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# Customs Post Clearance Control:

## Training; Road Map; and Recommendations

June 2015  
Ulaanbaatar, Mongolia



Project: Mongolia Business Plus Initiative Project (BPI)  
Report Title: ***Customs Post Clearance Audit Team Training and Road Map***  
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## **ABBREVIATIONS AND ACRONYMS**

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BPI	Business Plus Initiative
CVA	Customs Valuation Agreement
GATT	General Agreement on Tariffs and Trade
IPR	Inward Processing Relief
LOE	Level Of Effort
PCA	Post Clearance Audit
PCC	Post Clearance Control
WCO	World Customs Organization
WTO	World Trade Organization



## **TABLE OF CONTENT**

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ABBREVIATIONS AND ACRONYMS .....	i
TABLE OF CONTENT .....	iii
EXECUTIVE SUMMARY .....	v
SECTION I: INITIAL WORK .....	1
SECTION II: TRAINING DELIVERED .....	3
SECTION III: ROAD MAP.....	5
SECTION IV: RECOMMENDATIONS.....	11
ANNEX A: TRAINING SCHEDULE .....	13
ANNEX B: POST CLEARANCE CONTROL ROAD MAP:.....	15
ANNEX C: RECOMMENDATIONS FROM JUNE 2013:.....	21
ANNEX D: RECOMMENDATIONS FROM SEPTEMBER 2013 .....	27
ANNEX E: CONSIDERATION OF THE MONGOLIAN IMPLEMENTATION LEGISLATION FOR POST CLEARANCE CUSTOMS CONTROL OF IMPORTED GOODS:.....	31



## **EXECUTIVE SUMMARY**

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The purpose of this project was to:

- devise and deliver 12 days training to meet the perceived needs of new members of the PCA Team; and
- construct a 'road map' for the way forward for the Mongolian PCA Team.

During May 2015 the consultant held numerous discussions, via E-Mail, with Mr Amgalan, Chemonics, Ulaanbaatar and devised training based on Mongolian Customs Law, the General Agreement on Tariffs and Trade (GATT) Customs Valuation Agreement (CVA) and the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing studies, and adapted the following courses from the 2013 training:

- a five and a half day valuation course covering Method 1;
- a one day basic interview skills course;
- a two and a half day Post Clearance Audit course;
- a one day Post Clearance Compliance course; and
- a two day seminar introducing the concepts of Tax Planning, Tax Avoidance, Fraud and Transfer Pricing.

The mission in Ulaanbaatar covered the period 8<sup>th</sup> June to 20<sup>th</sup> June 2015. The training started immediately upon arrival.

On the 19<sup>th</sup> June there was a closing ceremony at which certificates were presented to all of the students by:

Jargalsaikhan, Director of PCA department of CGA;

Gankhuyag, Head of Customs Classification and Valuation Division of CGA; and

Rebecca Logan, Acting COP of the project.



## **SECTION I: INITIAL WORK**

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During May 2015, in the UK, the expert commenced the development of a 'PCA Road Map' and adapted previous training covering 18 days to meet the requirements of presenting the courses in 12 days. These courses were based on:

The Constitution of Mongolia;

Customs Law of Mongolia;

Law of Mongolia on Customs Tariffs and Customs Duties; and

A Regulation Concerning Post Clearance Audit.

In combination with the WTO's CVA and the OECD's Transfer Pricing reports four training courses and a two day lecture were devised. The courses comprise:

Modules;

Exercises; and

Handouts.

The lectures comprise:

Modules; and

Handouts

All the material was transferred to Mongolia by E-Mail, where it was translated/updated and printed.

During the first period in May/June 2013 the expert posed numerous questions for the Mongolian Customs Department to answer. By the commencement of the first course in 2013 approximately half of the final 100 questions were still outstanding. The majority of these outstanding questions remain unanswered to date.



## **SECTION II: TRAINING DELIVERED**

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All four training courses and the four lectures were held over 12 days at the Ulaanbaatar Customs Head Quarters Building, between 8<sup>th</sup> and 20<sup>th</sup> June 2015. As with the previous training in 2013, Customs Managers pulled students out of the course at a moment's notice to deal with their 'normal duties'. It may be that some of these issues were urgent, but this is a very short sighted approach to training. The purpose of training is to somehow get knowledge into the heads of the students and then reinforce it before it can be 'pushed out' by other considerations. It was apparent that the students' level of knowledge retention was considerably less than the 75 – 80% expected when students give the training their undivided attention and then practice what they have learned before returning to 'normal duties'. Additionally, the students' time keeping was poor, with at least one student arriving late for the closing ceremony on Friday 19<sup>th</sup> June even though they had been told on several occasions the time of this ceremony.

The content of the courses was:

- the first five and a half days covered the GATT CVA Method 1;
- the next day covered basic Interview Techniques;
- the next two and a half days covered Audit;
- the next day covered Compliance; and
- the remaining two day seminar covered: Tax Planning, Tax Avoidance and Fraud; and Transfer Pricing.

The content of each course is summarized at Annex I

As with the earlier training, students were often using their mobile phones whilst the training was underway and they would leave the room without apology more often than not. Additionally many students did not attend all of the days.

Only one student brought with her a copy of the CVA, notwithstanding the fact that this had been provided electronically to the previous students in 2013. Most students were still relying on the Mongolian Customs law contained in the 'little blue book' issued to Mongolian Customs Officers, even though this law conflicts with the CVA and, therefore, does not have force of law for Customs Valuation purposes in Mongolia.

I have said these two things before, but they are worthy of repetition:

The purpose of training is to improve the skills of the students. This requires sufficient time for them to 'digest' new information in order to both understand it and to work out in their own minds how to best put it into practice. This cannot be done if immediately after each training session they are required to think about something other than what they have just learned. It is even more difficult when students do not attend the training in the first place. During the 2013 training I stated that all of the training I provide is cumulative. In other words, if a student misses part of the training (s)he will not be able to make it up later and possibly will not understand some of the later sessions.

It is better to train staff to do a thing effectively than to require them to do that thing with inadequate training. Management must learn that staff on training courses are not to be withdrawn for an issue that management perceive as being important to them, especially when only half of the staff are being trained at any one time. These issues can nearly always wait until after the end of the training course.

I accept that when 'over view training' is provided my criticisms are less relevant, but when detailed technical training and law based training is being provided it is absolutely fundamental that the students be allowed to absorb the knowledge.

## SECTION III: ROAD MAP

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### Training Requirements for Customs Post Clearance Control (PCC) of Importers

1. Introduce new, and/or modify existing, law
  - a. International experts to assist in drafting law to reduce the possibility of ‘abuse’ and Tax Avoidance
  - b. The PCC team should have input into drafting/amending the law in order to:
    - i. Understand the law
    - ii. Advise the legislators in order to reduce Tax Avoidance loop-holes

*Currently Mongolian Customs Officers rely on The Customs Law of Mongolia and The Law of Mongolia on Customs Tariffs and Customs Duties, both of which were poorly drafted some years ago. Additionally, there are various customs regulations. All of these need to be updated and, in particularly with respect to import valuation, they must accurately reflect the Customs Valuation Agreement of the GATT and modern business operations*

2. Introduction of a three channel system – Red, Green and Blue
  - a. International experts to assist with the criteria for Authorized Economic Operators (AEOs)
  - b. The PCC team should advise on the criteria for AEOs and the checks still to be carried out at the frontier
  - c. A two way exchange of intelligence between the Frontier Customs and the PCC Team should be introduced and the Frontier Customs trained accordingly

*In the EU the concept of Authorized Economic Operator goes far beyond allowing goods to be quickly cleared at the port. However, at this time the additional flexibility of a full AEO is not recommended. Mongolian Customs should concentrate on devising the most appropriate criteria for selecting and controlling importers at their premises rather than at the ports. This ‘concession’ can become both a ‘carrot and a stick’. Making this concession available to large importers is the carrot to obtain compliance. The threat of it’s removal is the stick to encourage uncompliant traders to improve.*

3. Resources
  - a. The PCC Team Manager should initiate a training regime for the support staff
  - b. Follow-up action by support staff

*The correct staffing levels are important to the efficient running of the PCC Team. In particular there is no advantage in using Compliance and Audit staff to perform clerical functions.*

***I recommend*** that thought be given to how to use support staff and to employing sufficient staff to release the Compliance and Audit Officers to perform their own duties.

*It is not appropriate for the officers who assessed arears to ensure their payment. These functions MUST be separated in order to provide the Customs Department with assurance.*

***I recommend*** that enforcement action (collection of arears) be allocated to a separate section of the Department

#### 4. Basic Training

##### **a. Decision that training takes priority over performing tasks**

*Many managers around the world have the view that training is not really all that important and certainly secondary to performing the actual duties. There is little point in sending improperly trained staff to perform duties. It is much better to train them first. I understand that some issues are important, but very few are so urgent and so unforeseen that staff need to be removed from technical and law based training to immediately respond. Additionally, staff should not be allowed to take leave during a training course. As a training manager in the UK I would refuse to allow staff to attend a course unless they were prepared to attend for all of the training. Mobile phones MUST be turned off during training courses as not only do they interfere with the individual student's training, but they disrupt other students as well.*

*As a Compliance and Audit manager in the UK I insisted that my staff practice what they have been trained in immediately after the course and before undertaking any other functions/duties.*

*I know that many managers in the Mongolian Customs Department will believe that the above points are all very well and good for the UK, but in Mongolia they are impractical. However, this is not true and does not accord with 'Best Practice' for training staff. It is essential that staff are allowed/encouraged to make the most of the training they receive and any other attitude is very short sighted and counterproductive.*

*I recommend that the above be adopted as 'Best Practice' in Mongolia.*

##### b. Theoretical/class room training

##### **i. Law based Compliance training covering all Customs Regimes and business practices**

*I recommend that all technical training be based on the law.*

1. International experts to assist with devising and presenting training
2. National experts to assist with devising and presenting training

##### ii. Audit training covering accounting and audit techniques

1. International experts to provide Audit training
2. National experts to provide accountancy training

*ii above has already been achieved in Mongolia*

##### iii. IT training

1. Basic for all staff
2. Advanced for computer auditors

##### c. Practical training provided by

- i. International experts fluent in National language
- ii. Experienced staff and
- iii. Compliant traders

*Compliant traders should be selected to assist in training staff, as the trade knows it's own business better than any Customs Officer. This will enable the PCC Team to fully appreciate the issues and problems faced by traders who wish to be compliant and will enable the PCC Team to identify and tackle those who do not wish to be compliant.*

- d. Education of large importers and AEOs by Compliance staff

*Whilst this is costly in initial resource, it is far cheaper in the long term. It is better to show a trader how to do something properly at the outset than to try to investigate him later and correct all of the 'issues' that have arisen.*

## 5. Risk

- a. All members of the PCC Team, including the manager, should receive training in Risk Assessment and Threat Assessment from International experts

*A Risk Assessment will identify how much money is at risk, whilst a Threat Assessment will identify the likelihood of the issues actually happening.*

- b. Management Profiles for ALL Managers
- c. How will senior managers, with little or no experience of PCC, ensure the efficiency and effectiveness of their staff?

*Audit and Compliance Verification procedures (9 below) are vital to the Department's proper management of staff and the revenue.*

## 6. Penalty System

- a. The PCC Team and the Fraud Team should be trained in the new penalty system

*Currently the PCC Team MUST inform the Investigation Team when an offence is identified. Unfortunately the definition of 'offence' is any error above approximately MNT 4million. This will result in most audits and compliance visits, which are properly conducted, being suspended almost at the outset as most large businesses will have errors greater than this amount.*

***I recommend*** that the PCC Team Manger be authorized to continue with the audit or compliance visit regardless of the size of the arrears except, where there is evidence to support a prosecution for deliberate evasion of the revenue.

***I recommend*** that those charged with investigating deliberate fraud receive training from International and National experts.

## 7. Review and Appeals procedures

***I recommend*** that the current Review and Appeals procedures be evaluated by an International expert and amended to reflect a more modern system, which is both cheap and easy to use.

- a. **All** PCC (and Fraud staff?) to receive training from International experts
- b. **All** PCC (and Fraud staff?) to receive training from National legal experts

## 8. Succession Planning

- a. All managers should receive training in succession planning

## 9. Control

- a. Managers at all levels should receive training in Audit Verification procedures from International and National experts
- b. Managers at all levels should receive training in Compliance Verification procedures from International and National experts

*Verification procedures: ensure correct rulings; thorough auditing; appropriate behavior of staff; and provide anti-corruption assurance*

#### 10. Continuation Training throughout the year

- a. Self-training
- b. Training by the manager
- c. Colleagues training each other
- d. Trader provided training
- e. Expert Training
  - i. From within the Department
  - ii. From Other Government Departments
  - iii. International Experts
- f. Additional training
  - i. To meet the requirements of succession planning
  - ii. To meet the requirements of changes to the law
  - iii. To meet the requirements of International Agreements

***I recommend*** that all staff be tasked with training the rest of the team in at least one subject. This should not be an entire regime, but rather a particular issue within a regime (e.g. for valuation, how to determine whether the price between related parties has been influenced by that relationship, etc.).

***I recommend*** that the PCC Team Manager devise training events to meet the identified needs of the whole team and specific individuals within the team.

#### 11. Trade Sectors

- a. All PCC staff to become expert in at least two Trade Sectors, one as leader and the other(s) as 'back-up' expert

#### 12. Advise updates to the Law in the light of experience and issues identified

- a. Tax Avoidance
- b. Improve drafting of the law
- c. Changes to improve effective Control.

*As the PCC staff become more proficient in their duties they will encounter more Tax Avoidance/Fraud cases. They are ideally placed to identify barriers in the law to solutions and to advise how to address them.*

#### 13. Advanced Training

- a. By legal experts
- b. By regime experts

- c. By technical experts (IT, examinations, etc.)
- d. By International experts.

**Two generic road maps are at Annex B**



## **SECTION IV: RECOMMENDATIONS**

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### **Procedural Recommendations**

1. The most vital recommendation is training.

The PCA team should receive additional training in:

- I. Interview Techniques;
- II. Customs Law;
- III. Tax Regulations (Import Excise and Import VAT); and
- IV. Investigation Techniques;

As mentioned in my 2013 reports there are three ways to achieve this training:

- ‘In house’ training. This should take two forms:
  - Each PCA officer, or a pair of officers, should research a subject and provide training to the rest of the team (item 2 above);
  - It was apparent that several of the students were able to assimilate the training better than others. They should take the opportunity that helping the others will give them to reinforce the knowledge they have gained.
- ‘Official’ training. This will be provided by departmental experts (i.e. investigators) and non-departmental experts such as the courts, lawyers and accountants (items 1, 3 & 4 above); and
- Training from foreign experts. This is last on the list because there are very few ‘foreign experts’ with sufficient knowledge of Mongolian law, procedures and culture to provide really useful, detailed, training. The PCA team are beyond ‘overview training’. They now require specifics, based on the actual situations they face in their work.

Students **MUST NOT** be allowed to be absent from any part of a technical training course for any reason other than domestic emergency and the **MUST** be given opportunity immediately after receiving technical training to put what they have learned in to practice.

2. Understanding Business Practices.
3. Regime training.
4. Practical training.
5. The PCA staff should not be rotated to other duties before they have spent at least two and preferably three years practicing what they have learned.
6. Re-examine the recommendations from 2013 with a view to their implementation.

### **Legal Recommendations**

1. The mandatory definition for undertaking a fraud investigation should be changed to allow the PCA team to conduct audits to large traders without having to treat those audits as fraud investigation.
2. Auditors should be able to suspend an audit, for good reasons, without requiring approval from the head of the Customs Department

3. The concept of 'voluntary disclosures' should be extended to those businesses that are prepared to assist the PCA staff to improve their knowledge and expertise.
4. The Head of the PCA team should be empowered to reduce the standard penalties where a business fully cooperates with the auditors and provide accurate details of all errors.
5. The PCA team should be given the power to conduct 'instant audits' without the need to formally inform a business of who will be conducting the audit, for how long, about what particular subjects, etc.

**Structure of the audit team** (repeated from the previous reports as this has not yet been put into effect)

The PCA team does not have any dedicated support staff. I believe that this is an error. There are many routine tasks that can be performed by clerical support staff and trainee auditors. These staff can also save the team's manager considerable time by collating all of the information he will require for monthly statistics etc.

Amongst others it is the job of these support staff to:

- book visits for compliance staff and audits for the auditors;
- chase up traders who are late in rendering returns and schedules of arrears;
- obtain the research information required to undertake an audit, including a sample of customs declarations and the information held by other tax authorities;
- obtain details of the person to see at the beginning of the audit and to ensure (s)he knows what the auditors will require during the audit, both in terms of personnel to see and documents to examine; and
- perform the initial checks on the trader's arrears schedules.

All of this work takes time, but it does not require the skills of trained auditors or compliance officers. When this sort of work is undertaken by support staff it can increase the number of audits and compliance visits considerably.

**I recommend** that a number of audit support staff be recruited to complement the auditors.

In the UK I required all of my trainee officers to give me a 30 minute presentation on each aspect of customs (the three main arrears of duty payment and all of the duty reliefs), covering the major issues of each regime, its law and the risk areas. We regularly held team meetings during which I updated my staff on amendments to the law and current interpretation of aspects of the law. Additionally, I required each team of two officers to pose a problem to all the trainees. They had to provide a solution, which I vetted for accuracy, and they had to take the rest of the team through both the issues and the solutions. This not only improved the skills of all the team members, but it significantly improved the knowledge of the staff who had to present both the problem and the solution.

**I recommend** that all Mongolian Customs officers are properly trained in the Customs Laws of Mongolia and that they are regularly tested/updated on the law.

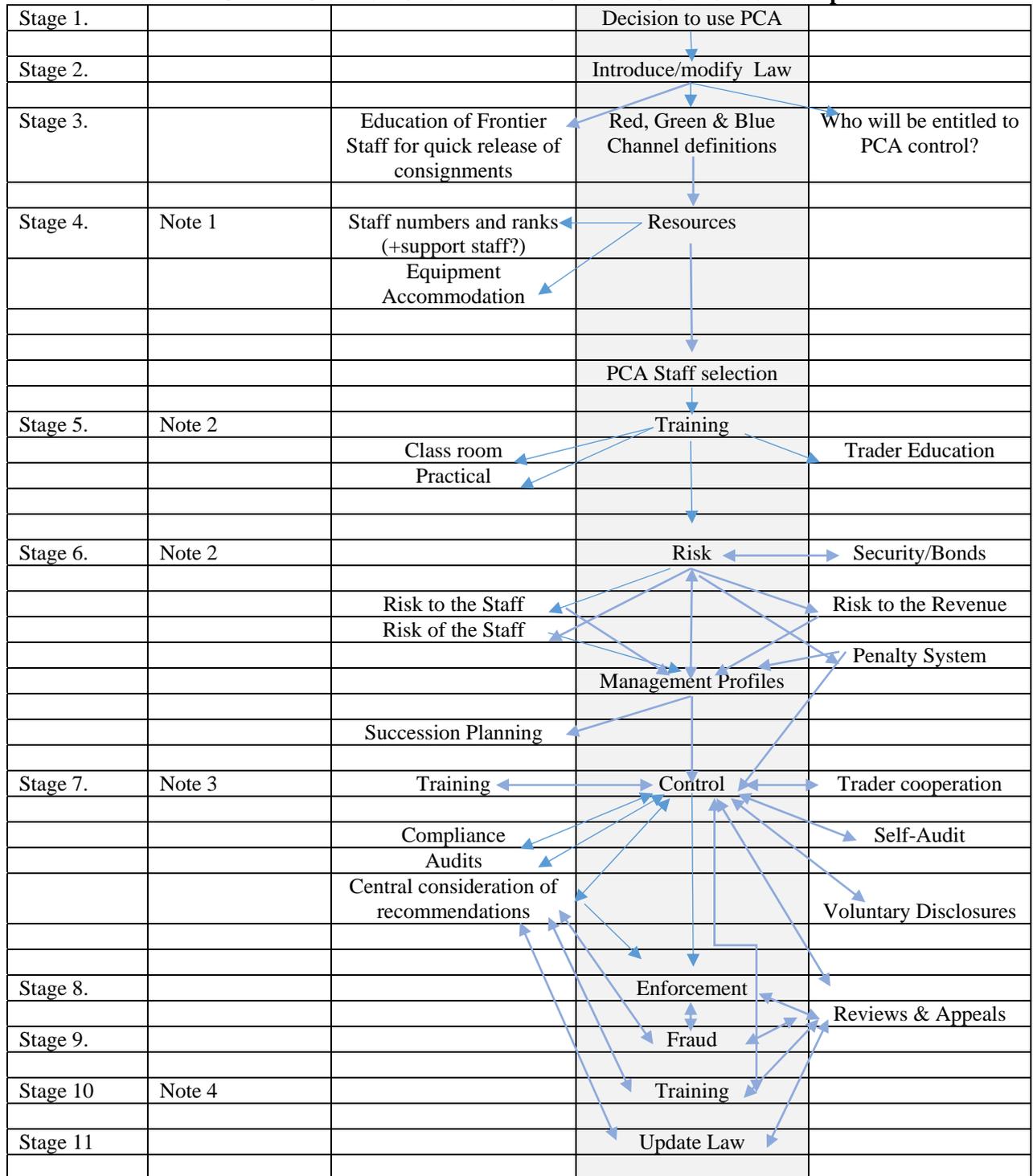


Compliance Tax Planning, Tax Avoidance, Fraud and Transfer Pricing June 2015

	Day 1	Day 2	Day 3	
09:30	Start	Start	Start	09:30
	<b>PCC Compliance</b> Inspections	<b>Tax Planning</b> <b>Tax Avoidance</b> <b>Fraud</b> Definitions	Examples: Tax Planning Tax Avoidance Fraud	
11:00	Tea	Tea	Tea	11:00
	Duty Payment Visits Specific Issues Visits	Technical Errors Tax Planning Tax Avoidance Fraud	Smuggling Slumbering Products <b>Transfer Pricing</b> MNEs	
12:30 – 13:30	Lunch	Lunch	Lunch	12:30 – 13:30
	Training Visits Education Visits	Tax Planning vs Tax Avoidance vs Fraud	Transfer Pricing MNEs OECD Guidelines	
15:15	coffee	coffee	coffee	15:15
	Cash Reconciliations	Regimes	Comparison OECD vs CVA Methods Customs vs Direct Tax	
17:00	Finish	Finish	Finish	17:00

## ANNEX B: POST CLEARANCE CONTROL ROAD MAP:

**Generic Skeleton Customs Post Clearance Control Road Map**



### Notes:

1. Support staff enable auditors to audit and not perform clerical functions.
2. It may be considered that stages 5 and 6 should be the other way around, but it is difficult for anyone to assess risk before receiving appropriate training. On the other hand, training should address the identified risk. In practice they are often considered simultaneously.

3. The training identified at stage 7 includes: self-training; training by the manager; and colleagues training each other, in regular sessions. Initially, each team meeting should include at least an hour for training.
4. Stage 10 covers the training of new staff and advanced training for experienced staff
5. The initial training will target specific regimes and Officers will only audit those first. Any other issues will not be covered in the training audit. Initially we will require simple traders with simple imports covering the specific regime the student needs training in. As the student becomes more proficient and confident, we should start to look for more complex situations and traders. Once we are satisfied that the student has reached an acceptable standard (s)he can consider the next regime.
6. Initially all auditors should work on a single trade sector, so that they can help each other. Later the auditors should be divided in half and they should work on two additional trade sectors. Then they should be given a different trade sector per team. Finally each auditor should become an expert in his/her own trade sectors and 'back up' experts for one of their colleague's trade sector.

## **The steps that a National Revenue Authority will go through when considering introducing Customs Post Clearance Control (PCC)**

1. Decision to adopt the use of PCC
2. Consultation with Stakeholders (including importers, exporters and their trade associations)
3. Introduce new, or modify existing, law
4. Introduction of a three channel system – Red, Green and Blue
  - a. Which importers will be able to use the system
  - b. Education of Frontier Customs Staff to enable swift clearance of goods to authorised traders (Authorised Economic Operators - AEOs);
5. Resources
  - a. Staff
    - i. Compliance Staff
    - ii. Audit Staff
      1. Documentary Audits
      2. Computer Audits
    - iii. Support Staff
  - b. Equipment
  - c. Accommodation
6. Staff selection
7. Training
  - a. Theoretical
  - b. Practical
  - c. Education of large importers and AEOs
8. Risk
  - a. To the Revenue
  - b. To the Staff
  - c. Of the staff
9. Management Profiles
  - a. Senior Management
  - b. Team Leader

c. Senior Staff

10. Succession Planning

11. Control

a. Compliance

- i. Audit or Compliance?
- ii. Control of resource time
- iii. Verification of correct rulings and actions

b. Audit

- i. Selection
- ii. Conduct of Audits
- iii. Audit Verification;

c. Training

- i. Self-training
- ii. Training by the manager
- iii. Colleagues training each other
- iv. Trader provided training
- v. Expert Training
  1. From within the Department
  2. From Other Government Departments
  3. International Experts

12. Trader cooperation

- a. Voluntary Disclosures
- b. Self-Audit

13. Central Body for consideration of recommendations

14. Enforcement (Revenue collection)

15. Fraud Investigations

16. Review and Appeals procedures

- a. Internal Reviews
- b. Independent Appeals System

17. Training

- a. Advanced training
  - b. To meet the requirements of succession planning
18. Update the Law in the light of experience and issues identified.



## **ANNEX C: RECOMMENDATIONS FROM JUNE 2013:**

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The primary legislation relating to Customs Post Clearance Audit in Mongolia is:

Order No 22 of 2011 **A REGULATION CONCERNING POST CLEARANCE AUDIT**

### **Structure of the Audit**

The PCA Team inform me that they cannot leave an audit half way through and return at a later stage, unless the Director General of Customs authorizes them to do so. This is a major obstacle to efficient auditing. It is the interpretation of Article 3.2 that produces this obstacle:

3.2. PCA shall be conducted on the basis of a directive issued by the Customs Commissioner.

The PCA staff and their management seem to believe that this Article requires them to get the permission of the Customs Commissioner to extend the time of the audit and to leave it without finalizing all issues, but to come back and resolve them at a later date.

Audit is defined as the structured examination of a business's relevant commercial systems, financial and non-financial records, physical stock and other assets, internally generated data and that produced independently of the business.

The idea of audit is to focus the tests so that they provide a representative view of the trader's systems. Mongolian Customs check every declaration 100%. As each declaration takes 30 to 60 minutes to fully check, this results in a considerable amount of time being required. It should be noted that 100% checking is not audit. This is just 'transaction testing'. In a 15 day audit the testing should normally take only two or three days.

The most cost effective way to perform an audit is to select a representative sample of transactions/records to fully test. Assume that 15% of all transactions are selected via the audit process and assume further that of these one third present errors. In the UK the auditor will explain to the importer that he has four to six weeks (depending on the number of transactions to be examined) to fully examine all of his own transactions and to provide a schedule of all errors. At this stage, whilst a selection of errors are identified to the importer, not all of the errors are identified to the importer. The importer is made aware of the fact that the auditor knows there are more than he has identified, so that the importer cannot just identify those the auditor already knows about.

When the final schedule is provided to the auditor a number of transactions not included on the schedule are checked to ensure that the schedule is accurate. If there were 300 declarations over the five years that Mongolian Customs can recover arrears, it would take in excess of 20 days just to undertake the testing phase of the audit to check all 300 declarations. By requiring the importer to do this work the auditor can reduce the time to two to three days during the audit and a further one to two days when checking the importer's schedule. This will double or treble the number of audits and auditor can perform.

**I recommend** that the Director of the PCA Team be authorized to extend/postpone the date of finalization of all audits.

Having detected errors it is more efficient (for maintaining the audit plan) to identify them in the audit report and pass that to the compliance officer for their resolution. However Article 3.13 provides a barrier to this:

3.13. The PCA team shall take necessary measures in regard to detected failures and violations by providing all kinds of advice including official demands and recommendations to fix/correct detected violations and offences.

**I recommend** that the Director of the PCA Team be authorized to allocate this work to the compliance officer and that this work is able to be deferred until after the original audit is completed.

The next issue is ‘criminality’. Articles 3.17, 4.2 and 4.3 raise a serious obstacle to audit:

3.17. If an incidence of a criminal nature is detected during the PCA, the Customs Inspector in charge shall collaborate with the Customs Violation Prevention Unit of the CGA in order to take immediate measures in accordance with the “Regulation to take an immediate measure against crime related complaints and information” approved by the Prosecutor General’s Order No 123 on the basis of the Criminal Procedure Code of Mongolia.

4.2. If the detected violations are not subject to criminal liabilities, then fine or tax shall be imposed on persons/companies in accordance with relevant legislation. The PCA team shall prepare “Statement of the Customs State Inspector authorized to conduct PCA” using the form attached to this regulation as Annex 2 and the “Record of Violations.”

4.3. If there is a need to register criminal cases involving persons engaged in the incidence specified in provision 3.17 of this regulation, or hidden a large sum of taxable income or evaded tax, the “Customs State Inspector’s Conclusions” must be prepared and the related documents should be transferred to a relevant division for due actions.

The definition of “an incidence of a criminal nature” seems to be if the error is above a (quite low) monetary threshold. Audit requires the cooperation of the trader who’s system is under review. It takes an exceptional officer to perform an audit under the circumstances that the importer is liable to criminal actions by the auditor/auditors colleagues. I do not believe that there will be such officers within the Mongolian Customs Department for a number of years as they do not currently have the experience, expertise or adequate training.

That is not to say that the staff do not have potential or enthusiasm – they do. There are a number of staff employed in the Mongolian Customs PCA team I would have been happy to serve under me in the UK. However, what they currently have is potential, not proven ability. They need the cooperation of the traders to increase their knowledge and expertise. In the UK I used a number of compliant traders to train my staff. Whilst all errors detected during training visits were required to be corrected and arrears paid, no penalty action was ever taken.

It is fundamental to the process of improving the technical skills of the auditors that they are able to convince the traders that there will be no penalty action if the trader cooperates, even if the errors are found by the auditors.

When errors are discovered a Customs Authority has two basic options: to treat the errors as fraud (which means proving that the trader’s actions were deliberate); or to treat the errors as a ‘control problem’. The idea of treating errors as a ‘control problem’ is that the Customs Authority and the trader work together to resolve the current issues and to try to ensure that they do not happen again. For this to work in practice, the trader has to give his full cooperation. To achieve this level of cooperation requires the Customs Authority to explain that there will be no penalty action, so long as there is full cooperation.

**I recommend** that the Director of the PCA Team be authorized treat all errors as a ‘control problem’ and not as fraud. A ‘control problem’ can be resolved by the compliance officer, without recourse to any criminal action or penalty. This will enable the PCA team to maintain the cooperation of the trader. The PCA team will produce significantly more revenue with the

cooperation of the trader than they would be able to do without it. This will produce significantly greater revenue than the lost penalties.

The types of audit require definition. In the UK we use compliant traders for ‘training audits’. These are audits where the trader helps the auditor to understand the business in question, the trade sector and the particular accounting system he uses. It is important that the traders are informed of the purpose of such audits and that if any errors are found during such an audit no penalty action will be taken with regard to any trader who cooperates with the training audit.

I also believe that the traders should be made aware of the benefits to them of this strategy. This will include ‘education visits’, where Mongolian Customs provide specific regime training advice to traders and their staff, and ‘trader specific visits’ which are aimed at traders who request help with particular problems. These are not audits as such, but a chance to understand the trader and to ensure that his staff get it right first time more often.

Furthermore, I believe that this strategy is fundamental to the Mongolian Customs Department moving towards the concept of ‘right tax, right time’. As I have said the level of tax in Mongolia is not a barrier in itself to traders becoming compliant, but inefficiency in the Government Departments is. Mongolian Customs need to break down the barriers to compliance.

**I recommend** that the Mongolian Customs Department adopt a strategy for undertaking ‘training audits’.

This will require the department to consider what strategy it will adopt to obtain the cooperation of traders. Customs cannot expect traders to assist them without some sort of reward for doing so. This clearly includes no penalties for errors, even those detected by the auditors. In addition the department should consider what it believes to be an ‘acceptable price’, that is to say, what the department is prepared to do to obtain the full cooperation of the trader. The following are some things that might be appropriate for Mongolian Customs to consider to ensure such cooperation:

- A cooperative trader can reasonably expect the majority of his consignments to clear boarder customs immediately, unless there is a specific risk identified. In other words his goods will be cleared without examination unless there is a positive reason for examining them.
- He might reasonably expect his enquiries to be dealt with quickly and efficiently.
- He should be able to rely on what Customs tell him. If Customs make a mistake then he should not have to pay for it. However, if the information he provides is not totally accurate, then he would be expected to pay any arrears that result from the incorrect advice.
- Education audits would also be a price worth considering. These are ‘events’ primarily aimed at ensuring the trader’s staff understand the customs regimes and requirements.

**I recommend** that Mongolian Customs engage with the traders and discuss these issues with a view to improving both cooperation and compliance.

### **Structure of the audit team**

I understand that the PCA team does not have any dedicated support staff. I believe that this is an error. There are many routine tasks that can be performed by clerical support staff and trainee auditors. In the UK a team of 20 auditors would be supported by at least four Assistant Auditors and two clerical support officers. These staff can also save the team’s manager considerable time by collating all of the information he will require for monthly statistics etc.

It the job of these support staff to:

- book visits for compliance staff and audits for the auditors;
- chase up traders who are late in rendering returns and schedules of arrears;
- obtain the research information required to undertake an audit, including a sample of customs declarations and the information held by other tax authorities;
- obtain details of the person to see at the beginning of the audit and to ensure (s)he knows what the auditors will require during the audit, both in terms of personnel to see and documents to examine; and
- perform the initial checks on the trader's arrears schedules.

All of this work takes time, but it does not require the skills of trained auditors of compliance officers. When this sort of work is undertaken by support staff it can increase the number of audits and compliance visits considerably. In the UK I evened used the Assistant Auditors to perform routine visits to traders to ensure repayment claims were correct.

**I recommend** that a number of audit support staff be recruited to complement the auditors.

There is a considerable benefit in splitting audit from compliance. In the UK all Customs Post Clearance staff were called 'Control Officers' until the mid 1990s. These staff performed all the duties of auditors and compliance officers. However, it was noticed that very few audits were ever actually completed and even fewer were completed on time. When the traditional audit was examined in detail what was discovered provided the clue to the problem. During the course of an audit a technical problem (often many and varied problems) would be discovered. The auditor would then spend the rest of the allocated time resolving these issues. As a consequence, auditing was inefficient.

It was decided to split the two functions and have staff dedicated to each. This resulted in almost all audits being completed, but not necessarily by the due date as the auditors would invariably leave the importers to determine the extent of the arrears. However, most audits were completed within the number of days allocated and most of them within the same three monthly period used for reports.

The real problem is time allocation. If it is decided that an 'average audit' requires two officers for 15 days, there is a tendency for managers to want the auditors to complete for audits within three months (60 working days). This is impossible if errors are detected. In Mongolia it is inevitable that many errors will be detected during the audit. Then a decision is required. Do the auditors resolve all the issues whilst they are there or leave the trader to do it himself and come back and check later?

If they resolve the issues before leaving this will add many days to the length of the audit, often doubling the time required, with consequent problems for the next audit (and the one following that!). In other words the carefully constructed Team Audit Plan does not survive the first month! Later audits will not only be delayed because of the additional time spent on the earlier ones, but the later trader's vital staff would have been organized to be available when originally planned. For Multi-nationals it is important to keep to the agreed time scales as their staff are often out of the country for long periods of time. One American Multi-national I audited in the UK required at least six weeks' notice for me to see the executive vice president who understood the company structure and it's transfer pricing policy. When he was available in the UK, for just five days each quarter, I had to be able to interview him.

**I recommend** that the Audit team be split into audit officers and compliance officers. It is possible for one officer to undertake both functions in the short term, but it must be made clear

that all audits must be completed before the more complex issues are resolved, otherwise the audits will either take an inordinate amount of time, or not be completed at all. In the long term, due to different training requirements, it is more efficient to split the two roles.

The cumulative effect of my recommendations should be substantial. Given the relatively small size of the penalties in respect of Mongolian Customs offences there is little incentive to the trader to be honest. The barrier to honesty is not the amount of the tax, but two real issues:

1. If the trader is to be fined, even when he notifies customs that he has made an error, he will rather wait to see if customs find it themselves and then only pay what they find, plus the penalties associated to what they find. He would almost certainly have to pay considerably more if he were to inform customs of all the errors he found himself; and
2. Incorrect interpretation of the law. By this I mean that some of the actions taken are contrary to the correct reading of both National Law and International Agreements. For example, most Customs Officers I have met around the world believe that if a value declared under Method 1 is not acceptable to them they can immediately impose a Method 6 value. However, Customs cannot choose which Method they will accept in its place. By law they MUST proceed through Methods 2, 3, 4 and 5 and if an acceptable value can be determined under one of these Methods, it MUST be accepted, rather than going straight to Method 6.

When a trader perceives that the authorities are acting in a way he thinks is illegal, he will feel that it is perfectly OK for him to do the same. He will have no moral qualms about such actions.

In the UK I required all of my trainee officers to give me a presentation on each aspect of customs (the three main arrears of duty payment and all of the duty reliefs), covering the major issues of each regime, its law and the risk areas. We regularly held team meetings during which I updated my staff on amendments to the law and current interpretation of aspects of the law. Additionally, I required each team of two officers to pose a problem to all the trainees. They had to provide a solution, which I vetted for accuracy, and they had to take the rest of the team through both the issues and the solutions. This not only improved the skills of all the team members, but it significantly improved the knowledge of the staff who had to present both the problem and the solution.

**I recommend** that all Mongolian Customs officers are properly trained in the Customs Laws of Mongolia and that they are regularly tested/updated on the law.



## **ANNEX D: RECOMMENDATIONS FROM SEPTEMBER 2013**

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### **Procedural Recommendations**

7. The most vital recommendation is training. The PCA team must receive additional training in:

1. Criminal Law;
2. Tax Regulations;
3. Investigation Techniques; and
4. Interview Techniques

There are three ways to achieve this training:

- ‘In house’ training. This should take two forms:
  - Each PCA officer, or a pair of officers, should research a subject and provide training to the rest of the team (items 1 & 2 above);
  - It was apparent that several of the students were able to assimilate the training better than others. They should take the opportunity that helping the others will give them to reinforce the knowledge they have gained.
- ‘Official’ training. This will be provided by departmental experts (i.e. investigators) and non-departmental experts such as the courts, lawyers and accountants (items 3 & 4 above); and
- Training from foreign experts. This is last on the list because there are very few ‘foreign experts’ with sufficient knowledge of Mongolian law, procedures and culture to provide really useful, detailed, training. The PCA team are beyond ‘overview training’. They now require specifics, based on the actual situations they face in their work.

8. Understanding Business Practices. This means understanding both Mongolian and Multi-National enterprises: how they are structured; their business philosophy; their trading techniques and problems; their accounting practices; and product specific issues (such as seasonal trade, the fragility of certain goods, speed of obsolescence, fashion changes and terms of trade – including samples etc.).

To achieve this the PCA team manager will have to look for ‘partners in business’. This will include lawyers and accountants, but primarily it will be actual businesses themselves. The idea is that ‘those who practice, should teach’. In other words, getting the people who actually do the things the PCA team need to understand, to teach the PCA team.

9. Regime training. It appears that the departmental training the PCA team members have received to date is based on ‘Customs Procedures’, rather than the actual law. As a consequence traders will be able to avoid paying some duty that is due and they will be required to pay additional duty that is not legally due.

All Customs training courses should be structured first from the actual law, then from the Regulations and only last from Customs Procedures. Where the Customs Procedures conflict with the law, the procedures should be amended.

10. Practical training. Training Duty audits and training Tax Avoidance audits should be arranged. These will be to reasonably compliant medium sized traders (Duty audits) and

traders where the amount of duty at risk is acceptable should the PCA team fail to break the scheme (Tax Avoidance audits).

5. The PCA staff should not be rotated to other duties before they have spent at least two and preferably three years practicing what they have learned.

### **Legal Recommendations**

6. The mandatory definition for undertaking a fraud investigation should be changed to allow the PCA team to conduct audits to large traders without having to treat those audits as fraud investigation. It would be appropriate for the head of Post Clearance Audit to decide whether or not to treat a case as fraud, where the total revenue appears to be less than a pre-determined amount, but at least MNT 100 million.
7. The concept of ‘voluntary disclosures’, where a company is not penalised if it reports an error before the commencement of an audit, should be extended to those businesses that are prepared to assist the PCA staff to improve their knowledge and expertise. Businesses which provide help in understanding their industry and their own accounting practices should only be penalised when a large scale ‘blatant’ fraud is discovered. However, it is to be expected that companies that have undertaken such frauds will not be prepared to assist the PCA team, so there is little likelihood of such a conflict arising.
8. The Head of the PCA team should be empowered to reduce the standard penalties where a business fully cooperates with the auditors. In the UK penalties can be reduced by up to 75% of the standard penalty for a business that fully cooperates and actually undertakes all of the work in calculating the errors. In such situations the PCA team need only check the company’s figures.
9. The PCA staff should be given the power to assess arrears. This means that they can check a small percentage of declarations (say 10%) and the errors discovered can be applied to all importations from the same suppliers during the period allowed for collecting arrears in law.
10. The PCA team should be given the power to conduct ‘instant audits’ without the need to formally inform a business of who will be conducting the audit, for how long, about what particular subjects, etc. This will enable them to react to issues that are discovered during one audit and which are likely to affect many other businesses.
11. Where a business ‘looses’ its records, or they are ‘stolen’ or there is a fire just before the start of an audit, the PCA team leader should have the power to assess arrears at 50% of the total revenues declared on the Customs declarations concerned, in the first instance. If the same ‘problem’ occurs again within three years this should be increased to 100%. However, care must be taken not to penalise those few businesses where these issues are actually genuine.

### **Structure of the audit team** (repeated from the previous report)

I understand that the PCA team does not have any dedicated support staff. I believe that this is an error. There are many routine tasks that can be performed by clerical support staff and trainee auditors. In the UK a team of 20 auditors would be supported by at least four Assistant Auditors and two clerical support officers. These staff can also save the team’s manager considerable time by collating all of the information he will require for monthly statistics etc.

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**I recommend** that all Mongolian Customs officers are properly trained in the Customs Laws of Mongolia and that they are regularly tested/updated on the law.



## **ANNEX E: CONSIDERATION OF THE MONGOLIAN IMPLEMENTATION LEGISLATION FOR POST CLEARANCE CUSTOMS CONTROL OF IMPORTED GOODS:**

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### **Order No 22 of 2011 A REGULATION CONCERNING POST CLEARANCE AUDIT**

This document is the basic regulation governing how a Customs Post Clearance ‘event’ is to be conducted and includes the rights and responsibilities of the Customs Officers and the Tax Payer and his staff.

The regulation describes the ‘events’ it covers as Post Clearance Audit, but includes all activities appropriate to compliance control as well, making no distinction between the two main aspects of Customs Post Clearance Control.

The way the regulation is structured it anticipates that staff will move from audit to compliance and back again throughout the ‘event’, with no distinction made as to which type of control is being performed. This suggests that the Mongolian Customs Department and the Legislators have not recognized the distinction between these two aspects of Post Clearance Control.

**1. I recommend** that the Customs Department reconsider the remit of the Post Clearance Audit Team. There should be a defined separation between Audit and Compliance. It is not necessary that different officers undertake the two functions, but it is vital to the timely completion of audits that whilst the audit is underway the auditors are not required to resolve the compliance issues. They should either be resolved at a later date by the officers, or a separate team/officer should resolve them. Having said that, it is entirely appropriate for the auditors to resolve issues that will take a few minutes, such as advising the correct form to use for a duty relief, or determining the correct Commodity Code for a very straight forward product (but not complex issues).

Audit is the comprehensive and logical examination of systems. As a consequence the taking of samples would not normally form a part of an audit. Whilst confirming that the tax payer has performed stock checks and resolved any issues arising from those stock checks does form a part of the audit, actually taking part in a tax payer’s stock check, or performing the stock check itself is a compliance matter.

There are a number of specific aspects within the regulation that require addressing.

Article 3.17. If an incidence of a criminal nature is detected during the PCA, the Customs Inspector in charge shall collaborate with the Customs Violation Prevention Unit of the CGA in order to take immediate measures in accordance with the “Regulation to take an immediate measure against crime related complaints and information” approved by the Prosecutor General’s Order No 123 on the basis of the Criminal Procedure Code of Mongolia.

This is a major obstacle to audit. It is very likely that errors exceeding the limits in the Criminal procedure Code will be found almost at the outset of the audit. Article 3.17 will, effectively, halt the audit in it’s tracks and require a criminal investigation. This will mean the tax payer and his staff will not cooperate, will not talk to the auditors or provide them with any information. It would be almost impossible to perform an audit under these circumstances, even if it were appropriate to do so, which it is not.

**2. I recommend** that this Article be removed from the PCA Regulation, or that it be amended so that the head of the PCA division may authorize the auditors to ignore Article 3.17 and to inform the tax payer that criminal action will not occur unless he refuses to cooperate or it can be shown that he acted deliberately to defraud the revenue.

Article 4.10. The Customs State Inspector who prepared the records and reviews shall supervise and take measures to ensure compliance with the matters contained therein.

Ensuring that the tax payer complies with the recommendations is a compliance issue, not an audit issue and should not be performed by the audit officer. Additionally, if this includes ensuring that the proper additional taxes are paid, this is not best practice. Enforcement actions (recovering the additional revenues) should be not be undertaken by the person who calculated the arrears/errors, but by an independent officer, i.e. not an officer who was employed on the audit itself.

**3. I recommend** that Article 4.10 be deleted.

Article 6.1. Premises and warehouses owned by audited persons/companies shall be sealed on following occasions:

6.1.3. the remaining goods if its sample and specimen has to be taken for analysis.

This seems to be totally inappropriate in the cases where the auditors are querying the correct Commodity Code of a product that is obviously not subject to any prohibitions or restrictions. It is appropriate where a product may be subject to such provisions, but where this prevents the legitimate trade of the tax payer it is totally inappropriate.

**4. I recommend** that Article 6.1.3 be amended by the addition of the following:

“...but only where there are grounds to believe that the articles to be analyzed may be the subject of a prohibition or restriction under ....”

Article 6.2. A new customs declaration may be filled out for following reasons:

6.2.1. if the concerned persons/companies decide to voluntarily declare the tangible or intangible assets acquired through engineering or technological solutions, construction, arts, ornamental and design works, general sketches or technical design drawings performed in a foreign country, and in order to correct the offences detected during internal compliance related self-assessments;

The problem with the way this is worded is that it pre-supposes that if these items have not been declared on the declaration then an offence has been committed. However, not all of these items are required to be added to the transaction value under Article 8 of the WTO's GATT Valuation Agreement.

Article 8.1 of the GATT Valuation Agreement:

1. In determining the customs value under the provisions of Article 1, there shall be added to the price actually paid or payable for the imported goods:

(b) the value, apportioned as appropriate, of the following goods and services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable:

- (i) materials, components, parts and similar items incorporated in the imported goods;
- (ii) tools, dies, moulds and similar items used in the production of the imported goods;
- (iii) materials consumed in the production of the imported goods;
- (iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in Mongolia and necessary for the production of the imported goods;

It is not clear which of these items are those mentioned in Article 6.2.1. It may be that Article 6.2.1 was meant to reflect the contents of Article 8.1 of the Agreement, but there have been translation issues. On the other hand it may have been intentional on the part of the legislators to include the items as stated as being something other than those in Article 8 of the Valuation Agreement. If the later, this raises the issue that as some of them are not mentioned in the Valuation Agreement they cannot be added to the customs value under Mongolian law.

**5. I recommend** that the purpose of the legislators in wording Article 6.2.1. in this fashion be established and corrective action be taken to bring this Article in line with the WTO's GATT Valuation Agreement.

Article 7.2. The CSI who is a member of the PCA team shall have the following duties in addition to those specified in provision 274.2, the Customs Law of Mongolia:

7.2.3. provide the persons/companies selected for PCA with customs legislation related information and advice;

and

Article 8.1. The persons/companies selected for PCA shall be entitled to the following rights in addition to those stated in Articles 16-18 and provision 57.1, the Customs Law:

8.1.2. seek and obtain customs legislation related information and advice; and

These two Articles require that the customs officers have access to copies of all the law that is in force in Mongolia in respect of imported (and exported) goods. In other words, the customs authority is required by these two Articles to provide copies to it's staff of, amongst others, the WTO's GATT Valuation Agreement and Article VII, together with all of the Decisions, Texts, Advisory Opinions, Commentaries, Explanatory Notes, Case Studies and Studies, or at least those upon which it intends to rely. When printed these amount to a bundle of papers approximately 2.5 centimetres high. The Customs Law of Mongolia itself runs to 299 Articles. The staff are, by inference if not by actual statement, required to read and understand all this law so that they can provide "information and advice" or they are required to provide the law itself to fulfill the requirements of these two Article.

**6. I recommend** that these two Articles be amended by adding after the word "advice" at the end of each Article "pertinent to the enquiries or audit activities."

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