PERFORMANCE AUDIT REPORT
ON THE
ROLE OF CUSTOMS
IN IMPLEMENTATION AND DEVELOPMENT OF
EXPORT ORIENTED UNITS SCHEME

FEDERAL BOARD OF REVENUE
(INLAND REVENUE & CUSTOMS)
AUDIT YEAR 2020-21

AUDITOR-GENERAL OF PAKISTAN

PREFACE

Articles 169 and 170 of the Constitution of the Islamic Republic of Pakistan, 1973 read with Section 8 and 12 of the Auditor General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001 require the Auditor General of Pakistan to conduct audit of expenditure and receipts of Government of Pakistan. The performance audit of the role of Customs in implementation and development of Export Oriented Units Scheme was carried out accordingly.

The Directorate General Audit, Inland Revenue and Customs (North), Lahore, conducted the performance audit of the Custom Department regarding its role in implementation and development of Export Oriented Units Scheme for the period July 2015 to June 2020 in October and November 2020 with a view to report significant findings to stakeholders. Audit examined the scheme with the broader parameters of economy, efficiency, and effectiveness. In addition, audit also assessed, on test check basis, whether the management observed applicable laws, rules and regulations in managing the scheme. Audit Report indicates specific actions that, if taken, may help the management to realize the stated objectives of the scheme. The observations included in this report have been finalized in the light of discussions in the DAC meetings.

The Audit Report is submitted to the President of Pakistan in pursuance of Article 171 of the Constitution of the Islamic Republic of Pakistan 1973 for causing it to be laid before the Majlis-e-Shoora (Parliament).

Islamabad
Dated: 29 July 2022

Muhammad Ajmal Gondal
Auditor-General of Pakistan

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ABBREVIATIONS & ACRONYMS

AGP	Auditor-General of Pakistan
CIR	Commissioner Inland Revenue
CRTO	Corporate Regional Tax office
DAC	Departmental Accounts Committee
DTRE	Duty and Tax Remission on Exports
EDB	Engineering Development Board
EFS	Export Facilitation Scheme
EOU	Export Oriented United
FBR	Federal Board of Revenue
FED	Federal Excise Duty
FTO	Federal Treasury Officer / Federal Tax Ombudsman
FY	Financial Year
GD	Goods Declaration
GST	General Sales Tax
HC Code	Harmonised System Code
IOCO	Input Output Coefficient Organization
IR	Inland Revenue
IOR	Input-Output Ratios
KIBOR	Karachi Inter Bank Offer Rate
LTU	Large Taxpayers Unit
MBCO	Manufacturing Bond Company
MCC	Model Customs Collectorate
PTR	Presumptive Tax Regime
PAC	Public Accounts Committee
PAO	Principal Accounting Officer
PCT	Pakistan Customs Tariff
PRA	Post Refund Audit
RA	Regulatory Authority
RTO	Regional Tax Office
SBP	State Bank of Pakistan
SMEs	Small and Medium Enterprises
SRO	Statutory Regulatory Order
WeBOC	Web Based One Customs
WHT	Withholding Tax

EXECUTIVE SUMMARY

Director General of Audit, Inland Revenue and Customs (North), Lahore, conducted a performance audit of the role of Customs Department in implementation and development of Export Oriented Units Scheme for the period July 2015 to June 2020 in October and November, 2020. The main objectives of the audit were to evaluate whether the Scheme had been implemented in terms of its prescribed rules and successful in meeting its stated objectives. The audit was conducted in accordance with the INTOSAI Auditing Standards.

Key findings of the performance audit report

1. In 46 cases, the Department issued the EOU manufacturing licences after an undue delay ranging from 10 to 349 days.[1]
2. In 25 cases, IOCO issued analysis cards under the EOU Scheme after an undue delay ranging from 50 to 395 days.[2]
3. In 20 cases, EOU licencees applied for analysis certificates after first import of input goods after an undue delay ranging from 11 to 531 days.[3]
4. MCCs Lahore, Faisalabad and Sialkot had issued only 25, 33 and 37 EOU licences, respectively, in more than 12 years since the inception of the EOU Scheme.[4]
5. There was a lack of skilled staff managing the licencees under the Scheme.[5]
6. Inadmissible exemption of duty and taxes on import of lubricating oil, etc. - Rs. 51.171 million.[6]
7. Non-recovery of government revenue on account of regulatory duty - Rs. 26.836 million.[7]
8. Non-realization of government revenue due to excess consumption of coal - Rs. 150.291 million.[8]
9. The prescribed online automated system for daily monitoring of EOUs was not found to be present in any EOU under the jurisdictions of MCCs Lahore, Faisalabad and Sialkot, despite lapse of more than 12 years since inception of the EOU Scheme.[9]
10. MCCs Faisalabad and Sialkot had no mechanism to collect and monitor the prescribed monthly returns.[10]
11. In 59 cases, there was an undue delay in conducting the post-exportation audit of the EOUs, ranging from 4 months to 10 years.[1]

[1] Para 4.1.1, [2] Para 4.1.2, [3] Para 4.1.3, [4] Para 4.1.5, [5] Para 4.1.6, [6] Para 4.2.1, [7] Para 4.2.2, [8] Para 4.2.3, [9] Para 4.3.1, [10] Para 4.3.2.

12. Given the nature and design of the Scheme, it has been very effective in attracting a significant section of manufacturer-cum-exporters in Pakistan. However, it would have been more effective if it had not been extended to public limited companies. Moreover, the implementation of the Scheme remained very slow, uneconomical and highly inefficient. Thus, keeping in view the potential for further improvement through better promotion, facilitation and monitoring of the Scheme among SMEs, the overall performance rating of the Scheme is unsatisfactory.[5]

Recommendations

1. With regards to key audit finding Nos. 1 to 3, inquiry may be conducted to assess reasons behind delays in issuance of EOU licences, analysis certificates and applications for analysis certificates to fix responsibilities or to amend the rules to provide for workable time-frames.
2. With regards to key audit finding No. 4, Customs authorities should make proactive efforts to reach out to potential EOU/EFS eligible SMEs in Pakistan or abroad through advertisements, seminars and targeted marketing.
3. With regards to key audit finding No. 5, dedicated and specially trained staff and section should be available to monitor and maintain the EOU/EFS Schemes.
4. With regards to key audit findings Nos. 6 to 8, effective financial management of the Scheme as per rules should be ensured to prevent loss of government revenue and misuse of the EOU licence at the import, manufacturing and export stages.
5. With regards to key audit finding 9 Nos. and 11, a probe may be conducted to assess reasons behind non-implementation of the prescribed online automated system, non-collection of monthly returns and delays in conduct of annual post-exportation audit and either responsibilities be fixed the rules be amended to provide for a workable oversight mechanism.
6. With regards to key audit finding No. 12, FBR should strengthen its internal controls to ensure periodic oversight of the EOU/EFS Scheme at the highest level within the Department.

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[1] Para 4.3.4, [2] Para 4.4.7

1. INTRODUCTION

The Directorate General Audit, Inland Revenue and Customs, Lahore, conducted performance audit of the role of Customs in implementation and development of the Export Oriented Units Scheme for the period July 2015 to June 2020 in October and November, 2020.

The Scheme was designed to boost Pakistan's exports along with other similar schemes such as Manufacturing Bond Scheme, Export Promotion Zones (EPZ), Duty and Tax Remission on Exports (DTRE) and Temporary Importation Scheme. However, the EOU Scheme has had greater significance because of its impact on both the micro and macro scales of economy of Pakistan through facilitation of small and medium enterprises around the country in manufacture and export of their goods.

The Scheme was introduced in 2008 after the Minister for Commerce announced in Trade Policy Speech on 12th July, 2007 that, "In order to facilitate SME exporters, the FBR will announce a new scheme for temporary importation of raw materials, including fabrics, to be used as inputs for export products." Subsequently, the explanatory note dated 1st April, 2008 issued by the FBR stated that it "has announced a Scheme of Export Oriented Units vide Notification No. 327(I)/08 dated 29.03.2008. Under the scheme raw materials and plant, machinery, equipment and apparatus, including capital goods to be used solely within the limits of an Export Oriented Units can be imported free of customs duty, sales tax and federal excise duty. The scheme will essentially have the same incentive as are available to units in EPZs. Existing units exporting at least 80% of production need to be registered with FBR under the scheme. New units, so registered, will be required to export 100% of their production. Under this scheme time limit for consumption of duty free locally purchased/imported raw materials was two years."

a. The governing rules

The EOU Scheme is governed by Export Oriented Units and Small and Medium Enterprises Rules 2008 (hereinafter referred to as "the Rules") notified through the aforementioned SRO 327(I)/2008 dated 29th March, 2008. The said SRO has subsequently been amended through 14 subsequent SROs, the last one being SRO 684(I)/2020 dated 5 August 2020. The Rules have 14 rules, which, in their current form, are briefly summarized as under:

i. The Rules have the widest possible scope as they are issued jointly under Section 219 of the Customs Act 1969, Section 50 of the Sales Tax Act 1990, Section 40 of the Federal Excise Act 2005 and Section 148 of the Income Tax Ordinance 2001. The overall responsibility for monitoring the Scheme was with the Collector of Customs (as per proviso to Rule 10(1)) but all operational responsibilities were assigned to the Additional Collector of Customs, who was designated as the "Regulating Authority" as per Rule 2(1)(ja).

ii. An Export Oriented Unit is defined in Rule 2(1) (d) as, among other things, a manufacturer having in-house manufacturing facility anywhere in Pakistan, registered under the Sales Tax Act 1990, and exporting at least 80% of its annual production. Further, Rule 2(1)(f) defines "input goods" as all goods used in the manufacture of output goods as approved by the ACC in the analysis certificate, such as "raw materials, accessories, sub-components, components, assemblies, sub-assemblies, coal, coke of coal, carbon blocks, diesel, gas and furnace oil (for generation of electricity/energy)".

iii. Under Rule 3, a person or firm can make an application to the ACC along with the specified documents and obtain a licence to operate an EOU within seven days after necessary verification.

iv. Rules 4 to 8 pertain to cancellation, suspension, revalidation or revival, transfer of ownership or title, and exclusive use of the premises of the EOU, respectively.

v. Rule 9 requires EOU licensee to apply for an analysis certificate - showing the input and output ratio of input goods viz-a-viz output goods along with wastages for goods to be manufactured in an EOU within seven days of import of input goods. The ACC then issues an analysis certificate within 30 days of licensee's application after verification from the Input Output Coefficient Organization (IOCO) or Engineering development Board (EDB). No fresh analysis certificate is needed if input goods have been accounted for in an earlier analysis certificate. Further, the ACC may issues a provisional analysis certificate pending verification by IOCO or EDB.

vi. Rule 10 provides for procurement, manufacture, export and removal of goods by a licensee, and requires submission of a monthly statement in this regard to the ACC. Similarly, Rule 11 provides for remission of taxes and duties in case goods or wastages are destroyed or used as samples and Rule 13 provides for disposal of input or output goods in exceptional circumstances.

vii. Rule 12 stipulates a period of two years for utilizing the input goods acquired under the licence, though Chief Collector may give an extension in exceptional circumstances.

viii. Rule 14 provides for monitoring and audit of an EOU through an online automated system to be maintained by the licencee to report its daily activity to the ACC and a year-end post-exportation audit to the satisfaction of the ACC.

b. Overall performance figures

As of 30th June, 2020, the Collectorate-wise performance of the Scheme, is shown under:

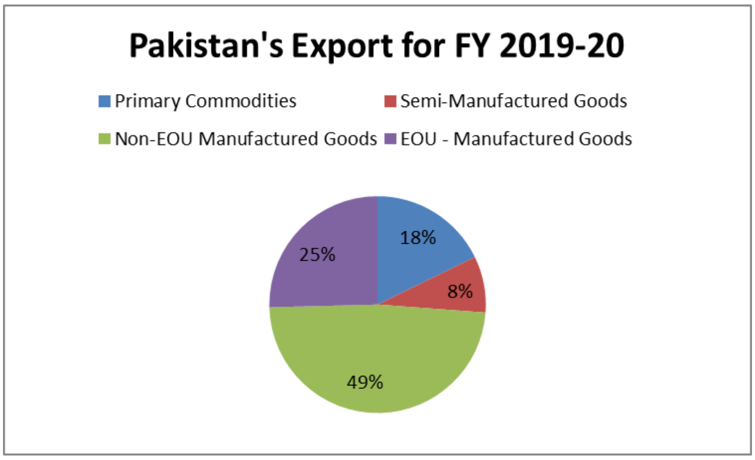
					Rs. in Millions		
Sr. No.	**Collectorate**	**Total Units**	**Opr.**	**Non-Opr.**	**Import Value**	**Duty & Taxes Remitted**	**Export Value**
1	Export Karachi	38	33	5	35,767	16,795	150,775
2	Karachi Port Qasim (Exports)	18	16	2	55,162	23,004	140,733
3	Lahore (Appraisement)	25	24	1	48,978	20,225	208,663
4	Islamabad	1	0	1	0.00	0.00	0.00
5	Peshawar (Appraisement)	0	0	0	0.00	0.00	0.00
6	Multan	9	6	3	6,985	1,190	34,879
7	Faisalabad (Appraisement)	47	40	5	17,292	3,171	139,234
8	Sialkot	37	36	1	3,740	1,940	17,761
9	Gawadar/Gadani	0	0	0	0.00	0	0.00
	Total	**175**	**155**	**18**	**167,925**	**66,326**	**692,046**

The above table shows that:

i. There were 155 operational EOUs across Pakistan with an export volume of Rs. 692,046 million, which, as per Pakistan Economic Survey 2019-20, was 34.4% of Pakistan's total exports of manufactured goods during the year, that is, Rs. 2,011,864 million, and 25.4% of Pakistan's total exports for the year, that is, Rs. 2,725,210 million.
ii. The value of goods exported under the Scheme is more than four times the valued of duty/tax-free input goods imported.
iii. Duties and taxes remitted under the Scheme are only 12.7% of the net exports, which implies that the government is earning almost eight rupees worth of foreign exchange for every rupee of tax/duty revenue forgone, indicating a cost to benefit ratio of 1:8.
iv. Majority of exports under the Scheme are from sectors like textiles, yarn and sports goods.

The share of EOUs in Pakistan's total export volume for the FY 2019-20, incorporating data from Pakistan Economic Survey 2019-20 (Statistical Table 8.5A), is shown in table and pie chart below:

Exports Class	Exports Value (Rs. in Millions	% Share
Primary Commodities	484,273	18
Semi-Manufactured Goods	229,073	8
Non-EOU Manufactured Goods	1,319,818	49
EOU - Manufactured Goods	692,046	25
Total	**2,725,210**	**100**



2. AUDIT OBJECTIVES

Performance audit of the EOU Scheme for the period of July 2015 to June 2020 was carried out to check its economy, efficiency and effectiveness. Audit objectives are broken down into following:

i. To review the impact of the Scheme against intended objectives;
ii. To assess the role of Customs authorities in expanding the Scheme to a variety of manufacturers having reasonable export potential;
iii. To review compliance with application procedures, internal controls and monitoring mechanisms prescribed by the Rules;
iv. To assess the impact of the Scheme over Pakistan's exports.

3. AUDIT SCOPE AND METHODOLOGY

Performance audit of the scheme was carried out at MCCs Sialkot, Faisalabad and Lahore for the period July 2015 to June 2020, while information regarding the objectives of the Scheme was obtained from FBR HQ, Islamabad.

The Directorate General Audit, Inland Revenue and Customs, Lahore, planned the performance audit in the Annual Audit Plan 2019-20. After approval of the Preliminary Survey Report, audit was executed as per audit assignment plan and audit programmes. The imports and exports GDs, analysis cards, post export audit reports and licenses issued by the Regulatory Collectors for the period July 2015 to June 2020 were scrutinized. Further, policy statements and overall performance figures were obtained from FBR HQ, Islamabad.

4. AUDIT FINDINGS AND RECOMMENDATIONS

Performance audit of the EOU Scheme for the period from July 2015 to June 2020 was carried out to check its economy, efficiency and effectiveness. The general attitude of management of Customs towards production of record was satisfactory. In the light of the Export Oriented Units and Small and Medium Enterprises Rules 2008, certain irregularities were pointed out and recommended for immediate review by FBR for taking remedial action under the Rules or, where necessary, seeking appropriate amendments in the Rules.

Audit findings are given below under three main headings of "Organization and Management", "Financial Management" and "Monitoring and Evaluation", while the "Overall Assessment" is presented under the fourth heading.

4.1 Organization and Management

The audit findings pertaining to organization and management are narrated in succeeding paragraphs:

4.1.1 Delay in issuance of manufacturing licenses under EOU Scheme

According to Rule 3(2) of SRO 327(I)/2008 dated 29.03.2008, on receipt of an application along with the documents prescribed in sub-rule (1), the Regulatory Authority after such verification as deemed necessary, may issue a license within seven days of such verification, to the applicant to operate an export oriented unit.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCCs Lahore, Faisalabad and Sialkot, undue delay occurred in granting licenses to 46 applicants ranging from 10 days to 349 days in contravention of the above Rule. This resulted in delay in start of manufacturing process and subsequent exports. This also depicts weak internal controls and inefficiency.

The Department replied that due care was taken and all applications for the grant of new licences were properly adhered to following the time limit given in the EOU Rules, 2008. However, sometimes delay occurred due to non-provision of requisite documents. Moreover, certain exporters applied for grant of licence without having sufficient in-house manufacturing facility.

The DAC in its meeting held in March, 2022 directed the Collectorates to:

i. Devise a check list for documents required for grant of EOU licences, display it prominently and disseminate it among the existing and potential exporters;

ii. Process the complete applications expeditiously under the law and take all steps for reducing the existing timelines and improvement of procedures; and

iii. Provide clear timelines for each step / hierarchical level engaged in processing and grant of EOU licences.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Sialkot-3, Faisalabad-2 & Lahore-3]

4.1.2 Late issuance of analysis certificates

According to Rule 9(2) of SRO 327(I)/2008, the Regulatory Authority shall after such verification as he deems necessary, or after getting inputs from the Input Output Co-efficient Organization (IOCO), or as the case may be, the Engineering Development Board (EDB), in this regard, issue an analysis certificate within thirty days of receipt of such application, showing the actual quantity of input goods used and wastage occurred in the manufacture of one unit of output goods.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCCs Lahore, Faisalabad and Sialkot, undue delay occurred in issuance of analysis card by IOCO – a pre-requisite for issuance of analysis certificate by the Regulatory Authority – to 25 licencees ranging from 50 days to 395 days in contravention of the above Rule. This resulted in delay in start of manufacturing process or claim of wastage at the higher side. This also depicts weak internal controls and inefficiency hampering efforts to enhance exports under this Scheme.

The Department replied that Collectorates had not sufficient staff and expertise to determine the input / output ratios and wastage occurred in the manufacturing of finished goods from a variety of raw materials. Therefore, the IOR on Appendix-III received in the Collectorate were forwarded to the Directorate of Input Output Co-efficient Organization or the Engineering Development Board, depending upon the capacity of manufacturing. The IOCO or EDB, after conducting survey of the manufacturing process, on case to case basis, forwarded IORs to Collectorate which were accordingly issued to the licencee and also fed in the WeBOC module. All the processes involved and calls for due participation of the licencee as the staff of IOCO could not conduct survey without availability and co-operation of the licencee. The IOCO staff was, however, asked time and again to expedite the issues related with analysis certificates strongly.

The DAC in its meeting held in March, 2022 directed the Collectorates to examine the aspect of late issuances of analysis certificates to further reduce processing / issuance time with clear timelines.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Sialkot-12, Faisalabad-5 & Lahore-4]

4.1.3 Non-submission of application by EOU for issuance of analysis certificate within stipulated time

According to Rule 9(1) of SRO 327(I)/2008 dated 29.03.2008, the licencee shall apply to the Regulatory Authority, within seven days of import of input goods, for issuance of an analysis certificate as set out in Appendix-III showing the input and output ratio of input goods viz-a-viz output goods along with wastages. Further, the licence may be cancelled by the Regulatory Authority on violation of any of the conditions specified in the licence under Rule 4 of the SRO.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCCs Faisalabad and Sialkot, 20 EOUs failed to comply with the above quoted Rule and applied for analysis certificate with a delay of 11 to 531 days after first import of input goods. The Department has not taken any action upon this violation by the EOUs which shows that the Collectorate is poorly monitoring the activities of EOUs.

The Department replied as under:

- MCC Sialkot replied that analysis certificates have been issued and imported quantity of raw material has been re-exported. Post exportation audits of the units have been completed. Moreover, according to SRO 957(I)/2021, all the existing schemes like DTRE, EOU, M.BOND have been merged in EFS (‘Export Facilitation Scheme’) where analysis certificates would be uploaded at the time of submission of application and approved by IOCO/EDB; and

- MCC Faisalabad reported that the licencees applied for issuance of analysis certificate with incomplete information / documents, which delayed the issuance of the analysis certificates. However, the contents of the observation have been noted for future compliance.

The DAC in its meeting held in March, 2022 observed that FBR had introduced a scheme called Export Facilitation Scheme 2021 (notified as amendment to Customs Rules 2001 through SRO No. 957(I)/2021 dated 30.07.2021 and effective from 14.08.2021) where application for analysis certificate and issuance thereof were done in the system and, due to doing away with physical interaction, time in issuance had been reduced and in cases where complete documents were submitted by the EOU licence holder, analysis certificate was issued within the prescribed time.

However, Audit is of the view that responsibility for lapses in the past should fixed after holding an inquiry. Moreover, Audit recommends that the latest monitoring reports indicating compliance with timelines relating to issuance of analysis certificates under the newly introduced Rule 877 of the Customs Rules 2001, as part of the Export Facilitation Scheme 2021, may be shared with the Audit at the earliest for reference.

[AO Nos. Sialkot-15 & Faisalabad-13]

4.1.4 Consumption of input goods and subsequent export without obtaining approved analysis certificate

According to Rule 9(1) of SRO 327(I)/2008 dated 29.03.2008, the licencee shall apply to the Regulatory Authority, within seven days of import of input goods, for issuance of an analysis certificate as set out in Appendix-III showing the input and output ratio of input goods viz-a-viz output goods along with wastages. Further, Rule 9(2) provides that the Regulatory Authority shall after such verification as he deems necessary, or after getting inputs from the Input Output Co-efficient Organization (IOCO), or as the case may be, the Engineering Development Board (EDB), in this regard, issue an analysis certificate within thirty days of receipt of such application, showing the actual quantity of input goods used and wastage occurred in the manufacture of one unit of output goods.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCCs Lahore and Faisalabad:

(i) M/s Hira Terry Mills Limited was granted EOU licence on 15.12.2010 but first analysis card by IOCO – a pre-requisite for issuance of analysis certificate by the Regulatory Authority – was requested by the Regulatory Authority on 20.04.2018 and approved on 21.06.2018, after more than seven years of issuance of licence. The very late application by the licencee and further delay in issuance of analysis certificate by the Regulatory Authority resulted in exports of Rs. 5,493.449 million by the licencee without approved analysis certificate from 01.01.2015 to 20.06.2018, the period covered under the instant audit. This depicts weak internal controls and inefficiency.

(ii) M/s Zafar Fabrics was audited by the Department vide Audit Report No. 87/2020 and it revealed that the unit had consumed "Bituminous Coal" worth Rs. 68.081 million involving exemption of duty and taxes of Rs. 21.722 million in manufacturing of exported goods without obtaining analysis card (used in practice as equivalent of analysis certificate required by the Rules). However, the Department has made no efforts to regularize or recover the said amount of duties and taxes exempted in violation of the Rules. This depicts weak internal controls and inefficiency.

The Department replied as under:

- MCC Lahore informed, with references to relevant correspondence, that in case of M/s Hira Terry Mills, delay in issuance of analysis certificate was due to late issuance of IOR by IOCO; and

- MCC Faisalabad informed that in case of M/s Zafar Fabrics, the delay was due to late issuance of IOR by IOCO and that the Department had conducted the post exportation audit of the licencee and found that the input goods imported under concessionary SRO were exported / consumed as per approved input-output ratios. There was no loss of government exchequer, rather it was only a procedural violation. The contents of the observations had been noted for future compliance.

The DAC in its meeting held in March, 2022 settled that para to the extent of MCC Faisalabad on the basis of post exportation audit report of the Collectorate which has been verified by Audit. The DAC further directed the MCC Lahore to get the stated position verified within a period of 15 days and report progress.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Lahore-11 & Faisalabad-12]

4.1.5 Lack of sincere efforts to enhance exports under the Scheme through promotions, seminars and publications

Export Oriented Units and Small and Medium Enterprises Rules 2008 were introduced through SRO 327(I)/2008 to incentivize and encourage small and medium enterprises (SMEs) to become export oriented units.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCCs Lahore, Faisalabad and Sialkot, no concrete efforts are being made by the Department to promote the scheme for enhancement of exports among SMEs through any promotional activity, i.e., workshops, seminars and advertisements in print media. The Department was asked to provide details of efforts being made to enhance the numbers of licences and volume of exports under the Scheme but nothing was provided in response. Audit further observed that the total number of manufacturers-cum-exporters registered with Regional Tax Office Faisalabad – the target class for the EOU Scheme – is 2,224 units but only 33 units have so far availed the Scheme, i.e., only 1.5%. Even the licences that have actually been issued took 12 years in which only a handful of licences are issued in a year, as shown by the table below for MCCs Lahore and Sialkot.

	Licences Issued	
Year	**Lahore**	**Sialkot**
2008	6	3
2009	1	0
2010	0	0
2011	0	1
2012	0	0
2013	2	0
2014	3	0
2015	1	11
2016	1	4
2017	3	6
2018	3	2
2019	2	7

2020	2	3
Total	25	37

This depicted that the Department was apathetic towards promoting the Scheme among its target class and thereby achieving micro and macroeconomic objectives of the Scheme.

The Department replied that hectic efforts were being made to encourage the indigenous manufacturer-cum-exporters to get EOU licences so as to enhance the exports of the country. Different lectures and seminars had been conducted by the Collectorates where notable exporters were invited to these lectures.

The DAC in its meeting held in March, 2022 directed the Collectorate to enhance its outreach to the exporters for availing the EOU scheme.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Sialkot-16, Faisalabad-6 & Lahore-16]

4.1.6 Lack of skilled staff dealing with Export Oriented Units and Small and Medium Enterprises Rules 2008

Export Oriented Units and Small and Medium Enterprises Rules 2008 were introduced through SRO 327(I)/2008 to incentivize and encourage small and medium enterprises (SMEs) to become export oriented units. Further, Section 4 of FBR Act 2007 empowers the Board of Revenue to, among other things, improve the productivity of the Department through a comprehensive and effective human resource strategy and to identify and select through Internal Job Posting process the employees for designated jobs.

During the performance audit of the EOU Scheme for the FYs 2015-20, Audit requested the Department to provide details of qualification, training and specialty of the staff dealing with the EOU Scheme under the jurisdictions of MCCs Lahore, Faisalabad and Sialkot. However, the Department did not provide any reply with respect to any EOU-specific qualification, training or expertise. The Scheme deals with manufacturing units spread across the country, especially small and medium enterprises, is governed by its own special procedures and rules, and is not meant to extract revenue but to facilitate exports. The highly special nature of the Scheme requires that it should be implemented and facilitated by specially trained or designated staff dealing exclusively with

EOUs. Absence of specialized staff depicts weak internal controls and inefficiency.

The Department replied that lectures were arranged by the Collectorates to equip the staff with the latest developments made in the Manufacturing Bonds law. Technical aspects regarding timely issuance of licence, analysis card, monitoring of units, submission of monthly returns, and timely action upon violations were also delivered by the area experts. The Directorate of Training also arranged training programs from time to time in order to develop the working skills pertaining to the EOU matters.

The DAC in its meeting held in March, 2022 directed the Collectorates to post better staff for the audit of EOUs.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Lahore-7, Faisalabad-15 & Sialkot-17]

4.1.7 Noncompliance with procedures devised by the Board of Revenue

According to Federal Board of Revenue letter No. 5(8)EP/2014-163956-R dated 03.12.2014, input goods specifically endorsed by description and HS Code on the licences of Export Oriented Units are eligible for import under SRO.326(I)/2008 and SRO. 327(I)/2008 dated 29.03.2008.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCC Sialkot, guidelines issued vide above said Board's letter were not being followed and input goods were being mentioned on licence without complete description and HS Code. Imported input materials without requisite description open the Scheme to be misused by the units through importation of unapproved and wrongly described goods. This depicts weak internal controls and inefficiency.

The Department replied that Audit was conducted for the period of 2015-16 and 2016-17 and at that time only description was mentioned on the licence and it was mandatory to mention PCT heading on analysis certificate. In 2018, the importers were directed to feed description of input/output goods along with their HS Cods in WeBOC portal. At present Description and H.S Codes are mentioned on the licences.

The DAC in its meeting held in March, 2022 observed that an online system under EFS 2021 had been introduced by FBR and, as such, manual procedures had become redundant.

However, Audit is of the view that responsibility for lapses in the past should be fixed after holding an inquiry. Moreover, Audit recommends that the requirement to mention PCT headings of goods exported during the last two years may also be added to the application for authorization under EFS 2021 (specifically, in clause 7 of Appendix I to the SRO) in order to avoid the circumstances that necessitated the issuance of the aforementioned FBR letter No. 5(8)EP/2014-163956-R dated 03.12.2014.

[AO Nos. MCC Sialkot-8]

4.1.8 Non-existence of mechanism to ensure exclusive use of EOU premises

According to Rule 8 of SRO 327(I)/2008 dated 29.03.2017, the premises shall be used only and exclusively for the Export Oriented Unit; the premises shall have clearly earmarked area for storage of imported goods; the manufacturing area and separate stores for imported and locally procured input goods as well as finished goods, rejects and waste, shall be clearly earmarked in the premises; and the premises shall be located on an independent area having an independent entry or exit from a public area, having no other entry or exit and independent of such premises which are not covered under these rules.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCC Sialkot, no mechanism to ensure exclusive use of EOU premises had been devised by the Department. Audit observed that merely one visit at the time of grant of licence was made by the departmental officials. Audit further observed that in case of M/s GOC (Pvt) Ltd, machinery imported under the scheme was installed outside the EOU premises, i.e., in Saddra Badra, but the department remained oblivious of this fact for more than a year. Moreover, the department vides its letter C. No. V.Cus/Smb/EOU/418/20209432 dated 08.10.2020 also substantiated audit viewpoint as elaborated earlier. This depicts weak internal controls and inefficiency.

The Department replied that the importer was directed to provide detail of machinery installed at Sadra Badra. In response the unit informed that the said machinery was shifted from Sadra Badra to M/s GOC, Sialkot. Furthermore, the officers / officials visit the EOUs frequently to monitor the activities of the licencees.

The DAC in its meeting held in March, 2022 directed the Collectorate to submit physical verification report to the effect that machinery was installed at the declared premises for the consideration of the DAC in its next meeting.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO No. Sialkot-11]

4.2 Financial Management

4.2.1 Inadmissible exemption of duty and taxes on import of lubricating oil, etc. – Rs. 51.171 million

According to Rule 10(1) of SRO 327(I)/2008 dated 29.03.2017, the input goods for production of output goods according to the specification approved in the analysis certificate shall be procured by the licencee in the manner that the input goods may be imported by the licencee without payment of customs duty, sales tax, federal excise duty and income tax after declaring on the goods declaration that such input goods are being imported for export oriented unit for manufacture of export goods

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdictions of MCCs Lahore and Sialkot, the licencees of EOUs imported consignments containing lubricating oils, LED bulbs etc., by availing the benefit of the SRO. However, such benefit under this SRO was inadmissible because instant imported goods were neither of the two types of goods that could have been imported under this SRO: firstly, plant, machinery, equipment, apparatus, spares and capital goods and, secondly, input material for which analysis certificates were issued. This resulted in inadmissible exemption of duty and taxes of Rs. 51.171 million due to weak financial management by the Department.

The Department replied as under:

- MCC Sialkot informed that the EOU licencees imported machinery for manufacturing of goods under SRO 327(I)/2008 with accessories. The machine is accompanied by lubricating oil solely used for the machines imported under EOU licence. The lubricating oil is essential for running of these machines and these cannot be operationalized without these lubricating oils. It is pertinent to mention here that lubricant oil is imported as an essential part of the machinery and the PCT Heading of under reference goods are also approved in the licences.

- MCC Lahore replied that an amount of Rs. 2.69 million is recovered, Rs. 1.64 million is under recovery, Rs. 43.75 million is contested and Rs. 1.70 million is under litigation.

The DAC in its meeting held in March, 2022 settled the para to the extent of MCC Sialkot as the goods were imported under SRO 327(I)/2008 which does not bar importation of the goods under its any provision and the goods under reference were also mentioned on the EOU licence issued to the exporter. And as such entire amount of Rs.1.39 million is not due. The DAC further directed the MCC Lahore to get the above stated position regarding recovered, under recovery and contested amount verified from the Audit and pursue the case in the adjudication for early decision and report progress within 45 days.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[Annexure-1]

4.2.2 Non-recovery of government revenue on account of regulatory duty - Rs. 26.836 million

According to SRO 214(I)/2010, regulatory duty @ 5% was levied on pigment thickener and acrylic thickener.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that:

i. MCC Lahore did not assess and recover regulatory duty leviable on pigment thickener under the aforesaid SRO. This resulted in non-realization of government revenue of Rs. 1.332 million due to weak financial management by the Department.

ii. MCC Faisalabad assessed but short-collected regulatory duty leviable on pigment thickener and acrylic thickener under the aforesaid SRO. This resulted in non-recovery of government revenue of Rs. 25.505 million due to weak financial management by the Department.

The Department replied as under:

- MCC Lahore informed that Regulatory duty has been exempted to units licenced under Customs Act 1969 vide section 86(1) (b) & 86(2) of Customs Act 1969; and

- MCC Faisalabad replied that the licencees as pointed by the Audit had filed Writ Petition in the Honorable Lahore High Court against the recovery of the Regulatory Duty. Moreover the recovery is also stayed by the Honorable Court. This Collectorate has requested the registrar of the Honorable Lahore High Court Lahore vide letter C. No. 3535 dated 14.02.2022 for early disposal of the cases. In view of the above, this Collectorate is vigorously pursuing the case for an early finalization. The updated position will be shared with the Audit in due course of time.

The DAC in its meeting held in March, 2022 directed the MCC Lahore to get the stated position verified from Audit. The DAC further directed the MCC Faisalabad to pursue the matter in the High Court for early disposal of the writ petition filed by the EOU licencee and proceed further in the light of judgment of the Honorable court and report progress within 45 days.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[Annexure-2]

4.2.3 Non-realization of government revenue due to excess consumption of coal - Rs. 150.291 million

According to Rule 9(1) of SRO 327(I)/2008 dated 29.03.2008, the licencee shall apply to the Regulatory Authority, within seven days of import of input goods, for issuance of an analysis certificate as set out in Appendix-III showing the input and output ratio of input goods viz-a-viz output goods along with wastages. Further, Rule 9(2) provides that the Regulatory Authority shall after such verification as he deems necessary, or after getting inputs from the Input Output Co-efficient Organization (IOCO), or as the case may be, the Engineering Development Board (EDB), in this regard, issue an analysis certificate within thirty days of receipt of such application, showing the actual quantity of input goods used and wastage occurred in the manufacture of one unit of output goods.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCC Lahore, M/s Sapphire Finishing Mills Limited applied for analysis certificate on 26.11.2018 for use of coal in its manufacturing activities and claimed usage of 3.1275 kgs of coal for manufacturing of 01 kg dyed/processed fabric. However, IOCO approved analysis card allowing the unit usage of coal at 1.80 kg on production of 01 kg dyed/ processed fabric on 28.10.2020, after a delay of 703 days. Meanwhile, the unit imported 90,239 MT of coal and used it in manufacturing activity as per ratios submitted for approval of analysis certificate, resulting in usage of coal at a ratio that was 42.44% higher than the one approved later by the IOCO/Regulatory Authority. The excess usage of coal resulted in non-realization of government revenue of Rs. 150.291 million due to weak financial management by the Department.

The Collectorate informed that out of pointed out amount, an amount of Rs. 117.9 million has been recovered and verified by the Audit whereas remaining amount of Rs.32.3 million is under reconciliation.

The DAC in its meeting held in March, 2022 settled the para to the extent of recovered amount and directed the Collectorate to expedite reconciliation / recovery of the remaining amount and report progress within 45 days.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[Annexure-3]

4.2.4 Non-realization of regulatory duty - Rs. 2.419 million

According to Section 30 of the Customs Act 1969, in case of the goods illegally removed from the warehouse, the rate of duty shall be the rate prevalent either on the date of in-bonding or detection of case or date of payment of the duty and taxes, whichever is higher. Further, SROs 505(I)/2017, 1035(I)/2017 and 640(I)/2018 levied regulatory duty on different goods at the rates mentioned therein.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCC Faisalabad:

i. M/s Zafar Fabrics removed goods from the export oriented unit illegally upon which contravention was framed against the unit. Later on, the unit deposited leviable duties and taxes on goods illegally removed. However, while calculating duties and taxes due, the assessing staff did not assess regulatory duty leviable on the goods under the aforesaid SROs. The omission resulted in non-realization of regulatory duty of Rs. 2.006 million due to weak financial management by the Department.

ii. M/s Gulfaraz Fabrics removed goods from export oriented unit illegally upon which contravention was framed against the unit. Later on, the unit deposited leviable duties and taxes on goods illegally removed. However, while calculating duty and taxes due, the assessing staff short-assessed regulatory duty @ 2.5% instead of 5% under the aforesaid SROs. The omission resulted in non-realization of regulatory duty of Rs. 0.413 million due to weak financial management by the Department.

The Department replied that contravention for Rs. 2.01 million has been framed for adjudication, whereas, regulatory duty of Rs. 0.41 million is not leviable under SRO 327(I)/2008.

The DAC in its meeting held in March, 2022 directed the Department to pursue the case for early adjudication, besides getting the stated position verified from Audit in respect of contested amount.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[Annexure-4]

4.3 Monitoring and Evaluation

4.3.1 Non-monitoring of daily activity of export oriented units

According to Rule 14(1) of SRO 327(I)/2008 dated 29.03.2008, the licencee shall arrange or install in his export oriented unit such online automated system to record and display the details of input goods, manufactured goods, and output goods exported besides inventory position on daily basis as may enable the Regulatory Authority to monitor all the activity being done by him.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCCs Lahore, Faisalabad and Sialkot, none of export oriented units had arranged or installed such online automated system despite lapse of considerable time, i.e., twelve years after issuance of SRO 327(I)/2008 dated 29.03.2008. Due to non-fulfillment of this condition, the Regulatory Authority could not monitor the activity of the units on daily basis, indicating weaknesses in monitoring and oversight functions of the Department.

The Collectorate informed that as per system in vogue, the information regarding import material, its utilization in exports and subsequent exports is captured in the WeBOC system and is available to the Customs officers for monitoring and analysis. The rule referred to by the Audit which requires monitoring of daily activity pertains to the period prior to computerized environment/system developed by the Customs as WeBOC and as such activities of the EOUs are now monitored under the computerized system.

The DAC in its meeting held in March, 2022 directed the Collectorate to examine the rule No.14(1) with regard to its redundancy as elaborated above and send reference for the suitable change in the rule.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Faisalabad-1, Sialkot-2 & Lahore-2]

4.3.2 Non-existence of mechanism to ensure timely submission of monthly returns by Export Oriented Units

According to Rule 10(2) of SRO 327(I)/2008, the record of input goods, manufactured goods and output goods exported shall be maintained in the form as set out in Appendix-V to these rules, one copy of which shall be submitted to the Regulatory Authority before the tenth day of the following month.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCCs Faisalabad and Sialkot, no mechanism had been devised to collect and monitor monthly returns under the aforesaid Rule 10(2). Submission of monthly returns by the EOUs is an integral part of the Scheme to keep checks on manufacturers regarding evasion or mis-declaration. Absence of mechanism for submission and analysis of monthly returns depicts weaknesses in monitoring and oversight functions of the Department.

The Department replied that proper system has been devised for timely submission of Monthly Returns for Export Oriented Units by keeping computerized record of each unit. Moreover, if any unit violates the above said rule, it is served with a warning letter thereon.

The DAC in its meeting held in March, 2022 observed that the act of late filing of statements, etc. is duly penalized at the time of annual audit by the Collectorate.

However, Audit is of the view that responsibility should be fixed for lapses in the past after holding an inquiry. Audit further recommended that the Department should get the stated position verified from Audit by providing the latest three months indicating compliance with Rule 10(2) of SRO 327(I)/2008 by MCCs Sialkot and Faisalabad, or, if applicable, the new Rule 910 of the Customs Rules 2001 (prescribing submission of monthly returns by the Common Export House).

[AO Nos. Sialkot-9 & Faisalabad-14]

4.3.3 Undue delay in carrying out post-exportation audit of EOUs

According to Rule 14(2) of SRO 327(I)/2008 dated 29.03.2008, the liability of a licencee to pay duties and taxes under a security instrument furnished by him under these rules shall not be discharged unless post-exportation audit is carried out and completed to the satisfaction of the Regulatory Authority the end of every financial year.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCCs Lahore, Faisalabad and Sialkot, the post-exportation audit had not been conducted in 59 cases under the above quoted rule. The post-exportation audit as stipulated in Rule 14(2) is required to be conducted every year but audits of the units were pending with a delay ranging from 4 months to 10 years. This undue delay in conduct of post-exportation audit depicts weaknesses in monitoring and oversight functions of the Department.

The Departmental replies are as under;

- MCC Sialkot informed that post exportation audits were delayed due to provision of incomplete documents by the licencees. However, the post exportation audits of the units have been completed;

- MCC Faisalabad informed that Audit Management Cell has been established to expedite the Post Exportation Audit of the licencee as pointed out by the Audit. Monthly Audit schedule was issued to the Audit teams to expedite the post exportation audits. The Post Exportation Audit of the licencees as pointed by the Audit are completed; and

- MCC Appraisement Lahore informed that issue of delayed audits is under serious consideration and, upon order of the Chief Collector Customs, teams have been formulated in order to conduct audits of the licencees. Much of the audit work has been completed and the rest is being carried out vehemently. The Assistant Collector MBCO is observing the whole audit drive and progress in this regard is discussed on weekly basis. The audit work is expected to be completed soon.

The DAC in its meeting held in March, 2022 directed the Collector to ensure that audits are conducted and completed timely as prescribed under the law. The DAC further directed the remaining MCCs to ensure that audits are conducted and completed timely as prescribed under the law.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Sialkot-23, Faisalabad-3 & Lahore-5]

4.3.4 Misuse of EOU Licence to import machinery

According to Rule 8(2) of SRO 327(I)/2008 dated 29.03.2008, the premises shall be used only and exclusively for the Export Oriented Unit.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCC Sialkot, M/s GOC (Pvt) Ltd imported machinery worth Rs. 3,754 million from 01.03.2016 to 13.03.2017 and installed it somewhere at Saddra Badra, outside the area designated as EOU premises. The Department came to know this fact on 11.09.2017 while conducting post-exportation audit of the unit. The unit was given deadline to shift the machinery to the place designated for the EOU by 15.12.2017, but no further action or compliance has been reported in this connection. The machinery was allowed duty-free import under the EOU scheme for production of goods but such tactics deprive government of revenue without providing any benefit by way of exports. This depicts weaknesses in monitoring and oversight functions of the Department

The Department replied that the importer was directed to provide detail of machinery installed at Sadra Badra. In response the unit informed the said machinery was shifted from Sadra Badra to M/s GOC, Sialkot. Furthermore, the record has been scrutinized from which it transpires that no local sale has been made by the EOU licencee.

The DAC in its meeting held in March, 2022 directed the Collectorate to submit physical verification report to the effect that machinery has been installed at the declared premises for the consideration of the DAC in its next meeting.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Sialkot-7]

4.3.5 Loss of revenue due to misuse of EOU Licence to import capital goods - Rs. 72.041 million approx.

According to Rule 10(e) of SRO 327(I)/2008 dated 29.03.2008, the exemption from customs duty, sales tax, federal excise duty and income tax, shall also be applicable to plant, machinery, equipment and apparatus, including capital goods to be used solely within the limits of an Export Oriented Unit. Further, Rule 4 states that the licence may be cancelled by the Regulatory Authority on conviction of the licencee for any offence under any of the Acts.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCC Lahore, two EOUs imported capital goods, spares and replacement parts but did not utilize them within the premises of EOUs. The fact came to the knowledge of the Department when officials visited the manufacturing units but the Department did not initiate any action against the EOUs for this violation of the Rules. The misuse of the EOU licence resulted in loss of government revenue of Rs. 72.041 million approximately as detailed below, indicating weaknesses in monitoring and oversight functions of the Department.

(In Million)

S.No	Collectorate	Unit Name	Amount
1	Lahore Appraisement	Hira Terry Mills Limited	56.47
2	Lahore Appraisement	Taiga Apparel (Pvt) Ltd	15.57
Total			**72.04**

The Department replied that an amount of Rs. 2.24 million has been recovered, whereas, remaining amount is subjudice as party filed appeal in Appellate Tribunal.

The DAC in its meeting held in March, 2022 settled the para to the extent of recovered amount and directed the Collectorate to pursue the cases in the Customs Appellate Tribunal for early decision and report progress within 45 days.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[A.O. Nos. Lahore-6, 13 & 14]

4.3.6 Non-encashment of expired indemnity bonds

According to Rule 10(1)(a) of SRO 327(I)/2008 dated 29.03.2008, the input goods may be imported by the licencee without payment of customs duty, sales tax, federal excise duty and income tax after declaring on the goods declaration that such input goods are being imported for export oriented unit for manufacture of export goods. The amounts of customs duty, sales tax, federal excise duty and income tax involved on clearance of imported input goods shall be secured by the Regulatory Authority of the importing station against indemnity bond and post-dated cheque as set out in Appendix-IV. Further, Rule 12 provides that the input goods acquired under these rules shall be utilized in the manufacture and export of output goods within two years from the date of their import.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that:

a) MCC Faisalabad had not encashed 72 expired indemnity bonds which were obtained from the licencees of EOUs. This resulted into non-realization of government dues of Rs. 211.752 million, indicating weaknesses in monitoring and oversight functions of the Department.

b) MCC Sialkot had not encashed 459 expired guarantees which were obtained from the licencees of EOUs. This resulted into non-realization of government dues of Rs. 348.441 million, indicating weaknesses in monitoring and oversight functions of the Department.

The Department replied that securities involving Rs. 164.55 million have been released after due verification / post exportation audit whereas post exportation audits of the remaining amount are being finalized.

The DAC in its meeting held in March, 2022 directed the department to get the stated position verified from Audit. The DAC further directed the department to finalize post exportation audits in remaining cases.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[A.O. Nos. Faisalabad-4 & Sialkot-19]

4.3.7 Non-recovery of government revenue upon non-fulfillment of conditions of the EOU Scheme – Rs. 37.166 million

According to Rule 2(1)(d)(i) of SRO 327(I)/2008 dated 29.03.2008, the scheme of EOUs applies to export oriented units exporting at least 80% of their production to other countries if established before 1st July, 2007. Further, Section 202 of the Customs Act, 1969 read with Recovery Rules, 2001, when, under this Act or under any other law for the time being in force, which provides for any tax, duty or other levy being collected in the same manner as customs duties are collected, a penalty is adjudged against, or notice or demand is served upon, any person calling for the payment of any amount unpaid which may be payable by way of penalty or by way of duty, tax or other levy or under any bond/guarantee or other instrument executed under this Act or such other law or the rules made there under, the appropriate officer shall recover the government dues as per procedure given in rule and law.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCC Lahore, the EOU licence of M/s Kohinoor Mills Limited expired on 09.04.2010 but the EOU applied for renewal after eight years, which was duly granted along with raising a demand of Rs. 59.322 million on account of unconsumed quantities and machinery imported during the intervening period. However, the unit deposited only Rs. 22.156 million whereas, remaining amount of Rs. 37.166 million still outstanding. Further, the unit did not meet the requirement of exporting at least 80% of its production during the intervening eight years but the Department did not take any action against the unit for this violation. This depicts weaknesses in monitoring and oversight functions of the Department. Audit is of the view that the misuse of licence by the unit has been substantiated and action should be initiated against the unit under the law.

The Collectorate informed that out of pointed out amount, an amount of Rs. 9.68 million has been recovered and copy of challan provided to Audit whereas remaining amount of Rs.27.48 million is under adjudication.

The DAC in its meeting held in March, 2022 settled the para to the extent of recovered amount and directed the Collectorate to pursue the case and report progress within 45 days.

However, no compliance was reported to Audit till finalization of this report. Therefore, Audit recommends early compliance of above directives of the DAC.

[AO Nos. Lahore-15]

4.3.8 Inaction on poor performance and non-recovery of duties and taxes on unconsumed quantities - Rs. 16.575 million

According to Rule 4 of SRO 327(I)/2008 dated 29.03.2008, the EOU licence may be cancelled by the Regulatory Authority on conviction of the licencee for any offence under any of the Acts or non-utilization of the licence during the last twelve months or for violation of any of the conditions specified in the licence or on the request, in writing, by the licencee.

During the performance audit of the EOU Scheme for the FYs 2015-20, it was observed that under the jurisdiction of MCC Sialkot, M/s W. Brother was granted the EOU licence for the period 10.08.2015 to 09.10.2017. During the period, the unit imported input goods valuing Rs. 36.790 million through eight import GDs but exported goods only valuing Rs. 4.117 million through one shipping bill dated 10.05.2017. Nevertheless, the Department renewed the licence of the unit for another two years without considering the progress of the unit, that is, input material imported for export purpose had remained unconsumed for more than three years. The unit has made no import or export since 16.03.2018. However, no action has been taken by the department against the unit for cancellation of its EOU licence or recovery of duties and taxes on unconsumed quantities, amounting to Rs. 16.575 million. This depicts weaknesses in monitoring and oversight functions of the Department.

The Collectorate informed that the licence has been renewed for a further period of two years in the light of export performance. Furthermore, no unconsumed material is lying pending as the entire quantity has been re-exported and securities have been released.

The DAC in its meeting held in March, 2022 observed that post exportation audit of the unit has been conducted by the Collectorate and no irregularity has surfaced in the said audit. The copy of the report has been provided to the Audit.

However, Audit is of the view that exports GDs showing export from the EOU should be provided to verify the Department's stance.

[AO Nos. Sialkot-14]

4.4 Overall Assessment

In light of the audit findings above, the overall assessment of the EOU Scheme is provided under the following headings suggested by the Performance Audit Manual:

4.4.1 Relevance

The EOU Scheme fills an important gap in utilizing the export potential of Pakistan's economy as a third-world country, i.e., all manufacturing concerns of any size outside of export processing zones virtually dedicated to exporting their production. The Scheme is therefore highly relevant to incentivizing exports, increasing foreign exchange, improving trade balance and enhancing competitiveness of Pakistan's economy at the international level.

4.4.2 Efficacy

Since the Scheme is currently making a significant contribution to Pakistan's exports, it should have been adopted by the local industry soon after its inception in March 2008. However, the progress under the Scheme has been very slow and lacking efficacy. Overall, 175 EOU licences have been issued by the nine Collectorates across Pakistan over the last 12 years. This implies an average of only 1.6 licences per annum per Collectorate. The slow progress on issuance of licences is corroborated by the facts that: (1) so far, only 1.5% (33 out of 2,224) of registered manufacturer-cum-exporters in the jurisdiction of MCC Faisalabad have availed the EOU licence, and (2) the annual figures for MCCs Lahore and Sialkot, tabulated below, show that only a handful of licences are issued in any given year:

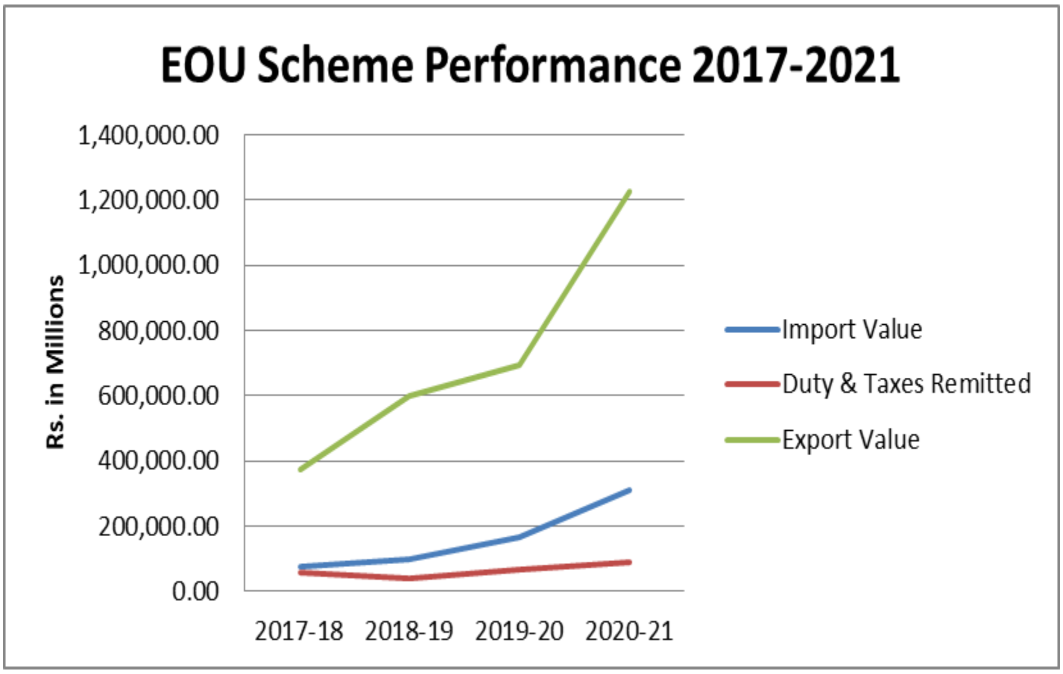
	Licences Issued	
Year	**Lahore**	**Sialkot**
2008	6	3
2009	1	0
2010	0	0
2011	0	1
2012	0	0
2013	2	0
2014	3	0
2015	1	11
2016	1	4
2017	3	6
2018	3	2
2019	2	7
2020	2	3
Total	25	37

4.4.3 Efficiency

The overall efficiency of the scheme is satisfactory as evident from following analysis. However, a number of allied issues that hinder efficiency have also been identified. These include extremely slow progress on issuance of licences, significant delays in issuance of analysis certificates and conduct of post-exportation audit, non-encashment of expired indemnity bonds, misuse of the EOU licence by the units, and non-monitoring of daily and monthly activity of the EOUs. Overall efficiency of the scheme can be gauged by the annual performance figures for 2017-2021 which are as follows:

				Rs. in Million		
Year	**Total Units**	**Opr.**	**Non-Opr.**	**Import Value**	**Duty & Taxes Remitted**	**Export Value**
2017-18	140	124	16	75,055.235	57,572.235	373,033.931
2018-19	151	132	19	97,544.902	37,881.885	598,861.954
2019-20	175	155	18	167,925.276	66,326.142	692,046.801
2020-21	226	207	19	308,879.004	87,687.018	1,227,959.458
4-year Multiple	x	x	X	4.12	1.52	3.30

The above table shows that while the primary cost of the scheme – the duties and taxes remitted has increased by a multiple of only 1.52, the value of imports under the scheme has increased by more than four times and the value of exports has increased by more than three times. The graph below represents the performance in the above table:



4.4.4 Economy

Although no special expenditure, training or promotions are being made by the Customs authorities to operate the EOU Scheme, Audit observed financial mismanagement depriving the public exchequer of Rs. 558,141,487 of government revenue. This is a very small percentage of the total amount of duties and taxes remitted under the Scheme during the FY 2019-20, i.e., Rs. 66,326.142 million, but it reflects poorly on the management by way of economy.

4.4.5 Effectiveness

In FY 2019-2020, there were 155 operational EOUs across Pakistan with an export volume of Rs. 692,046.80 million, which is 34.4 per cent of Pakistan's total exports of manufactured goods during the year, that is, Rs. 2,011,864 million, and 25.4% of Pakistan's total exports for the year, that is, Rs. 2,725,210 million. Further, the value of goods exported under the Scheme is more than four times the valued of duty/tax-free input goods imported. Similarly, duties and taxes remitted under the Scheme are only 12.7% of the net exports, which implies that the government is earning almost eight rupees worth of foreign exchange for every rupee of tax/duty revenue forgone, indicating a cost to benefit ratio of 1:8. Thus, from the monetary point of view, the Scheme is very effective.

However, judging the effectiveness of the Scheme from its publicly stated official objective of "facilitating the SME Exporters", it is noted with concern that out of a total of 95 EOU licencees at the three RTOs inspected, 15 (or 16%) were "limited", that is, public companies, while 27 were private limited companies and 53 appeared to be un-incorporated businesses. Of these 15 public limited companies, eight were in RTO Lahore and seven in RTO Faisalabad while there no was public limited company licenced by RTO Sialkot, as tabulated below:

Sr. No.	"Limited" company name	Collectorate Concerned
1	M/s. Arshad Corporation Pvt. Ltd., Jail Road, Faisalabad.	Faisalabad
2	M/s. Arzoo Textile Mills Ltd, Jaranawala Road, Khurrianwala, Faisalabad.	Faisalabad
3	M/s. Interloop Limited, Al Sadiq Plaza, P-157, Railway Road, Faisalabad.	Faisalabad
4	M/s. Kalash Ltd, Chak No. 117, JB. Dhanola Road Pahrang, Drainage, Millat Road, Faisalabad.	Faisalabad
5	M/s. Kamala Limited, 4-KM Jaranwala Road,	Faisalabad

	Khurrianwala, Faisalabad.	
6	M/s. Masood Textile Mills Ltd., Universal House, West Canal Road, Faisalabad.	Faisalabad
7	M/s. Sadaqat Limited, Sahianwala Road, Khurrianwala, Faisalabad.	Faisalabad
8	M/s. Kohinoor Mills Ltd.	Lahore
9	M/s. Indus Home Ltd.	Lahore
10	M/s. Sapphire Finiashing Mills Ltd.	Lahore
11	M/s. Nishat Mills Ltd.	Lahore
12	M/s. Nishat Chunian Ltd.	Lahore
13	M/s. Hira Terry Mills Ltd.	Lahore
14	M/s. Master Textile Mills Ltd.	Lahore
15	M/s. Service Global Footwear Ltd.	Lahore

These 16% public limited companies represent not only the shortfall on meeting the officially stated objective of facilitating the "SME Exporters" (which usually comprise private companies and un-incorporated businesses), but also undermines the overall effectiveness of the EOU Scheme.

4.4.6 Compliance with Rules

As noted above with regards to the efficiency of the Scheme, there has been very poor compliance with the applicable Rules. The most important provisions of the rules such as time limits for issuance of licences and analysis certificates, conduct of post-exportation audit and submission of applications for analysis certificates are not being strictly enforced. Similarly, monitoring of the units on a daily basis through an online automated system and on a monthly basis through filing of returns is also practically non-existent. In some cases, even expired indemnity bonds have not been encashed.

4.4.7 Performance Rating of the Scheme

Given the nature and design of the Scheme, it has been very effective in attracting a significant section of manufacturer-cum-exporters in Pakistan. However, it would have been more effective if it had not been extended to public limited companies. Moreover, the implementation of the Scheme has been quite slow, in-economic and highly inefficient. Thus, keeping in view the potential for further improvement through better promotion, facilitation and monitoring of the Scheme among SMEs, the overall performance rating of the Scheme is unsatisfactory.

4.4.8 Risk Rating of the Scheme

Audit found that, because of lack of monitoring of the EOUs in the prescribed manner, there is a high risk of misuse of the licence by the units who may be procuring their inputs and machinery free of duties and taxes but using them for production for the local market.

5. CONCLUSION

5.1 Key issues for future:

Audit identified the following key issues that have hampered and can continue to hamper the development and implementation of the EOU Scheme:

i. *Organization and Management:* Substantial and frequent delays on the part of the Customs authorities in the issuance of licences and analysis certificates to the EOU licencees are preventing the country from reaching its full exporting potential of manufactured goods. Further, the management has no policy or plans to either proactively promote the Scheme among the entire class of manufacturer-cum-exporters registered under the Sales Tax Act, 1990, or to dedicate exclusive staff and offices for the Scheme. This passive approach by the management is reflected in the erroneous use of special procedures prescribed for the Scheme to ensure consistency and compliance.

ii. *Financial Management:* In the absence of dedicated and trained staff and offices for the EOU Scheme, financial improprieties peculiar to the EOU licencees are frequently going unchecked despite the detailed procedures given in the governing Rules.

iii. *Monitoring and Evaluation:* Failure to enforce daily and monthly reports of EOUs and conduct their timely annual post-exportation audit has created an increasing risk of loss of government revenue through misuse of the EOU licence by the licencee, non-encashment of expired indemnity bonds and non-recovery of dues adjudged.

iv. *Overall Assessment:* Overall, the role of Customs authorities in implementation and further development of the EOU Scheme has not been as economical, efficient or effective as intended. Thus, the overall performance rating of the Scheme is unsatisfactory.

5.2 Lessons identified:

The EOU Scheme directly benefits local industry by giving exemptions from duties and taxes but indirectly benefits the Government by improving its trade balance and international economic position. General conclusions, both positive and negative, that can be lessons for similar schemes elsewhere, especially the new EFS 2021, are as under:

i. *Organization and Management:* When a Government scheme is meant to promote a commercial activity rather than extract revenue from it, it must be accompanied by detailed policies and plans to proactively promote the Scheme among the target class and implemented by dedicated and exclusive staff and offices.

ii. *Financial Management:* Compliance with all the rules with financial consequences under such a scheme can only be ensured through dedicated and exclusive staff and offices.

iii. *Monitoring and Evaluation:* Since the Government is giving sizeable relief to EOU licencees from taxes and duties only because of their ability to export their production, it should ensure that the licence is not misused in any way, shape or form for local sales. Perhaps the requirement of daily reporting is impractical and be done away with but obtaining monthly performance figures and conducting annual audit of the units is necessary to achieve the desired objectives and scope of the Scheme.

iv. *Overall Assessment:* A Government scheme for the benefit of the people can be reasonably effective because of its inherent appeal to the target class but still not be economical and efficient because of administrative lethargy and unjustified expansion of its scope.

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Annexure-1

4.2.1 Inadmissible exemption of duty and taxes on import of lubricating oil, etc. – Rs. 51.171 million

S. No.	Collectorate	Unit Name	GD No.	Date	Amount (Rs. in Millions)
1	Sialkot	AWAN SPORTS INDUSTRIES (PVT) LTD	SDRY-HC-394	20200218	0.34
2			SDRY-HC-551	20200611	0.18
3		CRESCENT BAHUMAN LIMITED	KAPR-HC-4369	20170116	0.13
4			KAPR-HC469	20170727	0.16
5			KEAP-ST-2799	20180516	0.16
6			KAPR-HC-4860	20180405	0.22
7			KAPR-ST-83	20180731	0.20
8	Lahore Appraisement	DIAMOND FABRICS LIMITED	KAPW-ST-77308	20200108	0.83
9		H. SHEIKH NOOR-UD-DIN & SONS (PVT.) LIMITED	KEAP-ST-382	20160831	1.77
10		INDUS HOME LIMITED	KAPR-ST-2143	20170317	0.18
11		M/S STYLE TEXTILE (PVT) LTD.	KAPE-ST-147805	20190313	3.07
12			KAPE-ST-182525	20190507	3.16
13			KAPW-ST-161012	20190510	1.10
14			KAPW-ST-161017	20190510	0.00
15			KAPE-ST-39513	20190917	3.95
16			KAPRE-ST-82619	20191204	4.08
17			KAPE-ST-131533	20200219	3.94
18			KAPE-ST-43721	20190925	1.12
19			KAPE-ST-104798	20200109	2.37
20			KAPE-ST-104798	20200109	4.73
21			KAPE-ST-104798	20200109	6.24

22			KAPE-ST-104798	20200109	4.57
23		NISHAT (CHUNIAN) LIMITED	LPAF-IB-41610	20190502	0.45
24			LPFI-IB-11620	20191029	0.00
25			LPAF-IB-44842	20200612	0.01
26			LPAF-IB-32110	20200206	0.31
27		NISHAT MILLS LIMITED	LPAF-IB-15269	20171009	0.19
28			KAPW-ST-133973	20190313	0.01
29			KAPW-ST-145860	20190409	0.57
30			LPFI-IB-28530	20200420	0.08
31			KAPR-ST-207	20170725	1.78
32			KAPR-ST-745	20170929	0.31
33			KAPR-ST-2806	20180630	0.19
34			KAPR-ST-2806	20180630	0.08
35			KAPR-ST-307	20160817	0.14
36			LPAF-IB-25091	20171212	0.12
37			LPAF-IB-27407	20190123	0.09
38			KAPW-ST-133973	20190313	0.22
39			LPAF-IB-39056	20190415	0.11
40			LPAF-IB-9880	20190913	0.12
41			LPAF-IB-32714	20200210	0.14
42			LPAF-IB-26436	20190116	0.22
43			KAPR-ST-899	20171025	0.13
44			LPAF-IB-3235	20170721	0.07
45		TAIGA APPAREL (PRIVATE) LIMITED	LPAF-IB-19508	20171103	1.03
46			KAPR-ST-882	20161031	1.10
47			KAPR-ST-1966	20170221	0.61
48			KEAP-ST-2129	20170420	0.58
Total					**51.17**

[AO Nos. Lahore-8 & Sialkot-1 & 10]

Annexure-2

4.2.2 Non-recovery of government revenue on account of regulatory duty - Rs. 26.836 million

S. No	Collectorate	Unit Name	Amount (Rs. in Millions)
1	Faisalabad Appraisement	M/s Sadaqat Limited	5.91
2	Faisalabad Appraisement	M/s Abdur Rehman Corp	0.49
3	Faisalabad Appraisement	M/s Bismillah Textile	1.25
4	Faisalabad Appraisement	M/s Kamal Limited	5.87
5	Faisalabad Appraisement	M/s Kamal Textile	1.77
6	Faisalabad Appraisement	M/s Magna Processing Industries	2.07
7	Faisalabad Appraisement	M/s Noor Fatima Textile	0.64
8	Faisalabad Appraisement	M/s Dawood Exports (Pvt) Ltd	5.02
9	Faisalabad Appraisement	M/s Niagra Mills (Pvt) Ltd	2.50
10	Lahore Appraisement	NISHAT MILLS LIMITED	0.11
11	Lahore Appraisement	NISHAT MILLS LIMITED	0.11
12	Lahore Appraisement	NISHAT MILLS LIMITED	0.11
13	Lahore Appraisement	NISHAT MILLS LIMITED	0.11
14	Lahore Appraisement	NISHAT MILLS LIMITED	0.17
15	Lahore Appraisement	NISHAT MILLS LIMITED	0.05
16	Lahore Appraisement	NISHAT MILLS LIMITED	0.11
17	Lahore Appraisement	NISHAT MILLS LIMITED	0.11
18	Lahore Appraisement	NISHAT MILLS LIMITED	0.22
19	Lahore Appraisement	NISHAT MILLS LIMITED	0.22
Total			**26.84**

[AO Nos. MCC Lahore-9 & Faisalabad-16]

Annexure-3

4.2.3 Non-realization of government revenue due to excess consumption of coal - Rs. 150.291 million

(In Million)

S. No.	Collectorate	Unit Name	GD No	Date	Amount (Rs. in Millions)
1	Lahore Appraisement	SAPPHIRE FINISHING MILLS LIMITED	PQIB-ST-3705	20180915	12.84
2			PQIB-ST-6340	20181114	1.96
3			PQIB-ST-6815	20181126	4.85
4			PQIB-ST-8092	20181217	3.57
5			PQIB-ST-9293	20190108	7.31
6			PQIB-ST-11328	20190215	5.98
7			PQIB-ST-11953	20190227	9.80
8			PQIB-ST-12152	20190302	2.77
9			PQIB-ST-13338	20190326	10.64
10			PQIB-ST-14892	20190426	6.59
11			PQIB-ST-18028	20190627	17.45
12			PQIB-ST-3173	20190913	0.02
13			PQIB-ST-3173	20190913	10.68
14			PQIB-ST-4950	20191017	9.97
15			PQIB-ST-8646	20191220	0.03
16			PQIB-ST-8646	20191220	8.30
17			PQIB-ST-8897	20191226	0.10
18			PQIB-ST-8897	20191226	9.58
19			PQIB-ST-9026	20191227	0.04
20			PQIB-ST-9026	20191227	8.65
21			PQIB-ST-12375	20200303	0.71
22			PQIB-ST-12375	20200303	18.45
Total					**150.29**

[AO Nos. Lahore-01]

Annexure-4

4.2.4 Non-realization of regulatory duty - Rs. 2.419 million

S. No.	Collectorate	Unit Name	GD#	Date	Amount (Rs. in Millions)
1	Faisalabad Appraisement	ZAFAR FABRICS (PVT) LIMITED	KEAP-ST-624	20161007	0.09
2			KEAP-ST-627	20161007	0.18
3			KEAP-ST-762	20161028	0.18
4			KEAP-ST-763	20161028	0.18
5			KEAP-ST-764	20161028	0.18
6			KEAP-ST-1577	20170204	0.19
7			KEAP-ST-1578	20170204	0.19
8			KEAP-ST-1587	20170206	0.19
9			KEAP-ST-1633	20170210	0.61
10		Gulfraz Fabrics	KEAP-ST-1897	06.02.2018	0.08
11			KEAP-ST-2951	31.05.2018	0.16
12			KEAP-ST-2998	05.06.2018	0.17
Total					**2.42**

[AO Nos. Faisalabad-7 & 9]