

Compliance Assessments and Customs Audits*

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The United States Customs Service has restructured its importer audit function to reflect a change in the legal relationship between importers and the Customs Service, and to develop a more useful tool for dealing with Customs compliance issues. Under the old system, Customs auditors conducted a traditional, detailed entry-by-entry transaction review, looking for very specific errors and omissions by importers, and calculating precise loss of revenue figures. Audit procedures were very time consuming both for Customs personnel and for audited companies. Because of time and workload issues, Customs was on a schedule under which significant importers could expect to be audited only about once every twenty five years.

The Customs Modernization Act (Title VI of the North American Free Trade Agreement Implementation Act, Public Law 103-182, signed December 8, 1993) effected a change in the relationship between importers and the Customs Service. While Customs retains the right and responsibility to make final determinations of classification, value, rate of duty, and related matters, importers are now subject to a standard of "reasonable care" in providing information concerning these issues for all entered merchandise, on a timely basis, and with an understanding of the legal implications of their declarations. Customs is promoting "informed compliance", and undertaking the burden of insuring that adequate information concerning rules, requirements, and obligations is widely available to the importing public. Importers have the responsibility of making themselves familiar with this information, and applying it to their particular import transactions (in much the same way as taxpayers have those obligations with regard to income, excise, and other taxes).

The new audit system is designed to implement Customs' desire to maximize voluntary compliance by importers. It recognizes the importance of large importers, primary focus industries, and trade priority areas. Rather than focusing on detailed entry transaction review, the approach is to review accounting records and internal systems, in order to determine the degree of compliance with Customs requirements already met by a company's procedures. This will allow Customs to make a more accurate assessment of the company's ability to meet Customs compliance goals.

Customs has conducted an analysis of the importing public, and determined (based on FY-94 figures) that the top 1,000 importers (by entered value) account for over 61% of the value of all imports. (FY imports totaled \$686 billion; the FY-95 figure is \$749 billion.) This group includes all companies which import about \$75 million dollars or more worth of merchandise (FY-94) annually. By looking very closely at this group, including members of the primary focus industries and those involved in trade priority areas, Customs believes it can have a significant effect on overall compliance rates. Approximately 50-60% of audit resources will be used for this group of importers.

The second tier of importers ("mid-level accounts") comprises those importing between \$10 million and \$75 million annually. This group of 6172 importers (excluding the top 1,000) provides a second focus area, and represents 21% of the total value of all imports. Identification of these priority groups allows Customs to impact 82% of all imports by directing much of its compliance efforts to a manageable number of companies, rather than diluting its efforts by trying to cover all 318, 814 importers (FY-94; 115,000 of the total were one-time importers) equally.

Customs plans to reach a three to five year review cycle for all of the top 1,000 importers, and develop a less time consuming but also effective procedure for the mid-level group. Audit resources and other enforcement efforts will continue to be used as necessary with regard to the remaining importers, largely on a transactional basis, with particular emphasis on fraudulent activities, repeat violators, and trade sensitive areas.

Customs' primary goal is to bring the maximum number of imports to satisfactory levels of voluntary compliance. This will be implemented through an assessment process intended to identify those companies which already meet compliance goals; these companies will benefit from fewer cargo examinations, less frequent audits, and fewer reviews of entries by Import Specialists. Companies which do not meet compliance goals will receive Customs suggestions and assistance on bringing procedures and systems into compliance; companies which fail to implement appropriate compliance actions and demonstrate compliance rates at unacceptable levels will find the assessment procedure expanded into a detailed audit.

Compliance Assessment

A compliance assessment is a formal review conducted by a Compliance Assessment Team (CAT). The assessment will be lead by the Regulatory Audit Division, but will be conducted by a unified team of auditors and data specialists from the Regulatory Audit Division; Program Managers and Industry Analysts from the Office of Strategic Trade; National Commodity Specialists from the National Commodity Specialist Division of the Office of Regulations and Rulings; Import Specialists and Entry Specialists from the Office of Field Operations; and ACS (Automated Commercial System) and ABI (Automated Broker Interface) representatives from the Office of Information and Technology. The team "will evaluate an importer's systems for processing import transactions from filing of entries to liquidation...and...will be dealing with companies as entities rather than dealing with each Customs entry individually." Customs sees this account based approach as a method to maximize its limited resources, and also believes the new procedure will be less burdensome for importers than the prior audit process.

Compliance assessment begins with selection of companies by Customs' Office of Strategic Trade. Importers in the top 1,000 overall; and the top 250 for the primary focus industries of advanced displays, agriculture, autos and auto parts, critical components, production equipment, steel, telecommunications, and textiles/footwear; and those involved with trade priority areas such as NAFTA , ADD/CVD, quota evasion, transshipment, intellectual property rights, health and safety issues, trade statistics, marking, embargo/sanctions, and specific classification and value issues (e.g. related parties) can expect to undergo an assessment sometime during fiscal years '96 through '98. Selection of smaller companies will be based largely on industry and trade priority areas, as well as known problem companies or prior violators.

Once selected, a company will receive an initial telephone notification, advising it of the purpose of the assessment and the preliminary audit requirements, including necessary records. This will be followed by a formal initiation letter, usually accompanied by a detailed questionnaire. Records identified will include the accounting records, chart of accounts, contracts, royalty and marketing agreements, price lists, financial statements, and the like. While Customs' current intention is to use sampling techniques rather than review of each and every transaction, the documentary review will include Customs entry documents and records, purchase orders, bills of lading, commercial invoices, receiving documents, payment records, and other transaction specific materials.

The questionnaire itself consists of five parts, one on general organizational information, one on Customs related activities, one on recordkeeping systems, one on internal controls, and a detailed section on company internal procedures for import related operations, with special focus on Customs value information. Customs seeks to secure from the responses to the questionnaire an understanding of the company's organization, its business, its relationship with suppliers, and its policies on procurement, payment, expenses related to importation, and internal controls. The internal control section reflects Customs' bias toward written, formally established company procedures, but recognizes that in many situations companies will be providing narrative descriptions of actual processes that have not previously been reduced to a formal writing.

The issues and areas raised in the questionnaire fairly apprise importers of the areas of Customs concern. Customs strongly recommends that a company conduct an internal review, based on

the questionnaire issues, before Customs begins its actual assessment. Should the company find any areas of non-compliance, it would have the opportunity to make a voluntary disclosure in order to avoid or reduce Customs penalties. (While the development of penalty cases is not a primary goal of compliance assessments, Customs will not ignore evidence of significant violations).

The next step in the assessment is an opening conference. (In some instances, the opening conference will precede submission of the questionnaire). The opening conference will include the auditors, trade analysts, import specialists, and other Customs officers assigned to the team, together with company officials and, at the company's discretion, its attorneys, auditors, and Customs brokers. Company representatives should be of sufficient rank to indicate to Customs the importance the company places on the compliance assessment, and should also include personnel knowledgeable about the accounting system and records and the details of the Customs entry process. At the opening conference, Customs and the company will seek to develop a timetable for the compliance assessment, including both supply of information to Customs for review at its own offices, and in-house review of company accounts, records, and documents.

In addition to review of formal written materials, records, and documents, the assessment team will interview responsible company personnel regarding their activities related to the submission of data to Customs, and seek to verify that the procedures and controls described to them are adequate and working correctly. In a change from past transaction analysis, Customs intends to use sampling techniques, computer analysis and testing to develop an estimate of overall compliance levels.

Customs intends the review to be an interactive process, with company officials not only kept apprised of Customs activities, but also working with the Customs officers to discuss processes and procedures. Customs believes there will be significant opportunity for incremental additions to the systems and procedures to raise compliance levels, and intends to work with companies during the assessment process to upgrade systems at the same time they are being analyzed. Customs does warn, however, that serious problems may be referred to the Office of Investigations if criminal or fraudulent activity is discovered.

The assessment process will also involve Customs personnel outside the Audit Office, to provide aid and assistance in dealing with classification and value issues (the national Commodity Specialists and local Import Specialists); to understand the relationship of a company to its particular industry or area of trade concern (International Trade Managers and Trade Specialists); to review automation and systems issues; and, where applicable, to evaluate the use of account managers. (Customs is in the process of developing a program to assign account managers to large importers on a national basis, in order to provide a single contact point at Customs for national issues affecting the importer. A similar local program for importers at individual ports is also under development). Legal issues may be pursued through the Office of Regulations and Rulings and/or the Office of the Chief Counsel.

Companies which are found to have generally met compliance requirements will proceed to a formal exit conference. At this point, Customs will have already made suggestions for improvement of policies and procedures, and will provide an overall assessment of the company's compliance levels and recommended remedial actions. A formal report will be completed within ninety days following the exit conference, and made available to the company within thirty days after the completion of the report.

Companies demonstrating a sufficiently high compliance rate through a compliance assessment can expect reductions in cargo examinations and Import Specialist review of entries, and a perhaps less extensive reassessment to confirm continued high compliance levels on approximately five year cycles. Companies with reasonably good compliance levels, but not fully up to Customs expectations, will be provided additional information, advice, and

recommendations by the Customs Service on how to upgrade their procedures. Customs would plan to conduct a subsequent review to confirm the implementation of the necessary changes, and hopefully determine that the company has moved into the high compliance level.

Enforcement Audit

If Customs finds the compliance rates are unacceptable (and cannot easily be remedied by suggested procedures), a compliance assessment will shift to a detailed audit. This is the area where "informed compliance" begins to change to "enforced compliance". Although Customs is prepared to use the full scope of enforcement tools, the primary goal continues to be maximization of voluntary compliance. Identified non-complaint companies which undertake suitable remedial efforts will be treated far differently than those which do not.

The detailed audit will start with a new round of meetings between the auditors and the company, reviewing the compliance problems which have been identified, explaining the additional - and more extensive - audit objectives, including additional testing; and developing a timetable for estimated audit completion. The detailed audit will seek to identify the conditions creating compliance problems, the causes of those problems, and the effects on Customs operations. All of these activities will be fully documented.

The audit team will then make recommendations for corrective action, asking the company to develop fully realized plans with Customs guidance. This is an area where Customs will insist on a written plan of action, with specific target dates for implementation. The audit will not be considered complete until an acceptable plan has been prepared.

Customs has indicated that the resolution of problems during the audit process is not intended to wait for completion of the audit, with the company responding only to a final formal report. Customs seeks to maximize compliance by working on specific inadequacies and identified problems as the process goes forward. The extent to which an importer shows immediate improvement on early identified problem areas will be considered in drawing final conclusions for the audit report.

A detailed audit will also conclude with a formal exit conference, discussing and explaining both the audit results and Customs expectations for the company in accordance with its written plans. A formal audit report will be completed within ninety days. If no formal enforcement investigation is initiated, the report will be issued to the company within thirty days following its completion. If an enforcement action is underway, the release of the report may well be delayed.

The completion of the audit and audit report will not conclude the matter for these affected companies. Customs will be back to conduct a follow-up review, testing the level of compliance by the company with its new procedures, as well as the extent to which the new procedures comply with general Customs requirements. Until the company can bring its compliance level, over a reasonable period of time, up to the level desired by U.S. Customs, it can expect a higher number of examinations, Import Specialist reviews, audit tests, and related procedures.

Conclusion

The Customs Service is faced with the challenge of static resources (both money and personnel) in an environment of continually increasing international trade. It believes that high levels of voluntary compliance by major importers will significantly reduce the direct Customs supervision required for those companies' shipments. This will free enforcement resources to deal with specific compliance problems. High levels of voluntary compliance by importers will also allow the Customs Service to demonstrate its effectiveness to Congressional and other oversight organizations.

Customs, although just beginning its new emphasis on account review rather than individual transactions, has made clear an outline of the process, and importers have access to the information necessary to take advantage of the changes. Companies which cooperate with the Customs Service and work to achieve high compliance rates will receive benefits from Customs (reduced inspections, audits, inquiries) so long as they continue to maintain those compliance levels. While voluntary compliance is Customs' primary goal, it has also clearly stated its intention to use "enforced compliance" whenever necessary to ensure that importers conform to the Customs laws and requirements. The choices which importers make about the level of resources to devote to Customs compliance will directly affect the nature of their relationships with the U.S. Customs Service.

Resources

Resources consulted in preparing this article include brochures and documents prepared by the Office of the Commissioner of Customs, the Office of Strategic Trade, (including "Regulatory Audit Division's Role in Compliance Assessment"), and presentations made by the New York, Dallas, and Los Angeles Strategic Trade Centers. The author has also had the opportunity to discuss and review many of these issues with personnel of the Office of Strategic Trade.

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