

USAID Trade Facilitation and Capacity Building Project (FASTrade)
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Trip Report
Nepal Customs Modernization and Reform Advice and Assistance

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November 7, 2006

Scope of Work

During the period October 12 to November 7, 2006, FASTrade advisor Walter Hekala performed the following to meet the objectives of the USAID funded FASTrade program in Nepal:

- Reviewed previous reports and materials relevant to the design and delivery of training to the Nepal Customs for risk management;
- Prepared appropriate training materials for the training of Nepal Customs for the implementation of risk management ;
- Provide risk management training to Nepal Customs that will enable them to apply the risk management principles using the application of the ASYCUDA Selectivity Module to target shipments at risk for high revenue loss or other wise incorrect declarations;
- Provide advisory assistance to the Nepal Customs relative to risk management outside of the classroom instruction; and
- Contribute to the post-training report projecting possible required follow-up assistance to ensure success and sustainability of the training provided.

Mr. Hekala was accompanied and participated as a team member in the Nepal training with Ms. Lori Brock, COP and train-the-trainer expert, Mr. Ben Irvin, customs valuation expert and Mr. Christopher Nelson, internal investigations trainer. This report summarizes the accomplishment of the tasks summarized above.

Initial Research and Training Preparation

Initial research conducted prior to the preparation of the training materials included:

- Review of a prior report prepared by Robert Holler, consultant to FASTrade in July 2004 entitled "Customs Valuation Assistance in Nepal, Cargo Selectivity Unit Organization and Training, Kathmandu, Nepal"
- Review of a prior trip report prepared by Robert Holler, consultant to FASTrade on May 14, 2005 entitled "Nepal Customs Modernization and Reform Advice and Assistance"

- Review of all relevant pages of the Nepal Customs Internet web site including current organization chart of Nepal Customs
- Review of the World Customs Organization Internet web site to determine current position of Nepal relative to the revised Kyoto Convention and the Framework of Standards to Secure and Facilitate Global Trade (SAFE Standards)
- Review of proposed organization chart reflecting creation of a director for risk management in Nepal Customs.

The initial review established that Nepal has not committed to one of the most foundational documents for the standards for customs administrations, the revised Kyoto Convention. The review did confirm that Nepal has formally notified the WCO of and intent to implement and follow the “Framework of Standards to Secure and Facilitate Global Trade” (SAFE Standards). These two documents and the standards contained within them are fundamental to the modern business practice of risk management within a customs administration. Having committed to follow the SAFE Standards means that Nepal, as part of its risk management strategy for customs will introduce an Authorized Economic Operator (WCO terminology) that recognizes and rewards low risk companies. Further, that under the SAFE Standards that Nepal will formally exchange risk assessment information with other customs administrations.

Based on the initial review, and the proposed SOW, the validation of revenue related risks appeared to be based on the erroneous assumption that undervaluation can be controlled through border examinations. The FASTrade workbook on risk management and prior expert visits from the FASTrade team appear to have attempted to overcome this misconception by the Nepal Customs but only with limited success. Valuation verification rarely can be confirmed based on physical examination of a shipment but is done through post entry audits of the importer’s records at the importers premise.

Review of the documents also indicated that a misunderstanding of the capabilities of the ASYCUDA system could be present within the Nepal Customs. ASYCUDA is a fundamentally sound customs declaration processing software system. It contains a historical bank of information on prior declarations that can provide data to the user customs administration. Further, ASYCUDA does include rudimentary features that permit the entry of selectivity criteria that can help the customs administration suggest to the front line officers the physical examination level that will be applied at the time of the crossing of the goods. ASYCUDA does not, however, include the core functions of risk management that analyzes the historical data on prior importations to predict future probability of compliance or non compliance. This analysis must be done external to ASYCUDA either by manual statistical calculations or by another automated program. Another key difference between the ASYCUDA approach to risk management and the modern customs business practice applied under the SAFE Standards is the recognition and the establishment of high confidence in low risk shipments. Low risk targeting as a priority allows the customs administrations to maximize the use of resources by eliminating low risk shipments from the total pool of transactions as the first step.

Based on this review, the training materials Mr. Hekala prepared and modified from existing FASTrade materials meet the objectives of introducing Nepal Customs to modern risk management practices. This includes information on how to introduce an AEO program into Nepal that is compliant with the WCO SAFE standards and how to maximize the use of the

limited capacity of the ASYCUDA system to implement risk management lookouts. Further, Mr. Hekala made a recommendation that rather than an on site visit to work with customs on the practice of risk management, the last day of the proposed visit would be more effectively spent in the development of a one-year action plan that would help the Nepal Customs focus on the macro issues of the establishment of a risk management approach to their business practices.

Initial Concerns on Arrival

During our initial introductory meetings with the Nepal Customs and USAID Mr. Hekala confirmed that Nepal Customs current organization chart was accurate. At the present time, Nepal Customs does not have a functional risk management unit. Further that the practice of post entry control including the visit to importers premises is not in place. The current concepts in practice for post clearance audit are more in line with an internal rechecking of the same documents rather than an external auditing program. At the present time the Nepal Customs does not have an AEO program, but is keen on starting this type of program.

During the initial visit Customs representatives and USAID concurred with the shift in focus to spending the last day in drafting a one-year work plan for key elements of a risk management plan. Further a minor change in the delivery schedule was agreed to by all parties to accommodate the standard Sunday to Friday workweek of Nepal Customs.

Training Delivery

Mr. Hekala delivered four, half-day sessions on risk management during the period of November 1 to November 5, 2006. During the training course he covered the points of the proposed training as outlined in the schedule (Attachment 1). The training methodology used a combination of presentation, interactive discussions and participant assignments. A general objective of the training was to introduce to the participants that "risk management" within a customs administration is not a "flip a switch" change that will resolve revenue or other non-compliance concerns but rather is a business process change that requires the introduction of many components to be effective. An objective of the training was to help the participants achieve a clear understanding that on root cause analysis, often the business practices of customs are causing the risks and the resultant losses in revenue. This approach has proved successful in other applications where the customs must first understand risk management at the 50,000 foot level before getting into development of specific programs for implementing a risk management approach to declaration processing. The training in this limited timeframe could not start to cover all the aspects of even a single component of a customs risk management program in detail. Even with technical assistance it take long term commitment of at least one to two years to implement and effective risk management shift in the customs business practices.

As an illustrative example of the training, Mr. Hekala introduced the participants to the three fundamental principles that he has identified that are core to an effective customs risk management program. These are:

1. For business - where the cost of compliance is lower than the cost of non-compliance, good businesses will be compliant.

2. For government – Voluntary compliance is more effective and economical than involuntary compliance.
3. For business and government – you can't comply or enforce regulations if you don't know the regulations.

Following these three core principles the training led the participants through a series of illustrative examples of how the principles can drive the decision process of the customs risk management. The participants were given a demonstration of the Jordan Customs Integrated Tariff System (CITS) that is an Internet program that provides both government and the private sector with easy access to all government regulations applied at the time of import export or transit (Meeting principle three above.). The participants were also given training on the WCO SAFE Standards approach to an AEO program that can target building a high confidence level within customs that eighty percent or higher of the revenue is collected through voluntary compliance.

Development of a One-year Action Plan

After the conclusion of the formal training, the last day as agreed to between Nepal Customs, USAID and the FASTrade team included working with a small team to develop a one-year action plan for the Nepal Customs to begin the shift to a risk based, intervention by exception approach to customs processing of commercial shipments. During the development of the first draft of the one-year action plan the participants were challenged to develop a logical sequence following project management best practices. The one-year action plan will be modified further and put into Nepalese for submission to the Director General of Customs. The action plan is based on assumptions that the Director General will, among other things, actually assign persons into jobs within a risk management unit. The first draft of the one-year action plan is Attachment 2 to this report.

Deliverables:

FASTrade provided all the participants with hard copies of the risk management presentation in both English and in Nepalese that Mr. Hekala delivered during the course of the four-day training event. In addition, representatives of Nepal Customs were provided with soft copies of other presentations that may be helpful in the further development of their risk management strategy as well as reference materials. A list of the materials delivered in soft copy to the Nepal Customs is Attachment 3 to this report.

Further Technical Assistance

During the course of the training the participants identified that Nepal reached an agreement with the Asian Development Bank (ADB) and the United Nations Conference on Trade and Development (UNCTAD) to establish the wide area network linking all the customs offices with ASYCUDA processing to a central server in the headquarters, to implement the selectivity module, to generally upgrade the ASYCUDA software and provide training on risk management. The Nepal Customs believes that UNCTAD will dispatch a technical advisor to Nepal to begin the start of a three-year project with the first quarter of 2007. Further technical assistance by USAID should be confirmed with ADB and UNCTAD for the prevention of

overlap with the ADB/UNCTAD project. That said, relative to risk management training and applications, the technical assistance that will be provided by UNCTAD relative to risk management will likely focus on the application of selectivity that can be applied in the UNCTAD software, ASYCUDA. It is less likely that the UNCTAD assistance will focus on the more modern approaches to customs risk management that place a greater emphasis on identifying high confidence in low risk through AEO programs or addressing root causes of non-compliance such as a lack of information on regulations readily available to stakeholders.

For further technical assistance the input from the Nepal Customs must first be to dedicate persons to risk management. Because of the Nepal Customs are forced by higher government to respond to a demand revenue system where the Nepal Customs are given collection quotas, the potential for the actual collection of revenues at the legal rate is at risk. Under the current practices the best return on investment for further technical assistance could be in the development of an automated trade information system as is currently in place in Jordan. By investing in transparent information and placing customs in a responsible role for the upkeep of such a system will both increase transparency and permit a key foundational tool to be put in place for better risk management. The ADB/UNCTAD project that will link the borders to headquarters has a potential to support the development of an intranet within the Nepal Customs. The same infrastructure that will support the flow of declaration information to the Customs Headquarters can also be used for information to flow back to the Customs Houses.

The second area for continued technical assistance that would likely not overlap with the proposed ADB/UNCTAD project would be the development of an AEO program compliant with the WCO SAFE Standards. Currently there are very few developed countries that have a program to meet the SAFE criteria. Nepal could move forward with such a program with the objective on not chasing after developed countries by coming up to par to the current international best practices. This type of program must be very carefully designed so that the AEO program does not become simply another way of extending benefits based on the payment of unofficial payments to customs officers.

The final area for further development would be to do an assessment and make modifications to Nepal Customs based on the revised Kyoto Convention. It is surprising that Nepal has not received technical assistance in this area particularly as they are preparing a new customs law that should be based on the revised Kyoto Convention if it is intended to meet the best international standards. A revised Kyoto approach could also serve as a conduit for resolving issues such as the current lack of a holistic, multi-agency approach to border management.

Attachment 1: Training Schedule

DAY	Risk Management Training 8:30 – 12:30
Nov 1	<ul style="list-style-type: none"> - Meeting with Director and Management Staff - Introduction - Current Status of Nepal Customs with Respect to Risk Management - Customs Challenges in the 21st Century; Understanding the Necessity for Risk Based Customs Controls - The Concept of Risk; Likelihood x Consequence - Putting Risk Management into Context; The First Step in the Process
Nov 2	<ul style="list-style-type: none"> - Identifying Potential Risks; Brainstorming, Interviewing and Data-Mining - Analyzing Risk; Gathering Information - The Proactive Approach; Making sense of your data - Risk Indicators; Objective vs. Subjective, Historical vs. Predictive
Nov 3	<ul style="list-style-type: none"> - Evaluating Risk; Quantifying Risk for Comparative Purposes - Treating the Risk; Different Treatments, Varying Intensities - Quality Examination Instructions and Reporting; Risk Analysis Unit Involvement
Nov 5	<ul style="list-style-type: none"> - Follow up Activities; Monitoring & Reviewing, Consulting & Communicating - Compliance; Measuring and Encouraging Business Compliance - Risk Management Action Plan Development
Nov 6	On-site mentoring – Drafting of one-year work plan

Attachment 2: One-year action plan

Nepal Customs Risk Management Action Plan

Version 1.1

Development Date: 6 Nov 2006

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Approval(s) Director General Nepal Customs, Bal Gobinda Bista _____
(Signature)

Approval Date: (Target 15 November 2006)

1. COMPLIANCE RISK BASICS

What needs to be done?

Nepal Customs needs to conduct a root cause analysis to determine why companies fail to comply with regulations. This root cause analysis may identify ways to increase the opportunities and benefits for voluntary compliance. This should be a combined effort with other stakeholders in border clearance including other border mandate agencies and the private sector.

Priorities for the coming year	Target Date	Responsible for Ensuring Success
<p>(1.1) Identify all stakeholders:</p> <p>Categories:</p> <p>Importers (include volunteer representatives from business associations)</p> <p>Exporters</p> <p>Brokers</p> <p>Other Government Agencies</p> <p>Other Customs Offices</p>	1 Jan 2007	(Mr. Sudeep)
<p>(1.2) Schedule event with stakeholders for problem identification and root cause analysis</p> <ul style="list-style-type: none"> ▪ Root Cause Analysis with stakeholders – What is causing companies to potentially not be compliant? <ul style="list-style-type: none"> – Over reaching duties, taxes and fees? – Information accessibility? – Technical capacity of customs and private sector? – Integrity issues? 	1 March 2007	(Mr. Rajan Khanal)

<p>– Other issues?</p> <p>Identify Nepal Customs strategy and resource balance between informed and enforced compliance.</p>		
(1.3) Prepare recommendations report to Customs Director and Government of Nepal	15 March, 2007	(Mr. Achyut)
(1.4) Lobby for acceptance of recommendations and authority for Nepal Customs to implement to: Director General of Customs Secretary of Finance	15 April 2007	(Mr. Achyut)
(1.4.1) Acceptance, Rejection or modification of recommendations, appointment of Project Manager for risk management changes	1 May 2007	Director General of Customs and Secretary of Finance
(1.5) Implement recommendations: Phased approach? (May extend beyond one year)	Start Date – 1 June 2007	Project manager to be named by Director General (May be Director of Risk Management)
(1.5.1) finalize project plan	1 July 2007	Project Manager
(1.6) Report to Government and stakeholders on implementation success	Start date 1 July 2007 – periodic reports every 6 months	Project Manager

2. INFORMED COMPLIANCE – AEO PROGRAM

What needs to be done?

Nepal Customs needs to develop an Authorized Economic Operator (AEO) Program that will identify and reward those companies that the Nepal Customs has the highest confidence will be voluntarily compliant with all requirements. This program should be open to all sectors of the international trade community following the “Full Circle Due Diligence” process.

Priorities for the coming year	Target Date	Responsible for Ensuring Success
(2.1) Form Compliance Audit Team in Nepal Customs (contingent on 1.3, 1.4.1)	1 May, 2007	Director General
2.1.1) Pre-select candidates for audit training	1 Dec 2006	DG, Acting Director RM Director, HR Director
(2.2) Train compliance auditors Contingency – Trainer and funding for training identified are secured.	1 March 2007	DG, training provider
(2.3) Identify beta test companies in each sector (with 1.1 process)	1 Jan 2007	(Mr. Sudeep)
(2.4) With beta test companies develop and review standards and rewards for AEO companies Contingent on 1.4.1, 2.2, 2.3	1 July 2007	Risk Man Director, trained auditors
(2.5) Write draft Nepal Customs Authorized Economic Operators standards & rewards Contingent on 2.4	1 Aug 2007	PM, DG, Finance Secretary
(2.6) Beta test companies implement standards and document in a due diligence manual contingent on 2.5	1 Nov 2007	Beta Test companies (potential technical assistance)
(2.7) Customs audits beta test companies Contingent on 2.2, 2.6	Target date exceeds 1 year – estimate 1	DG, Director Risk Management

	Feb 2008	
(2.8) Customs issues audit report to beta test companies for acceptance, conditional acceptance subject to changes to internal processes or rejection from program	Two weeks after audits	Director Risk Management
(2.9) Customs & accepted beta companies review standards & rewards for final adoption	1 month after all beta test audits.	Director General, Director Risk Management
(2.10) Customs launches open program for Authorized Economic Operator program	1 month after 2.9	Director General,
(2.11) Customs and private sector establish periodic review of standards and Authorized Economic Operator program for continuous improvement	Periodic review after 2.10	Director Risk Management

3. ENFORCED COMPLIANCE – STATISTICAL ANALYSIS

What needs to be done?

Once Nepal Customs has established an internal policy on the balance of resources between informed and enforced compliance, Nepal Customs must conduct a complete initial plan of how goods will be channeled into red, yellow or green lanes. Customs can then enter the targeting criteria into ASYCUDA. The entry of risk indicators into ASYCUDA will be contingent on Nepal Customs receiving training on the ASYCUDA selectivity module. This training is tentatively planned for 2007 with Asian Development Bank funding. International experience suggests that often ASYCUDA becomes clogged with “raised flags” with no continued justification. While ASYCUDA is a very good, dependable declaration processing engine, the ASYCUDA system is heavily reliant on external manual systems to modify the risk flags and entry of new regulation changes.

Priorities for the coming year	Target Date	Responsible for Ensuring Success
(3.1) Identify targets for risk management to put into ASYCUDA – conduct statistical analysis for valuation, tariff classification and country of origin Contingent n 1.1	1 Jan 2007	(Mr. Sudeep and Mr. Pandey)
(3.1.1) Send to borders and customs houses written instructions to test risk targets identified in 3.1 contingent on 3.1 and assignment of resources to risk management	1 Feb 2007	Director General, Director Risk Management, all Chief Customs Officers
(3.2) Create data base of inspection results <ul style="list-style-type: none"> • Define data to be collected • Write database • Create system for collection 	1 January 2007	Director Risk Management, Mr. Pandey, IT Director, Mr. Shresthen, Director of Inspection
(3.3) Conduct internal review and review with other border mandate agencies of risk priorities	1 April 2007	Director General, Finance Secretary

Contingent on 1.1, 1.2, assignment of agency coordination responsibility by Director General		
(3.4) Write proposed new polices for ASYCUDA flag raising and lowering with mandatory review dates contingent on 1.2	1 June 2007	Director General and Director Risk Management
(3.5) Write proposed new criteria for ASYCUDA flags and program ASYCUDA Contingent on receiving further training in the ASYCUDA system.	Unknown	Director Risk Management, Mr. Pandey, IT Director, Mr. Shresthen,
(3.6) Implement new criteria Contingent on 3.5	Unknown	Director Risk Management, Mr. Pandey, IT Director, Mr. Shresthen,
(3.7) Review new criteria for impact and validly per new policy	Unknown	Director Risk Management, Mr. Pandey, IT Director, Mr. Shresthen, with stakeholder review

4. COMPLIANCE UPDATES – TEAM REVIEW

What needs to be done?

Nepal Customs must recognize that risk management is a continuous process and a way of doing business, not a donor responsibility. As part of the Nepal Customs business process, the Nepal Customs must establish both policies for continual management of risks and identify the organizational support structures to maintain the risk management processes. This includes commitments to infrastructure and human capital development and management. Without the long term planning and commitment of resources to risk management the advances to process will not be met.

Priorities for the coming year	Target Date	Responsible for Ensuring Success
(3.1) Track and monitor steps one through three above at periodic milestone review dates	On going, monthly	Director General, Mr. Shiwakoti
(3.2) Conduct analysis of long term impact of risk management changes on <ul style="list-style-type: none"> • Infrastructure (hardware, software, facilities) • Human Capital Development and Management (Position descriptions and assignments including secondary aspects of pay, performance monitoring, recruitment, career track and accession planning) 	Ongoing, reported every four months	Director General, Mr. Shiwakoti
(3.3) Prepare long-term (five year) strategic and sustainability plans and implement	15 July 2007	Director General , IT and Modernization Director
(3.4) Assign responsibility for periodic review and update of risk management strategy.	Quarterly review and at least annual update	Director Risk Management
(3.5) Conduct at least one scheduled risk management strategy review	15 July 2007	Director Risk management

ASSUMPTIONS:

1. Director General assigns risk management into a unit and assigns an acting director of the risk management unit.
2. Statistics Division is directed by Director General to take assignments from Risk Management Director.
3. Other Government agencies will permit Nepal Customs to assist them.
4. ADB will fund and provide ASYCUDA Selectivity training within first quarter of 2007.

Attachment 3: Deliverables provided to Nepal Customs

As part of the training and capacity building by FASTrade to Nepal Customs the following documents were delivered in soft copy to Nepal Customs:

- PowerPoint presentation “Risk Management Based Cargo Selectivity” in English and Nepalese.
- PowerPoint presentation “Revenue Enhancement Analysis Based on ASYCUDA Data” in English (This is a FASTrade course covering very basic statistical analysis.)
- “Customs Risk Analysis Matrix:
- “Risk Profile Template”
- Two samples of risk profiles using the risk profile template.
- One-year risk action plan (Attachment 2)
- PowerPoint slides with Internet screen shots from the Jordan Customs CITS Program
- FASTrade Risk Management Handbook with Word formatted appendix models
- WCO “Framework of Standards to Secure and Facilitate Trade” (SAFE Standards)