# CUSTOMS-NOTES

Written by George R. Tuttle Law Offices for informational use by the trade and import community on selected topics of general interest concerning Customs and import related matters.

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## CUSTOMS AND THE "COMPLIANCE ASSESSMENT" PROCESS

By George R. Tuttle

The Customs Service's 1998 trade enforcement plan again focuses on Compliance Assessment Reviews for the top importing companies in the United States. A Compliance Assessment Review is an integral part of the new "informed compliance" strategy of the Customs Service.

### What Is A Compliance Assessment Review?

Customs maintains that a compliance assessment is different from an audit in that it focuses on the processes and procedures followed by the company to ensure compliance with the Customs laws. Using a statistical sampling technique, a Customs Compliance Assessment Team (or "CAT") selects entries (anywhere from 200 to 500 or more) filed by the company during a specific period (usually the more recently completed fiscal year) and reviews them to determine whether the information provided therein is accurate, complete, and otherwise in accordance with the laws and regulations administered by the Customs Service. The audit process begins with the selection of the candidate.

### How The Importer Is Selected For Review

Customs does its homework when selecting the importer for review. Using national selection criteria and data collected during the entry process, a Customs International Trade Specialist will determine the volume, value, and nature of imports by a company for any given period. The candidate is selected and an importer profile is prepared. This profile contains detailed company background information (Dun & Bradstreet, Web pages, trade and press reports) and customs history (including tariff provisions and exemptions utilized). As a part of the profile, information on company compliance is obtained from Import Specialists, the Office of Investigations, intensive exams, and cargo selectivity and entry summary reviews.

### Notification Of Selection & The Questionnaire

Once the candidate is chosen it is notified by mail that it has been selected. It may also receive a telephone call from the lead Regulatory Audit Specialist who will conduct the audit. Included with this notice is a letter explaining the compliance assessment process, and a lengthy, detailed questionnaire that is to be completed by the company. The company is given 30 to 45 days to complete the questionnaire. More frequently, however, importers are given 6 months or one year notice of the pending audit. This is intended to allow them to prepare for the audit by conducting their own self-assessment prior to the commencement of Customs' assessment. Customs believes that this will allow the audit process to move faster since the importer will be given the opportunity to review their documents and records, and to get their transactions in order.

The questionnaire asks for information regarding:

- organization and structure of the company;
- principal business activities;
- products imported;
- ownership relationship with foreign suppliers and vendors; and
- location of import documents and financial books and records and description of filing system.

It also asks for detailed information about:

- how the classification and valuation of imported products are determined;
- the company's Chart of Accounts (Customs will later verify payments to suppliers and determine whether there are any additional payments and/or dutiable assists);

- explanation of any internal controls, operation, or in-house procedures associated with the entry, classification or valuation of imported goods, and related recordkeeping systems.

It is to be noted that there is no legal requirement that companies have written procedures associated with the entry, classification, or valuation of imported goods and related recordkeeping systems. Customs has stated, however, that the presence of such procedures can significantly improve the likelihood of an early termination of the review, providing a review of selected transactions indicates that there are no material inadequacies in the company's procedures or systems.

The presence of internal procedures and a low error rate will also minimize the number of future cargo inspections preformed on the importer's goods.

<u>The Opening Conference</u>

Anywhere from 45 days to one year after notification of the compliance assessment, an opening conference will be conducted. This meeting allows the Compliance Assessment Team to meet with company officials and employees, and permits the parties to discuss questions about the importer, the questionnaire, or the CAR process.

Customs' CAT is made-up of various representatives of Customs. They include import specialists, who specialize in the products in question, one or two members of Customs Regional Audit division, and a representative from Customs' Office of Strategic Trade. During the opening conference, the CAT team will review the purpose of their mission, and provide the company with preliminary information obtained on company compliance levels based on intensive exams, cargo selectivity reviews, and entry summary reviews.

<u>Importer Self-Assessment</u>

Throughout the process, the importer is not expected to sit back and await the results. Rather, Customs expects the importer to take an active role and use the questionnaire and other information developed through the course of the review to identify potential problems and, where appropriate, make voluntary disclosures before discovery by the audit team, thereby avoiding the possible assessment of penalties.

Companies that engage in rigorous self-assessment prior to the arrival of the Assessment Team will generally be treated with more latitude with regard to problems discovered, than if the company did nothing, or engaged in only a cursory, or haphazard review of its Customs activities.

<u>The Auditors On-Site</u>

Most, if not all, of the on-site work will be conducted by one or two members of Customs Regional Audit division, who will visit and may work on-site at the company on a regular basis. The audit team typically asks for a long term contractor pass, desk, and a secure file cabinet. Before conducting any extensive reviews, the auditors will select a number of entries for review. The selection of entry line items is designed to ensure a statistically valid sample with an accuracy rate of 95%. This means that Customs could request to see records for 200 to 500 classification line items, or more. The auditors then go about documenting if each line item on the customs entry document is correctly classified and valued for customs purposes. The audit team will also check inventory records to ensure that there were not overages or shortages with regard to quantities reported.

If special or preferential duty treatment is involved, the team will audit for these requirements, as well. Typical areas where importers have problems with documentation include:

- Transformation and content requirements for NAFTA and other duty preference claims;
- HTSUS 9802 claims documenting U.S. components and values, or failure to capture all foreign components and costs;
- use of transaction value in related party transactions;
- payments to foreign sellers and third parties, engineering or product modifications, and royalty and license fees;
- providing unreimbursed equipment, materials and components to foreign producers.

The collection of supporting documentation for two, three, or four hundred line items on entries can be a daunting task, particularly if the company does not have a systematic method of filing entry records or in cross-referencing its record retention system to the Customs Entry Number. (Which is how Customs typically asks for information.) Most companies can, with some effort, locate the entry summary document, commercial invoice, airway bill, and packing list associated with the entry, as these documents are often maintained as a package. With a little more effort, the company can locate the purchase order and/or contract associated with each product on the commercial invoice (but multiply this by the number of entries requested!) Customs will also request, however, the following for each line item selected for review:

- Receiving report and inventory records showing the merchandise entered into the inventory system.
- Accounts payable and disbursement record for the merchandise.
- Correspondence with foreign suppliers related to the merchandise purchased.
- In the case of related party transactions, Customs will expect to see documentation to support transaction value such as requests for quotation, market price analysis, and/or records of price negotiations.
- Records of all other payments associated with the import.

If the entry or line item involves a claim of special or preferential duty treatment, the importer will be asked to produce information which substantiates the claim; such as, in the case of NAFTA, certificates of origin; or in the case of GSP or similar programs, qualifying cost analysis. For U.S. goods returned, U.S. and foreign manufacturers certifications will be requested. Merchandise catalogs and data sheets will also be requested to confirm product descriptions and tariff classifications.

All of this information will be collected and reviewed by the audit team, and the transactions scrutinized to determine if the selected line items on the entries have been correctly classified and valued, and whether any special duty or preferential treatment claimed is justified. This process can take weeks or months depending on the number of line items examined.

If the audit team finds an error rate greater than 5% in the universe of entries audited, the audit can expand to cover more entries, products, or time periods. Before expansion of the scope of the audit occurs, however, and absent a finding of fraud, the audit staff will review their preliminary findings with the company. The company will typically have an opportunity to respond and present information as to why a particular classification or stated value is correct, or why the goods are entitled to the preferential duty rate claimed. The issue may go as far as Customs Headquarters for resolution.

Discovery of significant errors in classification or value will also result in the issuance of a demand for payment of duties. Based on the error sampling rate, the percentage of the loss of revenue is calculated and projected over all imports for that year. Importers are then expected to pay the projected loss of revenue. A similar result might occur in connection with goods for which a preferential duty rate could not be justified.

Whether or not a separate monetary penalty will also be assessed under the provisions of 19 U.S.C. § 1592 for negligence or gross negligence remains to be seen. Customs has stated that absent a finding of fraud, they will notify importers of potential duty liability situations and allow them to conduct their own review and prior disclosure, if appropriate.

## Preparing In-House Customs Procedures & Follow-up

If any significant error rates are found after completion of the audit review phase, Customs has announced its intention to have the audit team work with and assist the importer in the development and implementation of in-house procedures, such as recordkeeping, classification, or valuation to correct the problem.

Customs will then schedule follow-up meetings to review the implementation of procedures, or conduct mini-reviews to ensure that any compliance related problems have been corrected.

## Customs And Its Self-Assessment Process

Customs is currently encouraging all importers, both large and small, to begin the self-assessment process, even if the importer has not received a notice that it is scheduled for a National Compliance Assessment Review. Customs is expected shortly to begin port initiatives that mirror many of the National Compliance Assessment Review procedures, but using local port resources. By conducting an importer self-assessment using CAT techniques, importers will be in the best position to respond to Customs when the time comes.

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