

GAO

U.S. General Accounting Office
Report to the Commissioner
of Customs Service

March 1994

**FINANCIAL
MANAGEMENT**

**Control Weaknesses
Limited Customs'
Ability to Ensure That
Duties Were Properly
Assessed**





United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-255669

March 7, 1994

The Honorable George J. Weise
Commissioner
U.S. Customs Service

Dear Mr. Weise:

This report presents the results of our review of controls over revenue at the U.S. Customs Service. We conducted this review as part of our financial statement audit of Customs pursuant to the Chief Financial Officers Act of 1990 (Public Law 101-576).

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report. A written statement also must be sent to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs; the House Committee on Government Operations; the House Committee on Ways and Means; the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations; and the Subcommittee on Oversight, House Committee on Ways and Means. We are also sending copies to the Secretary of the Treasury, the Director of the Office of Management and Budget, and other interested parties. Copies will be made available to others upon request.

Please call me at (202) 512-9510 if you or your staff have any questions concerning the report. Other major contributors are listed in appendix III.

Sincerely yours,

Gregory M. Holloway
Director, Civil Audits

Executive Summary

Purpose

As the second largest revenue collector for the federal government, the U.S. Customs Service reported collections of about \$20 billion during fiscal year 1992. This report describes the internal control weaknesses that GAO identified regarding Customs' ability to properly assess duties, taxes, and fees related to foreign goods imported into the United States.

Customs is 1 of 10 federal agencies that was required to prepare financial statements and have them audited by June 30, 1993, as a pilot project under the Chief Financial Officers Act of 1990 (Public Law 101-576). As authorized by the act, GAO elected to perform this audit for the fiscal year ending September 30, 1992. GAO's review of Customs' revenue processes was an integral part of this audit.

Background

Customs, as part of the Department of the Treasury, collects duties and taxes on imported goods and enforces trade laws primarily through its 44 district offices and 294 ports of entry across the country. About 90 percent of Customs revenue is generated from duties on imported goods. The remainder is generated primarily from excise taxes, user fees, and fines and penalties.

Customs assesses duties based primarily on entry documents submitted by importers and their brokers. These documents include entry summaries that list the goods being imported and supporting documentation, such as shipping manifests and invoices supporting the declared value of the goods. Most of these documents are due to Customs within 10 days after Customs has released the imported goods into U.S. commerce. In some cases, importers may transfer goods from their port of entry to another port or hold them in warehouses and foreign trade zones (FTZs). In these cases, duties are not assessed until merchandise is actually entered into U.S. commerce. Foreign trade zones are geographic areas within the U.S. where merchants may bring domestic and foreign merchandise for storage, exhibition, manufacturing, or other processing.

Customs may physically inspect imported goods at any time before they are released. Until the early 1980s, Customs' policy was to physically inspect a portion of all shipments. However, due to the increasing volume of imports, Customs modified its policy to limit its inspections primarily to shipments that, based on its experience, presented a high risk of trade violations.

Results in Brief

GAO identified significant weaknesses in Customs' ability to reasonably ensure that all duties and related revenues to which the U.S. government was entitled were assessed. Cargo inspections did not ensure that entry documents completely identified all goods imported, and goods that were transferred among ports or held in warehouses and foreign trade zones were not adequately monitored to ensure that all duties were promptly assessed when these goods were ultimately released into U.S. commerce. Because of these weaknesses, GAO cannot give assurance that the \$20.2 billion in revenue collections that Customs reported for fiscal year 1992 represented all revenues which should have been collected for that year. Further, controls over refunds of duties for items subsequently exported or destroyed were not adequate to prevent duplicate or excessive refunds, primarily because Customs did not have a practical means of maintaining the data needed to ensure that such refunds, which totaled about half a billion dollars during fiscal year 1992, were appropriate.

In addition, Customs did not have a reliable means of measuring overall compliance with trade laws in order to determine if it was maximizing the use of its inspection and enforcement resources. Most inspections were targeted at imports that Customs had determined, based on past experience, presented a high risk of violations. Customs also randomly selected some shipments for inspection. However, because these inspections were not performed consistently, they could not be used to estimate overall compliance. Consistently inspecting random samples would have allowed Customs to periodically assess the effectiveness of the criteria it used to target inspections and of other enforcement activities. In mid-1993, Customs began implementing a new inspection program intended to provide this capability. Top Customs officials see this as the beginning of a fundamental shift toward a more methodical and comprehensive approach to measuring and improving compliance with trade laws. GAO plans to assess these efforts as part of its audit of Customs' fiscal year 1993 financial statements.

Principal Findings

Weaknesses Over Import Verification Created Opportunities for Lost Revenue

Customs' internal controls did not provide reasonable assurance that all goods imported into the United States were properly identified and that the related duties were assessed. GAO found that most of Customs' examinations were limited to items reported by carriers and importers on

manifests and entry documents and, therefore, would not have been likely to discover items that were omitted from these documents. Inspectors rarely (1) observed cargo being unloaded to determine that all shipping containers were listed on manifests and entry documents or (2) verified the quantities of goods inside containers. In addition, Customs could not effectively verify that quantities identified on some manifests were completely identified on entry documents primarily because these manifests were submitted on paper, rather than electronically, and thus could not be compared by a computer to entry documents.

Customs Could Not Measure Overall Compliance With Trade Laws

Shipments that were inspected were selected primarily because Customs' experience indicated that they presented a high risk of violations. For example, importers with records of previous violations or first-time importers were more likely to have their shipments inspected. However, Customs did not conduct random inspections that could be used to estimate overall compliance and determine if the criteria used to target its inspections, the judgments of its inspectors, or its inspection techniques were effective in ensuring compliance with trade laws. As a result, Customs did not have a sufficient basis for managing its resources. Although some cargo was randomly selected for inspection, weaknesses in Customs' inspection process rendered the results unreliable for estimating overall compliance. GAO found that inspectors were allowed so much latitude in deciding when to perform randomly selected inspections and how many types of items in a particular shipment to inspect that the sample was invalidated. Also, GAO could not reliably assess the scope and quality of these inspections because Customs did not require inspectors to completely document them. For example, Customs did not have records showing the number of items actually inspected; only violations were required to be described.

In a September 1992 report on Customs' trade enforcement activities, GAO recommended that Customs reassess its trade enforcement strategy and develop means to better identify and prioritize areas of noncompliance. One of GAO's specific recommendations was that Customs test compliance with the laws it enforces using accepted statistical techniques. In response, in mid-1993, Customs began a new program of more carefully controlled random inspections designed to provide more reliable data on compliance with trade laws.

Weak Controls Over Goods in Bonded Warehouses and Foreign Trade Zones

Customs did not adequately monitor goods that had been imported but for which duties had not yet been assessed. This increased the risk that importers could enter goods into commerce without paying the related duties or without paying duties promptly. Systems designed to automatically monitor the movement and disposition of goods from one U.S. port of entry to another were of limited effectiveness because Customs personnel did not consistently maintain arrival and departure data. In addition, they did not always investigate overdue shipments to determine what had happened to the related goods. For goods held in warehouses, Customs did not (1) maintain accurate and up-to-date information on inventory levels and (2) periodically perform required on-site inspections of these facilities. Of the 14 district offices GAO reviewed, 7 did not maintain records that allowed them to readily determine the amount of goods in warehouse inventories at any given time. Further, GAO identified errors in the records that were maintained.

Oversight of foreign trade zones was even more lax. Customs did not require district offices to maintain inventory data on merchandise held in foreign trade zones, nor inspect these facilities. Customs relied almost exclusively on periodic audits, referred to as regulatory audits, to enforce FTZ compliance with its regulations. However, in fiscal year 1992, Customs performed such audits at less than 4 percent of these facilities. As a result, Customs had no record of merchandise moving through the facility and could not ensure that all merchandise placed in the facility was properly withdrawn with appropriate duties, taxes, and fees reported and paid.

Controls Over Refunds of Duties Were Weak

GAO identified serious control weaknesses in Customs' duty refund practices. Customs refunds 99 percent of duties paid when the related imported merchandise is subsequently exported or destroyed. Customs reported that it made almost half a billion dollars in such refunds, referred to as drawbacks, during fiscal year 1992. However, GAO found that procedures were inadequate to prevent excessive or duplicate payments or detect fraudulent claims. Specifically, Customs did not (1) compare the amount of drawback paid with the related import entry summary document to determine that the claim was valid and accurate, (2) ensure that only authorized claimants received accelerated drawback payments, and (3) ensure that required bonds, which guaranteed Customs' recovery of excessive refunds, were adequate.

Recommendations

GAO recommends that Customs

- implement a strategy for inspecting cargo from both high- and low-risk carriers to help ensure that all cargo delivered is accurately and completely identified on manifests and entry documents and
- require district offices to maintain perpetual inventory records of goods held in bonded warehouses and FTZs that they are responsible for overseeing.

GAO also makes a number of recommendations for improvements to Customs' automated systems so that Customs can more effectively verify the accuracy of entry documents, monitor activity related to goods held in warehouses and foreign trade zones, and validate drawback claims.

Agency Comments

Customs agreed with most of GAO's recommendations and cited several compliance measurement and systems development efforts to address them. The most significant of these efforts are

- a series of tests to determine whether carriers, brokers, and importers are completely and accurately reporting imported goods so that duties can be properly assessed and other aspects of the trade laws can be enforced, and
- development of a new automated drawback claim system capable of linking drawback claims and entries and monitoring compliance with various other aspects of the drawback claim process.

GAO believes that Customs' compliance measurement tests are a good first step in measuring compliance in these areas and is assessing the methodology that Customs is using in performing the tests as part of its audit of Customs' fiscal year 1993 financial statements. However, the tests' ultimate value will depend on the subsequent actions Customs takes to alter its inspection programs to increase compliance rates in the future. In addition, Customs is only in the early stages of developing an automated drawback system that is not likely to be implemented until sometime during fiscal year 1995, at the earliest.

Customs expressed concern with the recommendation that district offices maintain perpetual inventory records of goods held in bonded warehouses and FTZs. Customs stated that it believes improved monitoring of warehouse and FTZ inventories is desirable, but that other critical system improvement priorities preclude devoting resources to developing an inventory system. GAO recognizes that Customs must prioritize its

improvement projects. However, Customs has not performed an overall risk assessment of these operations but has identified some of its warehouses as high risk. GAO believes that maintaining current records on goods held in warehouses and FTZs is essential if Customs is to monitor these goods and ensure that related duties are properly paid.

Customs' comments are discussed and evaluated in chapters 2, 3, and 4 and are included in appendix II.

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Abbreviations

ACS	Automated Commercial System
AMS	Automated Manifest System
CFO	chief financial officer
CSS	Cargo Selectivity System
FTZ	foreign trade zone
IG	Inspector General
LQV	landed quantity verification

Introduction

This report discusses the effectiveness of the U.S. Custom Service's processes and systems for assessing, collecting, and accounting for revenue from duties and taxes on imported merchandise and related fees and penalties. As the second largest revenue collector for the federal government, Customs reported revenue collections of about \$20 billion for fiscal year 1992.

Our review of Customs' revenue processes and systems is an integral part of our audit of Customs' fiscal year 1992 financial statements. Customs is 1 of 10 federal agencies required to prepare financial statements and have them audited by June 30, 1993, as a pilot project under the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576). The CFO Act establishes a blueprint for effective financial management reform that includes a strong financial management leadership structure, the requirement for a long-range financial management improvement plan, audited financial statements, development of performance and cost data, and integrated financial management systems. As authorized by the act, we elected to perform the financial statement audit of Customs for the fiscal year ending September 30, 1992. This is one of several reports resulting from that audit. Previously issued reports are listed in appendix I.

Background

Customs, as part of the Department of the Treasury, is responsible for collecting duties and taxes on imports and administering and enforcing trade and importation laws. Customs carries out its operations through its headquarters, in Washington, D.C., and its 7 regions, 44 districts, and 294 ports of entry across the country. Over 90 percent of Customs' revenue is collected at the port and district level. Customs' reported revenue collections have increased from about \$8 billion in fiscal year 1980 to about \$20 billion in fiscal year 1992.

About 90 percent of Customs' revenue is generated from duties that Customs assesses and collects on merchandise imported into the United States. The remainder is generated primarily from

- excise taxes on wine, distilled liquor, and tobacco;
- user fees associated with services provided by Customs, the U.S. Army Corps of Engineers, and the U.S. Department of Agriculture; and
- fines and penalties imposed on importers for violating laws and regulations that Customs is responsible for enforcing.

Overview of the Import Process

Customs is responsible for monitoring the importing of, and assessing and collecting duties on, foreign goods arriving in the 50 states, the District of Columbia, and Puerto Rico, which are referred to collectively as Customs territory. Goods arrive at domestic seaports, airports, and land borders on carriers such as ships, airplanes, trains, and trucks. Until the early 1980s, Customs' policy was to physically inspect a portion of all shipments. However, due to the increasing volume of imports, Customs modified its policy to limit its inspections to high-risk shipments. As a result, most shipments are not inspected at all, and usually only a segment of others are inspected.

Customs monitors the entry, inspection, and release of imported goods and the payment of related duties primarily through its Automated Commercial System (ACS). ACS includes several modules that allow carriers and importers to electronically submit manifests and entry documents and facilitate Customs' matching and monitoring of this information.

Customs' process for reviewing manifests and entry documents, performing physical inspections, and assessing duties varies depending on whether the importer immediately enters imported merchandise into U.S. commerce, transports it to another port of entry, or transfers it to a bonded warehouse or foreign trade zone. In all cases, carrier operators and importers must submit to Customs manifests and required entry documents, which list the merchandise being imported, prior to or upon arrival at a port of entry. However, duties are not paid until merchandise is actually entered into U.S. commerce.

To immediately enter imported merchandise into U.S. commerce, an importer or its agent files with Customs an "entry/immediate delivery" form, along with a commercial invoice, which provides supporting information on the goods' description and value, and evidence that a surety bond exists, guaranteeing that duties will be paid. Customs may review these documents and may choose to physically inspect the related goods before approving their release. Within 10 working days of release of the goods, the importer or broker is required to file with Customs an "entry summary" form, which provides line-item descriptions of the type, quantity, and value of the imported merchandise; the duty category; and the estimated duties and fees payable. Generally, a payment for the estimated amounts due duties, taxes, and fees owed is to accompany the entry summary. Subsequently, Customs may review this documentation and make a final determination of the amounts owed. Such reviews may

result in a bill to the importer for additional amounts or a refund for overpayments.

An importer may choose to store imported goods in a bonded warehouse or transfer them to a foreign trade zone before releasing them into U.S. commerce and paying the related duties. Bonded warehouses are facilities, regulated by Customs, that may be operated by independent warehousing firms or by importers. According to Customs records, 1,273 bonded warehouses were in operation nationwide as of September 30, 1992, and the duties on merchandise withdrawn from them accounted for about 1.7 percent of the \$18.3 billion in duties which Customs collected during fiscal year 1992. Foreign trade zones are geographic areas designated in accordance with the Foreign Trade Zone Act, in which merchants may bring domestic or foreign merchandise for storage, exhibition, manipulation, manufacturing, assembly, or other processing. There are two basic types of foreign trade zones: general purpose zones, used primarily for warehousing and distribution, and special purpose or subzones, which are often large assembly complexes located in a zone user's private facilities. As a member of the Foreign Trade Zone Board, Customs shares responsibility for establishing, monitoring, and controlling foreign trade zones with the Secretaries of Commerce, the Treasury, and the Army. According to the most recent information available, in fiscal year 1991, 179 foreign trade zones were in operation, and they received merchandise valued at about \$84 billion, including \$18 billion in foreign merchandise. Subzones accounted for about 90 percent of this merchandise.

Customs is also responsible for refunding duties and taxes paid on imported merchandise that is subsequently exported or destroyed. Customs refers to such refunds as "drawbacks." Some drawbacks are made on an accelerated basis, before Customs has verified that such refunds are warranted. In these cases, Customs requires the importer to have a surety bond which is sufficient to ensure that Customs can recover the drawback if the related documentation does not support it and the claimant cannot repay the amount due. According to Customs' accounting records, during fiscal year 1992, it paid approximately \$496 million for over 53,000 drawback claims.

The direct responsibility for inspecting and monitoring imported merchandise and ensuring that proper duties are assessed is shared by Customs' Office of Inspection and Control, Office of Commercial Operations, and Office of Enforcement. Although these components have

similar goals, the Office of Inspection and Control is primarily responsible for cargo inspections, the Office of Commercial Operations is responsible for ensuring that imported goods have been properly classified and valued, and the Office of Enforcement focuses on investigations of suspected violations. In addition, Customs' Chief Financial Officer is responsible for providing advice and guidance on financial management to the Commissioner and for formulating and executing implementation of accounting, budgeting, and financial control systems.

Objectives, Scope, and Methodology

As part of our audit of Customs' fiscal year 1992 financial statements, we evaluated Customs' processes and systems for assessing, collecting, and accounting for revenue on imported merchandise. Our specific objectives were to evaluate the effectiveness of Customs controls for ensuring that

- all dutiable merchandise that entered the United States commerce was identified and duties, taxes, and user fees were assessed;
- merchandise held in bonded warehouses and foreign trade zones was adequately monitored; and
- only valid drawback claims were paid, only authorized claimants received accelerated payments, and bond coverage was sufficient to ensure that Customs would recover any inappropriate drawbacks.

To assess Customs' controls for ensuring that all dutiable merchandise that entered U.S. commerce was identified and duties, taxes, and user fees were assessed, we reviewed Customs policies and procedures for identifying and assessing duties and fees owed on imported merchandise. To confirm our understanding of these policies and procedures, we interviewed officials and reviewed documentation related to these processes for 74 ports of entry and 38 district offices, which were located throughout all seven of Customs regions. We also observed controls in operation at several of these ports. As part of this effort, we judgmentally selected both electronically and manually submitted bills of lading from eight manifests, which we reviewed to determine if items listed had been released, if duties had been assessed, and that remaining items were properly accounted for. In some cases, this involved visiting the facilities where unreleased items were stored to verify their existence. The eight manifests we reviewed were selected at four ports of entry: the Newark and Los Angeles seaports, John F. Kennedy Airport in New York, and Los Angeles International Airport. We also observed the manifest process and inquired about related operations at the Miami, Florida, seaport and

airport; Houston, Texas, seaport; and the Laredo, Texas, and Otay Mesa, California, land borders.

To assess the effectiveness of Customs' oversight of bonded warehouse and foreign trade zone operations, we made inquiries, observations, and inspections at 16 bonded warehouses in 14 districts and 6 regions, and 10 foreign trade zones in 5 regions. Specifically, we reviewed the operators' activities related to recordkeeping, inventory controls, and reporting of selected receipt and withdrawal of transactions to Customs. Also, we inquired about and reviewed district records regarding the level and results of Customs inspections performed during 1992.

To determine the validity and correctness of reported drawback payments for fiscal year 1992, we reviewed supporting documentation for two random samples of claims: 110 accelerated drawback claims valued at \$20.9 million and 24 nonaccelerated drawback claims valued at \$0.6 million. Our samples were selected from Customs refund and drawback payment files within ACS, which accounted for all of the \$496 million in drawback payments reported by Customs for fiscal year 1992. Specifically, we examined pertinent files to determine whether the drawback payment amounts in our sample cases were based on proper calculations and supported by valid import entry information, and whether the claimants had surety bonds. These files generally included agreements between the drawback claimant and Customs which specified the products exported and the percentage of imported raw materials contained in those exports, drawback claim forms, calculations of payment amounts, and other pertinent information.

In addition to ports of entry and district offices, we discussed Customs procedures with officials at Customs' National Finance Center in Indianapolis, Indiana, and headquarters in Washington, D.C. Our work was performed from January 1992 through September 1993 in accordance with generally accepted government auditing standards.

Customs provided written comments on a draft of this report. These comments are summarized and evaluated at the end of chapters 2, 3, and 4 and are reprinted in appendix II.

Customs Could Not Reasonably Ensure That Dutiable Merchandise Was Identified and Assessed

Due to weaknesses in Customs' ability to reasonably ensure that all dutiable imports were identified and related duties assessed, we cannot give assurance that the \$20.2 billion in revenue collections that Customs reported represents all revenues which should have been collected for fiscal year 1992. We identified two significant weaknesses in Customs' cargo inspection practices that increased the risk that imported goods will not be completely and accurately declared. First, most of Customs' examinations were limited to items reported by carriers and importers on manifests and entry documents and, therefore, would not be likely to discover any items that had been omitted from these documents. Second, random inspections of imported goods were not performed in a consistent and disciplined manner. Therefore, they could not be used to estimate overall compliance with trade laws or measure the effectiveness of new enforcement techniques. Since only a small percentage of shipments is examined, it is important that these efforts be as effective as possible in both identifying and deterring trade law violations.

In addition, Customs' ability to account for the movement and disposition of imported goods and to ensure that all appropriate duties were assessed was diminished because (1) some imports were reported on paper manifests that could not be readily matched to entry documents, (2) electronically submitted manifests did not contain description codes that could be matched by the computer to entry documents, and (3) data needed to monitor goods transferred from one port of entry to another were not up-to-date and complete.

Physical Inspections Did Not Ensure That Imports Were Completely and Accurately Reported

None of Customs' programs were designed to reasonably verify that cargo actually delivered at U.S. ports of entry was completely and accurately identified on manifests. Although inspectors could elect to board any carrier upon arrival and review various entry documents, Customs officials at one port of entry that we visited told us that this review was generally limited to ensuring that the manifest was written in English and that all pages were present. Verifying the completeness and accuracy of manifests is important because virtually all subsequent inspections and document reviews are based on the assumption that the manifest is complete and accurate. For example, Customs' Automated Manifest System uses manifests submitted by the carrier as a means of verifying information on entry documents, and entry documents are subsequently used as the primary basis for selecting items to be inspected and for determining if duties have been correctly assessed.

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One type of Customs inspection involved matching the cargo containers on board and their identification numbers with the related manifests to ensure that all containers were identified on the manifest. However, these inspections, referred to as landed quantity verifications (LQVs), were of limited value in verifying that all goods were identified because (1) they were narrowly focused on searching for illegal goods, such as drugs, on high-risk carriers and (2) Customs did not have formal, agencywide procedures delineating steps to follow when conducting LQVs.

A Customs headquarters official responsible for inspection operations said that developing LQV guidance was left to the discretion of local officials at the district and port level. Generally, Customs officials stated that, for carriers selected for LQVs, Contraband Enforcement Teams inspected the cargo to search for the specific reason it was identified as high risk. For example, if a carrier had a history of illegal shipments, the team would inspect the cargo for drugs, including opening some containers to determine whether such contraband was on board. However, according to Customs officials, although the teams generally verified that all containers were listed on the manifest, they typically did not verify that the nature and quantity of the goods enclosed within the containers were accurately reported on the manifest. For example, as part of an LQV that we observed at the seaport in Newark, New Jersey, the contraband inspection team matched each container's identification number to the manifest as it was unloaded and opened some containers to determine if they contained any illegal imports. However, the team did not verify that the container contents had been correctly identified on the manifest.

Regardless of the type of inspection performed, when containers were opened, Customs' policies did not require that the quantity of goods be physically verified. Customs officials at two ports of entry stated that such verifications were generally not made. Our observations verified this. Of the several inspections that we observed at one seaport and one airport, none involved counting, or even estimating, the quantity of items in the container being inspected.

In addition to its focus on high-risk shipments, Customs could provide greater assurance that cargo was completely and accurately identified on manifests by randomly selecting carriers to examine, randomly selecting containers to open, and matching the quantity and description of goods to the manifest. Random sampling is an efficient way to increase the likelihood that the items examined are representative of the entire universe of items imported and allows conclusions to be made about the

entire population from which the sample was drawn. In addition, knowing that their cargo may be inspected under a random selection process would be likely to deter carriers from misreporting cargo.

Random Inspections Were Not Consistently Performed

Most Customs inspections were narrowly targeted on searching for illegal or misidentified goods in shipments that had been either (1) identified as high risk by Customs' Cargo Selectivity System (CSS) or (2) suspected of violations by inspectors at ports of entry. CSS automatically reviewed information from the entry forms, compared it to risk criteria in the CSS database, and specified which shipments were to be inspected and the extent of the inspection. Risk criteria, which included factors such as country of origin, first-time importers, and importers with records of previous violations, were updated periodically based on the results of recent inspections. At any time, inspectors could examine cargo that they suspected might involve a violation regardless of whether it had been selected by CSS for inspection. In this way, Customs attempted to use its experience and its inspectors' expertise to focus its limited resources on the shipments with the highest risk of violating trade laws.

However, Customs had no way to determine if the criteria used to target its inspections, the judgments of its inspectors, or its inspection techniques were effective in ensuring compliance with trade laws. This was because it did not conduct random inspections in a way that would allow them to be used to estimate overall compliance and determine the impact of changes in its inspection strategy.

Although CSS randomly selected some cargo for inspection, weaknesses in Customs' random inspection process rendered the results unreliable for estimating overall compliance and for adjusting CSS criteria. We found that inspectors were allowed so much latitude in deciding whether to perform randomly selected inspections and in determining how many types of items in a particular shipment to inspect that they invalidated the randomness of the sample. For example, Customs officials at two ports of entry told us that cargo associated with each line item of the selected entry was to be physically inspected. However, one inspector also told us that inspectors generally used their own judgment in deciding how many line items on an entry to inspect and how many items within a line item to inspect. An inspector at another location told us that random inspections were usually given a low priority and sometimes not performed because targeted inspections resulted in the identification of more violations and, therefore, were viewed as more productive. Also, a headquarters official

responsible for cargo release policies said that he did not know how many random examinations were actually performed, but that examinations performed were probably less than the number selected because inspectors sometimes did not perform a selected inspection.

Also, we could not reliably assess the scope and quality of these inspections because Customs did not require inspectors to completely document them. For example, Customs did not have records showing the number of items actually inspected; only violations were required to be described. For these reasons, the results of the random inspections could not be used to reliably measure compliance with trade laws and regulations.

As we reported in September 1992,¹ random inspections could provide Customs a means of reliably estimating compliance with trade laws and periodically remeasuring compliance to assess the effectiveness of enforcement techniques. In that report, we recommended that Customs reassess its trade enforcement activities and develop means to better identify and prioritize areas of noncompliance. One of our specific recommendations was that Customs test compliance with the laws it enforces using accepted statistical techniques. In response, in mid-1993, Customs began a new program of more carefully controlled random inspections designed to provide more reliable data on compliance with trade laws. According to senior Customs officials, Customs plans to use the results of these reviews to better target areas of noncompliance and measure the effectiveness of its enforcement efforts in increasing compliance. These officials said that they see this as the beginning of a fundamental shift toward a more methodical and comprehensive approach to measuring and improving compliance with trade laws. We plan to assess these efforts as part of our audit of Customs' fiscal year 1993 financial statements.

Controls Over the Movement and Disposition of Imports Were Weak

Several modules within Customs' Automated Commercial System (ACS) are intended to provide Customs a means of accounting for imported goods from the time they arrive at a port of entry until they are either entered into commerce, exported, or otherwise disposed of. These include the (1) Automated Manifest System (AMS), which maintains manifest information that is electronically submitted by carriers, (2) Automated Broker Interface, which provides a communications link for the electronic

¹Customs Service: Trade Enforcement Activities Impaired by Management Problems (GAO/GGD-92-123, September 24, 1992)

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transmission of entry data on imported merchandise between importers, brokers, and carriers and ACS, and (3) automated In-Bond System, which provides a means of accounting for merchandise that is transported from one port to another in the United States.

However, we identified several deficiencies in AMS and the In-Bond System that diminished Customs' ability to monitor the disposition of goods and ensure that all appropriate duties were assessed. Specifically, Customs could not

- effectively verify data on entry documents with information on manifests because (1) some manifests were filed manually and could not be matched by a computer to other documents and (2) electronic manifests were not required to describe goods using standard descriptors that could be automatically compared by computerized systems or
- monitor the departure and arrival of goods being transferred to another port because data in the in-bond system were not entered promptly.

Customs' Ability to
Compare Data on
Manifests and Entry
Documents Was Limited

One of the ways that Customs attempts to ensure that all appropriate duties are paid is by comparing data on manifests with information on entry documents and other documents, such as invoices, to monitor the movement and ultimate disposition of goods. In 1985, Customs implemented AMS to provide (1) advance notice of goods that were arriving and (2) a means of accounting for the movement of imported goods from the time a carrier's cargo manifest is electronically transmitted to Customs until the goods are released into U.S. commerce, transported to another port, or entered into a bonded warehouse or foreign trade zone. However, some imported goods were reported on manually filed manifests that could not be cost-effectively compared to entry document data on a routine basis. As a result, Customs had no means of routinely ensuring that entry documents completely and accurately identified the goods listed on the manifest and that all appropriate duties were paid. Customs only control over the accuracy of manually submitted manifests were manual reviews of a sample of manifests, which generally occurred weeks or months after the goods had left the port of entry.

Customs port officials could not provide us with reliable estimates of the percentage of carriers filing manifest information electronically or the number of bills of lading that were filed manually. However, the headquarters officials we spoke with said that well over half of the sea bills of lading were filed electronically while a substantially lesser number

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Assessed

of air bills were filed electronically. Customs encourages use of AMS and plans to expand its availability to more carriers, including rail and truck carriers, for whom it was not available.

Carriers participating in AMS electronically transmit to Customs data from bills of lading, which create manifest inventory files in AMS. These data may be transmitted before the carrier arrives at the port of entry or upon arrival. Once the inventory records are created, Customs monitors the status of the goods by updating the records with entry and release information for each shipment. For example, when the importers or brokers transmit entry data to Customs for release of a specific shipment, this information is matched to the related manifest data and approved for release. When the time allowed for movement of goods has elapsed (5 to 30 days depending on the entry location), AMS identifies manifested goods that have not been reported as released and provides this information to the appropriate carrier for investigation.

These procedures provide Customs some ability to electronically account for quantities of goods released or disposed of. However, Customs written procedures did not require carriers to include description codes that could be matched by a computer to provide greater assurance that the goods released were the same goods that were identified on the manifest. For example, AMS could not compare the description of goods reported on the bills of lading with that reported on the various entry release forms because, although a field for this information was available, importers, brokers, and carriers were not required to enter this information using a standard descriptor that could be automatically matched among various documents. Therefore, Customs could not be sure that the goods reported on the manifest were the same goods released and, as a result, that the proper duty was assessed.

Customs uses codes, referred to as harmonized tariff codes, that could be used as descriptors. Each code represents a very specific type of goods, such as plastic-coated wire, and can be used to determine the rate of duty charged on that particular type of item. Importers are required to show the appropriate harmonized tariff code for each line item of goods identified on their entry documents. However, such codes were not required on manifests. Requiring such codes on manifests would be one way of providing descriptors that could be electronically matched by AMS.

Goods Transported “in Bond” Are Not Adequately Controlled

Customs did not have a reliable means of monitoring the movement of unreleased shipments, referred to as in-bond transfers, from one port of entry to another because data on departures were not properly maintained. As a result, Customs could not ensure that appropriate duties were assessed on these goods when they were finally released into U.S. commerce. An importer may transfer goods from the original port of entry to another port to delay paying duties until the goods are closer to their ultimate destination — for example, goods arriving by ship in New York that are ultimately bound for Chicago. Or goods may pass through the United States on their way to another destination, such as goods being transported from Canada to Mexico.

Customs accounts for goods that initially arrive at one port of entry (port of origin) but are shipped immediately to another port of entry (port of destination) through the in-bond module of ACS. Departure data are entered automatically for goods reported on electronic manifests showing that an in-bond transfer is planned from the port of origin. For other shipments, Customs officials are to input departure data manually at the port of origin to establish accountability for the merchandise. When the goods arrive at the port of destination, personnel there are to input data indicating that the goods have arrived, at which time accountability is transferred from the port of origin to the port of destination.

However, at two Customs locations we visited, officials stated that departure and arrival information was not consistently maintained because personnel at their location and at other locations did not input data promptly. As a result, in some cases, personnel at the port of destination were unable to anticipate a shipment’s arrival, and identify and report any delayed arrivals, because a record of departure had never been set up. In other cases, the port of destination did not promptly record arrival of the goods and the port of origin had to spend time investigating the goods’ whereabouts.

We reviewed recent operational reports entitled “Listing of In-Bond Shipments Overdue” at four locations and found that all showed shipments that presumably were overdue and undelivered. However, an official at one location told us that personnel there did not follow up on the overdue shipments identified in the report because they did not consider the report to be reliable.

Similar findings were reported by the Department of the Treasury Inspector General (IG) regarding fiscal year 1991 in-bond transactions.² The IG's report stated that "the in-bond program provides little assurance that significant revenue loss or transportation of contraband is not occurring." One reason cited was that ports were not effectively using Customs' automated systems to monitor the movement of in-bond shipments. In response to the IG's report, the Commissioner stated that Customs was planning to eliminate the current in-bond system and implement new procedures for monitoring in-bond transfers during early fiscal year 1994. According to Customs officials, the new system will contain more detailed and up-to-date data, relying more on electronic submissions by brokers and importers and less on processing of paper documents. If implemented properly, we believe that the new system may provide better control over in-bond transfers. However, because the new system was not operational at the close of our review, we could not assess its effectiveness.

Conclusions

Customs' internal controls did not provide reasonable assurance that all imported goods that enter Customs territory were properly identified and the related duty assessed. Physical inspection procedures did not ensure that all imported goods were accurately identified on related manifests, which provide the basis for most subsequent inspections and document reviews. Also, random inspections could not be relied on to measure compliance with trade laws, because they were not performed in a consistent and disciplined manner. In addition, systems designed to automatically monitor the movement and disposition of goods were of limited effectiveness because some manifests were submitted manually rather than electronically and important data on goods being transferred were not entered promptly. During fiscal year 1993, Customs began efforts to improve the value of its random inspections and provide better control over in-bond transfers. However, at the close of our review, it was too early to comment on their effectiveness.

Recommendations

We recommend that the Commissioner of Customs direct the Assistant Commissioner for Inspection and Control to develop and implement, in conjunction with Customs' Chief Financial Officer, a strategy for inspecting cargo from both high- and low-risk carriers to help provide reasonable assurance that all cargo delivered is accurately and completely

²U.S. Customs Service Transportation In-Bond Program (U.S. Department of Treasury Inspector General) September 22, 1993.

identified on manifests and entry documents. Carriers undergoing such inspections should be randomly selected to ensure that they are representative of all carriers.

In addition, we recommend that the Commissioner

- obtain reliable data on carriers' use of the Automated Manifest System as a percentage of all manifest submissions so that expanded use of the system can be more accurately monitored;
- consider requiring all documents, including manifests, to identify goods in a uniform manner, such as through the use of harmonized tariff codes; and
- monitor implementation of the new procedures for accounting for in-bond transfers to ensure that they address the weaknesses that have been identified. In conjunction with this effort, provide personnel involved in maintaining data on in-bond transfers with clear and detailed guidance and adequate training on complying with the new procedures.

Agency Comments and Our Evaluation

In commenting on a draft of our report, Customs agreed with our recommendations and cited various improvement efforts that are intended to address them. Regarding our recommendation that Customs develop an inspection strategy that helps provide reasonable assurance that all cargo delivered is accurately and completely identified on manifest and entry documents, Customs said that it is currently preparing for agencywide compliance measurement tests that will address these concerns. Customs said that it has completed compliance measurement tests of imported goods in five industries at selected ports and that these tests have identified some revenue shortfalls. In addition, Customs said that tests to measure the accuracy and completeness of bill of lading data began in November 1993 and that it would begin a landed quantity verification initiative for manifest compliance during early 1994.

We believe that such tests are a good first step in measuring compliance in these areas, and we are assessing the methodology that Customs is using in performing the tests as part of our audit of Customs' fiscal year 1993 financial statements. However, the tests' ultimate value will depend on the subsequent actions Customs takes to alter its inspection programs to increase compliance rates in the future.

Regarding our recommendation that Customs obtain reliable data on the percentage of manifests that are submitted electronically versus manually, Customs stated that it already has data on automated manifest

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submissions and that it plans to test the validity of reports developed by field personnel on manual submissions and alert these personnel to the necessity of capturing accurate data in this area. During our review, field personnel told us that reports on manually submitted manifests, referred to as CF-16 reports, were not reliable. We believe that by testing these reports, as planned, Customs headquarters officials can help ensure that they have accurate information on both automated and manual manifest submissions that will allow them to monitor the extent to which carriers are using the Automated Manifest System.

Regarding the use of uniform descriptors to identify goods entering Customs territory, Customs responded that it plans to study implementation of such a requirement. Customs stated that the recently enacted Customs Modernization Act (title VI of the North American Free Trade Implementation Act, Public Law 103-182) has provided the statutory framework that would make studying the feasibility of such a requirement possible. This law, signed in December 1993, contains provisions that affect a wide array of Customs' operations. At the time of this report's publication, we had not fully assessed the impact of the law's requirements. However, Customs is in the process of modernizing its automated systems, and we believe that, as part of that effort, it would be appropriate to assess the benefits and feasibility of using uniform descriptors.

In addition, Customs stated that it has provided written guidance and training related to implementation of its newly developed in-bond system and that it will monitor the new system to ensure that it addresses the identified weaknesses related to such transfers. We have not assessed the new system, which Customs began implementing in October 1993. Therefore, we cannot comment on its effectiveness or on whether Customs personnel are properly using the new system.

Oversight of Bonded Warehouses and Foreign Trade Zones Was Weak

Customs did not effectively oversee bonded warehouse and foreign trade zone (FTZ) operations. Such oversight by Customs is critical to ensure that these facilities comply with Customs regulations and, as with in-bond transfers, to ensure that duties are paid if and when goods are finally entered into U.S. commerce.

Most importantly, district offices did not always (1) maintain accurate and up-to-date information on inventory levels and (2) periodically perform on-site inspections of these facilities. Of the 14 district offices we reviewed, 7 did not maintain records that allowed them to readily determine the amount of goods in warehouse inventories at any given time. Further, 12 districts did not perform inspections as frequently as required by Customs policies, and 6 did not document them in a way that would facilitate follow-up actions.

Oversight of FTZs was even more lax. District offices did not maintain inventory data on merchandise in FTZs, nor inspect these facilities. Customs relied almost exclusively on periodic audits, referred to as regulatory audits, to enforce FTZ compliance with its regulations. However, in fiscal year 1992, less than 4 percent of these facilities were inspected.

Customs Did Not Maintain Accurate Information on Merchandise Stored at Bonded Warehouses

We identified significant weaknesses in Customs' ability to maintain accurate records of goods stored in bonded warehouses. Without accurate records, Customs cannot ensure that warehouse operators comply with requirements that they

- promptly alert Customs when all merchandise in an entry has been withdrawn so that Customs staff can review related transactions to ensure that the proper revenue has been assessed,
- remove all merchandise within 5 years after it enters a warehouse, as required by Customs regulations, and
- provide correct inventory records to Customs staff who count inventory during warehouse inspections.

The risk that goods may be released without proper assessment of duties is especially great when the facility operator also owns the merchandise, as is the case at some warehouses. Generally, independent parties are considered to be less likely to engage in improper transactions than are related parties.

Customs had no standard procedures or system for monitoring the inventory levels at bonded warehouses to ensure that duties were paid as soon as goods were released. ACS maintained data on goods initially placed in warehouses, but the system was not designed to maintain inventory balances when goods were gradually withdrawn from the warehouse. The files we reviewed showed that importers often withdrew warehoused items on a piecemeal basis.

All of the district offices we visited maintained files of paper entry and withdrawal documents. However, most of these files did not provide reliable, up-to-date, and readily accessible information on items remaining in warehouses because withdrawal documents were not filed with, or even near, related entry documents. Only four of the districts we visited routinely filed withdrawal documents, which had been submitted by importers for approval, with the related entry documents so that Customs could readily determine how much of the goods from a given entry remained in the warehouse.

Two of Customs' seven regions had adopted automated inventory control systems for monitoring inventory levels on a continuing basis. Records that are updated in this manner on an ongoing basis are generally referred to as perpetual inventory records. However, the regional systems had not been continuously and consistently used and, therefore, their information was not reliable. One of the main reasons for this was that the regions' inventory control systems were not integrated with ACS and, therefore, required duplicate input of entry information, once into the regional system and again into ACS. Three of the districts we reviewed had used one of these regional systems. However, one had stopped using the system because of the added data entry workload and another had not kept the records current. Officials at this second district office had assigned a team to resolve a backlog of several hundred records and bring the regional system up-to-date. The third district had continued to use the system.

Our review of Customs and warehouse inventory records confirmed that discrepancies existed, in part because Customs did not maintain its records on a current basis and promptly resolve errors. Customs requires warehouse operators to maintain complete receipt and withdrawal documents for each entry and to submit these documents to Customs within 10 working days after all goods associated with an entry have been released from the warehouse. However, one of Customs' regional automated systems showed 100 entries that were not in the warehouse operator's records. According to warehouse officials, the goods had been

withdrawn and the related paperwork forwarded to Customs as much as 2 years earlier. In following up on a sample of 18 of these entries, we found that Customs had received and recorded receipt of final documents for 5 of them in ACS but had not removed them from the inventory system. An additional 11 had not been recorded in ACS although Customs had received the related final paperwork. According to a Customs clerk, the agency was aware that the other two entries were closed, but had not yet removed them from their inventory records.

At another district with automated records, the warehouse we visited held goods associated with 14 entries, but Customs records indicated that goods for 6 of the entries were stored in another warehouse. Also, Customs records showed that the warehouse still held goods on two other entries, while warehouse officials told us that they had all been released several months earlier.

We found similar errors in manual records. For example, one district office's entry files showed that goods from 118 entries remained at one warehouse. However, the warehouse operator's records showed that merchandise from only 74 entries was in inventory or had been withdrawn so recently that Customs may not have had time to process the transactions. We discussed the remaining 44 entries with Customs personnel and found that goods from 27 had been stored in the warehouse but had been completely withdrawn and 17 others had never been stored in the warehouse. Of the 17,

- 3 had been released into the United States immediately,
- 11 had been stored in different warehouses,
- 2 had been seized by Customs before reaching the warehouse, and
- 1 was still at the port of entry awaiting transfer to the warehouse.

We also found that the warehouse operator's records included five entries that were not recorded in Customs' inventory for that warehouse because Customs records erroneously showed they were stored at other warehouses.

Customs Did Not Effectively Inspect and Audit Warehouses

For many years, Customs assigned officers to bonded warehouses to supervise the receipt and release of goods. However, the agency halted this supervision at warehouses in 1982 to reduce costs and replaced it with a program of periodic warehouse inspections—which Customs refers to as spot checks—and audits. Although Customs has recognized that these

inspections and audits are vital controls over bonded warehouse operations, the agency did not adequately carry out these reviews during fiscal year 1992 or document the extent and results of the reviews. District offices did not conduct all required spot checks and many that were completed were poorly documented. Also, few audits, which are more in-depth than spot checks, were performed during fiscal year 1992.

Without an effective inspection program and reliable records on warehouse inventory, Customs is dependent on the honesty of warehouse operators to obtain Customs' approval before releasing merchandise. This increases the risk that payment of related duties will be inappropriately delayed.

Spot Checks Were Not Performed as Frequently as Required

At 12 of the 14 districts we visited, we identified several warehouses that were not spot checked as often as required by Customs directive. A Customs headquarters directive requires that district inspectors conduct surprise spot checks, which usually last from a few hours to 2 days, at each warehouse no less than once a year. Primary requirements in the directive are to

- annually assess and document the degree of risk associated with each warehouse;
- establish a schedule of spot checks, based on risk assessments;
- conduct a spot check of each warehouse once a year for low-risk warehouses, twice a year for medium-risk, and three times a year for high-risk; and
- maintain a file for each warehouse that includes risk assessments, spot check reports, audit reports, liquidated damage (fee) notices, and related information.

Based on our review of district office records and discussions with district office officials, spot checks generally are to involve (1) walking through the warehouse to observe general conditions and (2) selecting a sample of entries from warehouse files, determining that related documentation was complete, determining the quantity of goods that should be in the warehouse at the time of the spot checks, and counting the goods to determine if their quantity and description matched information on the supporting documents.

Of the 16 warehouses we tested in detail, district records showed that Customs did not inspect 2 at all in fiscal year 1992. Another 2 were not

inspected often enough: 1 assessed at medium risk was inspected once, and 1 at high risk was inspected twice. In our more general review of 14 district spot check programs, we identified 1 office which performed spot checks at only 12 of the 93 bonded warehouses under its control. Another inspected 13 of 24, and one failed to inspect any of 8 warehouses located near one of the ports in its jurisdiction.

Officials generally told us that spot checks were not performed because priority was given to other work. However, at least two warehouses were not inspected because district officials did not realize that oversight of the facilities had recently been transferred to Customs. These were warehouses that stored only alcohol and had been overseen by the Bureau of Alcohol, Tobacco, and Firearms from 1986 to 1991.

Documentation of Spot Checks Did Not Always Show Work Performed or Results

Even when spot checks were completed, team members did not always sufficiently document valuable information, such as what specific controls or requirements were reviewed, what inventory was physically counted, whether verbal warnings were given to warehouse proprietors, or who performed the inspection. Such documentation is needed to help ensure that

- recurring violations are identified and related fines and penalties assessed,
- supervisory review is adequate,
- continuity is maintained for the review process as team members change, and
- inspections results are available for use in subsequent spot checks or the annual risk assessment.

The Customs directive on warehouse inspections includes an example of an optional spot check worksheet, but provides no guidance on using it. Worksheets at one district which used these worksheets often included vague notations that did not provide a clear description of the work performed. For example, one worksheet identified inventory counted as “various” and several showed letters to designate what general aspect of warehouse operations had been inspected, such as “B” to indicate “warehouse conditions” had been reviewed.

Nine of the 14 district offices we visited did not use the worksheet in the directive. Some of these developed detailed worksheets that required inspectors to annotate findings for each of numerous possible violations and record information on merchandise which was counted. However,

others prepared little documentation. For example, at two districts, spot check teams used only inventory count sheets to document their inspection, providing no information on other areas reviewed.

Headquarters Oversight of Spot Checks Was Limited

Customs headquarters staff did not monitor the warehouse inspection program. In 1991, headquarters rescinded requirements for quarterly reports from district offices on spot check activity and advised district directors to "properly monitor local activity." Other headquarters information on warehouses was also limited. In late 1992, headquarters staff had not updated listings of bonded warehouses since September 1990 and referred us to regional offices for current lists of warehouses. Regional office lists showed 1,273 active warehouses, compared to 1,419 on the headquarters list. Even the regional lists included some inaccuracies; in selecting warehouses to visit we found one warehouse which had closed in 1983 and another in 1988.

Detailed Audits Covered Few Warehouses

In addition to spot checks, the agency's Office of Regulatory Audit performed more detailed audits of warehouses. These audits, which generally took from 1 to 2 weeks but sometimes as long as a month to complete, included systematic reviews of warehouse inventory and financial records and of merchandise on hand. However, the office issued reports on only 36 of the 1,273 warehouses that, according to regional office records, were in operation in fiscal year 1992.

Similar Weaknesses Existed in Oversight of Foreign Trade Zones

Customs exercised less control over FTZs than over bonded warehouses. Prior to placing merchandise in FTZs, importers are required to submit documents for approval to Customs. Unlike warehouse transactions, however, Customs recorded no information in ACS on merchandise in FTZs. Moreover, after providing approval, only 1 of 10 district offices we visited monitored this merchandise, and none kept perpetual inventory records. Also, Customs did not reconcile information on FTZ entry documents with documents filed on merchandise being removed from FTZs. As a result, Customs had no record of merchandise moving through the facility and could not ensure that all merchandise placed in the facility was properly withdrawn with appropriate duties, taxes, and fees reported and paid.

As with bonded warehouses, this risk is especially great when the FTZ operator also owns the merchandise, as is the case at most subzone FTZs, which are usually manufacturing facilities. For example, at a subzone that

installed accessories in imported automobiles, we observed thousands of autos held in multiple car lots that were under the control of the subzone operator. During the time of our visit, Customs had no controls over these lots that would prevent or detect either entry or removal of autos that the owner did not report to the agency.

As at bonded warehouses, Customs has removed its inspectors that were once physically located at FTZs, but in fiscal year 1992 did not have a program of mandatory spot checks and audits. Nevertheless, for that year, district offices reported that inspectors performed 288 spot checks of general purpose zones. However, no spot checks or audits were performed at subzones, which the FTZ Board reported held about 90 percent of the dollar value of goods held in FTZs. According to headquarters officials, spot checks of many FTZs, especially manufacturing subzones, are not effective due to the complexity of FTZ operations.

Customs' Office of Regulatory Audit conducts more comprehensive detailed audits, each of which can last from a week to several months. However, such audits were performed for only 7 of the 179 FTZs in operation in fiscal year 1992 and just 42 from 1988 to 1991. According to the Customs manager of FTZ audits, audit work is primarily directed toward recently activated zones or zones which have not been audited for several years. In addition, the Office of Regulatory Audit began conducting surveys at FTZs in 1990. Surveys are shorter than audits and are used to more quickly assess overall zone operations and determine the need for a broader audit. However, these are also conducted infrequently.

Conclusions

Customs had not taken steps to sufficiently minimize the risk of loss from goods stored in bonded warehouses and FTZs. Because Customs' oversight was minimal, warehouse and FTZ operators could dispose of, alter, or replace the goods held in their facilities without detection by Customs, thereby avoiding or delaying payment of amounts due to Customs. Even if Customs suspected such illegal activities, it might have had difficulty proving it because its records of entries and withdrawals were not reliable.

Recommendations

We recommend that the Commissioner direct the Assistant Commissioner for Inspection and Control, in conjunction with the Chief Financial Officer, to

- require district offices to maintain perpetual inventory records of goods held in bonded warehouses and FTZs that they are responsible for overseeing and
- enhance ACS so that the district offices could use this system to maintain perpetual records of merchandise quantities at each warehouse and FTZ.

In addition, we recommend that the Commissioner direct the Assistant Commissioner for Inspection and Control and the Assistant Commissioner for Commercial Operations, as appropriate, to

- emphasize to district offices the importance of spot checks of bonded warehouses and monitor this activity to ensure that districts comply with headquarters directives,
- require district offices to periodically spot check all FTZs that have not been audited or surveyed for over a year, and
- provide more detailed guidance on the use of spot check worksheets so that they will capture complete information on these inspections.

Agency Comments and Our Evaluation

In commenting on a draft of our report, Customs agreed with our recommendations regarding periodic inspections of warehouses and FTZs and needed improvements in related guidance and agreed to implement them. However, Customs expressed concern with our recommendations that district offices maintain perpetual inventory records of goods held in bonded warehouses and FTZs and that ACS be enhanced to provide this capability. Customs stated that it believes improved monitoring of warehouse and FTZ inventories is desirable, but that other critical system improvement priorities preclude devoting resources to developing an inventory system. In this regard, Customs said that its resources should be applied in a manner that is proportionate to the relative risk and significance of the bonded warehouse and FTZ operations. Customs said that it does plan to expand its compliance measurement program to this area and to reinforce existing control mechanisms, such as spot checks.

We realize that Customs must prioritize its system improvement projects, and we agree that risk must be considered. However, Customs has not done an analysis regarding the overall risk of warehouse and FTZ operations although it has already identified some of its warehouses as high risk. We believe that maintaining current records on goods held in warehouses and FTZs is essential if Customs is to monitor these goods and ensure that duties are promptly paid when goods are withdrawn. As stated in the report, Customs generally maintains data on entries into and

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withdrawals from warehouses and FTZs, but does not maintain these data in a perpetual inventory format. Current perpetual inventory records would provide Customs personnel with a useful means of monitoring warehouse inventories and would be essential for conducting efficient spot checks of these facilities. For these reasons, we believe that instituting an automated means of inventory monitoring would significantly improve Customs' ability to oversee these operations.

Controls Over Drawback Payments Were Weak

Customs did not have internal controls in place to detect and prevent duplicate and excessive drawback payments, nor to ensure that accelerated payments were made only to approved claimants and that such claimants had purchased sufficient bond amounts to cover their drawback claims. Drawbacks are refunds of duties and taxes paid on imports when the imported goods are subsequently exported, in total or in part, or destroyed. The exporter or its designee can file a drawback claim for refund of up to 99 percent of the original duties paid related to the portion of the goods exported or destroyed. The remaining duty of 1 percent is retained by Customs. During fiscal year 1992, Customs made payments of approximately \$496 million on over 53,000 drawback claims. Although Customs recognizes that weaknesses exist in the drawback program, planned corrective actions have been delayed.

Drawback Claims Were Not Adequately Verified

Customs has not developed detailed guidance on how drawback claims are to be reviewed and verified before they are finalized, a process Customs refers to as liquidation. We reviewed a representative sample of 65 liquidated claims and found that Customs did not adequately verify the accuracy and validity of 14. In addition, we could not determine if 20 others had been adequately reviewed because Customs had deleted the claims from its automated records, including the information that showed which entry summaries had been requested for review by liquidators.

We determined that to ensure that only valid claims are paid, at a minimum, the review should verify that

- the claim can be correlated to the related entry summaries for which the duties were originally paid,
- the goods for which the drawback is being made were actually exported or destroyed, and
- total claims filed against a particular entry summary do not exceed 99 percent of the original duty paid.

Customs could not provide these assurances because of deficiencies in its automated systems and its manual procedures.

Automated System Did Not Support Liquidation Process

Customs' systems did not (1) have the capability to electronically compare key information on drawback claims to the original entries that were being refunded or (2) maintain a cumulative record of the quantity of goods exported and the dollar amount of drawback payments made against an

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entry summary. Although ACS had a drawback module, it was primarily used to maintain a list of drawback claims filed with Customs and as an automated device to locate and request entry summaries from the locations where they were filed. Some drawback information, mainly payment-related information, could also be entered into ACS' entry summary module. However, the two modules were not designed to automatically match drawbacks with the related information on entry summaries.

Even if Customs' automated systems could match this information, this capability would have been of limited benefit because it would have been too time-consuming to manually enter the critical data elements for the thousands of drawback claims filed. As currently designed, ACS is not capable of accepting electronically submitted drawback claims, so Customs' personnel would have had to manually enter the information needed to link claims with the original duties paid. In one case, a drawback claim we examined covered 957 different entry summaries.

In addition, the drawback module did not maintain drawback claim records long enough to provide liquidators with information on all of the entries for which a drawback claim had been filed. Drawback claims can be filed up to 8 years after the related entry summaries are submitted. However, a Customs official told us that the archiving procedures within ACS deleted the drawback claim record from the drawback module within 3 to 4 months after a claim was liquidated, thereby eliminating from Customs records any trail of import entries that were linked to drawback claims.

Customs officials we spoke with recognized that ACS did not link drawback claims to the associated import entries. However, planned improvements to the drawback module had been delayed. A Customs planning document, dated May 1, 1991, stated that improvements in the drawback module, including an update link to entry records, were anticipated for late 1991. However, as of late October 1993, these improvements had not been made and, according to a Customs official responsible for the module, were postponed due to pending legislation that could affect Customs' system modernization plans.

**Inadequate Manual
Controls**

In an effort to compensate for these limitations, Customs had implemented manual procedures to verify the validity of drawback claims. However, Customs still risked making duplicate and excessive payments,

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because only a small judgmentally selected sample of entry summaries was reviewed and many were inadequately documented. Of the 65 liquidated claims in our random sample of 134 drawbacks claimed during fiscal year 1992, 31 did not have any notations on the entry summaries to show that a drawback claim had been filed against them.

Customs had not developed any agencywide written procedures for these reviews. However, based on our review of drawback claims and discussions with staff responsible for processing such claims, we determined that liquidators generally selected a judgmental sample of the entry summaries from the total summaries listed on the drawback claim for review and sometimes made handwritten notations on the original copy of the entry summaries to indicate that a drawback had been paid against the entry.

In general, the sample selected on drawbacks with multiple entries was not representative of the entire drawback claim. For example, in one instance a drawback claim for \$851,891 was filed to claim a refund against 720 separate entry summaries. To determine the validity of the claim, Customs judgmentally selected 5 of the 720 entry summaries for review. In another example, Customs selected 5 entries for review of a drawback claim of \$24,705. Those 5 entries represented \$261 of the amount claimed.

The entry summary numbers selected for review were entered into the drawback module, but no indication of the drawback payment was made on the corresponding entry summary in the ACS entry summary master file nor in the drawback module. Also, neither module had any indication of the quantity of the imported goods which were exported as part of the drawback claim.

Representative Samples
Are Essential for Assessing
the Validity of Drawback
Claims

Until Customs develops a means of automatically verifying drawback claims, it could provide better coverage by manually reviewing a representative sample of entries related to each claim. Use of an appropriate sampling methodology is critical due to the large number of entry summaries that can be associated with drawback claims. In our random sample of 134 drawbacks, 113 of the claims had multiple entries associated with each claim, ranging from 2 to 957 entries.

To be representative, the sample must be chosen in a way that all items in the population have an opportunity to be selected. Generally, the most efficient way to achieve a representative sample is to use statistical

sampling techniques, which allow conclusions to be made about the entire population from which the sample was drawn, while minimizing the number of items which must be tested.

Assurance about the validity of drawback claims could also be achieved by selecting related entries for review in a nonstatistical manner. However, this would require reviewing a significant dollar amount of the entry summaries filed against any given claim to ensure that the portion not reviewed, if invalid, would be an acceptably low level of risk. A sample selected in a nonstatistical manner would not allow conclusions to be drawn about the entire population but only the portion reviewed.

Lack of Controls Over Accelerated Payments

About 80 percent of drawbacks are paid before Customs has reviewed the basis for the claim. These accelerated drawbacks are only to be paid to claimants who, based on Customs' experience, have consistently complied with Customs requirements. However, we found that Customs had not implemented the controls necessary to ensure that only reliable claimants were provided this privilege and that related bonds were sufficient to insure Customs against any losses resulting from accelerated payments.

Information Needed to Monitor Drawback Program Was Not Available

Prior to 1991, Customs had no established uniform policies and procedures for approving, denying, or revoking accelerated payment privileges. Consequently, regional offices used different means for responding to claimant requests for accelerated payment. For instance, in one location, a regional official said that claimants were verbally authorized for accelerated drawback payments and no written approval was maintained in Customs records. Another location only verified that the claimant had asked for the accelerated payment and that a sufficient bond was on file to cover drawback claims.

In February 1991, Customs established uniform national procedures for approving, denying, and revoking accelerated payment authorization, and required regional offices to document the basis for their decision to authorize accelerated payments. Customs regulations state that eligibility for accelerated payment is confined to claimants not delinquent or otherwise remiss in transactions with Customs. The regulations also provide for the denial of accelerated payments to claimants who repeatedly file claims in excess of the amount to which they are entitled. Although regional offices are to approve claimants' initial requests for accelerated payments, they are to (1) review, on an annual basis, whether

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claimants are complying with Customs' conditions for accelerated payment, (2) document decisions to authorize or deny the privilege to a claimant, and (3) review claimants for whom accelerated payment was authorized prior to the issuance of the directive to determine if they are still eligible.

However, we found that Customs was not complying with these requirements because key information was not being maintained. Consequently, Customs was vulnerable to making unauthorized and potentially unrecoverable accelerated payments to claimants who should have had their privilege revoked. Specifically,

- regional office records often did not include documentation to support Customs' authorization of the accelerated payment privilege to specific claimants, and
- verification procedures were too limited to verify that accelerated drawback claims were covered by sufficient bond amounts to ensure repayment if the accelerated drawback claim was subsequently determined to be invalid.

In our random sample of 134 drawback claims, 110 were accelerated payments. Our review found that for 52 of the 110 accelerated drawback claims, Customs lacked written approvals or documentation authorizing the claimant to receive accelerated payments. For example, Customs made accelerated payments totaling over \$2.4 million on four drawback claims filed by a single claimant, but had no record of this claimant being approved for accelerated payment of drawback as required by the 1991 directive. According to the liquidator for this claim, the claimant had been receiving accelerated payments before Customs adopted the 1991 directive, and a local decision was made that claimants already receiving accelerated payments at the time the directive was adopted would not be required to go through the approval process. In another location, a Customs official stated that his location did not have enough resources to review existing accelerated payment claimants as required by the directive to verify that claimants still met Customs' requirements for such payments.

Customs officials said that they did not maintain information in ACS on claimants approved to receive accelerated payment of drawback claims. According to Customs policy, approval or denial of a claimant's right to use accelerated payment by one region determines the claimant's eligibility for accelerated payment in all Customs regions, yet a national

database did not exist to maintain this information. Customs planned to include a drawback claimant record data base in the new drawback module. However, as discussed in the previous section, updates to the drawback module, originally anticipated for late 1991, have not been given a high priority in the ACS redesign plan.

**Controls to Determine
Bond Sufficiency Were
Ineffective**

Bonds posted to cover accelerated payments are to serve as insurance if the claim is subsequently adjusted down or denied during liquidation. However, controls did not ensure that these bonds were sufficient.

Customs regional officials were responsible for the sufficiency of continuous bonds posted by claimants to cover accelerated drawback claims. Customs allowed claimants to file either a single transaction bond or a continuous bond to cover accelerated payment of drawbacks. A single transaction bond covers one drawback claim and is equal to the amount of accelerated payment to be received. A continuous bond is fixed in an amount sufficient to cover the maximum amount of accelerated payment to be outstanding (unliquidated) at any time during an annual period and may cover numerous drawback claims. In addition, Customs allowed claimants using continuous bonds to post or file a dual purpose bond which covers both import activities (duties, fees, and taxes) and drawbacks.

In an effort to ensure compliance with Customs' requirements for continuous bonds, liquidators attempted to monitor drawback bonds, but lacked a servicewide automated system to assist them. We found that liquidators used either a manual ledger or a local automated schedule to monitor the amount of accelerated payments paid against a continuous bond; however, they did not compare the bond amount to the total of all unliquidated accelerated drawbacks filed by the same claimant in all regions, and some liquidators did not include import activities when determining the sufficiency of dual purpose bonds filed for drawbacks. Customs officials told us that they did not review every accelerated payment that was filed locally or in other regions due to the volume of accelerated claims that are processed. As a result of these ineffective and inefficient controls, liquidators did not have the critical information needed to determine if continuous bonds were sufficient.

Of the 110 accelerated drawbacks reviewed in our sample, we found 2 claimants who, at one time during fiscal year 1992, had exceeded their bond coverage. Manual controls were hampered in cases where a claimant

filed drawback claims at multiple Customs offices or used a dual purpose bond to cover drawback claims. These same limitations affected our audit procedures, so that our testing of individual payment transactions may not have identified all occurrences of bond insufficiency. For example, one of the claimants we identified as having insufficient bond coverage filed drawback claims in two separate Customs offices. At one point in fiscal year 1992, this claimant had outstanding drawback payments which exceeded its bond coverage by \$1,063,425. In addition, because this claimant had a dual purpose bond, covering both its import and drawback activities, the claimant's import entries were vulnerable to potential unrecoverable duties, taxes, and fees during the period that the bond was insufficient.

To illustrate the risks of insufficient bond coverage, our sample of outstanding accounts receivable¹ as of June 30, 1992, identified 81 individual cases related to drawback claims totaling \$16,021,474. Twenty-two of these cases totaling approximately \$3.4 million were related to one claimant whose debts were unsecured by a bond. In addition, during fiscal year 1992, Customs continued to pay accelerated drawbacks, totaling \$492,920 to the same claimant.

Customs officials agreed that liquidators have a difficult task in ensuring bond sufficiency given the lack of systems support. The lack of automated or effective manual controls increased the risk that liquidators authorized accelerated payments in excess of the bond amount. Although ACS has a bond liability module, Customs officials said that it was not designed to compare drawback transactions with continuous bond amounts, and thus could not be used by liquidators to ensure that accelerated drawbacks authorized for payment were adequately covered.

Conclusions

Despite the substantial risk of error and loss in Customs drawback program, Customs has not moved beyond the planning stage in implementing meaningful controls. Customs personnel responsible for reviewing drawback claims did not have the information they needed to ensure that drawback payments, including accelerated payments, were appropriate. They relied on manual, paper-intensive, procedures to verify a judgmentally selected sample of claims, and had virtually no reliable means of determining which claimants were entitled to accelerated claim payments. Until Customs institutes systems that can automatically

¹This sample was part of our comprehensive review of Customs' accounts receivable for fiscal year 1992. For further details, see *Financial Management: Customs Did Not Adequately Account For or Control Its Accounts Receivable* (GAO/AIMD-94-5, November 8, 1993).

compare drawback claims with the duties originally paid, it will not have a cost-effective way to monitor the program.

Recommendations

We recommend that the Commissioner direct the Assistant Commissioner for Commercial Operations, in conjunction with the Chief Financial Officer, to:

- develop a means of automatically entering information needed to verify drawback claims into ACS so that liquidators can use the system to automatically verify drawback claims;
- until this capability is developed and implemented, require that liquidators use representative sampling procedures for reviewing drawbacks that relate to multiple entry summaries;
- enhance ACS so that historical information on drawback claimants such as accelerated claim privileges, excessive claims previously filed, overdue receivables, and regulatory audit results are available to liquidators in a national database;
- require that liquidators review this database to ensure that special privileges such as accelerated drawback payments are granted only to claimants who have consistently complied with Customs claim filing requirements; and
- enhance the bond liability module to monitor the sufficiency of bonds posted for drawback transactions, including the ability to alert liquidators when coverage is exceeded.

Agency Comments and Our Evaluation

In commenting on a draft of our report, Customs agreed with all of our recommendations related to controls over drawback claim processing and said that it would address most of them as it institutes new regulations and systems provided for by the Customs Modernization Act. Although it seems reasonable to design new controls as part of these efforts, Customs is only in the early stages of developing a new automated drawback system and does not expect the new system to be implemented until fiscal year 1995, at the earliest. In the interim, Customs says that it plans to instruct its field offices to use representative sampling when reviewing entry summaries related to drawback claims, as we recommended. However, Customs plans to issue these instructions as part of revisions to the drawback portion of Customs regulations, and Customs did not specify in its response when this new directive would be issued. Because this new guidance will provide a critical control, Customs should consider issuing these instructions immediately in a memorandum to district and regional

Chapter 4
Controls Over Drawback Payments Were
Weak

offices. Also, although examining representative samples of entries will provide greater assurance that claims are valid, it is important that Customs move quickly in developing the new system so that all drawback claims can be readily linked to their related entries and, thus, verified.

Regarding bond sufficiency, Customs stated that its new automated processes will improve its ability to monitor drawback bonds on a national basis. However, to improve bond management further, a task force has been formed to review the centralization of all bond filing and storage. We believe that this is a step in the right direction, in part because bond sufficiency is a broad issue that affects many aspects of Customs' revenue operations.

Reports Resulting From GAO's Audit of Customs' Fiscal Year 1992 Financial Statements

Financial Audit: Examination of Customs' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-3, June 30, 1993)

Financial Management: Customs Lacks Adequate Accountability Over Its Property and Weapons (GAO/AIMD-94-1, October 18, 1993)

Financial Management: Customs' Self-Assessment of Its Internal Controls and Accounting Systems Is Inadequate (GAO/AIMD-94-8, October 27, 1993)

Financial Management: Customs Did Not Adequately Account for or Control Its Accounts Receivable (GAO/AIMD-94-5, November 8, 1993)

Financial Management: Customs' Accountability for Seized Property and Special Operation Advances Was Weak (GAO/AIMD-94-6, November 22, 1993)

Financial Management: Customs' Accounting for Budgetary Resources Was Inadequate (GAO/AIMD-94-23, December 14, 1993)

Comments From the U.S. Customs Service



THE COMMISSIONER OF CUSTOMS

January 24, 1994

WASHINGTON, D.C.

Mr. Donald H. Chapin
Assistant Comptroller General
U.S. General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Chapin:

The Customs Service appreciates the opportunity to review and comment on the draft report on Customs Financial Management. Customs generally agrees with the recommendations in the draft report and is committed to making efforts to accomplish the objectives of the recommendations. Plans have been developed to address the issues in the draft report. However, in some cases, implementation of comprehensive corrective action will require effort over the long term. In other cases, the recommended action may require further study to develop alternatives which will allow the objectives to be met but which will present fewer implementation difficulties. The following are Customs comments on the GAO report and recommendations.

GAO REPORT

As an overlay to any specific corrective action planned by Customs in response to findings, consideration should be given to the ongoing efforts of the Automated Commercial System (ACS) Selectivity Redesign Staff to provide a framework within which Customs can provide increasing assurance that trade enforcement and revenue collection efforts are optimized. The goals of Selectivity Redesign are in accordance with GAO's concerns that Customs be able to provide assurances that the collection of revenue is maximized and that there be a reliable means of measuring overall compliance with trade laws in order to optimize the use of its inspection and enforcement resources.

The Redesign Project was established in September 1992, in response to GAO's General Management Review and the agency's own recognition that a comprehensive plan to improve Customs Selectivity System was necessary. The Project Staff is addressing enhanced targeting of imports and compliance measurement of large scale, critical industries that greatly impact revenue. The system is being developed in consonance with the Trade Enforcement Strategy and revenue enhancement goals.

REPORT DRUG SMUGGLING TO UNITED STATES CUSTOMS SERVICE 1-800-BE-ALERT

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In preparation for a new Customs-wide Compliance Measurement Program, test measurements have been conducted in selected districts of five industries; automobiles, ADP, fiberboard, telecommunications and steel. A revenue gap shortfall was identified collectively across the five industries. In addition, compliance measurements have been expanded to each district in FY 94. Baseline compliance rates for fifteen additional commodities will be established in order to obtain detailed information regarding revenue shortfalls. In keeping with these efforts, standard procedures are being established and personnel are being trained in every district in order to facilitate the institutionalization of the compliance measurement program throughout Customs. In addition, the Redesign Group, in conjunction with the Offices of Inspection and Control and Commercial Operations is developing options for full implementation of the compliance measurement program, which incorporates compliance measurement of manifests, bills of lading, and the entry/entry summary process.

The efforts of this group, while necessitating long range implementation, are key in moving Customs towards a more dynamic, responsive, and efficient accomplishment of the goals of the Service.

RECOMMENDATIONS

-- Develop and implement, in conjunction with Customs Chief Financial Officer, a strategy for inspecting cargo from both high and low-risk carriers to help provide reasonable assurance that all cargo delivered is accurately and completely identified on manifest and entry documents. Carriers undergoing such inspections should be randomly selected to ensure that they are representative of all carriers.

Agree. The Office of Inspection and Control is currently working with the Selectivity Redesign staff in the development and testing of national manifest and bill of lading compliance procedures. On November 1, 1993, a bill of lading compliance test was initiated in nine east coast ports. The test will conclude on January 31, 1994. Following this test, other ports along the Gulf and Pacific coasts will begin the test procedures. Additionally, a Landed Quantity Verification (LQV) initiative for manifest compliance has begun, and test ports will begin this initiative in the first quarter of 1994.

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- Obtain reliable data on carriers' use of the Automated Manifest System as a percentage of all manifest submissions so that expanded use of the system can be more accurately monitored.

Agree. Customs agrees that expanded use of and monitoring of the Automated Manifest System (AMS) system is necessary. Customs can and does maintain statistics on system use at the bill of lading level.

A comprehensive view of the total population of bills of lading can be obtained through review of AMS and the CF-16, Workload Summary Report. AMS gives us the total number of shipments which were filed electronically. In addition, the CF-16 provides statistics on bills of lading filed manually by vessel. By comparing the data in AMS with that in the CF-16, we can determine the percentage of shipments which were filed electronically. In order to validate the accuracy of the CF-16, Customs plans to alert field personnel to the necessity of capturing accurate data in this area. In addition, Customs will review CF-16 data samples in order to verify its accuracy and to review the methodology used in data collection. Further, Customs will continue to encourage increased use of the system by carriers.

- Consider requiring all documents, including manifests, to identify goods in a uniform manner, such as through the use of harmonized tariff codes.

Agree. Increased standardization is required to correlate manifest data with entry documentation. The recent passage of the Modernization Act provided the statutory framework within which imposition of a requirement to use Harmonized Tariff, United States of America (HTUSA) codes or some other standardized descriptor can be more readily studied for feasibility. Since requiring the carrier industry to "classify" commodities is without precedent, the impact on industry and on international agreements will be reviewed and any cost or related effects assessed. Customs plans to work with the carrier industry and GAO to gauge what the concerns would be in implementing such a requirement or in determining what alternatives are available that would meet this goal.

- Monitor implementation of the new procedures for accounting for in-bond transfers to ensure that they address the weaknesses that have been identified. In conjunction with this effort, provide personnel

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involved in maintaining data on in-bond transfers with clear and detailed guidance and adequate training on complying with the new procedures.

Agree. Customs has developed a new automated in-bond system in AMS which contains more detailed and up-to-date data. The Service will continue to monitor the implementation of the system to ensure that weaknesses previously identified are corrected. Additionally, Customs will also continue to pursue eliminating and/or reducing the reliance on in-bond procedures.

The Office of Inspection and Control and the Office of Automated Commercial Systems have issued written guidance and provided training to field offices regarding the conversion to the new in-bond system. Both offices will continue to issue detailed guidance and provide necessary training on complying with all new procedures for the new system.

-- Require district offices to maintain perpetual inventory records of goods held in bonded warehouses and FTZs that they are responsible for overseeing.

While Customs intends to reinforce monitoring activities in bonded warehouses and FTZs, we have fundamental concerns with this recommendation in terms of costs versus benefits. We think that our resources should be applied in a manner that is proportionate to the relative risk and significance of the bonded warehouse and FTZ operations. Customs believes that improved monitoring of inventory levels in FTZs and bonded warehouses is desirable. However, as we understand the recommendation, it envisions an automated inventory system for bonded warehouses and FTZs. The significant number of very critical automation priorities in the Service precludes devoting resources to this project. We would, however, like to work with GAO in calculating the risks, determining the appropriate response, and placing these in the context of our strategic plans.

In addition, Customs plans to expand its compliance measurement program to this area and to reinforce existing control mechanisms, i.e., conducting annual risk assessments and spot checks, to provide efficient oversight.

-- Enhance ACS so that the district offices could use this system to maintain perpetual records of merchandise quantities at each warehouse and FTZ.

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The concerns expressed above apply equally to the enhancement of ACS for the recommended purpose. Customs is exploring re-engineering and redesign of its automated commercial processes. While it is the agency's long term goal to use automation to control operations, the construction of separate modules to address FTZs and bonded warehouses at this time is not a priority when compared to other automation initiatives and the resource requirements of these initiatives. In fact, the addition of separate modules would be counter-productive to ACS redesign efforts. We believe that increased use of compliance measurement, including risk assessment and spot checks, will address GAO's oversight concerns.

- Direct the Assistant Commissioner for Inspection and Control and the Assistant Commissioner for Commercial Operations, as appropriate, to emphasize to district offices the importance of spot checks of bonded warehouses and monitor this activity to ensure that districts comply with Headquarters directives.

Agree. Over the signatures of the two aforementioned Assistant Commissioners, a memo will be sent to all Regional Commissioners reminding them of the districts' responsibilities for completing an annual risk assessment for each bonded warehouse and conducting not less than one spot check annually in each warehouse.

- Require district offices to periodically spot check all FTZs that have not been audited or surveyed for over a year.

Agree. The Assistant Commissioner, Inspection and Control, will send a memo to each Regional Commissioner requiring that each district annually complete a risk assessment for the general-purpose zones within each district and conduct the required number of spot checks of the activated general-purpose zones within the district.

- Provide more detailed guidance on the use of spot check worksheets so that they will capture complete information on these inspections.

Agree. The Office of Inspection and Control will draft a new spot check worksheet which will capture information such as the Inspector(s) name conducting the check; specific controls or requirements reviewed; which items were physically counted; verbal warnings, if any, issued. The worksheet will be attached to the Risk Assessment/Spot Check memorandum.

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- Develop a means of automatically entering information needed to verify drawback claims into ACS so that liquidators can use the system to automatically verify drawback claims:

Agree. Customs plans to fully automate the processing of drawback claims to include the capabilities contained in this recommendation. The Customs Modernization and Informed Compliance Act contains new drawback provisions which require new or revised regulations. Once those regulations are formulated and agreed to Customs will begin full-scale system development.

- Until this capability is developed and implemented, require that liquidators use representative sampling procedures for reviewing drawbacks that relate to multiple entry summaries:

Agree. The drawback portion of Customs regulations, Part 191, is being revised as a result of new provisions in the Customs Modernization and Informed Compliance Act. As part of this revision, it is Customs plan to provide instructions to the field on the use of representative sampling procedures for retrieval and review of entry summaries related to drawback claims.

- Enhance ACS so that historical information on drawback claimants such as accelerated claim privileges, excessive claims previously filed, overdue receivables, and regulatory audit results are available to liquidators in a national data base:

Agree. The new automated drawback process will include a claimant database that will contain historical information on drawback claimants. Action on this portion of automated process will be developed in detail once the revised drawback regulations are formulated and agreed to.

- Require that liquidators review this database to ensure that special privileges such as accelerated drawback payments are granted only to claimants who have consistently complied with Customs claim filing requirements:

Agree. When the automated drawback system is operational, we will ensure that the liquidators review the special privilege database before privileges are granted, including accelerated payment. In the meantime, the national directive on accelerated

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payment requires that all drawback offices review each drawback claim that includes a request for accelerated payment to determine whether: the claim is properly prepared; the contract is valid; and that the claimant has not been delinquent in their dealings with Customs. Drawback offices have been instructed to perform this review before a decision to grant accelerated payment is made. We will stress to the Regions the importance of compliance with the directive and will work with them this year to develop internal controls to ensure these procedures are followed.

- Enhance the bond liability module to monitor the sufficiency of bonds posted for drawback transaction, including the ability to alert liquidators when coverage is exceeded.

Agree. The new automated process will have the capability to track bonds for accelerated payment. With respect to the bond liability portion of the Automated Commercial System, it assists drawback offices in determining the status of a company's bond on a national basis. This capability is, however, limited in its current version, and a task force has been formed to review the centralization of all bond filing and storage. If this is found to be feasible, the discrepancies in drawback bond management would be resolved.

We look forward to working with you in making improvements which will result in a more responsive, efficient and progressive Customs Service. If any additional information is required, your staff may contact J. Tony DelMoral at (202) 927-0194.

Sincerely,


George J. Weise
Commissioner

Major Contributors to This Report

**Accounting and
Information
Management Division,
Washington, D.C.**

Gary T. Engel, Senior Assistant Director
Jean H. Boltz, Assistant Director
Deborah A. Taylor, Senior Audit Manager
Maria Cruz, Auditor-in-Charge
Margaret Sherry, Auditor

**Los Angeles Regional
Office**

Eric D. Johns, Site Senior
Ted Hu, Auditor

Far East Office

Evelyn Logue, Site Senior
Karen L. Strauss, Auditor

**Seattle Regional
Office**

Carla J. Revell, Issue Area Manager
Susan T. Chin, Site Senior
Christopher M. Jones, Auditor

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