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The Honorable Sam M. Gibbons
Chairman, Subcommittee on Trade
Committee on Ways and Means
House of Representatives

The Honorable Philip M. Crane
Ranking Republican Member
Subcommittee on Trade
Committee on Ways and Means
House of Representatives

This letter responds to your March 13, 1991, request for our comments on two legislative proposals--the Customs Informed Compliance and Automation Act of 1991 (Compliance Act) and the Customs Modernization Act of 1990 (Modernization Act).[1] The proposals contain many similar provisions. For example, they both would authorize major automation changes dealing with the electronic (paperless) (1) transmission of information on imports that are subject to duties and (2) filing of import information with the Customs Service at Customs' locations other than the port where the merchandise arrives. The filing provision is called national entry processing. However, the two proposals contain differences in the time frames for implementing automation changes and in provisions dealing with fraud investigations, import examinations, duty payments, and debt collection.

If enacted, the automation changes in the two proposals dealing with paperless and national entry processing could result in major changes in the way Customs would do business into the next century. These potentially costly changes could affect Customs' organization, staffing, and interaction with the trade community. Consequently, we believe it would be useful if the Subcommittee were to explore the following two issues as it considers the proposed legislation:

-- the development of a strategy for operating in a fully automated environment, and

-- the time frame for implementing automation enhancements.

[1]These proposals have not been introduced; therefore, bill numbers have not been assigned.

We also have specific comments on several sections of the proposals dealing with (1) import examinations, (2) definition of civil fraud, (3) periodic duty payments, (4) waivers of duties and fees, (5) debt collection, (6) reimbursement of collection expenses, and (7) proceeds from the sale of unclaimed merchandise.

THE DEVELOPMENT OF A STRATEGY FOR OPERATING IN A FULLY AUTOMATED ENVIRONMENT

The paperless and national entry processing provisions in the Compliance and Modernization acts will present Customs a formidable task of integrating these changes into its systems and operations. Customs' previous attempts to modernize through increased use of automation have been criticized by us.[2] We reported that the agency has a history of implementing automated systems without adequate planning and we identified weaknesses in (1) documenting the systems under development, (2) testing the systems sufficiently before implementation, (3) controlling the revenues accounted for through the systems, and (4) securing the systems against unauthorized access.

A 1990 report by the Subcommittee on Oversight of the House Committee on Ways and Means identified planning and management weaknesses associated with Customs' automated systems and operations.[3] The Subcommittee report called for a revamping of Customs' approach to designing and developing information systems, including more strategic planning and better data sharing with the trade community.

In view of these past weaknesses, we believe it would be useful for the Subcommittee to use the opportunity presented in deliberating on these bills to have Customs articulate its

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[2] System Integrity: Stronger Controls Needed for Customs' Automated Commercial System (GAO/IMTEC-87-10, Feb. 10, 1987); Customs Automation: Internal Control Weaknesses in Customs' Revenue Collection Process (GAO/IMTEC-89-50, Apr. 11, 1989); and Customs Automation: Duties and Other Collections Vulnerable to Fraud and Abuse (GAO/IMTEC-90-29, Feb. 28, 1990).

[3] Report on Abuses and Mismanagement in U.S. Customs Service Commercial Operations (WMCP:101-22, Feb. 8, 1990).

strategy for achieving the transition to the proposed fully automated environment. One of the areas the Subcommittee may want to pursue in detail is whether Customs has an information resource management (IRM) framework for implementing complex automated systems. An effective IRM process starts with top management commitment and a vision of future agency mission and needs.[4] The Subcommittee may wish to have Customs explain the leadership structure it plans to use for ensuring that paperless and national entry processing is effectively implemented and how these provisions will help them accomplish the agency's mission in the most effective way possible. Since Customs already has existing systems, we believe that it is also important that the Subcommittee have Customs explain how it would incorporate paperless and national entry processing into its existing systems and whether there are any risks associated with this systems integration.

A second area the Subcommittee may want to pursue deals with some basic operational issues that need to be discussed to help ensure successful implementation of any new automation efforts. First, it is important that Customs address how the shift to a paperless environment will affect its ability to enforce the laws it administers. For example, section 212 of the Compliance Act and sections 115 and 116 of the Modernization Act provide that paperless transmission of data is to identify the importer in the same manner and extent as a signed paper document. Customs will need to ensure the integrity of this data to successfully carry out its responsibilities under the law. Because the traditional paper document with a handwritten signature would be replaced, we believe that electronic signatures that are (1) unique to the signer, (2) under the signer's control, (3) capable of being verified, and (4) linked to the data being signed are key components needed in such systems. Cryptographic data authentication as envisioned by Federal Information Processing Standard 113 can provide a basis for ensuring the integrity of such signatures.

Second, national entry processing could reduce the need to have import specialists stationed at the port of arrival. Currently, Customs inspectors generally examine selected merchandise, and Customs import specialists review related

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[4]Meeting the Government's Technology Challenge (GAO/IMTEC-90-23, Feb. 1990). Results of a GAO Symposium.

paper documentation (entries) at the port of arrival to ensure the merchandise and paperwork comply with trade laws and laws that Customs enforces for other agencies (e.g., Food and Drug Administration, Fish and Wildlife Service, etc.). With paperless entry filing and national entry processing, merchandise could be examined by inspectors at one location while electronically transmitted data could be reviewed by import specialists at another location. Consequently, import specialists could be consolidated at a particular Customs location, and their responsibilities could change from the current process of reviewing individual entries to greater attention to providing pre-import advice and post entry analysis and audit. To ensure that Customs will be able to carry out its mission effectively, the Subcommittee may wish to have Customs explain how it plans to (1) organize its import specialist work force for national entry processing and (2) provide staff the training needed for these changes.

Third, performance measurement systems are needed in order for Customs to monitor the effectiveness of paperless filing and national entry processing. Our past work at Customs identified management problems in its evaluation efforts.[5] The report by the Subcommittee on Oversight of the House Committee on Ways and Means also noted that Customs did not know if the programs it had initiated were accomplishing their intended purpose. To ensure that a similar situation does not occur with these initiatives, Customs should describe the Service-wide efficiency and effectiveness measures needed to assess program performance and evaluate trends.

Fourth, the transition to the fully automated operating environment will require the cooperation of the trade community. However, during our ongoing work at Customs, questions have been raised about the level of cooperation being obtained as Customs prepares for this transition. For example, Customs' pre-entry classification program (the duty classification of commodities before arrival) is one activity that Customs believes must function effectively before moving to a totally paperless and national entry processing environment. Customs officials have expressed concerns that

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[5]Air Cargo Imports: Customs Needs to Overcome Concerns to Benefit From Centralizing Examinations (GAO/GGD-88-64, Mar. 31, 1988) and Customs Service: Acceptance of Centralized Cargo Examinations Varies (GAO/GGD-90-24, Dec. 22, 1989).

importers have not shown the level of interest in pre-entry classification that Customs anticipated. The Subcommittee may wish to have Customs explain what actions are being taken to raise the level of interest in the pre-entry classification program so that Customs can move to a totally paperless environment.

Finally, we believe that the Subcommittee may wish to have Customs estimate how much the paperless filing and national entry processing provisions will cost not only Customs but the other federal agencies involved in administering trade and the trade community. As of May 1991, Customs had yet to develop cost estimates of the paperless filing and national entry processing provisions. Although the proposed legislation does not require mandatory participation in paperless filing and national entry processing by importers or their representatives (brokers), such provisions could have a significant financial impact on small importers and brokers who may have difficulty absorbing the equipment and record keeping costs that may be necessary for them to remain competitive in a paperless trade environment.

THE TIME FRAME FOR IMPLEMENTING AUTOMATION ENHANCEMENTS

A major difference between these two proposals is that the Compliance Act would set a 1-year time frame for implementing the automation enhancements while the Modernization Act would set no time limit. We recognize the need to set time frames for implementing automation enhancements, but we believe that the 1-year time frame is unrealistic in view of the amount of time previously needed by Customs to develop automated systems. For example, according to a Department of the Treasury report, many of the automated systems Customs currently uses to process imports took from 14 to 30 months to complete.[6] Moreover, Customs officials estimate that the design and implementation phases for national entry processing, which is in both the Compliance and Modernization acts, would take about 41 months.

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[6]The Automated Commercial System: Impact on Customs Commercial Operations. Department of the Treasury, Office of the Assistant Secretary of the Treasury for Management, Oct. 30, 1987.

Setting unrealistic time frames could cause Customs to improperly develop, test, and implement systems. The systems development problems previously identified resulted in part from a rush to get systems operating without sufficient attention to ensure that the systems processed information correctly or to integrate management information requirements into them. Customs, Congress, and the trade community would be better served by having Customs (1) establish realistic time frames for developing systems and (2) report periodically on the status of development efforts.

IMPORT EXAMINATION

Section 103(b) of the Compliance Act would require that Customs establish procedures for accrediting private independent testing laboratories, and Customs would be authorized to set the conditions that would be required to be met in order for the laboratories to maintain accreditation. The Modernization Act does not have such a provision. Currently, Customs laboratories test, analyze, and measure imports to assist its officers on a wide range of commercial and enforcement programs, including testing imports to deter substandard products from entering the United States.

While this section of the act would authorize Customs to establish procedures for approving and maintaining laboratory accreditation, the section would also permit importers to (1) submit merchandise samples to accredited testing laboratories, (2) receive the results from the laboratories directly, and (3) submit test results to Customs. Upon receiving this certification, Customs would be required to accept the test results without further testing of the sample if the importer certifies that the samples tested were taken from the merchandise being imported.

The Compliance Act would not allow Customs to exercise control over the samples that are sent to the private laboratories. By permitting the importer to (1) submit merchandise samples to the laboratories, (2) receive the test results from the laboratories, (3) report those test results to Customs, and (4) certify that samples tested were taken from the imported merchandise, the independent control provided by private laboratories reporting to Customs would be eliminated. We believe stronger controls over the integrity of private laboratory test results should be maintained by requiring Customs to send the merchandise

samples directly to the laboratories and requiring the laboratories to submit test results concurrently to Customs and the importer.

DEFINITION OF CIVIL FRAUD

Section 107(e)(1) of the Compli nce Act would amend 19 U.S.C. 1592 (Customs civil penalty statute) to define fraud. Currently, the definition of fraud applicable under 19 U.S.C. 1592 is set forth in Customs regulations. Before October 6, 1989, Customs regulations defined a violation as fraudulent if it resulted from an act or acts deliberately done with intent to deprive the United States of revenue or otherwise to violate U.S. laws. In 1989, Customs revised the definition of fraud because it believed it imposed a burden of proof that was greater than necessary to establish civil fraud. The regulations as revised require Customs to show that a violator knowingly intended to deceive, mislead, or convey a false impression in connection with a transaction. Unlike the prior regulations, the current regulations do not require Customs to show that the violator knew the direct consequences of his or her actions would be a loss of duties to the government or a violation of any U.S. laws.

Section 107(e)(1) of the Compliance Act would revert to the prior definition of fraud, as involving a violation deliberately done with intent to cause a loss of duties or to violate U.S. laws. Consequently, this change could hamper Customs' efforts to prove civil fraud. The Modernization Act does not contain such a provision.

PERIODIC DUTY PAYMENTS

Section 218 of the Compliance Act would permit importers to make payments of estimated duties on a periodic basis (e.g., monthly, quarterly, etc.). Section 218 specifies that the Secretary of the Treasury, when developing regulations for this section, cannot require payments more frequently than monthly. Section 129 of the Modernization Act permits the Secretary of the Treasury to set payment periods by regulation and does not restrict the Secretary from requiring payments more frequently than monthly. Under current payment practices, Customs generally requires importers to submit estimated duty payments within 10 working days after the merchandise has been released to the importer.

We favor the provision in the Modernization Act that gives the Secretary of the Treasury the responsibility for establishing payment periods. By restricting the Secretary of the Treasury's authority, the Compliance Act would permit importers to delay paying duties and cost the government interest earnings. Also, allowing more delay in duty payments could potentially make collecting payments more difficult. Customs already is experiencing problems collecting its delinquent accounts receivable, which as of December 31, 1990, totaled $151 million.

WAIVERS OF DUTIES AND FEES

Section 301 of the Compliance Act would amend 19 U.S.C. 1321 to increase the statutory amounts of duties and taxes that would be exempt from collection and to expand the exemption to import fees. These exemptions would provide a floor beneath which assessments and collection actions would not be made. For example, the Secretary of the Treasury would be required to waive collection of duties, taxes, and fees on an import when such duties, taxes, and fees are less than $20. Section 104 of the Modernization Act contains a similar provision. However, it would delete the specific dollar amounts and authorize the Secretary of the Treasury to specify such amounts.

We believe the flexibility contained in the Modernization Act provides Customs the opportunity to explore collection efficiencies that could make collecting small amounts economical and effective. For example, in March 1991, we reported to the Senate Committee on Finance and the House Committee on Ways and Means on Customs' efforts to change its systems for assessing and collecting duties and processing fees on mail imports.[7] In our report, we discussed how these changes could improve the efficiency and effectiveness of assessing and collecting duties and fees on mail imports. Such duties and fees are generally small sums. Customs estimated that during the first half of fiscal year 1991, duties and fees at or below $20 totaled about $6.7 million (or 54 percent) of the $12.5 million in mail duties and fees assessed during this period. If the Compliance Act provisions are adopted, Customs would be precluded from collecting sums below $20 despite possible system

[7]U.S. Customs Service: Efforts to Strengthen Controls Over Mail Imports Duties and Fees (GAO/GGD-91-37, Mar. 12, 1991).

improvements that would make collecting these sums more cost effective.

COLLECTION OF DELINQUENT ACCOUNTS

Section 301 of the Modernization Act would amend section 8(e) of the Debt Collection Act of 1982 to eliminate the prohibition of the use of private collection agencies to recover debts arising under the tariff laws. The Compliance Act does not contain such a provision.

As of December 31, 1990, Customs had delinquent accounts receivable totaling $151 million, of which $59 million was delinquent over 1 year. We are supportive of the provision to use private collection agencies as an additional collection tool after all administrative efforts to collect from importers have been exhausted. Over the years, we have reported on federal agencies' debt collection problems and have stressed the need for agencies to improve their debt collection practices.[8] One major improvement that we have continuously supported is the use of private collection agencies to collect delinquent debts. We believe that the use of collection contractors would provide Customs more resources for improving its debt collection capability and the opportunity to take advantage of private sector expertise.

REIMBURSEMENT OF COLLECTION EXPENSES

Customs collects harbor maintenance fees (HMF) for the U.S. Army Corps of Engineers. During fiscal year 1990, Customs collected about $169 million for the Corps of Engineers. These fees were increased by over 200 percent starting in 1991. The Corps of Engineers uses the collections to pay for port and harbor improvements. Section 304 of the Modernization Act contains an amendment to the Internal Revenue Code of 1986--which the Compliance Act does not contain--to remove restrictions on using HMF revenues to reimburse Customs for its HMF collection expenses. If this change is enacted, Customs could receive up to $5 million

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[8]Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986) and Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program (GAO/AFMD-90-12, Apr. 16, 1990).

annually in HMF revenues to pay for its HMF collection expenses. Under current law, Customs cannot use HMF funds to cover its collection costs as long as it is collecting the merchandise processing fees. The merchandise processing fee, which is supposed to pay for HMF collection expenses, is charged to importers, and it is assessed on the value of imported goods. However, U.S. trading partners have questioned the merchandise processing fee, in part because it was used to pay for expenses not related to Customs' expenses for processing imports. Because of these questions, Customs officials said the agency has devoted minimal effort and resources to auditing and verifying that it is receiving HMF payments from other parties who use ports and harbors (e.g., exporters and domestic shippers).

We are supportive of section 304 of the Modernization Act because in removing the restrictions to receive HMF revenues it could contribute to improving Customs' collection efforts by providing additional funding to audit and collect fees. Officials at Customs and the Corps of Engineers believe that there are large numbers of exporters and domestic shippers who fail to make HMF payments. Allowing Customs to use the HMF would provide additional resources needed for collecting the HMF from parties who fail to pay. Customs and Corps of Engineers officials have estimated that losses resulting from nonpayment of the HMF during fiscal year 1990 for both exporters and domestic shippers totaled between $20 to $22 million. Furthermore, officials from both agencies said that because the HMF was increased, they are concerned that the level of nonpayment could increase and result in even larger revenue losses.

Because of the potential for improved collections, we believe that a provision like section 304 in the Modernization Act should be added to the legislation that is ultimately enacted. However, we have one suggested change. Our past work has shown that Customs lacks data to support costs.[9] Without adequate cost data there may be little assurance that the payments from HMF revenues were reasonable. Therefore, we believe that the funding provision should be amended to require Customs to justify the costs of its collection activities that are to be reimbursed from HMF revenues.

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[9]U.S. Customs Service: Merchandise Processing Fee--Examination of Costs and Alternatives (GAO/GGD-90-91BR, June 15, 1990).

PROCEEDS FROM UNCLAIMED
MERCHANDISE SALES

Section 312 of the Compliance Act and section 121 of the Modernization Act would amend 19 U.S.C. 1493, which deals with proceeds from the sale of unclaimed commercial merchandise. Sections 312 and 121 would add taxes and fees to the list of expenses and liens to be paid from the proceeds of the sale and would prioritize the payments from the sale. Accordingly, payments from the proceeds would be made first for related selling expenses, followed by taxes and fees, and last for liens against such merchandise. Any remaining funds would be deposited into the Customs Forfeiture Fund.

The legislative analysis accompanying these sections is inconsistent with this change. The analysis states that 19 U.S.C. 1493 would be amended to require that the proceeds from the sale of unclaimed commercial merchandise be applied first to outstanding taxes and fees and second to expenses of sale and then to liens. Furthermore, the analysis states that the purpose of the amendment was to give priority to taxes and fees in allocating the proceeds from the sale. To avoid any questions about whether taxes and fees receive priority and to make the amendment consistent with what was intended, this inconsistency should be resolved and the law and/or analysis clarified accordingly.

Sections 312 and 121 would also amend 19 U.S.C. 1493 to require the deposit of any surplus proceeds--after payment of selling expenses, taxes, fees, and liens--into the Customs Forfeiture Fund. Authorized expenses from the Forfeiture Fund include operating and law enforcement expenses for (1) maintenance costs of property seized during drug enforcement activities, (2) investigative costs leading to the property seizure, (3) equipment purchases for drug enforcement use, and (4) payments to informers. The current law requires that surplus proceeds be deposited in the general treasury of the United States.

Amending the current law to allow deposit of surplus proceeds into the Forfeiture Fund would result in additional funds being available to Customs. This would be done without going through the normal appropriations process. We question the appropriateness of bypassing the appropriations process to use surplus proceeds from unclaimed commercial merchandise

sales to pay operating and law enforcement expenses associated with property seized as a result of illegal activities. Therefore, we believe that the proposed amendment to 19 U.S.C. 1493 should be changed to eliminate reference to the Forfeiture Fund and keep the current law's requirement to deposit the surplus proceeds in the general treasury of the United States. By keeping the law's current requirement, Customs would have to go through the appropriations process to receive additional funds to pay for authorized expenses from the Forfeiture Fund.

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We hope this information is useful in your deliberations on this proposed legislation. Should you need additional information on the contents of this letter, please contact me at (202) 275-8389.

Lowell Dodge

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