

A photograph of two men in a warehouse setting. The man on the left is older, with grey hair, wearing a light blue shirt, a dark tie, and a bright yellow safety vest. He is looking down at a clipboard held by the man on the right. The man on the right is younger, with dark hair, wearing a brown jacket and a bright yellow safety vest. He is also looking at the clipboard. The background shows tall blue metal shelving units filled with various boxes and packages. The title 'Post Clearance Audit: Reference and Implementation Guide' is overlaid in large white text on the right side of the image.

Post Clearance Audit: Reference and Implementation Guide

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Post Clearance Audit: Reference and Implementation Guide

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This Guide has been prepared by Professor David Widdowson and Adj. Professor Rob Preece, University of Canberra, on behalf of the International Trade Department of the World Bank. It forms part of a series of good practice guides prepared to assist reformers and policy makers in applying the principles outlined in the World Bank's publication: Border Management Modernization, Mclinden, G., Fanta, E., Widdowson, D., and Doyle, T. (eds) World Bank, Washington DC, 2011. See <http://www.worldbank.org/trade> for more information.

About this Reference and Implementation Guide

This Reference and Implementation Guide builds on the content of the World Bank's publication *Border Management Modernization* (2011), which provides policymakers, reformers, Customs and other government officials with a comprehensive perspective on improving trade facilitation through better border management.

This Guide focuses on the use of Post Clearance Audit (PCA) which represents one of the most effective trade facilitation strategies available to border agencies as it enables the immediate release of imported cargo through the subsequent use of audit-based regulatory controls. When implemented as part of an overall regulatory compliance framework, a PCA regime is capable of delivering improved rates of compliance. This is because its underlying methodology is based on contemporary research and analysis of the factors that contribute to the achievement of a

high compliance environment, while still facilitating cross-border transactions, without any loss of border control, when compared to traditional compliance strategies. The contents of this Guide have been developed to supplement the information contained in the World Bank publication by providing border management officials and development professionals with a thorough introduction to the key issues associated with implementing a PCA regime. It presents a practical, step by step approach to PCA that will inform and equip readers to understand the key steps and preconditions necessary to progressively establish an effective PCA capability.

Specifically, the Guide builds on the contents of Chapter 6 (Core border management disciplines: risk-based compliance management) and Chapter 11 (Reform instruments, tools, and best practice approaches) of the World Bank publication.

The trend by border agencies to adopt pre-arrival clearance and PCA reflects the many changes which are occurring in international trade today. Whilst the need to maintain high levels of compliance by traders has not changed, the volume of cargo moving in and out of a country, as well as the speed with which it is expected to move through the border, has changed significantly in recent times.

As such, border compliance managers face the challenge of an environment where there is rapid growth in the number of transactions being generated and communicated to agencies by traders, and greater pressure on the agencies to clear cargo more efficiently (i.e. reduced timeframes and costs for traders). Thus compliance efforts have been shifting towards advance reporting, screening out high risk cargo for immediate intervention, and undertaking PCA.

Pre-arrival clearance is a process that allows traders to submit data at an early stage in the transport of the goods for advance processing of that information by the regulatory agencies and thereby provide for immediate release of the goods once they arrive at the border or port or prior to the arrival of the goods if deemed appropriate by the controlling agencies. The pre-arrival clearance process is particularly important for certain types of goods that are highly perishable or that in some other way require prompt handling upon arrival.

However, pre-arrival clearance is not just about facilitation. It is also particularly useful for early identification of goods that may pose a health, revenue or security risk to the country. The effectiveness of the screening process is of course dependent on receipt of advance information, supported by the necessary technology to enable agencies to analyze information from a variety of sources and to link it to risk 'flags' or alerts.

Since the basis of pre-arrival clearance is early provision of information, it is necessary to combine it with a capacity to undertake more detailed analysis of the information and supporting documentation after the goods have arrived in the country. This is where the concept of PCA comes into play. Audits undertaken by PCA specialists can take a variety of forms, from random audits to verify compliance with regulatory requirements, to regularly scheduled audits with a focus on particular companies or industry sectors. What they all have in common is a legislative base that provides trained auditors with the power to enter premises and to inspect documents, either physically or electronically.

PCA represents a move away from traditional approaches which focus on the physical inspection of cargo and the relatively ineffective documentary checks that restrict auditors to reviewing a very small percentage of a trader's overall transactions. PCA rather is a focus on the business systems of the trader that generate and communicate transactions to the regulatory agencies, recognizing that good business systems with adequate controls will lead to high levels of regulatory compliance. In this context, risks to compliance can be mitigated if the audit process is used to identify enhancements to the trader's business systems and controls, thus working with the trader to improve future compliance (a concept that is often referred to as 'compliance improvement').

The World Customs Organization (WCO), in recognition of this need to adapt to the growing world economy, has spelt out in the Revised Kyoto Convention the need for Customs agencies to move towards post clearance controls to facilitate trade, which includes transitioning towards 'control based audit', which represents the auditing of traders' internal systems and controls as they relate to Customs requirements. The following Standards contained in the Revised

Kyoto Convention are of particular relevance (see also Annex 1):

- Standard 6.6: Customs control systems shall include audit-based controls; and
- Standard 6.10: The Customs shall evaluate traders' commercial systems where those systems have an impact on Customs operations to ensure compliance with Customs requirements.

PCA activities are designed to provide a clear indication of a company's level of compliance with regulatory requirements, and to highlight or confirm areas of potential risk where additional compliance or enforcement activity may need to be undertaken. However, PCA results not only allow agencies to identify potentially unlawful conduct, but also to identify highly compliant traders that may be regarded as low-risk. Such entities can then be granted meaningful benefits such as 'fast-track' permissions and simplified procedures that contribute to facilitation outcomes while reducing costs to government. This concept forms the basis of the Authorized Economic Operator (AEO) programs that are being introduced by border administrations worldwide.

The AEO initiative, sometimes implemented as a 'gold card' or 'trusted trader' program, is emerging as a central element of regulatory compliance management programs internationally. The concept of AEO is embodied in the Revised Kyoto Convention (see Box 1 and also Annex 2), and in the WCO's SAFE Framework of Standards. Essentially, an AEO is a member of the international trading community who is deemed to comply with relevant regulatory requirements and standards. AEOs can generally expect to have their performance monitored, rather than having their activities scrutinized transaction by transaction; their cargo is likely to be subjected to minimal intervention; and they may be eligible to use simplified clearance processes. It is therefore vital that regulatory authorities ensure that assessments of traders' compliance levels are accurate. PCA is an essential tool in that regard.

It is important at this point to draw the distinction between a PCA and an investigation, recognizing that both activities involve comprehensive examinations of trader systems and documentation. Whilst both PCA and investigations are responses to an identified

BOX 1 Revised Kyoto Convention General Annex Chapter 3

Clearance and other formalities—Special procedures for authorized persons

3.32. Transitional Standard

For authorized persons who meet criteria specified by the Customs, including having an appropriate record of compliance with Customs requirements and a satisfactory system for managing their commercial records, (*italics added*) the Customs shall provide for:

- ▼ release of the goods on the provision of the minimum information necessary to identify the goods and permit the subsequent completion of the final Goods declaration;
- ▼ clearance of the goods at the declarant's premises or another place authorized by the Customs; and, in addition, to the extent possible, other special procedures such as:
 - ▶ allowing a single Goods declaration for all imports or exports in a given period where goods are imported or exported frequently by the same person;
 - ▶ use of the authorized persons' commercial records to self-assess their duty and tax liability and, where appropriate, to ensure compliance with other Customs requirements;
 - ▶ allowing the lodgment of the Goods declaration by means of an entry in the records of the authorized person to be supported subsequently by a supplementary Goods declaration.

risk, a PCA is designed to determine and improve levels of compliance, whereas the purpose of an investigation is to determine whether a suspected breach of the law has occurred. Both processes require the collection of 'evidence' but PCA collects evidence to determine or confirm an opinion of compliance, whereas an investigation collects evidence in support of a possible prosecution. PCA should be performed in a non-adversarial manner, with both the agency and the trader working to achieve compliance with legislative requirements in the most cost effective manner. As such, PCA and investigation require significantly different skill sets, legislation and procedures which are not necessarily interchangeable.

While PCA does not signal the end of compliance-related interests in a trader, it does provide greater insight into existing levels of compliance, and identifies

areas in which compliance may be improved in the future. Those companies with sound systems and controls will of course require less direct intervention and scrutiny over individual transactions, but will remain subject to monitoring and regular audit cycles to ensure these high levels of confidence do not slip. Such monitoring may be undertaken through the use of IT systems, where available. Even the most highly compliant traders can alter that status quickly, and further intervention may be necessary in the following circumstances during periods of 'hands off' monitoring:

- Analysis of company declarations, returns, statements or duty payments indicates an anomaly or unexpected variance
- The company notifies the regulatory authority that a material change has occurred to its business systems or internal control structure

There has been a change to inherent risk within the industry, such as changes to legislation, reporting procedures, duty and tax rates, increased competition, or detection of common errors within the industry.

Finally, it is important to note that PCA may not be appropriate in all circumstances. For example, in situations where goods are deemed to pose a high risk, it is often necessary to refocus on immediate controls such as physical intervention and verification of goods whilst still subject to border controls at a wharf, airport, border crossing, depot or warehouse. For example, where the high-risk transaction is thought to involve prohibited or restricted goods, or where other illegal activity may be suspected, it would be inappropriate to release the goods on the basis that a PCA will subsequently be undertaken.

Even in situations where an audit is deemed to be appropriate, it may be determined that more traditional audit procedures may be preferable to a PCA in the following types of cases:

- Cost effectiveness—where the compliance plan has selected a small trader it may not be cost effective to document business systems, identify and analyse controls, and then perform relevant control and substantive testing procedures if the company has only imported a few consignments. In such cases it may be more efficient to ensure that all transactions are identified and a sufficient number tested
- Unreliable internal controls—where the owners of a company being audited, or persons with a direct financial relationship to that company, are those who would benefit from the controls operating incorrectly, then importantly no reliance can be placed on those systems and controls. As PCA focuses on the key controls of a business system, this approach is inappropriate
- Focussed audit—where, the agency is responding to a single risk issue, it may be more efficient to undertake a review of one particular area of the operations of a trader and/or a specific time-frame
- No consent—where audit powers in legislation are limited to goods and documents relating to those goods, then PCA will require a trader's consent to review the relevant business systems. In such situations PCA will be performed in a 'partnership' environment where the trader is looking to improve future compliance.

Key aspects of Post Clearance Audit

A major difference between the conduct of PCA and more traditional approaches to auditing is the skill set and knowledge required of the auditor. Customs audit has typically been based on a sound knowledge of customs law and technical skills in tariff, valuation and origin. PCA however requires an understanding of how a business operates and how this relates to its transactions with the broader spectrum of regulatory agencies.

There is also an expectation from the trading community that the skill level of auditors is of an appropriately high standard, given that the PCA process is designed to review their business systems and internal controls, assess the effectiveness of their compliance measures and make recommendations on enhancements or changes in order to improve future compliance.

Thus PCA can have a significant impact on a trader's business and should be conducted with a high degree of professionalism similar to the level of professionalism expected of private sector audit service providers. Private sector auditors are bound by International Standards on Auditing (ISA—which will form the basis of local auditing standards issued by the national professional auditing body). PCA should therefore be guided by those ISA's that are relevant to PCA conducted by border management agencies. The full set of ISA's can be found in Annex 3, the most relevant being those relating to:

- responsibilities of auditors and audit managers;
- audit planning and collecting information about the trader and the trading environment;
- identification of internal controls and risk assessment of the trader;
- audit testing and collection of sufficient audit evidence to form an accurate opinion about a trader's level of compliance;
- using the work of other auditors in assessing risks; and
- audit conclusions, reporting and communicating with the trader and agency management.

Looking at each of these areas in more detail, it becomes evident that there is considerable benefit in considering the content of the international standards when developing PCA programs, as they serve to enhance the PCA process significantly.

Quality Control

Quality control is applied at two levels—by the agency over its own operations, and by the agency over the conduct of each PCA. At the agency level, the following matters should be considered prior to the commencement of PCA:

- Independence must exist within the PCA team. In particular, there should be no financial, emotional or family relationships between PCA team members and the trader subject to PCA;
 - Staff must be sufficiently qualified to conduct PCA activities, particularly those in key roles, and
 - Each PCA process must be adequately supervised.
- Note: Further information can be found in ISA 220.

At the individual audit level, the following should be established by the audit manager and enforced throughout the audit process:

- Allocation of proper resources against the agreed audit plan;
- Review of delegated work for performance and consistency with the PCA process;
- Resolution of any audit issues as they arise; and
- Monitoring audit outcomes.

Documentation

All matters contributing to the auditor's overall opinion of compliance, or any evidence to support this opinion, should be captured and filed in audit working papers for review by peers and by the audit manager. PCA papers should incorporate the following:

- A record of audit planning;
- The testing that has been undertaken, including what is tested, how it is tested and sampling procedures;
- The results from testing;
- Any audit conclusions; and
- Evidence that audit managers have reviewed the audit data.

Note: Further information can be found in ISA 230.

Audit Planning: general considerations

The success of PCA hinges on an effective Audit Plan, which should be compiled under the direction of the audit manager, and signed off before field work commences.

The audit plan, the output of audit planning, should bring together the audit scope and objectives, matters for consideration, and a program of the procedures to implement the plan. Audit planning involves several key stages, each covered by individual audit standards. These are discussed in detail in Section 5.

Audit Planning: obtaining knowledge of the trader's business

Audit standards require the auditor to gain business knowledge sufficient to be able to identify and understand the events, transactions, and practices which may have a significant effect on the audit, or audit report. Auditors should be able to form an initial judgment as to the level of risk posed by the trader. Further information can be found in ISA 310.

Audit Planning: materiality

As well as forming an initial judgment about the level of risk, a judgment about materiality is required for

the audit plan. Materiality can be defined as being 'information which if omitted, misstated, or not disclosed has the potential to adversely affect decisions'.

Materiality will affect the audit plan in terms of the nature of the testing to occur. For planning purposes, materiality can be measured either quantitatively (e.g. dollars or percentages) or qualitatively (e.g. inadequate or weak policies, or lack of integrity). How it is measured will be determined by the nature of the company's business and the expectations of the administration in relation to compliance.

Audit staff will rely on the audit manager's direction as to what is 'material' should they find errors during field testing, in particular, how to respond to these errors and whether they need to expand their testing activities. Further information can be found in ISA 320.

Internal Controls and Risk Assessment

The audit plan also requires the auditor to gain an understanding of the internal control environment of the company and to have begun forming an opinion about their level of confidence in the trader. In this context, the 'control environment' can be defined as the management's attitude and actions towards controls.

audit managers will need to review the opinion (with evidence) of the audit team and sign-off on their views, as the initial risk assessment will determine early approaches to the extent of testing. Further information can be found in the ISA 400 series.

Audit Evidence

The standards require PCA evidence to be 'sufficient' and 'appropriate' to support the audit opinion. Audit evidence can be described as the information by which the auditors came to their conclusions in order to provide their audit opinions.

It will comprise copies of documents, records, and other information from the trader; information from within the administration such as duty payments, refunds, or production statements; and other internal or external documentation analyzed by the auditor.

Audit evidence is also generated during the PCA itself, for example, audit working papers relating to observations, interviews, and tests performed. Further information can be found in the ISA 500 series.

At all stages of PCA, audit managers should be reviewing audit evidence to ensure that it has been properly obtained, is relevant and supports the auditor's opinions.

Using the Work of another Auditor

PCA can take into account the work of another auditor such as the company's own internal auditor, or an external auditor at year-end sign off of financial statements. However, the audit manager must ensure that the following has been considered:

Was the auditor independent? (see ISA210, ISA220)

Was the auditor competent? (see ISA 220)

Can the PCA team review the audit evidence?

Do the views of the auditor differ from the initial views of the PCA team?

Considering the Work of an Internal Auditor

Internal audit can be defined as:

“An appraisal activity within an entity as a service to the entity. It is independent within the entity and its functions include ... examining evaluating and monitoring the adequacy and effectiveness of the internal control structure”.

Internal audit and some specific audit engagements form part of the internal control structure of an entity and if appropriate and relevant, these audit programs may decrease the company's level of control risk. However, given the greater perceived level of independence, audit managers should ensure that external audit results take precedence over internal audit or the work of any other ad-hoc auditors, where these services overlap.

While internal audit has the same objectives as external audit, i.e. seeking a level of assurance over company operations, internal and external audit have different purposes within the organization. Internal audit is more an ongoing management tool, and there is certainly a reduced level of independence given that internal auditors are generally the company's own employees. There is also a greater possibility of management 'influencing' the results of internal audit before those results reach the Board.

If a PCA auditor is to rely on internal audit work, that work should still be tested to some degree during the course of the audit. However, the extent of testing will be based upon the auditor's confidence in the internal audit arrangements, and this can be gauged by asking the following types of questions:

- Were internal audits conducted by trained personnel?
- Were the audits properly supervised?
- If there were audit conclusions, were these conclusion based on audit evidence?
- Are internal audit conclusions consistent with work performed?
- Were issues identified by internal audit followed up?

These same types of questions could be asked if the PCA auditor decides to use the work of an external auditor such as the audit company conducting the “year-end” financial statement audit. Further information can be found in ISA 610.

Using Experts

An expert could mean a person or business with a special skill, knowledge or experience outside of auditing and accounting. Experts are used when the audit could miss some material error without the assistance of professional knowledge. For example, a PCA may require the expert services of a chemist for classifying chemicals, or an intellectual property (IP) rights valuer to determine the customs value of certain IP. When selecting an expert, the audit manager needs to ensure that the proposed expert is:

- Properly certified by a relevant institution or association;

- Currently certified, i.e. the relevant certification has not expired;
- Qualified in accordance with professional references; and
- Independent (i.e. has no business, financial or other relationship with the company). Independence is a particular issue in small industry specialisations where experts are in limited supply, as the company itself may have used or intends to use the same expert at some point.

In the majority of cases an expert will not be a trained auditor, so there is a further need to ensure that:

- The audit objectives, scope and expectations are clear to the expert;
- Confidentiality is maintained;
- The expert is obtaining supporting evidence which the audit can also use; and
- The expert's work is also being reviewed—by a peer if possible, but at least by the auditor and audit manager.

Finally, experts have a reputation of sometimes being 'inconclusive' and such output needs to be managed so that their work usefully contributes to the audit. Further information can be found in ISA 620.

Audit Reporting

The standards relating to audit reporting are largely based on financial statement audits. However, of note to the PCA manager is that the audit report needs to be:

- Relevant to those who will use the report;
- Reliable, being based on audit evidence;
- Capable of identifying and discussing material issues;
- Issued in a timely fashion;
- Capable of being understood by the reader; and
- Consistent to allow comparisons.

The actual content, style and format of the audit report will be determined by the needs of the agencies' compliance area and it is the responsibility of the audit manager to ensure that such requirements are met. Finally, no audit report (draft or final) should be sent to the trader subject to PCA without sign-off from the audit manager. Further information can be found in the ISA 700 series.

PCA Objectives and Scope

The audit scope and objectives essentially reflect the reason or reasons why the trader has been selected for PCA, which will generally be linked in some way to the perceived level of risk posed by the trader. For example, a trader may be selected for PCA for one of the following reasons:

- The trader is a significant tax/duty payer who has not been visited for some time;
- The trader's last audit left several outstanding issues to be followed up and remedial activity to be undertaken;
- Monitoring the trader's performance, e.g. duty payment, permits, losses, conditional concessions, refunds, indicates that established patterns and trends of the trader, or between the trader and the trader's industry, are altered to the point that revenue or other requirements are at risk;
- There have been changes to legislation or administration within the industry in which the trader operates;
- The industry as a whole, in which the trader operates, has come to notice as a significant compliance risk; or
- A trend of non-compliance has been identified within an industry, and the extent of that non-compliance across the industry needs to be understood.

Audit Objectives

The PCA will need to address the areas of risk that have been identified, and these areas of risk will establish audit objectives. For example, in the case of a large trader that is included on an 'audit cycle' with other significant payers simply due to the size of the potential risk, the audit objectives may be quite broad, such as:

- 'To assess compliance with duty liabilities and other regulatory commitments'; or
- 'To determine that all duties and taxes payable, have been paid in full and on time, in compliance with the legislation'

Not all PCA audit objectives will be that broad. For example, if a desk-based analysis of data such as duty payments, declarations, operating statements or returns reveals unexplained deviations from the trader's normal or expected operations, a more focused set of audit objectives would result, such as 'To determine whether:

- all goods delivered under duty suspension schemes are entitled to receive such concessional treatment'
- all goods delivered from the licensed warehouse had the appropriate clearances
- all receipts of imported petroleum product can be properly accounted for in the trader's records
- all payments of VAT refund or duty drawback relate to valid export consignments.

It is important to identify and document audit objectives at the very start of the PCA planning process, as this helps the auditor to stay focused on relevant issues such as the type of information to gather, the systems to be identified and the relevant controls to be tested.

Audit Scope

Audit scope relates to the particular aspects of the trader's operations and the period of time the PCA activity will cover. For example, the time period may be financial year, calendar year, half year, quarter, or month. In establishing the timeframe, regard should be had to any legislative restraint, particularly in relation to record keeping requirements. A common feature of customs law, for example, is the need to

retain records for 5 to 7 years, thus restricting any PCA scope to the relevant statutory period.

Like audit objectives, audit scope may often be determined by the initial reasons for PCA selection. The same monitoring and analysis of industry data can often highlight those points in time at which an importer, exporter or manufacturer began to show signs that ‘things weren’t right’. The start of an unusual or unexpected pattern, or a period of time in which data were not following normal trends, should be clearly identified within the audit scope.

It is important to identify and document the audit scope at the commencement of PCA planning. Audit scope will also assist in estimating audit populations (or total transactions to come under the audit) and

sample sizes, again important in determining issues such as audit testing.

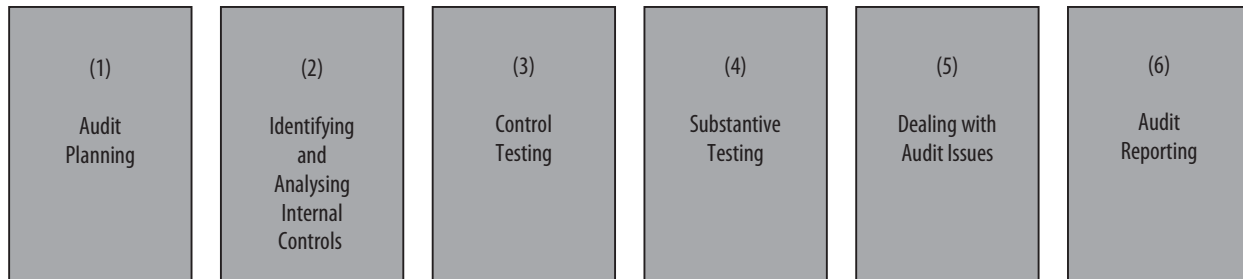
When combined with the objectives, the audit scope should provide all parties with a clear indication of what the audit will entail. For example, in the case of a trader who imports raw materials for further manufacturing, a PCA may be designed to form an opinion as to whether the trader’s losses in the previous calendar year were within relevant legislative provisions and/or administrative guidelines.

In this regard, the audit scope and objectives should be clearly identified in both the initial correspondence in which the company is advised of the intention to conduct the audit, and during the Entrance Interview.

This section provides a framework and step by step approach to the conduct of PCA using a series of practical examples. The methodology is comprised of the following stages:

1. Audit planning
2. Identifying and analyzing the trader's internal controls within their relevant business systems
3. Designing and undertaking tests of internal controls and assessing trader risk
4. Confirming a trader's risk assessment by designing and undertaking substantive testing
5. Dealing with issues arising during the audit and developing recommendations to improve compliance
6. Preparing and communicating the audit report.

Stages of a PCA



Note: In situations where PCA is not suitable, traditional transaction based auditing is utilized in which case Stages 2 and 3 of this methodology are omitted.

5.1 Audit Planning

Audit planning is essential to running an effective PCA. A proper investment in planning helps to ensure the success of what can be a complex set of procedures and tests. Audit planning is divided into a number of key steps as follows:

- Developing a draft audit plan
- Gaining an initial insight into the trader's business
- Formally commencing the PCA with an Entrance Interview
- Setting materiality in case errors are detected
- Documenting (and understanding) the traders business system
- Finalizing the audit plan.

5.1.1 Developing the Draft Audit Plan

The initial step for the PCA auditor is to properly set the audit scope and objectives (refer to Section 4), which will reflect the reasons why the trader has been selected for PCA, the expectations of the agencies' management, and the legislation which governs the trader's operations. For example, scope and objectives may be determined to be:

- conducting a comprehensive review of the trader's business systems in relation to the importation, exportation, storage, or manufacture of goods and their duty payment for the last financial year;
- conducting a review of recent amendments/upgrades made to a trader's business systems and/or internal controls as they relate to the reporting of imported goods;

- conducting a focussed review of the trader's use of duty suspension arrangements in the previous quarter; or
- conducting a follow-up to ensure recommended remedial action in a recently completed PCA has been implemented to agreed standards.

The scope and objectives of the audit then serve to co-ordinate the “core” aspects of the PCA, including:

- a program of audit procedures to be carried out to form an opinion about the trader's level of compliance;
- sites to be visited, persons to be interviewed, and processes to be observed;
- start dates, testing dates, and reporting timelines;
- audit team resources required, including expertise in areas such as IT, classification and valuation; and
- any other matters relevant to the conduct of the PCA.

The audit planning process must also address the following important areas, which will be identified and documented in the final plan:

- advising the trader of the intention to conduct a PCA of their operations and placing a copy of the correspondence on the audit plan file;
- any action needed to seek and establish a co-operative relationship with both the trader's management and those operational staff who will be important to the conduct of the actual audit;
- where the trader is willing, seek from them in advance of the PCA, any procedure statements, user manuals, policies, etc that they believe are relevant to their compliance obligations—noting each document received on the audit plan file; and
- identifying any other potential sources of information relevant to the PCA, in particular, how to gain sufficient knowledge of the trader's business (see below) and industry.

5.1.2 Gaining an Initial Insight into the Business

The auditor needs to gain a sound knowledge of the trader's business, and should gather sufficient

information about the entity to enable all events, transactions, and practices concerning compliance with importation, exportation, manufacture or duty payment processes, etc, as they relate to the audit scope and objectives, to be properly identified and understood.

While a detailed knowledge will be gained during the course of the audit, considerable information may be already be available from alternative sources that will provide the auditor with some initial insights into the business prior to the audit's commencement. Sources for such data can be either from outside the administration or, where such data exists, from within the agency itself.

The type of data available from within the agency will depend upon the information the agency captures and records from industry by way of lodgment of returns, declarations, statements or reports. Generally, it would be expected that agencies would require from traders the following types of information on either a transaction-by-transaction, or periodic reporting basis:

- import declarations for imported goods, warehoused goods, and for duty payment
- export declarations
- manufacturers' declarations or returns
- requests for refund, rebates, remissions, or drawbacks of duty and taxes
- manufacturers' production statements
- operational statements relating to packaging, storing, and delivering imported goods, including receipts, deliveries, losses, gains and other movements
- other statements or periodic returns which are required by legislation or as part of import conditions, such as duty suspension arrangements.

The agency may also generate its own information about individual traders that may be useful to the PCA auditor. For example, it may have historical records concerning companies and industries, gathered from earlier PCA work, including previous audit working papers and audit reports. The auditor should also look for the following types of internal information where relevant:

- import, export or bonded warehouse licensing files that may contain application and current status details
- license, permit or permission details
- import, export or excise statistical data for areas such as duty, values, refunds, exemptions, and volumes.

Where permitted under local legislation, it may also be possible to request relevant information from other Government agencies that hold data about the trader. The sort of information useful to the PCA auditor may include:

- movement of import and export cargo from port authorities
- company registration and ownership details from business registration authorities
- other relevant business activity details from industry, trade, economics, or finance agencies
- other taxation information from inland revenue or taxation authorities
- licence or permit details from permit issuing authorities.

The auditor should also consider the following useful external sources:

- articles in newspaper, trade journals and other industry press
- discussions with customers and suppliers
- Stock Exchange announcements (for public companies).

5.1.3 The Entrance Interview

Prior to conducting the entrance interview, it is necessary to formally advise the trader of the agency's intention to conduct a PCA, and should arrange a mutually convenient time to conduct the interview. The entrance interview represents the formal start of the PCA process with the trader.

It should be conducted with relevant senior managers, those company staff with whom the auditors will deal directly during the course of the audit, and possibly the trader's professional advisors. During the interview, the PCA team will look to:

- outline the audit scope and objectives and discuss reasons for PCA selection;
- request further information, or access to further information not available or forwarded by the trader during the early information gathering process, such as sales data, production data, customer data, product data, systems documentation, job descriptions, procedure manuals and internal policy documents;
- invite the trader to volunteer any issues or concerns about its own compliance. This may include findings of internal or external auditing commissioned by the company as part of its own internal control structure, or issues in dealing with border authorities such as disagreement with classification or values;
- agree on administrative issues including:
 - ▶ details of audit team contacts
 - ▶ details of relevant contact staff
 - ▶ use of outside experts and expertise if applicable
 - ▶ use of computer assisted audit tools if applicable
 - ▶ what sites should be visited and when
 - ▶ timing of commencement, conduct and finalization of tests
 - ▶ estimated time of PCA completion and reporting opinions to the trader.
- If applicable, discuss and document any concerns regarding relevant business systems uncovered after reviewing any procedure manuals, licensing files, or other materials previously forwarded by the trader.

5.1.4 Determining Materiality

Materiality may be defined as the potential of audit findings to influence the auditor's opinion about the trader's level of compliance. When PCA auditors identify errors, omissions or other forms of inaccuracy (as they inevitably will, in even the most highly compliant of companies), they need to ask themselves whether a particular error, omission or inaccuracy is likely to have an impact on their opinion of the trader's compliance.

Materiality can be measured in two ways. Firstly, it can be measured quantitatively. For example, an auditor may determine that, provided the valuation

of goods for duty purposes is within 1% or within \$50.00 on a line of any import consignment, the error will not impact upon the auditor's opinion.

Alternatively, materiality may be measured qualitatively, or in a more descriptive fashion. For example, it may be determined that a spelling error in a 'goods description' field will not impact the auditor's opinion provided the error does not affect the classification of the goods.

When applying materiality decisions during audit testing, the PCA auditor must bear in mind that, while a small percentage deviation on a low-value line may be considered immaterial and not affect the audit outcome, the same deviation occurring on a high-value line may well be considered material, and may consequently have an impact on the audit opinion. In such cases, the auditor would need to analyze the error and assess how likely or how possible it is that the same error could occur on a high value line. This issue is further discussed below in the testing and sampling sections of the methodology.

Once determined by the auditor and audit manager, materiality levels should be documented in the audit plan to inform the audit team of the procedures to be followed when finding errors during the course of their PCA fieldwork at the trader's premises.

5.1.5 Understanding and Documenting the Business Systems

Due to the nature of PCA with its approach of reviewing a trader's systems, the auditor must acquire sufficient information about relevant business systems so that any internal controls within that system can be both identified and assessed. The first requirement is therefore to gain the necessary knowledge of the business systems which are of relevance to the audit scope and objectives. These business systems will generally relate to areas such as:

- product files—including details of product classification, value, origin, and other relevant details for the range of goods the trader imports, exports or manufactures
- systems for reporting transactions to border authorities
- records of receipts of foreign goods or raw materials and, where appropriate, from local sources
- production records—including raw materials into production, production into inventory, and efficiency reports (losses/gains)
- packaged stock and deliveries
- sales and invoicing (domestic and export), including customer files
- returns and credits.

The type of documentation the auditor requires includes: procedure manuals, policy statements, operating instructions, computer system descriptions, and control manuals. The auditor may already have access to some of these documents, as they may have been forwarded by the trader upon notification of the upcoming PCA activity. The appropriate people within the company to approach in relation to such documentation include management, technical staff (e.g. information technology division), business managers (e.g. production, warehouse operations, etc), or financial managers (duty and tax payments) as necessary. The key action at this point is to confirm that all relevant documentation has been received and reviewed by the audit team.

During this stage the auditors should also obtain an understanding of the company's organizational structure and identify those groups which have a role which is directly or indirectly relevant to the audit objectives (for example, those responsible for performing relevant monitoring activities).

Other possible sources of information which may be available and useful to the PCA to confirm that all business documentation has been received and that business systems are effective, are:

- relevant internal audit reports and discussions with the company's internal audit staff
- relevant risk assessments performed during the annual external financial audit
- external audit management letters and reports and discussions with the external auditors.

Once all business systems documentation has been received by the PCA team, the documentation needs to be reviewed in relation to its accuracy and level

of detail. As previously noted, the business systems documentation should be sufficiently detailed to enable the identification and analysis of all existing internal controls that are relevant to the audit.

It may also be possible that the trader's business system documentation still remains on the audit files of previous PCA activity, in which case the PCA team need only verify that no material changes have been made to those systems. Where applicable, any material changes that have occurred to business systems should be incorporated into existing systems documentation. Further, where those changes are considered significant, the auditor should then verify that they have properly understood and documented the changes.

If business systems documentation is unavailable (or business system documentation is insufficient to analyze internal controls) then the PCA team will need to document the business systems themselves. The form of systems documentation may include a simple narrative of the relevant system, through to highly complex process flow-charts (or a combination of both). The narrative approach is useful where the business system under review is small or simple in nature, and flowcharting is more appropriate where the system is large and complex in nature. It is likely that, where such systems are large and complex, the system (or systems) will be broken down into sub-systems for the purposes of flowcharting. Computer software is also available to assist the auditor in producing large and complex flowcharts, and is useful for easy amendment or updating as the company makes changes to its business systems.

Again it is critical to note that the basic requirement for business system documentation, whether drafted by the trader, or by the PCA team, is that internal controls can be identified and analyzed for their relevance and effectiveness. In some cases, the business system documentation may indicate a high level of usage and reliance on IT systems, in which case it will be necessary to ensure that IT expertise exists in the PCA team or is available from an external source during the course of the PCA.

Once the PCA team has a full set of business documentation covering all relevant areas of the trader's operations, the business systems must be verified.

Systems verification can be achieved by conducting walk-through tests or examining system documents filed in the permanent files which were identified in the documentation.

Walk-through tests are used to confirm the completeness and accuracy of the auditors' understanding of how a significant transaction is processed, or how product storage and movement is controlled, and will complement the discussions with management noted above. The exact technique employed will depend on the nature of the system, type of evidence available and the audit objectives.

In executing a walk-through, the auditor should trace a transaction through the processes as documented in the flowcharts and/or narratives of each business system. Having walked through each significant process, the auditor will be in a position to assess whether the systems description is correct. Where audit activity is being undertaken at several sites, then this walk-through check must be undertaken at each site and local variations/extensions noted.

This is an essential component in the system documentation stage, as it is possible that one area of the trader's operations may have adopted its own 'local procedures' which either enhance or detract from the documented procedures. Once the auditor is satisfied that a complete set of all relevant business systems documentation is available, and the documentation is sufficient for the next stage of the audit where internal controls are identified and analyzed, the audit plan may be finalized.

5.1.6 Finalizing the Audit Plan

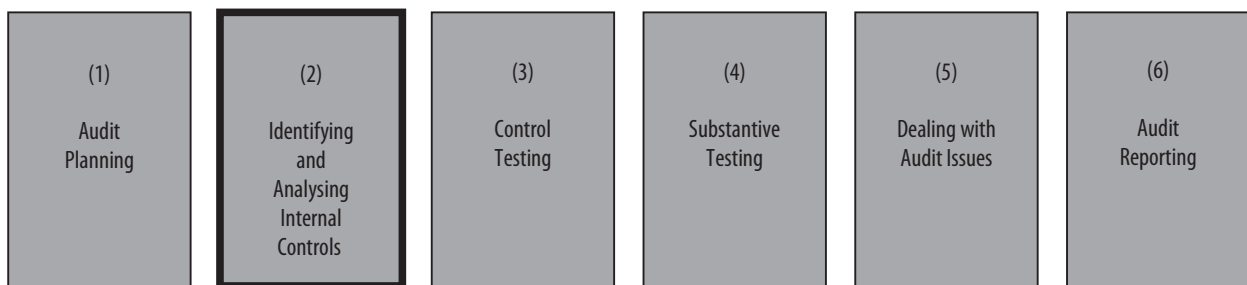
The audit plan should now be ready for completion. The auditor is aware of the scope and objectives, and importantly the audit approach, which allows for confirmation of what will be tested, where and when. An entrance interview will have been conducted during which this information will have been discussed with the trader, and the auditor will have a set of business documentation covering the relevant operations of the trader which they will have verified (alternatively the audit team may have documented the relevant business systems themselves).

It is important to remember that it is better to invest time in developing a good audit plan than to create the potential for duplication, lack of co-ordination, and other issues which detract from an efficient PCA.

The audit plan when finalized will bring together the following areas of the audit procedures:

- Audit scope
- Audit objectives
- Program of procedures (analytical procedures, testing, etc.)
- Levels of materiality in the event that errors are detected
- Sites to be visited, persons to be interviewed and processes to be observed
- Proposed timing of visits, tests and audit completion
- Audit team leaders and members, and where applicable, use of outside professional expertise such as IT specialists, chemists, valuers, etc., and their respective roles in the audit
- Any other matters that are relevant to the audit such as outstanding audit related issues, industry complaints to check, or queries generated during company research, etc.

5.2 Identifying and Analyzing Internal Controls



From the knowledge of the business systems gained during the audit planning stage it is time to identify and analyze the appropriateness and effectiveness of the trader's internal controls which are relevant in ensuring compliance. This stage of "Identifying and Analyzing Internal Controls" involves 3 key steps as follows:

1. Understanding what internal controls are, and the different types;
2. Understanding the relationship between controls and risk in the business systems;

Understanding the various audit risks, i.e. inherent risk, control risk and overall confidence in the level of compliance of the trader.

5.2.1 Understanding internal controls

Internal controls are company policies and procedures that are designed to prevent errors, omissions,

misstatements, non-compliance, and internal fraud from occurring. There are two types of internal controls within a business system:

- Preventive Controls—being internal controls designed to prevent errors and other non-compliance before they can occur; and
- Detective Controls—being internal controls designed to identify errors and other types of non-compliance once they have occurred, so that the company can take timely remedial action.

At this stage in the PCA process the auditor is required to identify the internal controls in the various business systems that are relevant to compliance and that the auditor will review as part of the PCA. Common examples of "preventative" internal controls could include:

- Any review, verification, re-calculation or re-assessment of data before it proceeds to the next stage of a process;

- Counter-signing of documents;
- Use of two persons to undertake particular tasks;
- Passwords on a computer;
- Maintaining the accuracy of flow meters and scales;
- Locks on a gate; or
- Swipe key systems that block access to unauthorized persons.

Common examples of “detective” type internal controls include:

- Stock-takes;
- Weekly or monthly reconciliations;
- Internal audits;
- Periodic quality assurance (QA) processes; and
- Exception reports.

A trader’s attitude to establishing and using internal controls is an important assessment to make in this early stage of the PCA as it will help shape the auditor’s opinions as the audit is carried out. The trader’s attitude is sometimes referred to as the ‘control environment’. The control environment is effectively the management’s position and commitment to the operation of relevant internal controls and the level of importance management has put into ensuring that such controls are properly utilized. Even with good internal controls in place, these become worthless if management is happy to cut corners or bend rules when things are busy, profits are down or perhaps when someone is away from work and an important task is overlooked. The auditor should examine the business documentation obtained during the audit planning stage and look for the following indications:

- Has the trader identified regulatory compliance as a priority and is this priority reflected in staff training, staff procedure statements, and other operational documentation?
- Does the trader arrange internal or external audit review of compliance with regulatory requirements, and do those reviews look at whether relevant internal controls are being applied properly?
- Has the trader engaged professional advisors to help establish compliant systems and controls, or assist with ensuring compliance in relation to particular transactions?

Where compliance is seen as a priority by the trader, the auditor will likely see comprehensive business process documents such as user manuals, procedure statements, rules and measures that focus on ensuring compliance, with very clear instructions to staff to follow, all of which should be considered positively by the auditor in shaping opinions on risk in the following steps of the methodology.

5.2.2 Understanding the relationship between controls and risk in the business systems

The next step is to document the risks and relevant internal controls for the trader’s business systems. This process provides order, direction and organization to the PCA itself.

A useful way of documenting risks and controls is by using a ‘controls/risk matrix’ (see example at Annex 7.) This approach enables the auditor to identify any potential errors in each business system that are likely to impact on compliance, and to link them to the trader’s internal controls (which should be designed to mitigate those risks). The controls/risk matrix approach allows the auditor to quickly review whether potential errors that have been identified have at least one internal control operating to prevent or detect them.

The matrix is further supported by use of control description/testing worksheets (see example at Annex 6), one of which is completed for each internal control in each business system being audited, and provides the auditor with the opportunity to fully describe each control, and to eventually design and record appropriate tests. Use of these forms, when properly completed and cross referenced between each control and each business system, creates a logical and sound set of audit working papers.

The process of identifying risks and relevant internal controls in each business system can be illustrated using the following examples.

Using the above case study as an example, the auditor will develop a control description/testing worksheet

Identifying Risks and Controls: “Container receipt and unpack”

A large importer has established a set of procedures for the arrival and the unpacking of shipping containers to ensure that their orders are properly filled by the supplier, and that there has been no pillaging of the cargo between the container leaving the supplier and arriving at the warehouse. The PCA has identified this system as being of relevance in the context of evaluating the level of compliance of the trader, as this control is also effectively ensuring that the goods received are the same as those which have been declared to Customs for duty payment. Consequently the relevant internal controls need to be identified and an initial assessment made as to their appropriateness.

The system has been documented as follows:

1. Container of imported goods arrives and is met by the warehouse supervisor and a senior storeworker. Documents for the consignment and the import declaration are checked against the container number, and if correct, the seals are broken and the doors of the container are opened.
2. Warehouse storeworkers unpack the container in the presence of the warehouse supervisor and senior storeworker, and the goods are verified against both the packing slip and import declaration as the unpacking occurs.
3. On completion, a “Container Unpack Report” is completed in triplicate with details of the consignment and any variance between what was in the container and the description on the packing slip and import declaration.
4. The warehouse supervisor and senior storeworker both sign the Container Unpack Report and send one copy of the document to Accounts Payable and another to Inventory Control, while one is retained in the warehouse supervisor’s office.

The system is important as it serves to ensure the accuracy of the import declaration by ensuring that the goods in the container are the same, and in the same quantities as declared on the import declaration. The internal controls in operation can be considered to be effective in ensuring compliance provided they are operating correctly and the verification is being performed properly.

(see Annex 6) and a control/risk matrix (See Annex 7) as follows.

Control/Risk Matrix

This working paper should be completed for each system or sub-system which is to be reviewed by the PCA. In the above example, the control/risk matrix would be titled “Container Receipt and Unpack”, and

the auditor would list all potential errors in an import declaration lodged by the trader such as tariff classification, description of goods, number of packages, number of units, value, origin (and any other risk). Then the auditor would list the internal controls such as the two-person count and reconciliation with the packing slip and import declaration. The auditor can then use this document to indicate which controls help to mitigate the risks (or potential errors).

Control Description/Testing Worksheet

A control description/testing worksheet should be created for each control listed in the control/risk matrix. The relevant internal control documented in the control description/testing form should be cross-referenced to the control/risk matrix.

The control description/testing worksheet is then completed by entering the name of the internal control, and including a full description of how the internal control operates. There should also be an indication of the auditor’s initial views of the control (see below).

Control Description/Testing Worksheet

Auditee	Audit Manager
<div>Control Description: Container Unpack Report</div> <div>1. Container of imported goods arrives and is met by warehouse supervisor and a senior storeworker. Documents for the consignment and the import declaration are checked against the container number, and if the correct consignment, the seals are broken and the doors of the container are opened.</div> <div>2. Warehouse storeworkers unpack the container in the presence of the warehouse supervisor and senior storeworker and goods are verified against both the packing slip and import declaration as the unpacking occurs.</div> <div>3. On completion, a "Container Unpack Report" document is completed in triplicate with details of the consignment and any variance between what was in the container and what was in the packing slip and import declaration.</div> <div>4. The warehouse supervisor and senior storeworker both sign the Container Unpack Report and sends one copy of the document to Accounts Payable, another to Inventory Control and one is retained in the warehouse supervisor's office.</div>	<div><u>System:</u> Container Receipt and Unpack</div> <div>Notes:</div>
<div><u>Preliminary assessment:</u> High level of confidence based on low inherent risk and low control risk.</div>	
<div><u>Description of control test</u></div>	
<div><u>Sampling:</u><ul style="list-style-type: none">■ size:■ selection method:■ period:■ population size:</div>	
<div><u>Summary of Test Findings:</u></div>	
<div><u>Control Assessment after test:</u></div>	

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The following is another example of a business system for which the compliance risk could be quite high. The risks and controls should be

examined and along with the relationship between the two in the context of completing a controls/risk matrix.

Inventory control

An alcohol trader with a license to store imported alcoholic beverages under bond until it is delivered into home consumption performs a weekly stock-take to ensure that receipts and deliveries of stock have been accurately recorded. The PCA has identified this system as being of relevance when evaluating the level of compliance and as such the risks (or potential errors) in the system and the relevant internal controls to mitigate these risks need to be identified and documented in matrix form.

The potential errors that would be recorded in the controls/risk matrix are as follows:

- ▼ Receipts of imported goods not correctly recorded in the bonded inventory records.
- ▼ Receipts of under-bond transfers from other licensees not correctly recorded in bonded inventory records.
- ▼ Transfers from production not correctly recorded in bonded inventory records.
- ▼ Approved remissions from breakages, out-of-date stock, etc not correctly recorded in bonded inventory records.
- ▼ Approved returns from customers not properly recorded in bonded inventory records.
- ▼ Wrong goods or wrong quantities of goods selected from inventory for delivery.
- ▼ Deliveries not correctly recorded in bonded inventory records.

The primary internal control here is the weekly stock-take conducted by the bond manager and assistant, which is likely to mitigate all seven potential errors/risks as a 'detection control'. The importer may well have other internal controls such as a "gate pass" and physical inspection of truck contents against paperwork at the exit gate—a control which could mitigate risks 6 and 7. Again, these additional internal controls in this system are listed in the control/risk matrix, with an indication of which potential errors they are mitigating. These controls are then copied to an individual control description/testing worksheet and will later be tested by the auditor.

5.2.3 Understanding the risks in the audit

As noted above, evaluating the operation and effectiveness of the trader's internal controls is the basis of the PCA approach. Where such controls are found to be sound and are being applied appropriately, then it is likely that the auditor will form an opinion that the trader is compliant, and where they are not, then the auditor will look to recommend enhancements to certain controls in order to improve future compliance.

However, an important part of determining whether the internal controls are appropriate and are being properly applied by the trader is to test them—and this will occur in the next stage of the PCA. When control testing occurs, the level or extent of those

tests is linked directly to the level of confidence the auditor has prior to commencing control testing.

The following matrix is useful in determining this initial level of pre-testing confidence. One axis identifies 'inherent risk' and the other 'control risk', with the body of the matrix showing an initial level of confidence, which is expressed as high, medium or low. For example a high inherent risk with a medium level of control risk provides the auditor with a "low" level of confidence which will translate during control testing to higher levels of testing. Alternatively, where a low level of inherent risk and medium level of control risk is perceived by the auditor, then the starting point is a high level of confidence which will mean lower levels of testing will be needed.

		CONTROL RISK		
		HIGH RISK	MEDIUM RISK	LOW RISK
INHERENT RISK	HIGH RISK	LOW CONFIDENCE	LOW CONFIDENCE	MEDIUM CONFIDENCE
	MEDIUM RISK	LOW CONFIDENCE	MEDIUM CONFIDENCE	HIGH CONFIDENCE
	LOW RISK	MEDIUM CONFIDENCE	HIGH CONFIDENCE	HIGH CONFIDENCE

Determining Inherent Risk

Inherent risk is also known as the business risk, and is best described as the risk of errors and other non-compliance by the trader if no internal controls were in place. Inherent risk can also be assessed from information which is generally gathered during the audit planning stage, and includes:

- What is the level of integrity of the management and staff at the company? Have any persons been found guilty of border agency or taxation offences, or indeed any other financial matters?
- What is the level of knowledge and experience of management and staff at the company—both in terms of working in the industry, and in working with border related legislation?
- What is the nature of the business systems and controls—are they complex; are they manual with a heavy reliance on human input; are they unclear?
- What is the nature of the industry in which the trader operates—is it highly competitive; does it have high duty rates; is it highly regulated; would non-compliance generally deliver substantial competitive advantages?
- Is there a history of poor industry-wide compliance, with a significant number of common errors occurring across the sector?

When considering these matters, the auditor must make an assessment as to whether inherent risk is high, medium or low. As a guide, and based on the above questions, the following conclusions may be reached:

High Risk

Any of the following are evident: poor or uncertain staff knowledge, experience and/or integrity; highly competitive industry where staff feel under pressure to perform; reliance on highly complicated or highly manual processes, or highly taxed and regulated industry in which there are many competitors who are regularly found to be non-compliant.

Medium Risk

Any of the following are evident: there is some staff knowledge and experience which can be accessed by all employees; competitive industry; some reliance on highly complicated or highly manual processes; medium level taxed and regulated industry in which there are several large competitors.

Low Risk

Most or all of the following are evident: good staff knowledge, experience and integrity; moderately competitive industry where staff feel little pressure to cut corners; no reliance on complex manual processes; industry has low rates of tax and regulation; and the industry has a good compliance record.

The auditor's assessment as to the level of inherent risk, with evidence, should then be documented in the audit working papers, including reference in the control description/testing worksheet.

Determining Control Risk

Control risk is simply the risk that errors and other instances of non-compliance will not be prevented or detected by the internal controls or their detection will be too late to prevent a breach of legislation. The auditor again must make an assessment as to the level of control risk by determining whether the controls are working effectively. This will involve taking a number of factors into consideration such as:

- use of the auditor's own skills, knowledge and experience. The auditor is likely to have seen many companies' internal control structures, and can 'benchmark' against these. The auditor will also be familiar with the relevant legislation with which the company must comply, and whether the controls are appropriate;
- the auditor's specific knowledge of the trader and the relevant systems and controls, as a result of reviewing the business system documentation during the audit planning stage;
- the auditor may have visited or audited the trader previously;
- the results if previously audited and any other information in the agency's possession relating to errors or instances of non-compliance;
- material changes to the business systems and controls since the last audit;
- review and query of relevant user manuals, policy and procedure statements and job descriptions; and
- observation of processes, systems and controls.

The auditor again needs to make an assessment as to whether control risk is high, medium or low. Remembering that if control risk is assessed unacceptably high or if internal controls are found to be entirely unreliable, then systems based auditing approach of PCA should be abandoned and a more traditional transaction-based audit approach

should be adopted. As a general guide to determining the level of control risk, the auditor could consider the following:

High Risk

Internal controls are present, but there are questions in relation to their effectiveness and their application by staff, and user documentation about performance of the controls is difficult to comprehend. There have been significant changes to business systems and controls since any previous audit.

Medium Risk

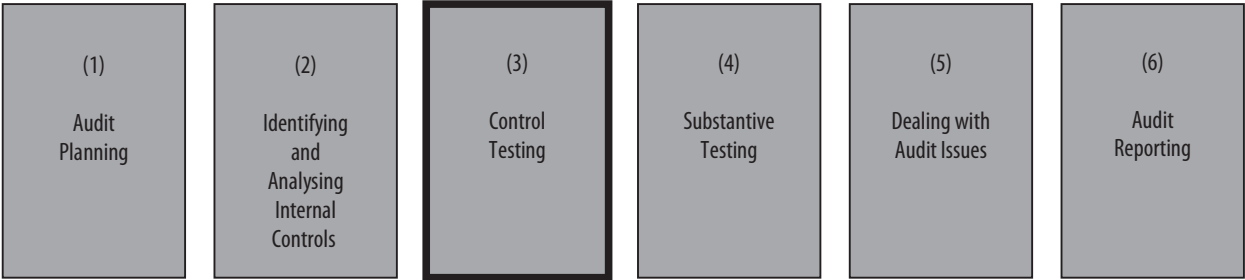
Internal controls are present and seem quite relevant to the process. Staff are generally applying the controls well, and each control is supported by clear and precise user documentation. There have been some changes to business systems and controls since any previous audit.

Low Risk

Internal controls are present and appear to be relevant and effective in their operation. Staff are well trained and are applying the controls. User documentation to support the controls is clear and precise. There have been no changes to business systems and controls since any previous audit.

The auditor's assessed level of control risk should then be documented in the audit working papers, including reference in the control description/testing worksheet. Once the auditor has formed an opinion about inherent risk and control risk, the matrix above can be used to gain an overall initial 'confidence level'. Once the initial confidence level has been determined and recorded in the audit working papers, this stage is effectively complete and the PCA can move to the next stage of control testing.

5.3 Internal Control Testing



Having identified internal controls in the business systems and made initial judgments about these and about the confidence as to compliance, the PCA now tests the effectiveness of those internal controls. This testing is conducted by following these 4 steps:

1. Understanding how the relevant internal controls operate;
2. Designing the control tests;
3. Selecting the sample size for the control tests;
4. Testing documenting and analyzing the control test results.

5.3.1 How do the internal controls operate?

The PCA is now at the point where the trader’s business systems have been documented, the risks to compliance have been identified, and the relevant internal controls to mitigate those risks have been identified and documented. It is now time to test the internal controls to confirm or modify the auditor’s initial judgments concerning the trader’s controls and level of compliance.

Having selected a particular business system, the auditor should refer to the relevant controls/risk matrix and all associated control description/testing worksheet for that system, remembering there will be one description/testing worksheet for each internal control. The control description/testing worksheets will have a description of how each control operates from the work completed at 5.2.2 above, and the auditor must now locate and document the following information which will be important for the design of each control test in the next stage of the PCA:

- What transactions are relevant?
- Where, when, and how often is the process applied
- Is it designed to be a preventative or detective control?
- Who performs the control?
- What is the nature of the errors and non-compliance that could occur in the identified transactions?
- What was the initial opinion regarding the effectiveness of the control?

This information may already be available from the documentation obtained during the audit planning stage, but as auditors are now in the trader’s premises, these types of questions can also be answered by observation of processes, talking to staff, or reading through procedure statements on site.

It is possible that many of the relevant internal controls in the business systems will be computerized controls, in which case the controls will be automated, or be dependent upon computer-generated information. Examples of such controls are:

- computer processes that perform significant calculations for example: import duty liabilities for transaction details;
- automated controls such as edit checks to ensure accuracy when data is input;
- system produced “exception reports” that are subsequently to be followed up by staff, e.g. receipts from one tank do not match with deliveries from source tank;

- computer produced management information, e.g. export sales for duty free purposes;
- controls to prevent or detect access to standing data files by unauthorised staff, such as tariff classification or duty rate updates.

The PCA may require specialist assistance in developing appropriate control testing from an IT expert at this point, and this would have been highlighted during audit planning. Such specialists are skilled in determining whether the company's computer controls are operating, and are operating in accordance with the system documentation that was provided by the company during the information gathering process. In such cases it will also be necessary to liaise with the trader's own information systems auditors and computing staff in order to determine the most efficient testing approach.

5.3.2 Designing the control tests

Based on the information gathered about each internal control, the auditor now develops and conducts the control tests. The nature of each test will depend on what the control is actually supposed to do. The auditor will examine each control and determine what the control entails, ensuring that the control is being performed by the appropriate person or by the appropriate computer program and at the appropriate time. The primary purpose is simply to gauge whether the internal controls being applied by the trader in the way that they should be, in other words the control is operating in the same manner as set out in the business systems documentation.

Examples of control test design could include the following:

1. "Container Unpack Report" (see example from the illustration in 5.2.2 above)

In order to ensure this control is working, the auditor could take a sample of customs import declarations and ask to see the relevant container unpack report. The PCA auditor would then look for the 2 signatures—warehouse manager and senior storeworker. Where discrepancies are found in a container unpack, the auditor could also follow up with the warehouse manager to ensure these were properly reported and acted upon. This control could also be further tested by the auditor observing the unpack process to be certain the tasks are performed properly before signatures are applied.

2. "Weekly Stock-take" (see example from the illustration in 5.2.2 above)

In order to ensure this control is working, the auditor could take a sample of weekly stock-take sheets and ask to see the relevant summary. The auditor would then look for the 2 signatures and/or 2 stamps—one from the bond manager and the other from the assistant. Where discrepancies are found in a stock-take, the auditor could also check to ensure that appropriate investigations were conducted to find and correct the discrepancy. Again, the control could also be further tested by the auditor observing the weekly stock-take process to be certain the tasks are performed properly before signatures are applied.

Internal Control	Control Test Design
Password security in any IT system relevant to a customs transaction	Attempt to sign into a customs IT system
Only allowing access to certain functions in an IT systems to certain levels of authorised employee and protecting this with password features	Ask non-agency staff to attempt to sign into an agency function
'Counter-sign' or 'approval' screen needs to be completed by a senior staff member, before transmitting a declaration, return, statement, etc to the agency.	Select a sample of lodged declarations, returns, statements, etc and confirm a senior staff member counter-signs or approves before transmission.
ID cards have 'swipe' function at building access points. ID card readers at each access point ensure ID card is valid before allowing access and record the movement of the staff member through the access point	Ask a staff member to walk through several building access points, observe ID swiping at each access point, and then ask building security manager for a print-out of the staff members' movements from the relevant building access program and ensure it matches the walk through route.
Certain areas of the trader are restricted, for example the bonded warehouse, where only permitted staff have swipe card access.	Ask a staff member from a non-related area to try and access the bonded warehouse with their ID card.

The examples above are 'manual process' type controls being performed by staff members. In some cases the controls which are relevant to a PCA may be part of an IT system, or be an automated process conducted by an IT system. These controls still require testing as part of the PCA and assessments made by the auditor based on the testing. The following table outlines some common examples of IT based controls that an auditor may need test.

5.3.3 Sample size for control testing

As previously noted, the extent of testing the trader's controls will depend on the level of confidence that the auditor reached at 5.2.3 above. The transactions that will be tested are known as the audit sample and form part of the audit population which is the total number of transactions that fall within the scope

period of the audit. Using the example again from 5.2.2 above, if the PCA covers the period 1 January to 31 December of the previous year, and in that that year 1,000 shipping containers are imported and 1,000 unpack reports are produced by the trader, then the audit population is 1,000 and those unpack reports that are to be selected and reviewed from the 1,000 will represent the audit sample.

Based on a level of confidence (high, medium, or low) decided at 5.2.3 above by the auditor, the following table provides a guide as to how many transactions will need to be tested to confirm the auditor's opinion. From this table, it is possible to select just 30 transactions as an audit sample from a population of several thousand provided the auditor during audit planning and analysis of the business systems and control has an initial high level of confidence.

High Confidence	Light testing (30 items)	The auditor is confident that the control procedure is working and is only looking to confirm this.
Medium Confidence	Medium testing (65 items)	The auditor is reasonably confident that the control procedure is working but is not sure.
Low Confidence	High testing (100 items)	The auditor is not confident that the control procedure is working and is looking to get some feel for the extent of non-compliance. In this case the auditor may choose not to proceed with testing of the control at all and assess the control as being unreliable.

If the initial testing of transactions finds an error then the auditor may choose to extend the testing to the medium or high level and see if any further errors or issues arise in this larger sample size. The auditor is expected to discuss the errors and the proposed action with the audit manager who will have regard to the materiality levels set during the audit planning stage as extended sampling will increase the time needed to conduct the audit. In extreme cases, the auditor could decide not to place any reliance on the control and both the risk rating and levels of substantive testing in the next stage will increase.

After determining the sample size for control testing, the auditor must then decide which samples from the total transactions are to be selected for testing. Where the auditor is not sure how to select a sample of transactions, there are four main sampling options available. These are outlined in full in Stage 4 of the methodology below, “Conducting the Substantive Tests”, however, in short, the sample selection options include: use of a random system; a systematic approach such as an every 10th transaction or item; a block sample such as all of a particular month’s transactions or items; and/or a haphazard approach which may involve some of each of the previous three approaches.

5.3.4 Testing, documenting and analyzing the results of control tests

The auditor now undertakes the tests, selecting the audit sample and conducting the review that comprises the test. For example: looking for 2 signatures on a form; looking at who has signed onto an IT system, looking at who has access to controlled areas, looking at approval stamps etc, with details of results entered on the control description/testing worksheets as the tests are being conducted. The auditor should record the following on each worksheet as it may be required later as audit evidence:

- what was found—e.g. all correct or provide an outline of an irregularity
 - a copy of the relevant documentation should be retained for any irregularities or errors that are noted., e.g. a copy of the report in error, a copy of the unsigned or unchecked document, etc.
- Returning to the sample control description/testing worksheet discussed in section 5.2.2, the auditor can now complete the document by outlining the tests they performed, the sample size and method of selection, as well as the results. Significantly, the auditor should also make a judgment as to whether the initial level of confidence in the controls has remained the same, or whether the level of confidence has improved or dropped.
- what reports (month/number, etc), what processes, what actions were reviewed
 - how many were tested and how was this sample selected
 - who from the trader’s organization was present

Control Description / Testing Worksheet**Auditee****Audit Manager**Control Description: Container Unpack Report

1. Container of imported goods arrives and is met by warehouse supervisor and a senior storeworker. Documents for the consignment and the import declaration are checked against the container number, and if the correct consignment, the seals are broken and the doors of the container are opened.

2. Warehouse storeworkers unpack the container in the presence of the warehouse supervisor and senior storeworker and goods are verified against both the packing slip and import declaration as the unpacking occurs.

3. On completion, a "Container Unpack Report" document is completed in triplicate with details of the consignment and any variance between what was in the container and what was in the packing slip and import declaration.

4. The warehouse supervisor and senior storeworker both sign the Container Unpack Report and sends one copy of the document to Accounts Payable, another to Inventory Control and one is retained in the warehouse supervisor's office.

System:

Container Receipt and Unpack

Notes:

Preliminary assessment:

High level of confidence based on low inherent risk and low control risk.

Description of control test:

1. Check Container Unpack Report for completed of all boxes and report has been signed by both Warehouse Supervisor and Storeworker.

2. Observe on container arrival to ensure process conducted as per operating procedures.

Sampling:

- size: 30 (high level of confidence)
- selection method: Systematic (every 33rd Container Unpack Report starting at 11/0001)
- period: 1/1/11– 31/12/11
- population size: 1,000 (Container Unpack Report No 11/00001 – 11/01000)

Summary of Test Findings:

30 sample Container Unpack Reports numbered 11/00001, 11/00034, 11/00077.....11/00991, reviewed for completeness and both supervisor and storeworker signatures. On Report 11/00041 the storeworker had not dated his signature, but this was considered immaterial and no extension to the sample was needed. The supervisor was shown the oversight and reminded to ensure both signatures are dated.

A container arrived during the audit on 2 May 2012, Report 12/000432 applies. The receipt and unpack process was observed and found to follow staff operating procedures.

Control Assessment after test:

The high level of confidence in the system is retained

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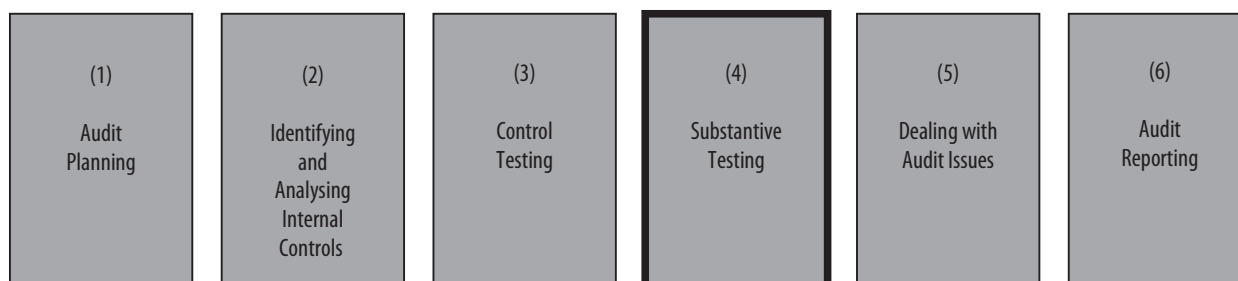
Once the testing has been conducted and working papers for each control test completed, the auditor should form an opinion as to the effectiveness of the internal controls, in particular those key controls that relate directly to ensuring compliance in the business systems. The confidence level, in terms of the controls, is again assessed and expressed as either high, medium or low, using the same guide that was used prior to testing. This opinion should be documented in the appropriate control description/testing worksheet and also in the relevant control/risk matrix for the business system in the box titled 'Control Assessment After Testing'.

If any material issues are found during testing, or compromises to controls detected, these should also

be outlined in more detail in a separate audit issues worksheet (see Annex 9) and each of these audit issues recorded in an audit issues log (see Annex 10). Errors or irregularities should be raised with the trader at this time, and indeed some may be quickly resolved. The auditor keeps track of the resolution of these issues through the audit issues log. However, material errors that are disputed by the trader will need to be dealt with at a later stage of the PCA.

Once an opinion as to the level of confidence in the internal controls has been documented, the auditor can move to the next stage of the process.

5.4 Substantive Testing



The PCA now tests the effectiveness of relevant internal controls by testing the passage of actual data from the business systems through the internal controls. There are four main steps to substantive testing which include:

1. Designing the substantive tests;
2. Selecting the sample size and sampling approach for the tests;
3. Conducting and documenting the tests;
4. Evaluating the results.

Even with the highest level of confidence in the trader's controls, a level of substantive testing is required to confirm this. The transactions that pass through these controls, if correct, provide the auditor with this confirmation.

5.4.1 Designing the substantive tests

Substantive testing includes any verification, inquiry, observation, inspection, confirmation, recalculation or analytical review that tests the accuracy of data that affects the trader's compliance with agency requirements. This form of testing may be familiar to auditors who have been involved in transaction-based checking activities such as documentary checks and cargo inspections. Substantive testing often relates to comparing information reported on declarations, statements or returns with the relevant commercial documentation. However one major difference between traditional audit methods and PCA relates to audit sampling which is discussed below.

The actual substantive test will relate directly to the business system or business systems being reviewed. For example, if the auditor was reviewing the tariff

Examples of Substantive Testing

1. Import Declaration lines. Sample of import declaration lines selected from total import declaration lines and compared with commercial documentation to verify:
 - ▶ tariff classification
 - ▶ duty rate usage
 - ▶ tariff concession usage
 - ▶ valuation
 - ▶ origin
2. Receipts at a petroleum installation. A sample of warehousing declarations selected from total warehousing declarations for petroleum product destined to the installation checked to ensure that each has been correctly:
 - ▶ received into the recording systems at the installation
 - ▶ adjusted to reflect any temperature variations
 - ▶ measured by ensuring that tanks were dipped properly pre and post receipt
 - ▶ received in a timely fashion
 - ▶ followed up in relation to any variances
3. Export declaration lines. A sample of export declarations selected from total export declarations and examined against commercial documentation to verify:
 - ▶ classification;
 - ▶ valuation;
 - ▶ destination
 - ▶ departure dates
 - ▶ permit requirements met
 - ▶ other compliance requirements.

master file system of a trader which holds information relating to tariff classification, origin and duty rates for each product imported, then substantive testing would be verifying the classification, origin and duty rates for a sample of import declarations.

5.4.2 Substantive testing sample size and sampling approach

In some situations substantive testing may involve 100% verification of all transactions, e.g. in the case of small traders, or traders considered to represent a high risk of non-compliance due to poor internal controls. However, for large traders this will not be feasible, in which case the auditor should select and test a number of transactions from the entire audit

population sufficient to form an opinion about the trader's level of compliance.

The extent of testing to be performed, i.e. the number of transactions to be checked for each test, will depend on both the auditor's initial level of confidence when first analysing the control environment, and the level of confidence directly after control testing, as to whether the trader has the systems and controls that will ensure compliance with the relevant legislative requirements.

Based on this approach, the following table provides an appropriate guide to sample size selection in the regulatory compliance context:¹

1. Designed statistically to establish a 95% confidence level that no more than 1.5% of transactions have errors.

Confidence	Post Control Test Confidence	Substantive Testing Sample Size
Not using PCA	Not using PCA	200
Low or Medium	Low	200
Low	Medium	200
Low	High	100
Medium	Medium	150
Medium	High	50
High	Low	100
High	Medium	50
High	High	30

After identifying the total transactions in the audit population (e.g. the trader may have 10,000 import declaration lines for the audit period), and the size of the audit sample based on the table above, the auditor will need to determine how to select the samples from the audit population.

The method of selection should ensure that the sample chosen is representative of the total population being examined. This means that, to the maximum extent practicable, all items in the population should have an equal chance of being selected. Common techniques to achieve this, explained below, include:

- random number sampling;
- systematic sampling;
- block sampling; and
- haphazard sampling.
- Random Number Sampling

Random number sampling is based on the use of a random number generator or random number tables. The first and last transaction number are input to the random number generator program or table, which then identifies the transactions or items to be tested, e.g. invoice numbers, declaration numbers, packing slip numbers etc

This method relies on the auditor's ability to establish the start and end numbers for the population to be sampled, and is only effective when the transactions or items in the population, i.e. the 'sampling unit', are either sequentially numbered, or stored in sequential number order.

This sampling technique ensures there is no bias or favoritism shown by the auditor, and ensures all transactions have an equal chance of selection in the sample.

Systematic Sampling

Systematic sampling involves selecting every 'X' number of items in a population, where X is the determined sampling interval. Systematic sampling requires the auditor to:

- determine the population size and sample size
- establish a sampling interval by dividing the sampling size into the population size
- randomly selecting a start point in the first sampling interval
- selecting the sampling items located at the start point and at subsequent sampling intervals from the start point.

For example, if the sample size is 50, and the audit population is 1,000, then the auditor will select every 20th transaction for testing.

Block Sampling

Block sampling involves the selection of a number of grouped sampling items, for example checking all transactions for selected dates, or from selected sites. Some auditors may use this approach if wanting to stratify an audit population, perhaps only wanting to test transactions over a certain value, or from a certain foreign supplier, or from another set of risk criteria.

However, care needs to be taken to ensure that sufficient blocks are selected to be able to reach a reasonable audit conclusion for the total period being audited. Selecting one or two small blocks over a large period with bias towards a certain target sample will not achieve this, and other issues could be missed. Examples of block sampling include:

- a number of days/weeks in the audit period
- all lines over a certain value
- all duty free deliveries
- all exports
- any combination of the above points.

Adjustments could be made to the block during the test process to avoid major over- or under-sampling.

Haphazard Sampling

Haphazard sampling is defined as sampling transactions or items which have been selected without any conscious bias. The items should be selected in a manner that can be expected to be representative of the population. However, it does not require any form of systematic selection.

Haphazard sampling is probably best explained by saying it is a combination of one or more of the three approaches listed above. However, care must be taken to avoid distorting the sample by selecting, for example, only unusual or physically small items or omitting items such as the first or last items. Further, this technique must not be used as a way of avoiding difficult items.

While it is acceptable to use any one or any combination of the above techniques, it is important to ensure that the sample is representative of the total population.

5.4.3 Conducting and documenting the substantive tests

The auditor should now complete a substantive testing worksheet (See Annex 8) for each test process (it is possible that two or three different substantive tests may have been conducted to review the effectiveness

of a single internal control). The substantive testing worksheets should also be cross-referenced to the relevant control/risk matrix in relation to the particular business system which will be tested, and the relevant control description/testing worksheets which relate to the controls in that business system, thus maintaining the organization of the audit working papers.

As a minimum, documentation of the substantive test should include:

- objective of the test
- description of the testing procedures
- level and extent of testing
- basis for sample selection and sample sizes (and stratification definitions if relevant)
- the total sampling population.

The sample of transactions is now selected from the total population using one of the sampling techniques listed above, and the substantive tests as designed are performed by the auditor.

If the sample size has been determined using the above table and no errors are detected, the auditor is able to reach a conclusion with a high level of confidence that there is a very small chance that an error in the total population has not been detected.

However, if errors, omissions or other forms of inaccuracy are found, these should be documented in the substantive testing worksheet, and an audit issues worksheet raised for each type of error. As with control testing, most errors or irregularities should be raised with the trader at this time, which may result in a speedy resolution of the issues.

In the following substantive testing worksheet the auditor has conducted a substantive test in the trader's tariff master file business system which manages the tariff classification, description, value, origin, and duty rate for all of its imported products, by testing a sample of import declaration lines against relevant commercial import documentation.

In this example the auditor has found a number of errors. Initially all errors must be regarded to be of equal significance, since relatively small errors (e.g. small duty loss) may in some cases represent

Substantive Testing Worksheet**Page 1/7****Auditee****Audit Manager****System:** Tariff Master File **Transaction:** Tariff classification and duty rates**Test Description:**

Import declaration lines reviewed against commercial documentation for accuracy in terms of: Tariff Classification; Value per Unit; Origin; and Use of Tariff Concession.

Sample Size: 100 (high initial level of confidence, low level of confidence after control tests)

Selection Method: Systematic (every 30th import declaration line)

Period: 1/1/11-31/12/11

Population Size: 3,000 lines from 500 import declarations

Transaction Details	Test Results
11000078A Line 3	Nil error
11000765F Line 6	Nil error
11000612K Line 1	Nil error
11000612K Line 16	Nil error
11000754A Line 2	Nil error
11000865M Line 4	Nil error
11000921N Line 7	Spelling error "goods description"
11000954G Line 3	Incorrect duty rate applied
11001002Y Line 2	Nil error
11001002Y Line 16	Nil error
11001234H Line 4	Nil error
11001245K Line 5	Nil error
11001356P Line 3	Nil error
11001378K Line 8	Nil error
11001456J Line 2	Nil error
11001789H Line 4	Nil error

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a risk if the same error was to occur in relation to a larger transaction. For example, where a tariff classification is incorrect on a low value line on an import declaration, the duty loss may be immaterial in terms of the audit plan. However, if that same error occurred on a high value line the duty loss would in fact be material.

Consequently small errors found during testing are documented and a judgment on whether to increase the sample size needs to be made after reaching the end of the sample. In this regard, the auditor needs to consider whether the small error was an isolated incidence (e.g. a staff member was away from work on leave, or there was an IT glitch). If so, there should be no other like errors found. If the auditor has started with a high level of confidence and the sample size was fairly small, then there may be a need for further testing in order to confirm that the small error was a one-off.

By increasing the actual sample size the auditor will be able to see if more of the same errors are occurring, and possibly one of these errors may appear on a high value line and change the auditor's confidence levels. The increase in sample size could be targeted, for example through the use of 'block sampling' to cover a particular period of time or perhaps all high value/high duty goods.

A decision to increase sample sizes depends on the circumstances of the error or errors and whether the explanations by the trader are acceptable. Such decisions should be discussed with and approved by the audit manager as this may increase the workload on the PCA considerably, particularly in the case of large traders.

5.4.4 Evaluation of substantive test results

Having completed substantive testing in each of the business systems subject to PCA, the auditor needs to consider what errors were found, how many were found, were they material, and more importantly what do they mean? Each error is now recorded in its own audit issues worksheet in the same manner as when errors were detected during control testing.

Where the auditor believes that there are no material errors and has completed the substantive testing worksheets to this effect, then provided the audit manager signs off, it should be possible to form an opinion that the trader is likely to be compliant. However, where errors have been detected during substantive testing, the auditor must make certain judgments about the nature of these errors, often in consultation with the audit manager. In this process, the following types of questions need to be addressed:

- Are the errors material as set out in the audit plan, e.g. leading to material under and over statements of duty, or are they immaterial and likely to have no impact on compliance?
- Are the errors consistent, i.e. is there a pattern of the same error occurring continuously? This is likely to indicate a breakdown in one of the systems or controls (for which the audit can recommend remedial action) and that a systemic error has occurred.
- Are the errors of a more serious nature in terms of frequency and size, indicating perhaps a large-scale failure of management and of the trader's controls (for which the company will be required to take immediate corrective action and may be the subject of sanctions)? Such errors could be an indication of carelessness, recklessness, or non-regard for compliance, and can actually facilitate internal or external fraud if not immediately rectified.

Consider, for example, the word 'spoons' being incorrectly spelt 'spools' in the Goods Description field on an import declaration. Would the trader be considered a high-risk of non-compliance? Such an error may or may not lead to a loss of revenue depending on the particular country of import. However, even if it did not lead to revenue non-compliance, it indicates a lack of quality assurance (QA) around the input of data into the trader's tariff master file or similar system. If the QA process of inputting data to a tariff master file is not picking up spelling errors, is it also missing incorrect input of other data? These are all issues that the auditor must consider.

The auditor's views about the nature of errors—one-off, immaterial, material, systemic, etc.—must be capable of being supported, and it is therefore

necessary for the auditor to keep copies of the relevant documents that were checked which relate to the error. This will form part of the audit evidence and be kept with the substantive testing worksheets in the audit working papers.

Where it is determined that errors are not of an isolated nature, a decision must be made as to whether the sample size will need to be made larger (perhaps even to 100% of the audit population in some situations) not simply to confirm an opinion on compliance, but to identify the impact of the error, such as calculation of the amount of revenue loss for recovery from the trader.

At the end of the substantive testing stage, the auditor must be satisfied that sufficient evidence has been collected to form and confirm their opinions on compliance. In this regard, consider how the auditor has worked through the two different errors found during the substantive testing above on the relevant audit issues worksheets, noting their contact with the trader for an explanation, the possible expansion of the sample size and the formulation of recommendations to remove these errors in the future:

Audit Issues Worksheet

Auditee

Audit Manager

Issue Description:

Substantive testing in Master Tariff File system.
One line in sample had goods description as “plastic spools” and not “plastic spoons” as per tariff classification.

Indicates possible lack of QA in terms of inputting product information to Tariff Master File.

Logged	2/5/12
Issued	2/5/12
Response	3/5/12
Follow-up	n/a
Closed	4/5/12

Company Response:

QA conducted on product data input to Master File, but not on immaterial fields like ‘goods description’. Operating procedures will be amended to include goods description in QA process.

Follow-up:

N/a

Closed:

Finance manager has shown the PCA team an updated QA procedure which includes a review of goods description field.

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Audit Issues Worksheet**Auditee****Audit Manager**Issue Description:

Substantive testing in Master Tariff File system.
One line in sample had the incorrect duty rate for the tariff classification.

Indicates recent duty rate increase not input to Tariff Master File.

Logged	2/5/12
Issued	2/5/12
Response	3/5/12
Follow-up	4/5/12
Closed	5/5/12

Company Response:

Updated the duty rate increase in Tariff Master File after the official start date of the new rate.

Follow-up:

Sample size expanded to 200. No further errors detected.

Closed:

Staff member responsible for updating Tariff Master File was on sick leave and information on the new duty rate was not input until the staff member returned. The error is considered material and will form part of the Audit Report and new procedures recommended for timely input of all duty rate changes.

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Suspected Fraud

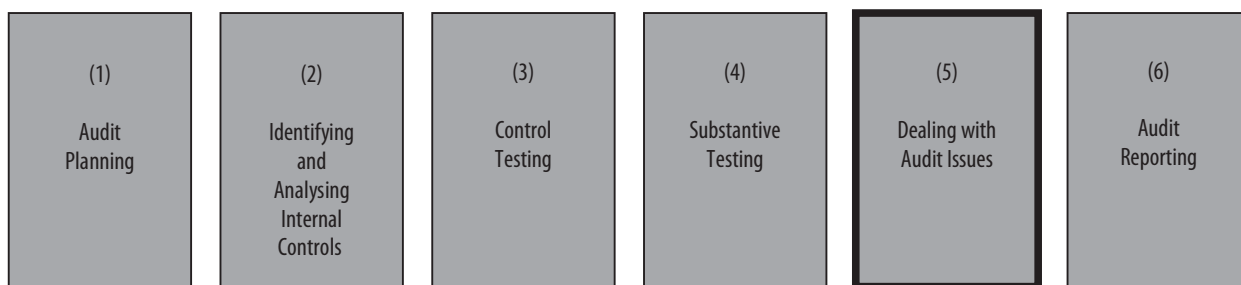
If it is the opinion of the PCA auditor that the non-compliance detected may be due to fraudulent activity on the part of the trade or individuals within the company, then this should be reported to the audit manager immediately.

Suspected fraud against the border administration should be handed over to the relevant investigation authority either within or external to the agency. Fraud is a crime, and its investigation and prosecution involves skills very different to those of the auditor.

Auditors should remember, however, that they may become prosecution witnesses, and their audit working papers would be used as evidence in any prosecution case. Therefore, all audit papers should be properly completed, filed, and stored securely.

Internal fraud will be treated differently, and will involve working with the company to address the relevant internal controls to ensure future protection of revenue and future compliance, as well as recovery of any lost revenues. The matter will then become an issue for the individual, the trader and local police.

5.5 Dealing with Audit Issues



Many issues that arise during the audit can and should be discussed informally at the time they are found. Less significant errors and issues, non-material issues and simple misunderstandings can often be dealt with at the time they are discovered and do not necessarily need to carry through to the current stage of the audit.

This stage of PCA seeks to resolve any issues identified during testing which could not be properly dealt with or agreed to at the time of testing, or issues that were discussed and were material and therefore need to form part of the Audit Report and its recommendations. This stage includes three main steps:

- Analysis of outstanding audit issues;
- Response by the trader to audit issues; and
- Initiating any immediate follow-up actions.

5.5.1 Analysis of outstanding audit issues

At this point in the audit control and substantive testing should be completed, and issues arising from that

testing, or from audit procedures generally, will have been identified and documented on an audit issues worksheet (Annex 9).

The audit issues should be discussed with the trader openly in the context of working collaboratively to improve compliance. All such issues should be listed on an audit issues log (Annex 10) which will be used as the basis for raising the various issues with the trader and recording their response.

The purpose of this stage of the audit is to ensure that traders are not surprised or ‘ambushed’ at the end of the audit with a range of issues involving possible non-compliance that may result in recommended remediation of systems and controls, or even sanctioning. Consequently PCA auditors should be looking to work closely with the trader to resolve the various issues, and this may require a number of meetings, reviews of the audit evidence, and discussions.

Sharing all audit issues with the trader at this point in the PCA also ensures that the auditor has properly understood the business systems under review, the

operation of the relevant internal controls and the transactions under review.

5.5.2 Response by the trader to audit issues

Before providing a response to some of the issues raised, the trader may wish to undertake its own internal checks to determine precisely how the errors or issues arose. The auditor should therefore allow a short period of time (usually no more than a week) for the trader to respond to any formal audit issues. Responses can be expected to take the form of one of the following:

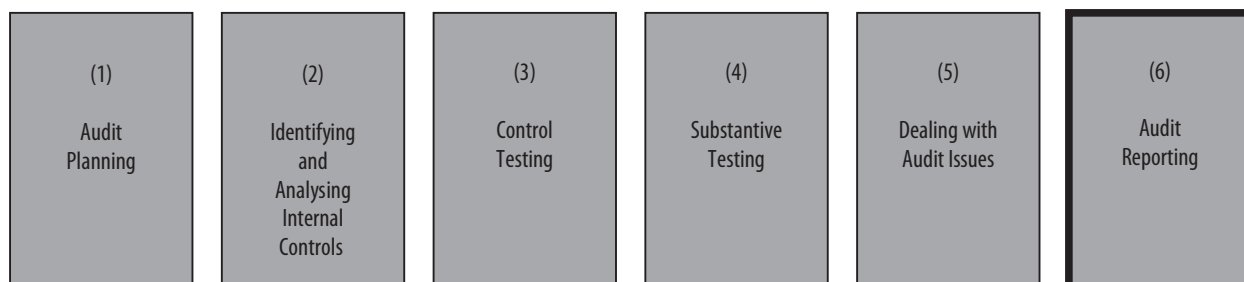
- acceptance of the issue and immediate resolution (that is resolution prior to audit completion), details of which can be incorporated in the final audit report;
- acceptance and an undertaking to implement any remedial action that will be recommended in the final audit report. The trader will implement the recommendation following completion of the PCA and the auditor will also need to consider whether the agency should return after a period to ensure the recommendations have been properly implemented;
- acceptance but disagreement that issue is material, arguing that the error or issue should not have any impact on the opinion as to compliance in which case the auditor and audit manager should review any supporting evidence from the trader and determine if the trader is correct;
- disagreement, claiming that the errors or issues have been incorrectly identified (and in fact do not represent errors or issues) in which case the auditor and audit manager should review any supporting evidence from the trader and determine if the trader is correct.

These trader's responses should be documented on the appropriate audit issues worksheet, and they will form part of the final audit report (and importantly its recommendations). Where the trader continues to disagree with a finding after discussions with the auditor, the auditor's opinion will stand and be included in the final audit report, but the trader's position will also be documented and included in the report.

5.5.3 Initiating any immediate follow-up actions

Where specific errors and audit issues are not resolved during the PCA, there may be a need for immediate regulatory action such as recovery of duty short-paid, recovery of over-paid refunds, or suspension of a licence or permit. Any such actions that are recommended by the auditor should be documented in the PCA working papers for subsequent referral to the appropriate areas of the administration for action. Such recommendations will also appear in the final audit report.

5.6 Audit Reporting



The findings of the PCA and importantly its recommendations on improving compliance are now formally communicated with the trader at management level. This stage includes:

1. Preparing the audit report; and
2. The exit interview.

5.6.1 Preparing the audit report

The audit report represents the formal communication from the audit team to the trader. It contains the findings of the audit, including the auditor's opinion as to the level of compliance based on the results of the audit procedures, and it makes certain recommendations as to how the trader can improve compliance in the future.

The audit report should be seen by both the agency and the trader as an opportunity for adding value to the trader's business. Discussion and recommendations about compliance should address the most efficient means of complying and where possible, enable the company to reduce its cost of compliance.

Significantly, the audit report will be one of the key starting points in any subsequent PCA activity, and should be used by the company's own internal or external auditors to inform their own reviews.

In the context of working collaboratively to improve compliance, the audit report is issued in draft form in the first instance. The trader is then given the opportunity to comment, in particular, in relation to the audit opinion, audit issues and recommendations. The trader should not be confronted at this late stage of the audit with any issues that are being raised for the first time.

- The following details must appear in the draft report:
- Title of the audit report (clearly showing 'draft');
- Name of the trader subject to PCA;
- Audit scope and objectives;
- Name of the audit manager who is approving the PCA; and
- Date of the report.

The content of the report should include:

- the main PCA findings and recommendations in summary form, such as a summary of the type and nature of errors found and the main business systems to which these errors relate;
- audit issues for resolution by the trader, and the need or otherwise for the agency to follow these up;

- comments from the trader on the PCA findings and recommendations, including agreements, disagreements and where applicable, comment on how and when recommendations will be implemented;
- an opinion as to the overall level of compliance of the trader in terms of the audit objectives and scope; and
- any qualifications or caveats to this opinion such as the need to await further information from the trader, or perhaps certain aspects of systems that were unable to be tested.

The draft audit report is then handed to the trader for review and submission of a formal written response in relation to opinions, issues and recommendations. The auditor should again work with the trader to resolve any disputes in the findings so that the final report, when issued, is acceptable to all parties. Of course, where an issue cannot be resolved, the auditor's findings prevail and will appear in the final version of the report.

The trader's responses will be added to the draft report, together with any further amendments by the auditor arising from consultations about the draft report. The report is now issued as a final audit report, ready for distribution to the trader and to relevant areas of the agency, including PCA management, risk assessors and profiling and targeting areas.

5.6.2 The exit interview

Following completion of the final audit report, the auditors will arrange for an exit interview with the audit manager and the management and other representatives of the trader—usually the same people involved with the entrance interview.

The main purpose of the exit interview is to:

- present the audit report to management;
- reach formal agreement with management as to the main PCA findings;
- obtain management commitment to implement or act on recommendations, together with relevant timeframes; and
- continue a co-operative relationship between agency and the trader.

Minutes or notes should be taken at the exit interview, particularly details of commitments to recommendations and relevant timetables for implementation.

These notes should then be filed with the audit working papers. These notes will help to inform future PCA planning activities (see section 8).

6

Audit Working Papers

Annexes 4 to 10 contain a set of working papers relevant to any audit that utilizes the generic PCA methodology discussed in this Guide.

Working Paper Index Page (Annex 4)

This index should remain on top of the audit working paper file. A reference letter (i.e. A, B, C, etc) should be used for each section of the working papers.

More detailed indexing may be added as each stage of the PCA is completed.

General Working Paper (Annex 5)

The general working paper is virtually blank note paper, which can be used for general note taking or in situations where none of the specific worksheets are suitable (e.g. where an auditor is taking notes while reading from a company document or interviewing a staff member). Annex 5 also contains an example of how the general working paper can be completed with notes that could be taken at an entrance interview (see section 5.1 of the Methodology).

Control Description/Testing Worksheet (Annex 6)

This worksheet is commonly used to describe in more detail the internal controls which have been identified in a business system, as well as details of both the relevant tests to be conducted on those controls and the results of those tests. Each business system could have more than one internal control and each internal control should have its own control

description/testing form, linked back to the business system in which it operates. The control description/testing form here should be read with section 5.2.2 of the Methodology.

Control/Risk Matrix (Annex 7)

The control/risk matrix is central to PCA with its focus on the business systems of the trader. A separate matrix should be used for each business system subject to PCA. The control/risk matrix example here should be read with section 5.2.2 of the Methodology.

Substantive Testing Worksheet (Annex 8)

This worksheet is intended to be used for recording the details of transactions to be tested, as well as the nature of tests, and the results of the testing.

Sufficient details should be recorded to enable a reviewer to see what item was actually tested, and the results against each item in the test. The worksheet should be read with section 5.4.4 of the Methodology.

Audit Issues Worksheet (Annex 9)

The Issues worksheet should be used when significant issues arise during an audit. In some situations these can be resolved readily with the trader and addressed at the time of discovery. This detail is noted on the worksheet. Other significant issues not readily addressed at the time, will form part of the overall assessment of the trader and feed into recommendations to improve compliance. The examples here should be read with the example in Annex 8 above, and with 5.4.4 of the Methodology.

Audit Issues Log (Annex 10)

The issues log is used to manage those audit issues documented on audit issues worksheets (Annex 9) including the communication of these issues with the trader. The audit issue log allocates a reference number to each issue then includes a summary and notes the date of communication. Importantly, the

audit issues log will also record the trader's responses to the issue, and dates. From here the auditor can look at whether those issues will impact on the final assessment of compliance, what recommendations to make and what needs to form part of the final audit report. The audit issues log is central to dealing with audit issues (section 5.5 of the Methodology.)

Quality assurance, filing and using audit results

Ensuring quality and integrity of the PCA

The PCA methodology outlined in this Guide regularly refers to the role of an audit manager. This is a key position, requiring someone with considerable experience in reviewing business systems in the context of risk to compliance and the skills and ability to ensure that the members of the PCA team are making judgments and recommendations based on appropriate testing and sound audit evidence. Responsibilities of the audit manager include:

- ensuring the audit is conducted to the standards set by the administration, including those which apply to the qualification of audit team members, the planning, testing, and the opinions and recommendations to be expressed in the audit report;
- reviewing and approving the work of auditors at each stage of the PCA before progressing to the next;
- ensuring that the audit working papers containing the audit evidence are properly completed, reviewed, signed and filed, and eventually stored securely for future use;
- taking responsibility for delivering the audit on time and within budget using appropriate resources, including external specialists when required;
- dealing with any issues arising with the trader during PCA, particularly those which are sensitive, or where there may be disagreement between the auditor and the trader in areas such as materiality of errors, opinions on compliance and recommendations;
- establishing formal contact with the trader, including chairing the entrance interview and exit interview; and

- delivering the finalized audit report to the trader at the completion of the PCA process.

Critical to the integrity of the PCA is the preparation and accurate completion of working papers at each stage of the audit. These must be completed in a logical order, matching the processes that are being reviewed, with a clear reference to the relevant business system. To facilitate this, the various working papers should be cross-referenced with other working papers relating to the business system under review. Each document should also identify which member of the PCA team has prepared and reviewed the worksheet.

Working papers, once completed, should be filed together with other working papers from the same business systems and then filed against an index which enables future users to readily identify any part of the audit. A sample of a working paper index which follows the above methodology can be found at Annex 4.

Safe care of audit working papers

Once the PCA has been completed, and working papers appropriately filed, audit evidence and reports should generally be accorded an 'audit-in-confidence' status, and be kept under lock and key, with restricted access. Where one or more documents of a higher security classification such as commercially sensitive materials or details of IT system access, etc, are included in the working papers or audit report, then the audit file and associated working papers will require a higher security classification, and may require a more secure storage and retrieval system.

It should be noted that such PCA working papers are likely to be used again as the starting point should

the trader be selected for PCA subsequently, including follow-up activities on certain recommendations requiring action from the trader. As previously noted, PCA working papers may also be required by investigators should the trader come under suspicion at a future point and may become evidence in possible investigation and prosecution proceedings. Consequently audit working papers need to be readily accessible to future users, who must have confidence that all materials are present, i.e. that none are missing or stored elsewhere.

It should also be noted that, in the case of civil or criminal prosecutions, the ability to demonstrate that PCA working papers have been properly and safely filed adds to their weight as reliable evidence.

Use of PCA working papers

At the end of the PCA process it is important to feed the results of the audit into the agency's broader compliance management process. This assists planning by updating a trader's risk assessment and identifying trader or sector specific compliance issues that the PCA has identified. Compliance analysts will be examining errors and other issues that have been identified across a range of audits, and it is therefore essential to provide a high degree consistency in the way in which audit results are communicated. Adoption of the following general principles when creating audit reports and databases will enhance their usefulness:

- Industry segregation of information should be provided, to enable monitoring of issues within and across industry sectors. This will require assigning all companies to a particular industry groupings (and sub-groupings if desirable). For example, the automobile industry grouping could be broken down further into sub-groups of importers of finished vehicles; manufacturers using imported components; importers of components; free zone manufacturers; vehicle distributors, etc.
- Stratification of companies by size, or volume of trade e.g. large businesses, medium businesses and small businesses
- Identification of risk areas. For example, importer risks may include valuation, tariff classification, origin, suspension regimes, import permits and licenses; while manufacturer risks may include classification, valuation, quantities, undeclared production, permits, licenses, losses, etc.
- Nature and value of detected errors, with a capacity to give a narrative on the errors detected and to quantify the extent of those errors in sufficient detail to allow for later analysis.

In essence, PCA results need to be captured in a format consistent with the risk management needs of the administration so that trends and other patterns in errors may become apparent or begin to emerge, allowing for better targeting in future compliance-planning processes. Whilst an audit report will highlight an area of risk, the actual working papers can provide an excellent insight in to how traders make the errors and how they can be detected, and this point emphasizes the importance of keeping good working papers which are properly linked to the relevant business systems in the audit file, and are easily accessed from the agency's database.

Following is a possible template for collating PCA results from the audit working papers and reports:

Table 7.1: Database of Results

PCA Plan 2012/13						
Trader Name	Date complete	Reason for PCA selection	Industry Sector/ sub sector	Material Error types	Follow up PCA needed	Audit Filing ref#
XYZ Co	03/07/12	Random selection of small trader	Agriculture / Chemicals	Nil	No	319b/12
ABC Ltd	14/07/12	Large importer not audited for 5 years	Auto / Parts supply	- tariff master file contained some outdated duty rates - new products not checked for accuracy before loaded into tariff master file	No, resolved No, resolved	432a/12
DEF Pty Ltd	30/7/12	Large usage of duty free end use by-law	Computer hardware	- Use of single use "education institution" certificate for multiple imports	Yes, recommend trader engage licensed broker to compile and lodge declarations	542c/12
GHI Partners	2/8/12	Duty drawback claims value for exported fuels doubled from previous year	Fuel / blending & distribution	- Multiple Customer Sales Invoices incorrectly coded as "duty paid exports to foreign vessels" when status of fuel was under-bond	Yes, trader agreed to implement 'approval' process prior to issuing Customer Sales Invoices, new process requires review.	558/112

Note that, in addition to material errors, the database should also contain details of required follow-up action such as the need for a follow-up audit resulting from adverse findings in a PCA which require the trader to take immediate remedial action to business systems and controls.

Finally, the database should contain adequate referencing to enable location of PCA working papers and files.

Developing a National PCA Plan from PCA Results

As noted above, PCA results should be fed into the agency's broader compliance management process, and the best way to achieve this is in the formulation or modification of the agency's national PCA plan. In particular, the major findings from PCA activity

should be reviewed for emerging issues, trends towards or away from compliance, and commonly occurring errors, all of which will inform the next national PCA planning and development process.

For example, a change in eligibility criteria for use of a particular duty concession may have generated a large number of under-statements of duty liability from traders who have been using the concessional arrangements for several years. The administration's risk response, which is incorporated into its current national PCA plan, may have been to target large users of the duty concession, and also to increase education and awareness of the criteria changes. However, if having reached the end of its current national PCA plan, material errors are still being discovered, then the agency should identify this as a high risk in its next national PCA plan and perhaps consider additional risk responses.

Alternatively, towards the end of a national PCA plan, risks identified at the outset of the plan may not be as apparent, and indeed higher levels of compliance are observed during PCA activity. Using the duty concession example, such findings are likely to indicate that the trading community has appropriately responded to the change in criteria as a result of the national PCA strategy. Therefore, the risk may now be reduced to an acceptable level and will not be specifically targeted in the next iteration of the national PCA plan. Rather, that particular issue will form part of the general risk analysis when reviewing a trader's business systems in the context of PCA.

Emerging risks, which can be fed directly into the planning process of the next PCA plan, may include the type and nature of material errors, and from which types of traders and in which types of industries they are occurring. For example:

- Types of material errors being detected. For example non-compliant origin certificates, certain cost elements being excluded from valuation, unauthorized access to IT systems that generate agency transactions, or unauthorized personnel accessing the bond-store;
- Types of trader making material errors. For example mid-sized importers, large exporters, or traders not visited for 5 years, etc; and
- An industry sector or industry sub-sector that is making an increased number of errors, or making common material errors.

In summary, the following details of the completed PCA should be capable of being taken directly from the PCA results database and fed into the next iteration of the national PCA plan:

- High risk in current PCA plan confirmed—yes or no;
- Success of responses to identified high risks;
- Emerging areas of risk;
- Ongoing areas of risk; and
- Required follow up activities.

This information then adds to the new information on risk emanating from other areas of the administration such as intelligence, cargo examinations; industry complaints, hot-lines; and legislative or administrative changes, in the preparation of the next PCA plan.

Enablers and Impediments

In this section we examine a number of regulatory, organizational and administrative issues that may have an impact on an administration's ability to implement a PCA regime, including the skill and qualification requirements of staff involved in PCA activities.

Qualification and Skill Requirements

Those involved in PCA activities must be appropriately skilled and experienced to do so, and for those administrations that have not yet introduced PCA, it is unlikely that existing audit staff will possess the skills required of a PCA auditor, particularly where current audit work is focused on transaction based checking. PCA auditors require higher level skills due to the broader range of functions and increased complexity of the audit activity, where the emphasis is on assessing the overall integrity of traders' systems.

Indeed, PCA auditors should not only possess high level audit skills, but must also have relevant border agency knowledge coupled with a knowledge of traders' operations, which includes an understanding of Government policy and environmental, commercial and international issues relevant to a given industry sector.

There is therefore a need to consider whether it is preferable to provide agency and industry knowledge to a person with relevant audit qualifications through an appropriate training program, or to supplement an employee's acquired knowledge with formal training in auditing. Put simply, it is a question of whether the agency should hire qualified auditors and educate them in agency/industry matters, or seek to educate existing staff in auditing matters.

It is generally considered that, given the range of available education programs, either situation is

acceptable. Indeed, a balanced mix of qualifications, skills and knowledge within PCA units is seen to be highly desirable. Consequently, existing staff with the ability and willingness to improve their skills and qualifications should be given the opportunity to do so. Equally, a program of entry level recruitment of graduates may be pursued to ensure a balanced mix of skills, qualifications and knowledge within PCA teams.

The main features of an education program should include:

- a procedural curriculum to provide base level skills and relevant agency and industry knowledge
- modules relating to higher level audit skills such as sampling, research and accounting which can be obtained through in-house or external courses
- elements such as team development, client service, management development, applying the law and negotiation skills, and
- a capacity for accreditation towards tertiary courses by educational institutions.

Each level of the program should include specific agency and industry elements, as well as elements addressing such skills as research, analysis, evaluation, planning, sampling, report writing, audit, accounting, negotiation skills, client service, etc.

The general trend in all fields of education is towards ensuring that courses can be accredited towards tertiary qualifications. This provides staff with a greater incentive to participate in educational programs, and accreditation received through the various agency programs may encourage staff to continue tertiary studies. Accreditation will also give individuals and the administration more credibility when dealing with the trading community.

Composition of PCA Teams

PCA teams are by their nature multi-functional, and the structure of teams should therefore reflect the various levels of knowledge and experience required to carry out PCA activities. Not all team members will need to possess the same level of skill, experience or qualifications. It is therefore important to stratify the levels of competencies, skills and qualifications to realistically reflect the composition and classification levels of multi-functional teams and the range of skill and knowledge requirements within that team. The process of stratification should also reflect the appropriate balance between agency and industry knowledge, audit techniques and other skills/qualifications required.

The key team member is of course the audit manager, who is responsible for assembling an effective PCA team from the available resources, looking each time to build a balance of audit experience, industry knowledge, technical skills and the opportunity to develop junior or new staff in the PCA area.

The audit manager must also identify potential gaps in relation to specialist knowledge, skills and/or competencies that may be required during the course of a particular PCA, taking into consideration the nature of the trader's activities and the types of the risks that are likely to be faced. If the necessary skills cannot be sourced from within the audit group, it may be necessary to fill these gaps using expertise drawn from other areas or in some cases from outside the agency. Other reasons for using external expertise include the need for a high degree of confidence in audit opinions relating to a politically sensitive trader or a trader who runs a particularly complex operation.

The audit standards referred to in section 3 above not only permit the use of outside expertise, but require it where it is necessary to ensure the deployment of an appropriately qualified PCA team. Externally sourced expertise may be required in situations where legislative complexities are involved, e.g. an expert in tariff classification may be seconded to the PCA team from another area to assist during the substantive testing stage where particularly complex classifications require confirmation.

Outside expertise may also be drawn from outside the agency, in which case the audit manager is required to establish the credentials of any experts who will be attached to the PCA team. This can generally be verified through professional peak bodies that accredit and certify experts in the field. Examples of expertise that is unlikely to be sourced from within the agency include specialists in areas such as jewellery valuation, antique certification, chemical classification, and experts in particular IT systems that are central to a trader's operation.

The composition of PCA teams will vary depending on the size and complexity of the trader to be audited, and some team members may be working across more than one audit, especially if they have a high level of expertise in particular areas such as IT systems, origin or valuation. In such cases the relevant audit managers need to coordinate their Audit Plans to ensure an efficient use of such specialists.

Audit managers themselves may also be required to manage more than one PCA concurrently. There is however a need for each PCA team to have a single audit manager with overall responsibility for the conduct of the audit.

Finally, while the number of auditors in a PCA team will vary according to the nature of the particular audit, it is important to ensure that at least two auditors are present during field testing or meetings with the trader to both corroborate issues and peer review decisions when appropriate.

Legislative Requirements

Legislative provisions relating to audit activities vary from country to country. However, most if not all border administration laws include a basic requirement for traders to keep documents relating to imports or exports for a statutory period of time, and generally such provisions allow these documents to be kept in electronic form. Similarly, most border administration laws provide for officers (in some cases limited to authorized officers) to enter a trader's premises without a warrant for the purposes of inspecting those records, be they in paper or electronic form. It is imperative that PCA teams fully understand the

extent of those provisions and act at all times within the limits of the relevant legislation.

These basic laws are generally adequate for the traditional transaction-based audit approach where the auditor will take a number of the trader's import or export declarations and review these against commercial documents such as invoices, bills of lading, purchase orders, packing slips, bank transfers, etc. PCA goes further than this and is focused on the various business systems and internal controls that

produce or process the commercial documentation and compile the trader's import or export declarations. This requires the auditor to review a broader range of commercial documentation such as procedure statements, user manuals for IT systems, policy and training documents, agreements with brokers and freight forwarders, and other internal documentation which may have implications for compliance. Consequently, if an administration is seeking to introduce a PCA regime, it will be necessary to amend the law to provide the necessary legislative support.

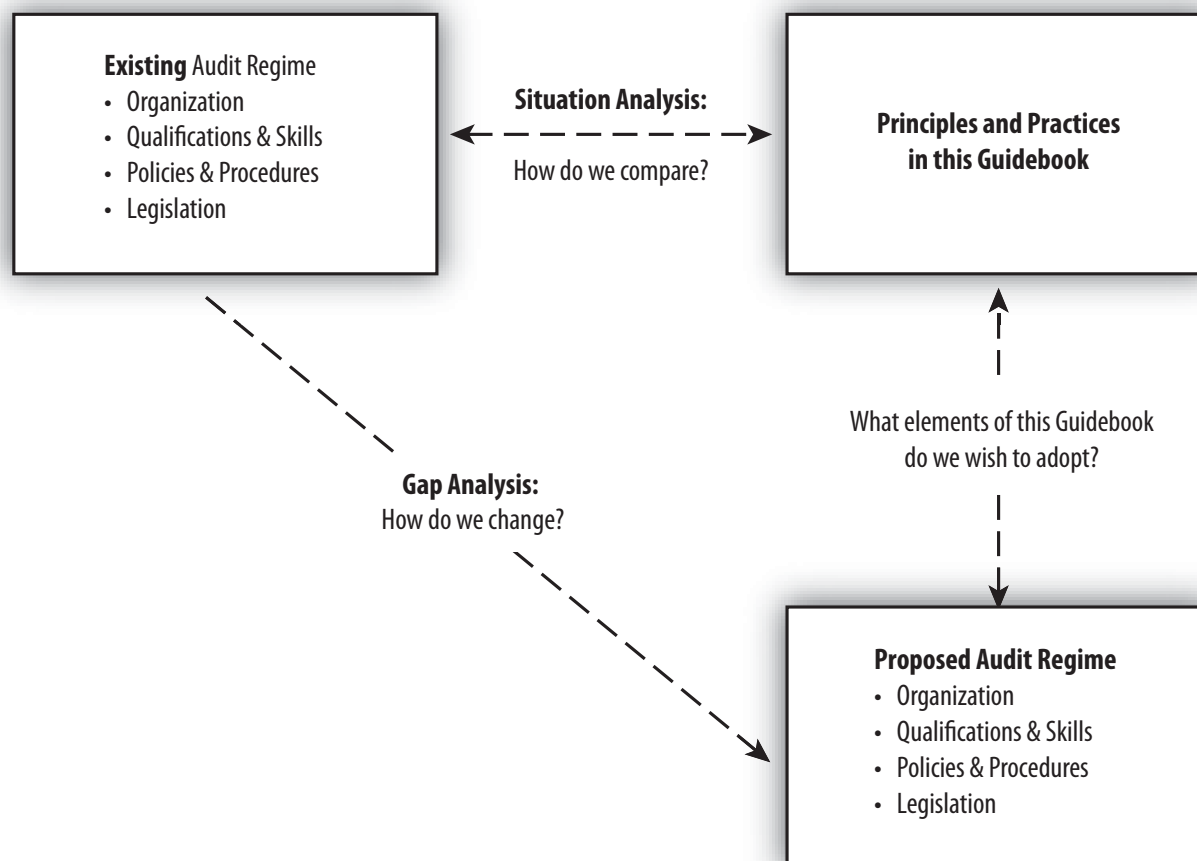
In this section we examine specific techniques that will help to facilitate the implementation of PCA. In particular, we consider ways of assessing an administration's current audit approach, its existing capabilities and reform priorities.

At the outset, it will be necessary to draw a comparison between the way in which the administration currently operates and the principles and procedures that are discussed in this Guide. The purpose of the

exercise is to identify those aspects of PCA that are already being applied by the administration and those which need to be addressed. This is referred to as a situation analysis.

The next step is to determine what the future PCA regime should look like and to identify the steps that are necessary to achieve the desired end-state. This is referred to as a gap analysis.

Figure 9.1 Situation and gap analysis



Situation Analysis

The administration's current approach to audit may well be limited to transaction-based checks, in which case some elements of PCA may already be present, but not all. For example, the existing legislative provisions may enable auditors to examine documents and cargo relating to import, export and warehousing declarations, but may not permit broader based reviews of a trader's systems and procedures.

Similarly, some audit staff may be skilled in undertaking audits where the focus is on substantive testing of import declarations, in which the details of a trader's declarations are checked against invoices, purchase orders, packing lists and other commercial documents in order to verify their accuracy.

In such situations it will become readily apparent that the existing audit environment in which the administration operates is quite different to the requirements of PCA in terms of organizational structure, staff qualifications and skills, operational policies and procedures, and the underlying legislative base. There is also likely to be a different cultural approach to the audit function, i.e. an adversarial approach rather than the collaborative compliance improvement approach that is required in the PCA environment.

The first stage in a move towards implementing PCA is to identify those aspects of the administration which differ from the principles and practices outlined in this guide, as well as those areas where the existing organizational situation aligns with those principles and practices.

Gap Analysis

The next step is to identify how the administration envisages the end state of the proposed PCA regime. Assuming that it is decided to implement PCA in the way that is based on the principles and practices outlined in this Guide, the following issues will need to be addressed:

- Would the current organizational arrangements be capable of supporting a PCA regime in terms of organizational policies, lines of reporting, structural arrangements, classification levels, etc?
- Do existing employees possess the necessary skills, qualifications and competencies to undertake PCA?
- Does the organizational culture support the concept of PCA?
- To what extent do the existing audit policies and procedures accommodate a PCA approach?
- To what extent do the existing legislative powers support the introduction of PCA?

It is then a matter of identifying the gaps and determining what needs to be done in order to effectively change from the administration's current audit approach to the PCA approach outlined in this Guide. This then sets the starting point for what will be a significant change management project involving the development and implementation of new policies, practices and procedures; and the development and implementation of a transition plan.

References

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ANNEXES

- Annex 1: Revised Kyoto Convention Guidelines—Chapter 6 Customs Control
- Annex 2: Revised Kyoto Convention Guidelines—Chapter 3 Clearance and other Customs Formalities
- Annex 3: International Auditing and Assurance Board—International Standards on Auditing
- Annex 4: Working Paper Index Page
- Annex 5: General Working Paper
- Annex 6: Control Description/Testing Worksheet
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- Annex 8: Substantive Testing Worksheet
- Annex 9: Audit Issues Worksheet
- Annex 10: Audit Issues Log

Annex 1

Revised Kyoto Convention Guidelines

Chapter 6: Customs Control

7. Control methods

facilitation measures in the form of simplified procedures (e.g. periodic entry system).

7.2. Audit-based controls

(Standard 6.6)

To manage the worldwide increase in trade and to provide traders with greater facilitation, Customs increasingly rely on audit based controls, using traders' commercial systems. These controls may vary from a simple post-clearance audit to trader self-assessment. Audit-based controls do not preclude physical examination of the goods.

To ensure the reliability of the traders' commercial systems for these purposes, they must follow the generally accepted accounting principles (GAAP) within the country. These principles determine which economic resources and obligations should be recorded as assets and liabilities, which changes in assets and liabilities should be recorded, how the assets and liabilities and changes in them should be measured, what information should be disclosed and how it should be disclosed, and which financial statements should be prepared.

7.2.1. Post clearance audit

7.2.1.1. Introduction

Post-clearance audit focuses on persons involved in the international movement of goods. It is an effective tool for Customs control because it provides a clear and comprehensive picture of the transactions relevant to Customs as reflected in the books and records of international traders. At the same time it enables Customs administrations to offer the trader

7.2.1.2. Development of audit programmes

Customs administrations should identify post-clearance audit categories, e.g. importer/exporter, value, foreign trade zone, broker, and carrier manifest, and produce manuals to provide step-by-step guidance for carrying out audits.

7.2.1.3. Selection of persons/companies for audit

The selection of persons/companies for audit should be based on risk profiles (see Section 6.2.2). Audits should generally be conducted for compliance verification purposes in the areas of valuation², origin, tariff classification, duty relief/drawback/remission programmes, etc., but other areas should be targeted as necessary. Depending on the profile of the auditee and its business (e.g. type of business, goods, revenue involved, etc.) the audit may be conducted on a continuous, cyclical or occasional basis.

7.2.1.4. Annual audit planning

Audit planning should take place every year, taking into account the availability of the auditor or audit team, in relation to work in progress and the start of new audits. Each audit area could be assigned standard hours of completion and each available auditor or audit team hour could be calculated in order to determine how many audits can be performed by each auditor or audit team in a given year. Alternatively, each stage of the audit activity could be broken down into time blocks in order to measure productivity against time spent. Both methods allow Customs to allocate resources effectively.

7.2.1.5. Audit process

Post-clearance audit places great emphasis on professionalism in the conduct of a review and the examination of the auditees' books and records. From pre-audit planning to completion, it is essential to maintain communication and co-ordination with the auditee and with other interested parties in Customs. A report should be produced to ensure that all findings and other relevant issues are fully shared and discussed. Follow-up visits may be needed.

Audit phases

Pre-audit survey: The first step in the audit process is to assess and evaluate the strength and weaknesses within the commercial system of the auditee. Depending upon the size and location of the company to be audited, Customs may choose to perform an on-site survey or request corporate data of the auditee via a background questionnaire.

Such a survey may include gathering data regarding: corporate organization and structure, commodity information, methods of payment, value of commodities, costs associated with commodities, detailed product-cost information/submissions for analysis, related-party transactions, and record-keeping systems. This information may be commercially sensitive and should therefore, as with other information passed to Customs, be treated as confidential.

Initial importer contact: Before carrying out a routine compliance audit, Customs administrations should contact the auditee to request detailed information on the types of records and documentation needed. These may include: commercial invoices, shipping records, purchase orders, delivery notes, accounts, records, contracts, royalty and marketing agreements, inventory records, journals, ledgers, business correspondence, records of payments.

Initial Audit conference: The initial meeting should be attended by the auditor or audit team, representatives of other Customs areas as needed, and representatives of the auditee (e.g. consultants, accountants, controllers, lawyers). The auditor or audit team will discuss the scope and objectives of the audit. The auditee has a vested interest in acquiring and maintaining Customs facilitation, and therefore has a responsibility to ensure that the audit is carried

out in a professional manner. Representation by a senior member of the company is invaluable to ensure a high level of co-operation. It is at this conference that the auditee should designate a representative to whom all requests for the production of documents (books, records, etc.) should be directed.

Audit questionnaire: Companies may be asked to fill out a questionnaire to obtain information about their structure, related-party transactions, commodities, methods of payment, valuation, manufacturing costs, sourcing and supply. In related-party transactions, the foreign parent company may also be asked to complete a questionnaire focusing on information regarding the relationship between the auditee and its parent company. Completion of such a questionnaire by the foreign parent company would be purely voluntary.

Internal corporate review: Customs administrations should encourage the auditee, where practical, to carry out a preliminary self-evaluation, review and analysis of its operations in relation to the audit.

Audit co-ordination: The auditee should be kept fully informed of any potential findings or other relevant Customs matters throughout the audit. However, if a significant misrepresentation or potential Customs offence is discovered during the course of the audit, the audit team should communicate and co-ordinate with the appropriate enforcement unit who will decide whether to start a formal investigation. The Customs administration may make information available to other revenue/tax agencies, in accordance with national laws on confidentiality.

Exit conference: A formal meeting should be held with the auditee to present the findings, and to provide an opportunity for the auditee to give any explanations needed, to assist preparation of the final report.

Final report: Customs administrations should prepare a final report and let the auditee have a copy, provided that national law provides for this. A copy should also be sent to the appropriate Customs office for resolution of any issue which has arisen.

Follow-up Visit: To conclude the audit process, Customs may carry out a follow-up desk audit to

ensure that any findings and recommendations for changes are carried out by the trader.

7.2.2. Traders' systems audit (Transitional Standard 3.32 and Standard 6.10)

7.2.2.1. Introduction

Customs must carry out traders' systems audit for control purposes, as a quid pro quo for greater facilitation, which can include a trader's use of his computer systems for preparation and submission of single or periodic declarations, and for self-assessment.

The audit of traders' systems aims to provide assurance that a particular activity or process is being carried out properly. Systems audit, as the name implies, means looking at the entire processing cycle rather than just the transactions themselves. It does not rely on a fully visible audit trail and substantive testing of all or a significant number of transactions, as in a manual system. Instead, systems audit uses the inherent properties of computer processing to provide user confidence.

If it can be established that the process itself is reliable and accurate and the controls which govern it are sound and complied with, then safe assumptions can be made regarding the quality of the output and facilitation measures can be granted.

The traditional method of checking the accuracy of the "books" on a transaction basis is not only inappropriate in a computer environment, but also probably impossible. Even advanced methods using file interrogation methodology are of little use unless the auditor or audit team understands how the computer and its associated manual procedures combine to produce the required information. This is where a systems audit is most effective.

The principal steps in a systems audit are as follows:

7.2.2.2. Planning

This initial phase, which is critical to the success and credibility of an audit, will define the direction, scope

and ultimate goal against which to measure the effectiveness of the audit.

The planning stage will determine amongst other things:

- the objectives;
- the scope;
- the risk areas;
- the conduct of the audit including preliminary and exit meetings with the auditee;
- the duration of the audit;
- the necessary resources needed to undertake the audit;
- the availability of key personnel for interview purposes; and
- the extent to which changes to the system or the organization operating it have affected previous audit knowledge.

When Customs is considering allowing self-assessment, the planning stage will include the establishment of criteria against which a trader's systems should be judged. These will include his financial soundness and his capacity to:

- distinguish between import, export and domestic consignments, allowing appropriate allocation of duty and taxes,
- allocate and identify consignments to specific Customs regimes,
- identify consignments requiring a licence or permit,
- calculate tax and duty liability on consignments,
- regularly update commodity code and duty rate files,
- cross match commercial part numbers against commodity codes,
- use valuation calculation methods appropriate to the traders business transactions,
- issue management reports providing assurance of completeness of accounting,
- identify outstanding, unreported consignments,
- perform quality cross-matching of commercial transport and accounting information with statistical and accounting information declared to Customs,
- exercise quality control and management checking procedures to ensure the system is functioning correctly,

retain historical data for long enough to comply with national legal requirements and use satisfactory back-up procedures in the event of a system breakdown.

7.2.2.3. Enquiry or fact gathering

By interviewing personnel at all levels in the management chain, both the application users and the data processors, the auditor or audit team can discover how the system actually works. The auditor or audit team will also refer to any material such as user guides, system specifications, which is available. The controls, or lack of them, both internal and operational can then be identified. Often the way the system works is at variance with how it was designed and implemented and how individuals, especially senior managers, perceive it to be working. The auditor or audit team can also deduce much from the state of system documentation, or the lack of it. For example, it may be out of date or incomplete.

7.2.2.4. Recording the system

The auditor or audit team will record the findings either by means of a narrative text or pictorially, by the use of flow diagrams, or both. The diagrams can be at different levels of detail, from a broad overview to actual stages in computer processing. They can cover the document flows before and after computer processing. At this stage the auditee will normally confirm the auditor's or audit team's understanding of the system, before moving on to the next phase.

7.2.2.5. Evaluation

By reviewing and evaluating the evidence gathered, the auditor or audit team will begin to discover actual or perceived weaknesses in the internal controls. They can then plan tests to measure the effectiveness of the controls and the credibility of the output.

7.2.2.6. Testing

Testing is carried out to some extent at various stages of the audit, for instance at the fact-gathering stage, by observation and as a result of evaluation. It can be by inspection of records, output reports, etc. or

even re-enactment of the processing cycle. Using advanced techniques, i.e. file interrogation software, it is possible to test for unusual combinations of data which could lead to incorrect processing as well as for straightforward situations.

7.2.2.7. Report

The outcome of the audit will usually be a report to senior management which will make recommendations as to how identified weaknesses can be eliminated or controls tailored to be more effective. Controls can even be discarded if they are seen to be irrelevant in a particular situation.

7.2.2.8. Conclusion

Once a system has been recorded and evaluated and any amendments to improve control have been implemented, it can be expected to perform reliably until the next significant change is undertaken. However periodic audits need to be carried out to confirm that nothing has changed and that the controls which have been built in to the system continue to be administered and adhered to. The use of audit packs (a set of pre-programmed audit tests) can be used to automate this process.

7.2.2.9. Development audit

Traders' systems audit can also be of great benefit in the development stage of a new application. In the past the need to implement a new application as soon as possible has meant that suitability for audit has been overlooked or only partially addressed. The consequence of poor suitability means at best inadequate or at worst non-existent controls. Part of the planning cycle of any new application should ensure the inclusion of controls and audit trails. This will enable the auditor or audit team to confirm the processing of data from inception to final recording. It will also enable the auditor or audit team to trace transactions in the reverse direction. If audit considerations are taken into account at the outset of a new system, the subsequent audit and control of that system will be much more effective and trustworthy.

Annex 2

Revised Kyoto Convention Guidelines

Chapter 3: Clearance and Other Formalities

7. Special procedures for authorized persons

7.1. Special procedures

Transitional Standard 3.32

For authorized persons who meet criteria specified by the Customs, including having an appropriate record of compliance with Customs requirements and a satisfactory system for managing their commercial records, the Customs shall provide for:

- release of the goods on the provision of the minimum information necessary to identify the goods and permit the subsequent completion of the final Goods declaration;
- clearance of the goods at the declarant's premises or another place authorized by the Customs; and, in addition, to the extent possible, other special procedures such as:
- allowing a single Goods declaration for all imports or exports in a given period where goods are imported or exported frequently by the same person;
- use of the authorized persons' commercial records to self-assess their duty and tax liability and, where appropriate, to ensure compliance with other Customs requirements;
- allowing the lodgement of the Goods declaration by means of an entry in the records of the authorized person to be supported subsequently by a supplementary Goods declaration.

7.1.1. Introduction

Through implementation and use of a risk management programme, Customs can determine which goods and which traders are generally in compliance

with Customs law and thus pose a low risk for control purposes. These traders can then be approved for special or "fast track" procedures that require little intervention by Customs for the release and clearance of their goods. Such traders are referred to as "authorized persons" for the purposes of this Convention. This provision is especially appropriate for traders who regularly import or export goods.

The special procedures enumerated in Transitional Standard 3.32 that are granted to authorized persons will allow:

- the provision of minimal information at the time of release of the goods; and—clearance at the declarant's premises or other inland locations. In addition Customs may also allow:
- lodgement of a Goods declaration covering multiple transactions over a certain period;
- the self-assessment and accounting of duties and taxes by the authorized person; and lodgement of the Goods declaration by an entry in the commercial records of the authorized person.

Special procedures are beneficial for both Customs and the trade. They facilitate the movement of goods, encourage compliance with Customs rules and enable more effective use of Customs resources. They also promote the modern concept of a partnership between Customs, traders and third parties within international trade.

It is therefore a requirement that at least two special procedures be introduced by all Customs administrations and that other special procedures are considered for possible implementation. Customs should consult regularly with the various parties involved to ensure that once special procedures have been

introduced, the optimum benefits are realized for all the trade partners, including Customs.

Although Contracting Parties to this Convention must implement a programme for special procedures in accordance with Transitional Standard 3.32, the procedures are applied at the trader's request. They are clearly not mandatory upon all traders, particularly as they are designed only for those who meet the qualifications to be authorized.

7.1.2. Authorization

Customs will determine criteria or conditions that a trader must meet in order to be considered eligible for a special procedure. Any trader can apply for approval to use the special procedures. Once Customs agrees that a trader meets the criteria they have identified as necessary to ensure the trader's compliance with Customs law, they will authorize the trader for one or more of the special procedures.

The criteria and conditions for this authorization should be developed by Customs through the consultative process with the trading community. Where possible, the criteria should be based on measurable requirements, such as the ability to supply the necessary information to Customs within given time scales. As illustrated in this Transitional Standard, the basic criteria are that the applicant can demonstrate a good record of compliance with all Customs requirements and the maintenance of an adequate system for commercial records. Compliance with Customs requirements includes all the elements associated with accurate and correct declarations, adequate security provided to meet obligations, timely duty and tax payments, proper methods for tariff classification and country of origin claims, and no history of significant recurring errors or violations.

In addition to the practical requirements, the assessment of any application by a trader for a special procedure will be based on risk management techniques as explained in the Guidelines to Chapter 6 of this Annex.

Once granted, the authorization will indicate the obligations of the authorized person concerning the use of a special procedure. Some Customs administrations allow the use of a special procedure without

an authorization to any trader who wants to use it. This can be considered as granting a greater facility in accordance with Article 2 of the Convention.

7.2. Types of special procedures

7.2.1. Release on minimum information

This procedure allows for the release of goods for the Customs procedure requested using a minimum amount of information.

The procedure usually requires an initial declaration to enable the release of the goods, followed later and within a specified period of time by a supplementary declaration containing all the normally required information or by the provision of any supplementary information. The amount of duties and taxes due will be based on the completed information. However, the goods will be assigned to the requested Customs procedure based on the initial declaration.

The information required on the initial declaration should be limited to that necessary to determine the admissibility of the goods. This will normally include the description, quantity and value of the goods.

In some administrations, the information in the initial declaration can also simply comprise the declarant's authorization number and a commercially recognized description of the goods or the commercial reference to the goods in the authorized person's records. With this reference to the authorized person's records it is possible for Customs to have access to all the information necessary. Some administrations also allow a commercial or official document to be the initial declaration.

Standard 4.5 of the General Annex requires national legislation to fix the point in time for determining the rates of duties and taxes. In many administrations the date of registration of the initial declaration establishes this time of lodgement of the Goods declaration. It is not always necessary for Customs to be able to assess the exact amount of liability for import or export duties and taxes at the time of release of the goods. This can be done at a later stage using the more comprehensive supplementary declaration. In most administrations that use this special procedure, the supplementary declaration is required at the end

of a month, or even longer, after the release of the goods. The supplementary declaration may be a single Goods declaration covering a single transaction or it may be a single Goods declaration covering a number of transactions within the given period.

7.2.2. Clearance of goods at the declarant's premises

This procedure allows the clearance of goods for the Customs procedure requested at designated locations away from the Customs office or at approved traders' premises. It provides advantages for the trade, not only for the treatment of urgent consignments such as perishables, but also for increasing the convenience of clearance, the security of the goods themselves and a degree of certainty for delivery at the expected time. For Customs, the procedure enables them to become more familiar with the goods and systems that they are dealing with and may create more favourable conditions in which to carry out their work.

Normally the goods arrive at the declarants' premise under Customs transit procedure or under an approved simplified system for the movement of goods. The requirement to use this procedure may simply be a notification to Customs of the impending arrival of imported goods at the approved premises or the despatch of goods for export. This is followed, within a period of time specified in the authorization, by the lodgement of the Goods declaration.

When the arrival or the despatch of the goods is on a regular basis, Customs may even accept a list of impending arrivals or despatches of goods for a certain period, or they may waive the requirement for the notification and only require the subsequent lodgement of the Goods declaration.

The procedure may also be divided into two stages: an initial declaration that may be accepted as the notification, followed by a supplementary declaration. Together these constitute the Goods declaration. This Goods declaration would have the same legal status as a normal Goods declaration.

Some administrations, particularly in Europe, grant the procedure described above combined with the procedure of lodgement by entry in the records as described in 7.3.3 as a Local clearance procedure.

7.3. Additional special procedures

The following procedures are optional and provide only an example of additional special procedures that could be introduced. They are not mutually exclusive, but provide a framework within which Customs and the relevant parties can work to find agreeable facilitation methods that meet Customs requirements. The decision to introduce these special procedures depends on each Contracting Party, although all Customs administrations are encouraged to make these special procedures available.

7.3.1. Periodic goods declaration

One of the more widely applied special procedures is permitting the lodgment of a single Goods declaration for imports and/or exports that have taken place over a given period of time.

This procedure has great benefits for both the trade and the Customs administrations. For the trade, the periodic declaration procedure allows for improved speed in their overall operations by more rapid release of goods and less repetitive documentation demands. This in turn should lead to reduced clearance and transport costs. For Customs this procedure enables a more rational use of the available resources and allows controls to be applied more flexibly as well as any overall reduction in the number of documents and transactions to be processed. This in turn results in more effective post-audit checks and enhanced risk management.

To implement this procedure, administrations must have either legislative or regulatory provisions in place that allow the Goods declarations for importation and/or exportation to be lodged periodically. This is an additional requirement since most administrations traditionally require a Goods declaration to be lodged for every import or export consignment.

The procedure may not be applied in situations where it may place undue risks on the revenue or on the administration of the procedure. Thus certain categories of goods may be excluded because of their nature (difficult to apply post-audit checks), because they are placed under Customs procedures that will not be facilitated by periodic lodgment of

the declaration (processing procedures) or because they are a high risk to the revenue.

Traders must obtain prior authorization by Customs to use the periodic declaration procedure. Customs can issue these authorizations at a central level or at the regional or local level. The authorization may be granted on a case-by-case basis for specific goods, operations or persons. The authorization may also be a general one for certain approved traders but subject to conditions that Customs might prescribe, by such as specific requirements for the premises where the goods are kept, the maintenance of adequate commercial records, a good record of compliance with Customs requirements, and so on. General authorization may also be granted for traders who conclude an agreement with Customs for the implementation of this simplified procedure and are usually based on the same conditions. Customs can also combine the two types of authorizations for a single trader, i.e. a case-by-case approval for certain types of goods and a general approval for other goods.

Goods are released under the periodic declaration procedure upon arrival if no physical examination is necessary. Customs requires only the provisional declaration at this initial stage. The trader may lodge a simplified provisional declaration either in the form of a list of the goods or with a commercial document, both of which are conditional that the trader maintains records of the goods in a format that is acceptable to Customs. In many administrations this provisional declaration is closely linked with that described in Standard 3.13 of this Chapter. These are normally very simplified and contain only the basic information relating to the goods. For highly reliable traders, Customs may allow the trader to simply enter the details of the goods in their records.

Customs retains the right to examine the goods covered by this procedure based on the initial information provided. Since this procedure is reliant on audit-based controls, Customs will base the requirement for any examinations on their risk management programme. For additional details on audit-based control systems, see the Guidelines to Chapter 6 on Customs Controls.

To clear the goods, the periodic Goods declarations are lodged at the end of a period specified in the

regulation or legislation. This is normally one month. The authorized trader would be required to submit the declaration in a standard format giving the details of the goods released during that period. As mentioned, this periodic Goods declaration is linked with the provision of certain minimal information at the time the goods are imported or exported or an entry made in the records. The date on which that initial notification was given to Customs or the date on which the entry was made is usually taken to be the date for the assessment of duties and taxes. Electronic submission of the periodic declarations is a common feature of this special procedure.

Under this procedure, the provisional and periodic declarations, which together constitute the Goods declaration, may have the same legal status and are regarded as normal Customs declarations, and thus the provisional declaration may determine the date for the assessment of duties and taxes. This may also apply where changes occur in the rates of duty and taxes or in the regulations during the period covered by the periodic Goods declaration, unless otherwise specified in national legislation under Standard 4.5. When Customs perform audit-based controls for the periodic Goods declaration, they ensure to their satisfaction that all goods imported under the procedure during the relevant period are declared and that the information contained in the declarations is accurate.

7.3.2. Self-assessment of duties and taxes using commercial records

This procedure is a system whereby the trader himself is authorized to determine the duties and taxes due. It is based on the principle that, in international trade, systems are required for commercial purposes in order to control the movement, supply and storage of goods and to carry out effective fiscal controls. Once Customs performs an audit of the trader's relevant system and commercial records and is satisfied that they meet the criteria necessary for authorization to use special procedures, Customs has a reasonable assurance that it can rely on the system for Customs control. In effect Customs control becomes an integral part of the authorized person's commercial activities.

This self-assessment procedure is accompanied by Customs performing audit-based controls as

provided for in Standard 6.6 of the General Annex and described in the Guidelines to that Chapter.

Goods imported under the self-assessment procedure should be released at importation immediately upon their arrival in the Customs territory. Likewise, goods exported under the procedure should be authorized to move directly to the place of exportation. Minimum checks or indeed no checks at all should be carried out at a Customs office or at the trader's premises in either situation under normal circumstances, other than random checks conducted as part of the risk management programme. Detailed checks are always appropriate in exceptional circumstances, for instance, where it is suspected that the procedure is being abused or where information is received that a consignment may be misrepresented or used as a medium to import or export illicit goods.

Once the physical movement of the goods has taken place for import or export, a declaration should be furnished by the authorized person or their representative. This normally indicates the amount of duties and taxes that will be due. Other information may be required in the declaration, such as value and origin, but it should be kept to a minimum. Some administrations require a supplementary declaration which may not be required for a month or more after the release of the goods. As described for the procedure of release on minimum information, the supplementary declaration may be a single Goods declaration covering a single transaction or it may be a single Goods declaration covering a number of transactions within the given period.

When the time of lodgement of the Goods declaration is used to establish the rates of duties and taxes applicable, it can be established by a number of methods. It is acceptable to use either the date of the provision of minimum information, the date of the entry of the individual consignment into the trader's accounts or the date of registering or acceptance of the periodic declaration.

Where the last method is used, it will constitute a single tax point for the period covered by the declaration. This single tax and duty point may therefore cover several imports and exports over the given period.

The method used to establish the point in time for duty and tax application will be specified in national legislation in accordance with Standard 4.5 and should be specified by Customs in the trader's authorization. For goods assigned to a Customs procedure which places them under the suspension of duties and taxes, Customs can authorize that these goods are not included in the periodic declaration until such time as they are either moved out of the regime and become liable for duties and taxes or are re-exported. Any goods held by the authorized person which are under suspension of duties and taxes should be identifiable in the commercial system.

Where Customs is satisfied that the trader's commercial system is operating correctly, the declarations submitted for the period should be considered to be correct unless there is evidence to the contrary.

The regularity of any checks on the authorized person's system should be based on risk management techniques and the nature and complexity of the business. Whenever controls are carried out, they should be targeted at the functioning of the system. However, this does not preclude checking individual consignments to verify that amounts of duties and taxes due have been correctly attributed.

In administrations which allow the special procedure of self-assessment, Customs retain the authority to determine the amount of duties and taxes.

7.3.3. Lodgement by entry in the records

Where release or clearance is allowed away from the border and at approved premises, allowing the Goods declaration to be lodged simply by an entry in the authorized person's commercial records can be a substantial facilitation measure for the declarant.

Customs can authorize this special procedure where they are satisfied that the applicant's records will enable them to carry out effective checks, particularly retrospective audits. Normally the entry in the records consists of specific information concerning the goods such as the shipper, consignee, quantity, value and country of origin, the date of release of those goods and any other information which may be required by Customs for the application of the Customs

procedure concerned. The information to be entered in the records of the authorized person will be specified in the authorization for this special procedure.

The entry in the records can be regarded as the initial declaration, which has to be followed by a supplementary declaration. A simple notification to Customs of the impending arrival of the goods at the approved premises or despatch of the goods from these premises can be required in order to allow Customs to perform random checks when deemed necessary.

The date of the entry into the records is regarded as the formal time for the lodgement of the Goods declaration. Customs administrations which grant any of these special procedures often combine more than one in the authorization since they have already determined with a satisfactory level of assurance that the trader will maintain high standards of compliance with Customs requirements. Many authorized persons are granted lodgement by entry in their records along with submission of periodic supplementary Goods declarations or with the self-assessment of duties and taxes.



Annex 3

International Auditing and Assurance Board—International Standards on Audit

The International Auditing and Assurance Standards Board (IAASB) is an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards. In doing so, the IAASB enhances the quality and uniformity of practice throughout the world and strengthens public confidence in the global auditing and assurance profession.

Structure of the ISAs

The ISAs now have a new structure, in which information is presented in separate sections: Introduction, Objective, Definitions, Requirements, and Application and Other Explanatory Material.

Introduction

Introductory material may include information regarding the purpose, scope, and subject matter of the ISA, in addition to the responsibilities of the auditors and others in the context in which the ISA is set.

Objective

Each ISA now contains a clear statement of the objective of the auditor in the audit area addressed by that ISA.

Definitions

For greater understanding of the ISAs, applicable terms have been defined in each ISA.

Requirements

Each objective is supported by clearly stated requirements. Requirements are always expressed by the phrase „the auditor shall.”

Application and Other Explanatory Material

The application and other explanatory material explains more precisely what a requirement means or is intended to cover, or includes examples of procedures that may be appropriate under given circumstances

Individual ISAs are available below via the linked version of the 2010 handbook.

- ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
- ISA 210, Agreeing the Terms of Audit Engagements
- ISA 220, Quality Control for an Audit of Financial Statements
- ISA 230, Audit Documentation
- ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements
- ISA 260, Communication with Those Charged with Governance
- ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
- ISA 300, Planning an Audit of Financial Statements
- ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
- ISA 320, Materiality in Planning and Performing an Audit
- ISA 330, The Auditor's Responses to Assessed Risks
- ISA 402, Audit Considerations Relating to an Entity Using a Service Organization
- ISA 450, Evaluation of Misstatements Identified during the Audit
- ISA 500, Audit Evidence
- ISA 501, Audit Evidence-Specific Considerations for Selected Items
- ISA 505, External Confirmations
- ISA 510, Initial Audit Engagements-Opening Balances
- ISA 520, Analytical Procedures
- ISA 530, Audit Sampling
- ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
- ISA 550, Related Parties
- ISA 560, Subsequent Events
- ISA 570, Going Concern
- ISA 580, Written Representations
- ISA 600, Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)
- ISA 610, Using the Work of Internal Auditors
- ISA 620, Using the Work of an Auditor's Expert
- ISA 700, Forming an Opinion and Reporting on Financial Statements
- ISA 705, Modifications to the Opinion in the Independent Auditor's Report
- ISA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
- ISA 710, Comparative Information-Corresponding Figures and Comparative Financial Statements
- ISA 720, The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements
- ISA 800, Special Considerations-Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
- ISA 805, Special Considerations-Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
- ISA 810, Engagements to Report on Summary Financial Statements
- International Standard on Quality Control (ISQC) 1, Quality Controls for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

Working Paper Index**Annex 4****Trader****Audit Manager**

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Systems Documentation		D
Internal Controls – Descriptions, Risk Matrices and Testing		E
Compliance Testing and Control Assessment		F
Substantive Testing		G

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General Working Paper

Annex 5

Auditee

Audit Manager

Prepared by	Reviewed by	Index	
/ /	/ /		

General Working Paper - Example

Trader

Audit Manager

Entrance Interview notes	Action
Monday 23 April 2012 at trader head office	
Introductions: <u>Agency</u> : PCA Manager and PCA team members <u>Trader</u> : Managing Director, Finance Director, Head of Internal Audit, Import Manager, Assistant Import Manager and Warehouse Supervisor	Assistant Import Manager appointed as main contact point
Confirmation of audit scope and objectives	Agreement from trader
Confirmation of start / finish dates, sites to be visited	Agreement from trader
Asked if any major changes to business systems, systems documentation, or operating procedures since previous audit	Upgrade to purchasing system, Assistant Import Manager to forward this asap.
Asked if any compliance or related issues during 2011	Nil
Confirmed will deliver final Audit Plan document to trader with 7 days	Copy of final Audit Plan to be sent to trader.

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Control Description/Testing Worksheet**Annex 6****Auditee****Audit Manager**

Control Description:

System / subsystem:

Preliminary assessment:

Notes:

Description of control test:

Sampling:

- size
- selection method
- period
- population size

Summary of Test Findings:

Control Assessment after test:

[Effective/Not Effective/Undecided]

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Substantive Testing Worksheet

Appendix 8

Auditee _____ Audit Manager _____

Sub-system _____ Transaction _____

Description _____

Transaction Details	Test Results

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Audit Issues Worksheet

Annex 9

Auditee

Audit Manager

Issue Description:

Priority:

Logged Issued Response Follow-up Closed	
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Company Response:

Follow-up:

Closed:

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Annex 10**Auditee****Audit Manager**

Issue Ref No.	Business System	Issue summary	Date to Trader	Trader Response & Date	
PO 1	Purchase Order Raising	Purchase Orders can be amended without approval after goods have been imported	1/5/12	Agreed, will implement immediately a soft-ware upgrade to require an 'approval' process with Finance Manager level access. Soft-ware provider contacted. 8/5/12.	
PO 2	Purchase Order Raising	Purchase Order copy to be sent to Customs Broker to assist confirming declaration details	1/5/12	Agreed. Operation procedures amended to ask import staff to obtain copies of Purchase Orders for "Documents to Broker" procedure. 2/5/12	
Prepared by		Reviewed by		Index	
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1818 H Street, NW
Washington, DC 20433

