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Speech at the Training Course of Risk Management & Follow-up Inspections for Customs of Eight Central Asian Countries

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Dear Colleagues:

It is a great pleasure to have the opportunity to take part in the Training Course of Risk Management and Follow-up Inspections held by the Customs Cooperation Committee, and to talk about the topic of follow-up inspections.

My speech comprises of two parts: 1. A brief introduction of the inspection system of China Customs; 2. Application of risk analysis technology in customs inspections.

Now, I'll come to the **Part 1: Inspection System of China Customs**

With the diversification of the world political pattern, economic globalization and technical advances, customs is confronted with a lot of fresh problems. The formation and development of modern international logistics and IT-driven E-commerce process calls for informatization of customs administration; the increasingly hot international economic competition demands customs to intensify law enforcement and safeguard state economic security; the closer international and regional economic ties require customs to facilitate trade; and the swift updating of theories and practices of corporate management demands customs to innovate the administrative concepts and supervision model. After China's WTO entry, the customs' law enforcement has come under the dual restrictions of domestic legal system and international rules. The intensified contradiction between rapid clearance and close supervision forces us to search for fresh administrative measures. By drawing on the prevailing practices with international customs, China Customs has come to realize that to achieve the effect of effective supervision and high

efficient operation, the management model has to be changed from “goods-oriented” to a combination of “enterprise-oriented” and “goods-oriented”. As a result, China customs set up the inspection system, indicating that the main function of China Customs have been turned to safeguard of market rules and order, and provision of better service rather than direct interference in corporate and market behaviors.

1. Basic concepts of customs inspection

In China, customs inspection system refers to the system under which the customs makes checks and examinations on account books, documents, statements and other related materials of import and export enterprises and relevant units within a prescribed period of time in accordance with laws so as to verify and supervise the authenticity and legitimacy of the import and export activities of the inspected persons.

2. Basic operation of customs inspection

As a new business system of the customs, the customs inspection system comprises of the 3 stages of inspection preparations, inspection implementation and inspection handling.

(1) Scope of customs inspection

According to the Regulations of PRC on Inspections, the scope of customs inspection covers all corporate units with direct relation to imports and exports, which can be divided into the following 6 groups:

The first group covers enterprises and units engaging in foreign trade, including special foreign trade companies, and industrial and trading companies approved by the State to engage in import and export, and other enterprises entitled to engage in import and export.

The second group comprises of enterprises engaging in foreign processing trade, including enterprises engaging in processing and assembly with supplied materials, enterprises engaging in processing with imported materials, and enterprises engaging in processing and production of finished products under compensation trade.

The third group is composed of enterprises engaged in bonded businesses, including those engaging in bonded warehouses, special factories and workshops engaging in bonded processing businesses, enterprises engaging in display, transportation and consignment of bonded goods, and production and processing enterprises in bonded zones and export processing areas.

The fourth group comprises of enterprises and units utilizing or dealing in duty-free or duty-reduced imported goods, including foreign-invested enterprises, enterprises importing foreign advanced equipment and apparatus for technological renovation, and units and organizations in the sectors of scientific research, culture, education and sports, which use duty-free or duty-reduced imported goods.

The fifth group is composed of enterprises engaging in application to the customs, including agents for clearing customs, enterprises engaging in businesses such as foreign trade storage and transportation, international transport vehicles, and service and agent

service for international transport vehicles that also serve as custom brokers or that apply to the customs on their own.

The sixth group covers other enterprises and units directly involved in exports and imports provided by the Customs General Administration of PRC, including enterprises engaging in transfer transport and those engaging in storage of goods supervised by the customs.

(2) Content of customs inspection

A. Account books, accounting documents, accounting statements, bills of entry, contracts and invoices, and business correspondence, etc. of the inspected persons;

B. Relevant imported and exported goods and articles;

C. Sites used for storage of imported and exported goods.

(3) Regulations on time limit for customs inspection

The time limit of customs inspection shall be within 3 years on and from the date of customs clearance of general trading export and import goods, and the time limit of customs inspections over bonded goods and duty-free and duty-reduced import goods shall be within the time limit of customs supervision and 3 years thereafter. In line with the customs' relevant regulations, the time limit of customs supervision over duty-free and duty-reduced import goods shall be:

A. Eight years for ships, airplanes and building materials (including steel, timber, veneers, artificial boards and glass, etc.);

B. Six years for motor vehicles and household appliances;

C. Five years for machinery and other equipment and materials.

(4) Classification of customs inspection

According to the Methods for Implementation of the Regulations of PRC on Customs Inspection, customs inspection is classified into two categories. One is routine inspection, which refers to the examinations and checks conducted as scheduled by the customs inspection departments on the enterprises and units directly involved in imports and exports in conformity with the legal power and procedures to supervise – a way of inspection that is designed to supervise the authenticity and legitimacy of imports and exports of the inspected enterprises and units. The other one is special inspection, which is a way of check the customs inspection departments follow to check and verify, based on the results of risk analysis of information, statistics and other materials, and in conformity with the legal power and procedures, the authenticity and legitimacy of the imports and exports of special commodities, industries and enterprises within the prescribed time.

3. The goal of customs inspection

The goal of customs inspection is to supervise the authenticity and legitimacy of import and export activities of the inspected persons. Its direct goal is to supervise the following

import and export activities of the inspected persons so as to examine and check the authenticity and legitimacy of import and export activities of enterprises involved:

- (1) Implementation of import and export license system;
- (2) Payment of tariffs and other import and export taxes and fees;
- (3) Import, utilization, storage, transportation, processing, sales, display and re-export of bonded goods;
- (4) Utilization and administration of duty-free and duty-reduced import goods;
- (5) Business operation of professional customs brokers and enterprises engaged in customs clearance on a commission basis;
- (6) Utilization and administration of transfer transportation and goods imported and exported temporarily;
- (7) Other import and export activities.

The ultimate goal of customs inspection is to streamline customs formality, improve customs' functions of supervision and administration, standardize corporate import and export behaviors through examination and supervision in a bid to guarantee the effective implementation of state laws and regulations on import and export, promote the healthy development of foreign trade, and safeguard state interests.

4. Ways and means for regulating corporate import and export activities

- (1) Making compulsory stipulations on bookkeeping obligations that enterprises shall perform.
- (2) Stipulating that enterprises shall perform the obligations of properly keeping accounting materials and import and export bills and documents.
- (3) The inspected persons shall submit on a regular basis the materials that reflect corporate financial and accounting systems and that have relation to import and export goods.
- (4) Introducing risk management system and regulating corporate import and export behaviors through implementing dynamic classification administration over import and export enterprises.
- (5) The enterprises that misconduct in import and export related activities shall be ordered by the customs to rectify and correct the misconduct within the set time limit, and otherwise shall receive administrative penalties imposed by the customs.

5. Achievements and major practices of customs inspection

Take 2002 for example, China Customs carried out investigations and inspections on a total of 12041 enterprises, tracked down 786 smuggling cases with a value of RMB2.89 billion, and found out about 2045 other cases involving tax evasion, demanding persons concerned to pay RMB2.311 billion of tax evaded to the central treasury, and collecting tax security or recognizance of RMB806 million. Our practices mainly include:

- (1) Stepping up inspection: Firstly, 105 enterprises without illegal records since 2000 were chosen from 22 customs supervision zones (mainly from hinterland customs supervision zones and the customs supervision zones in Nanning, Haikou, and Zhanjiang) for inspections aiming at regulating corporate behaviors. A total of 34 enterprises were found problematic, involving RMB162 million of tax evaded. Secondly, 38 large-sized processing trade enterprises were chosen, through data analysis, to be specially inspected on key commodities like milk powder, natural rubber and copper foil. A total of 148 enterprises were inspected, and 71 cases were found violating regulations or evading taxes, in which 63 enterprises were involved. The seizure rate was 43.55 per cent, and RMB200 million of tax evaded was involved. Thirdly, special inspections were carried out at the large-scaled high-tech enterprise Motorola (Tianjin) Electronics Co., Ltd., tracking down 2 illegal cases and 3 tax evasion cases, involving RMB100 million.
- (2) Further fighting against price humbuggery. Tailored at the rise in cases of price humbuggery in post-WTO, the functions of trade investigation and anti-price deceit were intensified to heavily crack down upon tax evasion, price deceit and tax evasion. Take 2002 for example, a total of 708 cases with relation to price deceit, smuggling and regulation infringing were tracked down, involving RMB3.024 billion. Firstly, based on information analysis, 7 customs including Beijing customs were organized to conduct special price investigations into the autos brands like Volvo, Benz, BMW, and Kia, which were found of price deceit and tax evasion, with the total payment of tax evaded being over RMB100 million. Secondly, nationwide customs were organized to carry out the 3-month long crackdown on price deceit, during which, the customs recovered a total payment of RMB878 million of tax evaded, and collected RMB551 million of securities. A total of 502 cases were found to engage in price deceit and smuggling, and illegal activities, involving RMB574 million of tax evaded.

Thirdly, through risk analysis, relevant customs were organized to carry out investigations into prices of special commodities like glycol, crude oil, styrene, PET, large-sized computers, sensitization materials, and Swiss-made watches. Fourthly, horizontal and vertical comparisons and studies were made among the declared prices of top 100 commodities imported from Shanghai and Gongbei Ports and the country's average prices, and those in 2002. Special price investigations into 66 of the top 100 commodities that were found decrease in declared prices were deployed. Fifthly, in the course of crackdown on price deceit, the customs strengthened its cooperation with tariffs, processing trade supervision, statistical and other departments, setting up an effective cooperative mechanism for cracking down upon price deceit. As a result, price indices of imported goods at each customs rose to a certain extent. All those played an active role in the improvement of taxation situation and the fulfillment of taxation task of the whole year.

Part 2 Application of Risk Analyzing Technique in Customs Inspection

Risk management was originally a management skill used in insurance industry, and later was used in finance, investment, stock market and other industries. As it was approved to be widely applicable, the term became a new management method in management

science. When revising the general appendix of the Kyoto Protocol, the World Customs Organization (WCO) introduced the risk management technique for the first time into the customs management system, included it in the chapter of customs supervision as a standard clause, and formulated a guidance for implementation of the technique. The EC customs deemed risk analysis as a principle of supervision and put it into the customs' development strategy 2000; the APEC subcommittee of customs procedures included risk management means into the collective action program, and agreed on customs of member states to implement risk management; and the United States, Canada, Australia, New Zealand, Holland, Japan and other countries have taken the lead in research and practice of risk management theories, and have made remarkable achievements in this field.

China customs made experiments on implementation of thorough risk management in 6 subordinate customs in July 1999, and has repeatedly put forward and emphasized the guiding ideology and requirements concerning enhancing customs risk management at meetings for chiefs of nationwide customs in recent years, and especially further required to base corporate inspection on risk analysis at the working conference on the nationwide customs survey 2001. This indicates that the time and conditions are mature for application of scientific management means based on risk management in customs administration in China.

1. The necessity of implementation of risk management in customs inspection

Over the past years, China customs inspection has been confronted with a prominent contradiction, i.e. how to combine the scientific risk forecasting methods with the practical inspection service to form an effective operation regulating system, in an aim to solve the contradiction between too many enterprises within the jurisdiction areas with complicated industrial distribution and limited number of customs inspectors with low percentage of inspected enterprises, and to improve the effectiveness of custom inspection, ensuring it to get twice the result with half the effort; and how to take practical measures to ensure inspections are based on precision and efficiency, minimize or control risk within an effective range, and ensure inspection can be effective in regulating corporate import and export behaviors. It may be said that these are also common problems to customs of majority of countries in the world. From the experience and achievements of customs of different countries in implementing risk management, we can see that besides efforts that are made to improve the inspection capacity and overall qualification of customs inspectors, it is a practical and effective solution to these problems by employing scientific methods based on risk management, placing emphasis on analysis of risk information and import and export data, and doing a good job in collecting information of inspected enterprises and their import and export commodities, and in summarizing and feeding back smuggling and regulation-infringing cases so as to improve the pertinence of inspection.

The introduction of risk management mechanism is an intrinsic requirement on improvement of foreseeability, systematization, timeliness, precision and effectiveness of inspection risks. It can reduce man-made intervention, improve customs' comprehensive capacity in recognizing, appraising and treating risks, and automatization level, and prevent and reduce risks of inspections. It is conducive to the building of an

honest and clean customs, and to the reduction of mechanical labor of inspection officers, thus providing them with more opportunities to display their wisdom and capacities. By putting in place the risk management methods, we can effectively change the passive situation, in which prevention measures were not taken appropriately in time, and management was not based on scientific sense. We can also improve the inspection efficiency and the risk consciousness of inspection officers, and effectively forecast, prevent and control risks.

2. How to do a good job in risk analysis when making inspections

Risk management is a systematic engineering, in which there have no complete conclusions in theory and practice. At present, there is no unified cognition and understanding in such issues as inspection risk, risk index system, methods and objectives for implementation of risk management, and organizational structure for risk management. Moreover, there is no specific model for risk analysis when carrying out inspections. Under this circumstance, risk analysis should be based on the principle of starting on the easy points first and dealing with the difficult points. Efforts should be made to improve supervision methods, make the focal points out, and do a good job in controlling key enterprises and key commodities. “Making the focal points out” refers to risk management, and the way to make the focal points out is to make risk analysis. Therefore, we should begin with the fundamental work in information collection, cases and experience summarization, and feedback collection, and then carry out inspections by employing risk analysis methods and means.

- (1) Keeping informed of the overall features and actual conditions of the enterprises and their import and export commodities within jurisdiction areas or at ports, and having a clear-cut insight into the overall import and export at ports. Based on collection, processing, classification and summarization of import and export date of the local enterprises, efforts should be made to identify the risk elements (for example, the commodities that have the same names for declaration commodities but fall under different categories of commodity codes), and compute and analyze the rankings and annual increase (decrease) margin of import and export commodities and enterprises’ export and import volume at the local jurisdiction areas or ports so as to fix on the key enterprises and commodity list with striking features. On this basis, we can make the focal points out, and do a good job in data statistics and analysis.
- (2) With the support of rich, complete, reliable and timely risk information, we can customized analysis on the data about import and export clearance. In addition, by combining high-risk elements from the cases investigated and tracked down by departments of clearance, supervision, inspection, investigation and antismuggling, and the feedback from related departments, we can summarize and analyze the substantial contents in common, and conduct fuzzy inquiries in the clearance database by inputting random combination of risk elements. Based on complete and scientific collection of date, we can make intercross comparisons, further analysis and comprehensive appraisals on the date so as to come up with the lists of sensitive import and export enterprises or commodities at the local ports or jurisdiction areas. This is also one of the ways for us to do a good job in risk analysis.

[Case 1] A company declared in 2001 at a customs its general trading imports from S. Korea 2864 kilograms of soybean sauce, 5911.2 litres of spirit, with the declared containers numbering 1000, the gross weight being 17247 kilograms and the net weight recording 8775 kilograms. Based on the analysis of the customs declaration documents of the batch of goods, the customs officers held that it contained high risk value, because: (a) in recent years, general trading imports of S. Korean foods were large in number and were listed as one of the key monitored commodities by the customs; (2) the actual consignee of the batch of goods had records in infringing regulations, and was listed as a key monitored enterprises; (3) the declared net weight of the batch of goods was only 1/2 of its gross weight, and the declared number was not in conformity with general number loaded in containers.

Based on the above analysis, the customs suspected the declarer of making false declaration or smuggling. After inspection, it was proved that the declared soybean sauce and spirit imported from S. Korea were placed at the exterior part of the containers, and that 2388 bottles of Scotch Blue whisky (Aged 21 Years) and 1152 bottles of Scotch Blue whisky (International) were hidden inside the containers, which were not declared at the customs. This was a smuggling case, involving a value of RMB2.13 million, and a suspected evasion of tax of RMB1.26 million.

[Case 2] In 1994 and 1995, computer language cards were best sold in Beijing area. It is learned from some computer materials and analysis of related experts, the language cards sold on the Beijing market were almost imported products. As sensitive commodities, we conducted the following analysis: Firstly, through applying the H883 computer programs, we looked up the summary statements of prices declared by the operational units of imported language cards in Beijing area, and made horizontal comparisons with the unit price declared by different operational units of the language cards. As a result, we found that the declared prices of the imported language cards declared by a computer multimedia company in Beijing were remarkably lower than those declared by other units. Secondly, after adding tax payments and about 30 per cent profit (according to market survey, the sales profit ratio of computer products in Beijing was about 30 per cent) to the price of the imported language cards declared by the company, we made a vertical comparison with the sale prices of the products on the domestic market, and found that the declared price of the language cards was suspected too low. Based on these analyses, we held that the company may have probably declared low prices for the imported language cards, and decided to conduct checks on the company.

This company was a solely funded technological enterprise. From the customs database, we found that in 1994 and 1995, the company successively declared general trading imports of more than 15000 pieces of computer language cards worthy of over RMB15 million from the Capital Airport. When making checks at the company, we first of all fix on the key accounts of our check in light with the business status and classification of accounts of the company, i.e. “Goods Procurement”, “Payable Account” and “Bank Account”. In debtor account under the “Goods Procurement”, we found that there were two prices for each batch of delivered language cards, one of which was identical to the price declared, while the other one was close to half of the price declared, and that the

entry price of each batch of delivered goods was about 50 per cent higher than the price declared. Then, we referred to the original evidences of the relevant prices and interrogated the personnel of the company involved. We learned that the language cards were procured overseas by the company's Hong Kong head office, declared with the delivery EX-WORKS invoice (Factory Price) at the customs, and charged tentatively to the account at the price. It handled the accounting as follows:

Debit: Goods Procurement (tentative estimation price)

Credit: Payable Account (tentative estimation price)

Some time later, the company charged to the account with the invoices delivered by the Hong Kong head office. The invoice price was composed of EX-WORKS and overseas procurement charges. It handled the accounting as follows:

Debit: Goods Procurement (the balance between the actual entry and the tentative entry)

Credit: Payable Account (the balance between the actual entry and the tentative entry)

In order to ensure whether the payment had been made overseas, we referred to the debit under the Payable Account and the debit under the corresponding account of "Bank Account", finding that the payment for the language cards had been paid overseas in the two years at the invoice price of the Hong Kong head office. The company had to acknowledge the facts that it had declared at customs with one invoice and charged to the account with another invoice, thus causing declaration of a lower price.

Before starting this check, we made sufficient risk analysis to make the focal points out for the checks. In the process of check, we fixed on the key accounts for check in light with the accounting handling methods applicable to general trading import of goods. In this way, we quickly found out the doubtful points in such a short time (only 1-day).

(3) Doing a good job in performance appraisal, that's to collect and study the conclusions of checks on inspected enterprises. After the inspection department has completed checks on the inspected enterprises, efforts should be made to exchange opinions with the inspectors, in an aim to collect the contents of the inspection reports and information about the inspections. Discussions and studies should be made on the issues discovered by the inspectors and the key issues to which the inspectors suggest to give priority. Moreover, experience should be summed up for further implementation of inspections. In addition, after completion of checks, records of cases should be filed by different nature, and cases in common should be summarized for further special checks so as to ensure the timeliness and effectiveness of checks. In light with the actual needs, corporate questionnaires and duplicated checks should be conducted for some cases that have been completed. Efforts should be made to do a good job in performance appraisal so as to reduce the risks of inspections, and ensure that prevention measures were taken appropriately in time, and management was based on scientific sense, and that a better work is done in regulating the imports and exports of enterprises.

3. Several opinions about the work goals under the implementation of customs cooperation in Central Asian Region

- (1) Strengthening cooperation among customs in Central Asian Region in information exchange and risk analysis, and constructing the China customs' data sharing platform against price bluffing.
- (2) Offering training to risk analysis personnel of customs in the Central Asian Regions and promoting business exchanges among them, and putting in place a complete knowledge training and information exchange mechanism.
- (3) Compiling and distributing information bulletin under the cooperation among customs in the Central Asian Regions (by stages).
- (4) Based on information exchange and risk analysis, coordinating the supervisions and checks on the key enterprises and commodities conducted by two or more countries.
- (5) Delivering the administrative mutual assistance requests for some imports and exports and cases among members of the regional customs.
- (6) Conducting cooperative researches, and compiling and publishing information bulletins and special reports on the update trend of cases in the regional customs.
- (7) Holding annual meetings and setting up the contacting and coordinating mechanism among liaison officers of the regional customs.

Thank you!