

# Assessment of the Challenges of Post Clearance Audit in Ethiopian Revenue and Customs Authority (a Case of Mekelle Branch office)

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## **Abstract**

*The increase in volume of international trade and the need for trade facilitation has necessitated the adoption of risk management and audit-based controls. Post Clearance Audit is one of the most important means/tools used by many countries in the customs reform and modernization. Ethiopia has introduced Post Clearance Audit in 2009, in its reform to improve trade facilitation and control at the Headquarters and Branch Offices. The Mekelle Branch Office also started the PCA in the same year. The main objective of this study is to assess the challenges of the Post Clearance Audit at the Mekelle Branch Office and tried to assess the proficiency and competency, of the PCA auditors, legal framework to implement PCA, the level of risk management, the contribution of PCA in the trade facilitation and revenue collection and tried to identify the major challenges in the implementation of PCA. To achieve these objectives, both quantitative and qualitative research approaches were used and data were collected from primary and secondary sources. The primary data were collected, using survey method, from the PCA staff, taxpayers or agents and non-PCA staff. About 128 structured questionnaires were distributed to the respondents and the response rate is 81.3%. The analysis provided that the PCA auditors have good education background but they are constrained by lack of training and development; the legal framework of ERCA (Customs Proclamation 859/2014, Article 21/ 4 has a problem concerning the long audit coverage period; risk management is not applied in the PCA to select cases for audit; the existing audit program doesn't contribute to the desired level; and PCA does not cover all the customs regimes. The study concluded that if PCA were conducted by competent auditors, it could have resulted in effective customs administration. Finally, the researcher recommends that the Tax Authority/ERCA/ should improve the capabilities of the PCA auditors; risk management should be adopted in the case selection; and the tax laws should be reviewed regularly, so that loopholes of the law can be addressed .*

**Key words:** post clearance audit, trade facilitation, risk management

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## 1. Introduction

The growth in international trade, coupled with declining resources for Customs administrations worldwide relative to the increase in volume of international trade and the need for trade facilitation, has necessitated the adoption of risk management and audit-based controls (EAC, 2012). These permit Customs authorities to release the vast majority of shipments and retain only consignments matching the risk profiles. Non-selected cargo will be released immediately but may be subjected to Post Clearance Audit later. Post Clearance Audit (PCA) means audit-based Customs control performed subsequent to the release of the cargo from Customs' custody. The purpose of such audits is to verify the accuracy and authenticity of declarations and covers the control of traders' commercial data, business systems, records and books. Such an audit can take place at the premises of the trader, and may take into account individual transactions, so-called "transaction-based" audit, or cover imports and/or exports undertaken over a certain period of time, so-called "company-based" audit (UNCTAD, 2011). A Customs audit examines the records of clients after the import or export transaction has been finalized.

## 2. Statement of the Problem

According to Puengpradit (2010), in the contemporary international trade environment, trade facilitation and customs regulatory control are two significant requirements for both government and the business community. These requirements, however, are difficult to put into practice and have become a major challenge for customs administrations. Customs administrations are required to facilitate international trade while at the same time

ensuring effective control in compliance with both national and international obligations, particularly in the light of current concerns about public health and safety and security issues.

According to WCO (2012), by application of a post-clearance, risk-based approach, Customs are able to target their resources more effectively and work in partnership with the business community to improve compliance levels and facilitate trade.

The introduction of Post Clearance Audit signifies that ERCA's commitment to provide fast service to its customers by reducing the release time. The researcher was interested to investigate those challenges that hindered the Authority in general and the Mekelle Branch Office in particular from achieving the objectives of the PCA.

### **3. Literature Review**

#### **Definitions of post clearance audit**

Post-clearance audit means audit-based Customs control performed subsequent to the release of the cargo from Customs' custody. The purpose of such audits is to verify the accuracy and authenticity of declarations and covers the control of traders' commercial data, business systems, records and books. Such an audit can take place at the premises of the trader, and may take into account individual transactions, so-called "transaction-based" audit, or cover imports and/or exports undertaken over a certain period of time, so-called "company based" audit. Post-clearance audits can be conducted on a case-by-case basis, focusing on targeted operators, selected on the grounds of risk analysis of the commodity and the trader, or in a planned, regular way, set out in an annual audit program. Furthermore, the audit could also be used as criteria to offer special treatment to certain economic operators. Post clearance audit is the process of verifying the compliance of a business with customs legislation, through an examination of accounts and other records of that business (East AFRITAC, 2008).

#### **The Risk Management Process and PCA**

According to Wulf and Sokol (2005) explanation, in an effort to achieve an appropriate balance between trade facilitation and regulatory control, customs administrations are generally abandoning their traditional, routine "gateway" checks and are now applying the principles of risk management with varying degrees of sophistication and success.

#### **Legal Framework and Essential Powers of Post Clearance Audit**

According to WCO (2012), to facilitate PCA, it is necessary to implement legislation which provides Customs with the legal basis to conduct an audit and also sets out the rights and obligations of the auditees. Each Customs administration will develop laws and regulations based on national requirements or, in cases where a Customs union exists, at a regional level.

#### **Constraint/Challenges of PCA Implementation**

According to EAC (2010), Apart from an inadequate resource envelope, amongst the key constraints to PCA implementations in the developing countries are: The absence of a legislative framework and bilateral/multilateral agreements fostering the sharing of customs information and intelligence in strengthening risk management and PCA. Relatively low percentages of compliant traders thus requiring a high investment in enabling and supporting the non-compliant traders attain minimum standards in order to be compliant inadequate baseline information about businesses; the voluntary nature of PCAs currently makes it difficult for Customs Administrations to enforce compliance using PCA approaches.

### **4. Objectives of the study**

#### **General Objective**

The main objective of this study was to identify the challenges of Post Clearance Audit implementation in Customs administrations, focusing on the case of ERCA'S Mekelle branch.

#### **Research Questions**

- i. Do PCA auditors' have the required proficiency and competence?
- ii. Are the legal frameworks of ERCA creates enabling environment?
- iii. How the risk management is implemented in the branch office?
- iv. What is the contribution of PCA in the trade facilitation and revenue collection at the Mekelle Branch Office?

- v. What are the major challenges of PCA, ERCA in general and that of the Mekelle Branch Office in particular?

## 5. Methodology

The researcher has used a mixed research approach. The reason to use this approach was to address problems of the study from different perspectives. The researcher used primary and secondary data sources. Questionnaires and interviews were used as the main instruments for data gathering from PCA auditors and taxpayers' communities/importer and exporter/. The target population or universe was 40 staffs and 120 taxpayers' The sample size of the study was 36 employees and 92 taxpayers and in this study, the researcher used both probability specifically simple random sampling techniques and non probability sampling for the 36 PCA audit staffs as a whole.

## 6. Results and Discussions

### 6.1 pilot study

Pilot test was performed to determine the appropriateness and relevance of the questions in the instrument. Test of content validity was performed which was measuring to the extent of the instrument provides adequate coverage, representativeness of the universe, specificity and clarity of the topic under study. The instrument was provided to three academicians and four practitioners who assessed each item thoroughly. The draft was also distributed and piloted on 20 large taxpayers of Large Taxpayers'.

### 6.2 Reliability Test

The researcher used reliability test analysis for the assessment the challenges of post clearance audit in customs administrations: the case of Mekelle branch office of the Ethiopian revenues and customs authority using cronbach's alpha ( $\alpha$ ). cronbach's alpha is the most common and widely used measure of internal consistency (reliability). The cronbach's alpha ( $\alpha$ ) of the scale used in the research is 0.87 which is far greater than 70%.the scales with the coefficient alpha above 0.70 is good and acceptable this shows that there is high internal consistency and reliability in the questionnaire. Therefore, the level of alpha was considered to be reliable enough to proceed with the data analysis.

## 7. Response Rate Analysis

The field survey result indicates that from 92 questionnaires distributed to taxpayers/agents 76 were returned representing 82.6 percent and 15 questionnaires were distributed to the Post Clearance Audit and all are returned and 18 questionnaires were distributed to non-Post Clearance Audit staff, 13 questionnaires were returned and represent 72.2 percent.

### 7.1 Demographic information of respondents

In the following tables and charts, information related to the PCA respondents', age, educational background, work experience and current occupation of staff and gender, age, education background and business sector of sample taxpayers are presented and analyzed. To get this information, the respondents were provided with structured questions.

Out of the 15 respondents 33.3 % are less than 25 years old and 60% respondents' ages range from 25-35 years old and the remaining 6.7% respondents' ages range from 35-45 years. In summary the majority of the Post Clearance Audit staffs' ages lie between 25 and 35 years which is a working age.

The qualifications of the PCA sample respondents. Accordingly, out of the 15 respondents, 93.33% of them have B.A Degree, 6.7% of the respondent has MA or MSC degree in different fields of study. Customs Post Clearance Audit officers should be trained and equipped with necessary skills and tools in order to perform their duties effectively and efficiently (EAC, 2012). Therefore, the audit staffs have good educational backgrounds which enable them to perform their duties effectively and efficiently.

The PCA staffs' work experience in ERCA shows that 20% have less than one year, 40% of the respondents have 1-3 years, 33.3.% have 4-7 years, and 6.7% has 8-10 years work experience in ERCA. The majority 93.3% have less than 7 years work experience.

The PCA staff's work experience in the PCA department is 26.7% of the respondents have work in the department for less than a year, 53.33% of them have work from 1-3 years and the remaining 26.7% have works 4-6 year work experience

Regarding PCA staff respondents' current positions About 46.7% of the respondents are junior auditors, 20% of the respondents are auditors, 20% of the respondents are senior auditors, 6.7% of the respondent is team coordinator and 6.7% of the respondent is process owner, who is responsible for both the tax audit and Post Clearance Audit. From this, we can understand that almost half 47% of the respondents are junior auditors and from the interview held with the team leader the researcher realized that there is only one auditor and one senior auditor who are working in the PCA department while the rest are rotated to other departments. Therefore, the department is not organized with well experienced auditors and this may result in weak performance both in the trade facilitation as well as in the revenue collection.

### **The Proficiency and Competence of the Post Clearance Auditors**

Regarding the educational background of PCA auditors 93.33% are degree holders and 6.7% is master holder. From this, we can understand that Post Clearance Auditors have good educational background which enables them to understand the complex tax laws and make different analysis. Regarding their work experience in the PCA unit, 26.7% have less than one year, 46.7% have 1-3 years and the remaining 26.7% have 4-6 years experience. As it can be understood from this, the majority of the PCA respondents 73.4% have less than three years experience in the department.

### **ERCA's Legal Frameworks in the Implementation of PCA**

Regarding the legal framework of ERCA, Articles 4 of the Ethiopian Customs Proclamation Number 859/2014 articulate that customs control or audit may be carried out in a defined period or only within 5 years from the date that customs declaration has been accepted (ERCA, 2014). It gives Post Clearance Audit full power to conduct audit by applying different kinds of audits such as desk audit, limited spot audit and field audit to ensure whether or not tax laws are respected and the government revenues are collected properly.

### **Application of Risk Management in Audit**

Regarding the application of risk management strategy at the Branch Office, the majority of the respondents 80% responded that the PCA has not yet developed risk management strategy, and 46.7% of the respondents replied that the Branch Office has already identified potential risk indicators, and 33.4% of the respondents responded that the branch office has not yet identify the risk indicators. In addition, 86.8% of the respondents agreed that the PCA records history of traders. The majority (80%) of the respondents replied that the risk profile and risk indicators were not constantly developed and updated regularly. Significant (66.7%) of the number of PCA respondents believed that risk identification occurs as a result of consideration of the findings from audits and evaluations, 80% of the respondents replied that the PCA allows customs to change the approach from a purely transaction based control to a more comprehensive, company oriented control. Regarding the application of ASYCUDA<sup>++</sup> module for risk based audit case selection, 80% of the respondents disagreed; further, out of the total respondents about 66.7% of the respondents also disagreed with the idea that PCA uses third party information. About 66.7% of the respondents also disagreed with the idea that PCA uses third party information.

### **Contribution of PCA in Trade Facilitation and Revenue**

The responses on the contribution PCA in trade facilitation and revenue contribution questions were forwarded to the PCA staff whether audit program is sufficiently contributing towards the desired outcome of audit work in collection of the government revenue. About 33.3% of the respondents strongly agreed, 53.3% agreed and 13.3% of the respondents are neutral. About 86.6 % of the respondents responded that PCA contributes for the trade facilitation in accordance with the Revised Kyoto Convention. With regard to the collection of the government revenue, about 6.7% of the respondents strongly agreed, 20% of the respondents are neutral, 46.7% disagreed and the remaining 26.7% strongly disagreed. an interview was held with the PCA team leader, whether the PCA is contributing to the desired level of trade facilitation and revenue collection. The interview result shows that currently the unit is not well organized both in material and manpower. As a result, it is not contributing to the desired level. The revenue collected for the last four years has been increasing but had the unit was well organized; more revenue could have been collected.

### Descriptive Statistics of PCA Contribution of the Mekelle Branch Office

Number of Declarations and Amount of Tax Due	Mean	Std. Deviation
Number of Declarations Audited	812.40	1047.775
Amount Tax Due	5.7710E6	3.94202E6

Source: Compiled from the Report of Mekelle PCA (2017/8).

The above table shows that the average number of declaration audited and the average amount tax due i.e.  $812 \pm 1024$  and Birr  $5,771,000 \pm 3,942,020$  respectively by the PAC Mekelle Branch Office for the five fiscal periods 2008/09-2012/13.

**Pearson Correlation Coefficient** A correlation test is conducted to determine the relationship between the Amount Tax Due as the dependent variable and the number of declarations audited independent variable in this study.

### The Correlations Between Number of Declarations Audited and Amount of Tax Due

		NDA	ATD
NDA	Pearson Correlation	1	.670
	Sig. (2-tailed)		.216
	N	5	5
ATD	Pearson Correlation	.670	1
	Sig. (2-tailed)	.216	
	N	5	5

Correlation is Significant at the 0.05 level (2-tailed)

Note that: NDA (Number of Declarations Audited), ATD (Amount of Tax Due)

Source: Compiled from the Report of Mekelle PCA and Own Computation (2014).

The above table shows the relationship between the numbers of declarations audited and the amount of tax due. The two variables have positive relationship with a coefficient of +0.670, i.e. when the number of declarations audited increases the amount of tax due also increases. Therefore, the Mekelle Branch Office should increase the number of auditors and the audit coverage so that the revenue can be increased significantly.

### The Correlations Between Number of Declarations Audited and Declarations with Audit Finding

		NDA	DWF
NDA	Pearson Correlation	1	.740
	Sig. (2-tailed)		.152
	N	5	5
DWF	Pearson Correlation	.740	1
	Sig. (2-tailed)	.152	
	N	5	5

Correlation is Significant at the 0.05 level (2-tailed)

Note that: NDA (Number of Declarations Audited), DWF (Declarations with audit Finding)

### The Major Challenges of PCA in the Mekelle Customs Branch Office of ERCA

Well organized PCA unit enables a tax authority to achieve its ultimate objectives. Regarding the organization of PCA at the Mekelle Customs Branch of ERCA, questions were forwarded to the PCA respondents. Accordingly,

Table 4.16 shows the respondents' responses to the question whether the PCA department is organized in all resources. Accordingly, 6.7% respondent agreed, 6.7% is neutral, 73.3% disagreed, and the remaining 13.3% strongly disagreed. The majority (86.6%) of the respondents replied that PCA is not well organized in all material resources and facilities like computers; customs rules regulations and manuals; the other question related to the organization of the unit was forwarded whether or not auditors are well organized. Accordingly 6.7% agreed, 20% neutral, 53.3% disagreed, and 13.3% strongly disagreed. In addition to these whether the department is supported by automation or not question was forwarded to respondents. About 20% of the respondents are neutral, 33.3% disagreed and the remaining 46.7% of the respondents strongly disagreed. Therefore, from the above response it can be concluded that the department is not well organized and automated.

### **The Problematic Areas of the Mekelle Customs Branch Office**

The responses of the non-PCA respondents indicates that 53.8%, of the respondents replied that customs valuation is the most Problematic and 30.8% of the respondents responded that classification is the most problematic and the remaining 15.4% replied that identification of Origins of goods is the most problematic one. From this it can be concluded that customs valuation, classification and identification of origin are the most problematic areas of Mekelle Customs Branch Office.

## **8. CONCLUSIONS AND RECOMMENDATIONS**

### **8.1. Conclusions**

According to the analyses and the findings obtained from the study:

The majority of the PCA respondents, and sample non PCA staff have good educational background and it is an opportunity for the Branch Office to implement modern way of customs administration. However, both the PCA staff and non PCA staff are less experienced and this may result in inefficiency for the Branch Office. Regarding their age, the PCA staffs as well as the non PCA staff are young and it is an opportunity because young staffs are ready to change.

The PCA auditors haven't got any kind of training, which was important to undertake their day to day duties. However, the tax and post clearance audit policy and strategy states that an auditor should be provided with the necessary training and skills at least 40 hours per year. The other finding indicated that the provision of the Ethiopian Customs Proclamation No.859/2014 article 4, which states that the time length of the audit coverage to be 5 years, is much longer and need to be adjusted to the maximum of 3 years. In addition to this, the tax laws are simple and understandable; there is a simple filing and payment procedures, but there inappropriate penalty and also inefficient and ineffective appeal system.

Cases for audit are selected by simple random sampling technique and manually without applying risk management, existing audit program is not at the desired level and PCA does not cover all the customs regimes. The survey result also revealed that PCA Unit is not well organized, auditors are not well equipped and it is not well automated.

### **8.2. Recommendations**

Therefore, the researcher has tried to provide briefly the following recommendations:

- There should be appropriate need assessment and based on the gap identified, the customs Authority should provide continuous training and development programs to the PCA auditors in the areas of investigation, computerized auditing and customs laws so that their skills are kept up-to-date and relevant to undertake their duty in a better way and to achieve the audit program to the desired level.
- The customs Authority should continuously review the customs laws and make amendments on those laws which can create loopholes for tax avoidance so that better results can be achieved.
- The customs Authority should amend the provision of the Customs Proclamation No.859/2014, Article 21/4, to reduce the audit coverage period from 5 years to the maximum of 3 years.
- The appeal system should be reviewed, to address taxpayers complain in an effective and efficient manner so that compliance costs could also be reduced.

- The customs Authority should improve the public awareness of the importance of tax payment and the effect of non-tax payment, using Medias, workshops and seminars so that the level of compliance can be improved and non-compliance will be minimized. In addition to this, intensive trainings and awareness creation programs should be prepared.
- Finally the customs Authority should apply risk management and ASYCUDA<sup>++</sup> modules to select cases for audit rather than simple random selection and manual based, so that resources can be allocated efficiently. In addition to these, new technologies should be adopted to deliver fast service to the taxpayers.

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