

Instruction No. 06 /2017

Government of India
Ministry of Finance, Department of Revenue
Central Board of Direct Taxes
Audit & Public Accounts Committee Division

F. No. 240/08/2015–A& PAC - II

Dated 21/07/2017

Sub.: Revised Instruction on Internal Audit - Regarding**1. Introduction**

1.1 The Internal Audit system of the Income-tax Department was revamped in 2007 by way of Instruction No 3 of 2007. Further, the role of supervisory authorities was specified by a supplementary Instruction No 15 of 2013. The working of the Internal Audit set up has been reviewed, in the light of observations of the C&AG Audit report. The Income-tax Business Application (ITBA) is being rolled out and assessment and other ancillary work would be done on the system. With the availability of data on the system, the objective of audit of top potential cases would be achieved, as such cases would be identified easily. Accordingly, in supersession of all existing instructions on audit in general and Instruction No 3 of 2007, Instruction 15 of 2013 and Instruction No 04 of 2015 in particular, the following instruction is issued for compliance by officers concerned.

2. Audit Set up

2.1 There shall be an Internal Audit set up, under the direct supervision and control of the Pr.CCIT. The Audit structure shall be headed by a CIT (Audit) in each Pr.CCIT region. In the metro charges of Delhi, Mumbai, Kolkata and Chennai, there shall be two CsIT (Audit) each. The CIT (Audit) shall have their headquarters at the same station as that of the Pr.CCIT. Each CIT (Audit) will have one JCIT (Audit) [for the purpose of this Instruction, JCIT shall include Addl. CIT]. Each JCIT(Audit) shall have one SAP (Special Audit Party) unit headed by DCIT/ACIT (Audit) and as many IAPs (Internal Audit Party) headed by ITO(Audit) as are mentioned in Cadre Restructuring Plan, 2013. The JCIT will supervise the work of SAPs and IAPs working under him, apart from audit of cases which are categorized and assigned to him for audit.

2.2 In case of AOs (assessment units) of International Taxation, Transfer Pricing, Central Charges, Exemption etc. stationed in the territorial jurisdiction of a Pr.CCIT/ CIT(Audit) which is different from the jurisdiction of the Pr.CCIT/CIT(Audit) where the controlling PCIT of such AOs is stationed, the responsibility for Internal Audit of all such assessment units will be of the local CIT(Audit) related to the Pr.CCIT in whose territorial jurisdiction the AOs are located.

2.3 For the purpose of control and settlement of objections raised in cases of para 2.2 above, the local IAPs, JCIT (Audit) and CIT (Audit) would be treated as Audit Officers in ITBA Audit module. However, for the settlement of such objections, the PCIT will be the PCIT concerned having administrative control over such assessment units.

3. Objective and Scope of Internal Audit

3.1 The three-fold objectives of internal audit were laid down by the Central Board of Direct Taxes in the Year 1972 as under:

- (i) To have a preventive and reforming effect in direction of avoiding mistakes.
- (ii) To play the corrective role by pointing out mistakes and ensuring remedies without loss of time.
- (iii) To improve quality of assessments so as to reduce the criticism of the working of department by statutory audit and the Public Accounts Committee.

3.2 The ultimate aim of Internal Audit is to contribute to improve the quality of assessments by reducing the errors and omissions and also prevent detection of mistakes by the Revenue Audit. The scope of audit scrutiny by Internal Audit shall be broadly to verify the following:

- (i) The arithmetical inaccuracy;
- (ii) Non-application or wrong application of relevant legal provisions;
- (iii) Orders passed not in conformity with binding judicial pronouncements/ precedence and also Circulars & Instructions issued by the CBDT;

The Audit Officer should not raise vague and ambiguous objections. Cogent reasons should be given in the Audit memo by the Audit Officer while pointing out mistakes.

3.3 It may be mentioned that in cases being selected by Computer Aided Scrutiny Selection (CASS) for 'limited scrutiny', scope of audit shall also be confined to the issues for which limited scrutiny was made.

4. Auditable Cases and Targets

4.1 There are three level of audit units, namely the JCIT, the SAP and the IAP. The minimum number of points to be achieved by each JCIT, SAP and IAP per annum shall be as under:

Audit Unit	Minimum Annual Target
JCIT	200 points
SAP	400 points
IAP	720 points (for computing the achievement of the target, each non- corporate case shall have a weightage of 1 and corporate case of 1.2)

4.2 The audit of regular or complete scrutiny case shall be counted 1 point whereas audit of 'limited scrutiny' case shall be 0.5 point as the scope of audit is also limited as mentioned in para 3.3 above. The target mentioned above is only the minimum number of points to be accumulated and each audit unit must try to manage the work in such a way that as many auditable cases as possible are actually audited.

4.3 The CIT (Audit) shall be competent to change the target and norms for SAP/IAP according to the exigency of the availability of manpower and workload, subject to the approval of the Pr.CCIT concerned. Moreover, the CIT (Audit) may also ensure that the annual workload is evenly distributed in different months of the financial year.

4.4 The Internal Audit plan would be flexible and adjustable according to the available workload of high risk cases. The cases for audit would be selected through ITBA system based on the factors like assessed income/loss, or refund granted, or claim of exemption / deduction, or any other criteria as may be decided by the CBDT. The list of auditable cases shall be generated through ITBA on quarterly or monthly basis as may be required. Out of the list of auditable cases so generated, the CIT (Audit) shall

identify cases of different category to be audited by JCIT or SAP / IAP every month having regard to norms applicable to them.

4.5 Till such time as the ITBA becomes fully operational, the CIT(Audit) shall obtain the list of auditable cases in prescribed format from the CIT(Admn. &TPS) by 5th of the month following every quarter and assign the auditable cases to JCIT, SAP and IAPs as per the norms and targets. Once the ITBA becomes fully operational, the CIT (Audit) shall generate such list of auditable cases through ITBA.

5. **Class of cases to be audited by various audit units:**

5.1 The capacity of Internal audit set up to audit cases as per the norms fixed in para 3.1 above, is quite limited compared to the number of auditable cases. Hence in order that high risk cases (where likelihood of mistake is more) are taken up for audit, a universal criterion has been devised taking into account various relevant factors. For this purpose, the generation of list by the ITBA for internal audit would be based on 'Audit Potential Index' to be worked out as under:

$$API = \text{Assessed income} + 2 \times (\text{Exemptions} + \text{Deductions}) + 4 \times \text{Total Refund granted (for the relevant Assessment Year)}$$

5.2 The exemptions and deductions referred to above shall be those under Chapter III, Chapter VI-A, sections 32, 35 and 54 to 54H. The ADG (Audit) shall review factors for determination of the API every year in March and indicate changes, as deemed appropriate, with the approval of the Board, in the computation of API.

5.3 API shall be computed in all cases where assessment has been completed, and they shall be arranged in descending order in the form of a list. The list may have following particulars which may be modified by CIT (Audit) as may be needed:

S.No	Name	Status	AY	Returned income	Assessed income	Limited Scrutiny(Y/N)	API	Nature of business	Turnover	PCI	Station
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5.4 A combined list for the Pr.CCIT in descending order of API shall be normally generated on quarterly basis. However, the CIT (Audit) may decide to get the list generated as per requirement. Once a list of all auditable cases is arranged in descending order of API, cases for audit may be assigned by CIT (Audit) to JCIT, SAP and IAPs. While assigning the cases to audit units, the CIT (Audit) may take into consideration, the following factors:

- (i) Preference for audit is given to high risk cases
- (ii) The target of minimum number of cases to be audited by audit unit has to be evenly distributed over the year.
- (iii) At least some cases from all assessment units (AOs) should be audited.
- (iv) In multi-station regions, cases from all stations are audited.
- (v) The cases audited are a reasonable mix of corporate and non- corporate cases as also complete and limited scrutiny.
- (vi) Sectors of business that have more potential for audit during the relevant year be preferred.
- (vii) Appropriate number of cases of International tax, Exemption, TDS are subjected to audit.
- (viii) Any other factor that may increase the effectiveness of internal audit.

5.5 In the ITBA environment, the CIT (Audit) shall simply identify and mark the cases in the system itself to be audited by JCIT, SAP and IAPs. The marked cases shall be visible to the audit unit concerned on the system itself.

5.6 In respect of TDS cases, the order u/s 201 may be subjected to audit depending upon the quantum of non-deduction of tax or non-payment. For this purpose, the list of 201 orders shall also be available to the CIT (Audit) in ITBA. The number of TDS cases to be audited will be decided by the CIT (Audit) within the overall target of audit units.

5.7 Till such time as the ITBA becomes fully operational, norms for the auditable cases to JCIT, SAP and IAPs would be as laid down in the Instruction No. 3 of 2007.

5.8 The CCIT (International tax) shall put in place a system of audit of one TPO by another TPO, preferably of another CIT (TP) charge or at least of different range. The audit objections raised shall be submitted to the CIT(Audit) attached to the Pr.CCIT in whose jurisdiction the AO concerned is situated for follow up & record purposes. This concept of chain audit would be in place till experienced officers are available to set up a dedicated internal audit team for Transfer Pricing.

5.9 The Pr. CCIT shall put in place a system of audit of one TRO by another TRO. The audit objections raised shall be followed up by CIT (Audit) similar to other objections.

5.10 After the issue of Orders for chain audit in Para 5.8 and 5.9 above by the CCIT (International Taxation) or, as the case may be, the Pr.CCIT, the CIT (Audit) shall request to the concerned RCC to assign the functions of audit officer to the corresponding auditor - TPO/TRO. The list of auditable cases of TP and TRO etc. may be separately prepared by CIT (Audit), if required.

5.11 However, the Board may prescribe different criteria for generation of list of auditable cases in respect of the orders for which it is not possible to apply API, like Transfer Pricing, TDS, TRO etc, based upon information available in ITBA, in addition to or in supersession of the API based criteria, depending upon the requirement from time to time.

6. Planning

6.1 The CIT (Audit) shall prioritize the work of Internal Audit of different Circles/Wards in accordance with audit Plan/calendar of C&AG with the stated objective of conduct of internal audit before the revenue audit is taken up.

6.2 In view of the 31st December being the revised time barring date for assessments, the Internal Audit units may take up the work of audit of cases in the following manner:

- (i) In the first quarter of the financial year: assessments made in previous FY & current FY.
- (ii) In remaining quarters of the financial year: assessments made in current year

7. Audit Procedure and classification of mistakes

7.1 The Assessing Officer shall make the assessment records available for audit on requisition from the Internal Audit unit. In post-ITBA scenario, requisitions would be made through the system. It shall be the responsibility of the Assessing officer to deliver the records to the Audit unit. In search & Seizure cases, the Appraisal Report shall also be made available to audit, if requisitioned.

7.2 The Audit unit shall complete the audit work expeditiously and forward the objection, if any, in the form of 'Audit memo' in a format prescribed at Annexure-A to this Instruction. The Audit memo shall

be sent to the office of PCIT (for the purpose of this instruction, PCIT shall include CIT) concerned, with a copy each to the CIT (Audit), JCIT (Audit), Range head and the Assessing officer.

7.3 In order to make it convenient to decide the appropriate course of remedial action and facilitate its settlement, the audit objection shall be categorized, depending upon the issue raised by the audit unit concerned, into

- (i) Factual, or
- (ii) Legal Question, or
- (iii) Mixed Issues

For each mistake, even for the same case in same assessment year, separate audit memo shall be issued for proper monitoring and ITBA system will assign a unique identification number (UIN) to each audit memo.

7.4 The audit memo shall be issued after vetting by JCIT (Audit), if the Revenue effect is more than Rs.1 crore and if the Revenue effect exceeds Rs.10 crores, it shall be vetted by the CIT (Audit) before it is issued. The vetting shall be done and recorded on ITBA system itself.

7.5 The Internal Audit Objections shall be classified by ITBA itself, on the basis of quantum of Revenue effect, into major or minor objection. The minimum revenue effect to be classified as major objection would be Rs.10 lakhs.

The remaining internal audit objections shall be classified as minor objection in ITBA system. Revenue effect shall include interest etc. also. The monetary limits for classification of major or minor objections may be reviewed by ADG (Audit).

7.6 All pending objections as on the date of issue of this Instruction shall be reclassified into major and minor objections accordingly and uploaded in the ITBA system for proper monitoring of their settlement.

8. Examination of Objections

The procedure for dealing with internal audit objection is outlined below.

8.1 Major Internal Audit Objection

8.1.1 The PCIT concerned shall, on the basis of report from Assessing Officer, examine major audit objection and decide whether or not, it is acceptable within a month of receipt.

8.1.2 Where the audit objection is accepted, remedial action shall be initiated. If the audit objection is not accepted, the reasons for the same shall be communicated to the CIT (Audit).

8.1.3 Where the objection is not accepted, the CIT (Audit) shall consider the reasons in the reply of PCIT and take following steps as may be appropriate:

- (i) If the view of the PCIT is acceptable, the objection will be settled as dropped and the decision shall be communicated to the PCIT concerned within one month of receipt of his reply.
- (ii) If the view of the PCIT is not acceptable, the reasons for disagreement shall be communicated to the PCIT concerned within one month of receipt of his reply.

8.1.4 If the PCIT on consideration of the response of CIT(Audit) is still of the view that the objection is not acceptable, he shall intimate the reasons for his view to the jurisdictional CCIT within 15 days, who will consider both the views and issue the final decision on acceptance or non-acceptance within 15 days.

8.2 Minor Internal Audit Objection

8.2.1 In respect of Minor audit objection, the Range head shall, based on report from Assessing Officer, examine the objection and communicate its acceptance or otherwise to the JCIT(Audit) within one month of receipt of such objection. In case objection relates to JCIT (Special Range), the JCIT being himself the AO, shall examine and communicate with JCIT (Audit).

8.2.2 Where the objection is not accepted, the JCIT (Audit) shall consider the reply of the Range Head or JCIT (Special Range), as the case may be, and take following steps as may be appropriate:

- (i) If the view of the Range Head / JCIT (Special Range) is acceptable, the objection will be settled as dropped and the decision shall be communicated to the Range Head / JCIT (Special Range) concerned within one month of receipt of his reply.
- (ii) If the view of the Range Head / JCIT (Special Range) is not acceptable to JCIT (Audit), the reasons for disagreement would be communicated to the Range Head / JCIT (Special Range) concerned within one month of receipt of his reply.

8.2.3 If the Range Head / JCIT (Special Range) is still of the view that the objection is not acceptable, he shall refer the matter, within 15 days of receipt of disagreement, to the PCIT.

8.2.4 If the PCIT agrees with the view of Range Head/JCIT (Special Range), he shall take up with the CIT (Audit) within 15 days, and the objection will be treated as settled if the CIT (Audit) agrees with the PCIT. Else, the matter will be referred to the jurisdictional CCIT who will give his decision within 15 days

8.2.5 If the PCIT finds objection acceptable, the remedial action shall be taken.

9. Remedial Action:

9.1 In respect of an accepted major internal audit objection, if the PCIT is of the view that a remedial action requires revision of the relevant order u/s 263, he shall call for the relevant records and proceed accordingly. In other cases, he shall communicate his decision not to invoke section 263 to the Assessing Officer.

9.2 In respect of an accepted minor objection, if the Range head is of the view that the matter may require examination by PCIT for invoking revision jurisdiction u/s 263, he shall refer the matter to the PCIT and the procedure as in 9.1 above shall follow.

9.3 In cases where the PCIT has decided not to invoke his revision jurisdiction, or the Range head has decided not to refer the matter to PCIT, the Assessing Officer shall examine an appropriate course of action, in the light of facts of each case and take a suitable action as per his independent application of mind on the facts of each case.

9.4 In case the Assessing Officer decides to choose section 154 as the appropriate remedial measure in 9.3 above, he shall initiate the action with the approval of the Range head.

9.5 The remedial action in cases of accepted objections must be initiated within three months of receipt of such objections and concluded within six months of initiation of the proceeding as per Income Tax Act, 1961.

10. Settlement of audit objections:

10.1 The accepted major internal audit objection shall be settled by the CIT (Audit) once the required remedial action has been completed in the case and demand notice issued.

10.2 The accepted minor audit objection shall be settled by the JCIT (Audit) after considering the reply of the Range head concerned about completion of remedial action.

10.3 Pr. CCIT shall review the progress of settlement of internal objections in the CCIT Regions under his administrative control on quarterly basis and take necessary steps to achieve Action Plan targets for the year in this regard. He shall submit a report within a fortnight of each quarterly review to the Member (A&J), CBDT.

11. Calling for Explanation:

11.1 Where a Major Internal Audit Objection has been accepted, the PCIT may call for explanation of Officer/staff concerned in appropriate cases, keeping in view the nature of objection and facts of the case, and take suitable action as deemed fit.

11.2 The PCIT may also call for explanation of the officers who delayed the process of remedial action beyond the time line laid down in this instruction and of those who failed to take remedial action in cases of accepted audit objection in time, causing irretrievable loss of revenue.

11.3 Where a Major Revenue Audit Objection has been accepted by the department in a case which was audited by the internal audit earlier and such objection was not pointed out by the Internal Audit Officer, the CIT(Audit) may call for explanation of such Internal Audit Officer in appropriate cases and may take suitable action as deemed fit.

12. Ledger Cards

12.1 Proper maintenance of record of mistakes committed by a particular officer is an essential step to enforce accountability and take reformative steps. This is to be done by maintaining Ledger Cards. The ledger card in respect of erring assessing officers shall be maintained on the ITBA system and would be available to supervisory officers.

12.2 However, until the time Audit Module in ITBA system is fully functional, the ledger card will continue to be maintained in the offices of the PCIT concerned as well as the CIT (Audit) in the format as in existence prior to this Instruction coming into force.

13. Monitoring and Regulation by Pr.DGIT(Admn)

13.1 The ADG (Audit), under the Pr.DGIT(Admn), shall continue to monitor the functioning and performance of the Internal Audit set up of the Department and shall be the coordinating agency for all CsIT(Audit). The ADG (Audit) shall also carry out review and inspection of internal Audit set up of any region with the approval of the Pr.DGIT(Admn).

13.2 For preparing list of auditable cases in respect of the orders for which it is not possible to apply API, like International Tax, Exemption, Transfer Pricing, TDS etc. as discussed in para 5 above, the ADG(Audit) shall decide appropriate criteria. After the criteria are tested and used for some time, ADG (Audit) may suggest appropriate method to work out risk factors and automatic preparation of list through ITBA.

13.3 The CIT (Audit), in consultation with the Pr.CCIT, shall devise suitable training programs from time to time for officers and staff engaged in the audit work. The training may be arranged through DTRTI or otherwise in the form of Workshops Seminars. The ADG (Audit) shall monitor uniformity and improvement in training programs by different CsIT (Audit).

13.4 In order to reduce the incidence of errors, the CIT (Audit) shall prepare a list of common/repeated errors noticed in the audit in preceeding two quarters in April and October every year to the ADG (Audit) who in turn shall compile and classify such common mistakes for the circulation to all field officers.

13.5 The CIT (Audit) shall also submit to the ADG (Audit) in April and October every year, a list of mistakes detected by the receipt audit in cases where Internal Audit was already done. The ADG (Audit) shall in turn compile all such mistakes for circulation to all the field officers and also to the internal audit officers.

14. Registers to be maintained:

14.1 The record of audit work i.e. the Audit memo, all subsequent communications and its settlement etc. with dates shall be available in ITBA system. The required information like pendency & settlement of major & minor internal audit objections on regular period can be availed from ITBA system as MIS.

14.2 However, until the time Audit Module in ITBA system is fully functional, the registers in the format as prescribed in the existing Instructions shall continue to be maintained.

15. Reporting system:

15.1 All work including correspondence regarding audit shall be done through ITBA system. The statistical and other report as may be required shall be generated from the ITBA system itself. However, for monitoring and control following standard MIS reports are prescribed:

- (a) Statistical report, to ascertain progress, in respect of number of audit objections raised, settled, pending etc in the format at Annexure-B.
- (b) List of pending audit objections with particulars as may be required out of those prescribed in Annexure-C.

For Audit Set-up

15.2 The CIT (Audit) shall be able to generate MIS report in Annexure-B for his jurisdiction or for each audit unit namely JCIT, SAP or IAP. The PCCIT shall be able to generate similar MIS report for his jurisdiction or CIT (Audit) wise, or CCIT wise or PCIT wise as may be required. The ADG (Audit) shall be able to generate similar MIS report for all or any of the Pr.CCIT or CCIT or PCIT or any CIT (Audit) in India.

For CCIT or PCIT

15.3 The CCIT or PCIT shall be able to generate, as and when required, MIS report in Annexure-B for his charge with break-up for each Range or AO in his region/ charge. The CCIT or PCIT shall also be able to generate list of all pending audit objections in Annexure-C for his charge or any Range or any AO in his charge.

15.4 The ADG (Audit) may, with the approval of Member (A&J), specify any other periodic MIS that is required to be generated through ITBA.

15.5 Until such time as Audit Module in ITBA becomes functional, the reports as per existing guidelines shall continue to be sent.

This may be brought to notice of all officers working under your jurisdiction for compliance.

Hindi version of the Instruction will follow.

Abbreviations used in this Instruction

PDGIT	Principal Director General of Income-tax
PCCIT	Principal Chief Commissioner of Income-tax
DGIT	Director General of Income-tax
CCIT	Chief Commissioner of Income-tax
PCIT	Principal Commissioner of Income-tax and includes Commissioner of Income-tax
ADG	Additional Director General of Income-tax
JCIT	Joint Commissioner of Income-tax(Audit) and includes Additional Commissioner of Income-tax(Audit)
Range head	Additional or Joint Commissioner of Income-tax heading the Range
AO	Assessing Officer

Sunita
21.7.17

(Sunita Verma)
Addl. CIT (OSD) A&PAC,
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AUDIT MEMO

1	Unique objection No.	To be generated by ITBA
2	Name of the assessee	
3	PAN	
4	Status	
5	Assessment Year	
6	Ward /Circle / Special Range	
7	Section & Date of order under audit	
8	Name & Employee code of AO who made the order under audit	
9	Date of Internal Audit	
10	Audit Unit	
11	Amount of under assessment / over assessment	
12	Revenue effect	Tax + interest
13	Category – Factual/Legal/Mixed	
14	Section(s) involved in objection	
15	Issue in objection in brief (150 character)	(drop down list preferable)

Audit Objection

Name & Signature of the officer

No: CIT(Audit)/-----/FY /----- (audit unit)/Memo No / **Date: dd/mm/yy**

Copy forwarded to:-

- 1) The PCIT / CIT(Audit)
- 2) The Addl/JCIT-Range concerned / JCIT(Audit)
- 3) The Assessing Officer

Name & Signature of the officer

Monthly report of Pendency of objections

Report for the : [PCCIT /CCIT/DGIT/PCIT/CT(Audit)]*drop down*

Status as on : [normally as on last day of the previous month / any specific date]

PART-I - MAJOR INTERNAL AUDIT OBJECTIONS

No of Objections pending as on 1.4.20.....	Revenue Effect of in Column (1)	Received during the month	Received up to the end of month	Settled during the month	Settled up to the end of month	Pending at the end of month (1-4-6)	Revenue effect of objections in Col (7)	Replies sent but pending	Objections (not accepted) out of (6)	Revenue effect in respect of Column (11)	Objections that are accepted out of (6)	Revenue effect in respect of Column (12)
1	2	3	4	5	6	7	8	9	10	11	12	13

Break up for the authorities below should be available till basic unit i.e. AO, IAP etc.

PART-II - MINOR INTERNAL AUDIT OBJECTIONS

No of Objections pending as on 1.4.20.....	Revenue Effect of in Column (1)	Received during the month	Received up to the end of month	Settled during the month	Settled up to the end of month	Pending at the end of month (1+4-6)	Revenue effect of objections in Col (7)	Replies sent but pending	Objections (not accepted) out of (6)	Revenue effect in respect of Column (11)	Objections that are accepted out of (6)	Revenue effect in respect of Column (12)
1	2	3	4	5	6	7	8	9	10	11	12	13

Break up for the authorities below should be available till basic unit i.e. AO, IAP etc.

