Guidelines
For Risk Management in Customs

As part of your review of a country's trade performance, you have come to the conclusion that Customs are generally considered an impediment. Through discussions with importers, you have found that one of the major problems is that Customs inspect every – or nearly every – consignment imported in the country. When comparing with what happens as you arrive at Dulles Airport, where (usually) Customs barely look at the form you filled on the airplane, you feel that there is probably something wrong. As everybody is talking about risk management, now is the opportunity, you think, to introduce it.[1]

These guidelines are only intended to assist you in facilitating the introduction of risk-based operations for commercial shipments (passenger control is outside the scope); they do not go into the technical aspects of risk management, or how it should be operated. (These are specialized activities, and the bibliography at the end will help you in finding out more on this.) Also, the Bank Customs and Cross-Border Facilitation Team is there to provide you with more information.

What you need to know:
- What is the reaction of the Customs administration to the notion of risk management, and their understanding of the concept?
- How long does it take, according to the authorities, to clear the goods? (You may have surprises later on.)
- What is the legislation like, does it provide for selective controls, or does it impose mandatory examinations?
- Are other organizations empowered to carry out physical checks on imported goods and vehicles transporting them? If yes, what are the reasons, and what are the inter-agency relations like?
- What kind of fraud is taking place?
- Are there Customs brokers, what is their role, what are the relations between Customs and the importers and brokers?
- Is there a Customs computerized clearance system, either in operation, or on the horizon? If so, does it include a risk management module?
- What are other donors doing, and what lessons they have learned?

This note will tell you more about:
- *The decision to introduce risk management – How should it be made*
- *The main functions performed under risk management*
- *Preparing for introducing risk management*
- *Organization*

[1] In addition, introducing risk management concepts is a condition for acceding to the Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures.

- Control policy
- Performance measurement and how to take advantage of it
- IT solutions

Black lettering describes the basic steps.
Blue boxes provide background information.
Red boxes tell you what you may want to find out before engaging in a project.

There are many ways to introduce risk management in Customs. If fact, Customs administrations practically all use, in one way or another, risk management techniques for their day to day work, although they may not know it. These guidelines do not attempt to impose a technique, but simply aim at suggesting an approach.

Seen by an outsider, risk management means fewer inspections and accelerated release of goods. In Customs, risk management is also often misunderstood as simply relating to the examination policy of Customs. In fact, risk management is:

- *A principle that underpins the entire operations of the administration;*
- *An organization that supports it; and*
- *A set of operations that perform risk assessment.*

Risk management results in intervention by exception.

A frequently asked question is "why and when should risk management be introduced?" The answer would be "it is essential, and now".

It is essential:

Risk management is part of the Customs process. Customs will never catch every fraud, so it is important to make sure that at least the major ones are kept under control.

Risk management helps to limit corruption. As part of the process is automated, discretionary inspections – or lack of inspections – become less frequent.

Risk management expedites clearance, because some consignments can be immediately released.

Risk management can lead to functional integration between agencies, thus further simplifying clearance procedures.

Risk management optimizes resources and reduces cost, for the same effectiveness.

Risk management has a positive impact on revenue collection.

It should happen now:

Risk management is part of the Customs modernization process, and leads to a new business process. It is just as well to factor it as early as possible.

Although risk management benefits from IT solutions, it (i) can be introduced even in the absence of a computerized clearance system (like it was in all Western countries), and (ii) needs to be planned before the introduction of computerization.

Risk management will probably require legislative, organizational, and staffing changes, which are usually envisaged under a Customs modernization project, and the necessary resources to implement risk management are likely to be identified early in the project.

A few definitions

Risk is the possibility of events or activities that will have an impact on the objectives of Customs.[2]
Risk management is the application of procedures designed to minimize the risk
Risk assessment is the evaluation of the level of threats
Risk profiles are the combination of elements resulting from risk analysis, which is applied to handle different risk levels in an appropriate manner
Selectivity is the application of risk profiles to declarations, operations, individuals, or transactions
Targeting is the pre-identification of operations declarations, operations, individuals, or transactions to be verified based on information or intelligence, visible external criteria, or control plans,
Compliance management is the holistic recognition of the level of conformity with laws, regulations, and obligations used as a tool for granting privileges and as an input to risk management.

The decision to establish a risk management system

Introducing a risk-based approach to Customs control operations always involves the apprehension that (i) some, if not many, fraud will be undetected, and (ii) revenue may be jeopardized. While this additional risk may exist, it should be balanced against the current practice of inspecting in one way or another (nearly) everything, with limited results.[3]

The second difficulty is that, in some countries, inspecting everything is considered as the duty of Customs officers. There is the feeling that risk management is fine for Western countries, but the serious way of doing things is to be comprehensive. This feeling, which exists in particular in transition countries is not entirely due to the Soviet period – it is also to some extent an archetype.

Of course, when Customs officers inspect everything, they can “select” goods from a wider range of samples, can claim it is impossible to do a good job given the workload, and feel they cannot be blamed for having missed something. It also has an effect on corruption: Honest officers are afraid to let imports go through a “no control” channel, because they could be accused of negligence, whereas dishonest officers oppose the system, because it could reduce their opportunities for gain.

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[2] David Widdowson *in* Customs Modernization Handbook, Chapter 5.
[3] The notion that quasi systematic inspections and controls constitute a deterrent has often, if not always, been proven wrong.

What you will (probably) hear from some people in Customs[4]:

- *We need equipment to do controls, then we will introduce risk management*

Wrong.
Equipment (e.g., x-rays and scanners, but there are many other types of tools and machinery, all rather expensive) has nothing to do with risk management. What equipment does is facilitate an inspection. Under a good risk management system, equipment will only be used if a risk has been detected.

- *You should see the crooks we deal with*

Not entirely wrong.
This does not prevent introducing risk management (on the contrary!), but it has an effect on the *rates* of control.

- *If we don't look at everything, we shall have the Police (Border guards, Government audit, Presidential office, Public Prosecutor) on our back*

A real problem, but with a solution.
In the former communist environment in particular, the Police were all powerful and controlled society. This has shifted somehow, but as the Police consider all Customs officers are corrupt, they may well re-inspect (with or even without the right to do so) what was released by Customs. If they find something, the chances are a Customs officer will go to jail. This syndrome may also exist in other societies. But there are solutions:
- The law (s) should clearly spell out that Customs need not inspect everything
- There should be strict government instructions and guidelines, to Customs and other agencies
- Above all, Customs must be able to show that they have better results through risk management.

- *If we don't look at everything, someone else will do it*

Correct to some extent.
With proper education of and cooperation between different agencies, this can be corrected. **This requires Government coordination.**

- *If we don't look at everything, people will cheat on declared values*

Wrong.
1. Except in a few cases, Customs values are not ascertained through physical checks, but rather after a documentary review.
2. If a category of goods is usually undervalued, nothing prevents Customs from creating a risk profile.

- *Detection will go down*

Doubtful.
Ask them how many cases they detect now. If they say "many", ask for figures. Then compare with the total number of import declarations. If it is anything below one percent, it means the results are poor. You may also ask how much detection occurs at airport security.

- *Examining everything is a deterrent*

Probably not.
Blanket control is notoriously expensive and ineffective. Not all criminals or smugglers get caught, in any society. The higher the level of control, the higher is the chance of bribery. On the other hand, post release checks maintain a fairly reliable "safety net".

[4] All these statements were made at one time or another to Bank staff.

- *You want us to open our borders and let terrorism in*

Certainly not!
We are not talking of opening borders to terrorists, we are talking about reducing physical examination of routinely imported goods by reliable traders. While it is true that terrorists have been found (once) in a container in Italy – and that was through an intelligence-led investigation – well trained Customs officers detect every day smuggling or illegal immigrants using a range of tools (which include risk management). Besides, physical examination of goods usually takes place at an inland facility, not at the border, and it is unlikely that a criminal will remain that long in a container.

- *We need training*

Correct.
Risk management is a mindset that must permeate the entire administration. It was equally difficult to introduce in Western countries. At the same time, many, if not all, Customs administrations use risk management in one way or another, but they have not systematized the concept.

- *We shall introduce risk management once we have a computer system*

Not altogether necessary.
Most Western countries had risk management long before they computerized their Customs. While IT plays a significant role, introducing the mindset and preparing risk profiles can happen in parallel with computerization.

What you want to find out:

- *What does the Customs law say?*

You will need to review the Customs law.

- You will find under the Customs declaration articles (usually around article 60, but it can come sometimes much later in the law) provisions governing control of the declaration, accompanying documents, and verification of the goods.

A few legislative examples (the bad ones):
- "For the purpose of establishing the truthfulness of the declaration, Customs officers *shall* inspect the declared goods"
- "Customs will apply principles of risk management in examining the *documents*" *(This leaves out the physical examination, which is* ***de facto*** *compulsory.)*
- "Using risk management techniques, Customs may only inspect part of a shipment" *(This still means* ***every*** *shipment is opened.)*
- "Customs examine passengers and goods" (*It is an error to mix the two, as examination techniques are totally different, so is the risk profiling.)*
. "Customs apply principles of risk management when dealing with compliant traders…" *(This is bad news, because the principle of risk management is to detect, assess, and regularly evaluate compliance, not the opposite.)*

- You may find useful the wording used in the EU Customs code, article 68:

For the verification of declarations which they have accepted, the Customs authorities may:

(a) Examine the documents covering the declaration and the documents accompanying it. The customs authorities may require the declarant to present other documents for the purpose of verifying the accuracy of the particulars contained in the declaration;

(b) Examine the goods and take samples for analysis or for detailed examination.

This covers everything: (i) Examinations result from a decision of the Customs administration, (ii) they are not compulsory and in the absence of any further prescription any risk management system can be used, (iii) Customs need not justify their decision, and (iv) the declaration is considered as a whole, including the declaration form, supporting documents, and the goods. It also lays down the logical sequence of verification: (i) Documentary review; (ii) Clarification; (iii) Physical examination of all or part of the goods; and (iv) Sampling for further analysis.

- The law should also provide for post release verification of declarations and imports.

What the EU Code says:

Post-clearance examination of declarations
Article 78

1. …

2. The customs authorities may, after releasing the goods and in order to satisfy themselves as to the accuracy of the particulars contained in the declaration, inspect the commercial documents and data relating to the import or export operations in respect of the goods concerned or to subsequent commercial operations involving those goods. Such inspections may be carried out at the premises of the declarant, of any other person directly or indirectly involved in the said operations in a business capacity or of any other person in possession of the said document and data for business purposes. Those authorities may also examine the goods where it is still possible for them to be produced.

3. …

The ability to carry out post clearance checks is essential. It is through these checks that Customs may detect false declarations, without having to inspect the goods. However, Customs post release checks are not fiscal audits. They are usually – at least at first – transaction-based. They can take the form of desk reviews[5], requests for additional information, or visits to the importers or their clients. In most cases, such checks are more destined to confirm the compliance of importers than to detect a pre-supposed fraud. They normally should not require the same restrictions as a tax audit.

To be effective, post release control should be supported by a legal requirement for record keeping and routine access for Customs auditors. The risk is that governments – and the business community – may feel it includes the danger of repetitive checks carried out by Customs, with obvious implications in terms of harassment and rent-seeking. This is a real danger, but it can be off-set by:

- An annual plan of control – companies which are not on that plan of control could only be audited if there were sufficient grounds to do so (management decision that needs to be documented)

- Audit reports written by the auditors – too frequent audits would be spotted by management

- Company feedback – Companies would be invited to report cases of apparent harassment to senior Customs management, or an independent body

[5] In such cases, they can be considered as "deferred checks" – the documentary checks that did not take place at the time when the declaration was initially lodged.

- Annual activity report of the post-release control unit.

- But the law should not set the risk profiles!

In many countries, Customs have introduced "risk management" criteria that are written in the law. For example, one Customs code stipulates that only companies established longer than three years with no record of violation can benefit from fewer examinations. Another describes risk management as "an examination of ten percent only of *each* consignment".

➢ *What do other laws say?*

It is important to find out where smuggling or other import-related offences are addressed, apart from the Customs law. This will determine the amount of flexibility that Customs can enjoy in introducing risk-based controls.

Even though another law – for instance the Penal Code – deals with smuggling, that does not mean that Customs cannot implement risk management. You may need to obtain clarification, and ensure that Ministry of Finance implementing regulations, and/or Government guidelines are consistent with the risk management objectives.

➢ *Are there other administrations involved in the clearance/control of imports?*

Two cases may be encountered (and sometimes overlap):

- A law enforcement agency is in charge – or considers it is – of checking on consignments going through, or having cleared, Customs. The recommendations above can deal with this problem. It is important to identify the two or three criteria used by that agency to double check on Customs inspections. If it is a blanket check, an agreement should be reached between Customs and the other agency. If this is impossible, it should be sought at Ministry of Finance level, and there are cases where the Bank (successfully) obtained Prime Minister or even Presidential arbitration.

- Another ministry involved in trade (often it is Commerce) has put in pace its own procedures, and carries out independent inspections for its own purposes. The solutions consist in (i) removing the mandate (not always easy), (ii) carrying out joint inspections, and (iii) trying to obtain a delegation for Customs to carry out most, if not all, the inspections, at least for basic controls.

➢ *Is there a flow chart of the current process?*

Remember: Risk management is NOT a trade facilitation measure simply granted to honest or supposedly honest importers, neither is it just the reduction of physical examinations. It is an entire set of operations that usually does result in reducing the rate of control (not only physical) on companies and importers that are known, over time, and through testing and audit, to be compliant.

The first step – Establish a Risk Management Unit (RMU)

The role of the RMU will be to prepare the introduction of risk management, and later to maintain the system. It is important that risk management be addressed at strategic level, and should not be treated as a side activity. Senior managers must be involved in the preparation and design of the risk management strategy.

1. Separate unit in headquarters

The RMU should preferably report, at first, to the deputy in charge of modernization, or another senior member of the organization. It should not be placed under the IT department, investigations, or internal affairs, although all these departments can, and should, provide inputs to risk management.

While the IT department usually only provides support to other activities within the Department, there is often a feeling, in Customs administrations that as risk management is strongly linked to computerization, it should be handled by the IT unit. This is usually an error: IT experts have limited knowledge of Customs operations, so the IT manager will be reluctant to take responsibility for the risk management policy, for which he could easily be blamed if initial results are disappointing. (However, there have been cases where the IT manager was fully proficient in Customs matters, very forward looking, and had a good understanding of risk management principles.)

There is sometimes a tendency to put risk management under investigations, because it is vaguely perceived as an enforcement activity. At the same time, investigations are a specialized part of Customs, and their focus will be less on regular commercial transactions and more on high profile fraud. The notion that risk management also serves compliance assessment may therefore be overlooked.

In a few of countries, there were plans to place the RMU under internal affairs. The logic was that risk management, or rather risk minimization, implied a close watch over potentially corrupt staff, and internal affairs were the best placed to do so. This however misses the point that risk management in terms of clearance is essentially based on commercial information, and that there are other, more effective, mechanism to identify corrupt officials.

As risk management is an integral part of the Customs process, it should not be treated as a minor activity, undertaken to please some donor.

What to look for:

- Can a RMU be established? (i.e., is it planned under the organization, will it be a full time operation, is there sufficient budget to fund several positions and to later expand the unit?)
- Where will it be located (i.e., in the headquarters building or in a separate facility, or within a Customs house.)

This will give an indication of (i) how serious the administration is about risk management, (ii) who will control the RMU, and (iii) how subsequent procedures for maintaining the risk management system should be designed.

- Will there be adequate equipment and a connection to the computer system if it exists?
- Is there a work plan for the RMU? (If you can, try and attend one of the initial meetings.)
- How will the RMU communicate (even informally) with the rest of the organization? In particular with investigations and post-clearance control? (i.e., to receive and pass information.)
- Will the RMU be able to communicate with other tax or law enforcement agencies?
- Make sure that every time an irregularity is detected, it is reported, preferably on the declaration (In many countries, reporting of irregularities is weak, and sometimes non-existent.)

2. Staffing

The role of the risk management unit will expand over time. At first, it will be responsible for drafting the risk management policy of the administration; next it will focus on risk assessment, and later prepare risk profiles for testing. Once the system is in operation, it will maintain these risk profiles. Therefore, in the initial phase, the unit does not require extensive staffing. A few experienced field and headquarters staff will be able to identify the major threats facing Customs, and submit the outline of a policy to senior management. Once this has been approved, the unit will need to be expanded so it can play an operational role.

The RMU should include valuation and tariff experts, and advisors from post clearance, investigations and intelligence. As a rule, the RMU should include members who have a very operational background, for example chosen from individuals who have served as mid-level managers at clearance stations.

What to look for:

- Where does the staff come from? Are the officers experienced in field operations?

Very often, management will assign to the RMU young and promising graduates, usually economists or electrical engineers, with little if any experience in clearance. What are really needed are weathered Customs officers, with a long experience in clearance, whose experience will be essential in designing the risk management strategy of the administration. **Academic qualification is not essential,** but sometimes bright young persons working with experienced officers can bring something new to the table.

- Which specialist areas of the Department are represented?
- Is the core RMU team employed full time? Are representatives of specialist units readily involved and do they participate regularly in the work?
- Is the RMU sufficiently shielded from external and/or corrupt influence?

The second step – Analyze the Threats

Unless you are a Customs specialist, you may find it difficult providing technical inputs here. The purpose of this step is to identify, categorize, and prioritize all that affects Customs daily work and may prevent the administration from reaching its objectives.

The approach can be by category of mandates of the Customs administration:
(For example)

1. Revenue collection
- Misclassification
- Under valuation
- Under reporting
- Exemptions
- Concealment
- …

2. Protection of the environment
- Imports of restricted goods without adequate/genuine authorization
- Mis-reporting
- End-use requirements
- Misuse
- …

3. Security
- Concealment
- Misdeclaration
- Forgery
- Dissimulation of origin or category of goods
- False identity
- …

4. Protection of society
- Prohibitions
- Standards and quality
- Counterfeits
- …

5. Regulation of foreign trade
- Licenses
- Quotas and contingents
- Rules of origin
- End-use requirements
- Time limits
- …

It can also be by type of fraudulent activity:

- Bribery
- Forgery and counterfeiting
- Concealment
- Violence
- Evasive action
- Internal conspiracy
- Fiscal fraud
- Category of users (fly-by-night companies)

These are only examples, and there can be many other approaches. It is here that the experience of Customs officers is important.

What to look for:

- Is this a real analysis (i.e., supported by experience, and properly documented) or a catalogue of *clichés*?

Once these threats are identified and described, and the purpose is to identify as many as possible, they should be translated into operational risks:

- What are the chances of this happening? Has it happened before (in the country, elsewhere)? Is it realistic, or simply a projection?
- How would I carry out a fraud along these lines?
- What would be the necessary resources to make the risk come true?

At the same time, the RMU should submit to Customs senior management a list of risks, arranged by probability, to decide what is the level of acceptability of these risks.

The third step – Draw Risk Profiles

This is the first attempt at turning the research done by the RMU into an operational tool. It can include two tasks:

1. Relate the risk elements to declaration data.

- **The standard declaration for (Single Administrative Document – SAD)** has 54 fields, each one describing an element of the transaction, its participants, and its financial aspects. The issue is to relate the risks to one or several of the fields. Usually, each risk would be included in a combination of fields when these reach certain values.

For example, if newly established importers are considered a risk, the identification number of the importer would be matched against the importers' file, and companies registered less than one year ago would be considered high risk.

- **Shipping documents** (transit, carriers' documentation, manifest, bill of lading, etc.) are normally attached to the declaration, and can be computerized. Their data provides additional information on the international transaction.

For example, indirect routes could point out the likelihood of *en-route* manipulation of the cargo.

2. Draw patterns.

Using past detection cases, the RMU should develop specific patterns of fraud, starting by the combination importer-classification-origin and progressively refining it.

3. Anticipate.

Using the “what if?” approach, the RMU should identify the tariff headings or countries of origin under which potential offenders would try to dissimulate their imports. This is in particular the case when there are two different tariff headings, with different rates of duty, for relatively similar commodities, and a closer scrutiny is necessary to establish their classification. The same can apply to two different origins.

Some countries use the notion of “risk countries” to set their risk profiles. Often they designate shipments from a particular country as high risk. This is not necessarily a good approach, as it results in overwhelming their examination facilities and is not good use of risk management principles. Importers will also probably declare another origin to avoid control. In any case, the system encourages them to do so. Obviously, country of origin should be considered, but it is only one element of the composite.

4. Include commercial intelligence.

- This involves the identification of the major importers, in terms of revenue, imported commodities, and number of commodities. It is also important to obtain all the offense reports. It also means drawing a list of the most frequently counterfeited or smuggled commodities by tariff items, and listing them by importers.

- Using records of past imports, the RMU should identify whatever does not fit usual patterns (e.g., infrequent importers, imports inconsistent with the importer’s usual activities).

- The RMU should establish and maintain a record of all importers and exporters, freight forwarders, brokers, transport companies, with a ranking of their compliance (using past records and cross-checking with the tax administration, or other relevant agencies).

5. Include risk profiles from other agencies.

Either other agencies provide the RMU with their own risk profiles, in a format compatible with Customs processing, or they provide their requirements, and the RMU can then assist in drawing the profiles. A Memorandum of Understanding may be necessary.

The format of risk profiles

Risk profiles should be in a form that will enable easy computerized processing as imports take place. They should therefore be codified according to declaration data format (essentially, origin, classification, identification of operators), and include a data range within which the profile will be active (for example, only certain categories of imports under a certain value shall be activated).

The profile should indicate:
- Description
- Period of validity
- Data range
- Date
- Additional comments

What to look for:

- Too general risk profiles (e.g., all imports from one country or group of countries, or all imports of one commodity)
- A bureaucratic or clerical approach (e.g., if there was once a fraud, all subsequent imports shall be considered as risk, without any re-evaluation)
- Too many profiles resulting in putting all imports in a risk category.
- Watch out for vested interests.

The fourth step – the testing phase

There are several ways to test profiles, but as in many countries senior Customs management is usually worried that the introduction of risk management may result in loss of revenue, it is a good idea to run the draft profiles against a batch of past operations. When Customs are computerized, this is easy.

1. Testing.

The RMU should produce a list of all declarations picked up under the risk profiles, and match them against offense reports.

Caution

It is not because a declaration has been picked up under a risk profile that it necessarily carries an offense.

- **If most declarations did lead to detection of an offense,** it means that profiling is good, and that examining officers did a good job. You then have a good point to show that risk management is a reality, and that all the other routine inspections and controls may no longer be necessary; it is useful to check if the detection did actually correspond to the risk profiles.

- **If little or few declarations did lead to detection of an offense**, it can mean that:

  - The risk profiles need refining and/or adjustment. If known past cases were not picked up, it means in most cases (but not all) that the risk profiles are not sufficiently precise.
  - The declarations may not have been scrutinized effectively at the time of lodging, and the physical examination may not have been done thoroughly enough (thorough does not mean an integral inspection of the whole consignment). It may be a good idea for the RMU to refer these declarations to the post release control unit.

- **If the declarations show a completely different pattern** of suspected offenses, it probably means that the administration should review its control policy and priorities.

In all these cases, the RMU should do an estimation of the potential revenue losses as implied by the selection.

2. Random selection blended-in.

A sample of past declarations (e.g., one in a hundred) should be selected without any profiling. The RMU, supported by the post release control unit, would then review these, and if any anomaly is spotted through documentary review, the RMU would establish the corresponding risk profile.

3. Risk management pilot-tested.

Once the RMU is reasonably comfortable with its risk profiles, it can start testing them in real time. A pilot office should be selected, where risk management is run in parallel with the current selection process (if there is any). Results should be evaluated, and, as in the previous tests, used to adjust the risk profiles. A random element of selection should always be used, either at the overall selection level, or at risk profile level, to (i) validate risk profiles, (ii) introduce an element of uncertainty, (iii) prevent "reverse engineering" from importers, who may promptly detect the risk criteria in use, and (iv) test compliant commodities and importers.

- Establish a three channel operation

Red channel means mandatory physical examination. It is usually better to carry out a full documentary check before the physical examination, as this check will reveal the anomalies in the declaration, and what to look for during the examination. The computerized risk management system can also describe the reasons for selection, but experience shows that an examining officer is more effective if he has done some desk work prior to the examination. Red channel does not systematically imply a complete examination of the entire consignment. It is quite acceptable to do only a detailed examination of a small part. This will be determined by the judgment of the examining officer, and can be supported by directions either provided by the risk management system, or through the documentary review process. **There should always be an examination report, irrespective of the findings of the examination.**

Orange channel means a documentary check. The system picked up some anomalies in the declaration elements, and further checking is required. After a documentary check, the declaration can either be released, or sent to the red channel. Here also, the system can indicate the elements of the declaration that need to be checked, and the type of physical examination that may be carried out if necessary.

Green channel means immediate release without a check. In a perfect world, the release note can be issued as soon as the duties are paid. However, there are systems where the release is delayed, allowing Customs some time to recall the declaration and carry out a rapid check. **This operation is not recommended in countries where it was difficult to sell the concept of risk management, as it may well result in annihilating the green channel principle (i.e., all declarations will continue to undergo a documentary check).**

Three points to remember:

(i) Green channel does not mean no checks at all: First, the computer has already carried them out, and done a risk assessment. Second, there is always the possibility of a declaration being referred to the post clearance unit (the "safety net").

(ii) Physical examination is not "the ace of controls". Many anomalies and frauds can be detected through a good documentary check (e.g., valuation, classification) rather than during the examination of goods (especially when it is a routine examination). Reducing the number of physical examinations has never had any significant impact on the efficiency of control, on the contrary.

(iii) Documentary controls (orange channel) must be done seriously. A documentary control is not a question of simply making sure all documents are present, it consists essentially in assessing the overall consistency of the importation.

- Decide on the rate of physical and documentary control, and green channel declarations (this is usually a senior management decision), based on the capacity of the examination facilities. *It does no good to generate fifteen examinations a day if the facilities (staff and examination bay) can only handle 5.*[6]

Most Customs administrations will probably want to be cautious at first. This is normal. The initial rate of green channel declarations can be set quite low (but has to be above ten percent, otherwise the effect of green channel processing will be lost). The rate of red channel declarations does not need to be very high (ten to twenty percent would be a good figure) as the orange channel does provide the opportunity to re-direct a declaration to the red channel. Most declarations would therefore be routed at first through the orange channel, but orange should NOT be the default channel.

These rates must be reviewed regularly.

- Adjust the computer settings to ensure that, over a short period of time (e.g., a day or a week) the number of declarations assigned to each channel meets approximately the overall rate decided by management. A few points above or below the set rate will not make much difference, especially if the rate of detection is satisfactory, but in case of longer distortion, the risk profiles may need to be reviewed, or the computer settings adjusted.

- Introduce purely random selection at three different levels:

    - A number of declarations should always be selected for orange or yellow, irrespective of what the risk profiles say. For example, the first three declarations lodged every morning can be directed to red. This is to avoid importers or brokers manipulating the system through reverse engineering. It

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[6] This should be the opportunity to establish a sensible physical examination policy and corresponding guidelines. Examinations should not be limited to cursory checks, but be carried out in depth – which does not mean a complete examination of the whole consignment, but rather an investigative inspection. Compared to current practice, it means "fewer but better examinations".

also gets the examining officers to start work early in the morning, rather than just sit around wait for something to turn up later in the shift.

- A percentage of green channel declarations should be re-directed to the red or orange channels. This provides a "Sword of Damocles", and also helps to validate risk profiles and detect new fraud.
- To ensure that importers, brokers, or companies, who have been identified as compliant, do not abuse the system, random selection ensures that, once in a while, they are selected for documentary and/or physical control.

The merit of random selection

When risk management was introduced in one country, the Customs administration had only a vague idea of what it involved, and after several attempts, was not convinced. Rather than go through a time-consuming risk profile trial-and-error scheme, Customs separated declarations in two batches. One was processed according to rudimentary risk profiles, and the second one was submitted to purely random selection. After the first few months, it turned out that the randomly selected declarations led to more detection than the ones picked up under risk profiles.

Customs then analyzed all the detection cases, and drew some patterns which were turned into more realistic risk profiles. These were added to the risk management data base, and soon risk management was operating satisfactorily. However, the country always kept a certain proportion of random selection.

What to look for:

- What is the rate of examination?
- What is the rate of detection? Is there a log of irregularity kept in the office? What are the types of offence detected?
- Are there repeat examinations performed by other agencies, and why?
- Is there a need for training? In which area? (e.g., documentary review, inspection?)
- **Is "green" really the default setting?**

This is where you have to look into the computer system. Normally, the declaration processing follows these steps:

1. Declarations are keyed-in by importers/brokers
2. The system carries out a formal validity check (i.e., ensure that all boxes in the declaration are filled with data consistent with the system tables)
3. The importers/brokers validate the declarations. At this stage, the declarations become legally binding documents. *In some countries, Customs will not let brokers or importers validate the declarations. When the case, this practice should be discontinued, as it contradicts the principle of* self assessment.
4. The system launches the risk management process, and assigns a channel to the declaration.
5. The declarations are either (i) assessed, duty is calculated, and the payment module is launched, or (ii) referred to a control channel (orange or red).

What is important is how step 5 is operated. Normally, unless the declaration is met by a certain number of risk profiles with a weight above a pre-set threshold, it will be released under the green channel. However, in some countries the system may have been configured differently: All declarations may be routed to red until the pre-set level of red channel declarations has been reached. In other cases, blanket criteria may override risk profiling (e.g., all imports from a range of countries). All this can lead to emptying the green channel quite significantly.

At the end of the testing, the RMU should produce an operational flow chart[7]*, with the declaration processing steps, and a matrix of profiles with their respective weights. It is only when the weight of all criteria reaches a (daily or weekly) level that a declaration will be routed through the orange or red channels. These thresholds should be adjusted frequently.*

The fifth step – Expand the system

After a few weeks of testing, the RMU is now ready to roll-out the risk management system to the entire country.

1. Information

The importers, freight forwarders, and brokers should be informed of the new approach to control. In particular, the emphasis should be put on (i) reduced clearance time, (ii) reduced costs as there will be fewer examinations, (iii) the reward to compliant companies, and (iv) the limited tolerance to frauds or even minor offenses detected at post clearance level.

2. Greater reliance on post release verification.

The post release control unit should be expanded:

- A greater number of declarations will be reviewed by the unit (many of the green channel declarations shall be reviewed, especially during the initial period).

- Reviews will be less bureaucratic, and will consist in desk audits. Further training may be necessary.

- There should be an annual plan of action whereby certain categories of imports or importers will be scrutinized.

- The role of the post release unit will also be to assess the compliance of importers. This will require regular contacts with them, and on-site visits.

- Some of the post release checks may imply visiting the importers, and examining their books and records, and possibly auditing their computer and other systems.

[7] Flow-charting is usually the first step in any analysis. It may be good here to compare the resulting flow chart to the initial process.

These “audits” are not comparable to fiscal audits. They are mostly compliance verifications. As such, they should not be limited and regulated. (For example, in some countries, Customs can only visit an importer once a year, and must have an official order issued by the head of the administration, which describes in detail the scope of the control and limits the operations that can be verified. This obviously prevents a simple post release review of a particular declaration, and implies a much more rigid – and possibly confrontational – approach.)

Customs must have the ability to carry out routine on-site checks. If the law does not clearly allow it, a Memorandum of Understanding can be signed between Customs and the importer, granting expedited clearance (i.e., use of risk management techniques) against the blanket possibility to carry out compliance checks.

3. Prosecution of offenses.

In many countries minor (or less minor) clerical errors are simply corrected during the declaration acceptance process. In the new system, which is a real self-assessment process, it is the computer system that carries out the checks. If an error is detected but the declaration has been accepted formally (i.e., all the boxes were filled with coherent data), the declaration is considered as a legally binding document. There must therefore be a mechanism to deal with errors and irregularities.

Such errors and irregularities can cover a very wide range, from the typing error (the tariff classification or country codes are mistaken, for example SLOvenia is entered instead of Sierra LeOne) to the deliberate misdeclaration. They may also include occasional or frequent negligence. It is important that Customs should have the means to deal with this.

- Customs should not simply correct the error. Once accepted, a declaration can only be modified under certain circumstances. Errors detected by Customs should follow a formal process.

- While in theory a misdeclaration is a fraud of some sort, there must be a scale of penalties allowing to deal with minor, unintentional errors. These should range from a warning to a nominal fine, and subsequently to revoking licenses and privileges (in particular for brokers). Another administrative way of dealing with repeated misdeclaration is to establish a company risk profile, and route (if only for a while) all declarations from that company through the red channel. In all cases, there should be some legislation to cover this.

- Prosecution of such offenses should not be interpreted by Customs as a way to (i) counteract expedited clearance, or (ii) collect unofficial payments. The process of dealing with these violations should therefore be transparent, and regularly audited by management.

Management of the system

1. Organization and day to day work.

The RMU is now a well established and professional unit. It should not be allowed to die away. The unit should be expanded, and include at least three sections:

- Data collection and analysis section
- Risk profile maintenance section
- Simulation and research section

It should also work routinely in close cooperation with (i) investigations, (ii) post release control, (iii) the private sector, and (iv) foreign counterparts.

2. Control policy.

The principles below outline the main principles only.

- The past approach consisting in examining everyone and everything is now totally unrealistic. Only a limited amount of imports should be subject to checks.
- While it is the responsibility of Customs to check goods, other agencies often replicate these checks, on many grounds (trying to find evidence of corruption in Customs, looking for drugs or illegal immigrants, or simply asserting power). This practice should be discontinued, or at least these checks should take place alongside Customs examinations. Downstream re-examination should be discontinued.
- Scanning equipment is often requested as an alternative to physical examinations. In fact, scanning a container is the same as physically inspecting it. Scanning 100 percent of all traffic is not realistic, and scans should be subject to specific rules of selection.
- Under the Geneva Convention on the simplification of Frontier Control of Goods[8], controls should be coordinated, take place at the same time in the same location, and, whenever possible, delegated to Customs.

3. Risk profile maintenance and statistics

- Risk profiles must be changed frequently:
    - ❖ Importers and brokers will rapidly find out what are the risk profiles. Changing them will disrupt attempts at reverse engineering.

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[8] http://www.unece.org/trans/conventn/harmone.pdf

- ❖ Risk profiles are sometimes seasonal, or based on external events, which may evolve in time.
- ❖ Routine is the worse approach to risk management. Risk management is based on objective criteria, and on de-stabilizing activities (such as frequently changing the criteria for selection).

• While the management of profiles is the job of the RMU, field staff should be involved. For example, feedback from clearance officers will guide subsequent research in the RMU. This participatory approach is also necessary to maintain interest in the system.

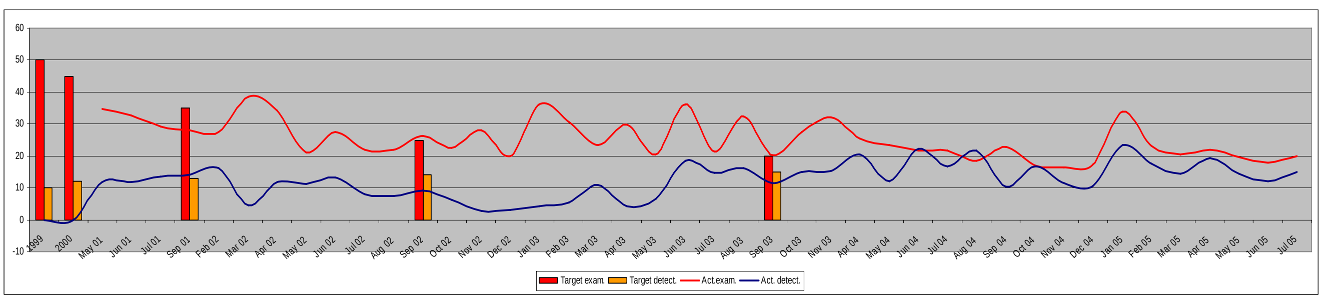
The question is to decide whether:

- Field staff can set their own profiles, and

- Field staff can override RMU profiles

It is better to adopt a cautious approach at first. To test the system, all risk profiles must initially be set by the RMU. As experience – and confidence – grows, some local flexibility can be introduced. The important point is that, whenever a local officer overrides a risk management decision, he should account for it in writing.

• The RMU should maintain a statistical data base of all examinations and controls. This will enable the preparation of charts similar to the one below:



Source: World Bank performance indicators, TTFSE program

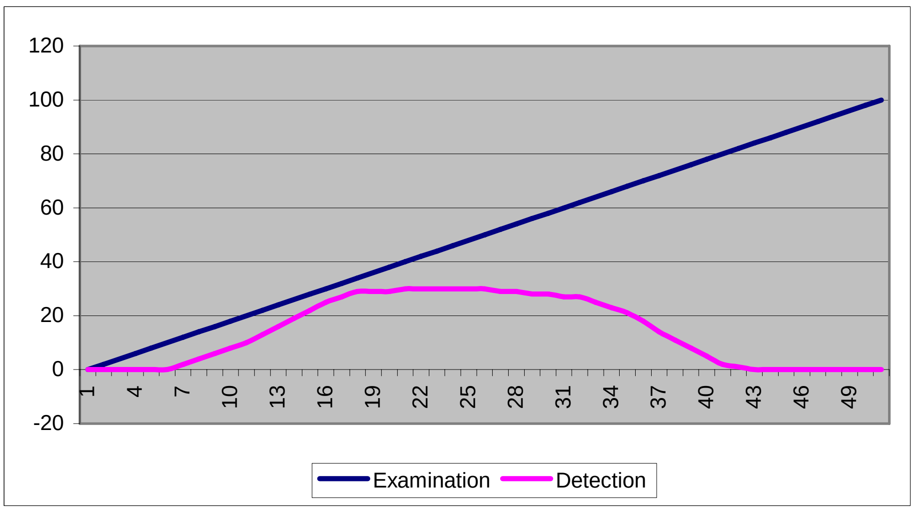
This chart shows, over a period of five years, the ratio between physical examination and detection at a Customs clearance station in a South East Europe country. What is remarkable is the correlation between the rate of examination (red line) and the rate of detection (blue line).

- In the first part of the chart, when examinations went up, detection came down, and vice-versa. This shows that extensive control stretches resources and reduces efficiency. In addition, when examinations are carried out routinely, they are always poorly conducted, so are unlikely to result in a high level of detection.
- Towards the right of the chart, the two curves started moving in parallel. This happened when a risk management system was introduced. The curves need not

converge (in any case, the red line is the rate of inspection, and the blue line is the rate of detection *out of these inspections* so even if they converged, it would not mean that all fraud is detected). What the chart shows is that, if risk management is well operated, inspections should actually *increase* in some cases, when the likelihood of fraud has gone up.

4. Compliance level

Using statistical data, the RMU should establish a compliance model for each clearance station. This model shows the optimal rate of control at a given time and in a specific environment. It should therefore be updated regularly.

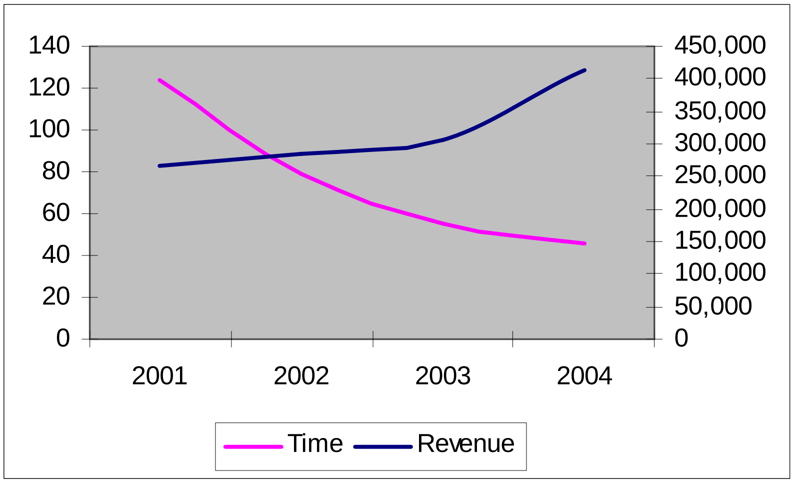


5. Operational conclusions for Customs

- While the obvious tendency would be to peg rates of control/examination to Western standards (i.e., below 10 percent), this may not be the right approach immediately. A baseline study would show that better results may be achieved initially with a much higher rate of examination.

- Trade facilitation is often interpreted as meaning less enforcement. In the above model, it is the opposite, as there is more scope for introducing incentives and rewards for compliant traders, in terms of reduced rates of inspection, or customized clearance procedures.

- There is often a fear that increased facilitation, in terms of reduced examinations and clearance delays may jeopardize revenue. The following table illustrates that it can be the opposite.



Comparison between time for clearance and revenue collection
at an Albanian inland clearance facility between 2001 and 2004.

There are of course many other reasons why revenue should increase over time. However, reducing clearance times does not affect negatively revenue collection.

Further resources

The following documents provide interesting models that you may want to explore for further information:

Customs modernization handbook, chapter 5
http://publications.worldbank.org/ecommerce/catalog/product?item_id=3077227

World Customs Organization, “Customs Compendium” collection, Volume 4 - global information and intelligence strategy (deals with the Global Information and Intelligence Strategy developed by the Secretariat of the World Customs Organization together with Customs Administrations Members of WCO. It is a summary document which sets out the framework for an information and intelligence management plan aimed at optimizing controls on the cross-frontier movement of goods and facilitating legitimate trade. This material is intended both for Customs administrations and for their partners, being both the sources and the users of information and intelligence.)

WCO Risk Management Guide, June 2003 D/2003/0448/7
http://www.wcoomd.org/ie/En/en.html

Sample terms of reference are available for the introduction of risk management.

For further information, please contact the Customs and Cross-Border Facilitation Team.

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