Managing customs risk and compliance: an integrated approach

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Abstract

This article introduces a contemporary framework for managing compliance in the customs context that fully integrates the principal elements of customs risk and compliance management. In doing so, it explores the manifold resources that have been developed by the World Customs Organization (WCO) and other parties that may be used by administrations to support implementation of the framework.

The integrated model draws together the author's contribution to the literature over several years and provides practitioners with a logical and inclusive methodology for managing compliance at a strategic or operational level.

1. Introduction

The role of Customs, like any law enforcement agency, is to ensure compliance with the law; and while this responsibility has remained unchanged for centuries, the manner in which Customs performs its role has changed dramatically over the course of the past three decades.

Customs represents the regulatory touch point for internationally traded goods, and in a rapidly changing world of new and emerging technologies and heightened commercial imperatives, social and political expectations no longer accept the traditional regulatory approach of intervention for intervention's sake. Rather, the current catch-cry is intervention by exception—intervention when there is a legitimate need to do so—intervention based on identified risk.[1]

Although most customs administrations now espouse a policy of intervention by exception, there is routinely a lack of congruence between organisational policy and operational practice. One reason for this is the absence of a clear procedural linkage between two key elements of customs control—the management of risk and the management of regulatory compliance.

Numerous researchers have developed risk management and compliance management models in the regulatory context (for example, Ayres & Braithwaite, 1992; Sparrow, 2000; Widdowson, 2003, 2005 & 2012; Widdowson & Holloway, 2011; Wilcox-Daugherty, 2018; and WCO, 2014 & n.d.), many of which tend to focus on enforcement activities. However, an operational framework that explicitly integrates the two processes has not to this point been developed.

Sparrow (2000), when examining compliance management from a broader perspective, advocates the adoption of an integrated compliance strategy that specifically addresses identified risks. In doing so, he highlights the tendency for law enforcement agencies to rely solely on enforcement actions in their response to identified non-compliance, whereas an integrated compliance strategy provides regulators with a broad range of alternatives to enforcement in such situations.

This 'enforcement culture' is prevalent among customs auditors, many of whom assume that their objective is to detect errors in a company's regulatory dealings, rather than to assess the degree to which a company is complying with the relevant statutory requirements. What these auditors fail to realise

is that such an assessment, regardless of the result, assists in determining where future compliance resources should be directed.

A corollary to this is that an auditor's finding of compliance is as good a 'result' as a finding of non-compliance. This is often overlooked, since a finding of non-compliance generally brings with it a tangible revenue return to government, whereas the identification of a compliant trader does not (Widdowson, 2010). In a similar vein, Sparrow (2000) notes that an integrated compliance strategy allows the agency to identify the mitigation of risks as an equally legitimate accomplishment as enforcement action.

Furthermore, the international standard on risk management requires the risk management process to form an essential part of organisational decision-making and to be integrated into the structure, operations and processes of an organisation (ISO, 2018). This makes perfect sense, as fully integrating the risk and compliance management processes abates the likelihood of adopting suboptimal risk mitigation strategies to address identified cases of non-compliance.

The adoption of an integrated framework will provide compliance staff with a logical process for applying the principles of risk management in their day-to-day activities and, while recognising that compliance management is an intricate amalgam of art and science, the framework provides the necessary infrastructure for the delivery of an effective compliance program.

2. Risk management standard

ISO 31000 is the acknowledged international standard for managing risk. It provides a common approach to managing all forms of risk and is neither industry nor sector specific (ISO, 2018). Its first iteration was published in 2009 (ISO, 2009), but its origins lie in a standard that had been in use since 1995, that is, AS/NZS 4360 (Standards Australia/Standards New Zealand, 1995). This standard was developed by a small group of organisations that saw the need for a formal approach to the management of risk in a variety of settings.

At that time, the Australian Customs Service, a founding member of this group, was specifically seeking to adopt a risk management model that would support its trade compliance role and ensure that its efforts and resources were focused on areas of highest risk.[2] Recognising the potential application of AS/NZS 4360 in the broader customs community, the World Customs Organization (WCO) subsequently incorporated the Standard in its Risk Management Guide (WCO, 2003), which was the forerunner to its current Risk Management Compendium (WCO, n.d.).

The Standard was also incorporated into the Revised Kyoto Convention (RKC)[3] (WCO, 1999), which is widely regarded as the blueprint for contemporary and efficient customs operations. It is a requirement that parties to the Convention:

- limit customs control to that necessary to ensure compliance with the law (Standard 6.2)
- use risk management in the application of customs control (Standard 6.3)
- use risk analysis to determine which persons and which goods, including means of transport, should be examined and the extent of the examination (Standard 6.4)
- adopt a compliance measurement strategy to support risk management (Standard 6.5).

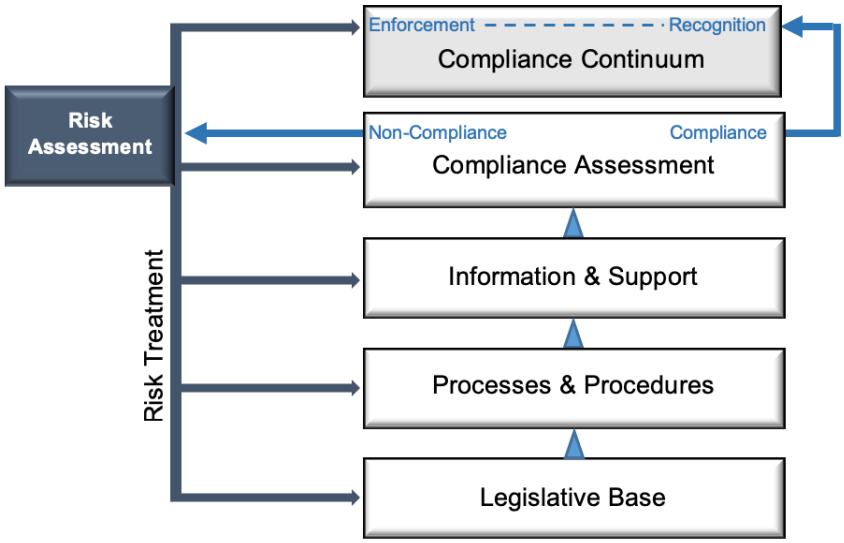
The World Trade Organization (WTO) Agreement on Trade Facilitation (WTO, 2014) also requires members to apply the principles of risk management in relation to customs control in order to avoid discriminatory practices, to focus regulatory resources on high risk consignments, and to expedite the release of low risk consignments (WTO, 2014, Article 7.4).

Note that, following the revision of AS/NZS 4360 in 2004, the joint Australia/New Zealand committee decided to promote the development of an international standard on risk management, based on its efforts to date. The resultant standard, ISO 31000 provides direction on how risk-based decision-making may be integrated into an organisation's governance, leadership, strategy, operations and culture.

3. Integrated Compliance Management Framework

This article introduces a contemporary approach that integrates the principal elements of customs risk and compliance management into a single operating framework. In doing so, it explores the manifold resources that have been developed by the WCO and other parties that may be used by administrations to support implementation of the framework. The integrated model (Figure 1) provides practitioners with a logical and systematic methodology for managing compliance in the customs context.

Figure 1: Integrated Compliance Management Framework



Source: Author

The framework incorporates the key aspects of an effective risk-based compliance management strategy, including:

- the law that is to be enforced
- processes and procedures that regulate the way in which the law is applied
- services to support the community's ability to comply with the law
- methods of assessing compliance with the law
- processes for assessing risks of non-compliance with the law
- techniques to mitigate identified risks
- strategies to address the continuum of compliance behaviour.

In essence, the framework is based on the legislation and associated processes and procedures which represent the regulatory requirements for which Customs has administrative responsibility. This includes all aspects of their direct regulatory responsibilities, including the import, export and transit of goods, as well as any matters that are administered on behalf of other agencies, such as health, agriculture, taxation, environment, statistics and in some cases, immigration. In order to ensure compliance with such requirements, there is firstly a need to make certain that members of the trading community are aware of their rights and responsibilities, by providing them with the necessary information and support to comply.

It is then necessary to assess levels of compliance through the use of various techniques such as data screening, documentary checks, non-intrusive inspection, audit and investigation, the result of which will be the identification of either compliance or non-compliance. Where non-compliance is identified, the reason for non-compliance must be established by assessing the relevant risk, leading to the identification of appropriate risk mitigation strategies, which may involve revisiting the legislative base, processes and procedures, information and support, or compliance assessment techniques, or may require some form of enforcement action. In situations where compliance is identified, the appropriate response is to actively recognise the compliant behaviour.

In practice, the level of compliance identified will form part of a continuum from criminal behaviour and fraud through to voluntary compliance. The relevant response will therefore depend on the trader's position on the compliance continuum. Enforcement strategies for identified non-compliers include warnings, penalties and other sanctions, while recognition strategies for compliers include increased levels of self-assessment, reduced regulatory scrutiny, and increased levels of facilitation.

3.1 Legislative base

In the broadest sense, the risk to be managed by any government agency is the risk to the achievement of its fundamental objective, that is, the risk of non-compliance with the laws for which it has administrative responsibility. Not surprisingly then, the starting point for the compliance management framework is the administration's legislative base, which may be very broad or quite limited, depending on the context in which the framework is being applied. For example, an administration's overall trade compliance strategy will need to encompass all associated statutory and regulatory provisions, whereas the focus of a particular customs audit is likely to be far more narrowly defined.

Regulations, often referred to as secondary or subordinate legislation, are regarded as extensions of a country's statutes, providing a greater degree of detail than would be practical to include in the primary legislation. For example, whereas primary legislation would allow duty-free goods to be sold to travellers, secondary legislation may require the duty-free shop operator to sight an approved travel document before selling the goods. In this model, both levels of regulation are included in the legislative base.

The RKC, which is designed to simplify and harmonise customs procedures on a global basis, provides a wealth of information on all aspects of customs law, both in terms of what should be included in national legislation and how it should be administered. It is also designed to facilitate legitimate trade and to ensure appropriate standards of customs control. In recognition of the fact that the focus of customs authorities is enforcement of their domestic laws, it is a requirement that member states incorporate the RKC's various conditions, formalities, practices and procedures in their national legislation (RKC Standard 1.2). Importantly, Standard 1.2 also specifies that such regulatory requirements should be as simple as possible.

The Harmonized System Convention[4] (WCO, 1986) is another important instrument that has been developed by the WCO to achieve international uniformity in the classification of goods. The Harmonized System (HS), which forms the basis of the tariff legislation in over 200 countries and economies, is relevant to a range of customs functions, including tariff classification, international trade statistics, rules of origin and tariff concessions.

The WCO SAFE Framework of Standards[5] (WCO, 2018) is also a significant policy document that builds on the provisions of the RKC by providing more specific guidance on customs policies and procedures to secure and facilitate cross-border trade. Over 170 countries have expressed their intention to implement the provisions by incorporating them into their national regulatory requirements.

The provisions of the WTO Agreement on Trade Facilitation complement those of the RKC and the SAFE Framework through their focus on particular policies and procedures that support the facilitation of international trade. These include areas such as publication and availability of information, advance rulings, customs formalities, release and clearance of goods, and border agency cooperation. It is a requirement for member states to implement these provisions through their national legislation, and to date over 120 countries have notified their intention to do so.

There are of course many other sources of international law which form the basis of national customs legislation, including the numerous instruments that form part of the United Nations treaty collection and those administered by the WTO—notably the GATT[6] and the Agreement Establishing the World Trade Organization,[7] the latter including other important elements of customs law such as the Agreement on Trade Facilitation, the TRIPS Agreement,[8] and the Valuation Agreement,[9] among others.

3.2 Processes and procedures

Regulatory processes and procedures provide further clarity and detail about how a particular law is administered and enforced. For example, in the previous section we noted that while primary legislation allows duty-free goods to be sold to travellers, secondary legislation may require an approved travel document to be sighted prior to such a sale. What constitutes an 'approved travel document' may then be further defined in administrative guidelines, which may stipulate, for example, an overseas ticket or boarding pass and valid passport.

Such guidelines, directives, operating instructions, procedural statements and the like therefore support the application of legislative provisions by specifying details such as information that must be provided to the authorities, the manner and timeframe in which it should be provided, the way in which compliance may be demonstrated, and the systems and procedures that are deemed to satisfy legal provisions. They put the meat on the legislative bones by providing the degree of detail that may not be appropriate to include in the statutes or regulations, particularly in relation to matters that may be subject to regular review.

The manner in which such processes and procedures may be determined often allows the administration a degree of flexibility in terms of the way in which laws are enforced. For example, the legislation may require traders to obtain a permit in order to import certain commodities. However, Customs may have the discretion to administer this provision in a number of different ways, depending on the perceived level of risk. Trusted traders may, for example, be granted a permit that allows unlimited importation for a period of time, whereas higher risk traders may be required to obtain permits on a shipment-by-shipment basis.

Importantly, as noted in the preamble to the RKC, customs procedures and practices should be applied in a predictable, consistent and transparent manner.

The resources available to support administrations in the design, implementation, maintenance and refinement of their processes and procedures are extensive. The best place to start is the RKC, specifically the guidelines to the General Annex and the Specific Annexes. The General Annex Guidelines cover a broad range of procedures such as clearance, duties and taxes, security, customs control, use of information technology, rulings and appeals, while the Specific Annex Guidelines address the arrival of goods, importation, exportation, warehouses and free zones, transit, processing, temporary admission, offences, special procedures, and origin.

As an example, Standard 4 of Specific Annex D requires Customs to develop requirements for the establishment and use of customs warehouses, and the associated guidelines identify particular controls that should apply, such as those related to physical security, supervision and accounting, as well as matters that should be considered when determining any specific requirements that should apply to individual premises.

The WCO SAFE Package[10] provides comprehensive guidance on practical aspects of the SAFE Framework including guidelines on integrated supply chain management, non-intrusive inspection of cargo, advance cargo initiatives, Authorised Economic Operator (AEO)[11] programs including validation guides and mutual recognition, together with a collection of best practice examples from member administrations.

Specific resources relating to the classification, valuation and origin of goods can be found in the WCO's Revenue Package,[12] which provides useful guidance on matters such as verification of preferential origin, origin certification, customs infrastructure for tariff classification, valuation and origin and technical guidelines on advance rulings.

There are many other potential sources of guidance on legal processes and procedures. All international organisations produce resolutions, decisions, declarations, recommendations, guidelines, operating directions and the like in relation to the implementation of particular treaties, conventions and standards.

3.3 Information and support

No matter how clear and predictable the law and its associated processes and procedures may be, it must be appropriately publicised if members of the trading community are to properly understand their legal rights and responsibilities. Put simply, if they don't know what the rules are, how can they be expected to comply? Providing clear information and relevant support to those who are being regulated is therefore an essential element of effective compliance management. In this regard, the regulated community goes beyond traders, and includes brokers, freight forwarders, carriers, port operators, warehouse operators and other service providers.

The manner in which regulatory requirements are publicised will vary depending on the circumstances, but a logical starting point is to provide comprehensive information on the administration's website. This should include, as a minimum, the legislation itself; details of any rulings, decisions and determinations that help inform the way in which the law is interpreted; a clear overview of relevant processes and procedures; administrative guidelines and explanatory material such as factsheets that serve to clarify such processes; and details of where further information may be obtained, including available learning packages.

An important principle of good compliance management is that, unless there are sound legal reasons to do so, the public should not be denied access to any information that is available to the administration itself. The WCO, when first introducing its Revenue Package (WCO, 2011), addressed the need for member administrations to access all applicable materials included in the package to ensure that all relevant revenue collection requirements were being met. At the same time it noted:

> It is equally important that commercial operators have access to the unrestricted information produced by the WCO and other bodies, which can assist an importer in meeting its obligations to Customs in respect of declaring and paying the correct Customs duty and to be aware of its rights and expectations (WCO, 2011, p. 1).

Similarly, a guiding principle of the RKC is that its rules and practices should be transparent and accessible to anyone who may be dealing with Customs, and that interested parties should be provided with all necessary information regarding customs laws, regulations, administrative guidelines, procedures and practices.[13] Further, while holding the declarant responsible for the accuracy of a goods declaration (Standard 3.8), the RKC requires that all relevant information concerning customs law is readily available to any interested person (Standard 9.1). The associated guidelines make it clear that the scope of such information is extremely broad:

> Such information would include the tariff classification of goods, rates of duty and taxes, valuation of goods for Customs purposes, information relating to exemptions, prohibitions and restrictions, Customs administrative arrangements and requirements, and any other pertinent information which will be of interest to the relevant interested parties (RKC General Annex Guidelines, Ch. 9, Standard 9.1).

Guidance relating to the more technical aspects of customs administration include the HS Explanatory Notes, Compendium of Classification Opinions, Harmonized System Database, HS Classification Handbook, Classification decisions taken by the HS Committee, Instruments of the WTO Valuation Committee and the advisory opinions, commentaries, case studies and explanatory notes of the Technical Committee on Customs Valuation.

On a more general note, the RKC addresses the need for information to be of high quality, accurate, relevant, clear, current and readily available; and provides examples of ways in which such information may be made available directly to interested parties as well as through more structured trade consultation processes.[14] In this regard, the Convention requires that Customs establish consultative, cooperative relationships with the international trading community in order to achieve effective operating methods that comply with relevant regulatory requirements (RKC Standard 1.3).

Other relevant standards include the requirement that, when asked for information relating to specific matters of law, Customs should respond quickly and accurately (Standard 9.4), and provide any additional advice that is considered to be of relevance to the request (Standard 9.5). Further, in relation to decisions and rulings, the Convention requires that these be notified in writing if so requested (Standard 9.8) and that if requested—and there is sufficient information to do so—such rulings should be binding in nature.

The WTO Agreement on Trade Facilitation (WTO, 2014) also provides useful guidance on the level of information and support that is expected of regulatory agencies. This includes, but is not limited to, prompt publication of information on legal requirements in a readily accessible manner; providing details of regulatory requirements, processes and procedures on the Internet; establishing enquiry points such as help desks; issuing advance rulings; and establishing appeal and review procedures. Note that, in terms of the appeal process, the RKC preamble identifies a requirement to provide easily accessible processes of administrative and judicial review to affected parties, while Standard 10.2 requires that those who are directly affected by a decision or omission of Customs should have a right of appeal.

3.4 Compliance assessment

Customs has a responsibility to enforce the law, and to do so it is necessary to firstly determine whether those who are being regulated are complying with the law. The powers that are available to officers to undertake this task are generally quite extensive. Like the laws they are assigned to enforce, the powers of officers must themselves be based in legislation, supported by formal processes and procedures, and promulgated to ensure that the public is fully aware of the administration's legal authority. (WCO, 2011, pp. 1–2).

The various methods of assessing compliance all form part of the system of customs control, which is addressed in Chapter 6 of the RKC. The Convention specifies that all internationally traded goods shall be subject to customs control (Standard 6.1)[15] and provides that such control shall be limited to that necessary to ensure compliance with the law (Standard 6.2), and that it should be applied using the principles of risk management (Standards 6.3 and 6.4). Consequently, there is a clear expectation that the various methods of compliance assessment should be applied in a way that provides legitimate trade and travel with an appropriate level of facilitation, and while physical intervention is appropriate in certain circumstances, such methods should only be used when there is a legitimate risk-based reason to do so.

The arsenal of controls that is available to Customs includes data screening and verification (generally prior to arrival); profiling and targeting; documentary checks; non-intrusive inspection; physical examination of the goods, including verification checks and analysis; leverage exercises;[16] pre- and post-clearance audit activity, including desk and physical audits; and investigations.

Analysing the results of a prudential audit is another legitimate method of assessing compliance. Such audits are undertaken by a third party at the request of a regulated entity to obtain an independent assessment of their level of compliance with statutory or other requirements. Prudential audit results may be taken into account by the regulator when assessing the risks associated with the particular entity, thereby complementing rather than replacing other forms of assessment. Accordingly, a prudential audit cannot be regarded as a mechanism for avoiding a customs audit.

In relation to audit procedures, the RKC asserts the need for these to be consistent with a country's generally accepted accounting principles (GAAP),[17] and highlights the value of the systems-based audit approach (commonly referred to as post-clearance audit, or PCA) that involves an evaluation of a trader's commercial systems and procedures. The Convention describes PCA as 'an effective tool for Customs control because it provides a clear and comprehensive picture of the transactions relevant to Customs as reflected in the books and records of international traders'.[18]

Regardless of which methods of compliance assessment are selected, they should be applied in a way that enables the administration to identify both compliant and non-compliant behaviour. As noted previously, it is just as important to identify those who are complying with regulatory requirements as it is to identify those who are not. By determining that certain members of the trading community are compliant, that is, 'low risk', the administration is able to focus its attention on those for which the risk has yet to be assessed. The WCO's AEO program, which embodies the principles of risk management, encourages administrations to actively identify low risk members of the international trading community for this reason.

Bersin (2012) uses a 'needle in the haystack' analogy to describe this principle, noting that one way to find the needle is to reduce the size of the haystack by differentiating between high and low risk consignments. It is the identification of compliant traders that enables the haystack to be shrunk in this way. Note, however, that the successful application of this strategy requires the administration to accept that a finding of compliance by the audit team is a legitimate and useful operational outcome.

The RKC provides valuable guidance on compliance assessment techniques including, but not limited to, documentary examination; physical examination and search; the identification of goods; and audit-based controls, including post-clearance audit. It also provides guidance on the necessary supporting infrastructure, including management, procedures and human resource development. In addition, the Convention provides extensive guidance on the use of information and communications technology (ICT) to support customs control.[19]

Other useful guidance on compliance assessment can be found in the WCO Voluntary Compliance Framework (WCO, 2014), which includes reference to the compliance frameworks of its member administrations. The WCO SAFE Package also includes comprehensive guidance in the context of AEO validations, including detailed validation procedures and information on best practices.[20] The WCO Revenue Package is another useful source of information, particularly in relation to its PCA Guidelines and Diagnostic Tool on PCA and infrastructure, as is the World Bank's post-clearance audit reference and implementation guide (Widdowson & Preece, 2013).

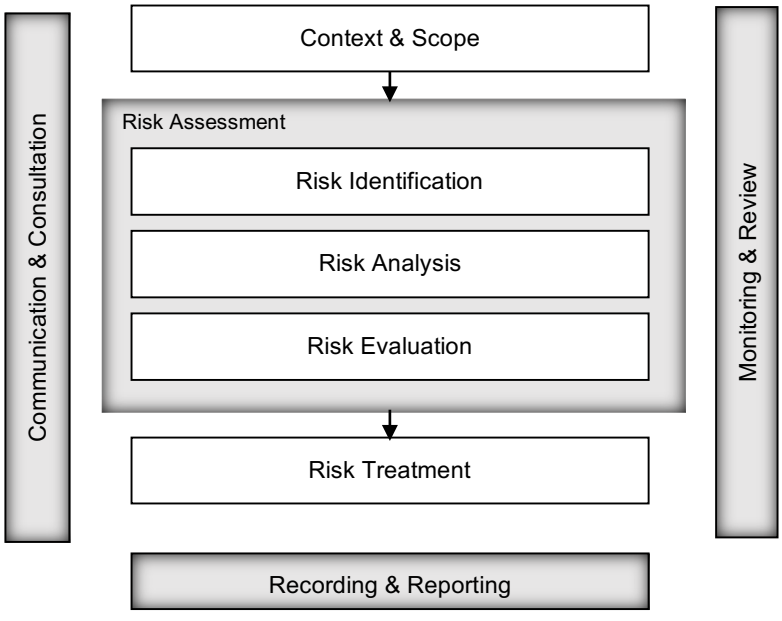
The result of any compliance assessment activity is the identification of either compliance or non-compliance. The way in which these two outcomes are addressed under the integrated framework is discussed in the following sections.

3.4.1 Findings of non-compliance

The traditional four-step approach to compliance management is to audit a company, find an error, penalise the company and leave. This achieves little in terms of improving future levels of compliance within the trading community, and is indicative of Sparrow's (2000) enforcement culture.

An effective compliance management strategy goes much further than this, by firstly seeking to find the cause of non-compliance and then identifying ways of preventing its recurrence. This is achieved through the application of the risk management process, the key elements of which are shown in Figure 2.

Figure 2: Risk management process



Source: Modified from ISO 31000 (ISO, 2018)

Context

The context and scope of the risk that is being managed is already defined by the context and scope of the audit (or other compliance assessment activity) itself. For example, the audit may be focusing on a trader's compliance with customs requirements in general, or with particular aspects of the regulations such as those relating to transit, export or warehousing activities.

Risk identification

Risk identification, which is the first step of the risk assessment process, essentially involves answering two questions:

- What could happen that may have an impact on the agency's objectives?
- How and why could it happen?

The first question helps to clarify the nature of risk while the second provides valuable information about potential causes. Note, however, that the error identified during the course of the audit (or other compliance assessment activity) has already answered the first of these questions. The next task is to determine how and why the error has occurred. For example, the company may have made an inadvertent error, its procedures may be flawed, there may be a general misconception within the industry sector about the customs treatment of certain goods, or indeed the error may have resulted from an intentional act. On the other hand, the legislation may be unclear or the administrative requirements may be ambiguous.

Risk analysis and evaluation

The next step is to analyse the risk by considering two discrete elements—the likelihood of the risk occurring, and the impact if it does in fact occur. The impact or consequence of a risk occurring is relatively easy to quantify in the context of revenue compliance, whereas in other situations there is generally a need to make qualitative assessments—for example, failure to obtain import or export permits.

Determining the likelihood of a risk occurring depends on two factors—those which Customs can control, and those which it cannot. Thus, when considering the likelihood of a risk occurring, it is important to take into account the existing customs controls that are designed to minimise the likelihood of non-compliance. When examining these factors in a criminal context, the effectiveness of existing controls is often referred to as 'vulnerability', whereas the factors over which Customs has little or no control are referred to as the 'capability' and 'intent' of the criminal organisation. In the intelligence community, the assessment of capability and intent is generally referred to as a threat assessment.

What constitutes a control regime essentially refers to the legislative, physical and information-related processes that are in place to minimise the likelihood of non-compliance. For example, when a truck crosses a border, it is required to do so at a specified location and certain formalities must be completed before the driver, the truck and its cargo are authorised to proceed. Similarly, a traveller arriving at an airport is not free to exit via the nearest gate but must follow clearly defined physical and documentary procedures before being authorised to leave the airport. In the absence of such requirements, it would be impossible to exercise any semblance of regulatory control (Widdowson, 2012).

Both the likelihood and impact of a risk are taken into account when determining the overall level of risk that has been identified. This then leads to the risk evaluation stage, which involves determining whether a risk is acceptable or unacceptable, and how the unacceptable risks are to be prioritised.

Risk treatment

Having identified the risks that require mitigation, the next step is to identify effective strategies that, in future, will eliminate or minimise the likelihood of the risk recurring, its potential impact, or both. In this regard, the appropriate mitigation strategy will depend on how or why the risk occurred. It may, for example, be necessary to address systemic problems within the company, or there may be a need to review the administration's published guidelines, or perhaps formal clarification of the law through binding rulings may be the most appropriate solution.[21] As such, one or more stages of the Integrated Compliance Management Framework will need to be reviewed.

If, for example, errors are occurring due to the complexity of the law, it may well be necessary to redraft the relevant legislation and/or the associated regulatory processes and procedures. While ignorance of the law may be no excuse, a poorly constructed, unpublicised or ambiguous regulatory framework can often explain instances of non-compliance. The need to amend the law may also arise as a result of the introduction of new government policies, and may well occur with very little warning, as was the case with the recent pandemic-driven measures to regulate cross-border trade in personal protective equipment (PPE) and other essential items. A further example is the global review of legislative provisions to adequately address new and emerging trends in international trade, such as e-commerce and blockchain technology.

The provision of information and support also represent valid risk mitigation strategies in situations where the reason for non-compliance is deemed to be a lack of knowledge, understanding, clarity or certainty on the part of the regulated community. Traders cannot be expected to comply with regulatory requirements in the absence of timely and open access to information that fully informs them of their legal rights and responsibilities.

In this context, an analysis of the errors detected as a result of compliance assessment activities may indicate the need for existing published advice to be revised, clarified or expanded; or for new guidelines or explanatory material to be promulgated. Such analysis may also demonstrate the need for the administration to enhance its use of formal decisions and rulings in respect of certain goods or activities. Equally, the results of the assessment may point to systemic flaws in the trader's systems or procedures, for which a compliance improvement plan can be developed.

Analysis of compliance assessment results may further indicate that detected errors may not be restricted to the entity that was the subject of the audit or other activity, and that other members of the trading community may be making similar errors. In such instances, it will be necessary to develop a compliance assessment plan that is designed to identify the extent of the problem. For example, the issue may be confined to a particular industry sector, or may have wider effect.

Note also that the way in which compliance assessment activities are conducted may lead to a failure to properly detect instances of non-compliance. For example, officers involved in such activities may not have the necessary knowledge, skills and competencies; there may be insufficient compliance resources, including equipment and technology; the range of available compliance assessment options may be restrictive; intelligence support may be ineffective; ICT systems may be inadequate; and operational procedures may be deficient. Equally, the compliance assessment activities may be ineffective due to poor management, including the lack of an effective national compliance management strategy upon which operational activities may be based. Consequently, ways of addressing shortcomings of this nature should also be considered when developing risk mitigation strategies.

Finally, it should be recognised that, while some non-compliers may genuinely make 'honest mistakes', others will deliberately attempt to circumvent the law regardless of how much information and support is provided, in which case enforcement strategies are required. Indeed, while the majority of traders and service providers will seek to meet their legal obligations, others will do so only in response to direct

enforcement activity, which essentially represents another form of risk treatment. Such activities are necessary to achieve compliance among those members of the trading community in whose lexicon the term 'voluntary compliance' does not exist.

Ayres and Braithwaite (1992) present a model known as the 'Enforcement Pyramid' which has been used as the basis of national customs enforcement strategies for many years. The purpose of their research was to determine the form of sanction that would achieve the highest level of improvement in compliance in different circumstances. The model provides a spectrum of compliance management options that range from persuasion, through to warning letters, civil penalties, criminal penalties, licence suspension, and finally licence revocation.

The WCO Customs Risk Management Compendium contains a wealth of practical information that will assist administrations to assess risk and identify effective risk mitigation strategies. The compendium includes guidance on developing an organisational framework for managing risk; embedding risk management in the organisational culture; risk assessment, profiling and targeting; risk indicators; and guidelines for intelligence analysis.

Other useful resources include the World Bank's Risk-Based Compliance Management Guide,[22] the WCO Enforcement Guidelines; WCO Strategic Trade Control Enforcement Implementation Guide; WCO Commercial Fraud Manual; WCO Guidelines on the development and use of a National Valuation Database as a Risk Assessment Tool; the WCO Mirror Analysis Guide, which includes case studies; and the WCO Good Practices Guide, including case studies relating to informal trade.[23]

3.4.2 Findings of compliance

As previously noted, a finding of compliance by the audit team is a legitimate and useful operational outcome. This is because, for every instance of compliance that is identified, the population of potential non-compliers reduces. The question then becomes, how should compliant traders be treated from a regulatory perspective?

It is now widely accepted that traders who are able to demonstrate high levels of compliance require a lower level of scrutiny than those with a history of poor compliance, or those about which little is known (Widdowson, 2010, p. 25). However, there is also an increasing realisation that compliant behaviour should not only be recognised through a reduction in regulatory scrutiny, but through various forms of positive reinforcement. Indeed, the WCO SAFE Framework formally recognises the need to provide benefits to compliant companies in the context of its AEO concept. According to the WCO:

> Authorized Economic Operators will reap benefits, such as faster processing of goods by Customs, e.g. through reduced examination rates... These processes will ensure that AEOs see a benefit to their investment in good security systems and practices, including reduced risk-targeting assessments and inspections, and expedited processing of their goods. (WCO, 2018, p. 5).

The WCO further specifies that such benefits should be clear, tangible and documented in order to provide members of the trading community with an incentive to seek AEO status, and to justify the costs incurred in achieving such status (WCO, 2018, Annex IV/2). As such, the WCO provides a formal link between a trader's low risk rating and the provision of regulatory benefits.

As noted by Widdowson (1998, p. 99), such an approach had previously been adopted by individual customs administrations, describing it as 'a more effective approach to compliance management which not only recognises the need to balance enforcement with assistance, but further recognises the benefits of providing industry with incentives to comply. In other words, more carrot and less stick'. However, it was the introduction of the first iteration of the WCO SAFE Framework in 2005 that legitimised the practice at the international level, thereby reinforcing the need to ensure that an appropriate balance exists between incentives for compliance and sanctions for non-compliance.

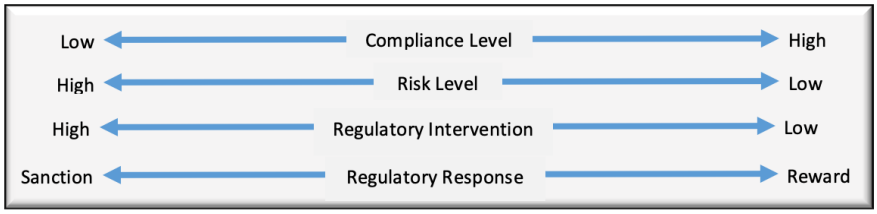
The WCO provides a comprehensive list of potential AEO benefits that its members should consider when developing their national programs (WCO, 2018, Annex IV). These include measures that are designed to expedite cargo release, reduce transit time, lower storage costs, facilitate post-release processes, and to provide support during periods of trade disruption or elevated threat levels. In addition, the WCO identifies benefits that may apply under mutual recognition arrangements[24] and specific benefits that may apply to different sectors of the industry, such as exporters, importers, warehouse operators, manufacturers, customs brokers, logistics operators, and other service providers.

Article 7 of the WTO Trade Facilitation Agreement requires members to provide trade facilitation measures for authorised operators in a manner similar to the AEO concept, although the level of guidance provided is minimal. Without referencing the WCO SAFE Framework, the WTO also encourages members to develop authorised operator schemes on the basis of international standards, even though the SAFE Framework is widely acknowledged to be the only international standard of its type.

3.5 Compliance continuum

The concept of a compliance continuum recognises the fact that some members of the regulated community will always seek to comply, while others have no intention to do so. These two 'compliance behaviours' sit at opposite ends of the compliance continuum (see Figure 3). Those who willingly comply represent the lowest risk, and those who are deliberately non-compliant represent the highest risk.

Figure 3: Compliance continuum



Source: Author

The appropriate regulatory response will depend on where the regulated entity sits on the continuum, and will range from the highest level of penalty to the highest status of AEO. Most members of the international trading community will fall between these two extremes, and the more compliant they become, the less punitive the regulatory response will be.

Ayres and Braithwaite (1992) contend that the softer regulatory approaches are likely to be employed most frequently by regulatory authorities and that, as the severity of the sanction increases, the incidence of usage is likely to decrease. Ayres and Braithwaite (1992) further argue that, as the enforcement strategy available to the regulatory agency increases in its severity, the agency is likely to be more effective in achieving compliance and is less likely to be required to resort to tough enforcement actions. In other words, as the size of the stick increases, the need to use it decreases. They further contend that self-regulation (or self-assessment) is a legitimate compliance management strategy for regulators to employ in situations where certain members of the regulated community are deemed to be relatively trustworthy, that is, pose a relatively low risk of non-compliance. Under such an arrangement, these parties are permitted to undertake their own assessment of their compliance with the relevant regulations, on the understanding that such assessment may be subjected to some form of government verification.

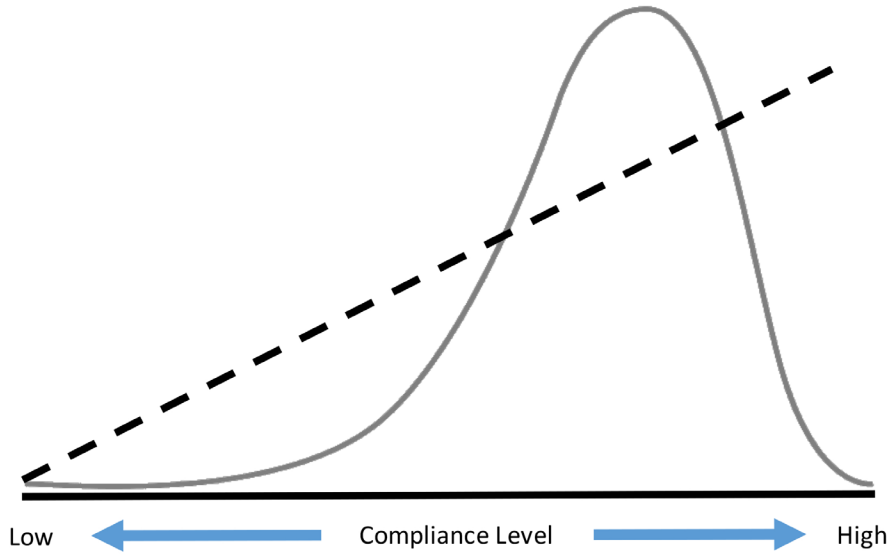
Different models are in use to map compliance strategies against a compliance continuum, several of which are included in the WCO's Voluntary Compliance Framework. In the Canadian model, for example, the compliance strategy for those who are 'willingly compliant' is one of facilitated voluntary

compliance, whereas for those who are 'purposely non-compliant', the response is one of enforced compliance. Similarly, in the New Zealand model, for 'people who are willing to do the right thing', the administration will make it easy for them to comply, whereas the full force of the law will be applied to 'people who decide not to comply'. Regulatory strategies between the two extremes come into play as compliance levels change.

The Australian model, which also maps compliance behaviour against regulatory responses, goes further by identifying the types of regulatory interventions that are considered appropriate to address certain types of compliance behaviours. For example, at the low risk end of the continuum the administration adopts a 'self-regulation' approach, using a monitoring program to oversee compliance behaviour, whereas at the other extreme an 'enforced regulation' approach is adopted, which involves investigation and prosecution. For those traders who are seeking to comply but not yet compliant, a strategy of 'assisted self-regulation' is employed, which includes a range of support services including education and advice.

Models that illustrate the compliance continuum generally depict the distribution of compliance behaviours as a straight line, as represented by the broken line in Figure 4. However, it is likely to be more appropriately represented by a skewed distribution curve, as represented by the solid line, in which the compliance levels of the majority of regulated entities are relatively high.[25]

Figure 4: Compliance continuum distribution curve



Source: Author

4. Conclusion

Several models have been developed to assist customs administrations manage compliance in a more structured and systematic way. At the same time, formal methodologies for managing risk have been established, based on what have now become international standards. However, an operational framework that explicitly integrates the two processes has not to this point been devised.

The absence of a clear procedural linkage between the management of risk and the management of regulatory compliance, both of which are critical to the achievement of effective customs control, has not only caused confusion in the application of the discrete methodologies, but has also resulted in a lack of congruence between regulatory policy and what actually occurs in practice.

The Integrated Compliance Management Framework presented in this article draws together the author's contribution to the literature over several years. It introduces a contemporary method of managing compliance in the customs context that fully integrates the principal elements of customs risk and compliance management, thereby providing practitioners with a logical and inclusive methodology for managing compliance at a strategic or operational level. In doing so, it identifies the manifold resources that are available to facilitate implementation of the framework, in particular those developed by the WCO.

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Notes

1 Intervention by exception is a term which the author first coined in the 1980s to describe a regulatory compliance strategy that is based on the principles of risk management. It later became the title of his doctoral thesis (Widdowson, 2003)

2 This followed a major review of the organisation—see Australian Attorney-General's Department, Office of General Counsel (1993)

3 The Convention on the Simplification and Harmonization of Customs Procedures (as amended), which entered into force in 2006

4 International Convention on the Harmonized Commodity Description and Coding System (with annex), as amended by the Protocol of Amendment of 24 June 1986

5 The SAFE Framework of Standards to Secure and Facilitate Global Trade was originally adopted at the June 2005 WCO Council Sessions, and has been updated several times since, the latest edition being published in 2018

6 General Agreement on Tariffs and Trade

7 Agreement establishing the World Trade Organization 1994, also known as the Marrakesh Agreement or WTO Agreement (WTO, 1994)

8 Agreement on Trade-Related Aspects of Intellectual Property Rights

9 Agreement on Implementation of Article VII of GATT

10 The WCO SAFE Package includes the SAFE Framework itself (WCO, 2018), and a range of instruments and guidelines such as Customs Guidelines on Integrated Supply Chain Management, NII Guidelines, Threats and Technology Solutions, Advance Cargo Information (ACI) Implementation Guidance, a number of AEO guidance documents, Strategy Guide for AEO Mutual Recognition, Coordinated Border Management Compendium, Single Window Compendium, Trade Recovery Guidelines, and best practice guides

11 An Authorised Economic Operator (AEO) is a member of the international trading community that is deemed to represent a low Customs risk and for whom greater levels of facilitation should be accorded (see Widdowson et al., 2014)

12 The WCO Revenue Package is a comprehensive collection of tools and instruments relevant to revenue collection including formal instruments and conventions, guidance notes and training material

13 See, for example, the Preamble to the RKC

14 General Annex Guidelines, Chapter 9, Standard 9.1

15 RKC Standard 6.1 provides that all goods, including means of transport, which enter or leave the Customs territory, regardless of whether they are liable to duties and taxes, shall be subject to Customs control

16 A leverage exercise is designed to achieve maximum compliance impact with minimum effort. For example, based on a particular finding of non-compliance in one company, Customs may contact other companies involved in similar activities, asking them to review their records and make voluntary adjustments for any errors found. Penalties are generally waived if adjustments are of a voluntary nature

17 See the Guidelines to RKC Standard 6.6

18 See the Guidelines to RKC Standard 6.10

19 See RKC General Annex Chapter 7 and associated Guidelines

20 The WCO Customs AEO Validator Guide, which forms part of the SAFE Package, is particularly useful

21 See, for example, Widdowson (1998)

22 Widdowson (2012)

23 These are available either through the WCO website, www.wcoomd.org, or directly from the WCO

24 Where two countries have a Mutual Recognition Agreement (MRA) in place, an entity's AEO status is to be recognised by the customs administrations of both economies

25 Based on preliminary research findings of the author

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