

Tax Services
Worldtrade Management Services

Customs Handbook Management



In China, approximately 45% of all imports/exports fall under Processing Trade. The main supervision and control tool of the Customs authority is the Customs Handbook. Companies engaged in Processing Trade that cannot reconcile and balance the Customs Handbook can face allegations of “smuggling”. At some point, the Customs authority will initiate an audit, the results of which can consist of duty assessments (including interest), financial penalty, a downgrading in enterprise classification, and the suspension of new Customs Handbook issuance.

This article assesses the challenges that exist in Customs Handbook Management and the measures that can be taken in order to mitigate the materiality of the imbalance.

Performance Benchmarking

In order to validate the challenges that companies face in Customs Handbook reconciliation and balancing, PricewaterhouseCoopers has undertaken a benchmarking study based on the following methodology and information sources:

- An examination of the applicable Processing Trade rules and regulations
- A compilation of PwC practical experience over the past 5 years with regional and local Customs in Southern, Central and Northern China
- A survey of over 100 companies with the following characteristics:

Enterprise Profile	Finding
Location	Inside or outside of a bonded zone Southern, Central or Northern China
Sector and Size	Tech, chemical, auto, and industrial sectors Anything from 500 to 5,000 employees
Operating Model	Toll manufacturing or contract manufacturing Supplying both the export and domestic market Fully bonded or semi bonded
Supervision & Control	Operating paper-based or electronic Customs Handbooks Enterprise classification from “AA” to “C”

The study revealed that all companies experience difficulties in Customs Handbook reconciliation and balancing. The reasons for imbalance are wide and varied and these are discussed in further detail below. The study concluded that a KPI of “Customs Handbook balance” is difficult to achieve unless the company has a very robust internal compliance and supply chain operations process and automated platform linked between internal MRP and Customs H2000 system.. Rather, a more attainable KPI is to achieve an imbalance that is within the acceptable threshold or tolerance of the local in-charge Customs and to ensure that controls and procedures are in place to safeguard against a serious violation of the rules.



Why does the Customs Handbook not balance?

The reasons for Customs Handbook imbalance vary case-by-case. A summary of the more common reasons is set out below.

Parallel Systems

Two systems - the ERP system and the customs handbook system - are running in parallel. When comparing the two systems the results are typically as follows:

ERP = Physical Inventory

ERP ≠ Customs Handbook

Customs Handbook ≠ Physical Inventory

The ERP system is usually an accurate and reliable record. It is the customs handbook system that tends not to reconcile with either the ERP system or the physical inventory. This is because the ERP system more accurately reflects the actual operating activities on a real-time basis. This is often not the case with the customs handbook system. However, as the customs handbook is the primary tool used by the Customs authority for exercising supervision and control over a bonded operation, Customs auditors will rely upon the customs handbook system.

Operating Mode

As a first step towards identifying the reasons for imbalance, it is important to validate whether a fully bonded or semi bonded operating model has been implemented.

- Fully bonded

The imported raw materials are all declared under bonded status and recorded into the e-handbook. This is despite the fact that after manufacturing the finished products may be sold on either the export or the domestic market. The whole manufacturing process and all of finished products are in bonded status. Customs duty and import VAT will be levied if the finished product is sold to the domestic market. No duties are levied on exported finished product.

- Semi bonded

When the company imports raw materials, they should decide what quantity will be used for export and domestic sales respectively. If the raw materials are for domestic sales, they will be imported under General Trade, with customs duty and import VAT paid. If the raw materials are for export sales, they will be imported under Processing Trade and bonded. Bonded finished products can be sold domestically, subject to obtaining pre-approval from MOFCOM/Customs and paying customs duty and import VAT on the imported materials.

Categories of typical route causes of imbalance

Once the operating model is known, a review of the potential route causes can take place. The main categories of typical route causes are listed below:

Category of typical route causes of imbalance
1. Bill of Materials (BOM)
2. So-called “grouping” of product information
3. Inward material handling
4. Cross-over (RM and at ‘supermarket’ level)
5. Scrap
6. Outsourced processing
7. Domestic sales
8. Finished product handling
9. Type of Customs Handbook
10. Other miscellaneous factors

As can be seen from above, there are 10 general categories. Within these general categories there are approximately 20 common route causes. Most route causes arise regardless of the operating model, except for “cross-over” which is more prominent when operating a semi bonded model or when using multiple contract specific paper handbooks.

What are the implications of Customs Handbook imbalance?

The implications of Customs Handbook imbalance vary depending on factors such as the nature of the route cause(s), materiality of the imbalance, nature of the imbalance (i.e. ‘surplus’ and/or ‘deficit’), enterprise classification status etc. The implications can consist of any or all of the following:

- Additional customs duty and import VAT assessment (including interest)
- Financial penalty based on the amount of underpaid duties or goods value
- A downgrading in enterprise classification (e.g. Category A to B)
- The suspension of bonded manufacturing
- The suspension of new Customs Handbook issuance
- Additional cash deposits to be paid to Customs
- More intensive goods and documentation inspection by Customs
- More frequent post-importation audit by Customs

What measures can be adopted to reduce the materiality of the imbalance?

A more attainable KPI for handbook balance is to achieve an imbalance that is within the acceptable threshold of the local in-charge Customs and to ensure that controls and procedures are in place to safeguard against a serious violation of the rules. A “best effort” approach is required. For example:

- Key areas for best-in-class operating practice:
 - Using an updated BOM and “fully-exploded” BOM, that includes engineering changes
 - Frequently completing self-assessments and avoiding a “snowball” effect
 - Declaring over shipments / under shipments and returns to vendor in a timely fashion
 - Upgrading from multiple paper handbooks to a single e-account handbook
- Key areas to control to safeguard against a serious violation:
 - Outsourced processing
 - Domestic sales
 - Cross-over
 - Disposal of scrap and waste

Summary and Outlook

All enterprises experience difficulties in Customs Handbook reconciliation and balancing. The reasons for imbalance are wide and varied. Attaining “balance” of the customs handbook is simply unrealistic. A more attainable KPI is to achieve an imbalance that is within the acceptable threshold of the local in-charge Customs and to ensure that controls and procedures are in place to safeguard against a serious violation of the rules.

Some enterprises, particularly those with multiple site locations and complex manufacturing supply-chains, are initiating a dialogue with the Customs authority to discuss whether supervision and control could be based more on the ERP system and less on the customs handbook system. For certain industry sectors, such as chemicals, new customized e-account handbook software is also being developed. Clearly, any progress in these areas would be welcomed.

As of now, some local service providers are offering automated solutions such as: automatic creation of import and export declaration (“e-Declaration”); the automated linking and discrepancy reporting of inventory in the ERP system and the customs handbook system; and an automated process for extracting data from ERP and generating scrap declaration reports.

The team at PricewaterhouseCoopers assists companies to better manage the customs handbook through conducting compliance reviews, assisting with voluntary disclosures, designing new processes, implementing new procedures, and conducting training for employees.

Contacts



Colbert Lam

Partner

colbert.ky.lam@hk.pwc.com

Damon Paling

Partner

damon.ross.paling@cn.pwc.com

Susan Ju

Director

susan.ju@hk.pwc.com

Michael Jiang

Director

michael.h.jiang@cn.pwc.com

pwccn.com

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