of ABC analysis can also be suitably applied for evaluating the systems of internal controls while carrying out verification.

6.8 Preparatory Visit:

The above steps viz., tour/study or evaluation of internal controls/walk through etc., are required to be completed by making a preparatory visit during the Desk Review stage itself, in respect of audit of **Large Units of Central Excise**, by giving advance intimation to the assessee/taxpayer (**Annexure – CE - XI**).

6.8.1 In respect of audit of Medium and Small units of Central Excise and **all units of Service Tax**, these steps can be carried out during the stage of actual audit verification.

6.8.2 The auditor should invariably record the findings, which are to be kept in the AMF in the format as mentioned at Part D of Working Paper (**Annexure –CE-VIII**).

6.8.3 During the subsequent audit of large units, the preparatory visit for desk review need not be made. During the verification, the auditor should verify and comment as to whether the system is in place or not.

6.9 Audit Plan

6.9.1 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.

6.9.2 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 Paper of each of the steps is filled up before commencing preparation of an audit plan. 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/taxpayer may also be added to this list.

6.9.3 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 audits (Annexure –CE-VII/ST-VII).

6.9.4 The summary results of desk review, along with the completed Working Papers, should be submitted to the Deputy/Assistant Commissioner for approval and guidance, if any.

6.9.5 The audit plan must be discussed with the Deputy Commissioner / Assistant Commissioner of the Circle and should be finalised after approval by the Commissioner/Additional/Joint Commissioner/Deputy/Assistant Commissioner as the case may be .

6.9.6 The audit group should put up documents received, along with filled in Questionnaire and working papers in the prescribed proforma, related to top 5 units of each audit circle mentioned in the Annual Plan for audit coverage to the Commissioner and the rest to the Additional / Joint Commissioner (Audit) through Deputy / Assistant Commissioner (Audit), for approval of the audit plan, after carrying out preliminary reconciliation, identifying discrepancies, if any, and carrying out detailed examination of the records and information (including that already captured in the Master File on assessee/taxpayer).

6.9.7 In the case of mofussil circles where ADC/JC is not available:

- i. In respect of large and medium units, the audit parties should forward the draft audit plans to the Additional/Joint Commissioner, through the DC/AC of the circle, by e-mail, for approval. The audit of the respective units should not be conducted till receipt of the approval of the ADC/JC, through e-mail. While sending the desk review and the draft audit plan, the information that is available in electronic format in the assessee/tax payer's profile should also be sent.
- ii. In respect of small units, the Deputy/Assistant Commissioner of the Circle is competent to approve the audit plan. However, the approved audit plan should be forwarded to the Additional/Joint Commissioner, through e-mail, at least 10 days before the conduct of actual audit so as to enable the ADC/JC to communicate additions, if any, before the actual audit takes place.

6.10 Audit Verification

6.10.1 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 for audit objectives identified in the audit plan. 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 to 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.

6.10.2 Audit verification involves verification of data and actual verification of documents submitted at the time of desk review, verification of points mentioned in the audit plan.

6.10.3 Verification of points mentioned in the audit plan:

The auditor should conduct the verification in a systematic manner, following the sequence of steps envisaged in the working papers. While conducting audit verification, special care should be taken to examine all those issues pointed out in the audit plan. The auditor should try to determine whether the apparent weaknesses in the internal control system of the manufacturer/service provider have led to any loss of revenue. He should also identify the procedural infractions on part of the assessee/taxpayer, which are recurrent in nature and which may obscure a significant fact. During the process, he must cross check the entries made by the assessee/taxpayer in various records and note discrepancies, if any. In all cases involving discrepancies, the auditor should make detailed enquiries regarding the cause of the discrepancies and their revenue implication.

6.10.4 The auditor should also examine the documents submitted to various Government departments/ Regulatory Authorities such as Customs, Income Tax, Commercial Tax/ VAT, Banks, etc. by the assessee/taxpayer. This should be used in cross verification of the information filed by the assessee/taxpayer for the Central Excise/Service Tax assessment. **Annexure-CE-IX/ST-IX** gives utility of some of the documents/ registers of the assessee/taxpayer that can be made use of by the auditor during the course of verification. Extensive use of information available with

open sources such as electronic and print media, internet etc should also be resorted to for verification of information filed by the assessee/taxpayer.

6.10.5 The audit verification gives maximum opportunity to the auditor to go through the assessee/taxpayer'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, after obtaining the approval of his Dy. Commissioner/Asst. Commissioner, go beyond the scrutiny envisaged under the Audit Plan and record the reasons for doing so. Despite audit verification being a structured process, it is flexible enough to accommodate needs on the spot. At the end of each entry in working papers, auditor must indicate the findings. If any of the planned verifications is not conducted, the reasons for the same must also be recorded. 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:

6.11 Physical Verification of Documents: All important documents are already verified at the time of desk review. However, in case of any discrepancy noticed and pointed out in the Audit Plan, a detailed scrutiny of the financial records of the assessee/taxpayer becomes imperative. The documents to be examined include Annual Financial Accounts containing Director's Report, Statutory Auditor's Report, Balance Sheet and Profit & Loss Account. If necessary, the auditor must go into details of the figures mentioned in the Annual Financial Statements and for that he must examine Trial Balance, Ledgers, Journal Vouchers and Invoices. He may also examine Cash Flow Statement, Groupings, Cost Audit Report and Tax Audit Report. He should also check whether the assessee/taxpayer is maintaining the statutory records as required under various statutes especially under the Companies Act, 2013.

6.11.1 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/taxpayer and other follow up action. It needs to be ensured that all audit documentation is complete, accurate and of professional quality. Working Papers are a synopsis of audit operations conducted by the Audit Group. Entry of all items mentioned in the audit plan must be made in the working papers, during Audit Verification.

6.11.2 In case of Central Excise audits, as well as Service Tax audits, if the auditors notice that the assessee has availed or utilised taxable services from service providers, they may attempt to ascertain from the assessee as to whether such service providers are registered with the department or not. In case such information is not available, the auditors should prepare a list of all such service providers who had provided total taxable services valued at more than Rs. Ten lakhs in a financial year from the documents available with the assessee and gather details of their location. Such information should be forwarded to the jurisdictional Service Tax authorities to verify proper discharge of service tax liability and for taking necessary action in case of any defaults.

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

- i. Be clear, concise, legible, organized, indexed, and cross-referenced;
- ii. Disclose the audit trail and techniques used in the examination of each significant item;
- iii. Support the conclusions reached and cover all queries raised;
- iv. Include audit evidence (e g., copy of a financial statement, an invoice, a contract, a bank statement, etc.) to support the assessment;
- v. 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;
- vi. See that audit reports are clear and disclose all material and relevant information; and
- vii. Take follow up action.

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

6.14 **Checking of cross utilization of credit on inputs and input-services:**

Manufacturers who are also providing taxable services, are required to file ER-1 Return and ST-3 Return separately. It is possible that the assessee/taxpayer may misuse the CENVAT credit facility by declaring different amounts of credit taken or utilized in ER-1 and ST-3 returns especially when the periodicity of filing both the

returns are different. Therefore, while carrying out audit of Central Excise cases, the Service Tax return filed by the assessee /taxpayer should also be scrutinized in order to ensure that CENVAT credit claimed in both the returns does not vary and vice versa. Further, where both the returns are filed in the same Commissionerate, audit of both the activities should be undertaken simultaneously. If these returns are being filed separately (one with the Excise Commissionerate and the other with the Service Tax Commissionerate, then this can be tackled by undertaking integrated audit for Central Excise and Service Tax. While undertaking the combined audit, both the Central Excise and Service Tax returns should be scrutinized in order to verify whether CENVAT credit claimed in both the returns is different.

6.15 Apprising the assessee/taxpayer of irregularities noticed and ascertaining his view point

It is important that the auditor discusses all the objections with the assessee/taxpayer before preparing draft audit report. The assessee/taxpayer should have the opportunity to know the objections and to offer clarifications with supporting documents. This process will resolve potential disputes at an early stage and avoid unnecessary litigation.

6.16 The ultimate aim of conducting an audit is to increase the level of tax compliance of assessee/taxpayer. Therefore, no audit can be considered to be complete unless the auditor has made all efforts to ensure maximum recovery of short levy before leaving the premises of the assessee/taxpayer. As the Audit system adopts a transparent methodology, it is necessary that all the audit objections noticed by the Audit Group are conveyed to the assessee/taxpayer with a view to ascertain his point of view before preparing the Draft Audit Report. Accordingly, the audit objections should be intimated in writing to the assessee/taxpayer, clearly stating 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/taxpayer for ascertaining his point of view. Where satisfactory explanation or evidence is submitted to the auditor, the findings should be revised as necessary after approval of Deputy/ Assistant Commissioner. However, if a response from the assessee/taxpayer is not forthcoming, draft audit paras should be prepared on the basis of available records after citing the lack of cooperation on part of the tax payer, in the Audit Report.

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

6.18 Suggestions to Tax Payer/ Assessee for future compliance

6.18.1 Before leaving the assessee/taxpayer's premises, the auditor must discuss future compliance issues with the senior management of the assessee/taxpayer. The auditor should also discuss the steps that management can take to reduce specific errors detected during the audit and to improve compliance by suggesting improvements in the accounting systems etc. Written or verbal assurances as given by assessee/taxpayer should be recorded in the Audit Report.

6.19 If, in any way, the department can assist the assessee/taxpayer to reduce errors and improve compliance, such offer of assistance should be made.

CHAPTER 7

EXPORT ORIENTED UNITS

7.1 SERVICE TAX: There is no general exemption to EOU / EHTP / STP / BTP units from payment of service tax. There are no special provisions governing payment of service tax by these units either.

7.2 CENTRAL EXCISE: 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, when cleared into domestic tariff area (DTA). They are also eligible for 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. 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.

7.3 Owing to options available to such units under the Foreign Trade 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.

7.3.1 Evaluation of Internal Controls 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.

7.4 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. 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.

7.5 The auditors should examine the following issues in addition to the usual checks:

- i. Whether approval of Board of Approval/Development Commissioner /prescribed authority has been obtained; whether the unit has become operational during validity of the letter of the approval; whether the items of manufacture and rejects conform to such approval;
- ii. 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.
- iii. Whether benefits of Customs/ Central Excise exemptions have been availed only on admissible items as 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;
- iv. 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;
- v. Whether any goods are imported in violation of the Foreign Trade Policy;
- vi. Whether any goods, procured free of duty, are removed unauthorisedly, i.e., they are transferred/ sold/sent for job-work/ supplied to other units without permission of the Assistant Commissioner/Deputy Commissioner or wherever necessary the Development Commissioner.

- vii. Whether permission for DTA sales has been obtained and if so whether the details of foreign exchange earnings and utilisation, furnished to the Development Commissioner tally with the records of the unit; and whether the conditions of exemption notification are satisfied;
- viii. Whether, the goods under DTA sales have been valued correctly in terms of the 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);
- ix. Whether excess DTA sales are effected at concessional duty by inflating the FOB value of exports.
- x. Whether duty on DTA sales is short-paid by under-invoicing the value or mis-classification.
- xi. 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 share common facilities and where they may not be under continuous Customs or Excise supervision.
- xii. Whether any imported goods/inputs/consumables attracting anti-dumping duty have been used in the manufacture of goods cleared into DTA. If so, whether proportionate anti-dumping duty leviable thereon has been paid or not.
- xiii. Whether there is any fudging and concealing of non-fulfilment of conditions 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). It is advised to verify as to whether

mate's receipts are available in respect of each of the exports made by the unit;

- xiv. Whether export obligation as prescribed is shown as fulfilled under both EOU scheme and duty exemption scheme by accounting for the same exports twice.
- xv. Whether values of exports are being mis-declared for showing the fulfilment of export obligation incorrectly.
- xvi. 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.
- xvii. Whether the CENVAT credit has been availed in accordance with the CENVAT Credit Rules, 2004.

7.6 Tips for conduct of verification:

Certain useful tips to conduct audit verification in case of duty free imports, indigenous procurements, sub-contracting etc. are discussed below. These guidelines are only for the general convenience of the officers. For actual application, the relevant notifications and Paras of Foreign Trade policy in vogue should be strictly referred to.

7.6.1 Duty free Imports

EOUs can import goods required by them, under Notification No. 52/2003-Customs dated 31.3.2003, as amended. The list of goods permitted for import would depend on the sector (such as aquaculture, agriculture, horticulture, granite production, gems and jewellery or others) 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 adequate internal systems in place, 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 the permission of the Competent Authority (and not exported), as long as the appropriate excise duty is paid on the finished products.

- i. 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.
- ii. 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.
- iii. Similarly, in case of other goods check whether they have been used for intended purposes or re-exported within three years or extended period.
- iv. 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.
- v. Check whether 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.
- vi. Check whether the unit has achieved positive Net Foreign Exchange Earning. If 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.
- vii. Check whether 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.
- viii. Check whether 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.
- ix. Check whether 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 whether the value of and rate of duty applicable on the relevant dates have been correctly applied. In case of capital goods, check whether the depreciated value has been properly worked out.

7.6.2 Procurement of indigenous goods

Exemption from excise duty is also available to goods procured from indigenous sources under Notification No. 22/2003 CE dated 31.03.2003. 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.

7.6.3 Subcontracting, Job-work:

There are two situations, i.e. i) Sub contract part of their production process and ii) Sub contract part of the product. In both the cases, check whether the procedure prescribed by Board from time to time is being followed by the unit.

7.6.4 Inter unit transfer (From EOU to EOU):

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

7.6.5 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 whether the third party exports as per Para 6.10 of Foreign Trade Policy read with Para 6.19 of Hand Book of Procedures, Appendix 14I of Handbook of procedures are in order.

7.6.6 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** in case of DTA sales, 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. Concerned S.No. in the Table annexed to the relevant notification should invariably be referred to while verifying the applicability of these rates.

- a) Check whether DTA entitlement is in force and is adequate to cover the DTA sales. Also check whether these clearances are in accordance with the provisions of sub-paragraph (a), (b), (d) and (h) of paragraph 6.8 of EXIM Policy.
- b) Check whether DTA sales of rejects are within the limit of 5% of Free on Board value (FOB value) of the goods actually exported.
- c) If the unit has manufactured/ produced any non-excisable goods that have been cleared into the DTA, check whether 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.

7.6.7 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) If the unit declares that these items do not have commercial value and opts for destruction, verify whether the same have been destroyed under the supervision of appropriate Departmental officer.

7.6.8 B-17 bond:

- a) Check whether the bond is in force and the Bank guarantee is 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.

7.6.9 De-bonding of goods procured duty free:

- a) Check whether depreciation allowed in respect of capital goods is as per the norms stipulated by the Board from time to time.

- b) Check whether the goods intended to be de-bonded 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 de-bonding of capital goods / raw material etc.
- e) Check whether the duty is paid within the prescribed time limit after 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.

7.6.10 Payment of cost recovery/supervision charges:

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

7.6.11 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 whether the procedure adopted for conversion of a DTA unit to EOU is in accordance with the provisions.

CHAPTER 8

PREPARATION OF AUDIT REPORT AND FOLLOW UP

8.1 Preparation of Draft Audit Report and submission to senior officers

8.1.1 After completion of audit verification, the auditor should prepare the verification report in the prescribed Proforma as mentioned in Part VI of Annexure-CE-VIII/ Part IVC of Annexure ST- VIII for each issue of the approved Audit Plan. This document should record the results of verification conducted as per the audit plan. Any additional issue (not mentioned in the original plan) verified/ point noticed should also be mentioned. The auditor would then discuss each of such issues with the assessee/taxpayer pointing out either non payment or procedural infractions. The initial views of assessee/taxpayer must be recorded in the verification document. The auditor should also apprise the assessee of the provisions relating to applicability of interest and encourage him to take advantage of those provisions in order to avoid disputes and litigation.

8.1.2 Where the assessee/taxpayer is in agreement with the short levy, as noticed, the auditor should explain the benefit available under Section 11A(2) of the Central Excise Act, 1944/Section 73(3) of the Finance Act, 1994 as the case may be and use persuasion as a measure of recovery of dues along with interest, if any, promptly. Details of spot recoveries and willingness of the assessee/ taxpayer to pay short levy should also be recorded. This document would then become the basis for preparation of the draft audit report.

8.1.3 The Draft Audit Report shall be prepared in consultation with the Deputy/Assistant Commissioner of Audit Circle. The audit Circles shall bring the NIL DARs to the notice of concerned Addl./ Jt. Commissioner for review.

8.1.4 The narrative of the objections in the audit report should be concise, to the point and self-contained and should convey the gist of objection raised. Telegraphic narration should be avoided. Where the objections are based on any circulars or clarifications issued by the Board, they 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, decisions of Appellate authorities or supported by technical literature, those should be cited.

8.1.5 The draft audit report should be finalised within the shortest time span possible i.e. within 20-25 days of the commencement of the audit in the assessee/taxpayer's place and placed before the MCM for decision.

8.2 Monitoring Committee Meetings

8.2.1 The auditor should submit the draft audit report, to the Deputy / Assistant Commissioner of the Audit Circle for consideration in the Monthly Monitoring Cell Meeting, preferably in soft form and hard copies should be avoided.

8.2.2 Monitoring Committee Meeting (MCM) should be convened by the Audit Commissionerate, to which the Executive Commissioner or his representative shall be invited to attend. The decision taken by the Audit Commissioner, with regard to settlement of audit objections after recovery of all dues or dropping of the unsustainable audit objections, shall be final. Approved audit objections, including those in which show cause notices are proposed to be issued, should be conveyed to the Executive Commissioner in the form of Minutes of the MCMs, who shall respond to these objections conveying his agreement/disagreement within 15 days of the receipt of the minutes of the MCM.

8.2.3 On points of difference, further consultations may be held for a period of 15 days. If the difference persists, the final decision rests with the Audit Commissioner.

8.2.4 The Planning and Co-ordination section of the Audit Commissionerate should organise, /Executive Commissionerate-wise / Circle-wise Monitoring Committee Meetings (MCM), at least at a monthly interval under the chairmanship of the Audit Commissioner, under intimation to the Executive Commissioner and the ADG (Audit) of the Zone concerned. The DD/AD (Costs) if available may also be invited for the said meeting. During the MCM each of the audit objections/ observations would be examined for its sustainability. The Committee (MCM) should also decide as to whether the extended period of limitation can be invoked or not and also on the applicability of the provisions relating to waiver of show cause notice in respect of each para (refer Section 11A(1)(b) of the CEA, 1944/Section 73(3) of the FA, 1994). To facilitate prompt decision, the Additional/Joint Commissioners and all the DC/ACs of Headquarters and all circles of the Audit Commissionerate should attend these meetings to offer their views on the spot, to ensure that uniformity in raising objections is maintained. The minutes of each such meeting should be drawn, pointing out the decision on each audit objection

regarding its sustainability and directions for future action. The objections rejected by the meeting will be treated as closed.

8.2.5 The Planning and Co-ordination Sections of Audit Commissionerate and the MIS of the Audit Circles should make prompt entries in the Registers of Audit Planning and Audit Follow-up in prescribed format (details as in Annexure XII), at every stage, until the closure of the audit point either by issue of a show cause notice or by recovery of amounts due or by closure on merits/reconsideration.

8.3 Final Audit Report

Based on the decision of the MCM, the draft audit report should be finalised within thirty days from the date of the meeting. The Planning and Co-ordination Sections of Audit Commissionerate shall upload the FAR using Audit Report Utility in ACES and issue FAR. A copy of the FAR, even if it is a NIL report, should be sent to the assessee/taxpayer, by e-mail and letter, and necessary records confirming such action should be kept in Assessee Master File.

8.4 Follow up action and issue of show cause notice

8.4.1 An audit objection should be closed after requisite action i.e., either recovery of amounts due or issuance of show cause notice, has been taken on it. After the issuance of Final Audit Report, wherever further action such as issue of Show Cause Notice is required, the Audit Group should prepare the Draft Show Cause Notice. In cases where the Show Cause Notice is answerable to the Superintendent, in-charge of the Range of Executive Commissionerate, the Superintendent in-charge of the audit group should issue the same, under intimation to Circle MIS section/Headquarters MIS section. In cases where the Show Cause Notice is answerable to the Deputy/ Assistant Commissioner, in-charge of the Division of Executive Commissionerate, the Assistant Commissioner in-charge of the Audit Circle should issue the same, under intimation to Headquarters MIS section. The cases where the Show Cause Notice is answerable to the Commissioner /Joint/Additional Commissioner of the Executive Commissionerate, Deputy/ Assistant Commissioner, in-charge of Audit Circle should submit the Draft Show Cause Notice to the Planning and Co-ordination Section/MIS Section of Headquarters along with the concerned file, which in turn shall be forwarded to the technical section of Headquarters which is in charge of issuing the show cause notice. In some cases, show cause notices are answerable to Superintendents, then the concerned Superintendent of Audit Circle shall take necessary action for preparing and issuing such show cause notice under

intimation to the Planning and Co-ordination Section / MIS Section of Headquarters. It is the responsibility of the Audit Commissionerate to pursue/persuade the assessee/taxpayer for payment of tax dues, especially on the paras admitted by the assessee/taxpayer. However, for any pending action i.e., recovery, especially on paras admitted **in writing** by the assessee/taxpayer, can be taken up with the jurisdictional Executive Commissionerate, for follow up. The issues relating to paras orally admitted should not be referred to the Executive Commissionerates. In case, new facts, necessitating reconsideration of findings in an audit report, come to the knowledge of officers who are required to take action on an objection, they should send their report along with supporting material to the Planning and Co-ordination Section for reconsideration. But this action must be taken most expeditiously, say within one month of receipt of the Audit Report. In exceptional cases involving cogent grounds, the views taken in the Monitoring Meetings shall be taken up for review/re-consideration by the MCM only. The Audit Commissioner should send a list containing details of Show Cause Notices issued during the month, by the Headquarters and Circles, to each of the Executive Commissionerates, on monthly basis.

8.4.2 The results of action arising after preparation of final audit report should be filled up in the follow up report utility and uploaded in the ACES database, as per the instructions in the Audit Report Utility Manual.

8.4.3 Each audit report should be examined by the Planning and Co-ordination Section/MIS Section of the Circle. Any objection with major revenue implication, objection specific to a particular issue or any objection 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 Principal Chief Commissioner/Chief Commissioner's office for circulation within the Zone, (iii) communication to the Directorate General of Audit for issue of audit circulars and (iv) communication of all important modus operandi to the DGCEI.

8.4.4 On completion of the above procedure the planning section shall place the documents in the Assessee Master file and also update the electronic file of the assessee/taxpayer.

RECORDS TO BE MAINTAINED IN HQRS AUDIT SECTION AND MIS SECTION OF CIRCLES ARE DETAILED IN ANNEXURE XII

CHAPTER 9

GUIDELINES FOR CONDUCTING AUDIT OF MULTI LOCATION UNITS (MLU) AND MULTI LOCATION SERVICE PROVIDERS (MLSP)

9.1 Definition:

9.2 CENTRAL EXCISE: A single manufacturer having more than one unit on the same PAN number is called a Multi Location Unit (MLU).

9.3 SERVICE TAX: A single service provider having more than one Service Tax Registration falling under different Commissionerates for providing services is called a Multi Location Service Provider (MLSP).

9.3.1 There may be three different situations in which the co-ordination of audit has to be done as detailed below:

i. **in case there is only one Audit Commissionerate in the PCC/CC Zone—**

identify all the assesseees /tax payers, with a common PAN , in the jurisdiction of the Audit Commissionerate and audit of all the units should be covered simultaneously even though the assesseees /tax payers are falling under different Audit Circles.

ii. **in case there are multiple Audit Commissionerates in the PCC/CC Zone—**

Audit of such assesseees /tax payers should be covered/scheduled simultaneously by the coordinating Audit Commissionerate (to be decided by the PCC/CC based on the jurisdiction of the highest Duty/Tax Paying Unit).

iii. **In case of Registrants falling in multiple PCC/CC Zones -**

The Zonal ADG, under whose jurisdiction, the highest duty paying unit/service provider falls, will be the nodal agency for co-ordinated audit.

9.3.2 Identification of MLUs/MLSPs: For identifying Multi Location Units/Service Providers, the Audit Commissioners/Principal Chief Commissioners /Chief Commissioners/ Additional Directors General (Audit), of Zonal Units may

use the Automation of Central Excise & Service Tax (ACES) Registration database. This could be done by identifying the assesseees/taxpayers having the same PAN but more than one Central Excise/Service Tax Registration falling under different jurisdictions for manufacture of goods/provision of service.

9.3.3 Selection of Units for MLU/MLSP:

- (a) In respect of MLU/MSLP categories (i) and (ii) mentioned above, the details of such units/service providers will be finalised by the DG (Audit)/Zonal ADG (A), while drawing up the Annual schedule in consultation with the Audit Commissionerate.
- (b) The preliminary list of MLUs/MLSPs of category (iii) above i.e assesseees/tax payers falling in multiple PCC/CC Zones would be generated by the 30th of April in each financial year and circulated by the DGA on a CD or any other electronic media to the Zonal ADGs.

9.3.4 Procedure for selection of MLUs/MLSPs:

- (i) **Five MLUs and five MLSPs per annum will be selected by each Zonal Unit for coordinated audit.** The selection would be based either on MLUs manufacturing sensitive or evasion prone goods showing adverse revenue trend and service providers providing evasion prone services and showing adverse revenue trend or selected randomly.
- (ii) The Zonal ADG (Audit) would send short listed assesseees/taxpayers for coordinated/simultaneous audit to the Audit Commissionerate.
- (iii) On receipt of such a list from the Zonal ADG , the Audit Commissioner should send the information maintained in electronic/ 'soft-form' from the Assessee/Tax Payer's Master File in respect of those MLUs/MLSPs to the Zonal ADG.
- (iv) The Zonal ADG should finalise the list of such MLUs/MLSPs selected for co-ordinated audit by 31st May every year so that such assesseees/taxpayers are not covered in the annual Audit schedule prepared by the Audit Commissionerate. Actual audit verification may generally be planned during November/December of that year and this period should be

blocked by the Audit Commissionerate for conducting these audits.

9.3.5 Guidelines for conduct of audit of MLUs/MLSPs:

- A.** In respect of category (i), the procedure laid down for standalone audit should be followed. However, those units of such MLUs/MLSPS, which are selected for audit based on revenue risk and figured in the annual schedule, should **only** be covered and audited simultaneously.
- B.** Similarly, in respect of category (ii) units/service providers (only those units/service providers, selected based on revenue risk and figured in annual plan), audit should be completed as far as possible simultaneously, in coordination with the nodal Audit Commissionerate, by exchanging information from desk review to MCM.
- C.** In respect of category (iii) units/service providers, the Audit Commissioners concerned should ensure that the Audit Group, to whom the audit of Assessee /tax payer in their jurisdiction is assigned, completes the Desk Review and prepares the draft Audit Plan. A copy of the draft Audit Plan duly approved by the Additional/ Joint Commissioner (Audit) along with the Working Papers, reconciliation and extracts of the note-sheet portion of the audit file should then be sent to the co-ordinating ADG. It should be ensured that calculations done as part of the ratio analysis, trend analysis or revenue risk analysis are also sent.

9.4 On their part, the Zonal unit should obtain the consolidated balance sheet, Profit & Loss Statement and other financial documents of the company from the Head Office/ Corporate Office for scrutiny. Once the audit plans for all the Assesseees/Taxpayers forming part of the MLU/MLSPs group are received, the ADG, if necessary, may convene a meeting with representatives (one per Group) of each Audit Group for finalization of audit plans. This would also be an opportunity for the ADG to explain the nature of relationship between the constituent Assesseees /tax payers and common issues to be verified during the audit. Similarly, the Audit Groups of the Commissionerates may have identified certain issues that would need to be verified from the records / documents maintained at other units. The final audit plan for each assessee/taxpayer would be approved by the ADG after the meeting (if convened) and returned to the Audit Group. In case the selected MLU/MLSP also have different Service Tax registrations/Central Excise registration

respectively, simultaneous audit of both Central Excise / Service Taxes to be taken up.

9.5 Role of Zonal ADG (Audit)

- i. Zonal ADG would ask the jurisdictional Audit Commissionerates to conduct a Desk Review in respect of each manufacturing unit as well as on the accounts of the Regd. Office, if registered under the Service Tax Law.
- ii. Zonal ADG would finalise the Audit plans of the Assessee /tax payer registrant-wise.
- iii. Zonal ADG would convene a meeting of the auditors, if needed.
- iv. The actual verification of the accounts at the Corporate / Regd. Office is to be done by the respective Audit Commissionerate under whose jurisdiction, the Regd. Office is located, if the premises is registered for the purpose of S.T.

NOTE : No visit should be made to the Regd /Corporate office of the Assessee /Tax payer for verification of books of accounts, if it is not registered under S.T law.

9.6 Audit Verification and Preparation of Draft Audit Report

- i. The Audit Groups should remain in contact with the Zonal ADG while conducting the verification so that new issues detected at the time of verification can be quickly conveyed to other Audit Groups. 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 Group and findings are recorded.
- ii. Whenever any assessee /tax payer is selected for Audit under the category of MLU/MLSPs, the audit of all units of such MLU/MLSPs is to be conducted in the coordinated manner as discussed above. In respect of **category (iii) units/service providers alone**, the Draft Audit Reports along with Verification Reports are required to be sent to the Zonal Co-ordinating ADG (Audit) for comments/ vetting. After receipt of comments of the Zonal ADG, respective Audit Commissionerates would place the objection before the MCM for decision.