

Tax Services
Worldtrade Management Services

Establishing and managing a Customs Centre of Excellence in China



It is now common for foreign invested enterprises (“FIE”) engaged in manufacturing to have anything from 5 to 25 site locations across China. FIEs engaged in trading and distribution are now dispensing with intermediary Import/Export company and importing/exporting direct.

As a consequence, FIEs, particularly those engaged in manufacturing across multiple locations are establishing and managing a Customs Centre of Excellence (“Customs COE”) in China in order to effectively manage the customs function. This article assesses the challenges that exist in setting up such a centre and the best-in-class practices that are being adopted.

Why does the Customs function need to be managed?

The regulatory environment in China is complex and continually evolving. The decentralised structure of the Customs authority leaves scope for local interpretation, which results in a gap between the national regulations and the local practices. For example, standard operating practice in Processing Trade is different in Southern China compared to the rest of the country. Meanwhile, business models typically evolve at a much faster pace than the rules themselves.

China Customs is a revenue-driven authority. In order to meet the revenue target set by the central government, Customs is employing all kinds of supervision means to ensure customs duty and import VAT collection, including post-importation audits. The closest scrutiny is given to such areas as customs valuation of related party transactions and the handbook operation of companies engaged in Processing Trade. Consequently, customs duty, consumption tax, and import VAT can form a significant cost in the supply-chain.

Core customs competencies, such as product tariff classification, impacts business at both strategic and operational levels. This is because the government implements certain economic and environmental policies by use of HS Codes, for example, the Prohibition and Restricted Lists for Processing Trade, and export VAT refund rates. So, incorrect classification can have a significant negative impact where for example it determines whether or not a business can engage in bonded manufacturing and what amount of export VAT refund it can claim.

Why has the Customs function not been managed well to date?

You would think therefore that given these diverse and significant risks and potential lost opportunities that companies would have developed adequate resources and centres of excellence to manage the customs function but this is far from reality. There are many reasons for this and some are specific to China and its environment.

For example, many multi-site companies have grown rapidly, often through acquisition or joint ventures, yet have failed to capitalise on pooling their increased customs resources or sharing of customs knowledge and systems/processes. Organisations with a strong business unit level culture of independence often suffer similarly. Multinationals who have entered into joint ventures or have acquired local Chinese businesses often inherit flawed customs practices or under-resourced customs functions and either do not have the knowhow to put things right or encounter significant resistance to change.

Even when a company wakes up to the benefits of setting up a CCOE there are many challenges to face and decisions to be made. Is the current headcount of customs resources sufficient? Should they be centralised or layered in terms of focus and business unit interface and who should they report to? The point at which companies realise they need to change varies considerably.

Although it is not always widely known, those current Customs best-in-class companies typically started from a low baseline. In many cases, they have been subject to Customs investigations even leading to the temporary detention of management and employees. Significant financial, operational and reputation exposure resulted. Thus, managing the customs function found its way onto the agenda of executive management. As a consequence, new resources were allocated to establish and manage a Customs COE and to attain alignment with an overall corporate governance program.

How should I structure my Customs COE?

This will depend greatly on the nature of your particular business and “customs” footprint and the objectives of the Customs COE based on the general business and regulatory environment. In our experience a best-in-class Customs COE will have the following objectives:

- Creating **value** through structuring and implementing smart customs planning strategies that are aligned to the direction of the business; and
- Proactively ensuring high levels of customs **compliance** through self-assessment, advance rulings etc.; and
- Managing **risk** by having a robust defence to resolve customs audits and investigations

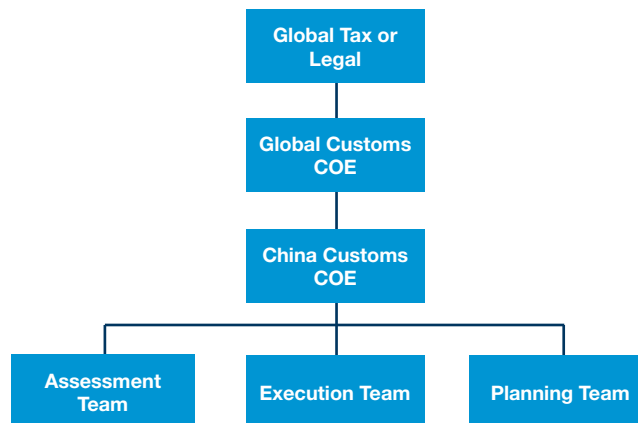
An effective Customs COE should achieve adequate balance between these three objectives.

From an organisational viewpoint the Customs COE can fall under either of the following:

- Operations; or
- Logistics/supply-chain; or
- Finance; or
- Legal; or
- Tax

Based on our experience the Customs COE should be structured under Legal or Tax function independently from day-to-day Customs operations. The Customs COE in a regional shared service mode in a multi-site manufacturing enterprise may have a head count of anything from 5 to 20 people, again, depending on the nature of the business footprint and objectives, and the regulatory environment. People responsible for day-to-day compliance at a site level would typically still have “straight line” reporting into the local entity management as the Customs COE is independent from operations.

A best-in-class Customs COE team often looks like the following:



Delivery of value, compliance and risk management within a China context

Obviously, different businesses will do things in different ways to suit their specific practices and corporate culture. The above chart sets out the structure of a typical best-in-class Customs COE. The Customs COE can be expanded to include Trade Compliance (export licensing, denied parties etc) and supply-chain security (C-TPAT, AEO etc).

A best-in-class COE will recruit personnel from diversified backgrounds with knowledge and practical experience in Processing Trade, General Trade, bonded zones, duty exemptions and reductions, foreign exchange controls, VAT refunds, internal audit and process improvement, logistics, supply-chain management etc. Personnel may come from industry, services providers such as 3PLs, customs brokers or consultancies, as well as government.

COE sub-teams and their role:

- The Assessment Team would focus on matters such as:
 - Conducting “simulated customs audits”
 - Identifying risks and gaps in policies and procedures
 - Recommending corrective action
 - Ensuring that corrective action is implemented

- The Planning Team would focus on matters such as:
 - Upgrading the Category local sites from say Category “B” to Category “A”
 - Upgrading the Customs Handbook from ‘manual’ to say ‘e-account handbook’
 - Optimizing the use of bonded zones in the supply-chain
 - Optimizing the use of preferential Free Trade Agreements
 - Implementing paperless customs clearance
 - Optimizing new structures and business models
 - Securing Customs and other government concessions related to trade
 - Facilitating consultation and discussion between the local site and the COE

- The Execution Team(s) would focus on matters such as:
 - Evaluating new regulations for daily business practice and application
 - Providing awareness building and compliance training
 - Delivering internal customs and trade updates
 - Developing and implementing standard procedures and processes
 - Establishing performance metrics
 - Developing company wise ePlatform for data auto exchange between ERP and Customs system for handbook reconciliation purpose
 - Managing Customs Broker and 3PL (optional)
 - Monitoring Export Compliance and Supply Chain Security (additional)

Additional teams could be created if the COE included Export Compliance and supply-chain security. Export Compliance would also include programs for: periodic self-assessment and follow-up on corrective action; developing processes for ECCN classification and license checking, denied party screening, license applications etc; training; timely updates on the latest regulations etc for US export control and Hong Kong TID dual-use control. Supply-chain security would focus on C-TPAT and AEO compliance, site-visits and accreditation etc.

The local site employees that are responsible for day-to-day activities will typically report to the local logistics manager and may be organised around the following functional activities:

- Customs Handbook for Processing Trade (registration, usage, balancing, cancelling)
- General import and export declarations and duty payments
- Other (duty-free capital equipment, returns to vendors, used capital equipment)

What needs to be managed?

The above structure and resources can enable the Customs COE to deliver value, compliance and manage risk for the business. Clearly, what specifically needs to be managed is very dependent upon the business footprint. A high-level summary of some of the most important areas to manage under different business footprints is set out as follows:

Area	Activity Type			
	Bonded Manufacturing	Importing & Distributing	Sourcing & Exporting	Regional Distribution
Customs handbook	√			
Duty exemptions	√			
Prohibition List	√			
Restricted List	√			
Bonded transfers	√			
Bonded zones	√			√
Bonded warehousing	√			√
VAT refunds	√		√	√
Customs valuation	√	√	√	√
Tariff classification	√	√	√	√
Country of origin	√	√	√	√
Foreign exchange	√	√	√	√
Miscellaneous Trade	√	√		√
Trade Compliance	√	√	√	√
Supply-chain security	√		√	√
Import/export licenses		√	√	√
Knowledge	√	√	√	√
Training	√	√		
Record keeping	√	√		√
Customs Brokers	√	√	√	√
Audit/investigations	√	√	√	√

What are some of the tools for the job?

For the Customs COE to be effective and to attain its objectives, the different teams will need different tools for the job. In the case of the compliance team for example, this would consist of: pre-questionnaires, document request lists, sampling methodologies, standard assessment reporting formats and a compliance rating system and gap analysis reporting on follow-up action items. The planning team, on the other hand would need access to global/regional/country regulations, be linked into management strategic planning and plant management activities, developing business modeling tools etc.

Use of technology

An investment in technology is essential in order to enable the Customs COE to be streamlined and deliver across a large territory with some degree of automation. At a simple level, standard operating policies, procedures and work instructions, forms, templates, records, papers and journals can all be uploaded to a dedicated intranet set. Training to executive management and operational staff can also be delivered on-line through use of a “virtual classroom” etc.

Summary

Attaining customs compliance, audit and investigation defence, and customs planning is arguably a far greater challenge in China than in most countries.

The above article is intended to be ‘food for thought’ and has been written based on our collective experience over a number of years. The focus of the article is on how to make the customs function in China most effective. Above all, communication and collaboration between the Customs COE and the local site stakeholders is fundamental to success.

On a final note, performance metrics should also be set for the Customs COE itself. As mentioned above, different businesses will approach this differently. Metrics may be based on operational reports from local site entities about breaches of the rules and assessment notices, collection of cash deposits by Customs, timeframe within which audits are resolved, reduction of customs duty costs, and cost avoidance through better compliance.

The team at PricewaterhouseCoopers assists companies to design, establish and manage the customs function, including trade compliance and supply-chain security. We do this for enterprises engaged in manufacturing, trading, sourcing and regional distribution.



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