

## Introduction

- 4.001 Excise Duty is imposed under the Customs and Excise Act 1996 on alcohol products, tobacco and tobacco products, and petroleum products. It is calculated by reference to “physical content” (for example, alcohol content).
- 4.002 Dutiable goods attract duty as soon as they are moved from the “Customs controlled area” in which they have been held or manufactured. A Customs controlled area is required to be licensed by the New Zealand Customs Service (the Customs Service), and there are approximately 500 holders of excise licences relating to the manufacture of dutiable goods in Customs controlled areas.
- 4.003 The Customs Service collected just under \$2,000 million in Excise Duty from licensees in 1998-99.
- 4.004 The Customs Service gains its assurance over the completeness and accuracy of the revenue from Excise Duty by undertaking a programme of excise audits. It utilises risk assessment techniques to ensure that the focus of the audit programme is on the management of risk.
- 4.005 In 1998-99 the Customs Service agreed with the Minister of Customs (the Minister) to carry out 55 to 60 excise audits, covering 10%-15% of the 500 excise licensees. The Minister required the audits to be *undertaken in a manner consistent with standard methodologies which can be externally audited*.

## Why We Undertook a Review

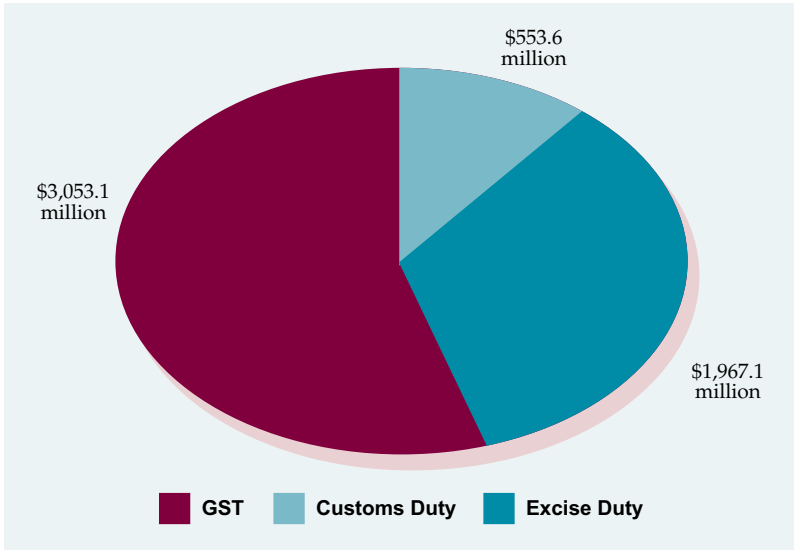
- 4.006 Excise Duty is a source of “Crown revenue”, which consists of *revenue received by a department on behalf of the Crown*.<sup>1</sup> Total Crown revenue from taxation for 1998-99 was \$32,156 million<sup>2</sup>, which is collected between the Inland Revenue

1 As defined in the *Estimates of Appropriations*, parliamentary paper B.5.

2 *Financial Statements*, parliamentary paper B.11, page 26.

Department and the Customs Service. The amount collected by the Customs Service was \$5,573.8 million<sup>3</sup>, made up as shown in Figure 4.1.

Figure 4.1  
Crown Revenue from Taxation Collected by the  
Customs Service 1998-99



4.007 A number of specific risks attach to the collection of Excise Duty. These risks can be classified into those arising from the actions or omissions of licensees of Customs controlled areas and those arising from the actions or omissions of the Customs Service.

4.008 The risks arising from the actions or omissions of licensees include:

- not making complete and accurate returns of their liability for duty;
- non-compliance with the law or licence conditions, especially when the liability for duty is substantial;

<sup>3</sup> Gross collections before refunds. Source: New Zealand Customs Service *Annual Report 1998-99*, page 13.

- inadequate control over stock movements into and out of the Customs controlled areas; and
- inadequate control over the measurement of “physical content”.

4.009 The risks arising from the actions or omissions of the Customs Service include:

- not being able to substantiate the validity of its audit procedures as a result of inappropriate, outdated, or poorly documented audit methodology; and
- sufficient resources not being available to ensure completion of the annual audit programme and respond to unplanned requests for compliance action.

4.010 The Customs Service recognises that there may well be entities that should be licensed for Excise Duty purposes, but which are not. However, in terms of the total Excise Duty revenue base, the Service estimates that the revenue loss to the Crown from such non-licensed entities is minimal.

4.011 By undertaking our review we sought to:

- give assurance to Parliament and the Minister that the Customs Service is addressing the foregoing risks in its audit procedures; and
- make recommendations where we could see room for improvement in those audit procedures.

## Customs Audit Methodology and Documentation

4.012 The Customs Service’s annual audit programme is driven by its Intelligence Division (ID), which is charged with developing an excise audit programme that meets the agreement with the Minister (see paragraph 4.005). The audits are performed by the Commercial Audit Division (CAD), which has responsibility for developing the audit methodology used.

### *Risk Assessment of Individual Licensees*

- 4.013 The ID performs risk assessments on individual licensees by assigning risk ratings against a number of criteria. The objective of the risk assessment is to help ensure that the excise audit programme focuses on those licensees that represent the highest risk to the Customs Service in terms of:
- completeness and accuracy of their Excise Duty returns; and
  - compliance with relevant legislation and licence conditions.
- 4.014 As a result of the risk assessment, each licensee is categorised as either “high risk” or “other”. “High risk” licensees are audited every three years, while “other” licensees are randomly allocated a number and audited once every eight years. However, the ID can vary these cycles for individual licensees should it be considered appropriate.
- 4.015 The ID uses the results of each audit to update its risk assessment of the licensee. This ensures that the risk assessment is kept up to date.

## What We Found

### *Audit Methodology*

- 4.016 The documented audit methodology provides assurance to the Minister, within the limits of the generally accepted audit confidence level of 95%, that Excise Duty revenue reflects returns that are complete and accurate, and that licensees have complied with relevant legislation and licence conditions.
- 4.017 The excise audit files we reviewed showed that standard methodology had been complied with. All audit findings were supported by appropriate, fully documented audit evidence.
- 4.018 Refinements continue to be made to the audit methodology – e.g. in respect of risk assessments and focusing work on specific risks. The refinements will help to ensure more efficiently focused audits, while continuing to provide the Minister with the required level of assurance.

- 4.019 However, the Customs Service needs to update its audit methodology and staff training to deal with paperless computerised systems. Such systems will become more and more prevalent in the medium term.

### Quality Assurance

- 4.020 Quality assurance procedures were not being consistently applied around the country, and some were not being applied at all. The current policy of ten per cent random selection of files for peer review precludes the ability to concentrate on specific risk areas.

### Staff Skill and Experience

- 4.021 The Customs Service places a significant amount of reliance on a number of highly experienced audit staff who have been with the Service for a number of years. It is faced with the risk that, if and when those employees leave its employment, its capacity may be impaired and the quality of audits may suffer. It is pleasing to note that the Service is beginning to address this problem through recruitment, and promoting knowledge sharing among staff.

## Measuring and Reporting Service Performance

### Performance Measures and Standards

- 4.022 For 1998-99, the work of the CAD was recognised in its own output class in Vote Customs: *Output Class D5 – Commercial Audit*.<sup>4</sup> As well as auditing excise licence holders, this output class included:

- . . . various levels of intervention to detect error or fraud, to ensure import and export control systems are complied with and to provide assurance that the correct classification,

<sup>4</sup> *Estimates of Appropriations 1998-99*, parliamentary paper B.5 Vol.1, pages 440-441.

*origin, and value are declared and appropriate duties and taxes are being paid, and refunds, drawbacks and revenue foregone are correctly assessed; and*

- . . . *licensing specific sites to which Customs jurisdiction relates, selectively checking and physically inspecting imports based on risk identification, auditing importers and places of cargo inspection . . .*

4.023 The performance measures and standards specified for the CAD were strong on the quantitative aspect of its work. However, there were few qualitative measures, and none on timeliness.

4.024 In our view, the work of the CAD should be the subject of more publicly declared qualitative measures and standards. For example, the methodologies for both Systems Based and Transaction Based Audits of Excise Duty licensees are designed to provide a specified level of assurance about the licensees' behaviour (see paragraph 4.016). The acceptability of the specified level, and whether it has been achieved, would be a good indicator of the quality of the audits carried out.

4.025 Two other useful quality indicators would be those required as part of audit quality assurance – review by the Audit Team Leader and peer review. That fewer of the former were performed than the quantity standard set, and the latter were not performed at all, is relevant to an assessment of the quality of the audits carried out.

4.026 In addition, we believe that including reference to the initiatives to improve the quality and risk focus of audits would have enhanced reporting on the qualitative aspects of performance – for example:

- reviewing and modifying risk assessments of licensees; and
- using (where appropriate) the results of past audits to eliminate inefficient testing.

4.027 However, we note that for 1999-2000 the Customs Service has adopted a new set of output classes. One result is that Commercial Audit is no longer an identifiable output class – its activities are now largely part of *Output Class*

*D4 – Compliance Checking of Import, Export and Excise Transactions* – and no performance measures and standards for excise audits are specified.<sup>5</sup> Parliament is therefore being provided with no information about the intended audit activities of the Service for the current financial year.

- 4.028 The agreement between the Minister and the Customs Service for 1999-2000 does include performance measures and standards for audits. However, the measures continue to be predominantly quantitative – even though some are labelled as qualitative.

### Organisational Capability

- 4.029 The Customs Service’s *Annual Report 1998-99* reported the CAD’s performance for the year, principally by reference to the performance achieved compared with the measures and standards specified in *The Estimates*. While the report met the requirements of the Public Finance Act 1989, it had its limitations in presenting the reader with a view of the CAD’s capability to perform the tasks expected of it.
- 4.030 The annual report contained two paragraphs of commentary – one on the need for additional training of audit staff on the growing complexities affecting the valuation of imported goods, the other referring to the suspension of the audit programme and some compliance activity from July to August 1998 to manage the additional refunds resulting from the elimination of motor vehicle tariffs. An inference of the second paragraph is that the CAD lacked the capability to maintain its principal operations in order to deal with a contingent event.
- 4.031 Having the capability to maintain “business as usual” as well as to cope with any and all contingent events is almost certainly unachievable. But the point is – as we discussed in our *Third Report for 1999*<sup>6</sup> – that organisational capability has a significant influence on the ability to deliver outputs.

5 Indeed, for what is a bigger output class, fewer performance measures and standards are specified altogether.

6 Parliamentary paper B.29[99c], pages 73-82.

- 4.032 When the Customs Service’s *Strategic Business Plan* was being prepared<sup>7</sup>, eight additional positions were identified as needed in the CAD to improve its ability to meet the varying demands on its services. To date only four of those positions have been filled (because of the inability to offer competitive salaries until a departmental remuneration policy is finalised).
- 4.033 The CAD has also had difficulty finding the resources to respond to unanticipated “alerts” that other government agencies have placed on its work plan. The CAD is taking the initiative to agree memoranda of understanding with other agencies with the objective of clarifying respective responsibilities and resolving issues of the “ownership” of requests for intervention.
- 4.034 Further, the CAD believes that refinements to risk assessment and the audit methodologies should result in efficiencies that free up staff time and allow greater flexibility to respond to contingencies as and when they arise.

### *Conclusions*

---

- 4.035 The performance measures for the CAD are strongly oriented towards quantities delivered. The quality dimension could be enhanced in order to demonstrate that the Customs Service is carrying out excise audits to the required standards.
- 4.036 Staff resourcing continues to be an issue. The CAD currently has four unfilled positions. Initiatives to improve the staffing position include continued recruitment, refinements to methodology to allow more efficient audit testing, and agreeing memoranda of understanding with other relevant government agencies for handling additional work at their instigation.

---

<sup>7</sup> The plan was published with the cover date 18 May 1998.



## Recommendations

4.037 We recommend that the Customs Service should:

- Introduce into its audit methodology the means to address the issues posed by “paperless computerised systems”. This element should be introduced in conjunction with appropriate staff training.
- Ensure that the quality assurance procedures for its audits are applied fully and consistently throughout the country.
- Review the basis on which audit files are selected for peer review, with the objective of gaining added assurance on the quality of audits of high-risk licensees.
- Establish more and better performance measures and standards for the qualitative aspects of the CAD’s work – supplemented by relevant commentary in the Statement of Service Performance – in order to demonstrate better the quality of its excise audits.

