

Summary: Intervention & Options		
<b>Department /Agency:</b> HMRC	<b>Title:</b> Impact Assessment of the introduction of Authorised Economic Operator (AEO) status	
<b>Stage:</b> Implementation	<b>Version:</b> 1	<b>Date:</b> January 2009
<b>Related Publications:</b>		

**Available to view or download at:**

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

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**What is the problem under consideration? Why is government intervention necessary?**

This measure reflects a wider EU drive to improve security in the supply chain of goods moving in and out of the Community and reduce the risks to its economy, infrastructure, businesses and citizens from terrorist attack.

Also, there are different levels of frontier interventions and post-clearance controls in each Member State. This can result in inconsistency of treatment and less certainty over delivery timescales for businesses. Those wishing to benefit from Customs simplifications frequently have to apply to each Member State (MS) in which they operate with no common recognition of status and reliability.

**What are the policy objectives and the intended effects?**

By introducing a new “kite mark”, it is expected that AEO standards will be the future basis for managing and securing the supply chain for international trade in goods, signifying that a company is trustworthy and compliant and enabling it to benefit from fiscal simplifications and lighter touch border controls. In the future, achieving mutual recognition of AEO status with similar schemes in third countries would provide a high level of confidence that the end-to-end international supply chains were secure, and would facilitate businesses trading with those countries.

**What policy options have been considered? Please justify any preferred option.**

This IA considers two options:

1. Do Nothing
2. Implement AEO status in line with the Security Amendment to the Community Customs Code (CCC) in Council Regulation 648/2005

Implementation is the preferred option as Do Nothing would not provide any supply chain security or trade facilitation benefits. Option 2 offers those benefits at proportionate cost.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** HMRC typically reviews impact assessments with a formal evaluation within 12-18 months and a compliance cost review 1-3 years after implementation.

**Ministerial Sign-off** For Final Proposal / Implementation Stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.*

Signed by the responsible Minister:



Date: 26 Jan 2009

# Summary: Analysis & Evidence

<b>Policy Option: 2</b>	<b>Description: Implement AEO status in line with the Security Amendment</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' Importers/exporters and freight companies who apply for AEO status will incur costs making their application. Total costs will depend on take up but are likely to fall within the range of £35m to £68m (best estimate £50m) over the first 5 years, and £5m per annum for new applicants thereafter. HMRC will incur costs of £17m over 5 years and then £2m per annum.		
	<b>One-off</b> (Transition) <b>Yrs</b>			
	<b>£ 67m (approx)</b>			5
	<b>Average Annual Cost</b> (excluding one-off) <b>Cost</b>			
	<b>£ 7m (approx)</b>	p.a.	<b>Total Cost (PV)</b>	<b>£ 67m (5 years)</b>
<b>Other key non-monetised costs by 'main affected groups'</b> The main costs for business are the time completing the C117/C118 application forms, and any subsequent inspection needed to approve their new status. Once approved there will be further minor costs to inform HMRC of changes in details to ensure the status is still valid.				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' The main benefits are qualitative and cannot reliably be measured in monetary terms, but because AEO status is voluntary, all applicants will have judged the benefits to outweigh the costs. Businesses will experience greater certainty and fewer delays in the supply chain. Customs checks will be more proportionate to the risk, and security will be improved.		
	<b>One-off</b> <b>Yrs</b>			
	<b>£ nil</b>			5
	<b>Average Annual Benefit</b> (excluding one-off) <b>Benefit</b>			
	<b>£ Unquantified</b>	p.a.	<b>Total Benefit (PV)</b>	<b>£ Unquantified</b>
<b>Other key non-monetised benefits by 'main affected groups'</b> AEO status will provide a degree of future-proofing, enabling businesses to take advantage of future reforms that depend on AEO status. At a more global level, the reforms provide a significant boost to national security and reduce the risk of disruption to both international trade and the public.				

### Key Assumptions/Sensitivities/Risks

The estimated costs and benefits are uncertain, primarily because the scheme is voluntary and take-up not yet known. The benefits will outweigh the costs in the longer term, with most costs being one-off in the first 5 years. The reform is not expected to have any impact on the amount of tax collected.

Price Base Year 2008	Time Period Years p.a.	<b>Net Benefit Range</b> (NPV) <b>£ Unquantified</b>	<b>NET BENEFIT</b> (NPV Best estimate) <b>£ Unquantified</b>
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What is the geographic coverage of the policy/option?	EC			
On what date will the policy be implemented?	1 January 2008			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£ Not applicable			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ Not applicable			
What is the value of changes in greenhouse gas emissions?	£ Not applicable			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro nil	Small nil	Medium nil	Large nil
Are any of these organisations exempt?	No	No	No	No

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)	(Increase - Decrease)
Increase of £ 5m	Decrease of £
<b>Net Impact</b>	<b>£ 5m increase</b>

Key: Annual costs and benefits: Constant Prices (Net) Present Value

### 1. The Issue

The challenges faced by trading nations as a result of the significant and continuing growth in global trade and heightened level of international security risk led the World Customs Organisation (WCO) to develop the WCO Framework of Standards to Secure and Facilitate Global Economy (known as SAFE). Over 100 countries, including the EU on behalf of the Member States, have agreed to implement the framework. This provides a basis for developing robust and secure supply chains that contribute to enhanced security and facilitation of international trade and movement of goods.

The EU response is introduction of Authorised Economic Operator (AEO) arrangements that provide common standards for safety and security and customs simplifications that are recognised by all member States.

There are currently different levels of risk assessments, frontier interventions and post-clearance controls in different Member States. This leads to:

- Inconsistency in treatment for traders by Customs administrations and
- Uncertainty over delivery timescales for businesses, particularly those operating on a 'just-in-time' basis.

With the exception of businesses authorised for Single European Authorisations and Single Community Authorisations, businesses wishing to benefit from Customs simplifications or facilitations must apply to each Member State (MS) in which they operate. This results in:

- No EU-wide recognition of trader status, compliance and reliability;
- Traders qualifying for a simplification in one MS but may be rejected by another;
- No commonly agreed levels of facilitation for authorised traders across MS;
- Companies operating in more than one MS potentially having to comply with different record keeping and operational requirements and standards.

### 2. Policy Objectives and Intended Effects.

By introducing a new "Kite Mark" status (known as "Authorised Economic Operator", or AEO) that is recognised across the EU by all Member States, the policy aims to:

- Enable more secure supply chains for goods moving in and out of the EU and increase confidence in the safety and security of consignments that reduces the risk to the economic and social well being of the Community, its Member States, businesses and citizens;
- Enable lighter touch border controls for businesses that improve certainty and ease with which goods can be imported and exported;
- Provide businesses with more straightforward and consistent access to customs simplifications taking into account their status and compliance.

The security amendment to the Community Customs Code (CCC) enables Customs authorities to grant the status of AEO to businesses engaged in international trade that are able to satisfy the relevant criteria. The criteria include things like:

- Having a safety and security assessment of the business;
- Measures to prevent unauthorised access to premises, transport units and goods;
- Demonstrating an appropriate record of compliance with Customs and tax requirements;

- Having satisfactory commercial and management record systems;
- Being financially solvent and able to meet financial commitments.

(The full criteria are set out in the Amendment to the Implementing Provisions (IP) for the CCC, within Commission Regulation 1875/2006, published in the Official Journal of the EC on 19 December 2006.)

Additionally, the policy contributes to development of wider international supply chain security initiatives and measures by providing a basis for negotiating and agreeing mutual recognition of AEO and similar schemes with 3<sup>rd</sup> country trading partners, such as the USA's Customs-Trade Partnership Against Terrorism (C-TPAT) scheme and EU-China pilot.

### **3. The Options.**

Two options were considered:

1. Do Nothing
2. Implement AEO status in line with the Security Amendment to the Community Customs Code (CCC) in Council Regulation 648/2005

#### **Option 1: Do Nothing**

The amendment to EU Customs legislation that implements AEO came into force on 1 January 2008 and do nothing was not considered to be a valid option. Doing nothing risks three important things:

- UK businesses engaged in international trade could be placed at a competitive disadvantage, both within our own borders and the wider Community, when AEO status is granted to businesses in other MS. Trade associations and businesses are generally supportive of the measure and would be concerned if traders did not have the opportunity to apply in the UK and compete on an equal footing with businesses in other member States.
- Damage to the UK's reputation and credibility with the EU, international trading partners and business. Critically it would stall work on mutual recognition and seriously affect UK ability to play a leading and influential role in enhancing international supply chain security through initiatives such as the EU-China pilot.
- Significant risk of infraction proceedings by the EU for failing to implement directly applicable EU legislation – the Security Amendment to the CCC and its Implementing Provisions. For the trade, applying to join the scheme is entirely voluntary but MS must have in place an effective and robust system to deal with applications that meets the requirements of the legislation.

#### **Option 2: Implement AEO Status**

Implementing AEO arrangements is the most appropriate option because it:

- Ensures the necessary basis for developing and enhancing supply chain security now and in the future to address heightened levels of security and safety threats and contributes to reducing the risk to the economic and social well being of the EU, UK, businesses and citizens.

- Provides the opportunity to make further customs simplifications and trade facilitations available to businesses in the future. Trade Associations and businesses are supportive and see the main benefits of AEO status in the medium to longer term linked to reduced data requirements for pre arrival/departure declarations (likely 2009), further simplifications and facilitations expected to be available on implementation of the Modernised Customs Code and its Implementing Provisions (around 2010), and when mutual recognition of similar schemes with major trading partners such as the USA and China are agreed. In the meantime recognition by Customs as a trusted and compliant business is seen as a very positive asset and marketing opportunity by many businesses in the very competitive international trade business and they would not wish this to be lost.
- Removes the risk of EU infraction proceedings against the UK for failure to implement directly applicable Community legislation.

The application and certification process for AEO will be in accordance with the requirements and criteria of the Amendment to the CCC Implementing Provisions that will apply equally to all EU member States.

### **Certificates and criteria**

Businesses can choose from 3 types of certificate to suit their particular business needs:

- Security and Safety certificate – access to facilitations in customs controls relating to security and safety when goods are imported and exported.
- Customs Simplifications certificate – access to simplifications provided under the Community customs rules.
- Full certificate - covers both Security and Safety and Customs Simplifications statuses.

To qualify as an AEO, businesses must be financially solvent, compliant with customs requirements, meet appropriate record keeping standards and, if applying for a security certificate, be compliant in respect of security and safety procedures and standards.

Information about the types of certificate available, application process, conditions and criteria to be met, and procedures for issuing, suspending and revoking certificates is contained within Commission Regulation 1875/2006. Detailed information about AEO in the UK is publicised in HMRC Notice 117 and on the HMRC and Business Link web-sites.

### **Application**

Application for AEO status is entirely voluntary. The form of application (Form C117 in the UK) is specified in Commission Regulation 1875/2006 and supported by explanatory notes. The information to be provided is relatively straightforward and most businesses should have little difficulty in completing it. To support the application process, assist businesses to carry out a self assessment against the AEO criteria and gather the necessary supporting evidence, a questionnaire (Form C118) should also be completed. This will also help HMRC to process the application more quickly, target assurance activity and may reduce the time HMRC officers have to spend at the business premises.

Businesses are given a choice of how to submit their application to HMRC. An all electronic interactive web-based application facility is available via the Business Link site. Alternatively the forms can be downloaded, completed electronically and emailed to HMRC, or printed out and sent by fax or post.

HMRC has designated Nottingham as the central office to receive, process and manage AEO applications for the UK. Acceptable applications will be recorded on the EU AEO database and central checks carried out. Applications are forwarded to HMRC's Large Business Service and Local Compliance Teams to undertake the required assurance including visiting the business premises to examine the traders systems and evidence to confirm the criteria are met.

Businesses will be given the opportunity to address gaps in their systems and procedures found during the assurance process. The timescale for doing this will be agreed with the business concerned and in the meantime the application will be held over rather than rejected pending confirmation that the issues have been rectified. An application cannot be held over indefinitely as there are processing timescales in the legislation that MS must comply with. An application may therefore be rejected if the shortcomings are significant, the trader is unable to agree or are not put right in a reasonable time.

### **Approval/rejection**

The central site will be advised by the assurance officer whether or not AEO status should be granted. An AEO certificate (the form of which is specified in Commission Regulation 1875/2006) or rejection letter as appropriate will be issued and the EU database updated. Rejected applications are subject to the normal reviews and appeals process for customs decisions.

### **4. Sectors Affected**

The AEO scheme is entirely voluntary. It will be available to all traders involved in the international supply chain and customs related activities irrespective of trade sector or size that are able to meet the criteria. Estimates of the potential UK trader population are:

- Multi-nationals and other companies operating in more than one member state – 1300
- Small/medium businesses - 7700
- Customs brokers/consultants – 250
- Logistics operators, carriers, freight forwarders, couriers, agents) – 2000
- Community service providers/port authorities – 6

Small businesses may consider that the relative costs of applying for authorisation outweigh the immediate benefits of having the status. We anticipate many will wait and see how AEO develops and what the attitude of their business trading partners is likely to be before they take a decision. However, we do expect a range of customs agents and freight forwarders to be amongst the early applicants – AEO status is a potentially strong marketing tool in this competitive industry sector. Applications from multi-national and large businesses are likely to take more time to arrive in any numbers, partly due to the complexity of the business structures and systems that need to be considered and, like their small business counterparts, because some businesses are not yet convinced that they need to apply immediately. Others have indicated that they will be applying as soon as they are ready because they want the AEO “kite mark” to demonstrate their trusted trader status and corporate responsibility rather than waiting until more tangible benefits are available through mutual recognition of similar schemes in 3<sup>rd</sup> countries and when the Modernised Customs Code and Implementing provisions are implemented.

### **5. Costs and Benefits / Impacts.**

## Benefits

Benefits from the AEO scheme have not been quantified in monetary terms in this IA. They fall both to the businesses applying, and to a greater extent, to the UK as a whole.

The voluntary nature of the scheme means that businesses need only apply if they judge the benefits to be worthwhile. Those benefits will begin to accrue to individual businesses immediately AEO status is granted, while the wider benefits to the UK will grow over time in line with the overall take up of the scheme. This means that once the new regime has bedded in, the benefits will outweigh the costs on a recurring basis.

Benefits to authorised businesses include:

- AEO status taken into account in risk management used to determine the frequency and extent of customs physical and documentary examination and checks. This would reduce the likelihood of consignments being selected and provide greater certainty for business as AEO goods selected for check would be given priority. Although the UK examines a relatively small proportion of import and export consignments, AEO status is recognised in all MS and the benefits to UK businesses operating in other MS with higher levels of examinations will be greater.
- Simplified trade with other major trading partners through mutual recognition of AEO and similar schemes, for example, the USA and its C-TPAT programme and EU-China pilot. Increased security and trust through mutually agreed standards will reduce the levels of intervention for authorised businesses allowing those consignments to pass through border formalities much more quickly and enabling resources to be targeted to areas of greatest risk. These benefits will extend as other trading partners implement the WCO SAFE Framework and work towards mutual recognition with the EU.
- Access to reduced data sets for pre-arrival/ pre-departure declarations. This is due to be implemented in July 2009.
- Access to further simplifications that may be made available on implementation of the Modernised Customs Code and its Implementing Provisions (around 2010) and linked to AEO criteria, such as guarantee waivers, centralised clearance and accreditation of agents.
- AEO status can be used as a marketing tool and provide increased business opportunities. A number of businesses commented during the pilot that they saw this as a positive aspect and that security was something they thought they should have to demonstrate corporate responsibility for.
- Large corporations fear that if their name gets connected to terrorism or inadequate security and safety standards this will have a negative effect on their sales, reputation, and corporate branding.
- Improved security should help to reduce cargo theft and the reliability of the supply chain.
- Increased efficiency in that a number of pilot companies identified that the AEO application had been a useful process for identifying gaps in their documentation and procedures.

However, the greater benefits are to the wider UK population and economy. The benefits of increasing the security of the supply chain is difficult to quantify as it is impossible to assess to what extent greater national safety is secured and the potential dangers avoided by such preventative measures. The human cost of a successful terrorist attack is impossible to quantify.

The economic cost and disruption to a large port or airport would run into many millions of pounds, depending upon the target and severity of the incident. For businesses operating a just-in-time or lean supply chain, the availability of raw materials and parts is likely to be a

vulnerable aspect of their supply chain, since a disruption could lead to production stopping, with major consequences for the whole business. To give an indication of the likely economic impact, the following table shows the average value of trade flowing through the main UK ports and airports on a daily basis.

**Table 1: Average daily value of trade through main UK ports, £ millions**

	by Air	by Sea
Imports	£262	£168
Exports	£205	£116

## Costs

### *AEO Applicants*

This section considers the main area of compliance costs, the cost of applying for AEO status. This covers small and large importers/exporters, and also freight companies who apply for AEO status. The scheme is voluntary, so costs will only be incurred where companies believe them to be justified.

The overall cost to business of this scheme is initially estimated to be in the region of £50 million (discounted) over a period of five years, the period in which the bulk of the initial applications are expected.

Costing a new scheme of this magnitude prior to implementation is difficult, and where possible we have ensured that the estimates are conservative and based on consultation. For example, the costs assume that businesses apply for a Full AEO certificate - Simplification and Security. Current information suggests this is the most likely case indicating a 90/10 split in favour of Full certificates. If a substantial number of applications are for only a simplification or a security certificate, the costs will be over estimates. Reflecting this, the impact assessment uses a range of possible values for the time and cost assumptions.

Another area of considerable uncertainty is the likely take-up of the scheme. We assume for the purposes of the impact assessment that between 3,000 – 4,000 businesses apply to the scheme over the first five years. This is based on discussions that HMRC's Large Business Service has had with its customers and a survey of 441 smaller businesses conducted by Local Compliance.

Based on the anecdotal feedback, we have assumed that a smaller proportion of larger businesses will apply in the first year or so, and that the bulk of larger businesses will follow later, reflecting the complexity of their applications. A higher proportion of smaller businesses are expected to apply earlier as the application will be simpler. We expect some businesses may defer their applications until mutual recognition with the USA and other trading partners is agreed or until pre-arrival and pre-departure declarations are introduced in July 2009. The assumed take-up rates used are shown below in table 2.

**Table 2: Assumed Take-up Rates**

	Low Take-up	Central Take-up	High Take-up
Micro/Small	1,350	1600	1800
Medium	800	1100	1350
Large	850	800	850
Total	3,000	3,500	4,000

The cost is broken down into three main elements:

- The application (C117), completion of the questionnaire (C118) and dealing with any gaps in procedures that the application process highlights
- Co-operating with the HMRC inspection following the application
- Submitting notifications of change of details to ensuring that the details that HMRC holds are kept up-to-date

The bulk of the cost relates to the C118 questionnaire, and the need for business to fill any gaps in security procedures that this process highlights. The cost for the questionnaire has been estimated based on discussions with a number of large businesses that took part in the pilot exercise. The pilot businesses indicated that the process of applying included:

- Familiarisation with the questionnaire;
- Working out what information was readily accessible within the organisation;
- Establishing who to talk to within the organisation to fill in gaps;
- Assessing whether all of the required standards had been met
- Putting in place processes and standards where the questionnaire had highlighted gaps ; and
- Completing the questionnaire and compiling the documents in preparation for the audit.

Discussions with the pilot group and a survey of early adopters from the smaller businesses gave a range of estimates for the cost per trading division. This was then used to estimate the likely number of hours spent by the various sizes of business. However, it should be stressed that the overall cost to a given business will depend heavily on to what extent its security procedures are up to date and well documented. We have assumed a certain amount of time spent filling in gaps, but this may not be required in all cases.

**Table 3: Time Estimates for C118**

Time (Hours)	Micro/Small	Medium	Large
Lower Case	30	300	900
Central Case	10	210	720
Upper Case	45	390	1,080

It has been assumed that for smaller businesses the work is likely to be carried out largely by a senior grade person, whereas for larger firms the bulk of the work is likely to be carried out by more junior grade staff, with limited input from senior grades.

A number of the businesses in the pilot indicated that they had used external advisors to help manage the process and judge whether standards had been met, rather than use internal resources. However, the survey of smaller businesses suggested that use of consultants was significantly lower for smaller businesses. We have assumed that around 10% of small businesses will use a consultant, whereas all large businesses are likely to consult advisors. We assume that fees depend on the size of business. Our cost estimates have been based on informal discussion with one of the large advisors about the likely fee levels, but these estimates remain subject to considerable uncertainty.

The application form (C117) is largely routine questions and the cost estimate for this has been based on similar questions from other tax regimes in HMRC's Standard Cost Model. We have assumed that the C117 takes around 2½ hours to complete per business, with up to 40 minutes for familiarisation for the form.

Evidence from the Standard Cost Model suggests that dealing with HMRC inspections and audits can be a burdensome prospect for a business. However, for the AEO application, businesses should have compiled all of the information together as part of the application process.

Based on discussions with HMRC's Enforcement and Compliance Operations unit, the pilot group and the survey of small businesses, we have estimated that it will take a large business around 90 hours to deal with an AEO audit of which around 70 is likely to involve the HMRC officer being on site. This is estimated to fall to 55 hours for a medium sized business (representing fewer trading divisions) and 20 hours for a smaller business. This compares to the Standard Cost Model estimate of around 45 hours for a large business to deal with an Employers' Inspection (PAYE and NICs records etc).

**Table 4: Time Estimates for Audit/Inspection**

Time (Hours)	Micro/Small	Medium	Large
Lower Case	20	55	90
Central Case	7	40	70
Upper Case	30	70	110

The cost of notifying HMRC is assumed to be around £10 per notification, with the number of notifications varying by business size. This cost is based on similar obligations from other tax areas in the HMRC Standard Cost Model.

Overall costs per business for the various aspects of the application process are shown in table 5. The burden for the application itself (C117 and C118) includes some costs of adapting systems and process to ensure that they are compliant with the requirements, as well as completing the application.

**Table 5: Compliance costs per business – Central Case**

	Micro/Small	Medium	Large
Applications (one-off)	£1,000	£14,000	£40,000
Audit/Inspection (one-off)	£600	£1,800	£2,300
Notifications (annual average)	£10	£50	£100

The EU Regulatory Impact Assessment includes a substantial cost for implementing a security management system. Costs range from €5,000 (micro) to €300,000 for a large business (approx £4,000 to £240,000). These figures are based on assumptions about existing safety and security standards across the EU. Within the UK however, businesses have had to operate security and safety standards for a number of years to deal with security and safety threats and many businesses already comply with other regulatory schemes such as the Regulated Agent and Known shipper schemes operated by the Department for Transport. It is therefore reasonable to assume that many UK large businesses already have the systems in place to meet the AEO safety and security standards. This assumption is borne out from the feedback from the UK pilot. For smaller firms the standards to be applied should be appropriate for their business and therefore we expect any costs incurred to improve existing standards to be less.

Costs may also be reduced where businesses hold certificates for other accreditations such as internationally recognised security and/or safety certificates issued under international convention or Community legislation, and ISO and ESO standards. These will be taken into account where the criteria correspond with those for AEO. Compliance with security requirements and standards set by intergovernmental organisations such as the United Nations may also be considered as part of the evidence. Where businesses are authorised for other customs procedures, the criteria and information previously examined will be taken into account when assessing an AEO application.

Overall compliance costs for the central estimate are shown below in Table 6. This assumes a take-up of 3,500 applications.

**Table 6: Compliance costs over five years, £ millions, Central Estimate, discounted**

	Micro/Small	Medium	Large	Total
Applications	£1.5	£13.5	£30.0	£45.0
Audit/Inspection	£1.0	£2.0	£2.0	£4.5
Notifications	£0.0	£0.0	£0.0	£0.5
				£50.0

(Totals may not sum due to rounding)

For the high take-up of 4,000 businesses, the discounted central case cost is £55 million, whereas for 3,000 businesses it is £46 million.

If we use the lower case time values, the range of estimates is £35-40 million, whereas for the higher case time estimates the range is £57 – 68 million. These ranges illustrate the uncertainty in the costing.

#### *Customs Brokers/ Consultants.*

Brokers and consultants will have to ensure that their guidance and systems are able to deal with AEO issues. However, there is the potential for new business opportunities arising from consultancy on AEO applications and requirements as well as advising on issues such as supply chain security and administrative procedures in other Member States. There may also be scope for assistance to businesses on AEO appeals matters for unsuccessful applications.

#### *Logistics Operators, Carriers, Freight Forwarders, Couriers, Agents.*

It is highly likely that these businesses will apply for AEO status, and the costs of this have been included in the previous section dealing with applications. These are highly competitive business sectors. Agents play an important role in the customs declaration procedure for imports and exports. Achieving and maintaining high standards and professionalism are key factors in ensuring the accuracy and quality of the information provided to Customs and this helps to ensure there is no undue delay in clearing consignments. Being able to demonstrate a compliant and trustworthy status is a potentially powerful marketing tool for such businesses and a strong incentive to raise standards. Many already operate quality systems and procedures as part of normal business practice and compliance with the AEO criteria should be relatively straightforward and cost effective.

Carriers shoulder significant responsibility by having physical charge of the goods during transportation and this is recognised as potentially one of the higher risk links in the supply chain. Air and maritime operators are already regulated or accredited through arrangements such as Regulated Agent or Known Consignor and International Ship and Port-facility Security administered by the Department for Transport (DfT). These businesses should to a large extent already have much of the necessary systems and controls in place and their status with the DfT will be taken into account when considering their application for AEO.

The road transport sector is less closely regulated in this respect and comprises a high proportion of small operators with fewer than 4 vehicles. These businesses usually maintain fairly simple records to meet minimum requirements but actual systems and processes are often not fully documented. The time taken to complete an application by these small operators should not be great given their usually straightforward business structure but it is anticipated that for some there will be additional costs to putting in place records and setting up and documenting procedures to meet the criteria. Also, operators may identify a need to improve their arrangements for protecting transport, cargo units and goods in order to meet the security

and safety requirements for AEO. Some businesses are likely to already have such measures in place to meet insurance requirements but others may have to invest to satisfy the requirements.

### *Community Service Providers (CSPs)/ Port Authorities.*

For CSPs and Port Authorities the changes to be able to cope with shipments from AEOs will be linked to the changes required to deal with pre-arrival/departure declaration initiatives. There may need to be some software and process changes to cope with the new data sets and additional information requirements, new submission time limits, and the need to be able to identify AEO shipments and apply AEO specific simplifications alongside standard import/export requirements. These elements are being discussed and developed in consultation with the trade as part of the delivery of a number of projects contained within the HMRC Customs Services Transformation Programme (CSTP) which incorporates EU-wide Customs modernisation projects from the Europeans Commission's Multi Annual Strategic Plan (MASP).

### *Government*

There are significant costs to HMRC in implementing the AEO scheme. These include:

- Set up costs in devising the systems and procedures for managing AEO and engaging stakeholders – estimated 10 staff years in 2007/8.
- Training for the Central Site team, Large Business Service and Local Compliance assurance staff.
- Processing AEO applications at a Central Site, including liaising with other Member States - estimated 6 staff years in 2007/8 likely rising to 12 in 2009/10 depending on number of applications.
- Carrying out assurance visits and premises inspections to verify applicants meet the required standards – estimated 93 staff years during 2008/09 rising to 106 in 2009/10 depending on take-up.

Changes to electronic customs systems to accommodate AEO are being incorporated with other changes being delivered as part of the wider Customs Services Transformation Programme (CSTP). This helps to reduce costs and improve efficiency through integrated solutions and use of common components. It allows HMRC to take full advantage of the strategic approach proposed for CSTP, including process automation and the ability to manage business processes in real time. It is not possible to separate out the AEO cost elements.

Location of the Central Site in Nottingham was decided taking into account resource and location opportunities flowing from HMRC workforce change programme. This has enabled the new work to be accommodated as part of an already established unit dealing with other customs approvals and has helped to reduce initial set-up costs.

HMRC assurance costs in respect of applications for a Simplifications AEO certificate should be reduced for those businesses already authorised to use other customs procedures as these will be taken into account in the AEO approval process.

Cost estimates are shown in Table 7 below.

**Table 7: Implementation and running cost estimates, £ millions**

	2007/08 implementation costs	2008/09 running costs (1400 applications)	2009/10 running costs (1600 applications)	2010/11 running costs (500 applications)
Systems, procedures, guidance, consultation	£0.680			
Training	£0.052	£0.022	£0.016	£0.010
Policy & operations		£0.806	£0.073	£0.054
Central Site/processing	£0.271	£0.454	£0.542	£0.227
Assurance, inspections	£0.021	£5.900	£6.700	£2.000

Due to financial constraints these additional costs have to be managed within HMRC existing resource allocation.

## 6. Administrative Burden

Administrative Burdens (AB) are an element of compliance cost, focusing on the collation and provision of information to HMRC and third parties. There are two main differences between the AB estimate and the compliance cost estimates above:

- AB focuses on the steady state costs, so the number of businesses applying assumes that all existing businesses will have signed up in the first five year period, and after that the steady state burden reflects the costs of new businesses applying (i.e. churn in the system, note that the notifications are an ongoing burden to all businesses registered); and
- AB measures the time spent collecting and providing the information to HMRC (including through the audit process). The cost of filling the gaps in security plans etc is not included in AB.

Table 8 uses the Standard Cost Model assumption that churn is around 15% of the overall population to calculate the admin burden estimates for the applications process, based on a total population of 3,500. Wage rates are from 2005 for consistency with the SCM baseline<sup>1</sup>. The annual admin burden in the steady state is estimated to be around £5 million.

**Table 8: annual admin burden in the steady state, £ millions**

	Micro/Small	Medium	Large	Total
Applications	£0.2	£1.5	£2.8	£4.5
Audit/Inspection	£0.1	£0.3	£0.3	£0.7
Notifications	£0.0	£0.1	£0.1	£0.1
				£5.3

## 7. Impact Tests

### *Competition Filter*

An initial issue in this assessment is how to define the market. HMRC judges that in the case of this impact assessment it is appropriate to apply the competition filter to a number of distinct markets which may be impacted by the proposal:

- Importers and exporters – covers businesses of all sectors and sizes.

<sup>1</sup> More detail about the admin burdens

- Logistics Operators, Carriers, Freight Forwarders, Couriers, Agents – Range of business sizes
- Software Suppliers/ computer bureaux – will need to ensure systems meet the required standards for audit trails and security access
- Community Service Providers (CSPs)/ Port Authorities.

In any affected market, would the proposal:

*1. Directly limit the number or range of suppliers?*

We do not believe the proposal would directly limit the range of suppliers in any of the broad markets identified above.

*2. Indirectly limit the number or range of suppliers?*

There may be competition effects in some of the markets identified. For example if mutual recognition is agreed with other schemes there may be additional costs (e.g. longer clearance time, lack of access to simplifications etc) for companies trading with those countries who are not AEO registered, and this could be seen as a barrier to trading in these countries.

There may also be an indirect impact on Logistics Operators, Carriers, Freight Forwarders, and Couriers due to the cost of applying. These sectors have a large number of smaller businesses (for example, 81% of businesses engaged in road transport have less than 10 employees<sup>2</sup>) and a small number of large businesses which have almost half of the sector's employment and turnover. As the AEO scheme is voluntary, the precise impact on competition will depend on the extent to which early adopters require their service providers to have AEO status, and the extent to which this works its way down the supply chain to the smaller operators.

*3. Limit the ability of suppliers to compete?*

Due to the voluntary nature of the scheme, we do not believe there will be any limitations placed on the ability of businesses to compete, e.g. there are no price caps. Although the questionnaire (C118) requires details on the businesses organisational form, there is no restriction placed on how they choose to organise.

*4. Reduce suppliers' incentives to compete vigorously?*

The proposal does not exempt registered businesses from any competition law. It may actually give suppliers and service providers an additional dimension on which to compete, and through the creation of a level playing field, enhance competition within the EU.

### *Small Firms Impact Test*

The EU RIA made clear that although micro companies can achieve compliance with the requirements through relatively simple means due to their simplicity, small businesses may be of a size and complexity where the measures they need to implement to secure their operations

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<sup>2</sup> SIC code 602: Other Land Transport. SBS statistics.

are becoming more costly, whilst their turnover is still fairly moderate. Because of this, consultation with smaller firms has been particularly important.

There have been a number of workshops held with business representatives to assess the likely impacts of these changes on their business operations. It seems likely that take-up in this business sector could be very slow. Information obtained from businesses by SITPRO (the UK Trade Facilitation Agency promoting simplified procedures) indicates that many are favouring a wait and see approach and have not yet researched or costed AEO to a sufficient extent to be able to take a decision either way on application. Within the JCCC consultation arrangements, trade associations were invited to provide details of the specific impacts and costs on their small business members but this information has not been forthcoming.

A survey of 441 small businesses by Local Compliance produced poor results and very limited information. Most of those contacted were either unsighted or not interested in AEO status; 29 were undecided about whether to apply; and only 10 said that they would be applying. No information on likely costs was available. A further survey of 100 businesses listed in the small business service register established that only a handful were actively involved in international trade and of those only one responded.

Three small businesses with up to 9 employees were contacted as part of a sample of the small number of early AEO applicants. The average time taken to complete the application form (C117) and questionnaire (C118) was 3 hours. Two out of 3 businesses did not need to make any changes in order to meet the criteria. The other small business needed to make some changes and had employed a consultant for advice and to assist in setting up systems at a cost of £900. The time taken to complete the application and questionnaire by 7 slightly larger businesses with between 10 and 49 employees varied quite considerably from 4 hours in one case to 6 days in another. Five of the businesses did not need to make any changes to their systems whilst the other 2 said they had two thirds or more already in place and only needed to enhance their records and document some of their procedures. Neither was able to quantify the cost.

### *Other Impact Tests*

In addition to the effects on competition and small firms, we have considered all the statutory and other impact tests listed on page 17, including human rights, gender equality, disabilities equality and race equality. We have not identified any significant impacts on these issues arising from this reform, but will continue to monitor the situation.

## **8. Caveats**

AEO is a voluntary scheme and it has been extremely difficult to obtain a clear view from business to inform the likely level of take-up and application costs. Many businesses are undecided about whether or not to apply and the level of interest and response from small businesses indicates that many have given AEO little thought or are presently not interested in applying. Inevitably businesses will incur costs in making an application and also may need to invest further in rectifying any identified gaps in records, systems and procedures to meet the criteria. Immediate benefits are difficult to quantify but in the future application costs could be offset against the benefits of reduced data provision for pre-arrival and departure notifications, fiscal simplifications for AEOs proposed under the Modernised Customs Code and Implementing Provisions, and mutual recognition of similar schemes with 3<sup>rd</sup> country trading partners. Until then many businesses are reluctant to commit themselves particularly where additional costs are likely to be involved at a time of economic uncertainty.

The information and costing in this assessment should therefore be treated with some caution. It provides the best picture that we are able to assemble at this time of the costs and impacts but experience of a sufficient number of early applications should give a better understanding of actual costs and issues.

## 9. Implementation

The measure to introduce AEO arrangements in the UK was implemented on 1 January 2008 when the legislative Amendment to the CCC Implementing Provisions for AEO came into force.

In preparation for its introduction, HMRC has undertaken extensive trade publicity and education, providing speakers at trade and business gatherings and arranging specific events. In addition an AEO sub-group was established under the HMRC Joint Customs Consultative Committee (JCCC) that comprises representatives from business, Trade Associations, SITPRO and the CBI to discuss and resolve implementation issues and impacts on business and HMRC.

There has also been extensive coverage of AEO in numerous trade publications that has helped to raise awareness of the issue and provide advice and information to businesses considering whether or not to apply.

An HMRC notice (Notice 117) explaining all about the AEO scheme was published in July 2007 and is available through the Business Link and HMRC web-sites and from the HMRC advice service. The notice has received excellent feedback from businesses and JCCC for its helpful content and clarity.

A Central Site to handle applications for the UK was established in Nottingham in May 2007. Necessary training was provided to the staff in order to prepare them to receive some initial applications from 1 July to test the process in practice and quality of applications. This would inform any necessary changes to the procedures or future advice and publicity in advance of full implementation across the EU.

The application form (C117), questionnaire (C118) and explanatory notes were developed in consultation with UK businesses through a pilot group and were publicised and made available to businesses in June 2007 through the HMRC web-site and national advice service; and from October 2007 via Business Link. The early work carried out in the UK was successfully used to inform and influence development of EU guidelines.

Training for HMRC assurance officers has been put in place to ensure they understand the AEO concept and to prepare them for assuring applications, in particular the new and unfamiliar security and safety elements. In the period October 2007 to March 2008 some 300 assurance officers were trained and this included input from security experts responsible for carrying out assurance of the Regulated Agents scheme operated by the Department for Transport.

AEO is essentially new mandatory work for HMRC flowing from directly applicable EU legislation. Due to financial constraints no additional funding is available to implement, manage and maintain the scheme and HMRC will therefore have to accommodate the work within existing resources.

AEO arrangements will be managed and policed by HMRC and by UKBA in respect of border activities. Errors, irregularities and offences discovered during inland assurance and compliance checks or found by UKBA as part of interventions at the border would fall to be dealt with under the appropriate legislation and penalty provisions relating to those regimes, procedures and activities. For example, non-compliance in respect of customs fiscal matters may be dealt with under the civil penalties arrangements, whereas smuggling or attempted importation of prohibited and restricted goods may be subject to compound penalty or formal offence action. Non-compliance by an AEO ultimately risks either suspension or revocation of their authorisation.

An IA would normally be published to coincide with implementation. This has not been possible for AEO due to the considerable uncertainty over the likely levels of take-up of this voluntary scheme and difficulty in obtaining the necessary input and detailed information from business to inform the assessment. Many businesses are not prepared to commit themselves and have adopted a wait and see approach in line with their competitors and business partners. That is unlikely to change in the current economic climate. It is therefore appropriate to now publish the

IA on the basis of best available information, analysis and estimation and to use the post-implementation evaluation process to examine actual costs and benefits in consultation with business.

## **10. Monitoring and Evaluation.**

This IA will be subject to formal evaluation 12-18 months after the new Regulation comes into force. This will be undertaken in partnership with Business and Trade Associations through the Joint Customs Consultative Committee (JCCC) working groups.

HMRC impact assessments are also subject to a compliance cost review 1-3 years after implementation.

Actual take-up of AEO will be closely monitored by the central site in Nottingham that is responsible for receiving, recording and processing all UK applications and inputting relevant information to the EU AEO database. Costs will be re-evaluated using information obtained from a sample of actual applicants during the period.

## Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No