

Intermediate Agency Customs Audits



Background

China, as we all know, has experienced phenomenal and unprecedented growth in the volume of imports and exports since accession to the World Trade Organisation in 2001.

The Customs authority, an organisation of about 48,000 officers, is tasked with multiple and often competing objectives. These objectives include the enforcement of customs laws as well the facilitation of legitimate trade. Of particular note is that the revenue collection target of the Customs authority over the past 7 years has increased year-on-year at about a rate of 11%. The revenue collected by Customs, when including customs duty, consumption tax and import VAT accounts for approximately 23% of total government revenue collection.

Since 2006, in order to enforce customs laws and meet revenue collection targets, the Customs authority has been trialling on a pilot basis the use of intermediate agencies – typically local CPA auditing firms – to conduct customs audits.

Customs has been holding meetings with interested parties in selected cities. PricewaterhouseCoopers has joined and participated in several of these meetings. A so-called recommended list of auditing companies will be built to conduct audits of companies engaged in Processing Trade and General Trade.



General Principles

Based on practical experiences during the trial period, the general principles of intermediary agency audit are summarised as follows:

- The Customs authority solicits, then reviews and approves qualifying audit firms. Relevant criterion has included information of auditing firm size, qualification, fee estimation, business license and reputation with government.

- The Customs authority will provide some training to the auditing firm.

- The Customs authority profiles and determines which companies will be subject to a customs audit.

- The Customs authority refers the recommended list and contacts an approved auditing firm for assistance in conducting a customs audit. The approved auditing firm reserves the right to accept or decline the request of the Customs.

- The fees of the local auditing firm may be paid by the Customs authority, the company selected for audit or a combination of the two.

- The local auditing firm conducts the audit – typically on-site over period of several days – and then produces a short report of findings to the local in charge Customs.

- The local in-charge Customs work with the company to conduct further checks and validate the findings. The local in-charge Customs will discuss non-compliance issues directly with the company, including the assessment of customs duties, interest, financial penalty and taking of corrective action.

Latest Developments – Circular [2008] 181

The GAC recently issued an internal circular 181/2008, under which five Customs (Tianjin, Shanghai, Qingdao, Wuhan and Guangzhou) were selected to apply the above principles on a trial basis. Under the trial, the intermediary agencies can provide the following three types of services:

- The intermediary agencies to be fully or partially engaged in a customs audit to work at the site of the company that is subject to a customs audit. Under this scenario, the intermediary agencies will be engaged by Customs and Customs will bear the professional fee. Accordingly, the audit report concluded by the intermediary agencies should be delivered to Customs.
- The intermediary agencies are requested to provide technical support to Customs during an audit. Under this scenario, the intermediary agencies will be engaged by Customs and Customs will bear the professional fee. The difference between (a) and (b) is that under (b), the intermediary agencies will provide service “behind the scene”, that is to say that the intermediary agencies will have no interface with the company under customs audit.
- Upon Customs’ consent, the company that is under customs audit can engage the intermediary agencies to provide an additional audit service in order to respond to Customs’ requirements. Under this scenario, the intermediary agencies will be paid by the company who engages them.

This will apply to the below scenarios:

- The annual audit report requested by Customs for the assessment of a company this is classified as “AA” grade;
- The companies other than “AA” grade who are under customs audit can apply to Customs for approval to engage an audit firm to conduct a self-review process and submit the audit report prepared by the audit firm for Customs review; and
- If the company under customs audit has already engaged an audit firm to conduct the self-review before receiving the Customs Audit Notice, it is possible for the company just submit the audit conclusion drawn by the audit firm to Customs for review.

In any one of the scenarios mentioned above, if Customs can accept the audit report/conclusion prepared by the audit firm after review, they may close the audit case without triggering further on-site review.

Circular 181/2008 also introduces the following mechanism for employing external audit resources:

- In order to solicit, review, and approve the qualifying audit firms at a national level and at a local level, GAC will establish a recommended list of the audit firms at a national level; while the regional Customs headquarters will also have its recommended list at a local level.
- To renew and update the qualifying audit firms on a timely basis so as to remove those unqualified ones from the recommended list.

Pending Issues

The current trial of intermediary agency customs audits has been underway for approximately 2 years. Based on our research and understanding from both local in-charge Customs as well as the General Administration of Customs, the following issues are currently pending:

1. Who and how to pay for the service provided by the intermediary agency?

2. Whether Customs' powers in conducting customs audits can be extended to the external intermediary agency?

We also understand that recently there has been a break on funding, except for bonded goods, where we believe that the Processing Trade Division has successfully obtained additional budget approval.



Outlook

Clearly, without a long term solution to the above two issues, it is difficult for Customs to expand the pilot and make the program permanent. The funding that has been secured can support the continued audit by intermediary agencies of companies that are engaged in Processing Trade. However, these Processing Trade intermediary agency audits are likely to be patchy in nature given the funding constraints.

Nevertheless, we still expect other divisions in Customs, such as the Audit Division, to also seek special funding from the Ministry of Finance to employ external intermediary agencies conducting customs audits.

With whatever funding is obtained, we expect local in-charge Customs to continue the pilot phase to the extent that financial resources permit. Those intermediary agencies that perform the audit for the lowest fee are more likely to be used by the Customs authority to conduct the audit.

Once the above issues are resolved, we expect that the GAC will issue a more comprehensive rule regarding intermediary agency audit.

Prudential customs audit is another approach that could be adopted in addition to intermediary agency customs audit. This may evolve in China in medium term but is unlikely to be rolled out in the short-term.

Best-in-Class Practice

Companies that are selected for an audit that is conducted by an intermediary agency are encouraged to respond in a way that would normally be adopted for a normal customs audit conducted by Customs Officers. Standard operating procedures should exist and training of management of employees should have taken place so that audits can be properly managed and resolved.

With a view to managing customs compliance in China, companies should implement a routine self assessment program whereby a proactive review of customs-related operations is undertaken in order to establish current levels of compliance and initiate necessary corrective actions. Voluntary disclosures can be considered on a case-by-case basis as appropriate.



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