

CHINA: INTERMEDIATE AGENCY CUSTOMS AUDITS

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Abstract

Over the past few years, the responsibilities and tasks of the China Customs authority have increased significantly and this has placed great strain on the authority itself and its control mechanisms. Since 2006, in order to maintain enforcement of customs laws and meet revenue collection targets, Customs has been trialling the use of intermediate agencies to conduct customs audits of import/export organisations. A brief summary of the general principles that have been developed and two issues that are pending are identified in this article.

Introduction

The China Customs authority, an organisation of some 48,000 officers, is tasked with overseeing those imports and exports which involve multiple and often competing objectives including the enforcement of customs laws and the facilitation of legitimate trade. Of particular note is that the revenue collection target of Customs over the past seven years has increased annually at a rate of about 11 per cent. The revenue collected by Customs, including customs duty, consumption tax and import VAT, accounts for approximately 23 per cent of total government revenue collection.

This has placed great strain on China Customs and their control mechanisms. Since 2006 therefore, in order to maintain enforcement of customs laws and meet revenue collection targets, Customs has been trialling (on a pilot basis) the use of intermediate agencies – typically local Certified Practising Accountants (CPA) auditing firms – to conduct customs audits.

Customs has been holding consultation meetings with interested parties in selected cities and PricewaterhouseCoopers has participated in several of these meetings. One of the main developments from this initiative is that China Customs will create and publish a so-called recommended list of auditing firms to conduct audits of companies engaged in Processing Trade and General Trade.

General principles of the new initiative

Subject to what is learnt during the trial period, the intended general principles of intermediary agency audit are summarised as follows:

- Customs will solicit, then review and approve qualifying audit firms. Relevant selection criteria include auditing firm size and qualification, fee estimation, business licence and reputation with the government.
- Customs will provide some training to the auditing firm.
- Customs will profile and determine which import/export companies will be subject to a customs audit.

- Customs will refer to the list of recommended suitable audit firms and contact an approved firm for assistance in conducting a customs audit. The approved auditing firm will have the right to accept or decline the request.
- The fees of the local auditing firm may be paid either by the Customs authority, the company selected for audit or a combination of the two.
- The local auditing firm will conduct the audit, typically on-site over a period of several days and then will submit a short report of findings to the local officer in charge of Customs.
- The local officer in charge of Customs will work with the company that has been audited to conduct further checks and validate the findings.
- The local officer in charge of Customs will discuss non-compliance issues directly with the audited company, including the assessment of customs duties, interest, financial penalties, and any corrective action to be taken.

Latest developments – Circular [2008] 181

The General Administration of Customs (GAC) recently issued an internal circular 181/2008, under which five Customs regions (Tianjin, Shanghai, Qingdao, Wuhan and Guangzhou) were selected to participate in the trial of the new initiative, adopting the principles outlined above. Under the trial, the intermediary agencies can be used to provide three different levels or types of services:

1. To fully or partially conduct a customs audit on site at the company that is subject to a customs audit. Under this scenario, the intermediary agencies will be engaged by Customs to assist them in their audit activities and Customs will bear the professional fee. Accordingly, the audit report produced by the intermediary agencies will be delivered to Customs.
2. To provide technical support to Customs during an audit. Under this scenario, the intermediary agencies will, again, be engaged by Customs and Customs will bear the professional fee. The difference between (1) and (2) is that under (2), the intermediary agencies will provide their service ‘behind the scene’, that is, the intermediary agencies will have no direct interface with the company under customs audit.
3. To provide audit services, upon Customs’ consent, to the company that is under customs audit in order to assist the company respond to Customs’ requests for data or other information. Under this scenario, the intermediary agencies will be paid by the company which engages them.

These arrangements will only apply where:

- a. The company under audit is classified as ‘AA’ grade.
- b. The companies other than ‘AA’ grade which are under customs audit 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.
- c. 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 to submit the audit conclusion drawn by the audit firm to Customs for review.

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

Circular 181/2008 also further stipulates that:

- GAC will establish a recommended list of audit firms at a national level, while the regional Customs headquarters will also have its recommended list at a local level.

- The list of recommended audit firms should be renewed and updated on a timely basis so as to enable unqualified firms to be removed from the recommended list.

Pending issues

The current trial of intermediary agency customs audits has been under way for approximately two years. Based on our research and understanding from both the local officers in charge of Customs as well as GAC, the following issues are currently pending:

- Who should pay for the service provided by the intermediary agency and how should this be done?
- Can Customs' powers in conducting customs audits be extended to these external intermediary agencies?

Outlook

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

Nevertheless, it is anticipated that other divisions in Customs, such as the Audit Division, will also seek special funding from the Ministry of Finance to employ external intermediary agencies to conduct customs audits.

With whatever funding is obtained, it is expected that local officers in charge of Customs will 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 therefore to be used by the Customs authority to conduct such audits.

Once the abovementioned issues are resolved, we expect that the GAC will issue a more comprehensive rule regarding the use of intermediary audit agencies.

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