

17.1 AUDIT UNDER CENTRAL EXCISE ACT, 1944

Central Excise Act, 1944 provides for two types of audit:

- (a) Special audit for valuation purposes under section 14, and
- (b) Special audit for Cenvat credit purposes under section 14AA.

The provisions in respect of each of the audit have been discussed below:

(a) Valuation audit [Section 14A]

Any Central Excise Officer not below the rank of an Assistant/Deputy Commissioner of Central Excise can order for valuation audit at any stage of enquiry, investigation or any other proceedings before him if he is of the opinion that the value has not been correctly declared or determined by a manufacturer or any person. However, for ordering such an audit prior approval of the Chief Commissioner of Central Excise is necessary.

The Central Excise officer will direct such manufacturer/person to get the accounts of his factory, office, depots, distributors or any other place, as may be specified by the said Central Excise Officer, audited by a Cost Accountant or *Chartered Accountant*. Cost accountant shall have the meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959. *Chartered Accountant shall have the meaning assigned to it in section 2(1)(b) of the Chartered Accountants Act, 1949.* Such Cost Accountant or *Chartered Accountant* will be nominated by the Chief Commissioner of Central Excise in this behalf.

The Cost Accountant or the *Chartered Accountant* has to submit the duly signed and certified audit report within the period specified by the Central Excise Officer. He shall also mention in the report such other particulars as may be prescribed by such Central Excise Officer. Such period can be extended by the Central Excise Officer at the request of the manufacturer/person for material and sufficient reason. However, the maximum period of submission of audit report shall be 180 days from the date of receipt of the cost

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audit order by the manufacturer. This audit shall be in addition to any other audit under any other law for the time being in force or otherwise.

The manufacturer/person shall be given an opportunity of being heard in respect of any material gathered on the basis of audit and proposed to be utilized in any proceedings under the Central Excise Act or rules made thereunder.

(b) CENVAT credit audit [Section 14AA]

The Commissioner of Central Excise may call for an audit if he has reason to believe that the credit of duty availed of or utilized by a manufacturer of any excisable goods –

- (a) is not within the normal limits having regard to the nature of the excisable goods produced or manufactured, the type of inputs used and other relevant factors, as he may deem appropriate;
- (b) has been availed of or utilized by reason of fraud, collusion or any willful mis-statement or suppression of facts.

The Commissioner shall direct such manufacturer to get the accounts of his factory, office, depot, distributor or any other place, as may be specified by him, audited by a Cost Accountant or Chartered Accountant nominated by him. Cost Accountant shall have the meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959. *Chartered Accountant shall have the meaning assigned to it in section 2(1)(b) of the Chartered Accountants Act, 1949.*

The Cost Accountant or the Chartered Accountant has to submit the duly signed and certified audit report within the period specified by the Central Excise Officer. He shall also mention in the report such other particulars as may be prescribed by such Central Excise Officer. This audit shall be in addition to any other audit under any other law for the time being in force or otherwise.

The manufacturer shall be given an opportunity of being heard in respect of any material gathered on the basis of the audit and proposed to be utilized in any proceeding under the Central Excise Act or rules made thereunder.

17.2 AUDIT PRESCRIBED BY CENTRAL EXCISE DEPARTMENT

The Central Excise Department also has evolved a system of departmental audit in view of the fact that all the statutory records to be maintained by the assessee have been abolished in year 2000/01.

17.2.1 History of provisions

In conventional sense, “audit” means scrutiny and verification of documents, events and processes in order to verify facts and, draw conclusions regarding the correctness of

recording of facts and the efficiency of a system under study. For Central Excise purposes “audit” means scrutiny of the records of assessee and the verification of the actual process of receipt, storage, production and clearance of goods with a view to check whether the assessee is paying the central excise duty correctly and following the central excise procedures.

Under the conventional /traditional system of central excise audit, audit parties visit assessee's unit without much preparation and verify all the statutory records (i.e. those prescribed under the Central Excise law) to check compliance of procedures and also leakage of revenue, if any. Experiences show that such audits do not result in detection of major aberrations. Most of the audit objections pertain to either minor procedural irregularity or duty short payment of small amounts mostly due to human error. Further, this method of auditing does not envisage checking of the internal records of the assessee as well as those records which are maintained by the assessee under the other laws like Income-tax Act, Sales Tax Act, Companies Act etc.

One of the announcements made during Budget 2000 as a measure of simplification of procedures, was the dispensation of all statutory records under the central excise law. No longer was the assessee required to record the receipt of raw material, production and clearance/sale of finished goods etc. in registers/documents prescribed by the central excise department. As a result, the assessee is now allowed to maintain all their records in whichever form they like (including maintenance of the entire records in electronic form) provided the essential information required for calculation of central excise duty liability can be obtained from such records. Under these circumstances it becomes necessary for the auditors to look into the assessee's own (private) records to verify whether the assessee is paying central excise duty correctly and following the laid down procedures.

Another change brought in recent years is doing away the system of assessment of the returns by the departmental officers. Now the assessee is required to self assess his monthly tax returns (called the E.R.1/E.R.2) before filing the same with the department. The departmental officers only scrutinise this return to check for any apparent mistake made by the assessee. They are not required to carry out detailed verification. Therefore, the entire burden of checking whether the assessee actually paying his taxes correctly, now lies with audit.

The statutory changes resulting in dispensation of statutory records as well as self assessment of central excise duty by the assessee has led to the conventional/traditional system of audit becoming irrelevant.

17.3 WHAT IS EXCISE AUDIT 2000?

Excise Audit 2000 (EA 2000) is a new system of audit initiated from 1st December 1999.

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The essential philosophy of EA 2000 is that this audit is based on the scrutiny of business records of the assessee. This is a more systematic form of audit wherein the auditors are required to gather basic information about the assessee and analyze them to find out vulnerable areas before conducting the actual audit. The audit is therefore more focused and in-depth as compared to the traditional audit. Further, at every stage of audit, the assessee is consulted. This makes EA2000 audit user friendly.

The frequency of conducting the Excise Audit 2000 is as follows:

Amount of annual duty (in cash + CENVAT credit) paid by assessee -	Frequency of audit
Above Rs. 3 crore	Once in every year
Between Rs.1 crore and Rs.3 crore	Once in two years
Between Rs.50 lakh and Rs.1 crore	Once in five years
Less than Rs.50 lakh	10% of units every year

17.4 PROCEDURE OF EXCISE AUDIT 2000

17.4.1 Selection of Assessee : The process of EA 2000 begins with identification of a unit to be audited. Normally, there are about 1000 to 1500 assesseees under the jurisdiction of a Central Excise Commissionerate. It is not possible for the audit staff to conduct audits of all the units every year. Therefore, depending upon the manpower availability, about 300 to 400 units are selected for conducting audit during a financial year. Under the conventional system of audit the units were picked up randomly without any scientific basis of selection. Under EA 2000, the selection of the unit is based taking into account in the 'risk-factors'. This means that the assesseees who have a bad track record (having past duty evasion cases, major audit objections, past duty dues etc.) are given priority for conducting audit over those having clean track record.

17.4.2 Desk Review: The auditors are assigned the assesseees to be audited at the beginning of the financial year. The auditors are required to gather as much information about the assessee as possible. They can gather information from the departmental records, published documents like balance sheets annual statements etc., and through market enquirer. Since this can be done without interacting with the assessee, this step called as 'desk-review'.

17.4.3 Documenting Information: At the stage of 'Desk Review' the auditors may have already identified certain areas, which warrant closer examination. The auditor may also require certain documents or information from the assessee to complete his preliminary investigation. For this he may write letter to the assessee or send him a questionnaire to obtain this information. This step is called 'gathering and documenting assessee information'.

17.4.4 Touring: The auditor then visits the unit of the assessee to see the actual running of the unit, the systems that are followed for maintaining records in various sections and the system of movement of goods and the related documents within the unit. This step is called 'touring of the premises'. This gives the auditors a general overview about the procedure adopted by the assessee and the possible loopholes through which revenue leakage can take place.

17.4.5 Audit Plan: Based on his experiences and the information gathered so far about the assessee, the auditor now makes a 'audit plan'. The idea of developing audit plan is to list the areas which, as per the auditor are the vulnerable areas from the revenue point of view. Since number of documents/records maintained by assessee is huge in number, it also necessary that the auditor should select only some of them for the actual verification. The preparation of audit plan helps him to do that. It must be remembered that audit plan is not rigid but a dynamic concept. During the course of audit if the auditor notices certain new facts or new aspects of the planned area of audit, he can always alter the audit plan accordingly, with the approval of his supervisor. Similarly, during the actual audit, if the auditor is convinced that any area which was earlier planned for verification does not require in-depth scrutiny, he may alter the plan midway after obtaining approval of the superior officers. Preparation of audit plan is one of the most important steps of EA 2000. A well thought audit plan generally increases the success of audit result manifolds.

17.4.6 Verification: The most important step of audit is the conduct of actual audit, which in technical parlance is called 'Verification'. The auditors visit the unit of the assessee on a scheduled date (informed to the assessee in advance) and carry out the scrutiny of the records of the assessee as per the audit plan. The auditor is required to compare the documentation of a fact from different documents. For example, the auditor may check the figures of clearance of finished goods showed by the assessee in central excise return with the sales figures of the said goods in Balance Sheet, Sales Tax Returns, Bank statements etc. The auditor may also enquire about the entries which appear vague (say an entry like 'Misc. Income') in various records and documents. The idea behind conduct of verification is to reasonably ensure that no amount, which as per the Central Excise law is chargeable to duty, escapes taxation. The process of verification is always carried out in presence of the assessee so that he can clarify the doubts and provide required information to the auditor.

17.4.7 Audit Objection and Audit Para: Where the auditor finds instances of short payment of duty or non-observance of Central excise procedures, he is required to discuss the issue with the assessee. After explanation provided by the assessee, if the auditor is satisfied that such non-tax compliance has occurred, he records the same as an 'Audit Objection' or 'Audit Para' of the 'draft audit report' that he would be preparing at the end of the verification process. Auditor is advised not to take formal objections to mere procedural

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lapses/ infractions/ adoption of wrong procedures, which do not result in any short payment of duty or do not have bearing upon the duty payment. In such cases the auditor is required to discuss the matter with the assessee and advise him to follow the correct procedure in future. Further, while making an audit para, attempt should be made to tabulate the duty short paid by the assessee at the spot and incorporate it in the para itself. However, if this is not possible for the paucity of time or for the want of some information not available at that time, the auditor should make a note of the same in his report.

17.4.8 Audit Report: At the end of the process of verification the auditor prepares an 'Draft Audit Report' which incorporates all the audit objections/audit paras. An audit report provides (issue or para wise) the issue in brief, the reply or the explanation of the assessee, the reason for the auditor not being satisfied with the reply, the amount of short payment (if tabulated) and the recoveries of the same (if could be made at the spot). The draft audit report is then submitted to the superior officers for review, who examine the sustainability of the objections raised by the auditors. After such review, the audit report becomes final and in cases where the disputed amounts have not already been paid by the assessee at the spot, demand notices are issued by the department for their recoveries.

17.4.9 Conclusion: EA 2000 is a modern, transparent and interactive method of audit wherein the auditor proceeds with audit fully conversant with the business of the assessee. On his part, the assessee is given full opportunity to explain his stand on any particular matter so that matters are resolved in full appreciation of legal position. EA 2000 is thus a participative audit.

A requirement of EA 2000 is that the auditors must be thorough in their knowledge of Central Excise law and procedures, notifications, instructions and circulars issued by the Finance Ministry and the judicial decisions on issues relating to central excise laws. To be successful auditor, knowledge about financial bookkeeping, accountancy and proficiency in understanding commonly used commercial books and documents is of great help. Further, being computer literate is an added requirement while auditing an assessee who maintains his accounts in electronic format.

Self-examination questions

1. Discuss the provisions of section 14A in respect of valuation audit.
2. Briefly explain the provisions of section 14AA in respect of CENVAT Credit audit.
3. What is Excise Audit 2000? Discuss.
4. Explain the procedure of Excise Audit 2000.