

The Auditor-General
Audit Report No.18 2005–06
Performance Audit

Customs Compliance Assurance Strategy for International Cargo

Australian Customs Service

Australian National Audit Office

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of Australia 2005

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Canberra ACT
30 November 2005

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Customs Service in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Customs Compliance Assurance Strategy for International Cargo*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

ACA	Air Cargo Automation System
ATO	Australian Taxation Office
CBT	Compliance Benchmark Testing
CCAS	Customs Compliance Assurance Strategy
CDMS	Client Data Management Strategy
CEF	Container Examination Facility
CMR	Cargo Management Re-engineering
COMPILE	Customs Online Method of Preparing from Invoices Lodgeable Entries
CRA	Cargo Risk Assessment
Customs	Australian Customs Service
CVAL	Customs Value
DVE	Declaration Validation Examination
EDN	Export Declaration
EXAMS System	Examination Data Management System
FOB	Free on Board
HVLV	High Volume/Low Value
ICS	Integrated Cargo System
IDIVE/EDIVE	Import/Export Data Integrity Variances and Errors
INS	Infringement Notice Scheme
NPC	National Priorities Committee
PWA	Post Warrant Amendment
QA	Quality Assurance
RI&I	Risk Identification and Intelligence
RPC	Regional Priorities Committee
SCA	Sea Cargo Automation System
UPE	Unaccompanied Personal Effects

Summary and Recommendations

Summary

Background

1. In 2004–05, Australia imported over 7.3 million cargo consignments¹ valued at approximately \$149 520 million and the Australian Customs Service (Customs) collected \$7 929 million in customs duty and taxes. For the same period, 1.3 million cargo consignments² valued at approximately \$126 720 million were exported.³ In 2005–06, imports are expected to grow by about 8 per cent and exports by 7 per cent.⁴
2. Customs is responsible for regulating the movement of goods and people across our border and collecting customs duty and other revenue. In this context, Customs plays a vital role in preventing illegal and harmful goods from entering Australia. It has to balance this community protection role with the need to ensure the legitimate movement of goods is not unnecessarily impeded.
3. Not every consignment of goods that enters or leaves Australia represents a risk to Customs' border controls. Customs' experience has been that the vast majority of importations are legitimate. A small number will however contain prohibited and restricted items.⁵ Similarly, most importers will pay the correct customs duty and taxes, with only a small minority misreporting, undervaluing or misdescribing goods to avoid paying duty and/or taxes. Customs adopts a risk management approach and has in place systems and processes for risk assessing, targeting and examining cargo.
4. Customs advised the cost of all compliance activities in 2004–05 was \$91.6 million and involved 455 full time equivalent staff. Customs Compliance Assurance Strategy (CCAS) provides a framework for these activities.

¹ Generally, the size of import consignments are smaller with fewer bulk commodities compared to exports. Exports have a higher proportion of high value consignments.

² Figure is based on the number of export declarations issued.

³ Australian Customs Service, *Customs Figures Australian Customs Service Quarterly Statistical Bulletin* June 2005, Issue 39, pp. 15, 27, 29, 32, 60, 63.

⁴ Budget Paper No. 1, Statement 3: Economic Outlook, Overview [Internet]. Australian Government Budget 2005–06, available from <<http://www.budget.gov.au/2005–06/bpl/html/bst3–02.htm>> [accessed 18 July 2005].

⁵ Prohibited and restricted items include: illicit drugs; weapons; pornography; unsafe products; therapeutic goods; wildlife; quarantine items; and items that breach intellectual property rights.

Customs Compliance Assurance Strategy

5. The CCAS is designed to provide assurance that industry and the international trading community are complying with legislative requirements in an environment that is largely self-regulated. The Strategy is intended to focus resources and activities on areas of risk, with a management and planning structure that is driven by intelligence and analysis. Specifically, the CCAS aims to provide the Government and the community with confidence that:

- reporting of all cargo and vessels entering or leaving Australia is accurate and timely;
- licence and permit requirements, prohibitions and restrictions in relation to imported and exported goods are complied with;
- the correct amount of revenue is paid or identified for collection or consideration⁶;
- community protection programs related to imported and exported goods are effectively implemented; and
- accurate and reliable data on trade statistics is provided to Customs.⁷

6. Customs undertakes compliance activities in the international cargo environment in a manner that reflects how cargo moves, the nature of the consignment, who has responsibility for that cargo, and the way clients interact with Customs. Under this approach, the international cargo environment is categorised into four segments: owners; service providers; cargo handlers; and carriers. These segments form the basis for risk assessing clients and consignments, the planning of compliance activity and delivery of compliance programs in the regions by Compliance Assurance teams. Customs' activities are aimed at encouraging compliance. Intervention by Customs is proportional to the assessed level of risk.

7. The CCAS articulates the increased emphasis being given to undertaking real time compliance activities. This change in focus followed the Business Re-engineering Project, which Customs completed in October 2002 to

⁶ Consideration is where a liability has been established but the duty and/or taxes have not been collected such as the deferred Goods and Services Tax.

⁷ Australian Customs Service, *Customs Compliance Assurance Strategy*, p.2.

establish the right organisational structure to deliver the Cargo Management Re-engineering project.

Audit objective and scope

8. The objective of the audit was to assess the administrative effectiveness of the CCAS. The audit focused on the following key areas:

- targeting non-compliance;
- real time compliance activity;
- post transaction compliance activity; and
- planning and performance evaluation.

9. As the imports phase of the Integrated Cargo System (ICS) was only introduced in October 2005, this system was not reviewed as part of the audit. Our audit programme for 2005–06 includes ICS as a potential audit topic.

Audit findings and overall conclusion

Targeting Non-Compliance – Chapter 2

10. Industry is required to give Customs advance notice of cargo being imported into Australia.⁸ The timely and accurate reporting of cargo information⁹ is crucial if Customs is to effectively target high-risk consignments and those that do not meet legislative requirements. In an effort to improve cargo reporting Customs implemented its Cargo Reporting Compliance Strategy in April 2003.

Cargo Reporting Compliance Strategy

11. The strategy initially focused on the timeliness of sea cargo reporting and was extended to include air cargo reporting in March 2004. It involves undertaking exercises to educate and raise awareness, monitoring the performance of reporters to identify non-compliance and developing intervention strategies. The ANAO found that all regions have effectively implemented the strategy.

⁸ Under the *Customs Legislation Amendment (Airports, Ports and Cargo Security) Act 2004*, sea cargo must be reported 48 hours prior to the vessel's arrival at the first Australian port and air cargo two hours before arrival at the first Australian airport.

⁹ Cargo is reported by owners, service providers and carriers.

12. The ANAO found that the strategy initially improved the timeliness of sea cargo reporting. For those cargo reports received 48 hours prior to vessel arrival, the national average increased from 72 per cent in 2003 to 76 per cent in 2004.¹⁰ However, the legislative change (which came into effect on 13 January 2005) requiring vessels to report prior to arrival at the *first Australian port* rather than port of discharge, impacted on compliance levels. The national average dropped to 70 per cent in 2005. The timeliness of air cargo reporting improved slightly, with the national average increasing from 78 per cent in 2004 to 81 per cent in 2005.

13. Customs is extending the focus of the strategy to include the accuracy of reporting. Reporting the movement of cargo also changed in October 2005 with the implementation of ICS and Trade Modernisation legislation. The legislation is designed to provide greater flexibility for industry and to address the problems of late, deficient, inaccurate or non-existent reporting that have undermined Customs ability to risk assess cargo. Changes include mandatory electronic reporting, cascade reporting¹¹ and sanctions for late or inappropriate reports. There is a six-month moratorium on applying reporting penalties. Given the extent of these changes, the ANAO considers that the Cargo Reporting Compliance Strategy should be reviewed, 12 to 18 months after the introduction of ICS.

Selecting non-compliant targets

14. The ANAO found that Customs has well-developed systems and processes for risk assessing and targeting cargo consignments. The information contained in cargo reports, import declarations (or customs entries) and export declarations (EDNs) is assessed to identify high-risk and non-compliant targets using a combination of risk indicators and system profiles.¹² Risk profiling and target development are interdependent and rely on high quality and current intelligence.

¹⁰ When the strategy began the focus was to improve reporting in preparation for ICS and this was to be 24 hours prior to vessel arrival at the port of discharge. The national average for cargo reports received 24 hours prior to vessel arrival increased from 85 per cent in 2003 to 87 per cent in 2004.

¹¹ Cascade reporting allows cargo reporters to nominate other parties who will be responsible for providing further cargo report details.

¹² Risk indicators can be information such as the origin of the consignment, the port of loading or description of the cargo, which alone, or in combination, suggests a consignment presents a risk. Risk indicators are the basis for developing system profiles.

Intelligence framework

15. Customs' Intelligence Philosophy sets out what strategic, operational and tactical intelligence is, for whom it is produced and why it is needed. The Risk Identification and Intelligence (RI&I) Branch (in Central Office and the regions) is the focal point for Customs intelligence activity. The ANAO reviewed the intelligence activity that supports the CCAS.

16. The ANAO found that, although the Compliance Assurance teams and RI&I analysts may have an understanding of the broad risks facing Compliance, there has not been a systematic analysis of the results of compliance activity at the operational and tactical levels to identify risks and emerging trends. To address these issues, Compliance Operations and RI&I in Central Office are undertaking an environmental risk analysis project to assess the compliance risks within the international cargo environment. Although this project is designed to identify risks from a national perspective, the ANAO considers that, where this project identifies risks that are relevant to specific regions, these risks should be evaluated at the regional level and appropriate compliance strategies developed.

RI&I intelligence support

17. The ANAO found that there was confusion surrounding the roles and responsibilities of RI&I and Compliance Assurance and concern regarding what is perceived as a lack of intelligence support being provided by RI&I to Compliance Assurance teams. Currently, intelligence support involves Compliance Assurance teams tasking RI&I to undertake research for planned audit/compliance activity or into particular industry segments. There is minimal information sharing between the two groups. Compliance Assurance teams provide little feedback to RI&I analysts on any of the work they undertake or the compliance activities completed as part of the CCAS. The current approach is fragmented and is not meeting the expectations of either Compliance Assurance or RI&I.

18. To address these concerns, the Victorian region has undertaken joint risk assessment and planning workshops to develop their 2005–06 work programs and outposted RI&I officers to work with the Compliance Assurance teams. The ANAO suggests that other regions consider adopting this approach. Formal feedback mechanisms should also be established so that the results of all compliance activity are analysed and incorporated into intelligence assessments, profiles and planning processes.

Real Time Compliance Activity – Chapter 3

19. The CCAS includes undertaking compliance activities in real time. This involves Customs risk assessing the information provided in import declarations, EDNs and unaccompanied personal effects (UPE)¹³ statements as they are received. Customs then determines whether the cargo will be released immediately or if further verification/examination is required.

Real time assessments

20. The ANAO considers that Customs has well-developed systems and processes for assessing and examining import declarations in real time. When an import declaration is received, the cargo data is matched against compliance risk profiles¹⁴ and sorted into two groups: green or red line entries. Green line entries are automatically cleared whereas a hold is placed on red line entries preventing the goods from being released. In 2004–05, Customs received 3.5 million entries, of which approximately 65 000 (1.9 per cent) were red line. The ANAO attempted to further analyse the volume and value of red line transactions. However, this data was not readily available and Customs expressed reservations about the accuracy of the data set.

21. Generally, UPE statements are lodged with Customs manually. Although these are not matched against Customs' electronic risk profiles, the regions assess all statements against specific risk criteria. The ANAO identified significant inconsistencies in UPE data and, as a result, was unable to undertake any valid analysis. Given that considerable resources are devoted to assessing and examining UPEs, the ANAO considers it is important that Customs determines a reliable data set so that it may assess the risks posed by UPEs to confirm that the level of compliance activity is appropriate.

22. Export declarations are submitted in ICS. If an EDN matches a risk profile, it will be evaluated by the relevant workgroup to determine whether the cargo is held, released for export or if further documentation/examination is necessary. Customs reviewed the implementation of the exports release of ICS in November 2004 and found the implementation was relatively successful. However, the review identified three key problems: a number of system defects; incorrect reporting practices; and deficiencies within Customs'

¹³ UPEs are personal or household items that are over 12 months old, excluding motor vehicles, that are imported by, but arrive separately from, a passenger when travelling to Australia.

¹⁴ At the time of the audit import declarations were only submitted through the Customs Online Method of Preparing from Invoices Lodgeable Entries (COMPILE) system.

support arrangements. The ANAO found that Customs has reinforced to clients the importance of reporting cargo correctly, revised its support arrangements and is addressing system defects.

Mass-Screening Intervention Strategy

23. The mass-screening¹⁵ of air cargo consignments is also carried out in real time. The Government initiated this intervention strategy as part of its continuing effort to prevent the importation of prohibited and illicit goods, particularly firearms. From July 2002, 70 per cent (nationally) of all imported air cargo consignments are to be mass-screened. The ANAO reviewed the strategy's intervention rate. Reliable data was not collected prior to 1 July 2004 and the ANAO found that, for 2004–05, Customs met the 70 per cent intervention target nationally.

Recording and reporting examination results

24. The ANAO found that it is currently very difficult to access and analyse the outcomes of compliance related examinations. The Examination Data Management (EXAMS) system does not record the workgroup requesting the examination and the business rules and procedures do not clearly define how positive finds are to be recorded. The ANAO considers that capturing examination results is important for evaluating trends, identifying emerging patterns of non-compliance and assessing profile effectiveness. At present, Customs does not analyse or effectively use the data retained in the EXAMS system or regional databases. If examination results are to be accurately and consistently reported and analysed, it is important that Customs: identifies specific compliance workgroups requesting examinations; and develops and implements 'compliance specific' business rules and procedures, particularly in relation to how a positive find is categorised.

Post Transaction Compliance Activity – Chapter 4

25. The CCAS also monitors the compliance of industry segments and individual clients in a post transaction context. Activities include audits of individual clients and compliance checks of Customs' licensed premises. Post transaction audits evaluate industry practices and records to assess the

¹⁵ Mass-screening is only undertaken in the air environment and refers to air cargo consignments that have been subject to either x-ray, visual inspection, physical examination or inspection by Customs' detector dogs.

integrity of the information provided to Customs. Compliance checks of licensed premises validate that the receipt, movement and release of goods was in accordance with legislation and correctly recorded.

Post transaction audit activity

26. Compliance audit activity includes focused, benchmark and desktop audits.¹⁶ The ANAO found that the audit planning process was often based on officer knowledge, experience and intuition and did not include a formal assessment of risks or the level of confidence in the client's ability to comply. The ANAO analysed an indicative sample of 65 compliance audits covering all regions and found: 25 audits did not have internal reports; audit outcomes were not evaluated; and very few identified follow-up visits were programmed.

27. The ANAO reviewed the number of audits completed during 2003–04 and 2004–05 and found considerable variation between the audits the regions advised they had completed and those recorded by Central Office. Based on regional data, the ANAO found there was a reduction in audit activity in 2004–05, predominantly this was focused audits. All regions indicated that a lack of resources had impacted on their ability to complete their audit programs and priority was given to benchmark audits. In response, the Victorian region developed a Desktop Audit Program to enable, within existing staffing levels, a greater coverage of industry segments and clients. The ANAO considers that other regions may benefit from introducing a similar program.

28. Non-compliance identified through audit activity generally relates to the non-payment or incorrect calculation of customs duty and/or taxes. The duty adjustments as a result of audit activity for 2004–05 were \$1.3 million underpaid and \$63 402 overpaid. Customs was unable to provide details of the penalties and infringement notices issued during this period because of data migration problems between the Interim Penalties System and the Penalties System (Version 2).

¹⁶ Focused audits are aimed at assessing areas where there is a perceived medium to high level of risk. Benchmark audits are randomly selected as part of Customs' Compliance Benchmark Testing Program to verify compliance industry wide and provide assurance in terms of revenue leakage and data integrity. Desktop audits are document verification checks of nominated transactions.

Compliance activities relating to licensed premises

29. Customs' licensing system enables importers and owners of imported goods to defer the duty payable on these goods by storing them in Customs' licensed warehouses until they are ready to be entered into home consumption or exported. Cargo depots may also be granted a license to hold, pack, unpack, and/or examine imported goods and export cargo, which is subject to Customs control. As part of CCAS, Compliance Assurance teams undertake compliance checks of these premises.

30. The ANAO found the frequency of compliance visits, the number and type of checks and the entries/lines sampled varies across regions. The regions generally developed their own visitation programs for licensed premises. Most warehouses and depots were risk rated although Customs advised that, for some, this rating was more intuitive than analytical. The ANAO was advised that these programs were not always completed because of a lack of resources. There is also considerable variation in recording the results of compliance checks.

31. Central Office is not advised of the results of these compliance checks and the regions do not evaluate them. As a consequence, there is little understanding, particularly nationally, of how compliant licensed premises are, the compliance issues relating to them or if there is consistency across regions when undertaking these checks. Although standard operating procedures have been developed, there is no national compliance strategy for licensed premises. To better coordinate and manage the compliance activities relating to licensed premises, the ANAO considers Compliance Operations should develop a national compliance strategy.

Planning and Performance Evaluation – Chapter 5

32. It is important that Customs has an effective framework for planning, monitoring and evaluating the effectiveness of its compliance activities. The ANAO found that Customs' Planning and Performance Framework is well designed and ensures plans are aligned and mutually supportive. The National Compliance Business Plan identifies compliance risks and reflects national priorities. Regional Work Area Plans incorporate these risks, identify regional priorities and outline the activities to be completed as part of the CCAS.

33. The CCAS is also prioritised and endorsed by the National Priorities Committee (NPC) and Regional Priorities Committees (RPCs) ratify regional compliance assurance programs. The ANAO found that these committees are not providing the direction and oversight envisaged when they were initially established. Customs advised that it is considering undertaking a formal review of the NPC. The ANAO considers that such a review would be beneficial, particularly as the NPC has considerable influence on the direction of the CCAS and the intelligence capacity that supports it.

34. The Victorian region has recently put forward a number of suggestions to raise the profile of the NPC/RPC relationship and to more effectively align intelligence and compliance resources. The ANAO considers that it would be worthwhile to include in the scope of the NPC review an assessment of the approach being adopted by the Victorian RPC. If considered appropriate, the model could be implemented nationally.

Evaluating the effectiveness of compliance activities

35. Customs found it difficult to provide the ANAO with accurate and reliable compliance data. Data relating to compliance activities is recorded in a number of systems and regional databases, as there is no national system. The ANAO noted a range of data integrity problems relating to the data recorded in these databases. This means that accurate and reliable data is not readily available or being used to evaluate the effectiveness of CCAS compliance activities or as a basis for management decisions. The ANAO found that, with the exception of the Compliance Benchmark Testing (CBT) Program, there is no systematic analysis of compliance data by either Central Office or most regions. As a consequence, compliance trends or patterns of non-compliant behaviour within or across industry segments may not be identified.

Compliance Benchmark Testing Program

36. Customs introduced its CBT Program in 2001–02. It is a statistical program of randomly selected company audits designed to estimate rates of compliance with Customs import and export entry-reporting requirements. In 2003–04, the maximum estimated revenue leakage¹⁷ for customs duty was \$18.8 million (0.38 per cent of total duty collected) and for the Goods and Services Tax (GST) was \$55.4 million (0.41 per cent of total GST collected).

¹⁷ Revenue leakage is an estimate of the total amount of uncollected revenue as a result of incorrect payments/declarations or other breaches of the legislative requirements.

37. The ANAO considers the benchmark program is a useful mechanism for estimating industry compliance. However, as the tobacco, alcohol and petroleum industries do not lend themselves to benchmark audits, the program should include a 'gap analysis'¹⁸ for these segments. As the Australian Taxation Office (ATO) also completes revenue assessments for these industries, Customs should, where appropriate, undertake this work in conjunction with the ATO.

Overall conclusion

38. Australia's international trading environment is complex, involves multiple industry participants and is largely self-regulated. Customs adopts an appropriate risk management approach and has developed and implemented systems and processes to risk assess and target high-risk consignments and non-compliant behaviour. Customs also monitors and, where necessary, enforces compliance with legislative requirements through the compliance activities of the CCAS. These compliance activities are undertaken in a real time and post transaction context. Intervention strategies to address non-compliance are tailored to the nature and extent of the risk involved.

39. The ANAO found that Customs' ability to target non-compliance is undermined by a lack of systematic analysis of risks and emerging trends. The intelligence support being provided to the CCAS is also reduced by inadequate feedback mechanisms and information sharing. Customs intelligence capacity would be enhanced if compliance activities were evaluated and the results of these activities fed into intelligence assessments.

40. The audit also highlighted significant data capture and data integrity problems. Accurate and reliable compliance data is not readily available or being used to evaluate the effectiveness of CCAS compliance activities or as a basis for management decision-making. Currently, Customs does not evaluate its compliance activities other than undertaking its CBT Program.

41. Customs is putting in place a number of initiatives to strengthen its targeting and risk identification strategies. For example, the environmental risk analysis project is designed to identify and assess risks within the international cargo environment. Improved intelligence and information sharing arrangements are also being developed. Customs is working to address its data

¹⁸ A 'gap analysis' compares the quantity of a commodity available from source versus the quantity of that commodity used or consumed in some way. Any difference or 'gap' is likely to correspond to unreported uses, such as illegal activities.

integrity issues so that it can properly evaluate compliance activities and provide assurance that the CCAS is meeting its objectives. The ANAO has made nine recommendations aimed at improving the operational and administrative effectiveness of the CCAS.

Agency response

42. Customs welcomes the report and has agreed with all the recommendations. The audit has been of considerable benefit to Customs. The reduction of resources undertaking Compliance activities in recent years has been a key contributor to many of the issues identified in the report. The additional resources received for compliance activity in the 2005–06 Budget is enabling us to address many of the issues. Action to implement the recommendations is already underway and Customs is sure this will facilitate further improvements in compliance activities. Customs full response is at Appendix 1.

Recommendations

The ANAO has made nine recommendations aimed at improving the administrative effectiveness of Customs Compliance Assurance Strategy. Report paragraph references and abbreviated Customs' responses are also included. More detailed responses are shown in the body of the report. The ANAO considers that Customs should give priority to Recommendations 1, 2, 3, 6, 7 and 8.

Recommendation No.1

Para. 2.18

As there will be considerable changes to existing reporting requirements with the introduction of the Integrated Cargo System (ICS) and Trade Modernisation legislation, the ANAO recommends that Customs review the Cargo Reporting Compliance Strategy 12 to 18 months after the introduction of ICS to ensure the strategy is operating effectively in the new environment.

Customs response: Agree

Recommendation No.2

Para. 2.32

To maximise the benefits to be gained through the national environmental risk analysis project, the ANAO recommends that Customs' regions:

- (a) evaluate those identified risks that are relevant to their region; and
- (b) develop compliance strategies tailored to their own environmental circumstances.

Customs response: Agree

**Recommendation
No.3**

Para. 2.41

To provide intelligence support to Customs Compliance Assurance Strategy and to ensure that compliance risks are identified and prioritised and non-compliant activity properly targeted, the ANAO recommends that the Queensland, New South Wales and Western Australian regions:

- (a) consider outposting Risk Identification and Intelligence (RI&I) officers to work with the Compliance Assurance teams;
- (b) clearly define the role of the RI&I Branch in supporting Compliance Assurance teams;
- (c) encourage cooperation by undertaking joint risk assessment and compliance planning workshops; and
- (d) establish formal feedback processes between the RI&I Branch and the Compliance Assurance teams.

Customs response: Agree

**Recommendation
No.4**

Para. 3.38

To enable the accurate and consistent reporting of compliance examinations, the ANAO recommends that Customs develop:

- (a) functionality within the EXAMS system to identify the compliance workgroup requesting an examination;
- (b) 'compliance specific' business rules and procedures for recording activities and examination results in the EXAMS system; and
- (c) standardised report templates in the Corporate Research Environment that are specific to Compliance Assurance and Compliance Operations.

Customs response: Agree

**Recommendation
No.5**

Para. 4.10

To supplement existing audit programs and to more broadly monitor the compliance levels of clients and industry segments, the ANAO recommends that Customs consider implementing nationally a Desktop Audit Program similar to that being undertaken by the Victorian region. This program should be properly planned and the audits recorded, reported and evaluated.

Customs response: Agree

**Recommendation
No.6**

Para. 4.23

To better coordinate and manage the compliance activities relating to licensed premises, the ANAO recommends that Customs:

- (a) undertake a review of current compliance activities being carried out by the regions;
- (b) develop and implement a national compliance strategy incorporating an annual visitation program; and
- (c) regularly evaluate the results of this strategy.

Customs response: Agree

**Recommendation
No.7**

Para. 5.19

To assist in allocating resources, targeting non-compliance and to determine the effectiveness of its compliance activities, the ANAO recommends that Customs:

- (a) determine the key performance data that is to be collected;
- (b) ensure that this data is recorded and reported consistently and accurately across regions; and
- (c) regularly evaluate this data.

Customs response: Agree

**Recommendation
No.8**

Para. 5.27

To enable Customs to consistently and accurately report compliance data and to assist in evaluating the effectiveness of its compliance strategies, the ANAO recommends that:

- (a) a scoping study be undertaken to determine the user requirements for a national compliance module;
- (b) as part of this scoping study, a staged solution be developed that could be implemented over time; and
- (c) a revised business case supporting a staged solution be developed.

Customs response: Agree

**Recommendation
No.9**

Para. 5.41

To ensure the Compliance Benchmark Testing Program provides assurance across all industry segments, the ANAO recommends that Customs:

- (a) undertake gap analysis for the tobacco, alcohol and petroleum industry segments; and
- (b) where appropriate, incorporate the revenue assessment work being undertaken by the Australian Taxation Office.

Customs response: Agree

Audit Findings and Conclusions

Air cargo shipments



Source: Australian Customs Service

Containerised sea cargo wharf



Source: Australian Customs Service.

1. Background and Context

This chapter outlines Australia's international trading environment and Customs' role in regulating this environment. The purpose and framework of Customs Compliance Assurance Strategy is discussed. The objective and scope of the audit and report structure are also outlined.

Introduction

1.1 In 2004–05, Australia imported over 7.3 million cargo consignments¹⁹ valued at approximately \$149 520 million and the Australian Customs Service (Customs) collected \$7 929 million in customs duty and taxes. For the same period, 1.3 million cargo consignments²⁰ valued at approximately \$126 720 million were exported.²¹ In 2005–06, growth in imports is expected to be about 8 per cent and exports are forecast to grow by 7 per cent.²²

1.2 Customs is responsible for regulating the movement of goods and people across our border and collecting customs duty and other revenue. In this context, Customs plays a vital role in preventing illegal and harmful goods from entering Australia. It has to balance this community protection role with the need to ensure the legitimate movement of goods is not unnecessarily impeded.

1.3 Not every consignment of goods that enters or leaves Australia represents a risk to Customs' border controls. Customs' experience has been that the vast majority of importations are legitimate. A small number will however contain prohibited and restricted items.²³ Similarly, most importers will pay the correct customs duty and taxes, with only a small minority misreporting, undervaluing or misdescribing goods to avoid paying duty

¹⁹ Generally, the size of import consignments are smaller with fewer bulk commodities compared to exports. Exports have a higher proportion of high value consignments.

²⁰ Figure is based on the number of export declarations issued.

²¹ Australian Customs Service, *Customs Figures Australian Customs Service Quarterly Statistical Bulletin* June 2005, Issue 39, pp. 15, 27, 29, 32, 60, 63.

²² Budget Paper No. 1, Statement 3: Economic Outlook, Overview [Internet]. Australian Government Budget 2005–06, available from <<http://www.budget.gov.au/2005-06/bpl/html/bst3-02.htm>> [accessed 18 July 2005].

²³ Prohibited and restricted items include: illicit drugs; weapons; pornography; unsafe products; therapeutic goods; wildlife; quarantine items; and items that breach intellectual property rights.

and/or taxes. Customs adopts a risk management approach and has in place systems and processes for risk assessing, targeting and examining cargo.

Customs' role

1.4 Customs has three principal roles, to:

- facilitate trade and the movement of people across the Australian border while protecting the community and maintaining compliance within Australian law;
- efficiently collect customs revenue; and
- administer industry specific schemes and trade measures.²⁴

Customs Compliance Assurance Strategy

1.5 Customs Compliance Assurance Strategy (CCAS) is an intelligence driven program designed to provide assurance that industry and the international trading community are complying with legislative requirements in an environment that is largely self-regulated. The Strategy is intended to focus resources and activities on areas of risk, with a management and planning structure that is driven by intelligence and analysis. Specifically, the CCAS aims to provide the Government and the community with confidence that:

- reporting of all cargo and vessels entering or leaving Australia is accurate and timely;
- licence and permit requirements, prohibitions and restrictions in relation to imported and exported goods are complied with;
- the correct amount of revenue is paid or identified for collection or consideration²⁵;
- community protection programs related to imported and exported goods are effectively implemented; and
- accurate and reliable data on trade statistics is provided to Customs.²⁶

²⁴ Australian Customs Service, *Annual Report 2003–04*, p.14.

²⁵ Consideration is where a liability has been established but the duty and/or taxes have not been collected such as the deferred Goods and Services Tax.

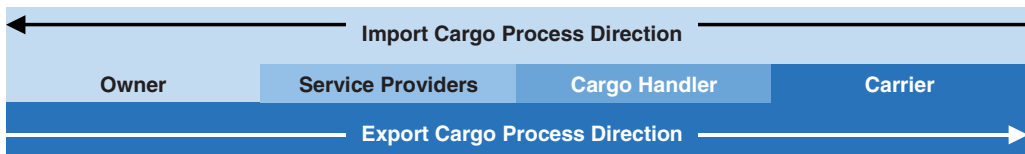
²⁶ Australian Customs Service, *Customs Compliance Assurance Strategy*, p.2.

1.6 Customs undertakes compliance activities in the international cargo environment in a manner that reflects how cargo moves, the nature of the consignment, who has responsibility for that cargo, and the way clients interact with Customs. Under this approach, the international cargo environment is categorised into the following four segments (illustrated in Figure 1.1):

- owner (importers and exporters);
- service providers (brokers, cargo reporters and freight forwarders);
- cargo handlers (stevedores, depot and warehouse operators, airport and sea port owners); and
- carriers (shipping lines and airlines).²⁷

Figure 1.1

International cargo environment



Source: Customs Compliance Assurance Strategy

1.7 These segments form the basis for risk assessing clients and consignments, the planning of compliance activity and delivery of compliance programs in the regions. Customs' activities are aimed at encouraging compliance. Intervention by Customs is proportional to the assessed level of risk.

1.8 The CCAS articulates the increased emphasis being given to undertaking real time compliance activities. This change in focus followed the Business Re-engineering Project Customs completed in October 2002 to establish the right organisational structure to deliver the Cargo Management Re-engineering (CMR) project. Customs completed a post implementation review of the CCAS in November 2004.

²⁷ *ibid.*

Post implementation review of Customs Compliance Assurance Strategy

1.9 The review was undertaken to determine whether the Strategy had been effectively implemented. As part of the review, the compliance arrangements of three domestic regulatory agencies²⁸ and the Canada Border Services Agency were also examined. The review found that, although the CCAS has key elements²⁹ of better practice, the Strategy had not been fully implemented. In particular, there were gaps in the:

- development of robust performance measures;
- use of client behaviour and segmentation to assess risk; and
- process supporting the identification of national priorities to drive compliance related activities on the basis of risk.³⁰

1.10 The review considered that these gaps were related to: the limited awareness of the CCAS; uncertainty over stakeholder roles and responsibilities in the planning and management frameworks; gaps in the provision of strategic intelligence; and lack of standardisation in recording and reporting results. Also, to some extent, the full implementation of the CCAS has been impeded by the lack of systems support including the implementation of the Integrated Cargo System (ICS), the electronic reporting component of the CMR project. The review put forward a number of recommendations aimed at improving the CCAS, which Customs is progressing.

1.11 As the CCAS was originally premised on the CMR project, a number of processes have changed with the introduction of the imports phase of ICS³¹, although the fundamental principles of the Strategy remain.

Cargo Management Re-engineering project

1.12 The CMR project is multi-faceted, involving organisational, legislative and technological changes and is designed to improve the speed and efficiency with which cargo is cleared. The project, which commenced in 1997, has

²⁸ These were the Australian Taxation Office, the Australian Competition and Consumer Commission and the Australian Securities and Investments Commission.

²⁹ These elements include client segmentation, self-assessment and the use of electronic reporting.

³⁰ Australian Customs Service, *Customs Compliance Assurance Strategy Review*, November 2004, p.ii.

³¹ The imports component of ICS was implemented in October 2005.

experienced delays and cost overruns. Customs advised the total projected cost of the project is approximately \$210 million.³²

1.13 The most significant change introduced by CMR is ICS. This system is the core component of the project and replaces four transaction-processing systems.³³ Customs' initial cost estimate for ICS was \$30 million. This figure was based on an expectation that there would be an integrated cargo system component only and did not include a Customs Connect Facility³⁴ and other costs. The cost of ICS is now estimated to be \$57.1 million. The system was introduced in two releases. Release One in October 2004 allowed the processing of exports. Release Two, in October 2005, included cargo reporting, imports processing and the processing of documents through air express couriers.

1.14 The Trade Modernisation legislation³⁵ accompanying ICS is expected to improve Customs control over goods being imported and exported and ensure that Customs is aware of the movement of those goods through all parts of the logistics chain. Customs, in partnership with industry, has invested considerable resources to inform all entities involved in the import and export of cargo of the changes associated with the implementation of ICS.³⁶

1.15 In 2003–04, the Government granted Customs an equity injection³⁷ of \$43 million to address higher than expected costs in several programs, including the CMR project. As part of this decision, an independent financial review of Customs' operational funding requirements was carried out by the Department of Finance and Administration.

1.16 Customs advised that the resources assigned to post transaction activities had been reduced from approximately 200 full-time equivalent staff to 140. This reduction was largely because Compliance resources had been

³² Costs include: Integrated Cargo System software \$57.1 million; Customs Connect Facility \$54.6 million; and Customs costs and other providers \$98.2 million.

³³ These are the Export Integration system, Air Cargo Automation system, Sea Cargo Automation system and Customs Online Method of Preparing from Invoices Lodgeable Entries (COMPILE) system.

³⁴ Customs Connect Facility is a secure electronic 'gateway' to Customs applications, including ICS.

³⁵ The Trade Modernisation legislation package includes: the *Customs Legislation Amendment and Repeal (Trade Modernisation) Act 2001*; the *Import Processing Charges Act 2001*; and the *Customs Depot Licensing Charges Amendment Act 2001*.

³⁶ Communication mediums included: Customs' Internet Home Page; newsletters; fact sheets; booklets; industry publications; training forums; and discussions with industry groups and client organisations.

³⁷ Equity injections are provided to agencies to, for example, enable investment in new capacity to produce departmental outputs when normal cash flows are insufficient.

re-directed to community protection roles. These included the first port boarding of vessels and the inspection of 70 per cent of all air cargo consignments for which Customs did not receive additional funding. Funding of \$8.1 million was provided in the 2005–06 Budget for 60 additional Compliance staff to increase Customs' capacity to implement its Compliance Assurance Strategy. Customs advised the cost of all compliance activities in 2004–05 was \$91.6 million and involved 455 full time equivalent staff.

Overseas compliance programs

1.17 From publicly available information, the ANAO sought to compare the CCAS with other Customs agencies and looked at New Zealand, Canada³⁸, the United Kingdom and the United States of America. The ANAO found it difficult to benchmark the CCAS against the compliance programs operating in these countries. Although the principles underlying these programs were similar, there was considerable variation in the scope of the programs and their individual components.

1.18 For example, the United Kingdom has combined its revenue and customs functions under its new agency HM Revenue and Customs. The Canada Border Services and United States Customs and Border Protection agencies incorporate passengers, excise, quarantine and immigration functions into their compliance models and have a greater focus on land border security. The New Zealand Customs Service incorporates passengers and excise.

1.19 Despite these differences, the ANAO found that, like Australia, all these agencies attempt to minimise disruption to the flow of legitimate goods and encourage voluntary compliance. All agencies also incorporate risk assessment practices, client service and education and responsible enforcement into their compliance programs.

³⁸ As noted in paragraph 1.9, Customs also reviewed the activities of the Canada Border Services Agency in its post implementation review of CCAS.

Audit objective, scope and methodology

1.20 The objective of the audit was to assess the administrative effectiveness of the CCAS. Particular emphasis was given to the following areas:

- targeting non-compliance;
- real time compliance activity;
- post transaction compliance activity; and
- planning and performance evaluation.

1.21 As the imports phase of ICS was only introduced in October 2005, this system was not reviewed as part of the audit. Our audit programme for 2005–06 identifies this as a potential audit topic.

1.22 The audit was conducted in accordance with ANAO auditing standards, at a cost of \$353 400.

Methodology

1.23 The audit methodology was a combination of quantitative and qualitative analysis, file and documentation reviews, and interviews with agency officers and industry stakeholders in Sydney, Melbourne, Brisbane, Fremantle and Canberra. Audit fieldwork was undertaken during March to June 2005.

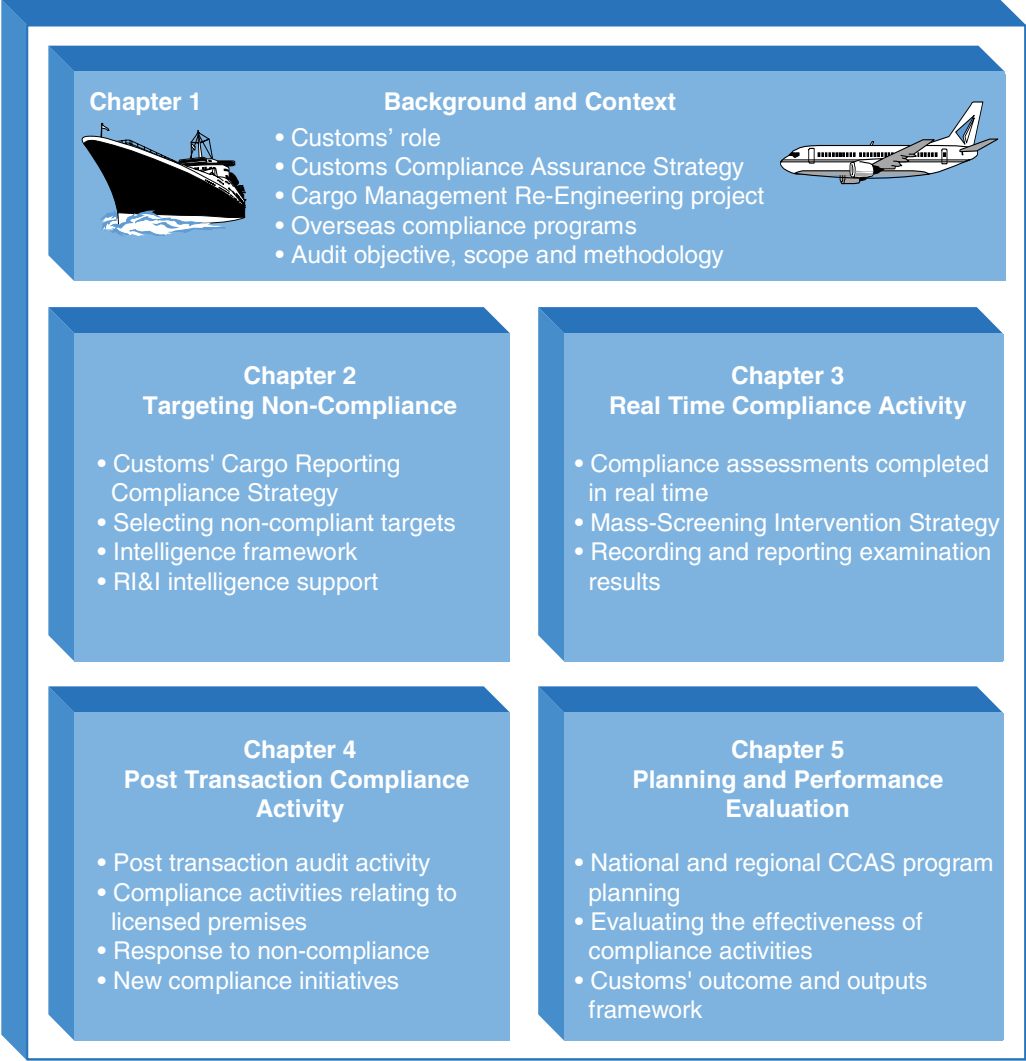
Acknowledgements

1.24 The ANAO would like to express its appreciation to Customs' management and staff for their assistance in the conduct of this audit.

Structure of the report

1.25 Figure 1.2 illustrates the framework used by the ANAO to assess the administrative effectiveness of the CCAS. This framework formed the basis for the structure of this report.

Figure 1.2
Report structure



2. Targeting Non-Compliance

This chapter outlines Customs' strategies for targeting non-compliance and the intelligence framework that supports the Compliance Assurance Strategy.

Introduction

2.1 Customs approach to targeting non-compliance is based on an assessment of the risks that the cargo may present. The timely and accurate reporting of cargo information³⁹ is crucial if Customs is to properly assess these risks and put in place appropriate intervention strategies. Industry is required to give Customs advance notice of cargo being imported into Australia.⁴⁰ Sea cargo must be reported 48 hours prior to the vessel's arrival at the first Australian port (24 hours if the voyage is likely to take less than 48 hours) and air cargo two hours before arrival at the first Australian airport.

2.2 At the time of audit fieldwork, air cargo reports were submitted via the Air Cargo Automation (ACA) system and sea cargo reports via the Sea Cargo Automation (SCA) system. The importer or customs broker is also required to complete an import declaration (or customs entry) for any goods being entered for home consumption where the value exceeds \$250.⁴¹ Exporters must also submit an export declaration (EDN).⁴² The cargo report, import declaration and EDN are assessed to determine whether the cargo is released from Customs control or held for further examination. The systems and processes for reporting the movement of cargo and assessing the risks associated with it have changed with the introduction of the Integrated Cargo System (ICS) and Trade Modernisation legislation.

2.3 In assessing how cargo is targeted for non-compliance, the ANAO reviewed the:

- strategies in place for ensuring cargo is properly reported;
- systems and processes for assessing the risks associated with cargo;
- cargo reporting when using ICS; and
- intelligence framework to support targeting strategies.

³⁹ Cargo is reported by owners, service providers and carriers.

⁴⁰ *Customs Legislation Amendment (Airport, Port and Cargo Security) Act 2004.*

⁴¹ At the time of the audit, an import declaration was lodged in Customs Online Method of Preparing from Invoices Lodgeable Entries (COMPILE) system.

⁴² EDNs are submitted in the Integrated Cargo System.

Customs' Cargo Reporting Compliance Strategy

2.4 In an effort to improve cargo reporting across all regions and industry segments and in preparation for ICS, Customs implemented its Cargo Reporting Compliance Strategy in April 2003. The strategy, which is coordinated by Central Office and implemented by the regions, initially focused on the timeliness of sea cargo reporting. It was extended in March 2004 to include air cargo reporting and includes the following key elements:

- developing a sound understanding of the levels of non-compliance;
- general education and awareness for industry;
- client specific awareness delivered through leverage activities⁴³;
- identification of and response to the least compliant reporters; and
- assessment of the effectiveness of the strategy.

2.5 To enable the regions to monitor performance and identify those reporters who are not meeting reporting requirements, a monthly performance-reporting regime was established.⁴⁴ Although there were initial difficulties in extracting air cargo data from the ACA system, ongoing monthly air and sea cargo reports are now provided to the regions.

Implementation of the strategy

2.6 The implementation of the strategy is at the discretion of the regions and varies across regions, depending on the number of cargo reporters and resources available. The ANAO found that all regions are:

- undertaking exercises to educate and raise awareness, primarily through correspondence and follow-up visits;
- monitoring, on a monthly basis, the performance of individual companies to identify non-compliant reporters for follow-up action; and
- developing intervention strategies to address those companies that fail to comply.

⁴³ A leverage activity is defined as one that assists in identifying, monitoring and treating a risk.

⁴⁴ Customs advised that reports were based on the final amended version of a cargo report rather than when the original report was received. Cargo lines originally reported on time but subsequently amended may show up in the data extraction as being reported late.

2.7 The ANAO found that considerable resources were devoted to identifying cargo reporters and undertaking awareness exercises (telephone contact and correspondence) and follow-up visits. However, particularly in the larger regions, resources do not allow Customs to sustain regular visits to reporters so follow-up contact may be via telephone, email or correspondence. Monthly summaries of activities are provided to Central Office.

Intervention strategies

2.8 The regions determine the intervention strategies to be adopted in response to non-compliance and these are tailored to individual circumstances. The primary method of intervention is education. This is undertaken as part of general awareness exercises and on a one-to-one basis with individual companies. As the immediate focus for Customs and industry has been the introduction of ICS and related legislative changes, recent education activities have primarily been aimed at reporting in this new environment.

2.9 Where there is an ongoing issue of non-compliance, some regions are asking cargo reporters to provide a written explanation for their non-compliance. This approach helps to identify the need for system or process improvements and Customs will work with the company to improve compliance levels. The Victorian region has initiated a 'desktop audit'⁴⁵ program for non-compliant reporters. The region advised that this is also used as an opportunity to understand issues unique to the sea environment.

2.10 Western Australia is asking companies to sign a *Compliance Improvement Agreement*. This agreement is developed in conjunction with the company's senior managers and formally outlines the: immediate intervention steps; corrective action to ensure an ongoing compliance solution; and processes in place to verify that the remedial actions are effective. The company is closely monitored and visited on a monthly basis until compliance levels are consistent and to a standard accepted by Customs. The agreement is then closed and normal monitoring arrangements resumed. At the time of audit fieldwork, Western Australia had six agreements in place and found this intervention strategy to be particularly successful where a company fails to comply following a sustained period of monitoring.

⁴⁵ Documentation is requested and verified under sections 240AA and 240AC of the Customs Act.

Figure 2.1

Comparison of sea cargo timeliness statistics

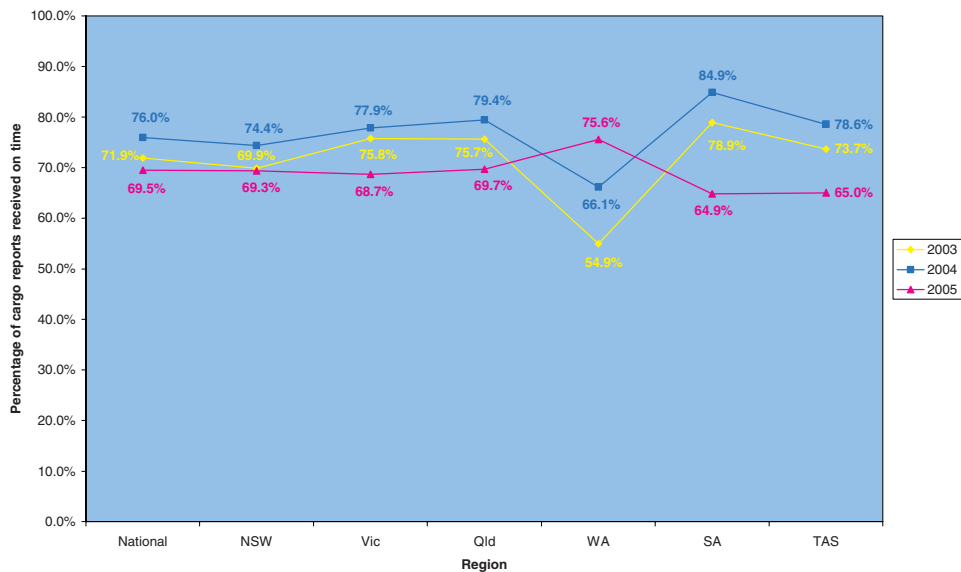
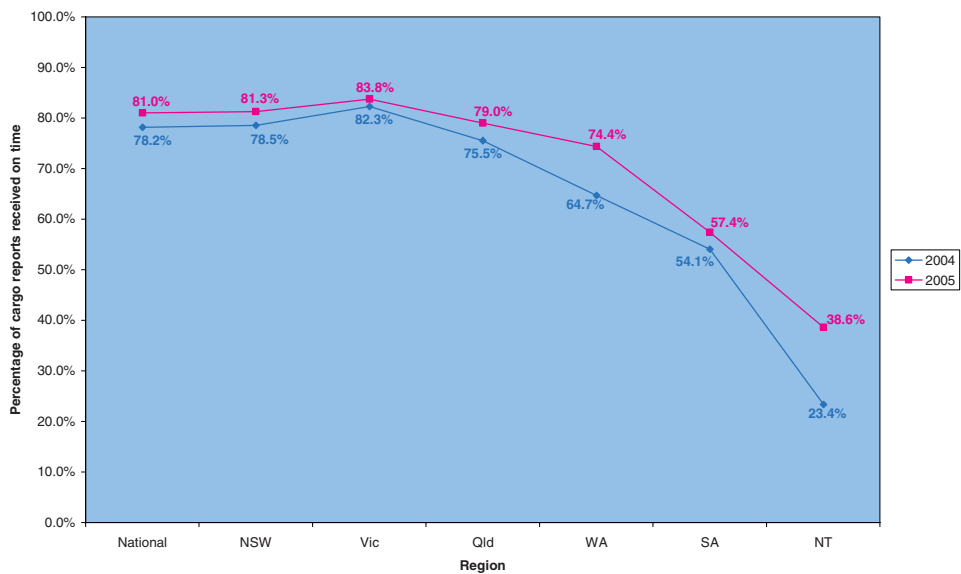


Figure 2.2

Comparison of air cargo timeliness statistics



Note: Data for 2005 covers the period 13 January to 30 September when the cargo reporting requirements changed

Source: Customs' Sea Cargo and Air Cargo Automation systems

2.11 Penalties may be imposed with the commencement of the Trade Modernisation legislation for late or inappropriate cargo reports.⁴⁶ The issuing of a penalty is not automatic. Customs' response is based on the extent and nature of the non-compliance, in accordance with its Regulatory Philosophy.⁴⁷ The Compliance Improvement Agreement supports this approach. The ANAO considers there would be benefits in Customs assessing the merits of using this agreement and, if appropriate, implementing nationally.

Effectiveness of the strategy

Sea cargo reporting

2.12 Customs advised that the Cargo Reporting Strategy allowed it to gain a better understanding of the issues facing cargo reporters. The ANAO found that the strategy initially improved the timeliness of sea cargo reporting. When the strategy began the focus was to improve reporting in preparation for ICS and this was to be 24 hours prior to vessel arrival at the port of discharge. However, the reporting timeframe remained at 48 hours. For those cargo reports received 48 hours prior to vessel arrival, the national average increased from 72 per cent in 2003 to 76 per cent in 2004.⁴⁸

2.13 Reporting requirements changed in January 2005 and vessels must now report prior to arrival at the *first Australian port* rather than port of discharge. This change impacted on compliance levels with the national average dropping to 70 per cent in 2005. These changes also meant that additional general awareness exercises were required to highlight the new reporting requirements. Figure 2.1 (opposite) compares the sea cargo statistics for January to December 2003, January to December 2004 and January to September 2005.⁴⁹

Air cargo reporting

2.14 Air cargo reporting statistics are not available prior to the strategy being implemented because of difficulties in extracting the data from the ACA system. Figure 2.2 (opposite) compares air cargo statistics for March to

⁴⁶ To allow cargo reporters to put in place the necessary systems to comply with the new legislation, a six-month moratorium period applies from the commencement of the legislation.

⁴⁷ Customs' Regulatory Philosophy and the Infringement Notice Scheme are discussed in Chapter 4.

⁴⁸ The national average for cargo reports received 24 hours prior to vessel arrival increased from 85 per cent in 2003 to 87 per cent in 2004.

⁴⁹ Customs collects and analyses cargo reporting timeliness statistics across calendar years.

December 2004 with January to September 2005. There was a slight improvement in the timeliness of air cargo reporting in 2004 to 2005.⁵⁰

Future focus of the strategies

2.15 Customs is now looking to extend the focus of the strategy to include the accuracy of reporting. Reports to identify high amendment rates are being devised and a national approach developed. It is proposed that the new accuracy reports will be used in combination with the existing timeliness reports. Customs advised that there is often a direct correlation between late cargo reporters and the accuracy of their reports.⁵¹

Cargo reporting under ICS

2.16 As previously noted, reporting the movement of cargo changed in October 2005 with the implementation of ICS and Trade Modernisation legislation. The legislation is designed to provide greater flexibility for industry and to address the problems of late, deficient, inaccurate or non-existent reporting that have undermined Customs ability to risk assess cargo. Changes include mandatory electronic reporting⁵², cascade reporting⁵³ and sanctions for late or inappropriate reports. There is a six-month moratorium on applying reporting penalties.

2.17 Given the extent of these changes, the ANAO considers that the Cargo Reporting Compliance Strategy should be reviewed, 12 to 18 months after the introduction of ICS. This will allow Customs to assess whether:

- the strategy is working in the new environment or if elements need to be modified;

⁵⁰ Air cargo reports for New South Wales represent approximately 66 per cent of the national figure followed by Victoria with 21 per cent, Queensland 6 per cent, Western Australia 5 per cent, South Australia 1 per cent and the Northern Territory less than 1 per cent.

⁵¹ Statistics on reporting of sea cargo were based on the time the latest amended version of the cargo report was received by Customs. In some instances original, or earlier, versions of those cargo reports had been received in accordance with the legislated timeframe.

⁵² To assist industry to manage the change to full electronic reporting, the legislation allows current manual reporters a general moratorium period of six months, following the implementation of the cargo reporting provisions. The moratorium conditions also allow Customs' Chief Executive Officer to grant individual manual reporters additional time (up to 18 months) to meet electronic reporting requirements.

⁵³ Cascade reporting allows cargo reporters to nominate other parties who will be responsible for providing further cargo report details.

- the reports provided by ICS and the Corporate Research Environment⁵⁴ are adequately assessing the performance of cargo reporters in terms of both timeliness and accuracy;
- there are specific issues that need to be addressed or industry segments targeted;
- intervention strategies are consistent across regions and targeting appropriate areas; and
- the principles developed for applying sanctions are being effectively implemented following the moratorium.

Recommendation No.1

2.18 As there will be considerable changes to existing reporting requirements with the introduction of the Integrated Cargo System (ICS) and Trade Modernisation legislation, the ANAO recommends that Customs review the Cargo Reporting Compliance Strategy 12 to 18 months after the introduction of ICS to ensure the strategy is operating effectively in the new environment.

Customs response

2.19 Agreed.

Selecting non-compliant targets

2.20 The ANAO found that Customs has well-developed systems and processes for risk assessing and targeting cargo consignments. The information contained in cargo reports, import declarations and EDNs is assessed to identify high-risk and non-compliant targets using a combination of risk indicators and system profiles. Risk indicators can be information such as the origin of the consignment, the port of loading or description of the cargo, which alone, or in combination, suggests a consignment presents a risk. Risk indicators are the basis for developing national and regional profiles.⁵⁵ This risk assessment is based on judgement and available intelligence and determines whether the cargo will be released immediately or referred for

⁵⁴ The Corporate Research Environment was established to provide Customs with an integrated analytical facility, supporting a wide variety of data sources and users.

⁵⁵ National profiles are consistent across all ports of entry. Regional profiles are created by regions based on Customs' research and intelligence or specific information from other sources.

further examination. The risk profiles in the ACA, SCA and COMPILE systems have been migrated to the Cargo Risk Assessment (CRA) system in preparation for the introduction of ICS in October 2005.

Cargo Risk Assessment system

2.21 Cargo information reported in ICS is risk assessed by the CRA system, which has two main components:

- the profiling component – *Alert/Profile Maintenance*: and
- the post-match component – *Work Management*.

2.22 The CRA system is designed to identify potentially high-risk cargo and refers the report to a workgroup for assessment. Evaluators within the relevant workgroup will decide whether the cargo is released or held for further examination. The CRA system places significant emphasis on the creation, maintenance and evaluation of national and regional profiles, which were reviewed in preparation for ICS.

Review of national and regional profiles

2.23 A system profile review was undertaken by Customs between February 2003 and March 2004 to identify profiling gaps and duplication within existing profiles, and to ensure a smooth transition of profiles into ICS. The review highlighted the disparate methods employed in managing profiles across systems. It also reinforced the need to regularly evaluate all profiles, whether national or regional, regulatory or risk driven.

2.24 The ANAO has been advised that the CRA system includes a number of reports to assist in evaluating the effectiveness of profiles. As well, the processes for creating, reviewing and evaluating the effectiveness of profiles in ICS will be outlined in standard operating procedures to be developed by Central Office.

2.25 Risk profiling and target development are interdependent and rely on high quality and current intelligence. This is provided through the strategic, operational and tactical intelligence activity undertaken by Customs and the cooperation and information-sharing arrangements it has with other law enforcement and government agencies.

Intelligence framework

2.26 Customs' Intelligence Philosophy sets out what strategic, operational and tactical intelligence is, for whom it is produced and why it is needed. The Risk Identification and Intelligence (RI&I) Branch (in Central Office and the regions) is the focal point for Customs intelligence activity. The ANAO reviewed the intelligence activity that supports the CCAS and the arrangements in place to share information and intelligence between Compliance Assurance and RI&I.

Intelligence assessments

2.27 Strategic intelligence assessments are produced primarily for the use of Customs' senior executives and provide an analysis of issues that have national implications or are of national significance. The ANAO found that four assessments covering compliance related issues were completed in the last five years.⁵⁶ Periodic reports are also produced for illicit drugs detections and the legal and illegal movement of firearms and tobacco.

2.28 Operational intelligence assessments are generally prepared by the regions to inform and support target development and operational response activity. Tactical intelligence covers the activities, capabilities and intentions of specific suspect individuals and organisations. The ANAO found that, although the Compliance Assurance teams and RI&I analysts may have an understanding of the broad risks facing Compliance, there has not been a systematic analysis of the results of compliance activity at the operational and tactical levels to identify risks and emerging trends. This lack of analysis was also highlighted in the recent review of the CCAS.⁵⁷

2.29 In response to the review's recommendation that 'greater integration of risk identification by segments be encouraged to identify areas of high risk and potential future priorities', Compliance Operations and RI&I in Central Office are jointly undertaking an environmental risk analysis project. The project aims to: map existing activity and identify areas of non-compliance; identify and prioritise risks and vulnerabilities across all industry segments; propose compliance activities to address perceived risks; identify emerging issues; and provide a comparative basis for allocating resources.

⁵⁶ The assessments covered the illicit tobacco market and fraudulent and illegal activity in the motor vehicle industry.

⁵⁷ Australian Custom Service, *Customs Compliance Assurance Strategy Review*, November 2004, pp. 24-25.

2.30 Central Office will undertake the project and the regions will participate in a number of workshops to assist in identifying processes and risk areas. This project provides Customs with an opportunity to assess the compliance risks within the international cargo environment, particularly from a national perspective. It will also provide baseline data that should be regularly reviewed and updated. The scope of this project is extensive and, if all objectives are to be successfully achieved, it will need to be properly resourced and, where possible, risks and vulnerabilities based on quantitative and qualitative data analysis. To be reliable, such analysis will need to consider the quality of the data sources used. Currently, there is no national compliance system and the ANAO has found that some data sources are disparate and the integrity of the data questionable.⁵⁸

2.31 The regions should also take the opportunity to review their own environment, based on the outcomes of this project. All risks identified by the project will not be relevant to all regions as not all industry segments operate to the same level in each region. However, the ANAO considers that where the project identifies risks that are relevant to specific regions, these risks should be evaluated at the regional level and appropriate compliance strategies developed.

Recommendation No.2

2.32 To maximise the benefits to be gained through the national environmental risk analysis project, the ANAO recommends that Customs' regions:

- (a) evaluate those identified risks that are relevant to their region; and
- (b) develop compliance strategies tailored to their own environmental circumstances.

Customs response

2.33 Agreed.

RI&I intelligence support

2.34 Current intelligence support primarily involves Compliance Assurance teams tasking RI&I to undertake research for planned audit/compliance activity or into particular industry segments. Prior to Customs' organisational

⁵⁸ Data integrity and the recording of compliance activities are discussed further in Chapters 3 and 5.

restructure in 2002, the Compliance Assurance branches had their own analysts. These analysts now work in RI&I.

2.35 The ANAO found that there was confusion surrounding the roles and responsibilities of each area and concern regarding what is perceived as a lack of intelligence support being provided by RI&I. There is minimal information sharing between the two groups. Compliance Assurance teams provide little feedback to RI&I analysts on any of the work they undertake or the compliance activities completed as part of the CCAS. The current approach is fragmented and is not meeting the expectations of either Compliance Assurance or RI&I. This situation was articulated in a paper prepared by RI&I Victoria, which stated that:

Compliance was clearly looking for more pro-active support in identifying risk-driven targets whereas RI&I was looking for more clearly defined taskings for long term projects that would identify high risk targets.⁵⁹

2.36 The paper further noted that the confusion over roles and the lack of industry experience had resulted in each area relying on the other to initiate action. The ANAO found this to be the case for all regions reviewed.

2.37 RI&I Victoria has put in place a number of strategies to address these concerns. RI&I and Compliance Assurance are working together to develop a work program that will identify and test risks across a broad spectrum of compliance activities over an extended period of time (possibly three to five years). This involved undertaking joint risk assessment and planning workshops to develop their 2005–06 work programs.

2.38 The broad risks facing Compliance Assurance, the resources required to complete non-risk based tasks and those available for risk-based compliance activity were identified and prioritised. RI&I will prepare assessments for the highest priority risks and identify compliance targets. These targets will be incorporated into the compliance program. Compliance Assurance teams are to provide RI&I with feedback and the results of the targeted activity as each activity is completed. The program will be adjusted based on these results and reviewed every six months. This approach has been supported by the National Managers of Compliance and RI&I.

2.39 The Victorian region is also encouraging cooperation and a more productive relationship by outposting three RI&I officers to work with the

⁵⁹ *RI&I Support to Compliance Assurance Planning*, prepared by RI&I Victoria, 2005.

Compliance Assurance teams. Being co-located with the teams facilitates the two-way exchange of information, an important part of intelligence gathering and analysis. RI&I continue to supervise the work of these officers to ensure that the intelligence product is meeting the needs of Compliance Assurance. The ANAO suggests that other regions consider adopting this approach, as there are practical benefits in the two areas working closely together.

2.40 The ANAO supports the initiatives being implemented by the Victorian region. It will only be through the collaborative efforts of RI&I and Compliance Assurance that the objectives of the CCAS are achieved. The CCAS is intended to be an intelligence driven program so compliance risks must be identified and prioritised and non-compliant activity properly targeted for it to be effective. Formal feedback mechanisms must also be established between the two areas so that the results of all compliance activity are analysed and incorporated into intelligence assessments, profiles and planning processes.

Recommendation No.3

2.41 To provide intelligence support to Customs Compliance Assurance Strategy and to ensure that compliance risks are identified and prioritised and non-compliant activity properly targeted, the ANAO recommends that the Queensland, New South Wales and Western Australian regions:

- (a) consider outposting Risk Identification and Intelligence (RI&I) officers to work with the Compliance Assurance teams;
- (b) clearly define the role of the RI&I Branch in supporting Compliance Assurance teams;
- (c) encourage cooperation by undertaking joint risk assessment and compliance planning workshops; and
- (d) establish formal feedback processes between the RI&I Branch and the Compliance Assurance teams.

Customs response

2.42 Agreed.

3. Real Time Compliance Activity

This chapter outlines Customs' systems and processes for assessing and examining cargo in real time. The implementation and success rate of the air cargo Mass-Screening Intervention Strategy is also reviewed.

Introduction

3.1 Customs reviewed its business processes as part of the Cargo Management Re-engineering (CMR) project. Following this review, an increased emphasis was given to undertaking compliance activities in real time and the Customs Compliance Assurance Strategy (CCAS) articulates this focus. Customs adopts a risk management approach to determine whether the correct customs duty and taxes are being collected and that legislative requirements are met. The information provided in import declarations (or customs entries), export declarations (EDNs) and unaccompanied personal effects (UPE)⁶⁰ statements is assessed to determine whether the cargo will be released immediately from Customs' control or if further verification/examination is required.

3.2 The mass-screening⁶¹ of air cargo consignments is also carried out in real time. The Government initiated this intervention strategy in July 2002 as part of its continuing effort to prevent the importation of prohibited and illicit goods, particularly firearms. Under this strategy, 70 per cent (nationally) of all imported air cargo consignments are to be mass-screened.

3.3 The ANAO reviewed Customs' systems and processes for assessing and examining cargo in real time, the implementation of the 70 per cent air cargo mass-screening strategy and its success rate.

Compliance assessments completed in real time

3.4 At the time of the audit, import declarations were lodged in Customs Online Method of Preparing from Invoices Lodgeable Entries (COMPILE) system and UPE statements at the relevant Customs House in each region.

⁶⁰ UPEs are personal or household items that are over 12 months old, excluding motor vehicles, that are imported by, but arrive separately from, a passenger when travelling to Australia.

⁶¹ Mass-screening is only undertaken in the air environment and refers to air cargo consignments that have been subject to either x-ray, visual inspection, physical examination or inspection by Customs' detector dogs.

These documents may now be submitted through the Integrated Cargo System (ICS) which was implemented in October 2005.⁶² Export declarations are submitted in ICS.

Import declarations

3.5 When an import declaration is received the cargo data is matched against compliance risk profiles⁶³ and sorted into two groups: green or red line entries. Green line entries are automatically cleared whereas a hold is placed on red line entries preventing the goods from being released. In 2004–05, Customs received 3.5 million entries, of which approximately 65 000 (1.9 per cent) were red line.

3.6 COMPILE automatically notifies the owner/broker that a consignment has gone red line and further documentation is required. These documents are then validated by Customs. Where Customs identifies duty and/or taxes have been incorrectly calculated, the owner/broker is required to amend the entry before the cargo is released. If an examination is considered necessary, the red line area will request a cargo examination team examine the goods. Legitimate cargo is released. Where the examination team suspects non-compliance, the goods may be sampled and/or seized, with the red line area being responsible for any further action.⁶⁴ Non-compliance may also result in a penalty or infringement notice being issued. After all action has been finalised, outcomes are recorded in the EXAMS system⁶⁵ and regional databases. Appendix 2 outlines this process.

3.7 To determine whether Customs has appropriate controls in place for processing red line transactions, the ANAO reviewed, as part of the annual financial statement audit process, transactions in Victoria, New South Wales and Queensland. The ANAO considers that Customs has well developed systems and processes for assessing and examining import declarations in real time.

⁶² UPE statements may still be lodged manually at the relevant Customs House in each region. Following the implementation of ICS imports, as an interim measure only, import declarations can be submitted through either ICS or COMPILE.

⁶³ A profile is one or a cluster of risk indicators that, when grouped together, present the characteristics of a high-risk consignment.

⁶⁴ This may, for example, involve the goods being sent for scientific testing to determine whether the alcohol content of a product meets specific requirements.

⁶⁵ EXAMS is the national system used to record cargo examinations.

Analysis of red line entry results data

3.8 The ANAO attempted to analyse the volume and value of red line transactions from 1 July 2003 to 30 June 2004.⁶⁶ This data was not readily available and it was a difficult and time-consuming process for Customs to provide this information. The data had to be extracted from both the COMPILE system and regional databases. Central Office coordinated this information to present a national picture but expressed reservations about the accuracy of the data set.⁶⁷ The data provided is outlined in Table 3.1.

Table 3.1

Results of red line transactions for the period 1 July 2003 to 30 June 2004

	Total Number	Total Value (\$)
Red line entries	44 913	
Physical examinations	5 646	
Additional customs duty & taxes		\$2 933 096
Non-compliance records	88	
Penalties	76	\$53 925
Seizures	485	

Source: Australian Customs Service

Unaccompanied personal effects statements

3.9 UPE statements are completed by the owner of the goods (or a representative) and lodged manually. Although the statements are not matched against Customs' electronic risk profiles, the ANAO found that the regions assess all statements against specific risk criteria. If this documentary check does not provide adequate assurance, a physical examination is carried out.

3.10 The ANAO found that, apart from the New South Wales Compliance Assurance team dealing with high volume specialist operators (HVSOs)⁶⁸, all regions record the results of their examinations in the EXAMS system and

⁶⁶ Data for 2004–05 was not available until late-2005 and, due to the difficulty in compiling 2003–04 data, the ANAO has excluded 2004–05 data.

⁶⁷ The importance of accurate and reliable data is discussed in Chapter 5.

⁶⁸ In New South Wales, Cargo and Trade deal with UPEs for private individuals and a Compliance Assurance team deals with HVSOs. Containers of personal and household effects may be moved to HVSO depots for unpacking with Customs' permission.

regional databases.⁶⁹ The ANAO considers that all UPE examinations should be recorded in the EXAMS system. This will enable Customs to assess UPE compliance results from a national perspective and to compare performance across regions.

3.11 The ANAO's analysis of UPE data from Customs' Border Statistics database indicated considerable inconsistencies across regions. As a result, this information was requested from each region and also from the EXAMS system for the period 1 July 2003 to 30 June 2005. Appendix 3 compares these data sets for the regions reviewed.⁷⁰ Significant variations between these data sets raised further concerns regarding the integrity of UPE data and the ANAO was unable to undertake any valid analysis.

3.12 Customs completed a strategic assessment of the risk posed by UPEs in October 1999. This assessment noted that UPEs did not pose a greater risk than commercial cargo but their level of risk was assessed as significant.⁷¹ Given that considerable resources are devoted to assessing and examining UPEs, it is important that Customs determines a reliable data set so that it may re-assess these risks to confirm that the level of UPE compliance activity is still appropriate.

Export declarations

3.13 If the EDN matches a risk profile⁷² in ICS, an evaluator in the export workgroup will determine whether the cargo is held, released for export and dealt with post-entry⁷³ or if further documentation/examination is necessary. Examinations are carried out by the Container Examination Facility (CEF) in each port or Compliance Assurance examination teams.

⁶⁹ This data is also reported to Central Office for border statistic purposes.

⁷⁰ A national figure was also included because the ANAO only reviewed four regions and UPEs are received in all regions.

⁷¹ Australian Customs Service, Strategic Assessment No.9/99 *The Risk Posed by Unaccompanied Personal Effects*, October 1999, p.9.

⁷² Export profiles in ICS relate to, amongst other things, issues such as community protection, diversion, international sanctions and the need for permits.

⁷³ Customs advised that it is often difficult to examine air cargo consignments because of the time-critical nature of the air environment. Often there is very little time available from when the cargo arrives at the airport to when the flight is due to depart.

The introduction of ICS exports

3.14 Customs reviewed the implementation of the exports release of ICS in November 2004 and found it to have been relatively successful, although Customs' staff were required to provide an unexpected level of support to industry in the clearance of goods. The review, which is seen as the first step of an ICS post implementation review identified three key problems: a number of system defects within ICS; incorrect reporting practices which do not accord with business rules introduced through the Trade Modernisation legislative amendments; and deficiencies within Customs' support arrangements. The ANAO found that Customs has put considerable effort into reinforcing to clients the importance of reporting cargo correctly, revised its support arrangements and is addressing system defects.

System availability

3.15 The system consists of two separate communication channels.⁷⁴ These channels are measured for availability and performance, based on the operation of cargo movement transactions between industry and Customs. Production system measurement criteria has been in place since April 2005 and, for the period April to August 2005, the system has, on average, recorded 99 per cent availability and 95 per cent performance.

Cargo examinations

3.16 The purpose of compliance related cargo examinations is to verify that the actual cargo corresponds to what was declared on the import declaration, EDN or UPE statement. Compliance Assurance examination teams generally undertake these examinations at the owners nominated premises or at Customs' licensed premises. Examinations are also carried out at the CEFs.⁷⁵

Container Examination Facility examinations

3.17 CEFs have been established in Melbourne, Sydney, Brisbane, Fremantle and Adelaide. The CEFs have an inspection target of approximately 100 880 containers per annum and are required to physically examine 10 per cent of these containers. To utilise the capacity of the CEFs to examine cargo from a

⁷⁴ These channels are Customs Interactive—an Internet browser based interface; and a business-to-business interface based on electronic data interface message exchange.

⁷⁵ The ANAO tabled an audit of the CEFs in December 2004 (refer Australian National Audit Office, Audit Report No.16 2004–05 *Container Examination Facilities*).

compliance perspective, Customs introduced a Declaration Validation Examination (DVE) process in late 2004.

3.18 The purpose of the DVE process is to validate the information provided in the import declaration with the contents of the container. CEF officers are required to undertake specific compliance checks for all containers unpacked, where an import declaration has been lodged. Any discrepancies are verified during examination of the cargo and, if these cannot be resolved at the CEF, the consignment will be referred to the relevant Compliance Assurance team.⁷⁶ Results of these checks are recorded in a DVE database and reported to Compliance Central Office. Currently this database is not linked to the EXAMS system, although it is anticipated that EXAMS will be capable of accepting this data as part of the next system release. The ANAO found that all regions have effectively implemented the DVE process.

Mass-Screening Intervention Strategy

3.19 In June 2002, the Government announced that Customs would increase its examination of air cargo entering Australia. From July 2002, 70 per cent (nationally) of all imported air cargo consignments are to be mass-screened. At that time, Customs was already inspecting 100 per cent of high volume/low value (HVLV)⁷⁷ consignments imported by air express couriers as part of the Government's Increased Quarantine Intervention (IQI) Strategy.⁷⁸ IQI was in response to the outbreak of foot and mouth disease in the United Kingdom and Europe, and other emerging quarantine risks.

3.20 Under IQI, Customs was funded to increase its intervention strategies in passenger processing, international mail and air cargo.⁷⁹ In the air cargo environment, this meant inspecting all HVLV cargo – specifically bulk document consignments and bulk mail order consignments. Screening is

⁷⁶ Generally, the container is returned to the wharf and, where necessary, CEF officers will take detailed photos and/or samples.

⁷⁷ Low value means the value of each consignment must be less than \$250 and have a combined duty/tax liability of less than \$50. High volume relates to the volume criteria an applicant must meet to be able to be registered as a special reporter under the HVLV scheme.

⁷⁸ The ANAO tabled a performance audit on Quarantine Effectiveness in June 2001 (refer Australian National Audit Office, Audit Report No.47 2000–01 *Managing for Quarantine Effectiveness*) and is currently undertaking a follow-up audit, which is expected to table in November 2005.

⁷⁹ Customs received additional resources of \$62.5 million each year. The Government has extended this funding until at least 2008–09, subject to a review of the IQI programme.

carried out jointly with AQIS and contributes to the 70 per cent national air cargo intervention rate.

Air cargo 70 per cent intervention rate

3.21 Customs was not provided with additional funding to achieve the 70 per cent intervention rate. Existing x-ray resources were used and staff were deployed from other areas. Customs estimated the salary cost of deploying these resources was approximately \$4.9 million per annum. The intervention strategy covers all air cargo examinations, including:

- inspecting 100 per cent of all HVLV consignments;
- physically examining specifically targeted high risk air cargo consignments – these may be covert examinations;
- compliance related air cargo examinations; and
- screening low risk general air cargo consignments.

3.22 To assess the success of the 70 per cent strategy, the ANAO reviewed the intervention rate and successful detections. Customs advised that reliable intervention data was not collected prior to 1 July 2004. The ANAO found that, for 2004–05, Customs met the 70 per cent intervention target nationally.

Success rate of mass-screening of air cargo

3.23 A strategic intelligence assessment of the impact of mass-screening on Customs' drugs and firearms detections was completed in March 2003. The assessment, which covered the period 2000–02, noted that the 70 per cent target was being achieved:

....but is focused on the lower risk sub-streams [such as HVLV] due to their suitability for mass-screening. Detections in the general air cargo stream, believed to be the highest threat sub-stream in air cargo, will likely remain static until there are greater resources to examine and target consignments at a greater rate and depth.⁸⁰

3.24 The report noted that the impact of mass-screening of air cargo is most successful in the HVLV stream. Consignments containing anything more than documents are easily detected using x-ray technology, leading to an increase in

⁸⁰ Australian Customs Service, Strategic Assessment No.01/03 *The Impact of Mass Screening on Customs' Detections*, March 2003.

the detections of drugs in tablet form. The assessment also found that there was no substantial impact on the detections of firearms.

3.25 At the time of the audit, detections in the air cargo environment were recorded in the EXAMS system under the relevant 'positive finds' category⁸¹ and were not attributed to the mass-screening strategy. This means that data could not be extracted from the EXAMS system to assess the detections resulting from the mass-screening initiative.

Firearms and compliance related data

3.26 The regions provide firearms data in a six-monthly report to Central Office. Analysis of this data showed that mass-screening has had no major impact on firearm incidents or detections. The Compliance Branch records compliance related detections for Customs' Border Statistics.⁸² These detections can be attributed to the mass-screening strategy however, reliable data was only available from 1 July 2004. In 2004–05, the majority of compliance related finds were for minor quarantine goods and minor prohibited imports.⁸³

Drug related data

3.27 Illicit and other drugs data is recorded by drug type in Customs' DRUGLAN database. Customs could only determine whether the detection was as a result of targeting or mass-screening by reviewing the intelligence report for each case. This is resource intensive and was only completed for illicit drug detections in 2004–05. Customs' analysis is outlined in Table 3.2.

⁸¹ Positive find categories in the EXAMS system include: currency, drugs, firearms, intellectual property, prohibited items, quarantine, revenue, stowaway, other weapons and wildlife.

⁸² Positive finds categories include: major/minor quarantine; major/minor prohibited imports; major/minor revenue; currency; wildlife; and other.

⁸³ Minor undeclared quarantine items and minor undeclared prohibited items are goods found where no record of interview is held and no referral to the Investigation Branch takes place.

Table 3.2**Targeted and mass screened drug detections in air cargo for the period 1 July 2004 to 30 June 2005**

	Count		Weight (grams)	
	Targeted	Mass Screened	Targeted	Mass Screened
Cocaine	42	14	31 249	6 546
Heroin	23	10	10 761	2 227
MDMA (Ecstasy)	5	4	821 125	697
ATS	4	6	1 323	136
Total	74	34	864 458	9 606

Source: Australian Customs Service DRUGLAN database and National Intelligence System records

3.28 There were considerably more targeted detections than those resulting from mass-screening. The weight of drugs detected in targeted consignments was also significantly higher than in the mass-screening stream. Customs advised that mass-screened detections may lead to further detections through targeting, and is undertaking further evaluation in this area.

Evaluation of strategy

3.29 Apart from illicit drugs and firearms detections, the ANAO found that Customs has not evaluated nationally, or regionally, whether there have been other positive/negative effects flowing from this strategy. For example, has there been an increase or decrease in compliance related detections for the period and in what regions. It may be useful for Customs to undertake a further intelligence assessment on the impact of mass-screening, extending the scope beyond illicit drugs and firearms detections. The knowledge gained from such an assessment may assist the neutron scanner project that Customs is currently piloting.⁸⁴ If this project is successful, all air cargo will be inspected for explosives, drugs and other risks at the consolidated level.

Neutron scanner project

3.30 Customs has been working with the Commonwealth Scientific and Industrial Research Organisation (CSIRO) to develop an innovative and cost effective solution to enhance air cargo security. Tests with a laboratory

⁸⁴ The neutron scanner trial was funded as part of an aviation security package announced by the Government in December 2003.

prototype have shown that fast neutron imaging technology can screen air cargo containers successfully.

3.31 The CSIRO has constructed and installed a full-scale commercial prototype unit at Brisbane Airport. Customs advised that a field trial, of up to 18 months, will commence in the near future. An independent evaluation of the facility, including the technology and Customs processes will be undertaken from the commencement of the trial to allow an assessment of its full capacity in a real working environment.

Recording and reporting examination results

3.32 Customs initially developed the EXAMS 1A database as a mechanism for notifying the CEFs of containers selected for examination. In October 2003, the database was upgraded to the EXAMS 1B system and became Customs' national system for recording all cargo examinations. EXAMS 2 was released in June 2005 and the next system release will interface with ICS. This release will reduce the data entry workload as a number of fields will be pre-populated.

3.33 The ANAO found that there are difficulties surrounding data entry requirements, the integrity of the data and the ability to access, extract and analyse examination results. Officers are required to record the results of positive detections in the EXAMS system. The ANAO found that this procedure is not always enforced in the mass-screening of air cargo⁸⁵ and, as previously noted, not all UPE examinations are recorded in the EXAMS system. The ANAO also found that, although the EXAMS system is being used to record examinations, all regions have developed local databases for recording compliance activities and examination results because of the perceived inadequacies of the EXAMS system.

Extracting and analysing compliance data

3.34 The ANAO found that it is currently very difficult to access and analyse the outcomes of compliance related examinations. The system does not record the workgroup requesting the examination and therefore it is not possible to match the results of an examination to the area that initiated it. The ANAO considers that this information would allow Customs to monitor and evaluate the performance of each workgroup. Determining the positive finds

⁸⁵ Because of the volume of air cargo being examined and the time-consuming process of recording data in EXAMS, not all regions are recording minor detections that will not be followed up.

associated with compliance activities or areas is also problematic. The business rules and procedures in the EXAMS workbook do not clearly define how positive finds are to be recorded. For example, a detection involving multiple items may be recorded as either one find or a number of finds. This is currently determined by the examining officer.

3.35 The ANAO recognises that, currently, the process for entering data into the EXAMS system is time consuming. However, capturing examination results is important for evaluating trends, identifying emerging patterns of non-compliance and assessing profile effectiveness. This type of data analysis should be feeding into intelligence gathering and compliance planning processes. This is the purpose of the reporting and analytical capacity offered by the Corporate Research Environment (CRE) in Central Office. Customs established the CRE to provide an integrated analytical facility that supports a wide variety of data sources and users, including the EXAMS system.

3.36 At present, Customs does not analyse or effectively use the data retained in the EXAMS system or regional databases. If examination results are to be accurately and consistently reported and analysed, it is important that Customs:

- identifies, in the EXAMS system, specific compliance workgroups requesting examinations; and
- develops and implements 'compliance specific' business rules and procedures, particularly in relation to how a positive find is categorised.

3.37 Currently, results are recorded in local databases, the EXAMS system and the Border Statistics database. This duplication of effort is unnecessary. The EXAMS system is designed to capture most of the data that is being stored in the other systems/databases. If activities and results were accurately and consistently recorded in EXAMS, there would be no need for the monthly reporting of examination results to Central Office, this information could be obtained from the CRE using standardised report templates.

Recommendation No.4

3.38 To enable the accurate and consistent reporting of compliance examinations, the ANAO recommends that Customs develop:

- (a) functionality within the EXAMS system to identify the compliance workgroup requesting an examination;
- (b) 'compliance specific' business rules and procedures for recording activities and examination results in the EXAMS system; and
- (c) standardised report templates in the Corporate Research Environment that are specific to the Compliance Branch.

Customs response

3.39 Agreed.

4. Post Transaction Compliance Activity

This chapter examines Customs' processes for undertaking post transaction audits and compliance checks. The compliance strategies developed for exports and the Free Trade Agreements are also reviewed.

Introduction

4.1 Customs monitors the compliance of industry segments and individual clients in a post transaction context to verify compliance with legislative requirements and in response to identified risks. Activities include audits of individual clients and compliance checks of Customs' licensed premises. The ANAO reviewed these activities and Customs' response to non-compliance. The new compliance strategies developed for exports and the Free Trade Agreements were also examined.

Post transaction audit activity

4.2 Customs' post transaction audit activity evaluates industry practices and records to assess the integrity of the information provided to Customs and, in turn, the level of compliance with legislative requirements. Substantive testing verifies that correct payments/declarations were made over the audit period. Audits also provide an opportunity for Customs to test client's systems and controls and to identify operational or systemic weaknesses.

Types of audits

4.3 Compliance audit activity includes focused, benchmark and desktop audits. Focused audits are aimed at assessing areas within a client's operations where there is a perceived medium to high level of risk. Benchmark audits are undertaken as part of Customs' Compliance Benchmark Testing Program to verify compliance industry wide and provide assurance in terms of revenue leakage and data integrity.⁸⁶ These audits are randomly selected by Central Office and are not conducted in response to identified risks, however, where results indicate non-compliance, Customs will initiate the appropriate response. Desktop audits are document verification checks of nominated

⁸⁶ This Program is discussed in Chapter 5.

transactions.⁸⁷ The actual number of transactions will depend on the level of import and export activity and the risks they present. If the audit identifies a risk of non-compliance, a focused audit, client education or other appropriate response will be recommended.

Audit activity

4.4 Annual audit programs generally include: benchmark and focused audits; referrals from other areas; and audits from the previous year that were not completed. The frequency of auditing specific clients and industry segments is based on the perceived level of risk they pose. The ANAO found that the audit planning process was often based on officer knowledge, experience and intuition and did not include a formal assessment of risks or the level of confidence in the client's ability to comply.⁸⁸

4.5 Clients are advised when an audit will be undertaken and an entry interview arranged. Testing of transactions is undertaken at the client's premises and all documentation, analysis and results are recorded in the TeamMate system⁸⁹ and Import/Export Data Integrity Variances and Errors (IDIVE/EDIVE) spreadsheet. An audit report is prepared and the client's level of compliance is discussed at the exit interview. An internal report is circulated to relevant areas within Customs.⁹⁰ Appendix 4 outlines the audit process.

Quality assurance program

4.6 In April 2002, Customs initiated a quality assurance (QA) program to refine audit processes, ensure consistency across regions and to identify adverse trends. In 2003–04, 30 audits were reviewed as part of the QA program and, in 2004–05, 19 audits were reviewed. Issues identified were the incorrect use of consent forms and the inconsistent and inappropriate use of TeamMate. Customs advised that these issues are being addressed through staff training and improved TeamMate libraries.

⁸⁷ Documentation is requested and verified under sections 240AA and 240AC of the Customs Act.

⁸⁸ Customs' confidence in a client's ability to comply is recorded on the Import/Export Data Integrity Variances and Errors spreadsheets.

⁸⁹ TeamMate is the electronic system used by Compliance auditors to record all elements of Customs' audit methodology.

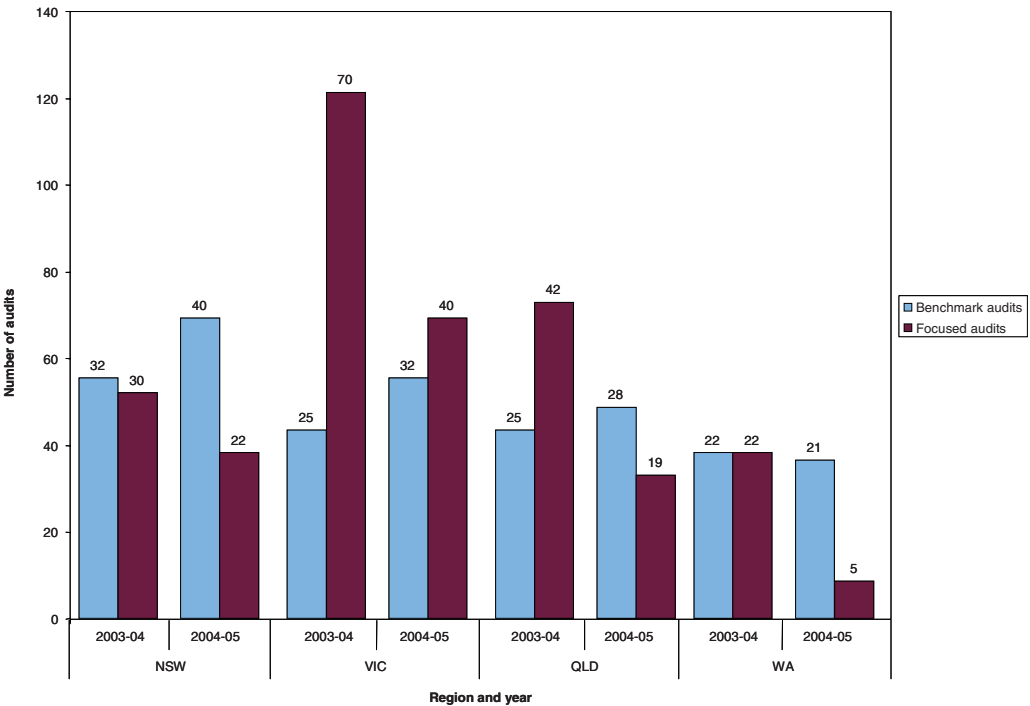
⁹⁰ The internal report does not replicate the audit report; it contains a more detailed and relevant compliance record. The report provides managers with information about the conduct and results of the audit, identifies any tactical or technical issues and should be used for future risk assessments.

Audits completed

4.7 The ANAO reviewed the audits completed by each region during 2003–04 and 2004–05 and found considerable variation between the number of audits the regions advised they had completed and the number recorded by Central Office. Appendix 5 details the differences between the data sets. Customs agreed that regional data would be used for the analysis of audit activity, which is outlined in Figure 4.1.

Figure 4.1

Benchmark and focused audits completed in 2003–04 and 2004–05



Source: Australian Customs Service

4.8 The ANAO found that there was a reduction in audit activity in 2004–05, this was predominantly focused audits. All regions indicated that a lack of resources had impacted on their ability to complete their audit programs and priority was given to benchmark audits. This has meant that, particularly in the smaller regions, (such as Western Australia), the majority of audits completed in 2004–05 were benchmark audits and these were at the expense of focused audits. Additional compliance resources have been funded in the 2005–06 Budget.

4.9 The Victorian region developed a Desktop Audit Program⁹¹ to enable, within existing staffing levels, a greater coverage of industry segments and clients. The Program provided the region with another mechanism to: identify non-compliance; develop client risk ratings; and monitor low risk clients. The ANAO was advised that other regions also complete desktop audits. However, these audits are not part of a planned program or reported to Central Office. The ANAO considers that other regions would benefit from introducing a program similar to Victoria's. This program should be properly planned and the audits recorded, reported and evaluated.

Recommendation No.5

4.10 To supplement existing audit programs and to more broadly monitor the compliance levels of clients and industry segments, the ANAO recommends that Customs consider implementing nationally a Desktop Audit Program similar to that being undertaken by the Victorian region. This program should be properly planned and the audits recorded, reported and evaluated.

Customs response

4.11 Agreed. This recommendation has been implemented and is included in the audit programs for 2005–06.

ANAO audit sample results

4.12 The ANAO reviewed an indicative sample of 65 compliance audits covering all regions and found:

- 25 audits did not have an internal report. The ANAO considers this report should be provided to Risk Identification and Intelligence as part of the intelligence feedback process and reviewed when planning future audit activity;
- audit reports and IDIVE/EDIVEs completed for focused audits were not evaluated by either the regions or Central Office;
- only five revisits had been scheduled despite 37 audits noting the need for further improvement. There is no mechanism to ensure that follow-up visits occur; and
- the use of TeamMate was often inconsistent and inappropriate (as noted in the QA program).

⁹¹ The Program included 56 desktop audits in 2003–04 and 64 in 2004–05.

Audit outcomes

4.13 Non-compliance identified through audit activity generally relates to the non-payment or incorrect calculation of customs duty and/or taxes. In these cases, a post warrant amendment (PWA) is submitted⁹² and, depending on the circumstances involved, a penalty or infringement notice may also be issued. The duty adjustments as a result of audit activity for 2004–05 were \$1.3 million underpaid and \$63 402 overpaid. Customs was unable to provide details of the penalties and infringement notices issued during this period because of data migration problems between the Interim Penalties System and the Penalties System (Version 2).⁹³

Compliance activities relating to licensed premises

4.14 Customs' licensing system⁹⁴ enables importers and owners of imported goods to defer the duty payable on these goods by storing them in Customs' licensed warehouses⁹⁵ until they are ready to be entered into home consumption or exported. Cargo depots may also be granted a license to hold, pack, unpack, and/or examine imported goods and export cargo, which is subject to Customs control.⁹⁶ As part of CCAS, Compliance Assurance teams undertake compliance checks of these premises.

4.15 The regions develop an annual compliance visitation program, which is based on an assessment of the risks posed by the warehouse or depot.⁹⁷ Compliance checks are based on a random selection of entries or lines of stock and are designed to validate that the:

- receipt, movement and release of goods was in accordance with legislation;
- goods were as reported; and
- goods released for home consumption were correctly recorded.

⁹² A PWA may be either voluntary or involuntary. A voluntary PWA is where the client identifies the short payment and an involuntary PWA is where Customs identifies the short payment.

⁹³ The Penalties System is discussed in para. 5.16 of Chapter 5.

⁹⁴ The Licensing Group in Central Office is responsible for approving licence applications.

⁹⁵ Warehouses are licensed under section 79 of the Customs Act and fall into two categories: private warehouses where the goods are held by the owner of the goods; and general warehouses where the proprietor holds the goods on behalf of one or more owners.

⁹⁶ Depots are licensed under section 77G of the Customs Act.

⁹⁷ New operators are treated as high risk until they have developed a compliance history.

4.16 Where non-compliance is detected, for example, goods being delivered without Customs' authority, the client is asked to provide a written submission explaining the reasons for and circumstances surrounding the breach. This information is taken into account when determining Customs' response.

4.17 The ANAO found the frequency of compliance visits, the number and type of checks and the entries/lines sampled varies across regions. The regions generally developed their own visitation programs for licensed premises. Most warehouses and depots were risk rated although Customs advised that, for some, this rating was more intuitive than analytical. The ANAO was advised that these programs were not always completed because of a lack of resources. This means that, in some regions, low risk operators may not be visited for a number of years and there are smaller operators who have never been visited from a compliance perspective. The lack of resources should be addressed when the additional compliance officers, funded in the 2005–06 Budget, become available.

4.18 The ANAO found considerable variation in how the regions record the results of these compliance checks. For example, in New South Wales most compliance checks for warehouses are recorded in TeamMate and depot checks are recorded in a local compliance database. Victoria and Western Australia record checks in a local database or operational file and Queensland uses a spreadsheet. The ANAO requested data from the regions relating to: the number of warehouses and depots; the visits undertaken; the number and value of penalties issued and section 35A claims (where goods could not be accounted for) for the period 1 July 2003 to 30 June 2005. This information was not readily available and, for some regions, it was not possible to provide it. For example, Western Australia does not record details of the visits it undertakes for depots, only the checks completed each month. This has emphasised the need for clear guidance on what information is to be recorded and where it is to be recorded.

4.19 Similarly, it was difficult to obtain the number of penalties issued. Licensed premises are not a 'searchable field' in the Penalties System and, as previously noted, there were problems in migrating data into the new system. To get an accurate figure, individual records and/or operational files had to be reviewed. Table 4.1 summarises for the two-year period the total value of penalties issued and section 35A claims in relation to licensed premises.

Table 4.1**Penalties issued and section 35A claims for 2003–04 and 2004–05**

Period	Penalties Issued	Section 35A claims
2003–04	\$43 560	\$515 062
2004–05	\$38 280	\$834 570
Total	\$81 840	\$1 349 632

Source: Australian Customs Service

4.20 Central Office is not advised of the results of these compliance checks and the regions do not evaluate them. As a consequence, there is little understanding, particularly nationally, of how compliant licensed premises are, the compliance issues relating to them or if there is consistency across regions when undertaking these checks. Although standard operating procedures have been developed, there is no national compliance strategy for licensed premises.

4.21 To better coordinate and manage the compliance activities relating to licensed premises, the ANAO considers Compliance Operations should develop a national compliance strategy that draws on the experience of the regions and incorporates annual regional visitation programs. The strategy could give guidance on how depots and warehouses are to be risk rated, the frequency of scheduled visits, the compliance checks to be undertaken and how the results of checks are to be recorded and evaluated.

4.22 The results of these activities should be evaluated to determine whether the strategy is being implemented properly and to provide baseline data. Prior to developing the strategy, the ANAO considers it would be useful for Compliance Operations to undertake a review of existing compliance practices. This would provide an appreciation of the work currently being done by the regions and the issues relevant to this industry segment.

Recommendation No.6

4.23 To better coordinate and manage the compliance activities relating to licensed premises, the ANAO recommends that Customs:

- (a) undertake a review of current compliance activities being carried out by the regions;
- (b) develop and implement a national compliance strategy incorporating an annual visitation program; and
- (c) regularly evaluate the results of this strategy.

Customs response

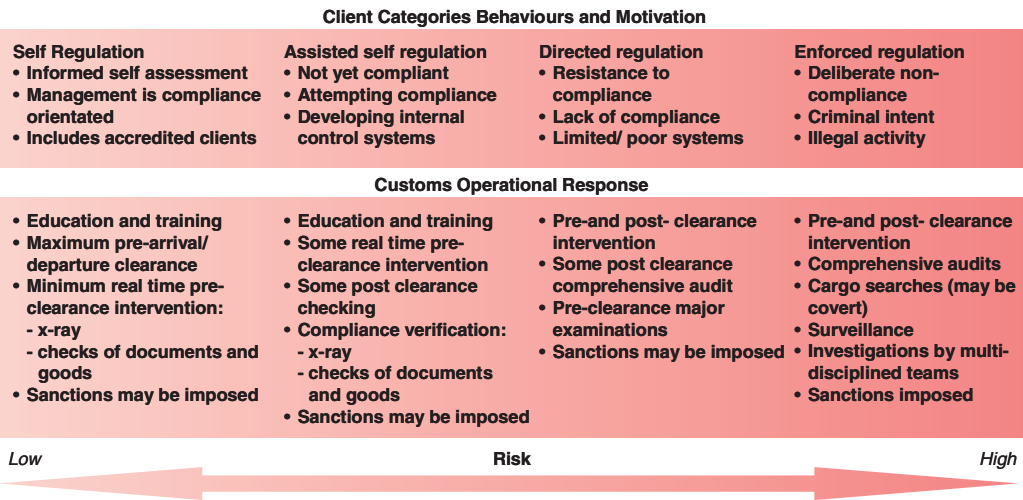
4.24 Agreed.

Response to non-compliance

4.25 Customs’ response to non-compliant behaviour is determined by the extent and nature of the non-compliance. Customs’ Compliance Continuum outlines this philosophy and is illustrated in Figure 4.2.

Figure 4.2

Customs’ Compliance Continuum



Source: Australian Customs Service

4.26 At one end of the spectrum, compliance activities are aimed at educating and persuading clients to comply with legislative requirements while, at the other, activities deter, detect and correct non-compliance. The

CCAS is seen as the operational embodiment of this philosophy, assisting clients who are willing and capable of complying and imposing sanctions on individuals who refuse to comply. Intervention strategies and the circumstances under which they may be applied are outlined in the CCAS.

4.27 The ANAO found that clients were advised of the outcome of compliance activities including the details of any non-compliant actions. Response initiatives were tailored to the particular circumstances and included education strategies⁹⁸, issuing warning letters, discussions with the company's senior management, development of compliance improvement plans, focused audit activity, penalty action and infringement notices.

Infringement Notice Scheme

4.28 A range of new penalties was introduced in July 2002, including a number of strict liability penalties.⁹⁹ The Infringement Notice Scheme (INS) guidelines assist the delegate through the decision-making process and administrative thresholds ensure offences of similar consequences are recorded and referred to the delegate. The ANAO considers that Customs has provided clear guidance and policy direction to enable an appropriate response to non-compliant behaviour. The Regulatory Philosophy, CCAS and INS guidelines articulate responsibilities, options and processes to be followed. The ANAO found that all regions were implementing these instructions.

4.29 Where non-compliance is regarded as being serious or criminal, Customs advised that enforcement action will be taken. Under the Commonwealth Fraud Control Guidelines (May 2002), Customs is able to investigate offences and prepare briefs of evidence for the Commonwealth Director of Public Prosecutions or Australian Government Solicitor. The Investigations Branch undertakes such investigations either independently or in conjunction with other government organisations and law enforcement agencies. In 2004–05, Compliance Assurance referred 56 cases to the Investigation Branch.

⁹⁸ These were undertaken as part of industry wide forums, with particular industry segments and on a one-to-one basis with clients.

⁹⁹ Strict liability offences do not require intent to be proven.

New compliance initiatives

4.30 New compliance strategies have been developed to address the Free Trade Agreements with Thailand and the United States of America and changes in the export environment.

Exports Compliance Strategy

4.31 Customs has increased its focus on exports compliance because of the changes associated with the implementation of ICS and the Trade Modernisation legislation, international security concerns and the potential for revenue leakage, particularly GST through diversion into home consumption.

4.32 Whilst acknowledging the absence of any nationally coordinated risk or industry trend analysis of the export environment, Compliance Operations has developed an Export Compliance Strategy and compliance program for 2005–06. It is intended that the strategy will provide a focus and direction for all compliance activity within the exports environment and the program outlines the compliance activities to be undertaken by the regions.¹⁰⁰

4.33 The ANAO considers the strategy reflects the principles outlined in the CCAS and provides a framework for export compliance activities. An important element of this strategy should be the evaluation of the program's results. This information will: provide baseline data for an environmental risk analysis; determine whether the objectives of the strategy are relevant and being met; and underpin future planning activities.

Free Trade Agreement Compliance Strategy

4.34 Australia has entered into the following Free Trade Agreements (FTAs)¹⁰¹:

- Thailand – Australia Free Agreement¹⁰²; and

¹⁰⁰ Activities include projects, benchmark and focused audits and will also address the new responsibilities of cargo terminal operators, depots and warehouses as a result of the recent legislative changes.

¹⁰¹ An FTA is a bilateral, preferential agreement between two countries aimed at securing maximum access to each other's domestic markets in order to facilitate trade in goods and services. FTAs generally involve a removal or lowering of explicit trade barriers, including tariffs and import quotas.

¹⁰² This Agreement, signed in July 2004, will lead to the elimination of all of Thailand's tariff and quota barriers on imports from Australia. Australia will also eliminate tariffs on goods produced in Thailand.

- Australia – United States Free Trade Agreement.¹⁰³

4.35 Customs' responsibility in relation to the FTAs focuses on the administration and enforcement of Rules of Origin (ROO). The ROO are used to determine which goods may enter Australia under preferential duty treatment. Customs' focus on FTA compliance is designed to strike a balance between the increased whole of government emphasis on facilitating free trade and the potential loss of revenue by not adhering to the ROO.

4.36 The strategy, which commenced on 1 July 2005, will provide focus and direction for all compliance activity relating to the enforcement of the FTAs. The strategy outlines the compliance activities to be undertaken and these will allow Customs to gain a better understanding of the environment, develop targets for subsequent intervention and meet the international obligations of the FTAs.¹⁰⁴ As there is no historical data to draw on, the ANAO considers it is particularly important that the results of these compliance activities are routinely evaluated. As well as providing baseline data, this analysis will be an important input into the proposed half-yearly review of the strategy.

¹⁰³ This Agreement, signed in May 2004, provides Australia and the United States with, among other things, preferential access to each other's goods. Over time, each Party will eliminate tariffs on the import of those goods from the other country.

¹⁰⁴ These include: electronic profiling; documentary checks; focused audits; physical examinations; export verification audits; and saturation exercises.

5. Planning and Performance Evaluation

This chapter discusses the planning processes that underpin the Compliance Assurance Strategy. The mechanisms for evaluating the effectiveness of the Strategy overall and its compliance activities were also reviewed.

Introduction

5.1 It is important that Customs has an effective framework for planning, monitoring and evaluating the effectiveness of its compliance activities. This framework should be aligned with the organisation's outcomes and outputs structure and generate information that is appropriate for both internal performance management needs and external reporting requirements. The ANAO reviewed the planning processes that underpin Customs Compliance Assurance Strategy (CCAS) and how it determines the effectiveness of the compliance activities that contribute to the Strategy.

National and regional CCAS program planning

5.2 CCAS planning is based on a current strategic risk assessment, Government and stakeholder priorities and policy objectives.¹⁰⁵ Although national priorities are identified and the CCAS is managed and evaluated centrally, the Strategy is implemented through regional work plans. These plans incorporate activities specific to local risks and environments and are developed within Customs' Planning and Performance Framework.

Customs' Planning and Performance Framework

5.3 Customs' Planning and Performance Framework encompasses three levels: governance, operational and individual. Plans are linked hierarchically and align management decisions and the implementation of those decisions by the relevant work areas and staff members. Customs' strategic direction is outlined in its Corporate Plan and Corporate Priorities Statement. At the operational level, National Business Plans and Work Area Plans outline how the strategic direction will be delivered and the tasks that each area will

¹⁰⁵ Australian Customs Service, *Customs Compliance Assurance Strategy*, National and Regional CCAS Program Planning (Attachment 2), p.8.

complete. An assessment of risks is incorporated into each plan and appropriate treatment strategies developed.

5.4 The ANAO found that Customs' Planning and Performance Framework is well designed and ensures plans are aligned and mutually supportive. It articulates responsibilities and acknowledges the relationship between managing resources and delivering outcomes. The National Compliance Business Plan identifies compliance risks and reflects national priorities. Regional Work Area Plans incorporate these risks, identify regional priorities and outline the activities to be completed as part of the CCAS.

5.5 The CCAS is also prioritised and endorsed by the National Priorities Committee (NPC) and Regional Priorities Committees (RPCs) ratify regional compliance assurance programs.

National and Regional Priorities Committees

5.6 The NPC and RPCs were established to guide Customs' intelligence and compliance activities. The ANAO found that there were concerns in Central Office and across all regions that, collectively, the committees were not providing the direction and oversight envisaged when they were initially established.

National Priorities Committee

5.7 The key responsibilities of the NPC¹⁰⁶, which first met in July 2003, are to:

- prioritise national risks in order to identify and articulate national intelligence and compliance priorities;
- consider, prioritise and endorse national intelligence projects and assessment taskings and Compliance Assurance programs; and
- report on priorities determined for national intelligence effort and compliance programs.

5.8 The ANAO has been advised that Customs is considering undertaking a formal review of the NPC to determine whether the Committee is achieving the purpose for which it was established and that its terms of reference are still relevant. The ANAO considers that such a review would be beneficial,

¹⁰⁶ The Committee is to meet bi-annually but will deal with matters referred by the National Manager Compliance or the National Manager Risk Identification and Intelligence out of session and will meet to consider significant matters as required.

particularly as the NPC has considerable influence on the direction of the CCAS and the intelligence capacity that supports it.

Regional Priorities Committees

5.9 The primary role of the RPCs is to articulate regional priorities, allocate resources to address these priorities and assess the performance of the region against the priorities. The RPCs are to meet quarterly and whenever required to deal with urgent issues. The ANAO found that, in some regions, the RPCs have not met quarterly as required.

5.10 The Victorian region has put considerable effort into making its RPC more effective as well as looking at ways that it may best influence the NPC agenda. The region recently put forward a number of suggestions to raise the profile of the NPC/RPC relationship and to more effectively align intelligence and compliance resources. These initiatives broadly cover: developing a model that will enable it to examine resources; producing quarterly and longer-term intelligence assessments; and developing a reporting framework. The ANAO supports these initiatives, as they will provide the RPC with a more strategic view of regional activity.

5.11 The ANAO considers that it would be worthwhile to include in the scope of the NPC review, an assessment of the approach being adopted by the Victorian RPC. The ANAO was advised that other regions are looking at this model to help guide the direction of their own RPC. If considered appropriate, the model could be implemented nationally. This would ensure a consistent approach across RPCs and the reporting framework would give the NPC a national picture of regional activity against national priorities.

National assessment of compliance program risks

5.12 The CCAS planning model requires Central Office to consolidate the overall CCAS program risks and priorities. However, there has been no evaluation of compliance activities or their results on which to base such an assessment. Customs' environmental risk analysis project¹⁰⁷ should identify compliance risks, priorities and emerging issues and allow Central Office to take a greater role in coordinating activities. The regular review of environmental data and evaluation of compliance strategies should be incorporated into planning and risk assessment processes.

¹⁰⁷ Discussed in Chapter 2 paras 2.29 - 2.32.

Regional assessment of compliance program risks

5.13 The ANAO found that in the regions, compliance activity planning is generally undertaken at the individual Compliance Assurance team level rather than across all teams and in conjunction with Risk Identification and Intelligence (RI&I) Branch. In Victoria, the Compliance Assurance teams and the RI&I's Assessment and Analysis group have undertaken joint risk assessment and planning workshops to develop their 2005–06 work programs. This approach allows compliance risks to be assessed and prioritised and activities coordinated. The ANAO has recommended that all regions consider adopting this approach.¹⁰⁸ The regions will then be in a position to provide input into the national assessment of compliance risks and priorities in line with the program-planning model.

Evaluating the effectiveness of compliance activities

5.14 Performance information should help to identify trends within and across industry segments and patterns of non-compliant behaviour. Internally, it will also enable comparison across regions, assist in determining compliance priorities and resources and provide input into management reports. The ANAO reviewed how compliance activities are reported and evaluated.

5.15 As noted in Chapter 3, compliance data is recorded in a number of systems and regional databases, including:

- the Border Statistics databases¹⁰⁹;
- a Central Office database to record audit activity¹¹⁰;
- national systems: COMPILE; EXAMS; and Penalties;
- the Declaration Validation Examination database¹¹¹; and
- multiple regional compliance databases/spreadsheets, which duplicate some of the above data, and also record additional information such as: the customs duty and taxes collected as a result of red line intervention;

¹⁰⁸ Refer Chapter 2 paras 2.37 - 2.41.

¹⁰⁹ There is a border statistics database in each region and one in Central Office. The data from the regions is downloaded each month into the Central Office database.

¹¹⁰ This database is based on data in the Import/Export Data Integrity Variances and Errors (IDIVE/EDIVE) spreadsheets received from the regions. An IDIVE/EDIVE is a template that uses the results of the audit to calculate a level of confidence in the client's compliance.

¹¹¹ This database records the results of compliance checks undertaken when examining cargo at the Container Examination Facilities.

compliance activities relating to licensed premises; and unaccompanied personal effects (UPEs) assessments and examinations.

Data integrity

5.16 During the audit, Customs found it difficult to provide the ANAO with accurate and reliable compliance data. The following examples give some indication of the data integrity problems facing Customs and the heavy reliance that is being placed on regional databases.

- Red line transactions: as limited data was available from the COMPILE system, each region was required to access their local databases. To compile this information was a time consuming exercise and Customs expressed reservations about the accuracy of the data set eventually provided.
- UPE data: data extracted from the Border Statistics database was incomplete and had significant discrepancies.¹¹² As a consequence, data was sourced directly from each region. The ANAO also requested examinations and positive finds data be retrieved from the EXAMS system. There were considerable differences between these data sets.¹¹³
- Penalties System (Version Two)¹¹⁴: problems occurred when migrating data from the Interim Penalties System into this system.¹¹⁵ As a result, this data had to be sourced from regional databases/spreadsheets and, in some instances, operational files.
- Audit activity: the number of completed audits in the Central Office database could not be reconciled with regional audit work programs.
- Licensed premises: data is only retained by the regions and is not recorded consistently across regions.

5.17 Each region has developed local databases/spreadsheets to record the compliance activities they undertake, as there is no national compliance system. However, the ANAO is not confident, based on the identified discrepancies between the various data sets, that the information is accurate and recorded consistently across regions. The discrepancies also highlight that accurate and reliable data is not readily available or being used to evaluate the

¹¹² Information from this database is used in management reports and public documents such as the Annual Report and Customs Figures.

¹¹³ Refer Appendix 3.

¹¹⁴ Non-compliance records, penalty records, infringement notices and the value of penalties are recorded in the Penalties System (Version Two).

¹¹⁵ Any record created on or before 31 March 2005 is recorded as being created on that date.

effectiveness of CCAS compliance activities or as a basis for management decisions. Customs initiated a project to develop a standard set of performance measures for regional compliance activity in October 2004. However, this project has not been finalised nor has it resolved the data integrity issues raised in this audit.

Data analysis

5.18 The ANAO found that, with the exception of the Compliance Benchmark Testing (CBT) Program¹¹⁶, there is no systematic analysis of compliance data by either Central Office or most regions. As a consequence, compliance trends or patterns of non-compliant behaviour within or across industry segments are not being identified. The ANAO acknowledges the difficulties in extracting reliable data however, this does not mean that compliance activities should not be evaluated. The regions and Central Office should be analysing all available compliance data, as required by the CCAS. Without this analysis, it is difficult to know whether the Strategy is achieving its objectives, that the areas of greatest risk are being appropriately targeted and resources allocated effectively.

Recommendation No.7

5.19 To assist in allocating resources, targeting non-compliance and to determine the effectiveness of its compliance activities, the ANAO recommends that Customs:

- (a) determine the key performance data that is to be collected;
- (b) ensure that this data is recorded and reported consistently and accurately across regions; and
- (c) regularly evaluate this data.

Customs response

5.20 Agreed.

5.21 The problems associated with data reliability and integrity, particularly in the longer term, would be addressed by a national compliance management system. It was intended that a compliance module would be part of Customs' Client Data Management Strategy (CDMS).

¹¹⁶ Discussed in paras 5.34 - 5.41.

Client Data Management Strategy

5.22 The original CDMS business case (June 2001) included a Compliance management module. There have been several revisions¹¹⁷ to the original business case and the aim of the latest revision was to:

- incorporate a number of recent program changes; and
- present a revised program delivery strategy in support of the National Resource Allocation (NRA) funding submission for 2004–05.

5.23 In this business case, it was proposed that the Compliance module be included in a case management module, which would also include Investigations, Intelligence and Targeting. It was considered that there was a common set of principles for these modules that centred around the concept of case management. As a result, the CDMS Steering Committee endorsed a proposal to combine these elements into a single case management module. Customs advised that it has recently been recognised that a case management module may not meet the needs of the Compliance Branch.

5.24 The ANAO would agree that the random or periodic compliance activities undertaken as part of the CCAS, although client based, are in no way similar to the complex fraud investigations undertaken by the Investigations Branch. These activities are not managed on an ongoing case basis and it may not be practical to record them in a case management system, which would need to be developed to record evidence, witness statements and prosecution briefs.

5.25 The ANAO was advised that funding was not approved for the Case Management Module in 2004–05 and that it will be re-submitted as part of a future NRA request. To ensure that the system being developed meets the requirements of the Compliance Branch, the ANAO considers a scoping study should be undertaken and, if necessary, a revised business case submitted for a national Compliance module.

5.26 The ANAO recognises that developing a CDMS module could take some time and that the project will have to compete for funding based on Customs' priorities and other projects. Therefore, as part of the scoping study, a staged solution should be developed that could be implemented over time, similar to the approach adopted for the EXAMS and Penalties systems.

¹¹⁷ These revisions include: April 2002; November 2002; January 2003; August 2003; and March 2004.

Recommendation No.8

5.27 To enable Customs to consistently and accurately report compliance data and to assist in evaluating the effectiveness of its compliance strategies, the ANAO recommends that:

- (a) a scoping study be undertaken to determine the user requirements for a national compliance module;
- (b) as part of this scoping study, a staged solution be developed that could be implemented over time; and
- (c) a revised business case supporting a staged solution be developed.

Customs response

5.28 Agreed.

Customs' outcome and outputs framework

5.29 Performance monitoring and reporting is undertaken within Customs' outcomes and outputs framework, which is outlined in Appendix 6. Output Groups Two and Three relate to the compliance activities that underpin the CCAS.

Customs' Corporate Performance Measurement Framework project

5.30 In December 2003, Customs commenced a Performance Measurement Project. This project is designed to: improve Customs performance reporting arrangements; ensure they are accurate, correct and justifiable; and better align planning processes with the development of performance measures. The ANAO has been advised that, as a result of this project, Customs' outputs have been revised and performance measures will be reviewed on an ongoing basis. The following paragraphs put forward a number of ANAO suggestions to improve performance reporting for Output Groups Two and Three.

Customs' output groups

5.31 Output Group Two relates to the processing, interception and control of restricted and prohibited imports and exports. In Customs' 2003–04 Annual Report, the number of detections and/or seizures of prohibited items (other than illicit drugs) were grouped under quarantine, restricted goods, wildlife and revenue. There is no further breakdown of this data to identify detections/seizures resulting from compliance activities. In addition, the

definitions for major and minor finds do not provide an adequate indicator of effectiveness. For example, it would be more appropriate to apply a dollar value threshold to the revenue indicator rather than whether an interview was conducted.¹¹⁸

5.32 The ANAO considers that Customs should report in Output Group Two the number of detections/seizures by the method of intervention (such as red line or UPE examinations). This information can then be compared against specific targets, benchmarks or activity levels. For example, the proportion of clients subject to compliance activities could be compared to the detections/seizures as a result of these activities. Customs can also use this information to compare trends across time periods. Time series analysis across a number of years would indicate whether an increase in the proportion of activity has had any impact on the number of detections/seizures.

5.33 Customs advised that the performance measure for revenue adjustments recovered in Output Group Three only includes post warrant amendments received as a result of audit activity. The ANAO considers that Customs could also report the number and value of penalties issued and recovered and the results of its CBT Program under this Output Group. The CBT Program provides an indication of industry compliance and the maximum possible percentage and dollar value of revenue leakage.

Compliance Benchmark Testing Program

5.34 Customs introduced its CBT Program in 2001–02. It is a statistically based program of company audits designed to estimate rates of compliance with Customs import and export entry reporting requirements. Key areas of compliance that are tested include: revenue payment; statement of CVAL and export FOB values. The sample methodology is a two staged stratified sample¹¹⁹ using cluster sampling, the clusters being importers, exporters or service providers. These clusters are grouped into industry segments, each segment being a stratum. From each sector a representative sample of companies is randomly chosen, and entry lines selected from within these companies for benchmark audits.

¹¹⁸ A minor find usually refers to an incident where a record of interview is not conducted or prosecution action did not commence. Refer Australian Customs Service, *Annual Report 2003–04*, p.34 Figure 6.

¹¹⁹ The population data set (all import/export entry lines) is broken up into sectors or 'strata' based on predetermined risk factors and samples are drawn from each stratum. Results from each stratum are combined at the end of the year to estimate overall error rates. Risk factors used have been high CVAL/FOB, or high duty liability.

5.35 Customs' measure of comparison for its leakage rates is based on a 5 per cent materiality limit referred to in the Australian Accounting Standards. A summary of the revenue leakage estimates from 2001–02 to 2003–04 is outlined in Table 5.1 and shows that revenue leakage is well within this materiality limit.

Table 5.1

Revenue leakage estimates for periods 2001–02, 2002–03 and 2003–04

Year	Customs duty (\$ million)				Goods and Services Tax (\$ million)			
	Total Duty	Calculated Leakage	Maximum Estimated Leakage ⁽¹⁾	Max % of duty	Total GST	Calculated Leakage ⁽²⁾	Maximum Estimated Leakage ⁽¹⁾	Max % of GST
2001–02	1 446.8	16.6	42.7	2.95	5 892.1	43.9	90.6	1.54
2002–03	2 824.5	1.1	8.8	0.31	11 941.3	-31.7	27.9	0.23
2003–04	4 958.6	7.1	18.8	0.38	13 389.1	-10.5	55.4	0.41

Note 1: This value includes calculated leakage and sampling error with 95 per cent confidence

Note 2: Negative amounts imply that the audit estimated that the quoted amount was overpaid in net terms

Source: Australian Customs Service

5.36 Although the purpose of the CBT Program is to achieve as wide a coverage as possible of the trading environment, significant gaps remain as the tobacco, alcohol and petroleum segments have not been sampled.¹²⁰ To address these gaps, Customs completed a 'gap analysis'¹²¹ for tobacco and alcohol.¹²² Both studies recommended that the exercises should be continued and the methodology further refined. In the case of tobacco, liaison with the Australian Taxation Office (ATO) was also required to source excise data.

ATO leakage surveys

5.37 The ATO also undertakes leakage assessments for tobacco, petroleum and alcohol. There is a Memorandum of Understanding between Customs and the ATO that supports inter-agency liaison, particularly in relation to the administration of the GST and excise duty.¹²³ During 2005, the ATO and

¹²⁰ This is because of the difficulty in reconciling import entries with movement permissions.

¹²¹ A 'gap analysis' compares the quantity of a commodity available from source versus the quantity of that commodity used or consumed in some way. Any difference or 'gap' is likely to correspond to unreported uses, such as illegal activities.

¹²² The petroleum industry is of lower risk to Customs. The majority of petroleum importations move into the excise environment immediately upon importation and become the responsibility of the Australian Taxation Office.

¹²³ An Interdepartmental Liaison Committee and a Compliance Operations Group Sub-Committee have been established.

Customs have committed to greater co-operation, particularly in relation to compliance activity. The ANAO considers there could be benefits for both agencies in undertaking the revenue leakage projects jointly where it is appropriate to do so. If this is not viable, access should be given to the relevant data.

Benchmark audits

5.38 The ANAO supports the CBT Program but also recognises the difficulties it presents to the regions. The regions give priority to benchmark audits and, as there has generally been a lack of audit resources, this has resulted in less risk-based audit activity. To reduce the burden on the regions, the sample size of the 2005–06 CBT Program has been reduced. This, coupled with an increase in compliance resources, should restore balance to regional audit programs.

5.39 In the ANAO's view, the purpose and the benefit of the CBT Program is not clearly understood by the regions. This is exacerbated by the fact that they do not receive program reports or feedback on audits. The results of the program should be communicated to regional Compliance Assurance teams. It is important for the regions to understand that, although it is not risk-based, the benchmark program indicates a level of compliance across industries nationally. This assurance is not provided by focused audits or other compliance activities undertaken as part of the CCAS, particularly as these activities are currently not being analysed or evaluated.

5.40 The ANAO considers the benchmark program is a useful mechanism for indicating industry compliance. The methodology is sound and in line with similar work being done by other Customs agencies. However, as the tobacco, alcohol and petroleum industries do not lend themselves to benchmark audits, the program should include a gap analysis for these segments. As the ATO also completes revenue assessments for these industries, Customs should, where appropriate, undertake this work in conjunction with the ATO.

Recommendation No.9

5.41 To ensure the Compliance Benchmark Testing Program provides assurance across all industry segments, the ANAO recommends that Customs:

- (a) undertake gap analysis for the tobacco, alcohol and petroleum industry segments; and
- (b) where appropriate, incorporate the revenue assessment work being undertaken by the Australian Taxation Office.

Customs response

5.42 Agreed.



Ian McPhee
Auditor-General

Canberra ACT
30 November 2005

Appendices

Appendix 1: Agency Response



Chief Executive Officer

Customs House
Canberra City ACT 2601

Mr Peter White
Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Mr White

I refer to your letter of 4 October 2005 regarding the ANAO's Performance Audit of Customs Compliance Assurance Strategy.

Customs welcomes the draft report. Progress in implementing the recommendations will be reported through the Audit Committee, which the ANAO attends. Customs response to the recommendations raised in the audit is at Attachment A. All recommendations have been agreed and some progress is also noted in our response. A Summary section has also been included for use in the Report's Summary and the brochure you propose to produce.

The audit has already been of considerable benefit and Customs is sure it will facilitate further improvement in our compliance practices. The opportunity to comment throughout the audit and during the draft report phase is appreciated. The thorough and constructive approach to the audit by Barbara Cass and Dianna Smith has contributed to a very practical report and a positive environment that will also assist Customs to implement the recommendations.

If you require any additional information please contact Shane Davie, Director Compliance Operations on (02) 6275 5936.

Yours sincerely


[L B WOODWARD]

/ November 2005

Telephone: 02 6275 6800 Facsimile: 02 6275 6796

ANAO's Performance audit of the Customs Compliance Assurance Strategy

Summary

Customs welcomes the report and has agreed with all the recommendations.

The audit has been of considerable benefit to Customs. The reduction of resources undertaking Compliance activities in recent years has been a key contributor to many of the issues identified in the report. The additional resources received for compliance activity in the 2005-06 Budget is enabling us to address many of the issues. Action to implement the recommendations is already underway and Customs is sure this will facilitate further improvements in compliance activities.

Recommendations

Recommendation No. 1, Paragraph 2.18

As there will be considerable changes to existing reporting requirements with the introduction of the Integrated Cargo System (ICS) and Trade Modernisation legislation, the ANAO recommends that Customs review the Cargo Reporting Compliance Strategy 12 to 18 months after the introduction of ICS to ensure the strategy is operating effectively in the new environment.

Customs Response

Agree

Recommendation No. 2, Paragraph 2.31

To maximise the benefits to be gained through the national environmental risk analysis project, the ANAO recommends that Customs regions:

- (a) evaluate those identified risks that are relevant to their region; and
- (b) develop compliance strategies tailored to their own environmental circumstances.

Customs Response

- (a) Agree
- (b) Agree

Recommendation No. 3, Paragraph 2.39

To provide intelligence support to Customs Compliance Assurance Strategy and to ensure that compliance risks are identified and prioritized and non-compliant activity properly targeted, the ANAO recommends that the Queensland, New South Wales and Western Australian regions:

- (a) consider outposting Risk Identification and Intelligence (RI&I) officers to work with the Compliance Assurance teams;
- (b) clearly define the role of the RI&I Branch in supporting Compliance Assurance teams;
- (c) encourage cooperation by undertaking joint risk assessment and compliance planning workshops; and
- (d) establish formal feedback processes between the RI&I Branch and the Compliance Assurance teams.

Customs Response

- (a) Agree
- (b) Agree
- (c) Agree
- (d) Agree

Recommendation No. 4, Paragraph 3.38

To enable the accurate and consistent reporting of compliance examinations, the ANAO recommends that Customs develop:

- (a) Functionality within the EXAMS system to identify the compliance workgroup requesting an examination;
- (b) 'Compliance specific' business rules and procedures for recording activities and examination results in the EXAMS system; and
- (c) standardised report templates in the Corporate Research Environment that are specific to Compliance Assurance and Compliance Operations

Customs Response

- (a) Agree
- (b) Agree
- (c) Agree

Recommendation No. 5, Paragraph 4.10

To supplement existing audit programs and to more broadly monitor the compliance levels of clients and industry segments, the ANAO recommends that Customs consider implementing nationally a Desktop Audit Program similar to that being undertaken by the Victorian region. This program should be properly planned and the audits recorded, reported and evaluated.

Customs Response

Agree

This recommendation has been implemented and is included in the audit programs for 2005-06.

Recommendation No. 6, Paragraph 4.22

To better coordinate and manage the compliance activities relating to licensed premises, the ANAO recommends that Customs:

- (a) Undertake a review of current compliance activities being carried out by the regions;
- (b) Develop and implement a national compliance strategy incorporating an annual visitation program; and
- (c) Regularly evaluate the results of this strategy.

Customs Response

- (a) Agree
- (b) Agree
- (c) Agree

Recommendation No. 7, Paragraph 5.19

To assist in allocating resources, targeting non-compliance and to determine the effectiveness of its compliance activities, the ANAO recommends that Customs:

- (a) Determine the key performance data that is to be collected;
- (b) Ensure that this data is recorded and reported consistently and accurately across regions; and
- (c) Regularly evaluate this data.

Customs Response

- (a) Agree. This work has been completed
- (b) Agree
- (c) Agree

Recommendation No. 8, Paragraph 5.26

To enable Customs to consistently and accurately report compliance data and to assist in evaluating the effectiveness of its compliance strategies, the ANAO recommends that:

- (a) A scoping study be undertaken to determine the user requirements for a national compliance module;
- (b) As part of this scoping study, a staged solution be developed that could be implemented over time; and
- (c) A revised business case supporting a staged solution be developed.

Customs Response

- (a) Agree
- (b) Agree
- (c) Agree

Recommendation No. 9, Paragraph 5.39

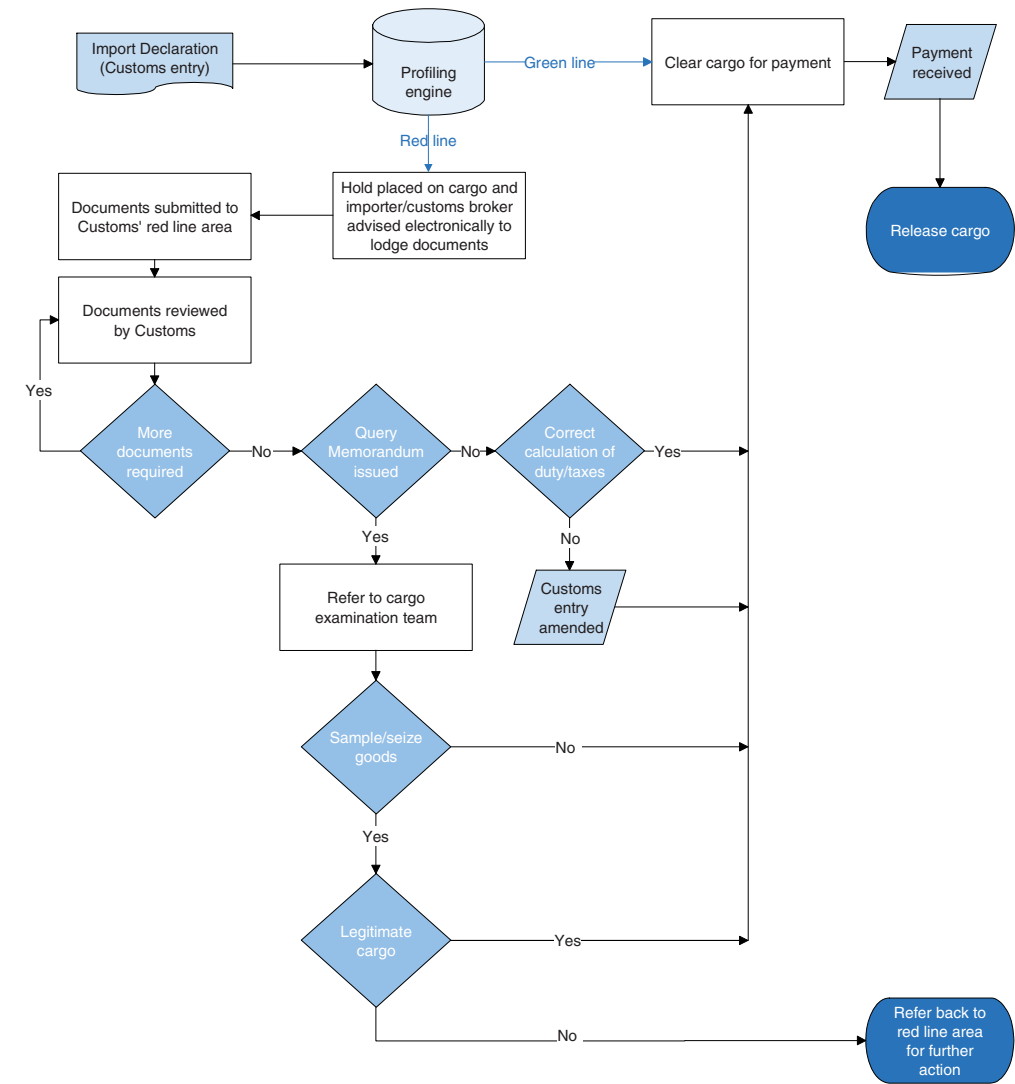
To ensure the Compliance Benchmark Testing Program provides assurance across all industry segments, the ANAO recommends that Customs:

- (a) Undertake gap analysis for the tobacco, alcohol and petroleum industry segments; and
- (b) Where appropriate, incorporate the revenue assessment work being undertaken by the Australian Taxation Office.

Customs Response

- (a) Agree
- (b) Agree

Appendix 2: Red Line Process



Source: ANAO analysis of Customs' processes.

Appendix 3: Unaccompanied Personal Effects Data

Comparison of UPE data from the EXAMS system and regional databases for the period 1 July 2003 to 30 June 2004

	National	NSW	Vic	Qld	WA
UPE statements assessed (Regions)	83 052	15 544	34 985	20 378	5 699
Physical Examinations (EXAMS)	396	23	38	285	30
Physical Examinations (Regions)	13 226	2 989	651	7 556	660
Difference between data sets	12 830	2 966	613	7 271	630
Positive Finds (EXAMS)	395	4	36	308	27
Positive Finds (Regions)	1 511	212	104	1 061	42
Difference between data sets	1 116	208	68	753	15

Source: Australian Customs Service

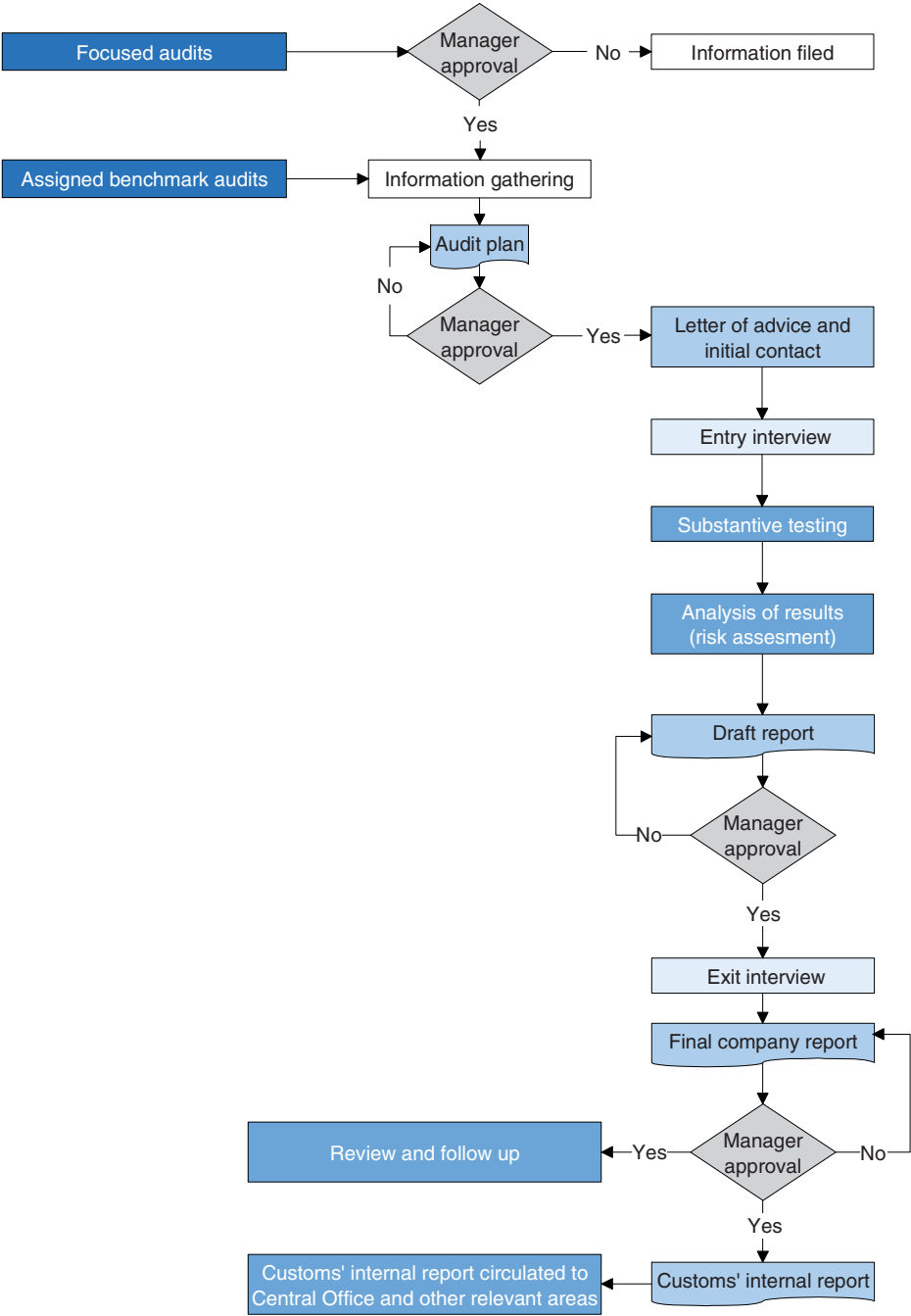
Comparison of UPE data from the EXAMS system and regional databases for the period 1 July 2004 to 30 June 2005

	National	NSW	Vic	Qld	WA
UPE statements assessed (Regions)	63 837	5 998	31 541	16 888	4 919
Physical Examinations (EXAMS)	651	31	61	528	14
Physical Examinations (Regions)	6 869	2 351 ⁽¹⁾	400	3 052	427
Difference between data sets	6 218	2 320	339	2 524	413
Positive Finds (EXAMS)	681	20	61	568	14
Positive Finds (Regions)	948	348 ⁽¹⁾	58	453	40
Difference between data sets	267	328	3	115	26

Note 1: Excludes NSW's High Volume Specialist Operator data as they do not record this information in the EXAMS system and regional data was only recorded from 1 August 2004.

Source: Australian Customs Service

Appendix 4: Audit Activity Process



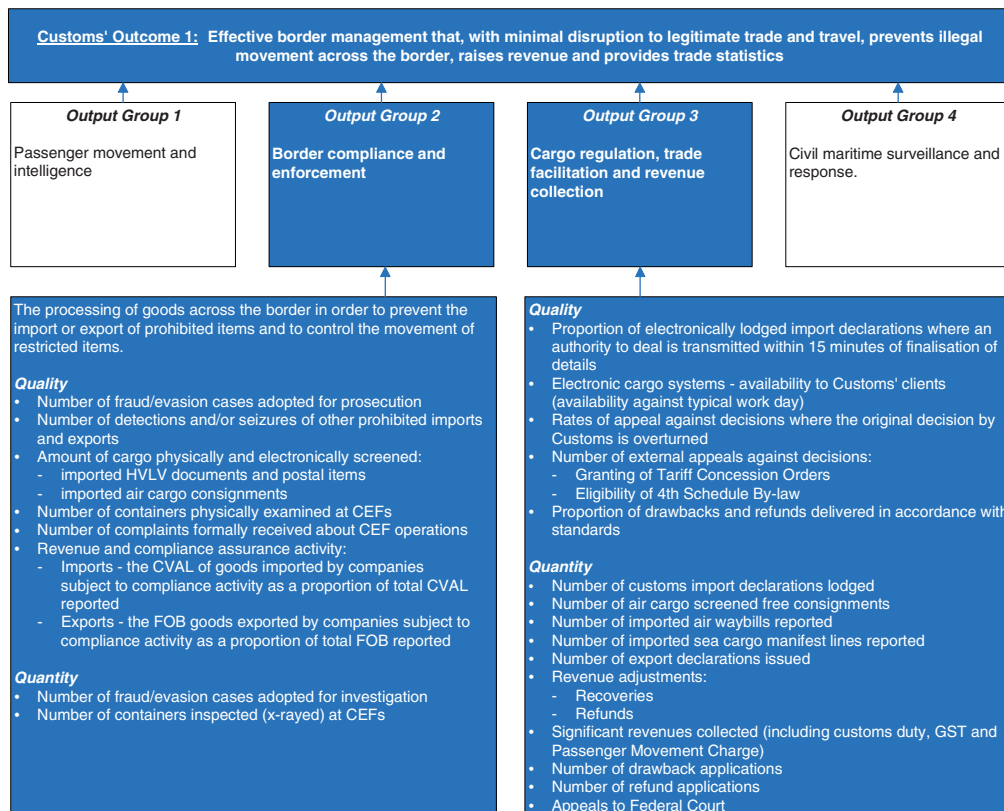
Source: ANAO analysis of Customs' processes

Appendix 5: Comparison of Audit Data for 2003–04 and 2004–05

2003–04	NSW	Vic	Qld	WA
Benchmark audits (Central Office)	32	25	24	19
Benchmark audits (Regions)	32	25	25	22
Difference between data sets	0	0	1	3
Focused audits (Central Office)	11	92	33	36
Focused audits (Regions)	30	70	42	22
Difference between data sets	19	22	9	14
Other audits (Central Office)	0	6	1	0
Other audits (Regions)	0	56	0	0
Difference between data sets	0	50	1	0
Total (Central Office)	43	123	58	55
Total (Regions)	62	151	67	44
Difference between data sets	19	28	9	11
2004–05	NSW	Vic	Qld	WA
Benchmark audits (Central Office)	40	38	27	21
Benchmark audits (Regions)	40	32	28	21
Difference between data sets	0	6	1	0
Focused audits (Central Office)	19	91	18	4
Focused audits (Regions)	22	40	19	5
Difference between data sets	3	51	1	1
Other audits (Central Office)	1	3	0	2
Other audits (Regions)	1	64	55	0
Difference between data sets	0	61	55	2
Total (Central Office)	60	132	45	27
Total (Regions)	63	136	102	26
Difference between data sets	3	4	57	1

Source: Australian Customs Service

Appendix 6: Customs' Outcome and Output Framework



Note: Shaded sections represent the elements of the outcome and output framework and the performance measures relevant to Border Compliance

Source: Australian Customs Service summarised by the ANAO.

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