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Customs modernisation and controls

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STANDARD RISK MANAGEMENT FRAMEWORK

This document presents a standardised framework for the risk management process. The risk management framework is a flexible framework which does not replace existing systems but offers a bases for a common approach on risk management in which the existing risk management systems could be integrated.

The framework has been developed based on best practices of EU customs administration introduced by customs experts of the Member States who participated in two Customs 2002 project groups "Harmonised Model for Risk Management" and "Risk Management Framework".

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1. INTRODUCTION

Following the Customs 2000 seminar in Sweden - "Risk Analysis in the New Millennium" December 1999, a risk analysis implementation plan (document TAXUD/607/2000) was approved containing future actions to be undertaken in the risk analysis area. Fiche 1 of the implementation plan contains an action to establish a common harmonised model for the risk management process.

This framework identifies the key elements of the risk management process. It has been prepared by the Customs 2002 Project Groups "Harmonised Model for Risk Management" and "Risk Management Framework".

The risk management process should be based on a common framework in order to bring uniform treatment of risks and to ensure equal treatment of trade across the European Community to help the Single Market work better.

2. CUSTOMS DEFINITION OF RISK MANAGEMENT

"Risk" means the likelihood that something will prevent the application of Community or national measures concerning the customs treatment of goods.

To minimise the occurrence of risks, customs can use risk management as a technique to more effectively set priorities and more efficiently allocate resources necessary for maintaining a proper balance between controls and facilitating legitimate trade.

Risk management can therefore be defined as; a technique for the systematic identification and implementation of all the measures necessary to limit the likelihood of risks occurring. International and national strategies can be effectively implemented by collecting data & information, analysing & assessing risk, prescribing action and monitoring outcomes.

3. GENERAL PRINCIPLES FOR RISK MANAGEMENT

For customs administrations there is always an element of risk in controlling and facilitating the movement of goods. The extent of controls to ensure compliance with the laws and regulations that Customs are responsible for enforcing should be proportionate to the level of assessed risk.

In modern customs control techniques the process of risk management is an important aspect. It helps to determine where the greatest areas of exposure to risk exist, and supports management decisions on how to allocate limited resources effectively.

In managing risk a balance must be struck between costs and benefits, as clearly it will not be cost effective to address all risks equally. Criteria are needed to decide what constitutes an acceptable or unacceptable level of risk.

For a good and effective risk management process, appropriate tools and skilled people are needed. This is especially true of I.T. systems that are essential given the volume, speed and complexity of international trade today.

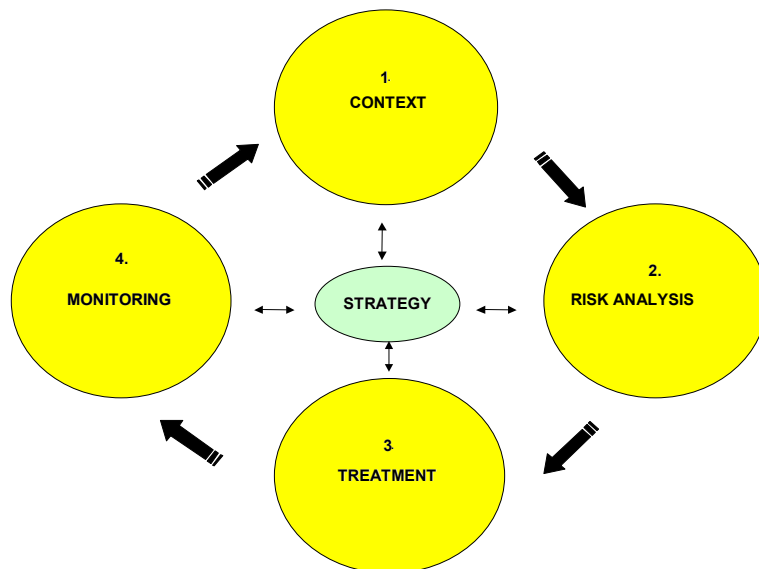
4. THE ELEMENTS OF THE EU RISK MANAGEMENT PROCESS

Risk management must not be seen as a static process but as an interactive process in which information is continuously updated, analysed, acted upon and reviewed.

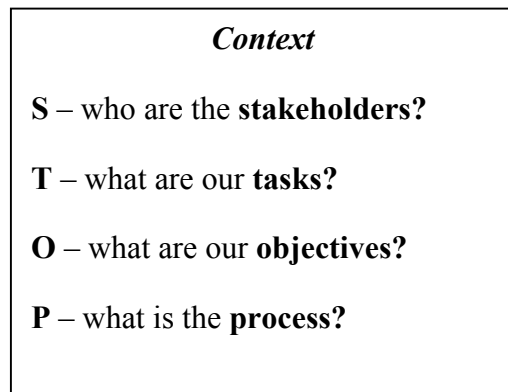
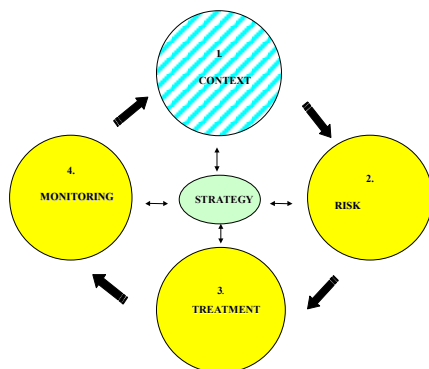
The risk management process comprises the following elements.

- Context
- Risk Analysis
- Treatment
- Monitoring

A diagram of the process is shown below, it includes the central theme of ‘Strategy’ that is set by Ministers & Director-Generals and is the raison d’être for the framework. Each step of the process should be viewed interactively with the organisations’ strategic objectives to ensure cohesion with and delivery of those objectives.



4.1. Element 1 - Establishment of the strategic, organisational and risk management context.



In step 1 the context is the environment in which the risk management process is performed. A range of factors such as resources, political & legal objectives and social aspects influences the context. The acronym S.T.O.P (above) is a summation of how to establish the context; more detail is given below. The result of this element should be a description of the relationship between the customs organization and its environment.

Today, customs administrations are required to provide extensive facilitation while ensuring that the international movement of goods, means of transport, luggage and other goods carried by or on persons are appropriately controlled. The level of risk is determined in the context of the national and international priorities set for customs administrations. Customs are responsible for the implementation of Community regulations relating to external trade, but not only for duty or trade regulation purposes, but also for environmental, anti-dumping, consumer protection, cultural and agricultural purposes. These responsibilities are a main feature of the strategic context established by customs administrations.

The **strategic context** can be defined by thinking about the following question:

WHAT ARE CUSTOMS EXPECTED TO ACHIEVE?

Many customs organizations have mission statements, long term visions or high-level control priorities and strategic objectives that can provide the answer to this question. It is within these documents that the future direction for customs is set and which leads to consideration of the organizational and risk management context.

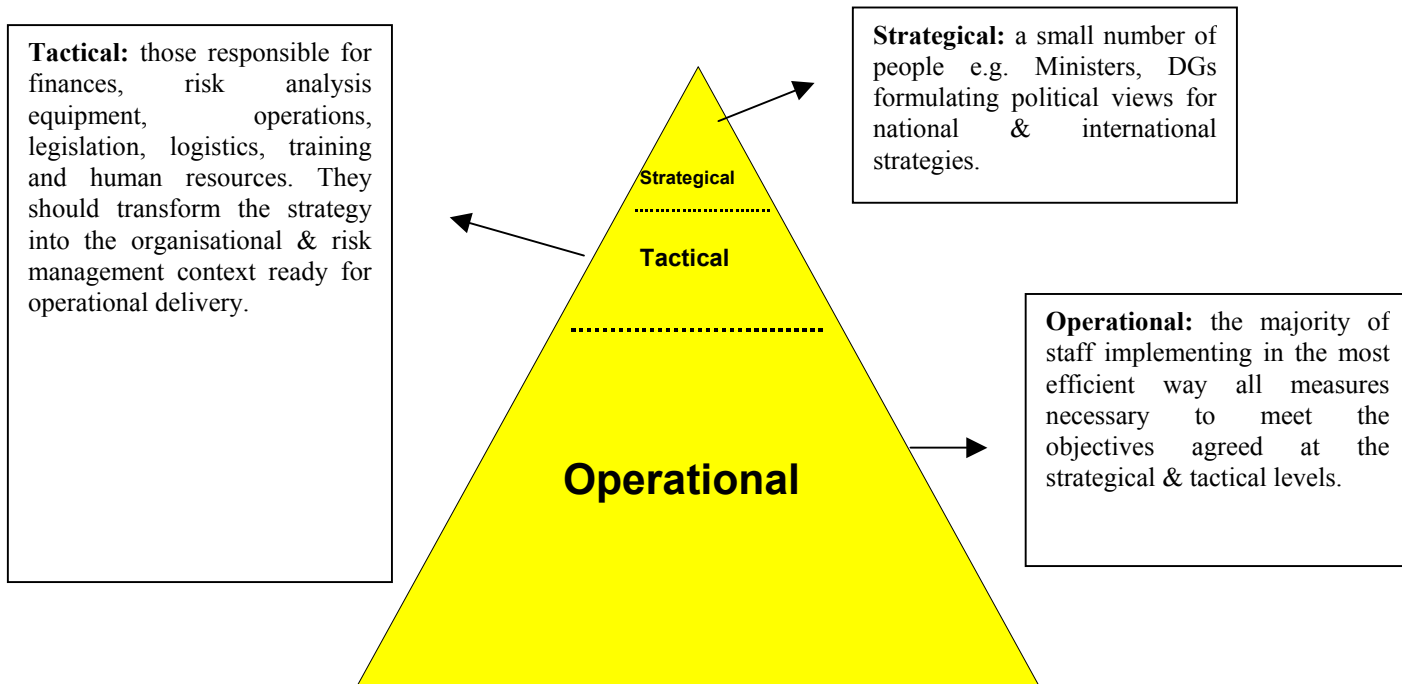
The **organizational and risk management context** can be defined by thinking about the following question:

HOW CAN CUSTOMS ACHIEVE THE STRATEGIC OBJECTIVES?

Senior managers, technical and analytical experts provide the answer to this question and with that define the organizational & risk management context. They assess & understand the strategic context in the light of the organisations capability to deliver the strategic objectives. They then consider risk management of the strategy by taking into account the need to balance costs, benefits & opportunities, resources and equipment. They may need to prioritise certain strategic objectives or seek additional resources to

tackle important objectives. The key issue here is the accurate assessment of the capability to deliver the strategic objectives. They need to consult widely with stakeholders and operational staff before implementing a risk management plan. They also need to consider the extent to which they need to monitor outcomes (element 4) and ensure that the capability to assess the effectiveness of the strategy exists or can be put in place. It may be the case that the measure of success is an improvement in the level of compliance, or an increase in the number of detections. If this is so, a benchmark should be established from which improvements can be measured.

The organisational structure necessary for establishing strategy, organising the risk management context and delivering results is shown below and is fairly typical in many countries.



The table below contains some additional key questions that can help to establish the contexts.

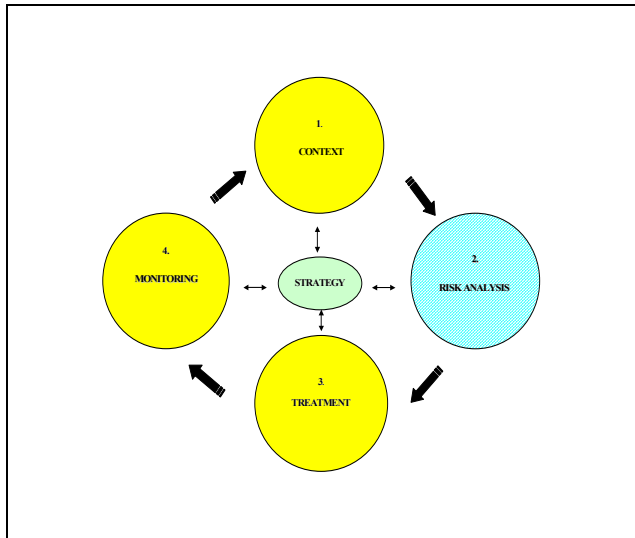
<p>What is the policy, the process or activity?</p>	<p>For example, at EU level a strategy for the Customs Union has been published by the Commission [COM (2001) 51 dated 08.02.2001] in which it is indicated that customs role is changing from collecting duties to protecting health and safety of the European society and its citizens.</p>
<p>Determine risk areas.</p> <p><i>“Risk areas” means customs regimes, procedures and other areas where the customs authorities exercise their responsibilities. This also applies to traders..</i></p>	<p>Scrutiny of existing Community and national legislation requiring customs checks can reveal risk areas. New legislation or changes in existing rules may give rise to new areas. For instance, new anti-dumping legislation on a particular product originating in a given country, adopted during a given year, should alert</p>

	<p>customs to the possibility of diversion. This in itself enables a risk area to be identified, serving as a basis for proper risk analysis.</p> <p>Similarly, the appearance of new trade flows which may affect economic activity, consumption patterns or public safety should be noted. They may give rise to new risk areas, perhaps necessitating a risk analysis.</p> <p>Nor should it be forgotten that an individual trader or group of traders may constitute a risk area. Traders are very important factors. As a rule, structures, operating methods, reputation and financial standing are good indicators of whether a particular trader represents a risk area and should be subjected to risk analysis.</p> <p>Evaluation of the results of controls is also important. Evaluation should be undertaken over a long period so that a wide perspective of risks can be considered. The Commissions' working document "inventory of control areas" [document TAXUD/609/2000] can also serve as basis for the establishment of risk categories</p>
<p>What are the anticipated major outcomes?</p>	<p>It could be the collection of duties and taxes or effective controls on prohibitions and restrictions. Alternatively the main focus could be improvements in the operation of the Single Market to make it more competitive for business.</p>
<p>What are the Strengths, Weaknesses, Opportunities and Threats of the system?</p>	<p>Engaging the staff in a simple S.W.O.T. analysis will expose these areas and enable appropriate action to be taken.</p>
<p>Who are the organisations' stakeholders?</p>	<p>Stakeholders can be the Commission (collection of own resources - standardised controls at external frontier of the EU), national parliament (fight against fraud), trade (increased use of simplified procedures etc.) The stakeholders' interests and any threats related to these interests should be defined and prioritised.</p>

What are the crucial elements - internal and external - which influence the risk management process?

These might include elements such as organisational structure, human resources, political influences, finance and equipment. Each of these may support or impair the risk management process.

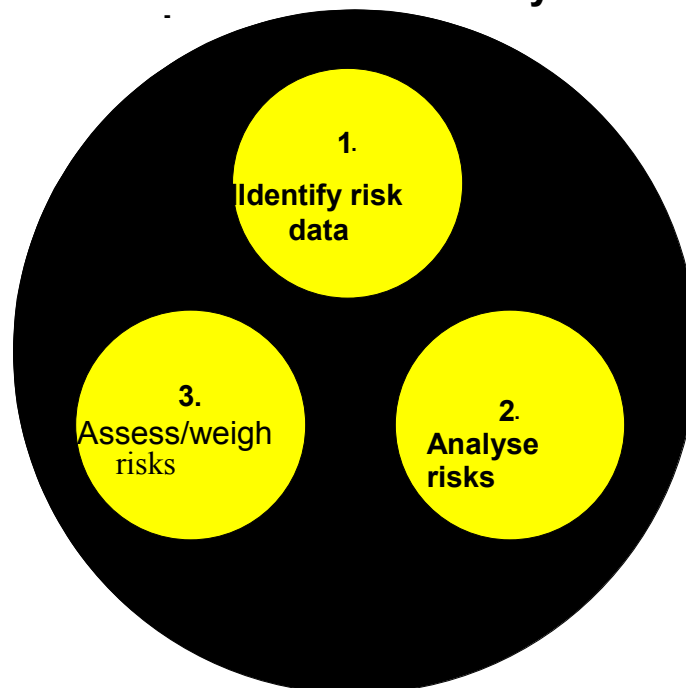
4.2. Element 2 - Risk analysis



Risk Analysis

This step of the risk management process can be complex. Some member states prefer to view this step in greater detail and use a sub-process as shown in the diagram below. The message is simple, do what best suits the organisations needs.

Element 2 Risk Analysis



Identify risk data

In this step information is vital. All available information should be examined as potential sources of risk data, evaluated for accuracy and where appropriate, be made available to the operational service. The information can also be valuable for legal departments to help them consider changes to legislation. Sources of information for this element of the process can be trade flows, declarations rendered, payments made on time/debt on file and new or changed legislation. The experience of operational staff should also be seen as a source of information as well as the results of their control actions. Information in TARIC, laboratory reports are useful sources. In respect of operators, the catalogue of risk indicators (working document TAXUD/697/2000) is an important source of information. The risk data should then be analysed.

Analyse risks

Using the risk data, and assessment of the risks in each aspect of the context should be undertaken. There are two main ways to view this, by analysing **proven risk** and by analysing **potential risk**.

Proven risk is historical fact, an irregularity has occurred and the organisation has a record of the incident and the facts surrounding the case. Lists of these risks can be analysed against current data to see if conditions surrounding the risk currently exist. If yes, an assessment of the likelihood and consequence of the risk should be undertaken (see below).

Potential risks are risks that have not yet been uncovered but are suspected. For example the development of a new commodity to which the owner assigns their Trade Mark®, may become the target of others wishing to breach the owners intellectual property rights. These risks should also be analysed against current data and if the conditions for the risk exist, an assessment of the likelihood & consequences should be undertaken.

Exchange of risk information between member states is an additional source of information, this is an important aspect to help equivalence of controls and to counter emerging threats rapidly.

Analyse the risks in terms of likelihood and consequence. The analysis should consider how likely an event is to happen and, if it were to happen, what are the potential consequences and their importance. Combining these elements will produce an estimated level/weighting of the risk in the next step of this element.

Weighting the risks

There are different types of ranking systems. The assessment into HIGH, MEDIUM, and LOW is widespread. Although ranking in three levels is widespread, it can be defined in only two levels (high and low) or if desired it can be more than three levels. The output of this element in the risk management process should be a prioritised list of risks and the future treatment action specified.

High risks are generally likely to arise and have severe effects. Treatment actions for these risks should be highly visible to senior management and possibly agreed in control plans. In exceptional cases where a control is not acted upon, the reasons for not acting should be documented and made transparent to those responsible for assessing the risk.

Medium risks may be less likely to arise, or have less severe effects, but not necessarily both. Also with medium risks it is recommended to document the reasons for not acting.

Low risks are acceptable risks that can be assessed by standard or routine procedures or even where no action is necessary.

A consistent strategic approach, based on common criteria, understanding, methodology and procedures that applies across all areas of the risk management exercise should minimise unnecessary subjectivity in the decision process. The consistent use of inputs including criteria, procedures and data will promote the production of comparable outputs, such as identified risks that are prioritised according to a common measurement scale. Logical categorisation of risks is considered necessary to set level of priority for assessing the identified risks.

In a frontier environment the levels of risk could be treated as follows:

1. *Dynamic parameters*: profiles based on information from various sources such as the Risk Information Form (RIF), AM-fiches etc. can be introduced into a clearance system. Parameters can be inserted which cause the consignments to be selected for checking based on data of the single administrative document. If the consignments are selected, based on the inserted parameters, the document will mostly be assessed as *a high risk* because the information on which the profiles are drafted are based on concrete risks.

2 *Fixed parameters*: are where there is a mathematical selection based on pre-determined risk values for every procedure code, country code, product code and company number. A total score value is calculated and can be assessed by a score table resulting in high, medium or low risk

3 *Random selection*: local customs officials have to be in a position to undertake random checks on consignments otherwise not selected. This can be done by a statistical random selection run in a computer programme or by manual system based on an agreed technique that eliminates individual's subjectivity. The output of this element in the risk management process should be a prioritised list of risks and definition future actions needed.

Notwithstanding 1, 2 & 3 above the selection by the officer at the spot, based on his intuition and experience continues to be an important selection criteria!

In respect of operator risks the catalogue Risk Indicators for Operators (document TAXUD/697/2000) is an excellent reference document.

The following example from France illustrates the distinction between proven and potential risk.

Definition of the components of risk: actual risk and potential risk

Two major types of risks can be distinguished: actual risks and potential risks, and these apply to companies as well as to products.

**** actual risk of fraud***

This can be divided into two categories:

- subject of dispute

For companies, this involves, on the one hand, analysis of the frequency of checks already carried out within the company and their results and, on the other hand, the history of disputes (type, number, degree of seriousness of breaches observed). Primarily, this study is carried out through examination of databases.

For products, this involves, on the one hand, the number of irregularities noted on a product or a product sector at national or Community level, determined from analysis of the statistics, and, on the other hand, the types of fraud observed for each product at national and Community levels, and their seriousness.

- information

This includes targeted, operational information likely to result in material declaration of the fraud. This information can come from various national or external sources: customs officers, advisors, other authorities, international mutual government assistance (AAMI), OLAF, cases of mutual assistance on fraud (AM cases) of the Commission.

**** potential risk of fraud***

The potential risks of fraud include:

those connected to companies or operators and the customs and economic environment for their activity,

those connected to imported and exported products and the regulations that apply to them,

information of a general nature.

- The risks of fraud connected to a company or operator relate to the general data for the operator and their activity. For example:

◦ commercial structures: situation of monopoly, quasi-monopoly or competition, company in personal name, company whether or not belonging to a national or multinational group, marketing company, broker, producer, onward processor, manufacturer under foreign licence;

◦ the financial structure of the company or operator: balance sheet (fixed assets, inventory, debts, cash assets), taxable income (profits and losses);

◦ the organisation of the business: methods of supply, logistics, service location, identification of responsibilities within the company, reliability of the internal management system, circulation of documents and links between the various departments, levels of qualification of the customs representatives, goods accounting;

◦ the trade structure: the significance of the trade with foreign countries in comparison with national activity, development of its imports and exports (passage through a subsidiary company,

change in tariff classification, change in values declared etc), ratio of duties and taxes paid compared with the value of purchases abroad, amount of aid paid by EAGGF in relation to the turnover for the export of agricultural products, normal methods of transport and contract (CIF, FOB etc.), type of financial security put in place (overall, flat-rate);

◦ the customs strategy, i.e. the customs clearance procedures used (common law, domiciled, simplified), the customs clearance conditions for the products (time slots), changes in locations for customs clearance (single, multiple, frequently altered) as well as the customs procedures used: direct imports, imports for subsequently putting into free circulation in another Member State, leaving the Community by another Member State for CAP products, inward or outward processing, warehouse etc.

◦ changes in behaviour following the development of a regulation affecting the imported or exported products: change of supplier, of countries, of tariff classification etc.

- *The risks of fraud connected with products involve looking for the weaknesses in a regulation in relation to:*

◦ a product: complexity in working, effect of the change in the regulation on flows (tariff slippage etc.), financial interests involved, nature of the goods (sensitive products such as cigarettes, alcohol, textiles, mineral oils, certain agricultural products, in particular those subject to the prior notification system as regards transit);

◦ the procedures and regimens used: Community transit, TIR, common law customs clearance procedures and simplified procedures, economic regimens;

◦ the product-country pairing in imports and exports in order to analyse, on the one hand, regimens linked to the import or export: quotas (quantity and duration), preferential tariff systems (reduced or zero rates of duty), various prohibitions ... and, on the other hand, the possible tariff slippage in view of the amount of the financial interests concerned (customs duties, anti-dumping duties, export refunds etc.).

◦ the tax differential between the Member States of the Union for the products (in the case of forwarding to a country with lower taxation, risk of increase in the quantities registered on the accompanying administrative documentation with fraudulent payment of the market difference for the state of origin) or risk of substitution of lightly or un-taxed products for highly taxed products for e.g. mineral oils;

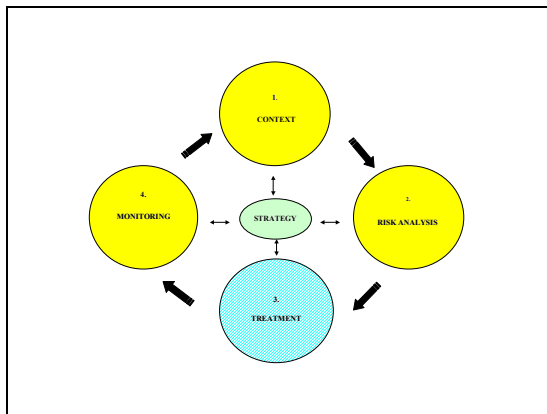
◦ the amounts transported (if they are too great, risk of fictitious deliveries);

◦ the transport time (if it is too great in view the destination, risk of use of the same documentation for several trips);

- *Information of a general nature*

This might be based on mere suspicion, questioning or indication by a customs officer, an advisor or another national or foreign government department; non-customs information provided in documentation (press, media), by Minitel servers or through the Internet.

4.3. Element 3 - Treatment of risks



Treatment

Develop & implement treatment of selected risks. Control actions can be (documentary and physical) on the spot or at the traders' premises. It could be decided to undertake a posteriori controls such as audit to minimise the burden on the trade at the frontier or for more detailed checks.

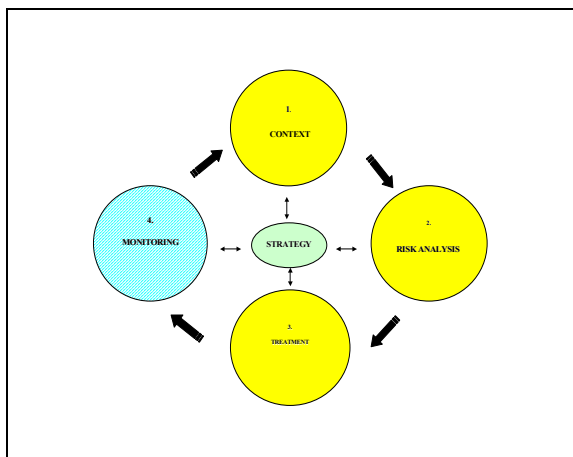
Accept low-priority risks with minimal further treatment. For risks in other categories, develop and implement treatment as specified in management plans. In the Court of Auditors report no. 13/98 it was indicated that a precondition for the creation of a homogenous approach to customs control throughout the Community is the existence of consistent national control plans.

Whenever a transaction is selected for control, a control form can be provided with the control advice including explanatory notes so that the local officer has information of the risk assessment. The result of the controls can also be recorded on the control form (on paper or electronically). If possible, results should be linked to each of the selection criteria as defined in element 2.

A local officer could also report if he has taken no action and the reason why no action has been taken. This is important input in the next element of monitoring and review. It might result in deleting existing profiles or introducing new ones.

Whilst the development of a common format for a control plan is seen as difficult, the idea of having indicated actions linked to control areas is considered to be useful. The document TAXUD/609/2000 contains details of control objectives and could be used to aid selection of the most suitable types of treatment.

4.4. Element 4 - Monitoring and reviewing



Monitoring

Knowing the effectiveness of the strategy, implementing changes to procedures and the improvement of controls are best achieved with the use of an effective monitoring system.

Monitor and review the performance, effectiveness and efficiency of the risk management system and changes that might affect it. Evaluation and review should be carried out by a regular mechanism.

The Court of Auditors report no. 13/98: reported that; no structured system would be complete without an effective monitoring and review process to ensure that all pertinent information underlying the assumptions and decisions taken, is accurate, up-to-date and relevant. Such monitoring must be carried out across the customs services of the Community, in a spirit of co-operation. The review must use information feedback from the process and lead to updating the analysis and prioritisation of control work.

A distinction should be made between feedback, which leads to changing and updating the risk profiles and monitoring, which is a process to evaluate the effectiveness of the system.

In both cases IT-support is considered important. Most Member States are seeking better systems to deal with monitoring and review of the risk management process. Sharing experiences is considered useful in this area.

As an example of a monitoring system, a brief description is given of the Danish system.

Danish example

In Denmark the risk analysis work is based at the Customs Control Office (8 customs centres) in a kind of "intelligence unit" relating to the commercial trading.

After all the transactions have passed through the customs and the risk analysis system, the high risk transactions will be subject for control. Mostly physical control and/or audit. After the control the local official will document the results and control experiences in the customs system. All data concerning the customs declarations, risk analysis and control results are saved in a Data Warehouse enabling subsequent preparation of reports and statistical overviews.

The intelligence unit is therefore able to receive the following reports from the system:

- ❖ Report on all control results.
- ❖ Report on dynamic parameters inserted by Customs Centres or by the Administration.
- ❖ Report of risk sector which are marked as "high-risk".
- ❖ Report on number of transactions received in a period by a Customs Centre.
- ❖ Report on physical checks run related to the total number of transactions.

This system requires current monitoring and action at the Customs Centres to evaluate and implement control results all the time.