



COUNTRY REPORT PAKISTAN CUSTOMS POST CLEARANCE AUDIT

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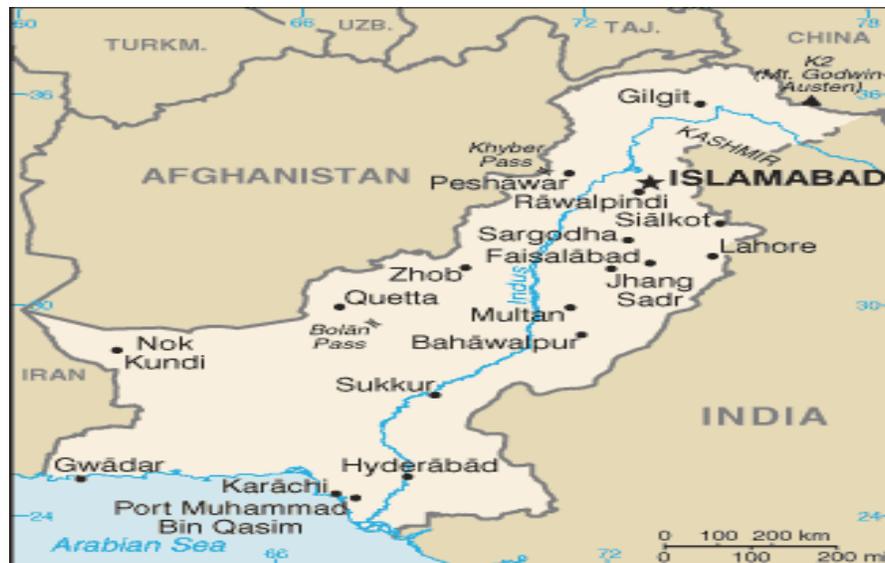
PAKISTAN COUNTRY REPORT

1. HISTORICAL BACKGROUND

The Indus Valley civilization, one of the oldest in the world and dating back at least 5,000 years, spreads over much of what is presently Pakistan. During the second millennium B.C., remnants of this culture fused with the migrating Indo-Aryan peoples. The area underwent successive invasions in subsequent centuries from the Persians, Greeks, Scythians, Arabs (who brought Islam), Afghans, and Turks. The Mughal Empire flourished in the 16th and 17th centuries; the British came to dominate the region in the 18th century.

In 1947 the British India was divided into two states namely Pakistan and India. The **administrative units of Pakistan** consist of four provinces, one federal capital territory, two autonomous territories (Kashmir and Gilgit Baltistan) and a group of federally administered tribal areas.

Pakistan is located in Southern Asia, bordering the Arabian Sea, between India on the east and Iran and Afghanistan on the west and China in the north. Pakistan has a total area of 796,095 sq km, with a population of 188 millions.



2. ECONOMY OF PAKISTAN

Pakistan, is a developing country, the development has been marred by decades of internal political disputes and low levels of foreign investment. Pakistan's economy already under duress of international economic factors was further burdened by the war on terror beginning in 2001, cost estimated to the tune of US \$ 67 Billion. Between 2001-07, however, poverty levels decreased by 10%, as Islamabad steadily raised development spending. During 2004-07, GDP growth in the 5-8% range was spurred by gains in the industrial and service sectors - despite severe electricity shortfalls - but growth slowed in 2008-09 and unemployment rose. Inflation remains the top concern among the public, climbing from 7.7% in 2007 to more than 13% in 2010. In addition, the Pakistani rupee has depreciated since 2007 as a result of political and economic instability. Record floods in July-August 2010 lowered agricultural output and contributed to a jump in inflation, and reconstruction costs will strain the limited resources of the government. Some facts of Pak economy are as under:

GDP (purchasing power parity): \$464.9 billion (2010 est.)

Budget Revenues: \$26.3 billion

Taxes and other Revenues: 14.2% of GDP (2010 est.) 12.9% of GDP (2011 est.)

Tax to GDP Ratio: 10.5

3. FEDERAL BOARD OF REVENUE

The **Federal Board of Revenue** (more commonly known by its initials as **FBR**) is the semi-autonomous, supreme federal agency of Pakistan that is responsible for auditing, enforcing and collecting revenue for the government of Pakistan. FBR has the responsibility for (i) formulation and administration of fiscal policies, (ii) levy and collection of federal taxes and (iii) quasi-judicial function of hearing of appeals. FBR is estimated to be the largest federal bureaucracy in Pakistan. As the agency conducts audit of taxpayers regularly, it's regarded as the guardian of national treasury in Pakistan. FBR primarily operates through its main collection arms, its field formations, the Regional Tax Offices (RTOs) and Large Taxpayer Units (LTUs) across the country and Customs Collectrates.

FBR has two major wings: Customs Wing and the Inland Revenue Wing. For the purpose of collection of revenue and pursuing tax evaders, FBR's powers & functions also include but are not limited to: carrying out inquiries and audits/investigations into the tax affairs, commanding arrests, attachment as well as public auction of movable and immovable assets of a non-compliant.

3.1 TAX COLLECTION

During the fiscal year 2010-11 the FBR collected Rs 1558 Billion as tax revenues. Out of this Rs. 599 billion was in the form of Direct Tax and Rs 951 Billion as Indirect tax (Sales tax, FED and Customs etc)

3.2 EXPORTS

Pakistan has total exports of \$30.9 billion (2011 est.)

Major export commodities are textiles (garments, bed linen, cotton cloth, yarn), rice, leather goods, sports goods, chemicals, manufactures, carpets and rugs where as Major export partners are US 15.8%, Afghanistan 8.1%, UAE 7.9%, China 7.3%, UK 4.3%, and Germany 4.2% (2010).

3.3 IMPORTS

Pakistan's imports stood at \$39.35 billion (2011 est.)

Major import commodities are petroleum, petroleum products, machinery, plastics, transportation equipment, edible oils, paper and paperboard, iron and steel, tea. Major import countries are UAE 16.3%, Saudi Arabia 12.5%, China 11.6%, Kuwait 8.4%, Singapore 7.1%, and Malaysia 5% (2011).

4. POST CLEARANCE AUDIT IN PAKISTAN

The Pakistan Customs through an indigenous reform agenda moved towards automated clearance procedures. In 2005 PACCS was launched as pilot program providing end to end automated solution. The main focus was to reduce the dwell time and expedited clearance. The idea of post clearance audit also emerged with the emergence of automated system. The Directorate General of Post Clearance audit was established in 2008.

4.1 AIMS AND OBJECTIVES

The aims and objectives of the Post Clearance Audit were to:

- a. Develop a comprehensive monitoring mechanism to verify the correctness of trade related declarations;
- b. Detect and investigate commercial and trade-related frauds and propose measures to prevent its occurrence;
- c. Assist the Federal Board of Revenue to evolve, develop and update systems, procedures and organizational structure meant to scrutinize and ensure compliance of the trade with the national trade laws, procedures and controls; and
- d. Recover the escaped revenues.

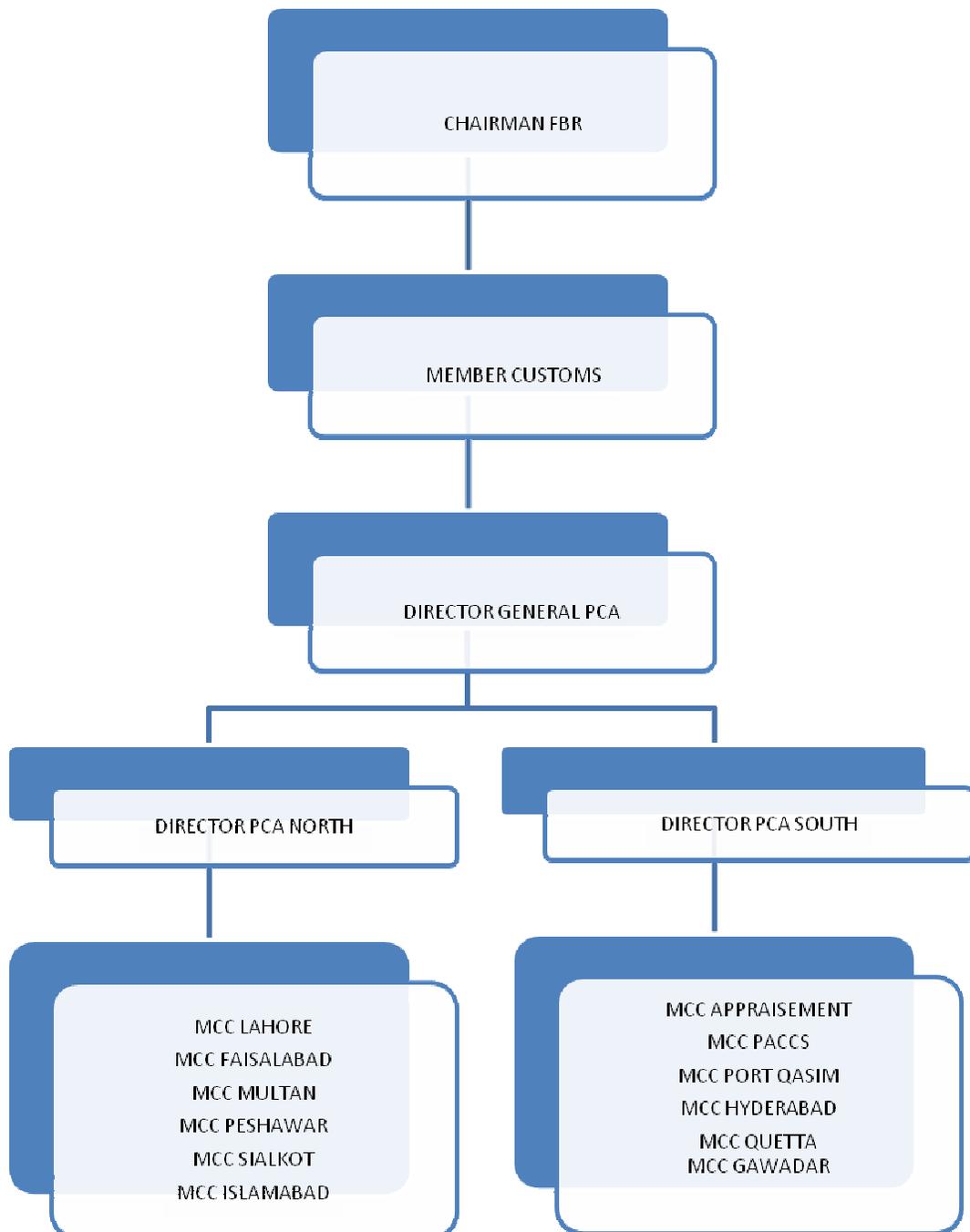
4.2 CHARTER OF FUNCTIONS

- To establish update and operate records, databases pertaining to goods exported from or imported into Pakistan and profiles of importers and exporters covering all aspects of their trade and business.
- To evolve a pro-active monitoring mechanism to ensure compliance with national trade laws, rules, procedures, controls restrictions, prohibitions etc.
- To set up a mechanism to detect and investigate commercial and trade related frauds and propose measures and controls at the operational level to prevent its occurrence.
- To set up mechanism and machinery along with ancillary and auxiliary sub systems for audit, intelligence investigation, prosecution, dispute resolution

and initiate contravention report/ recovery proceedings for adjudication in exercise of powers vested in the officers of Directorate General of Post clearance Audit under relevant laws promulgated from time to time.

- To analyze data, risk assessment and selection of sectors/cases for generating the work orders for field formations to conduct audit, and monitoring of the follow up action.

4.3 ADMINISTRATIVE SET UP



4.4 BENEFITS OF POST CLEARANCE AUDIT SYSTEM

Introducing post-clearance audit reflects a different approach to Customs controls as it has the effect of offering an immediate release of goods or reduced release times. Implementation of post clearance audit is part of the risk management strategy.

4.4.1 Reduced Release Time

The time taken while goods are in Customs custody will be reduced as compared to traditional Customs controls and traders can dispose of their goods promptly upon their arrival in the country, by applying risk management techniques and audit-based controls.

4.4.2 More Efficient Control

Post clearance audits can cover all Customs regimes, i.e. temporary importation, inward processing, duty free zones, end use tariff items, - and therefore enhance Customs control over some of these regimes which could not be checked at the border. Post-clearance audit allows Customs to change the approach from a purely transaction based control to a more comprehensive, company-oriented control. Customs audit can benefit from a broader picture of the transactions over a longer period of time.

4.5 LEGISLATIVE POWERS

The officers of PCA have been empowered by the federal government through CGO 13/2009, SRO 500(I)/2009 and SRO 469(I)/2009.

4.5.1 TERRITORIAL JURISDICTION:

All Customs Collectorates of Pakistan

4.5.2 FUNCTIONAL JURISDICTION:

PCA has been authorized to conduct scrutiny of;

- All imports and exports including temporary imports
- All customs clearances under concessionary regimes, DTRE, transshipment, transit and warehousing etc.
- Bulk oil imports
- Public private and manufacturing warehouses
- Exports duty drawback
- Import refunds
- Baggage
- Ship stores
- Client accreditation program
- National historic database
- Risk management system

4.5.3 OPERATIONAL JURISDICTION

The Directorate General of Post clearance Audit has the authority to;

- Determination of Customs Value of goods
- Requisition record, conduct audit and access for the purpose of audit to the importers' premises and warehouses
- Raise demands for short paid revenue
- Initiate cases of fiscal fraud
- Powers to arrest and issue search warrants
- Power to arrest and search without warrant
- Seizure of goods

5. PCA AUDIT MANUAL

AUDIT MANAGEMENT UNIT

In the Directorate general of PCA HQ an Audit management unit is set up, with the functions to:

- Set and monitor Audit policy
- Set overall audit annual audit programs
- Risk analysis
- Annual audit report

SELECTION OF CASES FOR AUDIT

The AMU selects cases for audit on the basis of:

- Historic database system
- Traders risk profiling
- Sectors/commodity selection
- Random selection
- Risk parameters such as origin, classification, valuation and procedural codes

TYPES OF AUDIT

Directorate General is conducting three types of audits

I. DETAILED WORK ORDER BASED AUDITS (ENTITY BASED AUDIT)

These audits are assigned by the Audit management unit under a proper audit schedule. Selection for audit are based on Risk management unit.

II. DESK AUDIT OR TRANSACTION BASED AUDIT.

These audits are based on information or duty payment trends or commodities.

III. INVESTIGATIVE AUDIT

These audits are conducted in cases of fiscal frauds and may lead to prosecution of traders.

FLOW OF PCA OPERATION:

- Preparation of audit by the audit team
- Profiling the selected importer and his business
- Risk profiling of the trader as well as imported goods regarding origin, valuation, classification and procedural requirements.
- Visiting the traders/importers unit
- Selection of transactions for audit
- Identification of any discrepancies and preparation of audit report
- Issuance of audit observation
- The trader/importer is given opportunity to defend his case before the supervisory officer of the audit team
- Issuance of a contravention report to adjudication authority
- Issuance of show cause notice and adjudication of the case by the adjudicating authority
- In case any recovery is accrued, the case is referred to the clearance collectorate to ensure recovery of the arrears

RIGHTS OF THE TRADER

The PCA Audit manual grants the following rights to the taxpayers

- It will be right of the taxpayer to know the identification of the auditors visiting his premises
- To seek written authority form the auditor to intimate the taxpayer about auditors purpose of visit
- It will be taxpayer's right that his business commitments are recognized and therefore flexible scheduling follow up visits.
- The taxpayer shall be informed about their right to file internal review with the additional Director PCA against the opinion on any adjustment sought by the audit team.

6. INCENTIVES AND REWARD SYSTEM FOR PERFORMANCE

Presently there is no audit/ detection/recovery based reward system in Pakistan. However on the basis of recommendations of the supervisory officers the PCA staff is granted annual performance award.

7. PERFORMANCE OF PCA

Although PCA was established in October 2008, a relatively nascent organization, PCA has been successful in detecting Rs. 41.3 Billion, till date. Astounding number of 1782 cases was detected. Rs. 1766.29 million were decided in favor of the department after due process of adjudication while Rs. 208.39 million were decided against. Recovery of Rs. 40.89 million was effected by the Clearance Collectorates.

Summary of Performance of PCA

S.No.	No. of Cases Detected	Amount Involved Rs in Million	Amount Decided in favor of Department	Amount decided against the Department	Amount Recovered
Karachi	1673	40521.95	1737.26	135.16	24.50
Lahore	109	846.53	29.02	73.23	16.39
Total	1782	41368.48	1766.29	208.39	40.89

Areas of detection	Amount Evaded
Duty free shops	1521
Undervaluation/Non-application of Valuation Rulings	2153
Misuse of Exemptions	1266
Duty Drawback/Refunds	386
Withholding Tax	372
Misdeclarations	961
Antidumping duties/Regulatory duties	390.7
Total	7049.7

S.No	Major Cases of Tax Evasion Detected by PCA	Amount Detected (Rs. In Millions)
1	Evasion of duty through under valuation by importers of copper tubes	120
2	Non application of valuation ruling on imports of tin plates	46.7
3	Misuse of FTA on import of shoes	48
4	Evasion of duty and taxes on imports of room air conditioners	230
5	Non application of valuation ruling on welding electrodes	30
6	Undervaluation of ceramic tiles	150
7	Non application of valuation rulings on mobile batteries	7.5
8	Non application of valuation ruling on Velcro tape	9.4
9	Mis-declaration of car batteries	8
10	Non-payment of FED on beverage flavors	1400
11	Non application of valuation ruling on paper board	2.5
12	Non-payment of sales tax by OMCs on imports of HSD	35500
	TOTAL	38039.3

8. PERFORMANCE ENHANCEMENT OF PCA

Post clearance audit is still in evolutionary stages. Data base centers are being created to carry out audits and monitoring, however, problems are being faced due to ongoing reforms in automation and currently the clearance is going on two parallel systems one in automated system and others through manual system. Once complete automation is done, then the system of PCA will be fully operational and effective in Pakistan.

7.1 CENTRAL DATA CENTER

Objective:

The Central Data Centre is a specialized unit to provide access to computerized data of all customs clearances for post clearance audit.

Functions:

The functions of the Central Data Centre of the Directorate General of PCA, Islamabad are as follows;

- To provide single window access of all Customs clearance data (One-Customs, PaCCS, WeBOC etc) for post clearance audit purpose
- Provide assistance in selection of cases for audit by using risk management system.
- Generate reports and run specific queries for scanning customs clearance data for identifying revenue leakages and tax fraud.
- Maintain historic data base,
- Maintain traders profile record,
- Maintain centralized computerized record of all Audit observations and Contravention reports. It will also help keep track of adjudication status and position of recovery of Government dues against the cases made out by PCA
- In future, to provide electronic data interchange (EDI) linkages through PCAS to other agencies (Federal Excise, Sales Tax, Inland Revenue, Banks, etc)

OPERATIONS OF CDC:

1. **Types of Audit to be performed by CDC:** The Central Data Centre at PCA Head Quarters shall conduct the following types of Audit:
 - i) **Detailed work order based audits (Entity Based);** Selection for audit to be based on Risk Management system and associated parameters.
 - ii) **Desk Audit or Transaction Based Audits;** these audits are to be based on information or duty payment trends of traders or commodities.
 - iii) **Investigative Audits;** these audits are to be conducted in cases of fiscal frauds and may lead to prosecution of traders.

2. **Automated Selection of Cases by the CDC;** CDC will be responsible for the selection and of cases for Audit to the Regional Directorates of the PCA. The case selection would be performed through the application of risk criteria in an automated environment. However, the Regional Directorates of the PCA may propose the audit of certain traders based on local intelligence or the information gathered during audit of other traders. In such cases, a written proposal incorporating the reasons for case selection would be forwarded to the Director General (Headquarters), who may issue a work order for audit to the relevant Directorate.

The CDC after selection of the case would refer it to the Director General of PCA for the Approval and Allocation of the Audit to the concerned Directorate of PCA.

3. **Selection of Audit; Tools for the Central Data Centre;** Historic Data Base System developed as a component of the PCAS, along with any other report generated and incorporated into the PCAS would be the tools for carrying out the audit by the CDC.

4. Function of Historic Database System; The Historic Database System (HDS) will be available to the Central Data Centre based upon the Post Clearance Assistance System (PCAS) developed by PRAL and ancillary data-base developed by CDC staff to select traders based on known risk factors. The HDS reports facility will help in generating reports listing importers of specific commodities, from specific origins and subject to specific procedure codes. This facility will enable the CDC to retrieve data of the targeted products, by commodity code, origin, period, and value. The output will contain a list of GD CRN/Machine numbers and Single Unique Identification (SUI) Numbers. Information in relation to the traders identified by the HDS will also be available from the Trader Profile Record (TPR) system once it is developed (To be developed by PRAL and incorporated into PCAS).

The HDS will also allow the CDC to call pre-structured reports on most aspects of import and export declarations over a given period for a specific trader. This information will be of great benefit while targeting and selecting traders for audit. It will serve as the main tool in creating a trader profile. In addition to the specific trader reports, this system will contain a number of restricted management reports which will help in the development of parameters for automated selection for audit. These reports may include:

- **Top statistical value by commodity code:** It highlights the commodity codes with the highest statistical values.
- **Top duty by importer's Unique Identification Number:** It lists the traders by UIN who have paid the highest duty. This report will also highlight the duty type.
- **Top duty by commodity code:** It highlights the commodity codes on which the highest amount of duty was paid.

Due to the heavy drain on computer resources involved in producing these reports, they will be run periodically and used by the CDC as a basis for quarterly

case selection and assignment to the Regional Directorates of the PCA after approval of the Director General.

- 5. Selection of Traders for Audit;** Selection of persons/companies for audit should be based on risk profiles. Selection criteria for audit candidates should be developed taking into account *intelligence, trade trends, and high risk priority areas*.

Selection criteria could include:

- Past history of the company;
- Type of commodity industry;
- Volume and value of imports/exports;
- Referral information from other Customs units, e.g. investigators, physical control officers, commodity specialists and other revenue agencies;
- Origin of goods;
- Potential for duty/revenue recovery;
- Risk of revenue loss;
- Government program priorities, etc.

The selection of person/company for the audit is made locally and it can be based on the risk rating, data from other authorities and local knowledge. For this purpose, it is highly recommended to establish a national database to be developed by CDC and RDC, which contains risk rating parameters for each trader based on their compliance records, types of business, volume of imports and total duty payments. Information gained from the filed audit can be used to evaluate the accuracy of the risk rating.

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**. The audit frequency is basically set in accordance with the time limitation of recovering deficiency. Depending on the results of the risk assessed, the frequency can be increased or decreased]

6. **Post Clearance Assistance System (PCAS) and CDC:** PCAS developed by PRAL would provide the functional framework for the CDC operations. Operations of CDC would include but would not be limited to PCAS software functions. CDC would develop its own Data Base and reports as required by the Directorate General later to be incorporated in to the PCAS if so necessitated. Functioning of PCAS is a streamlined process of information gathering and audit parameter selection. Functioning of PCAS would be based upon PRAL software.

Staffing

S.No.	Designation	No of Post Required	Remarks
1	Assistant Director (CDC)	1	PCS
2	Superintendent	1	Customs
3	Data Analyst	2	PRAL
4	DEOs	4	PRAL

IT Equipment and Support

- VPN networking of CDC with the RDCs.
- Broad Band Connectivity and associated linkage and networking.
- Proper IT equipment and associated equipment including Desktop computers, printers, Scanner.
- Back up electricity supply for the CDC
- Training of staff on PCAS, WeBoC, PaCCS, One Customs to prepare them for CDC responsibilities.

Output of Data Centre

- Ready access to WeBoC, One Customs, PaCCS data.
- Trader Profile record.
- RMS Feedback.
- Generating monthly reports pertaining to the adjudication and recovery of the pending cases.
- Generating and maintaining data of Audit Observations and Contravention Reports.
- Allied Functions.

9. HUMAN RESOURCE DEVELOPMENT OF PCA

A properly trained and motivated workforce is the most essential component of Post Clearance Audit. The Directorate General is striving hard to get its officers and staffs trained in the field of Post Clearance Audit, and provide them the right tools to conduct the audit. In-house-training sessions on data mining and PCA software are frequently conducted. Workshops and seminars have also been arranged both for staff as well as Business community to apprise them of the benefits of PCA and get their cooperation as well. JICA has been of great help in arranging several international training programs, broadening the horizon of officers and staff and development of audit techniques.

10. WAY FORWARD

- PCA is on its way to the country wide expansion. New directorates of PCA are being established in the provinces of Khyber Pakhtunkhwa (KPK) and Baluchistan.
 - Training of the operational staff on the PCA and Customs Automated Clearance soft-wares like WeBOC needs to be focused. Capacity Building of the officers and staff through domestic and international trainings is fundamental for the optimal performance and expansion of PCA.
 - Streamlining of the Adjudication and Recovery proceedings also needs to be focused upon.
 - Enhancing the awareness of Trade Community about PCA through;
 - Publications
 - Seminars involving trade community
 - Computerization and I.T equipment
 - Gradual transition towards Entity based Audits
 - Capacity Building of the officers and staff
 - Online linkage with all customs field formations for feedback, reporting of adjudication and recovery proceedings.
 - As per charter of functions, coordination with JICA and other donor agencies, for future development and capacity enhancement of PCA on international lines.
 - Development and further improvement of Risk Management criteria for selection of transactions/entities for audits.
 - Trader profiling for the purposes of Post Clearance Audit.
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