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AUTHORISED ECONOMIC OPERATORS

THE AEO COMPACT MODEL

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THE AEO COMPACT MODEL

In 2002 a Customs 2002 Project Group was established to revise the catalogue of Risk Indicators for Economic Operators and to develop a common framework for risk assessment of economic operators called COMPACT (Compliance Partnership Customs and Trade).

1 THE METHODOLOGY

Customs has a very long tradition in performing controls on shipments of goods. Also in the second half of the 20th century all goods declared were still checked by a customs officer up to 100 %. However due to the immense flow of goods and the globalisation of trade the Customs administrations of today are facing a continuous changing role. For a Customs officer it is no longer possible to check every declaration due to lack of capacity in relation to workload. And even if it would be possible, it would neither be necessary nor desirable. The exercise focused on the use of modern risk analysis methods and audit based controls, thereby reducing compliance costs for the legitimate Trade. In doing so the Customs will contribute to the competitiveness of EU operators on the world market and at the same time allocate the customs resources where they are most needed.

One of customs main tasks is to assess risks in the flow of goods. Risks are those factors that could influence Customs objectives. In pursuing those objectives it is important to have good knowledge of the risks that we face and the impact they might have on the objectives. The Customs administrations in the Member States have opted to base the control on economic operators on the basis of risk management. The purpose of using risk management is to aim Customs' control activities on risks rather than on random selected aspects or declarations.

In using risk management Customs takes into account the measures that the operators themselves have taken to prevent risks in their business processes. Customs administrations want to aim their limited capacity in particular towards risks that are not or not sufficiently covered by measures taken by the economic operator. In order to be able to follow that approach it is necessary to create a good picture of the economic operator, it's business processes and the measures the operator has taken to reduce the risks in fiscal and non-fiscal processes including the supply chain. Customs therefore have to assess the economic operator's organisation, processes, procedures, administration, and so on. In short the operator's administrative organisation and its internal control system must be assessed.

The COMPACT framework is a methodology to perform such an assessment. Not only on a national level, but also on an international level, when more countries are involved.

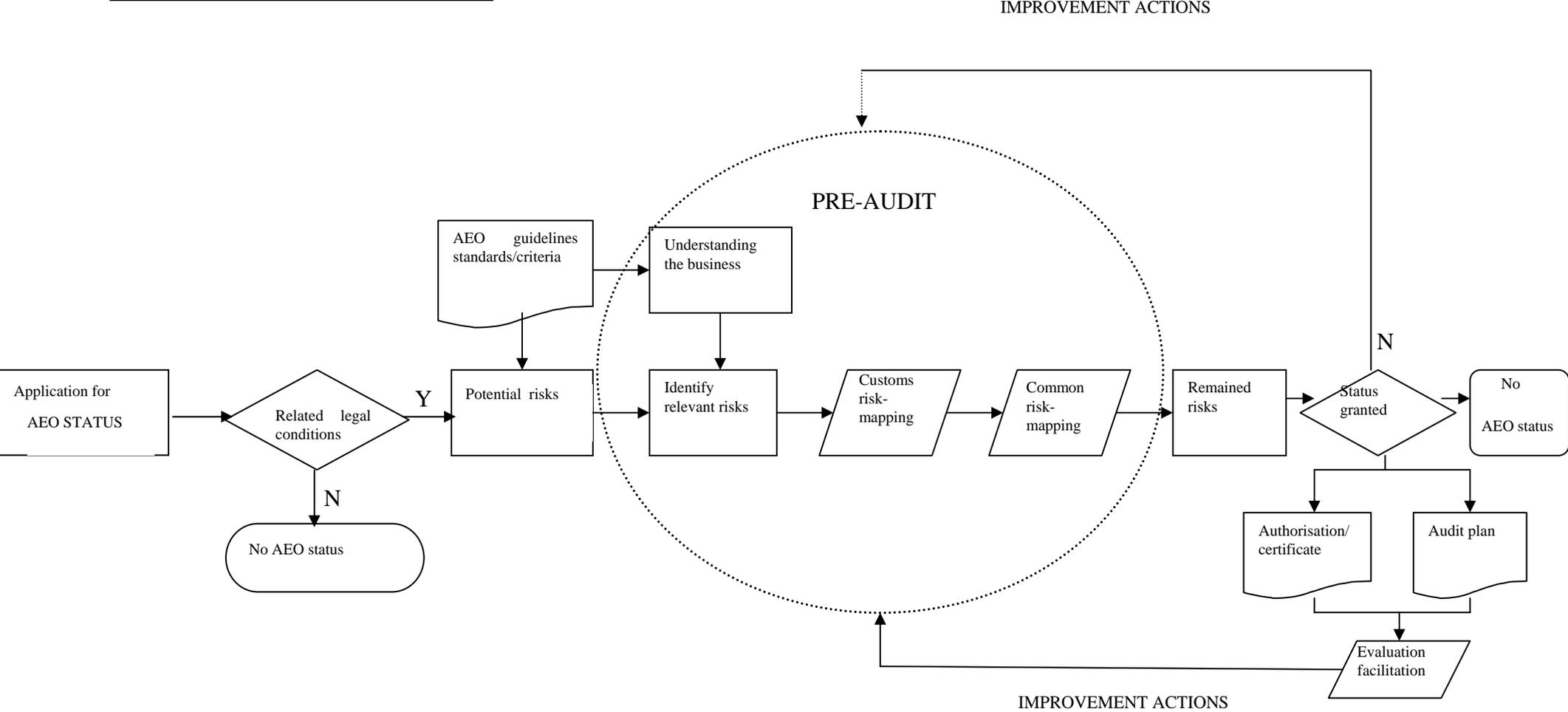
It is a flexible tool that can be used not just in the protection of the fiscal interests of a Member State or the Community, but also in the protection of the non-fiscal interests such as the protection of the external frontier of the Community (e.g. Supply Chain Security and Anti Smuggling).

Integrated parts of the AEO COMPACT Model are the Risk Mapping method described in this document and the guidelines on standards and criteria. The economic operator applying for AEO status shall implement, in conformance with its business model and risk analysis, the systems, the procedures, conditions and requirements established in the Community Customs Code and the guidelines on standards and criteria.

Customs and the economic operator shall work cooperatively toward realizing the commitment of the applicant in the risk assessment work outlined in this document. The customs authorities must audit that the applicant satisfies the requirements relevant for its business and established in the Community Customs Code.

- The framework can be used by customs officials to determine whether potential risks are relevant (or not) in respect of the individual economic operator and its business processes.
- The framework is also a tool to establish the operator's compliance and the consequent control level customs have to put in place to control the individual economic operator.
- The framework is meant to perform a pre-audit. The aim of a pre-audit can be to investigate whether an application for status of Authorised Operator and the possible simplifications and facilitations can be granted.

THE AEO COMPACT MODEL



2 THE STEPS OF THE FRAMEWORK

The COMPACT framework is divided into a number of different phases, which are described in the following paragraphs. The phase described below might give the impression that each phase is an isolated phenomenon. In practice these phases often merge into each other, e.g. regarding the dialogue between customs and trade.

2.1 Application for receiving the AEO status

Has to be completed when the final legal text is agreed.

2.2 Related formal conditions

The first step in the process of dealing with the application is that customs authorities have to determine whether the formal conditions related with the procedure or facilitation in question are fulfilled. This step can be taken relatively quick. If the applicant can not fulfil the formal conditions, the application must be refused. In such a case there is no need for the customs authorities any more to go through the whole assessment process.

2.3 Guidelines on standards and criteria

2.3.1 The content of the guidelines

As stated before the tables in this document listing the risks and requirements are an integrated part of the AEO COMPACT framework.

The guidelines contain standards and criteria divided in five sections:

- 1) Company's information
- 2) Compliance record
- 3) The Company's accounting and logistical system
- 4) Financial solvency
- 5) Safety and security requirements

Each section is divided in a number of sub-sections. For example Section V – Safety and Security Requirements consists of sub-sections: 5.03 Physical security areas; 5.07 Storage of goods and 5.11 Personnel security. In each of the sub-sections one or more areas of attentions listed.

All risk indicators are linked to a risk description and points of attentions which should guild the customs officials as well as the operators in doing the appropriate assessment of the risks. The points of attention can be used to detect if risks are actually relevant for a specific individual operator and to investigate what measures that operator has taken to deal with these risks. In the pre-audit process the guidelines are an instrument of great importance.

2.3.2 The dual purpose of the guidelines

The guidelines on standards and criteria can be used in two ways.

The first possibility is, to send provide the guidelines to the operator, who will then be able to do a self-assessment and prepare a profile of his business processes and the supply chain aspects in particular. The profile can then be compared by the customs authorities to the actual situation. It depends on the expertise and skills of the operator's staff if this option can really be effected. The second possibility, is that the customs authorities use the

guidelines to determine which aspects must be investigated during the pre-audit. In this case the customs auditor himself seeks for the answers to the questions.

Although the guidelines have been developed as a common instrument, it is so flexible that it is possible to add specific national risks to the common risks. In that way it is possible to cover differences in local or regional aspects.

2.4 The risk mapping process

2.4.1 Introduction

As described before, the assessment of the operator's risks is the cornerstone of the COMPACT framework. This assessment can be done by using the risk mapping method. Within the business community the risk mapping method is used to a great extent. Also the Customs can benefit by developing the risk mapping method to be used as a systematic method to the assessment and judgement of risks. Furthermore, a systematic approach is also needed to determine in what way a certified operator should be controlled and evaluated afterwards.

The method is meant to prioritise risks by evaluating the likelihood and impact risks will have on the Customs' objectives. It is a method that structures and supports the weighing and judging of risks. By using the risk mapping approach together with measures expressed in the COMPACT framework you will have a structured approach aimed at risk identification, risk assessment, control approach and the evaluation for continuous improvements.

The risk mapping process originally consists of five basic steps:

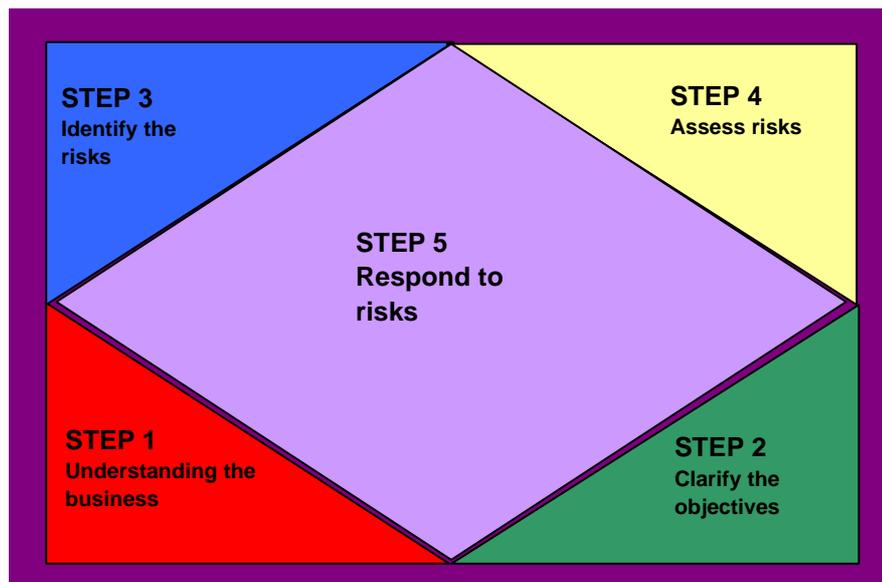
Step 1; Understanding the business (of an operator),

Step 2; Clarify the customs' objectives,

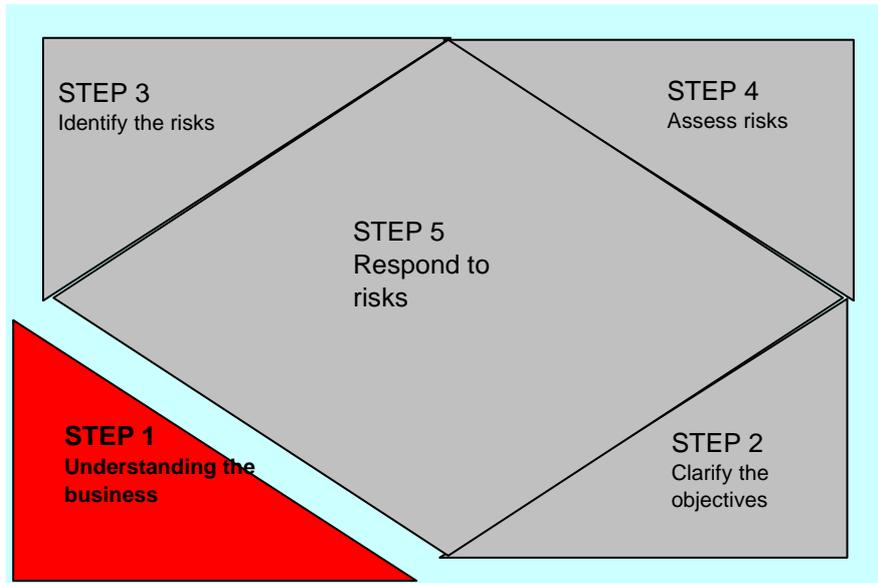
Step 3; Identify risks (which risks might influence the customs' objectives)

Step 4; Assess risks (which risks are the most significant)

Step 5; Respond to risks; what to do about the (remaining) risks.



2.4.2 STEP 1 *Understanding the business*



Customs authorities must gain insight into the operator's business. An essential part of understanding the business is having a clear view on the operators processes (the logistical chain of goods consignments). In which business environment he operates (e.g. processes, goods, procedures used).

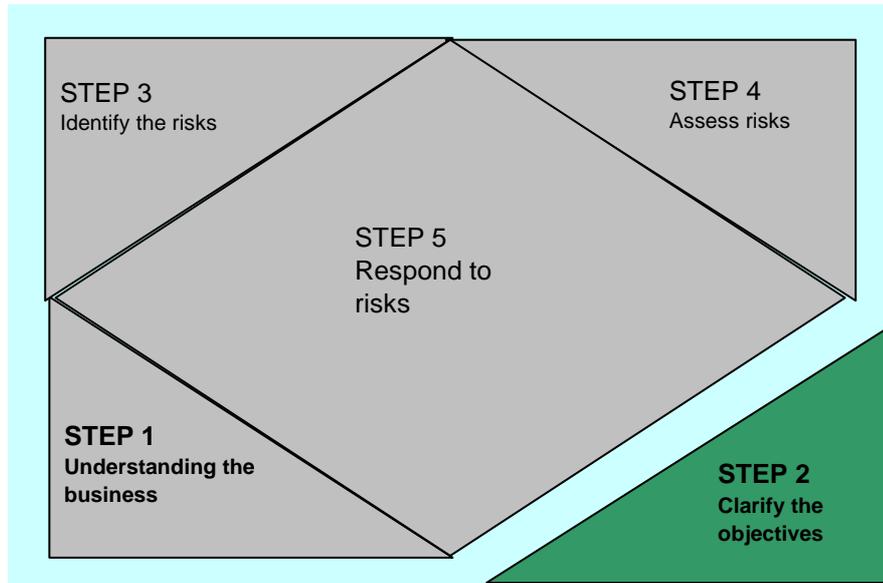
To support the understanding of the business of the operator, applying for AEO status, several sources are available. Internal as well as external sources can be used.

- Examples of internal sources, of course depending on the local/national situation, customs has access to. Sources can be, the VAT or other information from the tax services; Intrastat databases; information gathered in the past through customs import and/or export systems; previous audit reports; records on customs authorizations and intelligence databases.
- Examples of external sources; Chambers of Commerce, Statistics, published annual reports, the operator's website and last but not least information from the operator himself.

In particular the first section of the guidelines is providing the indicators for collecting the right information to get the necessary insight into the operator's business. Other ways to obtain information are the performance of interviews, and the search for documented proof in the operator's administration.

It is important that the obtained information is properly documented and recorded.

2.4.3 STEP 2 *Clarify the objectives*



Not all requirements and sub-sections in the guidelines are of interest for each operator. In the introductory part of the guidelines the different responsibilities of the stakeholders in the supply chain are described.

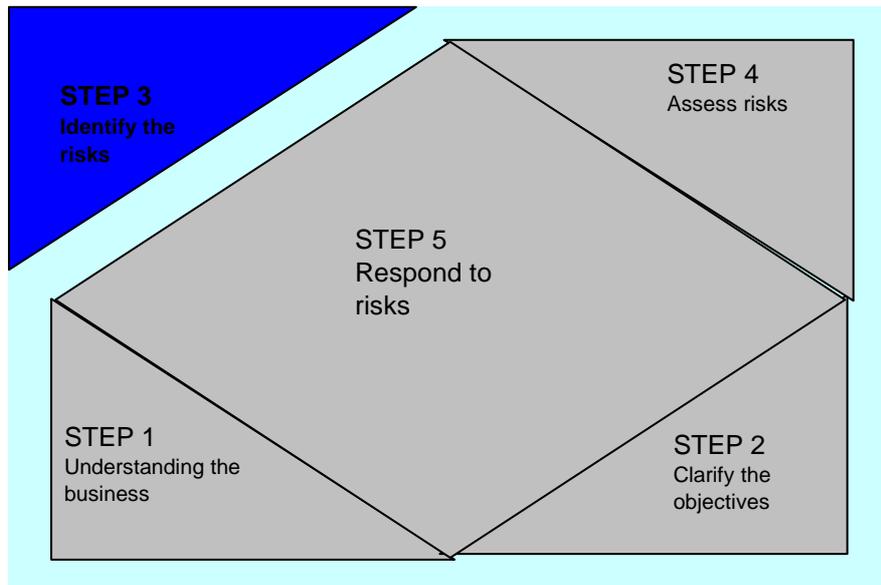
In general: whether risks are relevant must be judged in view of the objectives of the customs organisation and the kind of facilitation and benefits that the operator is applying for.

The objectives of the customs organisation are in first formed by the assurance that customs wants to have on the implementation of the fiscal as well as the security requirements. These are common objectives laid down in the Community Customs Code. The objectives are becoming more specified in relation with the facilitation and benefits the operator is asking for.

In clarifying the customs objectives of the AEO process to the economic operator, the customs authorities can decide to work with a team that can be set up to work together during the certification process. The team should consist of experts, e.g. in the field of legislation and (EDP) auditing.

When the objectives are clarified they can be explained to the economic operator in order to determine that the economic operator expectations are in line with what the AEO programme requires and offers.

2.4.4 STEP 3 *Identify Risks*



"Risk" means the likelihood of an event occurring, in connection with the entry, exit, transit and end-use of goods moved between the customs territory of the Community and third countries and the presence of goods that do not have a Community status which

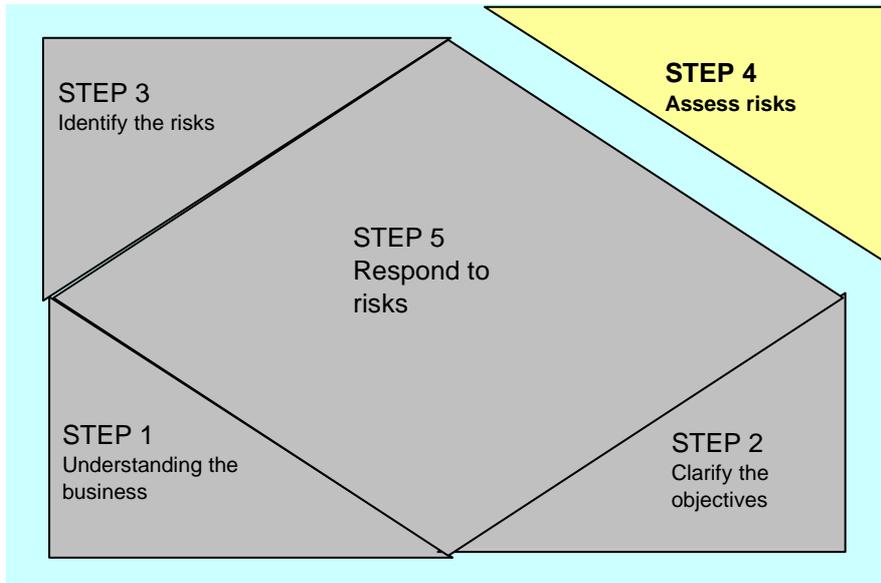
- Prevents the correct application of Community of national measures; or
- Comprises the financial interests of the Community and its Member States; or
- Poses a threat to the Community 's security and safety, to public health, the environment or to consumers.

When the Customs authorities have an operator in focus and the objectives are clear, they can determine whether potential risks are relevant for that specific individual operator. Also they can form an opinion of the measures that the operator itself has taken to deal with these risks.

Potential risks are risks that exist from a theoretical point of view. When we speak about potential risks, we do that from a general point of view. Potential risks are not related to an individual operator. The individual operator is not in focus. Inventory of potential risks does not have to be repeated each time. It can be done once and then used in all subsequent cases. The project group has made this inventory. The risk indicators and the corresponding points of attentions in the guidelines form together the potential risks.

In the further process it is important to identify those risks which are related to the particular operator and its business processes. It is therefore essential to understand the details of the business processes of the operator. From/to who do they import/export, what do they import/export, whom are they business partners, and in which parts of the supply chain do they operate. Good attention should be given to the information that is relevant and relate the information to risks that may occur in the situation/procedure opted by the operator.

2.4.5 *STEP 4 Assess risks*

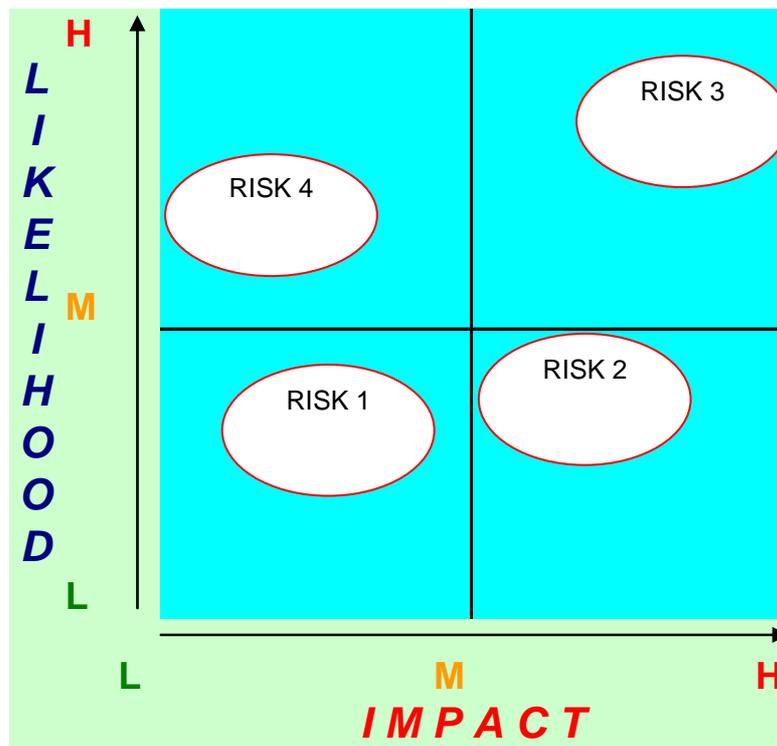


The risks identified in Step 3 should be assessed by prioritising risks through evaluating the impact on customs objectives and the likelihood of the risk materialising.

This approach makes it possible to aggregate the risk into a big (and comprehensive) picture and establish the relative relationship between risks in terms of significance. At this stage it is essential to determine to what extent the operator himself has taken measures to cover identified risks and in which way the operator prioritised different types of risks (also the operator has interest in having a structured approach for risk identification, assessment and response to risks).

As previously mentioned, involving specialist as for instance in the field of legislation and (EDP) auditing are essential/desirable for this step. Knowledge and perspective will vary especially between people with different functions within the customs administration. Once the risks are identified as relevant and assessed, they can be placed on a risk profile to provide a comprehensive picture of all significant risks. The different risks are mapped in terms of their impact and likelihood of occurrence.

Although the assessment of the risks is not always quantitative, the risk map will provide a certain degree of transparency into the risk environment of the operator in relation with the customs facilitation.



L = Low

M = Medium

H = High

Once the risk profile has been created it is important to step back and reflect on it.

- ✓ Does it make sense from an intuitive point of view? Does it cover all relevant risk areas in the checklist?
- ✓ Do you need to quantify any of the assessments for particular risks?
- ✓ Has the comprehensive picture of all significant risks changed drastically from previous mapping on the operator in the past and if so, why?

After the internal assessment it is necessary to share the outcome of the internal assessment with the operator to assure the correctness of this assessment.

By using the risk mapping approach as simple as possible in terms of the working performance, it is desirable to separate the risk mapping method into a two actions by performing the **mapping internally** (within customs) first, followed by a **common mapping** (together with the operator) in which the customs eventually has to come to a decision where to set the risks and how to respond on these.

The reasons for separating the risk mapping method are the following:

- Easier to make up your own judgement
The customs officials have the opportunity to make their own judgement without any need to take all steps that follows in the process immediately.
- More structured
Provides a structured way to document how risks are moving in one or another direction from the initial till the common (final) mapping.
- Supports the officials performance
It will make it easier for the customs officials to get knowledge of how the framework works and what to do in the different steps, avoiding any potential confusion.

- Encourage transparency and partnership
By splitting the method both Customs and Trade are encouraged to work together as it gains both parties to take proper actions towards risk identified and having a transparent documentation thereof.

It is necessary to make a structured and proper documentation of the contents of the assessment made, in particular it should be documented why a specific risk was assessed at a particular level, to follow possible (positive/negative) developments of a risk.

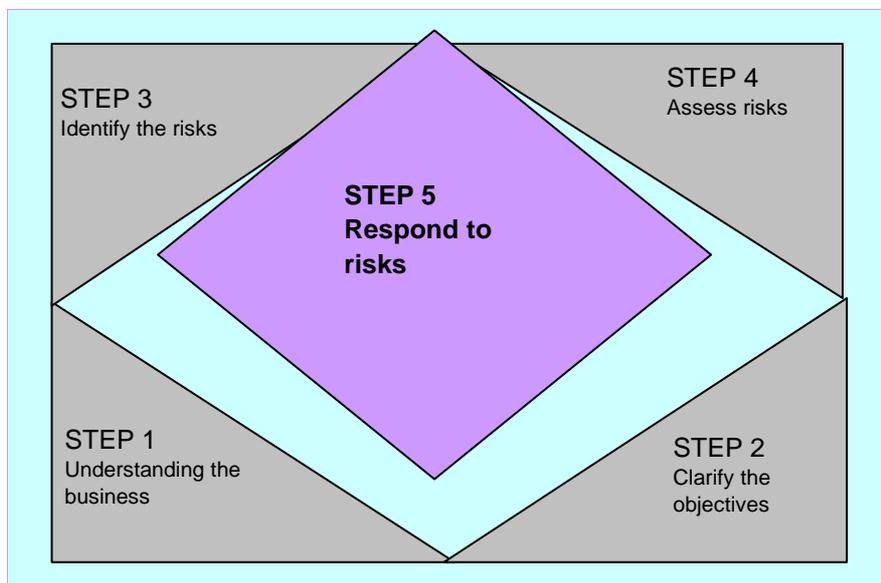
For validating the risk it is important that the processes described in writing are verified in practical, for financial aspects that can be covered with random sample checks in the operator's administration but most of the security aspects should be verified through physical verification again on a random basis.

Once all relevant risks are mapped and completely documented in the Customs risk mapping phase, the common risk mapping can take place. This starts with presenting and discussing the outcome of the customs risk mapping with the operator. After that must be determined whether the assessment made within customs corresponds with the current situation (i.e. finally determining to what extent the operator himself has taken measures to cover identified risks and also in what way the operator prioritises different types of risks internally).

Finally a decision must be taken about the weaknesses and strengths of the operator's AO/IC in terms of general as well as procedural aspects and place each identified risk in terms of its impact and likelihood.

After all relevant risks are assessed, including the operator's own measures regarding these risks, there may be some risks not (sufficiently) covered. This we call **the remained risks**.

2.4.6 STEP 5 *Respond to risks*



Risks are part of doing business. It is the intention that the customs administration understand the significant risks, set boundaries for risk taking and applies (tailor made) risk responses.

Granting the AEO status with the consequent facilitation/simplification can start in theory if all risks can be covered. If not, there must be an evaluation whether the status is to be rejected or adjustments or improvements are to be made by the operator to cover the risk or to reduce it to an acceptable level.

Responses to risk utilise one or several of the following strategies:

TAKE	= within the acceptable materiality
TREAT	= audit plan
TRANSFER	= guarantee
TERMINATE	= rejecting the facilitation

Take the risk

To some extent there is a degree in every response to most significant risks. Some risks can not be avoided, some risks can be practically and affordably reduced to zero likelihood/zero impact. For example it is physical impossible to check all exports shipments to third countries. Whenever risk taking is significant, it should be explicitly stated, understood and approved by an appropriate level of management.

Treat the risk

Because the response to significant risk will be active rather than passive there will be some degree of treatment in the response to significant risks. By treating risks, the aim is to change the likelihood and/or impact of a recognised risk in order to achieve the customs objectives. In the evaluation provided that the customs facilitation is possible, it can be considered that significant risks can be (effectively) reduced by specific administrative or audit measures carried out by customs. These must be described and planned in a control/audit plan.

Transfer the risk

Sometimes it is possible to transfer risks to another party. For example, an operator can transfer the risk of unauthorized access to a surveillance company. Agreements made between the company and the third party involved have to be examined and assessed.

Terminate the risk

Risk can be avoided by intense controls and/or regular audits or even not granting the status.

A “fit for purpose” risk response will combine various strategies and mechanism to achieve the desired results.

2.5 Granting the AEO status

When the pre-audit process is completed through the five steps, the following conclusions can be possible:

- (1) There are no remained risks or if the remained risks can effectively and efficiently be covered by additional control measures, **the AEO status can be granted**. When after the (first or second) pre-audit the decision has been made that the AEO status can be granted, customs issues the authorisation/certificate to the operator. If necessary specific working agreements are added to the authorisation/certificate.
- (2) There are too many remained risks or the remained risks are too big to cover them effectively and efficiently by additional control measures but it is possible for the operator (and the operator is willing) to undertake improvement actions regarding the administrative organisation and the internal control system, in this case **granting of the status is not possible at that time**, but it may be possible after the operator has undertaken improvement actions. These improvement actions must be checked by Customs in a (second) pre-audit (including the common risk mapping procedure) to establish if the remained risks from the first pre-audit are now covered in a sufficient way and in the end the status might be granted.
- (3) There are too many remained risks or the remained risks are too big to cover them effectively and efficiently by additional control measures and it will not be possible for the operator (or the operator is not willing) to undertake improvement actions regarding the administrative organisation and the internal control system, in this case **the status will not be granted**.

It is desirable to make this final assessment in a team. Important is good documentation why the risks have been set, where they are in the mapping and/or why the risks have moved in one or another direction in the map, is of vital importance.

2.6 Lower risk score for AEO's

In the future processes of customs controls it will be necessary to identify an economic operator as an AEO, which in the end might lead to a lower risk score. An AEO data base will not be ready yet therefore something a document will be uploaded at the AEO site of CIRCA on which the member states can mention the AEO certificate number.

The national contact points have to transmit these numbers to the national risk analysis centres which can incorporate the numbers in their risk analysis systems with as consequent a reduced risk score.

2.7 Audit plan (control approach)

Customs must draw up an audit-plan describing the way in which customs intends to respond to the risks identified. All intended control measures, checks on declarations, physical inspections of goods and/or audits, that will be carried out by customs should be described and planned in the audit-plan. The results of the control activities must be documented.

A client coordinator should be appointed after a company has got the AEO-status to take care of the ongoing risk management. Supervision can for instance consist of regular reviews of general and specific company data. Should any changes regarding company behaviour or trade pattern occur, the client coordinator evaluates, whether the company should be contacted.

2.8 Evaluation

It is of great importance that the status and benefits granted to the AEO are evaluated on a regular basis. A number of elements play a role when the evaluation can take place:

- The results of the control activities as described in the audit plan.
These results can give an indication that risks are no longer sufficiently covered by the operator. The customs authorities should evaluate the results of the control activities on a regular basis. This may result in adjustments of the control approach or in the approved facilitation used.
- Signals from the operator about changes in its activities, organisation, procedures, etc. The AEO is legally obliged to inform the competent customs offices of significant events which could affect his certificate, including the cases when there is a change in the condition of access to information or in the way the information is made available.
- Other general or specific information that may have an impact on the facilitation granted to the operator.
- It is necessary that Customs authorities check thoroughly that the operator is still in control of the risks. Are there any new risks? Is the quality of the administrative organisation and the internal control system still as good as it was during the time of the pre-audit. For this reason Customs authorities must from time to time perform an evaluation audit.
- If (one of the elements of) the evaluation leads to the conclusion that the operator is not or no longer in control of one or more risks, customs informs the operator about that conclusion. The operator then must undertake improvement actions. It is the customs duty again to assess these improvement actions. In the ultimate situation this can also lead to the conclusion that the AEO status should be suspended or withdrawn.