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The World Trade Organization's Trade Facilitation Agreement and Post-Clearance Audit – What Are the Benefits and Challenges?

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The World Trade Organization Trade Facilitation Agreement (WTO TFA) has been ratified by the requisite two-thirds majority of WTO member states. Consequently all member states are now bound to implement the reforms covered by the agreement. The WTO TFA requires among its provisions the implementation of a post-clearance audit function in customs organizations which is risk-based. International implementation of post-clearance audits has not been uniform amongst revenue and border management administrations, and the WTO TFA creates an opportunity for greater rigour internationally in the approach to post-clearance audit.

Keywords: border management, customs, post-clearance audit, revenue administration, trade, WTO Trade Facilitation Agreement

Introduction

The implementation of the GATT following WWII ushered in the new age of global trade and, from the lows of the 1930's, the world economy has seen marked increases in trade. The United Nations Conference on Trade and Development (UNCTAD) stated in its 2015 Trade and Development Report that following the 2008-2009 world financial crisis the world global economy post recovery was growing at an annual rate of 2.5 percent (UNCTAD, 2015). The rate of growth in international trade

follows a similar pattern, with rates of growth between 2 percent and 2.6 percent over the 2011-2014 period (UNCTAD, 2015). To support the global recovery from the 2008 crisis the members of the World Trade Organization successfully negotiated the WTO Trade Facilitation Agreement (WTO TFA) (aka the "Bali Package"). This was the first negotiating success since the commencement of the Doha Round in 2001. The WTO TFA focuses on customs administrative processes for expediting the movement, release and clearance of goods as well as cooperation measures between customs and other authorities to facilitate the movement of goods, including provisions for transshipment. The WTO TFA also contains provisions for capacity building and technical assistance – which include the development of post-clearance audit within customs/revenue/border administrations (WTO, 2017).

Post-clearance audit (PCA) is the verification, review or audit of customs declarations through the examination of books, records, systems or other documentation held by traders or their agents after the goods have been "released" from customs control. It is a key control methodology to facilitate the movement of goods through a risk-based selection process that moves border management organizations from a purely transaction-based process to an audit-based approach (UNECE, 2012). Prior to the negotiation of the WTO TFA, post-clearance audit was receiving attention from customs and border management administrations around the world. The concept of post-clearance audit is not new; various national administrations have been using these types of systems in one form or another for over 30 years. The approach to post-clearance audit has evolved over the years and, with the entering into force of the Revised Kyoto Convention[1] (RKC) on February 3, 2006, a greater focus on modernizing and improving customs processes in border management administrations developed. The RKC laid the foundation for customs and border administrations internationally to develop comprehensive and transparent legislation to facilitate international trade. This was to be accomplished by increasing international harmonization of customs processes and fostering a range of trade facilitative activities by encouraging the use of modern technology, implementing risk management and audit-based controls as well as coordinating with other border agencies and partnering with traders, to name a few (WCO, 1973).

The driving philosophy behind post-clearance audit is that by using resources to conduct reviews, verifications and audits after the goods have been released from customs, following a risk-based sampling process, border administrations can direct resources to areas of highest risk rather than attempting to inspect every shipment. As a result, customs administrations are made more effective in allocating their limited resources and at the same time facilitating the movement of legal trade. While this

underlying philosophy has significant merit, some challenges remain in devising a robust, functional post-clearance audit mechanism for modern border management organizations.

As mentioned, many customs and revenue administrations have implemented post-clearance audit functions; however, challenges remain in terms of their effectiveness and consistency in approach as well as providing a positive return on investment for administrations. In some jurisdictions auditors are instructed that should they uncover what appears to be fraud they are to abandon their audit and begin developing the fraud case. In other jurisdictions, such as Canada, the auditor is to complete the audit and refer any potential fraud to a criminal investigator.[2] The investigator will conduct a separate investigation and must not, however, direct or influence the audit; the audit file can be accessed by the investigator. Most jurisdictions have limited time periods to complete audits and verifications before the transaction in question becomes statute barred. For example, in Canada the Canada Border Services Agency (CBSA) has four years under the Customs Act (Sec 59(1)) to review and correct importations, (Government of Canada, 2017). Other jurisdictions have differing amounts of time.[3] For some administrations this can be problematic in the case of importers that enter and exit the market quickly (open their operations for only a few transactions, then close and become a different corporate entity), such as "informal" traders, anyone using a "cash-based" system or black market participants.

Some customs and revenue administrations assign customs audits and verifications to tax auditors who have limited training or too small a case load to maintain effective capacity in the customs audit/verification processes, thus relying heavily on customs labs (if they exist) to complete tariff classification for auditors.[4] Other administrations remain focussed on narrow issues without using a risk-based process to select companies and commodities for review. Another challenge is that the data and intelligence developed by customs verification officers or auditors are not used as part of the intelligence profile for other areas of the administration.

Of significant concern for administrations that are tasked with integrated border management is that the work of post-clearance verification officers does not have the profile of the work of front-line officers working in contraband, interdiction, security or anti-terrorism. Consequently, integrated border management organizations seem to fail to see the relatively unique skill set required by a post-clearance auditor compared with a front-line border officer. In the internal competition for resources it becomes very easy for the post-clearance audit function to lose ground to other more visible priorities. Further, the challenges in administrations where customs and tax revenue management are cohabiting include industry mistrust of how information provided for

customs uses may be used for tax programs. Focus on revenue collection may weaken the support for effective security programs. In addition, revenue administrations seem to fail to recognize the significant differences in skills that a customs post-release audit requires versus the skill set for a tax auditor. Regardless of the structure of the border administration in a country, it is critical that there be an effective use of risk management and intelligence to support both security and trade facilitation goals and programs.

The entering into force of the WTO TFA for all WTO member states is now a reality with the ratification of the agreement by Chad, Jordan, Oman and Rwanda on February 22, 2017. The ratification by these four nations pushed the number of WTO member states who have ratified the agreement to 112, above the 110 threshold required for implementation. Consequently, now is the time for border management agencies to ensure they have in place robust policies and programs to support trade facilitation. The value of the Trade Facilitation Agreement is estimated to be in excess of US$1 trillion, with simplified customs processes reducing time and red tape benefiting all trading nations (Miles, 2017). The implementation of the WTO TFA will necessarily include reviewing existing post-clearance audit functions and developing a *best in show*[5] approach to trade compliance. The current broad approach leaves too much variation in post-clearance audit activities and a lack of consistency, which increases risks for traders. Current post-clearance audit methodologies are, by and large, tied to verifications of individual import transactions, and while the import transaction remains the foundational activity for the import process, a robust audit process needs to be more than a review of individual transactions. By using a transaction-based audit process, border administrations learn about the individual transaction, i.e., whether the importer has declared the correct tariff classification, valuation or origin of the good, and may be able to draw some broad conclusions about the overall compliance of the importer, or perhaps about the commodity verified, if enough of a sample of a given commodity is verified.

The WTO Trade Facilitation Agreement provisions for expediting import, export and transit procedures touch on all aspects of government regulation for imports and exports, including the movement, release and clearance of goods, with a view to streamlining procedures in aid of reducing the costs associated with engaging in international trade activities. The agreement also "sets forth ground-breaking rules on special and differential treatment, linking implementation by developing and least developed countries (LDCs) to their acquisition of technical assistance and capacity building" (UNCTAD, 2017, 2). The WTO TFA implementation is expected to reduce the costs of trade by between 10 percent and 18 percent, depending on the commodity

and the income level of the trading countries (with lower income countries, such as developing and LDCs, seeing the greatest benefit). The agreement states the following in Section 1, Article 7 5.1: "[W]ith a view to expediting the release of goods, each Member shall adopt or maintain post-clearance audit to ensure compliance with customs and other related laws and regulations" (WTO, 2017, 10). The agreement stipulates the need for audit selection to be done in a "risk-based manner" that is transparent and engages the audited entity early in the process. The WTO TFA also indicates that the results of post-clearance audits should be used for "applying risk management" as well (WTO, 2017). Currently, there is no internationally standardized approach to using the results of post-clearance audits for risky importers and exporters, and each border administration has the latitude to use (or not) the data gleaned from the audit process.

When reviewing the post-clearance audit process several questions arise. The first of these is how to measure the effectiveness of the audit program. The second is how to measure the compliance level or "compliance health" of the importing and exporting community. Is a straightforward return-on-investment calculation sufficient, or should there be some other measure to ensure that post-clearance audit functions not only reduce losses to government revenues but also encourage voluntary compliance and improve the overall efficacy of customs regulations? The current general trend in post-clearance audit processes is, by and large, transaction-based verifications with limited or nonexistent systems reviews. Hence, they generate only limited information about the importer or the commodity. The current post-clearance audit process in many administrations reveals information only about one given commodity for one given importer or exporter. Unless the border management administration has a methodology to aggregate the audit results and to ensure that the approach is statistically sound, the results say nothing about the overall compliance of importers and exporters.

The OECD Centre for Tax Policy and Administration (CTPA) produced an information note in 2006 entitled Strengthening Tax Audit Capabilities: General Principles and Approaches (OECD, 2006) which, although specific to tax administrations, has some solid recommendations that could apply to any audit-based program, such as PCA. Border administrations charged with conducting post-clearance audits have a similar mandate to tax administrations in that in their "primary role of detecting and deterring non-compliance, tax [or customs] auditors are often required to interpret complex laws, carry out intensive examinations of taxpayers' [or importers' and exporters'] books and records, while through their numerous

interactions with taxpayers [or importers and exporters] operating very much as the 'public face' of a revenue [or border management] body" (OECD, 2006).

Due to the international nature of the import and export industry, compliance challenges can be significant. There can be a lack of documentation to support or challenge the importer's or exporter's records; third parties are in foreign jurisdictions and may not co-operate with auditors; and jurisdictional differences on how to conduct audits and verifications may result in confusing and inconsistent decisions for traders that engage in importing and exporting with multiple countries. The reality is that importer and exporter compliance behaviour is complex, with multiple factors to consider when attempting administration of border regulations. This complexity is not easily resolved, nor is there any one strategy for regulatory enforcement that will succeed in all cases. The audit program of a revenue body must include various roles and approaches in its strategy for improved compliance. In addition, a border management organization must have a variety of roles and strategies when promoting and enforcing importer and exporter compliance. In accordance with the OECD's CTPA, border management administration must:

1. **Promote voluntary compliance:** The primary role of an audit program is to promote voluntary compliance. This is accomplished by reminding importers and exporters of the risks of noncompliance through the development of a level playing field amongst importers and exporters and building confidence amongst compliant traders that noncompliance by importers and exporters will be detected, adjusted and penalized.

2. **Detect noncompliance at the individual importer or exporter level:** Post-clearance audit focuses verification and audit activity based on risk. Primary risks of noncompliance are duty evasion by misclassification (classification in a duty-free or lower-duty tariff classification than is correct) or under-valuation of goods (declaring a lower customs value). Verifications and audits may uncover these and other issues as well as generating additional government revenues.

3. **Gather information on the "health" of the import and export systems, including information on compliance rates and trends in noncompliance:** Post-clearance audit and verifications are a rich source of information on industry compliance and emerging compliance issues. The use of targeted verifications and audits addresses issues of known noncompliance, while random audits and verifications help to uncover potential issues and identify emerging trends in compliance.

4. **Gather intelligence:** Audits and verifications can uncover evasion and avoidance schemes, and this intelligence can be used to develop strategies to counter abuse by less scrupulous members of the importing and exporting community.

5. **Educate importers and exporters:** Audits and verifications are important learning opportunities for those companies that are audited. Compliance auditors or officers throughout the audit process can clarify expectations and requirements under law, regulation and policy. The guidance and advice received from auditors thus contributes to improved compliance by importers and exporters in the future.

6. **Identify areas of the law that require clarification:** Audits may bring to light areas of import and export law that are causing confusion and problems for traders and thus require further efforts by the border management administration to clarify the laws' requirements and/or to better educate traders on what they need to do to comply in the future.

Post-clearance audit is critical in encouraging the trading community to be in compliance, while at the same time the reality of limited resources requires a strategic approach to planning, implementing and maintaining an effective post-clearance audit program. Unlike a tax audit, a customs post-clearance audit is rarely a "full audit". In the tax world the scope of a full audit is all encompassing, with a comprehensive review of all aspects of a taxpayer's liability (OECD, 2006), whereas a customs post-clearance audit is similar to a limited-scope audit or a single-issue audit, where one or two programs are generally reviewed around a sampling of commodities and, consequently, a full picture of trader compliance is difficult to achieve. The end result is that the border management administration knows something about the trader, but not everything in terms of the trader's compliance with customs and border regulation. The application of a risk-based audit selection protocol is critical, as is a method for capturing, collating and sharing audit results at an enterprise level. As indicated in the WTO TFA, border management administrations must ensure that there is a comprehensive legal framework to support post-clearance audits. In addition there should also exist within the border management administration, similar to the case with tax and revenue authorities, well defined organizational and management processes, including a comprehensive performance management measurement framework with well defined verification and audit procedures and techniques with the necessary support structure. Robust human resource management and development programs should support the entire process (OECD, 2006).

The legal framework clarifies the traders' obligations in terms of declarations and record keeping, the auditor's authority to examine the traders' books and records, the ability of the border management authority to request information from other countries' border management authorities, the authority to amend import or export declarations or to direct the amendment of same and the ability to assess duties and taxes as well as apply interest and other penalties.

Well defined organizational and management processes ensure that there are sufficient resources in place to conduct post-clearance audits such that the return on investment for the border management authority is positive. In many cases this can be demonstrated by increased revenue for the government, improved statistical information on international trade and reduced time and money spent at the border for traders. In addition, well defined organizational and management processes will use a strategic, risk-based approach to managing compliance issues, focusing resources on issues of highest risk or on emerging risks as required. This, in turn, will support a nimble, adaptable approach to addressing post-clearance compliance issues. Underpinning this strategic approach will be an effective use of delegation of authority so that front line post-clearance auditors and their managers can effectively respond to individual issues with maximum flexibility while still ensuring adherence to audit and compliance protocols. Other factors in operational management for consideration include the following:

1. Who will be responsible for auditor supervision (managers or team leaders or both)?
2. How will supervision happen (throughout the process or by means of a review at the end; use of technical experts or mentors)?
3. What tools and systems will be used?
4. What will be the scope of the verification or audit? As mentioned above, most border management organizations use a limited-scope audit. Organizations should consider broader-based compliance reviews which touch on more than one aspect of trade.
5. Who will conduct the audit? What skills, abilities and credentials are required? Many border management authorities use either tax auditors or border (customs) officers, yet the skill set for a post-clearance auditor is significantly different from the core work of these two critical professions.
6. The audit cycle: Once a trader has had a post-clearance audit, are they removed from the audit pool for a period of time? If most audits address a single issue, then this process will not sufficiently resolve compliance issues.

7. Materiality: How will the border management organization deal with high-risk issues of noncompliance that are of low material value? In high-tariff jurisdictions the issue of materiality can be straightforward; however, with trade agreements reducing tariffs it can become an increasingly complex challenge.

For effective management of any post-clearance audit or verification section, effective performance objectives and measurements for auditors are required. Clear expectations with well articulated audit protocols, which define the audit process and the expected outcomes from the audit program, are required. Expectations for individual auditors should be clearly articulated with expected hours per case and numbers of cases per year. This does not abrogate the responsibility of managers to have regular dialogs with their employees about expectations and progress. Likewise, individual auditors should know how much output is expected from management and be able to identify learning and developmental needs. Management needs to be well versed in the audit process as well as performance management using regular updates and reviews to ensure that auditors are on track or to identify issues as they emerge. A case-management system for the audit process with a robust management reporting facility is ideal to assist managers and team leaders in ensuring cases are progressing and that the quality of the audit process meets or exceeds expectations. Any issues of nonperformance can be managed either through improved training and learning, coaching and mentoring or effective performance management activities. A well managed audit team with systems and standards also combats corruption, as supervision and review of work against standards reduces the opportunities for corruption.

Outcome measures in a post-clearance audit regime can be challenging. With most audit programs outputs are easily measured (number of cases closed, number of issues resolved, amount of revenue generated, etc.). However, an outcome measure can be much more difficult to determine. Due to the transactional nature of most post-clearance audit work it can be difficult to determine the impact of the work completed. An ideal outcome measure would be increased compliance with trade and customs laws; however, without a robust measurement methodology and clear baseline data it can be very difficult for border management administrations to articulate the outcomes associated with post-clearance audits. Outcomes based on improved compliance should include improved reporting by traders, with increases in revenue, while the number of resultant random (non–risk based) post-clearance audits should decrease. A complete post-clearance audit program should include both risk-based audits as well as randomly selected audits to achieve some picture of the outcomes associated with

the program. The border management administration will need to review the results of the post-clearance audit process, looking at issues such as sustained noncompliance (did a trader change their behaviour following a post-clearance audit) as well as the availability of information, guidance and client services to create the opportunity for voluntary compliance.

In Article 7 of the WTO TFA, post-clearance audit is one of the required activities for all WTO members. This activity, and other activities such as advanced rulings, published laws and regulations and the implementation of Authorized Operators[6] to name a few, come together to create an opportunity to reduce bureaucratic red tape for traders and trading nations (WTO, 2017). More and more countries are seeing global trade as an effective method to assist developing nations. In its economic development strategy the United Kingdom's Department for International Development (DFID) outlines how the UK will use an approach that "integrates trade, investment and aid policies to foster economic development and drive poverty reduction" (ICTSD, 2017). While using trade to drive development is not a new concept, the focus by Britain on a broadened trade philosophy post-Brexit shows a willingness to "reset" its international relationships post-EU and further underscores the importance of the WTO and its attendant agreements in promoting development and trade. As mentioned earlier, post-clearance audit is not a new phenomenon in the customs and border management world. Many border management administrations have implemented some type of post-clearance audit process. However, with the fast-approaching implementation of the WTO TFA it would be propitious for border administrations to conduct reviews of their post-clearance audit programs to ensure that they are well aligned with WTO expectations in that they support trade facilitation as the WTO TFA intends (Shepherd, 2016). The use of comprehensive international standards for post-clearance audit would increase predictability and consistency for traders, making costs more predictable and thus improving the bottom line for business while improving return on investment for border management administrations.

Post-clearance audit is a key requirement for a modern customs administration. Through the use of PCA, fewer resources are required at the border for inspection, freeing up resources for other important border work. PCA is critical in reducing revenue leakage for both developed and developing countries. The greater the reliance on customs duties as a source of revenue the larger the return on investment can be for the administration. However, even countries with relatively low duty rates can benefit significantly from an effective PCA regime. The challenges faced by both developing and developed countries are chiefly around resources. Border management agencies facing increasingly complex issues such as illegal migration, security, contraband,

antiterrorism and illegal goods smuggling have a challenge to find resources to support effective PCA. Regardless of the return on investment for PCA, too often there are too few tools, too little training, underdeveloped or nonexistent systems. A well developed, robust post-clearance audit program can be a critical tool in managing legal trade and can provide important intelligence on the functioning of the trading community while at the same time increasing revenues for governments.

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Endnotes

[1] The International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention) was negotiated amongst the members of the Customs Co-operation Council (CCC) (now the World Customs Organization, or WCO), which was established as part of the General Agreement on Tariffs and Trade (GATT). The Kyoto Convention entered into force in 1974 and was revised and updated to its current form as the

Revised Kyoto Convention and came into force on February 3, 2006. The revision was to ensure that it (the RKC) meets the current demands of governments and international trade.

The WCO RKC is the international blueprint for modern and efficient customs procedures in the 21st century. The *raison d'être* for the RKC is to provide international commerce with the predictability and efficiency that modern trade requires. The key governing principles of the RKC include:

- transparency and predictability of customs actions;
- standardization and simplification of the goods declaration and supporting documents;
- simplified procedures for authorized persons;
- maximum use of information technology;
- minimum necessary customs control to ensure compliance with regulations;
- use of risk management and audit-based controls;
- coordinated interventions with other border agencies;
- partnership with the trade.

The WCO Secretary General is the depositary of the convention (UNECE, 2012). The RKC creates the foundation upon which the WTO TFA builds in terms of streamlining and improving customs procedures as a method to facilitate international trade.

[2] Based on the legal precedents set in the *R. v. Jarvis* and *R. v. Ling* tax audit and investigation cases (Schabas, 2004).

[3] For example, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu may conduct a PCA within two years from the date of release of the goods. Regardless of the outcome of the PCA, any duty which is payable or refunded has to be notified within three years of the release date. (Separate Customs Territory Chinese Taipei, 2012). On the other hand, Singapore Customs allows five years for changes to commercial declarations (Singapore Customs, 2015); the UK requires customs records to be kept for five years (GOV.UK, 2017); and similarly the U.S. Customs and Border Control requires records to be kept for five years from the date of entry, or five years from the date of the activity that required the maintenance of the records (USCBP, 2015).

[4] Post-clearance audit describes a variety of customs verifications or audits under different programs – tariff classification, valuation, origin, trade incentives (drawbacks or duty deferral) – to name a few. For the most part, tariff classification is the first step in the audit or review process. Through the activity of tariff classification, the determination is made if the good in question is classified correctly and the correct tariff rate is applied. For other programs such as origin, each good has a unique rule that applies, and it is critical that the good be classified correctly to ensure that the correct rule of origin applies for access to the preferential tariff.

[5] This would typically be a post-clearance audit function that has a robust specialized training regime, systems and tools to support post-clearance audit as well as risk-based selection of audit targets and the sharing of information gained through the audit process to enhance border management.

[6] Authorized Operators are sometimes also described as "trusted traders". They are traders who, after being vetted by border management agencies, have their goods expedited through the customs process. Authorized Operators are also purportedly less likely to be subject to post-clearance audit or verification. An Authorized Operator program is a requirement under the WTO TFA.