Customs Risk Management

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Abstract

Risk analysis remains a key element for the efficiency of customs control, allowing customs authorities to focus their controls in an environment where the increasing volume and pace of trade more than ever requires a selective and targeted approach. The trends and challenges related to the modernization of customs administrations prove the role of customs organization in the effective implementation of the process and the importance of the competence of the authorities (within the object of control). The aim of this research is to present the trends in customs risk management. In the study have been used the descriptive - analytical approach, the methods of comparison, analysis and synthesis.

Keywords: customs, risk management, risk analysis, customs control

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Introduction

In recent years, it has become clear that Member States' customs authorities face a number of difficulties in fulfilling their different roles. Despite the significant modernisation of European Union (EU) customs legislation in 2016, there is evidence of problems such as ***undervaluation of goods*** to avoid customs duties and VAT and ***smuggling of illegal or dangerous goods***. There are also concerns about ***imbalances*** between Member States in terms of customs controls and about goods being diverted to the weakest entry and exit points in the EU customs territory to avoid detection.

The dynamically changing world, characterised by the acceleration of ***digital transformation*** and the imposition of new business models such as ***e-commerce***, has added new challenges for Customs in implementing and enforcing EU import and export legislation. At the same time, customs must continuously strive to ***facilitate legitimate trade***, as international trade is crucial to the success of the EU. In addition, the ***intensive preparations for the UK's exit*** from the EU customs union at the end of the transition period have significantly increased the workload of EU customs authorities. Under these conditions, there are ***huge risks*** of revenue losses to the EU budget, of threats to the safety and security of EU citizens, and of excessive burdens on legitimate trade if measures are not taken to improve the performance of national customs authorities across the EU. European Commission President Ursula von der Leyen said in 2019 that the Commission would propose "***an integrated European approach to strengthen customs risk management*** and support effective controls by Member States." (Communication from the Commission, 2020). In this regard, how the concept of risk and its management is applied in customs control determines the ***relevance and interest*** of the authors to the problem.

The **aim** of this research is to present the trends in customs risk management. In the study have been used the ***descriptive - analytical approach, the methods of comparison, analysis and synthesis***.

1. Characteristics of Risk Management Process

Risk assessment and risk management is well established as a scientific field and makes an important contribution to decision support in practice. Basic principles, theories and methods exist and are being developed (Aven, 2016).

Under the Public Sector Financial Management and Control Act (PSFMCA), Risk Management is one of the interrelated elements of Financial Management and Control Systems (FMCS1) in public sector organizations (PSOs). Each organization has common activities, processes and risks that apply to all business areas within the organization (Raanan, Kenett & Pike, 2010). Not only industrial enterprises, but also government organizations, research institutes and hospitals are already implementing risk management to some extent (Berg, 2010). This in turn means that customs administrations are also concerned.

Public sector organizations face risks (potential events) in carrying out their activities and functions that may hinder their operations. The occurrence of such events, in cases where they have not been anticipated and assessed, forces the managers of organizations to take measures and sometimes to spend significant public funds to eliminate their consequences. In general, risk and the likelihood of its realisation are associated with the random nature of the event and the uncertainty of the possible outcomes of its realisation, the possibility of different solutions and approaches, the ability to predict and, in certain cases, to calculate the probabilities of one or another outcome (result) of the event, as well as the possibility of realizing a loss or profit in a given development of the event

There are different types of risk management techniques. Most of them, including those used by internal and external auditors for the purpose of their audit work, involve a quantitative and qualitative assessment of risks to enable the identification of the activities, functions and tasks that contain the most risks and the subsequent classification of those risks in terms of their importance. Reference may also be made to the periodic analyses of economic and technological factors relevant to the activity, management meetings for the purposes of strategic and operational planning of the activity and meetings at which an analysis is made of the environment in which the organization carries out its activities.

Risks can be identified in the course of long-term, medium-term and short-term activity planning. It does not matter what the method for determining the risks will be. What is important is that management considers the factors that may contribute to the occurrence of a risk or to increasing the severity of an already identified risk. As an illustrative example, key factors in this case could be:

- failure to achieve previous targets;
- staff competence;
- geographical distribution of functions and activities;
- complexity of the operations carried out;
- degree of importance of operations, etc.;
- changes in legislation, staff turnover and others affecting the organization (Ukazaniya za upravlenie na riska, 2020).

According to the definitions of the standard (ISO 31000), *risk is the impact of uncertainty on the achievement of objectives, and its management consists in coordinated activities to guide and direct an organization with respect to risk.* Risk is inherent in any activity and leads to the conclusion that any person can be a risk or protection producer, or both together. Therefore, in order to combat risk, it is not enough just to know the nature of it, but also to know who creates it and who manages it. The authors add that it is important to know the origin in order to determine the risk management that should be undertaken. The source of risk is dual; it is equally the result of the internal and external activities of the enterprise (Iacob, & Stefan, 2012).

The risks are not zero and cannot be reduced to zero. Regulating risks based on this principle creates the need to know the magnitude of risks and to limit the acceptability of those risks by

setting finite, non-zero standards. The systematic handling of risks is called risk management. In this context, risk management is divided into four stages (Figure 1):

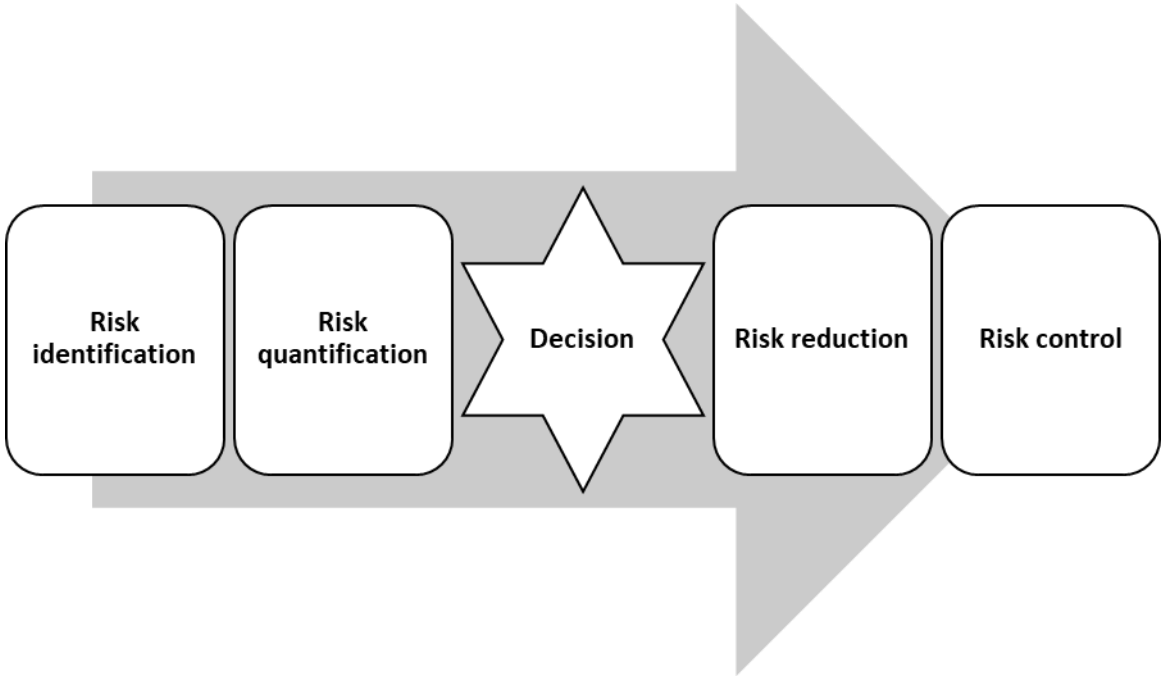

Figure 1. Risk Management Process
Source: adapted from Ale, 2002.

In these, the decision is not so much a phase as a distinction between the more analytical part of the process and the more managerial part of the process. Quantitative measurement plays a central role in the risk management process. It is therefore necessary to standardize to some extent the indicators by which risk is expressed and the methodology used to quantify risks and manage them. Risk has two dimensions that need to be defined separately: the magnitude of the consequences and the probability of the consequences occurring (Ale, 2002).

According to the authors (Stoyanova & Stefanova, 2017), an activity that uses "inputs" and turns them into "outputs" can be seen as a process, i.e. applying a "process approach". The process approach is the systematic identification and management of both processes and the interrelationships between them. The advantage of the process model lies in the ongoing control exercised over the processes and the relationships between them. The advantage of the process model lies in the ongoing control exercised over the processes and the links between them (Figure 1), including the identification of the resources required to secure it. By applying the process approach, each Organization will have the ability to plan its processes and determine their level of influence, which will ensure that its processes are resourced and managed appropriately, including that opportunities for improvement are identified according to the influence of the external environment.

Risk management processes (RMPs) are logically consistent and structured approaches to identifying and understanding potential risk factors and to assessing the consequences and uncertainties associated with those identified risk factors. Based on this information, we can assess and select the best course of action to address the identified risks and achieve the desired objectives of a project (Tummala & Burchett, 1999).

Risk management is concerned with decision-making that contributes to the achievement of the organization’s objectives, and is applied both at the level of individual activities and across functional areas. It supports decision-making such as the alignment of evidence-based and other factors; the costs with benefits and expectations when investing limited public resources; and the

governance and control structures needed to support due diligence, responsible risk-taking, innovation and accountability (Berg, 2010).

2. Risk Management and Customs

Risk management offers undeniable benefits to the international customs community, which needs to continuously improve its efficiency, effectiveness and performance, as well as be increasingly transparent, accountable and professional. According to the authors (Anouche & Boumaaz, 2019), customs risk analysis techniques are powerful control tools, but the evolution of technology and the volume of information, as well as the categories of risks, in a complex environment require additional efforts to build strong systems to focus and improve cost and time efficiency.

Increasing trade volumes bring different challenges and risks for customs to maintain the balance between trade facilitation and strict border control. With limited resources and manpower, it is quite difficult to ensure comprehensive physical inspection of all import and export consignments. In order to strike a balance between control and trade facilitation, the Revised Kyoto Convention (RKC) and the World Trade Organization (WTO) Trade Facilitation Agreement (TFA) clearly specify the implementation of an effective risk management system (Regmi & Timalsina, 2018).

Customs control risk is the probability of an event occurring, weighed against its impact, in relation to the entry, exit, transit, movement or specific use of goods moving between the customs territory of the EU and countries or territories outside that territory, and in relation to the presence within the customs territory of the Union of non-Union goods, which would impede the proper application of EU or national measures, jeopardise the financial interests of the EU and its countries or would endanger the security and safety of the EU and its inhabitants, human, animal or plant health, the environment or consumers (Special report No 19/2017, 2017).

According to the authors (Basir, Satyadini & Barata, 2019), risk management is considered to be a relatively new key area in the practice of customs services. However, in the context of customs administration, it is worth recognizing that risk management plays a crucial role in coordinated risk targeting and control activities that help customs officials to cope with the problems of limited resources, increased trade volumes and the need for rapid clearance.

In the opinion of others (Thuy & Huong, 2018), the application of risk management (RM) is considered important in modern customs management. Risk management in customs can identify key areas of potentially high risk of smuggling, trade fraud, tax evasion and budget shortfalls so that customs administrations can take effective preventive measures. At the same time, it will create favorable conditions for businesses to comply with customs legislation.

Risk management, which is based on risk-based thinking in accordance with the requirements of the international standards ISO 31000:2009 and ISO 31010:2009, allows optimal use of customs resources without reducing the effectiveness of customs control, and will relieve the majority of those involved in external economic activity from unnecessary bureaucracy and make it more practical. The application of modern management methods, based on risk-based thinking, in the practical activities of customs authorities, as proposed by the authors, will allow to reduce the time of customs control and clearance, the costs of their implementation, to minimize corruption in this area and thus lead to an increase in the efficiency of the activities of customs authorities. Customs risk should be understood as a combination of the likelihood of a breach of customs legislation and its negative consequences (Afanasieva, Ivanov & Yanushkevych, 2017).

In the World Customs Organization (WCO) Risk Management Manual, modern risk-based compliance management is based on several key foundations. These can be grouped into four main categories - ***the country's legislative framework, as well as the administrative framework, risk management framework and technological framework*** adopted by customs administrations. Taken

together, these four categories represent the main factors determining the way in which cross-border flows can be expedited and the way in which customs control over these flows can be exercised.

Within the scope of customs, the control and risk management of goods, means of transport or people begins at the point of export or departure, continues with ongoing controls at the point of import or arrival and then with follow-up controls. The modern approach to compliance management recognizes that risk mitigation strategies can and should be applied throughout the supply chain. It also recognizes that the ***combination of multiple measures*** often leads to better results and more efficient use of resources. When appropriate legal, technological and operational measures are in place, a multi-layered approach can also facilitate the identification of risks, the coordination of responses and cooperation between and among governments (WCO Customs Risk Management Compendium. 2012).

The authors (Iordache & Voiculet, 2007) point out that there is always an element of risk for customs administrations in controlling and facilitating the movement of goods. In modern customs control techniques, the risk management process is an important aspect. It helps to identify where the greatest areas of risk exist and assists management decisions to effectively allocate limited resources. The main feature of the customs risk management approach is the determination of which persons, goods and means are to be checked and to what extent. High-risk persons, goods and means of transport are subject to a high level of scrutiny and intervention; however, low-risk ones receive a high level of trade facilitation (Biljan & Trajkova, 2012).

A risk-based framework for customs control is considered an essential part of modern customs administration. Well targeted customs controls could improve the overall performance of customs administrations and save costs and time spent on customs controls. It should be noted, according to the authors, that the establishment of effective risk-based customs control requires the following activities to be organised in stages: combining risk management with the customs development strategy; strengthening the capacity building of the risk management unit and its staff; using a computer-assisted selective control system; and developing related software to harmonise risk management with internal audits and post-clearance audits (Davaa & Namsrai, 2015).

Risk management, as the systematic identification and application of all necessary measures to limit exposure to customs risk, can ensure compliance with customs regulations in a way that facilitates trade. By identifying, analysing, assessing and treating risks, Customs significantly improves its performance (Biljan & Trajkova, 2012).

3. Trends in Customs Risk Management

The expanding responsibilities and challenges faced by modern customs require a ***more sophisticated approach*** to identifying and selecting shipments for border intervention. For Customs in particular, risk analysis and management techniques are useful for optimising human and financial resources, reducing costs, speeding up customs clearance, reducing corruption (when inspection processes are automated), thereby improving their overall efficiency and effectiveness (Desiderio & Bergami, 2011).

According to Antov (2017), underestimating the process of analysing customs risks and, consequently, improperly developing control actions, would lead to significant difficulties for customs authorities. These difficulties are primarily related to the effective performance of their assigned functions of collecting revenue for national budgets, protecting the interests of society as a whole from unregulated foreign trade operations, etc.

In order to manage risk, the customs administration needs to change the way it thinks and acts. It needs to move away from traditional methods and adopt new ways of solving problems, including developing ***accountability*** in decision-making. Effective risk management increases accountability in decision-making and provides an audit trail, helping to ensure that decisions comply with relevant legal requirements and government policies. It also ensures that the conduct of customs officials is consistent with public service standards.

Customs administrations operate in an environment of uncertainty driven by internal and external changes. ***Internal factors*** include the expectations of government, traders and travellers for efficient, effective and seamless service delivery at the border. External include the ***changing trade*** environment, including increased security requirements for cargo entering and the need to comply with global standards, such as those developed by the World Customs Organization.

A comprehensive approach to customs risk management, according to the authors, should combine risk management with ***intelligence and operations***. Effective processes require *well-trained staff, appropriate systems, knowledge transfer between national agencies and international cooperation*. Risk management enhances trade security and facilitation by allowing customs administrations to focus on high-risk trade (Foley & Northway, 2010).

According to another author (Zhou, 2019), the main characteristics of high-risk transactions are analyzed to detect potential fraud, and customs is also confronted with potential cases of ***declaration fraud***. A third adds that customs administrations have a large amount of data on trade and financial flows. However, the amount of data available is not as important as ***what administrations do with it***. Only reliable analyses can make this data useful and usable in the decision-making process (Chermiti, 2019). The study (Nemirova & Savelyeva, 2020) confirms the importance of the risk management system in the provision of customs services, especially the customs declaration service.

Auditors warn in a European Court of Auditors (ECA) report that some Member States do not carry out the necessary risk analysis for all import declarations, and imports with a higher level of risk ***may not be checked*** with sufficient priority. The authors' conclusions suggest that risk management should be aimed at ***simplifying customs procedures and improving duty collection and hence cost-effectiveness*** (Musau, 2018). This is confirmed by others who summarise that developing country customs administrations are moving slowly in the direction of using electronic data and risk analysis and focusing their resources on ***post-clearance controls***. Consequently, risk analysis appears to be a priority for modernizing customs systems in developing countries. Customs should adopt ***modern human resource management***: staff should be recruited on the basis of well-defined job descriptions. and staff assigned to risk management services should be recruited for the long term (Laporte, 2011).

It should also be noted that, according to Komarov (2016), ***customs authorities also generate risks***. This occurs when the violation is committed with the support of or directly by customs officials or due to negligent or poor performance in the exercise of their functions and responsibilities. In this context, the modern management paradigm requires the practical application of a combined approach, which implies the management not of separate, individual risks, but of the entire risk environment, including external and internal aspects. The latter can be described as bureaucratic risks in customs administration.

Supporting this reasoning Sreya (2020) summarized that there are many types of risks that customs around the world must manage, including revenue risks. fraud, harm to public health and the environment, illegal importation of prohibited and restricted goods, and fair economic competition. He concludes that a ***gap analysis*** is needed: Without all customs officers, especially frontline officers, having risk management knowledge, risk analysts can hardly perform their jobs because ***customs officers do not meet the requirements*** of risk management department (RMD) officers. The U.S. Agency for International Development states that the capacity of risk analysts is important, as is building the capacity of all Customs officials in the organization, which is necessary for risk analysts to effectively and efficiently perform risk assessments. The work in the RMD should be assigned based on the skills, experience of the official. and abilities related to risk analysis and relevant functions. Unfortunately, there is currently no monitoring and evaluation process that assesses an RMD officer's competency in risk management skills. A gap analysis shows that having specialists in each specific area is key for an organization to achieve the best

outcome. RMD staff should have competent skills related to risk analysis and identification. Without these qualities, the outcome cannot reach its best result.

A study on Customs Risk Management (CRiM) carried out in 24 customs administrations within the World Customs Organization (WCO) found and recommended: ***updating recruitment and career planning, training programmes***, recognition and remuneration of specialised risk management staff, as this often proves to be the weak point in human resource management (Hintsa et al., 2011).

In 2014 The Commission adopts an EU strategy and action plan for customs risk management. The Third Progress Report on Risk Management in Customs states that risk management allows customs authorities to more accurately identify and target for inspection shipments that are at risk. It allows these risks to be countered at the right point in the supply chain to ensure the security and safety of EU residents and the protection of the financial interests of the EU and its Member States. It also allows the use of ***customs resources to be optimised***. It is clear from the progress report that under *Objective 4 - Strengthen capacity to ensure effective implementation of the Common Risk Management Framework and improve responsiveness to newly identified risks and Improve implementation of the Customs Risk Management Framework (CRMF),* many Member States have reported obstacles that have prevented them from implementing all desired actions or making further progress. The biggest challenges are ***insufficient IT infrastructure, financial constraints and lack of human resources and available data***. The report concludes that risk analysis remains a key element for the efficiency of customs control, allowing customs authorities to orientate their control in an environment where the growing volume and pace of trade, and more than ever, require a selective and targeted approach (Report from the Commission, 2021).

However, the ECA (Special report 06/2022, 2022) concludes that the risk management framework, developed by the Commission in cooperation with the Member States does not ensure sufficient harmonization of the selection of import cases to be subject to control in order to protect the financial interests of the EU. The ECA finds that the Commission has not yet developed a ***common intellectual property rights (IPR) risk management framework, an EU customs control strategy for IPR infringements or IPR risk profiles***.

As part of risk management, the European Commission (EC) proposed to introduce pre-load and pre-arrival data analysis for all products and all modes of transport by 2024. However, it is not clear ***what human resources*** will be required in each Member State or what level and duration of training will be required for these staff. The same applies to the additional risk management process that is planned for the procedures "after the arrival of the goods". The European Economic and Social Committee (EESC) has already called "*to develop common training frameworks based on the EU Customs Competence Framework, which aims to harmonize and raise standards of customs work across the EU* (Yiapanis, 2021).

Customs risk management is essential to develop appropriate techniques to systematically identify risk and implement all measures necessary to facilitate legitimate trade, to limit exposure to risk, to implement strategies in accordance with relevant legislation, to analyze and assess risks, to identify actions and to monitor results in order to facilitate, improve and streamline control procedures COMCEC Coordination Office, 2018).

Conclusion

As a relatively new area in customs, risk management requires a modern and systematic approach, considering the trends of development and modernisation of customs administrations, the scope of global trade in goods and the regulatory requirements for them. In a context of increasing trade flows and digitalization of processes, risks in the entry, exit, transit, movement or specific use of goods moving between the EU customs territory and non-EU countries increasingly threaten the

financial interests and the health and safety of all consumers, determining the need for effective staff management in customs.

Risk analysis remains a key element for the efficiency of customs control, allowing customs authorities to focus their controls in an environment where the increasing volume and pace of trade more than ever requires a selective and targeted approach. The trends and challenges related to the modernization of customs administrations prove the role of customs organization in the effective implementation of the process and the importance of the competence of the authorities (within the object of control).

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