U.S. Customs and Border Protection
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Focused Assessment Pre-Assessment Survey
Audit Program

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OVERVIEW OF THE FOCUSED ASSESSEMENT PRE-ASSESSMENT SURVEY AUDIT PROGRAM

This document provides information about the Focused Assessment Pre-Assessment Survey (FA PAS) Audit Program and what to expect when an FA PAS is performed. FAs are performance audits conducted in accordance with Government Auditing Standards[1]. Part I of this document provides a general overview of the FA Audit Program and contextualizes the PAS phase of the FA. Part II contains the standard audit program for the FA PAS and explains the general audit procedures that may be applied during an FA PAS. The standard FA PAS audit program will be revised as necessary to meet the specific circumstances of the audit as determined by the audit team or at the discretion of RA management. Attachment 1 contains a list of the acronyms and abbreviations that are used throughout this document. The additional attachments provide supplemental information for certain steps in the standard audit program.

BACKGROUND

On December 8, 1993, the U.S. Congress enacted modernization provisions for the former U.S. Customs Service under Title VI of the North American Free Trade Agreement Implementation Act (Public Law 103-182). These provisions are commonly called the Customs Modernization Act (Mod Act). The Mod Act is based on two basic tenets: shared responsibility and informed compliance. Shared responsibility means that importers and U.S. Customs and Border Protection (CBP) have a mutual responsibility to ensure compliance with CBP laws and regulations. The purpose of informed compliance is to maximize voluntary compliance. The informed compliance concept imposed many publication, consultation, and notice obligations on CBP.

The Mod Act fundamentally altered the relationship between importers and CBP. The Mod Act shifted the legal responsibility for declaring the value, classification, and rate of duty applicable to entered merchandise to the importer and requires importers to use reasonable care to assure that CBP is provided accurate and timely data. CBP retained the ultimate responsibility to "fix" the value, classification, and rate of duty. Informed compliance is based on the premise that, in order to meet their responsibilities, importers need to be clearly and completely informed of their legal obligations, with the goal of maximizing voluntary compliance and reducing the need for enforced compliance.

The Mod Act codified at Title 19 U.S.C. 1484(a) requires importers to exercise reasonable care in providing entry information including the values, tariff classifications, quantities, and rate of duty applicable to their merchandise. Implementing a system of internal control with respect to imports is an element of reasonable care in carrying out responsibility under Public Law 103-182. Without a documented system of internal control, CBP does not have reasonable assurance that the information submitted is accurate and complete or that any subsequent adjustments to the information will be reported to CBP.

[1] Information about Government Auditing Standards (also known as generally accepted government auditing standards or GAGAS) may be found at http://www.gao.gov/yellowbook/overview.

Role of the FA Program in Risk Management

The FA Program fulfills critical components of CBP's risk management strategies. CBP performs its duties in an environment in which decisions regarding the allocation of finite resources have become increasingly important. RA defines risk as the degree of exposure to the chance of noncompliance that would result in loss or harm to the Government, domestic industries, or the public. Risk management is the integrated process for identifying and managing risk to trade compliance. The key to risk management is to gather and analyze relevant data efficiently and effectively and use the data to make decisions about allocating resources. CBP acknowledges that not all importers present the same level of risk for noncompliance and many importers do not present a risk that justifies a significant allocation of resources. Similarly, not all aspects of an importer's import activity present the same level of risk for noncompliance. For purposes of planning and performing an FA, that means identifying those imports that represent the greatest risk of material noncompliance so that RA can focus audit resources in those areas.

Role of the FA Program in Maximizing Voluntary Compliance and Reasonable Care

The FA Program fulfills critical components of CBP's strategies for maximizing voluntary compliance and ensuring importers use reasonable care. During the FA, auditors consider the size and complexity of the importer as it impacts the extent and complexity of the importer's system of internal control over its import activities necessary to ensure compliance. For example, larger importers with greater resources are more likely to have a more formal system of internal control and therefore auditors will contemplate an audit approach that involves greater emphasis on assessing and testing internal control. On the other hand, smaller or medium sized importers may have simpler or less formal processes and procedures addressing CBP compliance and therefore auditors would contemplate an audit approach that involves greater emphasis on assessing and testing compliance.

Regardless of the emphasis of the audit approach one of the primary goals of the FA Program is to ensure importers are using reasonable care to maximize voluntary compliance through maintenance of a system of internal control. During the FA, auditors provide their assessment of whether the importer's system of internal control addresses the relevant risks and importers gain a better understanding about internal control relative to CBP laws and regulations. When the FA results indicate improvements are needed in the importer's system of internal control and the importer agrees to develop and implement a CIP, the changes made to the importer's system of internal control facilitate voluntary compliance and reasonable care in the future.

PART I – OVERVIEW OF THE FA PROGRAM

The FA Program is a comprehensive, risk–based approach to audits of importers that involves considering both internal control and compliance. The internal control component relates to an assessment of the importer's internal control for providing reasonable assurance of achieving compliance with CBP laws and regulations and identifying internal control deficiencies. The compliance component relates to an assessment of the importer's compliance with relevant CBP laws and regulations and determining the cause of any identified noncompliances.

There are two primary users of the results of the FA Program:

- The importer's management to facilitate decision making with respect to initiating corrective action to address identified noncompliances and internal control deficiencies.

- CBP Officials to facilitate decision making with respect to initiating collection or other enforcement action to address identified noncompliances.

The FA Program comprises three phases: PAS, Assessment Compliance Testing, and Follow-Up. During the PAS phase auditors evaluate the risk of material noncompliance with CBP laws and regulations relating to the importer's import activity through an assessment of its internal control. The ACT and Follow-Up phases are performed as necessary for areas found to represent an unacceptable risk during the PAS. Generally, during an ACT, auditors perform more extensive compliance testing to determine a compliance rate or quantify the loss of revenue relating to noncompliances identified in the PAS. The Follow-Up phase is performed, as necessary, to verify corrective actions taken by the importer to address identified internal control deficiencies and, if applicable, validate the importer's quantification of the loss of revenue resulting from self-testing.

Special Considerations Impacting the PAS

There are several situations that may arise during the PAS that will require special consideration, including:

- The submission of a disclosure by the importer.

- A request to delay the FA while the importer applies for the ISA program.

- A request to delay the FA while the importer applies for C-TPAT.

- Conflict resolution.

Disclosures Presented During the PAS

If the importer submits a disclosure during the course of the PAS, auditors will assess the impact on the audit. Generally, auditors evaluate the cause of any significant disclosed violations as part of their internal control assessment as this may disclose internal control deficiencies. Auditors will also consider whether it is necessary to further evaluate the disclosure. The decision to review the disclosure as part of the PAS is a matter of professional judgment; however, the audit team will consider whether the disclosure has sufficient information for them to assess whether there are timing issues impacting the PAS. For example, disclosures presented early in the PAS generally may not have sufficient details about the nature and dollar amounts of the noncompliances being disclosed, thus making it difficult to address timing issues and/or determine the extent of audit work that will be necessary to evaluate the disclosure.

When an importer submits an initial disclosure letter early in the PAS process, it may be beneficial to coordinate the perfection of the disclosure so as not to duplicate the effort. For instance, if there is sufficient detail about the nature of the violations and the disclosed noncompliances are significant to the audit areas included in the PAS, auditors may decide to rely on the disclosure and forego or reduce the nature and extent of compliance testing to be performed in the PAS or subsequent phase of the FA (e.g., ACT or self-testing under CBP supervision). However, before the auditors can rely on the disclosure they should perform audit work to evaluate the disclosure to comply with Government Auditing Standards (e.g., using the work of others as the basis for audit conclusions).

The extent of the audit work that will be necessary to evaluate the disclosure will depend on the significance of the violations. For instance, audit work may be limited to assessing the reasonableness of the methodology used to develop the disclosure. Alternately, extensive procedures may be performed to evaluate the accuracy and completeness of the disclosure to ensure that risks significant to the audit areas included in the PAS have been sufficiently addressed.

The scope of the PAS may be expanded to include the evaluation of the disclosure provided that the evaluation itself does not negatively impact the timely completion of the PAS. When the disclosure will be included in the scope of the PAS, auditors will plan and perform audit procedures for evaluating the disclosure. In such instances, the results of the evaluation of the disclosure will be included in the PAS report. If an evaluation of the disclosure cannot be reasonably completed within the PAS timeframe (e.g., the perfected disclosure is received later in the PAS process), it may be necessary to defer the evaluation of the disclosure to a subsequent assignment (i.e., separate disclosure evaluation or Follow-Up Audit).

Requests to Delay the FA for ISA Application

At times importers will request a delay of the FA in order to apply for the ISA program. Such requests must be submitted in writing on official company letterhead, signed by a corporate officer, to the Executive Director, RA and must include:

- A statement of the importer's intentions to apply for ISA;
- The date by which the importer anticipates it will submit the ISA application package to CBP; and
- A statement requesting that RA delay performing the FA.

RA Headquarters is responsible for considering and responding to such requests. Generally, requests made before the entrance conference are granted; however, if there are concerns regarding known violations or other significant concerns (e.g., if an importer has previously been granted a delay but failed to get accepted into the program or subsequently withdrew its application), RA Headquarters may determine that the FA will proceed. If the importer notifies RA of its intent to apply to the ISA Program after the entrance conference, the FA will proceed as planned. RA Headquarters will respond to the importer's request in writing indicating whether the delay request has been accepted or rejected.

Delay Requests to Apply for C-TPAT

An importer may request a delay of the FA while they are applying for C-TPAT. Auditors will inform RA Headquarters of the delay request and will suspend work on the FA while monitoring the importer's C-TPAT application status. Generally, a delay to apply for C-TPAT should be no more than 30-60 day. Once the importer has submitted their C-TPAT application, auditors will resume audit work.

Conflict Resolution

At times disagreements or conflicts may arise between the importer and the members of the audit team. To the extent possible, such conflicts should be resolved at the audit team level; however, at times it may be necessary for a higher level of management to resolve the matter. Concerted efforts should be made by all affected parties to resolve conflicts at the lowest resolution level although matters may be elevated to the next level as necessary until the matter is satisfactorily resolved. Auditors will discuss with the importer the appropriate lines of authority within RA for resolving issues that may arise during the course of the audit. Auditors will request that the importer and its independent third party specialist (i.e., consultant or attorney) follow these lines of authority and provide the specific contact information and resolution levels:

- Resolution Level 1: AIC's name, E-mail address, and telephone number.
- Resolution Level 2: AFD's name, E-mail address, and telephone number.
- Resolution Level 3: FD's name, E-mail address, and telephone number.
- Resolution Level 4: Professional Standards Division Director's name, E-mail address, and telephone number.
- Resolution Level 5: XD's name, E-mail address, and telephone number.

Transition to Importer Self-Assessment Program

The ISA program is a joint government-business initiative designed to build cooperative relationships that strengthen trade compliance. It is based on the premise that companies with strong internal controls achieve the highest level of compliance with CBP laws and regulations. On June 7, 2002, the former U.S. Customs Service (now CBP) published a Federal Register notice (67 FR 41298) announcing the ISA program and describing the requirements for participation in, and benefits under, the program. For the most part, the requirements for participation in the ISA program remain as described in the 2002 Notice, except that the program has been expanded to accept Canadian as well as U.S. importers and participants must retain self-testing results for three years. On October 5, 2012, CBP published a Federal Register notice (77 FR 61012) announcing that a company that has successfully undergone a FA may be eligible to transition into the ISA program without further CBP review.

The FA process provides a thorough examination of an importer's system of internal control over compliance with CBP laws and regulations and is a more rigorous examination than the ISA evaluation process. Therefore, CBP has decided that importers having successfully completed the FA (i.e., having received an acceptable risk conclusion) will be provided an opportunity to transition directly into the ISA program within twelve months of the FA audit report date.

CBP opened this opportunity to importers that have successfully undergone a FA audit only if the importer also:

- Is a U.S. or Canadian resident importer.
- Obtains Customs-Trade Partnership Against Terrorism (C-TPAT) program membership. Importers that are not C-TPAT certified will need to request certification by applying on the C-TPAT Portal[2], and their C-TPAT applications will be reviewed in an expedited fashion, within 30-45 days of receipt, rather than the typical 90-day schedule.
- Develops a written risk-based self-testing plan.
- Completes the ISA Memorandum of Understanding (MOU) as noted in the ISA Handbook[3], and agrees to meet all of the ISA program requirements identified in the Federal Register notice (67 FR 41298), dated June 7, 2002, and as update in the Federal Register notice (77 FR 61012), dated October 5, 2012.

CBP has also decided that importers that are eligible to transition to the ISA program will not need to undergo the Application Review Meeting (ARM) that is normally scheduled for an ISA application evaluation. CBP normally conducts an ARM to review an ISA applicant's corporate structure as it relates to CBP-related work, its internal control processes, its entry processes from purchase order to payment for certain entries selected by the ISA team, and to discuss the scope and methodology of the self-testing plan developed by the importer. The ARM review is not needed because most of the information has already been covered during the FA process and the importer is better positioned (informed) to design a risk-based, self-testing plan for ensuring continued future compliance.

Participation in the ISA program is voluntary and although the importer may be eligible, they must submit an application to the Chief, Partnership Programs Branch, Office of International Trade, U.S. Customs and Border Protection, 1400 L Street NW., Washington, DC 20229-1143. Applications must include:

1. An ISA Memorandum of Understanding (MOU) listing the importer of record number(s) included in the FA and the MOU must be signed by an officer of the company; and

2. A written, risk-based, self-testing plan that should include: The risk assessment methodology used by the importer; the testing methodology; the frequency of self-testing activities (i.e., monthly, quarterly, etc.); the number of sample items to be tested; and the name and contact information for the person who will review the self-testing results. The self-testing process should be conducted at least annually.

Pre-Assessment Survey Audit Objective

The objective of the PAS is to determine whether the importer's import activities represent an acceptable risk to CBP through an assessment of its internal control over compliance with

[2] C-TPAT Portal can be found at https://ctpat.cbp.dhs.gov
[3] The ISA Handbook can be found at http://www.cbp.gov/linkhandler/cgov/trade/trade_programs/importer_self_assessment/isa_hb.ctt/isa_hb.pdf

applicable CBP laws and regulations. This is a standard objective; however, it may be expanded upon to include the review of disclosures submitted by the importer during the course of the audit or to reflect the calculation of the LOR or compliance rates as appropriate given the facts and circumstances of the audit.

Scope of the Audit

Auditors establish the scope of the FA based on the results of the Preliminary Assessment of Risk and adjust as necessary based on the performance of subsequent risk assessment and additional planning procedures. The scope will include, at a minimum:

- The time period which is typically defined as the importer's most recently completed fiscal year. However, other periods may be used where circumstances warrant it. For example, if reconciliation entries are selected for review, the scope would be adjusted to include the underlying entries that were flagged in a prior period.

- The Importer of Record number(s). Auditors are cognizant of records location when considering the inclusion of multiple IOR numbers to ensure they will have access to all records pertaining to the audit scope.

- The subject matter of the PAS, scoped into distinct audit areas (e.g., value, classification, Free Trade Agreements, AD/CVD, etc.). Generally, at a minimum the audit areas of value and classification will be included initially in the audit scope; however, auditors may determine to eliminate them from the scope following the PAR based on the performance of subsequent risk assessment and additional planning procedures.

- If disclosures are evaluated as part of the PAS, the scope may be expanded to include the time period covered by the disclosure and the subject matter of the errors or noncompliances reported in the disclosure.

- If the calculation of the LOR or compliance rates is performed during the PAS, the scope will be expanded to include the time period covered by the LOR or compliance rates.

Significance/Materiality

Significance – also referred to as "Materiality" – is the relative importance of trade issues to CBP stakeholders and is often described quantitatively (e.g., in terms of dollar value) or qualitatively (e.g., in terms of sensitivity). Title 19 CFR Part 171, Appendix B states, in part, that a document, statement, act or omission is material if it has a natural tendency to influence or is capable of influencing agency action including, but not limited to, CBP action regarding the:

- Determination of the classification, appraisement, or admissibility of merchandise (i.e., whether the merchandise is prohibited or restricted).
- Determination of an importer's liability for duty, including marking, anti-dumping, and/or countervailing duties.
- Collection and reporting of accurate trade statistics.

- Determination as to source, origin, or quality of merchandise.
- Determination of whether unfair trade practices have been committed under AD/CVD laws or similar statute.

Auditors continually assess significance/materiality throughout the audit as they obtain new or additional information about the importer's import activity and particularly when noncompliances are identified. Noncompliances may be identified when evaluating implementation of controls, testing operating effectiveness of controls, and/or testing compliance. When assessing the significance/materiality of noncompliances, auditors consider the noncompliances both individually and in the aggregate (i.e., collectively).

Risk Assessment and Additional Planning Procedures

Auditors use the "audit risk model" to frame their risk assessments which is an analytical approach used to evaluate the components of audit risk and to decide the amount of audit work necessary to reduce the possibility that the auditor's findings, conclusions, recommendations, or assurance obtained from the tests performed may be inappropriate or incomplete (e.g., the procedures performed or number of items tested were insufficient to provide a basis for the conclusions). Auditors plan to reduce audit risk (i.e., reduce the risk of not arriving at the appropriate conclusions) to an acceptable level through consideration of three interrelated components: inherent risk, control risk, and detection risk.

- Inherent risk is the possibility that a mistake, inconsistency, significant error, or fraud will occur, assuming there is no internal control. Inherent risk relates to characteristics of the imported merchandise and complexity of the compliance requirements pertaining to them.

- Control risk is the possibility that a mistake, inconsistency, significant error, or fraud will not be prevented or detected by internal control. Control risk relates to the policies and procedures over compliance that the importer has established and its desired level of risk mitigation.

- Detection risk is the possibility that auditors will not detect a mistake, inconsistency, significant error, or fraud. Detection risk relates to the amount of audit work the auditors perform and degree to which they support their findings and conclusions.

Auditors perform risk assessment and additional planning procedures to (i) identify and assess the specific inherent risks relative to the imported merchandise, (ii) identify and assess the design and implementation of the importer's system of internal control, (iii) decide whether the controls are likely to mitigate the identified risks of noncompliance, (iv) assess the overall risk for noncompliance with CBP laws and regulations, and (v) plan (design) the audit approach (i.e., further audit procedures) that will be performed to reduce audit risk to an acceptable level. Auditors may make adjustments in the amount and type of audit procedures they perform in order to reduce audit risk as appropriate for the facts and circumstances of the audit.

<u>Preliminary Assessment of Risk</u>

Auditors conduct a PAR and identify audit areas relevant to the importer's import activities based on the auditor's consideration of qualitative and quantitative factors relative to significance and the risk of material noncompliance. In conducting the PAR, auditors perform procedures to analyze CBP data and other readily available information to obtain an understanding of the nature of the importer's import activities and prior audit and compliance history.

The audit areas identified in the PAR will depend on the nature of the importer's import activity and will vary from audit to audit. There may be areas for which the audit team determines amount/volume of import activity is not significant and does not warrant inclusion in the scope of the audit. Generally, auditors will consider the potential risk for value, classification, IPR violations, and AD/CVD violations as these highly sensitive areas for CBP.
Based on the results of the PAR, auditors select entries or entry line items to be used for the walkthroughs and interviews. Auditors will also tailor the PASQ to ensure questions are relevant to the importer's import activity and to obtain information relative to the identified risks as well as the importer's environment (e.g., knowledge and skill of importer's personnel) that will be useful when finalizing the assessment of risk. Prior to requesting supporting documentation for the walkthrough entries and the importer's responses to the PASQ, the AFD will review and approve the PAR.

The PAR provides an ***initial*** assessment of the potential inherent risks for each audit area where there is significant import activity. However, because the PAR is limited to an analysis of CBP and other readily available data, it is premature to assess the level of inherent risk at this point. Auditors continue to reassess risk as they perform additional planning procedures and obtain additional information. Note that value, classification, IPR, and AD/CVD may be excluded from further review in the PAS, if appropriate, based on additional information obtained subsequent to the PAR (e.g., via the importer's responses to the PASQ, walkthroughs, and interviews). Auditors finalize their assessment of inherent risk based on the additional information from the importer's questionnaire responses, evaluation of accounts of interest, walkthroughs, and interviews with the importer's personnel.

Internal Control Assessment

For those audit areas for which the auditors have determined there is inherent risk, auditors evaluate the design, implementation, and effectiveness of internal control using COSO's Internal Control – Integrated Framework[4]. The auditor's understanding of internal control will be derived through an assessment of:

- The five components of internal control and the auditor's judgment as to whether the importer has significant controls that mitigate specific risks relating to the audit areas.

- The design and implementation of controls for each audit area and the auditor's expectation as to whether controls are likely to be effective at preventing and/or detecting and correcting material noncompliances at significant control points (e.g., activities or processes that occur

[4] Information about COSO's Internal Control – Integrated Framework may be found at http://www.coso.org/ic.htm.

before or after items are imported when there are opportunities for the importer to take actions to mitigate the risk of noncompliance relative to the imported merchandise).

Auditors obtain an understanding of the design and implementation of the importer's internal control by reviewing questionnaire responses, examining written policies and procedures (as applicable), interviewing the importer's personnel, and conducting walkthroughs. The purpose of these procedures is to identify key control points and assess whether controls are in place that are likely to prevent and/or detect and correct material noncompliances.

Auditors assess control risk based on their expectation of the operating effectiveness of internal control. If auditors assess control risk below maximum (e.g., auditors believe there are controls that are likely to mitigate the risk of noncompliance to some extent), they would plan to perform tests of controls to obtain sufficient, appropriate evidence to support the operating effectiveness of internal control. If the auditors assess control risk at maximum (e.g., auditors believe the controls are not likely to mitigate the risk of noncompliance), they would not plan to perform tests of controls.

Assessment of Risk

Auditors summarize their assessment of and planned responses to significance and audit risk based on the results of the risk assessment and additional planning procedures in the Written Audit Plan (i.e., a summary document in the audit file). The AFD reviews and approves the auditor's risk assessment prior to the auditors proceeding with further audit procedures.

The Written Audit Plan includes the following information:

- Identification of the relevant audit areas.
- Summary of the quantitative and qualitative factors.
- Identification of the specific risks associated with each audit area, including potential fraud risk indicators.
- The auditor's assessment of inherent risk for each audit area.
- The auditor's assessment of control risk for each audit area, including a summary of controls that may mitigate the specific identified risks, deficiencies in the design and implementation of the controls, and/or instances where there is insufficient evidence of the implementation of the controls.
- The auditor's overall assessment of the risk of noncompliance (which is based on the combination of the auditor's assessment of inherent risk and control risk) for each audit area.
- The auditor's planned response to the identified risks for reducing audit risk to an acceptable level.

Further Audit Procedures

Auditors plan and perform further audit procedures in response to the auditor's overall assessment of the risk of noncompliance in order to reduce audit risk to an acceptable level. In designing the planned response, auditors consider:

- The significance/materiality of potentially noncompliant items (e.g., how much of the total entered value may be at risk for noncompliance; the potential LOR for the items at risk for noncompliance; extent of harm to domestic industries).

- The significance or sensitivity of requirements pertaining to the importer's import activity (e.g., how important is the risk to CBP or other government officials; what actions will be taken when items are noncompliant).

- The overall risk of noncompliance for the audit area (e.g., the amount of risk that remains given the extent to which controls mitigate the identified inherent risks).

- The degree of assurance the auditors would like to obtain from the tests performed.

If auditors do not believe the controls can be relied on to reduce the risk of material noncompliance to an acceptable level, auditors will design and perform compliance testing to obtain evidence about the importer's compliance with applicable CBP laws and regulations. That is, the planned response typically would not involve performing tests of controls.

If auditors have determined that significant controls were being used and would like to obtain assurance that the controls may be relied on to some extent to reduce the risk of material noncompliance to an acceptable level, auditors will design and perform a combination of tests of controls and compliance testing. Auditors design and perform tests of controls to obtain evidence about the operating effectiveness of relevant controls when they have an expectation that the controls are likely to prevent and/or detect and correct material noncompliances. Tests of controls are only performed on those controls that the auditors have determined are (i) significant controls occurring at key control points, (ii) suitably designed, and (iii) supported by evidence.

The AFD reviews and approves all testing and sampling plans prior to when the auditors submit the selections to the importer. Testing and sampling plans, at a minimum, will include:

- The objective of the test or procedure.
- The data source(s) used and a brief summary of the procedures that were used to determine that the data is reliable, if applicable.
- The characteristics of the population form which items were selected (e.g., certain MIDs, tariff numbers, values, etc.).
- The basis used to select items (e.g., random and/or the basis for individually selected items).
- The specific/selected transactions/items that will be tested.
- The criteria that will be used to evaluate the selected transactions/items.
- The characteristics that will be tested.
- Explanation of how the results will be projected over the universe of transactions, if applicable.

Note that at times auditors may decide that it is efficient and convenient to complete tests of the operating effectiveness of certain controls during the risk assessment/additional planning

procedures. For example, it may be more efficient when there are two or three significant controls and testing can be done relatively quickly. It may be convenient because there records or documentation supporting the controls are readily available, the individuals performing the procedures are available for discussion, and/or the performance of the procedures may be observed while the auditors are at the importer's facility. When using this approach, testing plans are prepared and the results evaluated before the auditors summarize their assessment of the overall risk of noncompliance. As a result, it may not be possible or efficient to obtain supervisory approval prior to performing such testing. In such circumstances, the auditors will obtain supervisory approval of testing plans as soon as practical.

Developing Risk Conclusions

Auditors consider the results of the tests of controls and/or compliance testing in order to form a risk conclusion for each audit area. The risk conclusions will be expressed in terms of "acceptable risk" or "unacceptable risk." The risk conclusion is a matter of professional judgment; however, auditors will consider the following in forming those conclusions:

- An acceptable risk conclusion is generally appropriate when the auditors determine that the risk of material noncompliances is not significant (e.g., material noncompliances were not detected or detected noncompliances were not systemic or material in nature; significant internal control deficiencies were not identified). For example, this may be the conclusion when tests of controls support that the controls were being performed at an acceptable level to be effective and compliance testing supports that material noncompliances are not likely to exist. When there is limited documentary support for the implementation of controls and there are no material noncompliances based on compliance testing performed during the PAS, the conclusion may be acceptable risk. However, the risk conclusion may be qualified to the extent that due to the limited documentary support for the implementation of controls, there is no assurance that internal control over the audit area will be performed consistently and effectively to mitigate the risk of noncompliance in the future.

- An unacceptable risk conclusion is generally appropriate when the auditors determine that the risk of material noncompliance is significant. For example, this may be the conclusion when material noncompliances were detected, repetitive immaterial noncompliances were detected, or significant internal control deficiencies were identified (e.g., controls were not suitably designed or were not being performed at an acceptable level to be effective).

Unacceptable Risk Conclusions and Compliance Improvement Plans

Auditors prepare finding sheets to report significant internal control deficiencies and material noncompliances when the risk is determined to be unacceptable. Typically, auditors will provide preliminary finding sheets to the importer and request that the importer prepare a CIP to address significant internal control deficiencies and material noncompliances. When the importer agrees to develop and implement a CIP, auditors will:

- Discuss with the importer what will be expected regarding the CIP content and implementation to avoid misunderstandings.

- Work with the importer to establish reasonable timeframes for developing and implementing the CIP.
- Review the CIP prior to implementation and consider whether the corrective actions are appropriate, logical, and complete.
- If applicable, attempt to resolve any obvious deficiencies or defects in the CIP prior to implementation.
- Plan to perform a Follow-Up Audit to verify the implementation and effectiveness of the corrective actions.
- Periodically contact the importer to monitor the progress and determine when the CIP has been fully implemented.

After the importer has validated that the CIP is fully implemented (i.e., all corrective actions have been taken and the importer is satisfied that the controls will be effective to mitigate the risk of material noncompliance), they should notify the auditors to schedule the Follow-Up Audit.

Unacceptable Risk Conclusions and Further Compliance Testing

Auditors consider the potential risk for material noncompliance in the PAS (e.g., other items in the population not specifically tested in the PAS, other time periods not included in the scope of the PAS). When auditors have determined that more extensive compliance testing is needed to quantify a loss of revenue or calculate a compliance rate based on the results of the PAS, they will plan to either permit the importer to perform self-testing under CBP supervision or perform an ACT. When there is potential risk for material noncompliance relating to other time periods, the auditors will request a waiver of the statute of limitations from the importer.

Compliance testing may be performed under an ACT when auditors determined it is inefficient or impractical to perform such testing during the PAS. An ACT is typically appropriate when:

- The importer is not a good candidate for self-testing under CBP supervision.
- There are significant, complex, or sensitive issues over which the auditor needs to maintain control over the testing.

Compliance testing may be performed by the importer via self-testing under CBP supervision when the importer agrees to take corrective action (e.g., develop and implement a CIP) to address the identified internal control deficiencies and there is consensus for the importer to perform self-testing under CBP supervision. In such instances, auditors either provide testing/sampling plans to be executed by the importer or approve the self-testing plans prepared by the importer. In either case, auditors will plan to perform a Follow-up Audit or separate disclosure evaluation, as appropriate, to verify the accuracy and acceptability of the importer's work. In determining whether the importer should be permitted to perform self-testing under CBP supervision, auditors consider the cooperation and competency displayed by the importer's personnel during the course of the PAS, as well as the significance of the risk and potential impact of material noncompliances.

Though self-testing is directly related to the performance of an audit, it may present management participation or self-review threats to independence. As a result, when providing testing or sampling plans to be executed by the importer, or when reviewing and approving self-testing plans prepared by the importer, auditors will discuss the following limitations of self-testing with the importer prior to permitting the performance of self-testing. Specifically:

- The importer's understanding and acceptance of its management responsibilities including designating an individual who possesses suitable skills, knowledge, or experience to execute the self-testing; overseeing the performance of the testing; raising any matters or issues that may require altering the plan to the auditor's attention; and ensuring the accuracy and acceptability of the results.

- The auditor's plans to subsequently review the results of the self-testing for accuracy and acceptability and the limitations of self-testing. Self-testing is performed in lieu of the auditor's performing their own testing. If the auditors were performing the testing and additional information came to their attention, they would be able to reassess risk and modify the testing as necessary. Self-testing is limited in that auditors do not have such an opportunity and there is a possibility that previously unknown information or factors may come to the auditor's attention while reviewing the results that causes them to alter their previous judgments and, as a result, it may be necessary for the importer or the auditors to perform additional work. For instance, testing may disclose unexpected errors for which the sampling objective and expected error condition were not designed to address. Such inconsistencies between the outcome and the sampling objective may preclude the auditors or importer from projecting those particular errors onto the universe. As an example, assume (1) the universe contains a mix of entries for which the importer claimed duty free treatment under an FTA on only a small portion, (2) the original sampling objective and expected error condition addressed classification only, and (3) self-testing discloses that the FTA portion of entries do not actually qualify for duty free treatment and there is a loss of revenue. Because the universe contains a mix of entries, a large portion for which the importer did not claim duty free treatment, it may not be appropriate to project those errors as it could negatively impact the reliability of the projection.

Reporting the PAS Results

Auditors prepare and issue audit reports for all completed PAS assignments in accordance with RA policies and procedures. RA has Audit Report templates that contain standard language and formatting to assist auditors in complying with reporting requirements and to promote consistency. The templates will be tailored as necessary to explain the specific facts and circumstances of the audit. Each PAS report will include the following:

- The Introduction and Background section with background information about the importer's responsibilities relating to exercising reasonable care and the FA Program.

- Objectives, Scope, and Methodology section, including the following details:

    - Identify the IOR number(s) and time period(s) included in the scope of the audit.

- Identify the audit areas included in the scope of the audit. Only those audit areas for which auditors performed further audit procedures will be identified. If an audit area was identified in the PAR but was subsequently eliminated, auditors will not render a risk conclusion.

- If applicable, a statement describing the limited nature of the procedures performed in assessing the audit areas of IPR, FTZ, and NAFTA relative to the other audit areas.

- Explanation of the methodology used to accomplish the audit objective. The methodology will include sufficient detail of the evidence gathering and analyses performed. The methodology will reflect the actual circumstances and the following:

  - Analysis of the importer's responses to the PASQ, evaluation of the documented policies and procedures, performance of walkthroughs and inspection of supporting documents for selected entry line items, and conducting of interviews with the importer's personnel in order to obtain an understanding of internal control.

  - Evaluation of the design and implementation of the importer's internal control over compliance with applicable CBP laws and regulations with respect to the five interrelated components of internal control, including control environment, risk assessment, control activities, information and communication, and monitoring activities.

  - If applicable, description of the procedures performed during tests of controls. For each audit area, the report will identify the control(s) tested and the number of items that were examined. In addition, there will be an explanation of the characteristics of the control that were tested and the procedures used to test the control.

  - Description of the procedures performed during compliance testing. For each audit area, the report will explain the sampling methodology, data source, characteristics of the population, number of items/transactions that were examined, and the criteria that was tested for compliance.

- The appropriate GAGAS compliance statement.

- The following inherent limitations paragraph following the GAGAS compliance statement: "*Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over compliance with applicable CBP laws and regulations to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.*"

- If applicable, a Scope Limitation(s) sub-section to describe any circumstances leading to a GAGAS exception or any other limitations and the resulting impact on the audit results.

- Summary of Audit Results section, including:

  - The overall risk conclusion for the period under audit. If risk is determined to be acceptable in all audit areas, the overall risk conclusion will be acceptable risk. If the risk is determined to be unacceptable in one or more audit areas, the overall risk conclusion will be unacceptable.

  - The risk conclusion for each individual audit area and a brief summary of the basis for the risk conclusion. For unacceptable risk, there will be a description of the internal control deficiencies and/or material noncompliances.

  - A statement describing planned subsequent actions to address unacceptable risk (e.g., ACT, self-testing under CBP supervision, CIP, and/or Follow-Up Audit).

- An Other Matters to Be Reported section may be included to bring certain matters to the attention of the importer's management and/or CBP officials such as immaterial noncompliances, minor internal control deficiencies, or other issue that were determined not significant enough to warrant an unacceptable risk conclusion. For instance, auditors may have determined that a control activity may be missing at a critical control point; however, compliance testing did not disclose any material noncompliances. Auditors may have determined that there were other compensating controls that ensured compliance and, therefore, the deficiency may not be considered significant enough to warrant an unacceptable risk conclusion. In such instances, the auditor may include this section in the report to provide detailed information about the matter so that the importer's management may take actions to improve the system of internal control.

PART II - STANDARD AUDIT PROGRAM FOR THE FA PAS

The standard audit program contained in this section establishes general audit procedures to be applied when performing an FA PAS. The purpose of the standard audit program is to assist auditors in complying with the professional standards established in GAGAS and RA's policies and procedures, and to promote consistency among different audit teams. Auditors use their professional judgment to modify the standard audit program as necessary based on the specific facts and circumstances of the audit and so there will generally be some variations in the audit approaches used by the audit teams.

SECTION A – PREPARE A WRITTEN AUDIT PLAN TO DOCUMENT THE OVERALL AUDIT STRATEGY	
	Note that Section A does not have distinct audit steps, but rather explains the elements of the Written Audit Plan that are developed throughout the performance of other audit steps. *Auditors prepare a Written Audit Plan to summarize the overall audit strategy that will be used to accomplish the audit objective(s). As such, the Written Audit Plan is a "summary audit document" and Section A address the elements of information that are to be included in it. The Written Audit Plan will be refined and updated throughout the audit as information is obtained in subsequent audit steps.* *BACKGROUND INFORMATION: Auditors summarize background information about the importer (e.g., its business or industry, description of core products, location, etc.) in this section of the Written Audit Plan.* *AUDIT OBJECTIVE: The objective of the PAS is to determine whether the importer's import activities represent an acceptable risk to CBP through an assessment of its internal control over compliance with applicable CBP laws and regulations. The audit objective may be expanded to include the review of disclosures submitted by the importer or to reflect the calculation of a loss of revenue or compliance rates as appropriate given the facts and circumstances of the audit.* *SCOPE: Auditors identify the IOR numbers, time period(s), and audit areas included within the scope of the audit in this section of the Written Audit Plan. Note that the scope can be adjusted to add or eliminate audit areas (e.g., while an area may have been identified as a potential risk area during the PAR, auditors may later determine to eliminate the audit area from the scope of the audit after acquiring additional information from the importer). When reviewing a disclosure as part of the FA PAS, the scope will include the date of the disclosure, the time period covered by the disclosure, and the subject matter of the errors and/or noncompliances reported in the disclosure (e.g., undeclared assists, misclassified line items).* *AUDIT CRITERIA: Auditors identify the required or desired state or expectation with respect to the importer's import activity in this section of the Written Audit Plan.*

Criteria provide the context for evaluating evidence and understanding the findings. The criteria used in performing the PAS may include:

- *Laws and regulations included in Title 19 of the United States Code (U.S.C.), Title 19 of the Code of Federal Regulations (CFR), etc. The cited criteria will include the title of law or regulation at the section level and general heading (e.g., Title 19 of the CFR, Section 141 – Entry of Merchandise).*

- *CBP rulings. The cited criteria will include the ruling number, date, and category (e.g., HQ H088423, dated September 2, 2010, on classification).*

- *AD/CVD cases. The cited criteria will include the Department of Commerce's case number, effective date, brief description of the products, and country imported from (e.g., A-428-840-000, effective November 20, 2008, covering lightweight thermal paper products from Germany).*

ASSESSMENT OF INHERENT RISK: Auditors summarize the quantitative and qualitative factors for the relevant audit areas (e.g., the visibility and sensitivity associated with the importer and its activities; the nature and volume of activity; the knowledge and experience of the importer and any changed conditions; external factors or conditions; and the needs of potential users of the audit report). This section of the Written Audit Plan is also used to identify the specific inherent risks relating to the relevant audit areas, as well as information on potential fraud risk indicators, and supports the auditor's determination of the level of inherent risk (e.g., high, moderate, or low).

ASSESSMENT OF CONTROL RISK: Auditors summarize their evaluation of the importer's system of internal control for each audit area. This section of the Written Audit Plan is used to identify (i) those controls that the auditors expect to be effective in addressing the specific inherent risks and will be likely to produce compliant transactions (e.g., controls that the auditor consider when developing tests of controls); (ii) deficiencies in the design and implementation of controls; and/or (iii) instances where there is insufficient evidence to support the implementation of controls. This information is used to support the auditor's determination of the level of control risk (e.g., below maximum or at maximum).

RISK OF NONCOMPLIANCE AND PLANNED APPROACH TO REDUCE AUDIT RISK TO AN ACCEPTABLE LEVEL: The overall risk of noncompliance is the auditor's assessment of the combined effects of inherent and control risk for each audit area, and is expressed in terms of high, moderate, or low. The determination of the overall risk of noncompliance is a matter of professional judgment rather than a mechanical calculation.

The planned approach summarizes the further audit procedures that the auditors plan to perform to reduce audit risk to an acceptable level. Note that this section of the Written Audit Plan will not have the detailed audit steps but rather the will be used to

	describe the types of procedures that the auditors plan to use (e.g., tests of controls and compliance testing). Typically: • *When control risk is below the maximum, auditors will plan to perform a combination of tests of controls and compliance testing.* • *When control risk is at maximum, auditors will forego tests of controls and only perform compliance testing.* *SUBSEQUENT EVENTS IMPACTING THE OVERALL AUDIT STRATEGY AND/OR ASSESSMENT OF RISK: Auditors may encounter previously unknown information that causes them to alter their original objective, scope, and/or assessments of risk (e.g., inherent risk, control risk, or overall risk of noncompliance). Auditors describe changes in circumstances or new information in the Written Audit Plan, and explain the impact of the changes/new information on the objective, scope, assessment of risk, and or planned approach to reduce audit risk to an acceptable level.*

	SECTION B – RISK ASSESSMENT AND ADDITIONAL PLANNING PROCEDURES
	Section B (Steps B-01 – B-10) of the audit program contains the risk assessment and additional planning procedures performed to assess audit risk and its components and to document the auditor's overall assessment of risk and significance and planned further audit procedures. These procedures assist the auditors in identifying audit areas as well as the specific risks associated with each audit area relative to the importer's import activity. *Note that the audit work performed in B-01 through B-09 provides details that support the overall audit strategy.*
B-01	**Identify active IOR numbers and determine which will be included in the scope of the audit.**
	Auditors query CBP data systems to identify active IOR numbers used by the importer during the time period subject to audit. Factors auditors may consider in determining whether to include multiple IOR numbers in the scope of the audit include the amount and type of activity associated with the IOR numbers and whether the import activity is subject to the same system of internal control that will be subject to the current audit (e.g., centralized versus decentralized). Auditors may need to discuss the matter with the Import Specialist, National Account Manager, or importer's personnel before they can decide which IOR numbers to include.

B-02	**Research publicly available information about the importer to obtain background information, including any factors or circumstances that represent potential risks relevant to the importer's import activities.**
	Auditors research publicly available information about the importer and consider whether there are conditions specific to the importer's industry or business environment (e.g., news releases about buyouts, merger, or acquisition) that could potentially affect its CBP activities and/or pose a risk of noncompliance. Auditors obtain information about the importer's organizational structure, geographic locations, and product information. Sources such as the importer's website may have product information, financial information, and news releases with leads on changes in the importer's environment. If the importer is publicly traded, SEC website "www.sec.gov/edgar.shtml" will have the importer's financial statements. *The CBP Library has access to various databases with business and industry information that may be useful in assessing potential risk. For example, D&B reports may be used to obtain information about the importer's financial condition, its organizational structure, and other related information. Accurint® for Government is an investigative tool that has information about bankruptcies, liens, and other business information for companies. LexisNexis® Dossier has information about companies, business partners, and industry.*
B-03	**Notify the importer's point of contact of the FA PAS and confirm active IOR numbers, the location of accounting records and other documentation pertaining to its CBP activities, the importer's address, and other information as needed.**
	Typically, auditors call the importer's point of contact to notify them that they have begun to prepare a preliminary assessment of risk and that a FA PAS will be performed. Auditors may use the opportunity to confirm information, for example, about active IOR numbers, the location of accounting records, or other documentation pertaining to the importer's CBP activities. *If the importer is new to or unfamiliar with the FA program, auditors may offer to provide an informational package that explains the FA process and/or to schedule a conference call to discuss questions that the importer's management or other interested personnel may have about the FA process. Audits tend to run more smoothly if the importer knows what to expect from the start, and so auditors will be available to answer any questions.* *Auditors may also use the opportunity to request certain information that is readily available and may aid the auditors in preparing the PAR. For example, written policies and procedures often have answers to some of the auditor's questions and may prevent the need to ask for information in the questionnaire that would otherwise be irrelevant or redundant. If the importer agrees to provide the requested information, they will be sent a written "request for initial information" letter.*

	However, it is understandable if the importer is not ready to provide such information at such an early stage of the audit. For example, the importer may use the period between notification and the entrance conference to "clean up" written policies and procedures or memorialize unwritten procedures. If this is the case, auditors may re-request the information at a later stage in the audit. *Note 1: Written policies and procedures that are out of date and do not reflect the importer's actual practices may not be particularly useful. Also, where the importer does not have formal written policies and procedures, auditors will plan to obtain an understanding of the importer's system of internal control by soliciting information about its procedures via the PASQ, interviews with importer personnel, walkthroughs, and inspecting documentation.* *Note 2: If the importer advises that they have applied or intend to apply for C-TPAT or the ISA program, refer to Part I, "Special Considerations Impacting the PAS" for procedures related to requests for delaying the FA.*
B-04	**Conduct the PAR by performing the procedures described in Steps B-04a through B-04d below. Based on the identified audit/risk areas in the PAR, select walkthrough entries and prepare a questionnaire (e.g., PASQ) to solicit information relating to the identified audit/risk areas described in Step B-04e below.**
	The PAR is a preliminary assessment of inherent risk based on the auditor's consideration of the susceptibility of the import activity to noncompliance with the relevant laws and regulations, the importer's history for complying with laws and regulations, and specific concerns of CBP officials. The subject matter of the FA PAS is scoped into specific audit areas such as Value, Classification, FTAs and Preferential Trade Legislation Programs, AD/CVD, IPR, etc. depending on the volume and nature of the import activity and the auditor's consideration of risk and significance. The PAR aids auditors in identifying which audit areas initially are to be included in the scope of the audit and the specific risks associated with each audit area. *Auditors consider whether there is potential risk for material noncompliance by analyzing CBP data and other available information to assess qualitative and quantitative factors about the importer's import activity. The PAR provides an initial assessment of the potential inherent risks for each audit area where there is significant import activity. For qualitative and quantitative considerations, auditors use the criteria (i.e., laws, regulations, importer specific rulings, etc.) that pertain to each audit area to identify specific inherent risks. When deciding whether to include an audit area, the identified risks may be prioritized based on an assessment of the significance/materiality in relation to the total imported during the period.*

Quantitative considerations ask how much is at risk (e.g., dollar values, quantities, percentages, etc.) and serve as a foundation for significance/ materiality considerations. Such considerations might include:

- *Volume of activity in terms of dollars (e.g., declared value, duty, spread of duty rates).*
- *Volume of activity in terms of quantity (e.g., number of entries, number of entry line items, number of tariff numbers used, spread of duty rates).*

Qualitative considerations are attributes or characteristics such as:

- *Visibility and sensitivity of matters such as areas with executive, congressional, or public interest.*
- *Nature of import activity relative to Priority Trade Issues. CBP focuses resources on PTIs that are considered high risk because noncompliance may result in significant revenue loss, hurt the U.S. economy, or threaten the health and safety of the American people.*
- *Nature of import activity relative to areas of concern (e.g., high risk manufacturers, HTS numbers, or countries of origin; related party transactions, etc.).*
- *Newness or complexity of the laws and regulations relevant to the import activity.*
- *Nature of the importer's operations and business processes, its ownership characteristics, and the way that the entity is structured.*

Based on the identified audit/risk areas in the PAR, auditors select walkthrough entries and customize the PASQ to solicit additional information from the importer about the identified risks and importer's system of internal control. It is important to note the following:

- *Except for AD/CVD and IPR, there is no assessment of risk where there is no import activity for an audit/risk area. The potential risk for AD/CVD and IPR infringement may not be obvious based on a review of CBP data and so auditors will plan to obtain additional information from the importer.*

- *The understanding of inherent risk is not completed until after auditors have reviewed the importer's responses to the PASQ, analyzed accounting records, performed walkthroughs, and conducted interviews with the importer's personnel.*

The audit team may determine that the import activity for a particular audit area is not significant and does not warrant inclusion in the scope of the audit. The significance/materiality of risk will vary depending on the facts and circumstances of the audit. It some cases it will be obvious that the total value or volume of activity for an audit/risk area is small in comparison to the total entered value or volume of activity (e.g., total value imported under HTSUS 9801 is less than .01 percent of the total entered value). However, it is also important to consider who the stakeholder is

	(e.g., CBP or another government agency such as CPSC), why the risk is important to that stakeholder (e.g., CBP has PTIs), and what the stakeholder will do when items are noncompliant (e.g., enforcement action). *Note 1: Calculations of the potential loss of revenue are not really predictions but may provide the auditors with some perspective when deciding whether to include an audit/risk area. However, in some cases it may not be practical or realistic to estimate the potential loss of revenue until after additional information is obtained from the importer.* *Note 2: Conditions may have changed such that the auditors may need to evaluate whether the importer is still a viable candidate for an FA PAS. If it is decided to close the FA PAS subsequent to the PAR but before further audit procedures have been performed, a written letter will be sent to the importer notifying it that the PAS will not proceed, refer to Part I, "Special Considerations Impacting the PAS" for procedures to close the FA PAS.*
	a. Review prior audit work to identify areas with potential risk.
	Auditors identify audit reports pertaining to the importer that have been issued within the previous 3 – 5 years to determine if there were previous noncompliances or internal control deficiencies and assess whether there may be a risk of significant/material noncompliance relative to the instant FA PAS.
	b. Analyze CBP data to evaluate the nature and volume of the importer's import activity and identify changes in conditions, trends, inconsistencies, or anomalies that represent a risk to CBP compliance.
	Auditors obtain CBP data (e.g., ACS or ACE) for the relevant IOR numbers and time period and evaluate the nature and volume of import activity by: • *Performing an initial assessment of the volume of activity and revenue implications based on tariff number, entry type, special indicators, etc. This is a high level assessment to get an idea of the types of audit areas that may be relevant.* • *Comparing data about the importer's past import activity (e.g. three year trend analysis) to its current import activity (ACS/ACE) to identify significant changes, trends, or anomalies. For significant changes, auditors consider the need to obtain additional information from the importer via the PASQ, walkthroughs, and/or interviews.* • *Reviewing the CBP Trade Strategy to identify the current PTIs and evaluate whether there is significant import activity relating to the PTIs. Information about*

current PTIs can be found on CBP's website: cbp.gov/xp/cgov/trade/priority_trade/.

- *Evaluating current import activity for items that the importer may have a history of noncompliance (i.e., prior disclosure, previous audit findings, penalty case(s), IS reviews, cargo exams, seizures, etc.) to assess the potential for continued noncompliance.*

  Note that correspondence between the importer and the Port may have information about the importer's compliance history. Auditors will consult with the IS, TEC, and/or FP&F Officer to determine if the importer has submitted any prior disclosures in the past 3-5 years and/or whether the Port has issued any penalties relating to Title 19 U.S.C. § 1592 violations. Cargo exams and Import Specialist's reviews may also contain information about the importer's compliance history. Auditors are aware that prior disclosures are not necessarily an automatic indication of control deficiencies, but may be corrective actions taken by the importer as a result of effective internal control (e.g., post entry review procedures or other monitoring activities).

- *Evaluating the data for tariff numbers, MIDs, country of origin, etc. depending on particular requirements in the relevant criteria to determine whether there is a potential for significant/material noncompliance.*

c. Identify the relevant laws, regulations, rulings, and other criteria against which import activity will be evaluated based on the risk areas identified in the previous step, and assess the susceptibility of the criteria for potential material noncompliance.

Auditors determine which provisions of CBP laws and regulations or other criteria will be used to evaluate the import activity such as laws and regulations included in Title 19 U.S.C. and Title 19 CFR, CBP rulings, and AD/CVD cases.

Auditors may research rulings that have been issued to the importer and by topic (e.g., value, classification), and may inquire via the PASQ whether the company has obtained or uses any issued rulings.

When assessing the susceptibility of the criteria to potential noncompliance, auditors consider:

- *Volume of import activity subject to the relevant criteria.*

- *The newness of the laws, regulations, rulings, etc. and whether there may be a higher risk for noncompliance generally attributed to being unfamiliar with requirements.*

	• *Complexity of the requirements in the law, regulation, or other criteria and whether there may be a higher risk for noncompliance, for example, because the requirements are hard to understand without legal advice or because the requirements may require a significant investment in resources.* • *Compliance history (i.e., prior disclosure, previous audit findings, penalty case, IS reviews, cargo exams, seizures, etc.).*
	d. Obtain an understanding of the needs and concerns of relevant CBP Officials. Discuss fraud risk indicators relative to the audit areas and determine the materiality criteria that will be used to evaluate potential noncompliances.
	Auditors determine if the IS or NAM have specific concerns about the importer's import activities or believe there may be potential fraud risk indicators relative to the audit areas. Note that Government Auditing Standards require auditors to assess the risk of fraud occurring that is significant within the context of the audit objectives and design procedures to obtain reasonable assurance of detecting any such fraud. Whether an act is, in fact, fraud is a determination to be made through the judicial or other adjudicative system and is beyond auditors' professional responsibility (GAGAS 6.30). *The audit team may also discuss the types of information and documentation to be obtained from the importer during the audit and other administrative matters (e.g., procedures for requesting documentation from the importer, agreed upon timelines).*
	e. Select walkthrough entries and customize the PASQ to address the relevant audit areas and obtain information about the potential risks identified in the PAR.
	Auditors select walkthrough entries that will be used to (i) identify significant control points, (ii) obtain an understanding of the importer's typical processes and procedures related to import activities and compliance with CBP laws and regulations, and (iii) assess the implementation of controls. In addition, auditors customize the PASQ to solicit additional information from the importer about the identified risks (e.g., information that will help to finalize the assessment of inherent risk and to obtain an understanding of the importer's system of internal control). *Auditors plan to obtain documentation that supports the implementation of controls and will prepare a list of the types of documentation that will be requested during the walkthrough discussions. If not previously obtained, auditors may use the PASQ to request copies of written policies and procedures, accounting records, or other documentation relating to inherent risk and/or the various components of internal control.*

	Note that the purpose of the walkthroughs is to identify the types of potential noncompliance that may occur, factors that affect the risk of noncompliance, the likelihood of noncompliance, and potential sources of information that could be used to as evidence. That is, the walkthroughs assist auditors in understanding what could go wrong, where it could go wrong, and the likelihood that it might go wrong. The focus of walkthrough discussions are on the processes and procedures that were in place during the scope period of the audit since that is the period for which risk is being assessed and tested. However, the importer may have made significant changes to its processes and procedures in the current period, which may impact corrective actions and future compliance. *Auditors may select several line items for each audit area based on the risks identified in the PAR as it may help them to identify variations in procedures used. Items are primarily selected for the purpose of understanding the importer's typical processes and procedures. At times, auditors may consider selecting unusual items for walkthroughs in order to understand whether there are procedures in place to address atypical or infrequent events that pose a risk of material noncompliance. The amount of effort expended on evaluating and addressing unusual items will be consistent with the associated significance and risk.*
B-05	**Plan and conduct the entrance conference.**
	The entrance conference commences on-site audit work at the importer's facility. Prior to the meeting, auditors prepare (i) a questionnaire to solicit information from the importer about internal control relating to the identified audit areas (i.e., PAR areas), (ii) a list of the types of documentation that will be requested during the walkthrough discussions, and (iii) a PowerPoint presentation that will be used to conduct the entrance conference.
	a. Establish the date for the entrance conference and send a confirmation letter, including the PASQ, walkthrough entries, and list of requested documentation.
	Typically auditors contact the importer's POC via telephone to arrange a date for conducting the entrance conference and follow up with a confirmation letter. The confirmation letter includes the following: • *A brief description of the objectives and scope of the audit.* • *The date, time, and location of the entrance conference.* • *Statement of RA's authority to conduct the audit.* • *Attachments containing the PASQ, list of walkthrough entries, and list of requested supporting documentation.* *When scheduling the date of the entrance conference, auditors generally allow 30 days for the importer to provide its responses to the PASQ plus additional time for the audit*

	team to review the importer's responses and plan questions for discussion prior to conducting the entrance conference. *The amount of time needed for the importer to respond to the PASQ and/or the audit team to review those responses will vary based on the facts and circumstances of the audit. Auditors coordinate with the importer's point of contact in setting the timeframes and scheduling any subsequent changes in the agreed upon dates, if necessary.*
	b. Review the importer's responses to the PASQ and other documentation submitted by the importer prior to the entrance conference, and prepare for discussions with the importer's personnel.
	Auditors discuss with the importer's point of contact the protocol for distributing sensitive information and ensure that all team members are aware of it. The audit team will collectively review the importer's responses and prepare questions for discussion during the walkthroughs and interviews. *Auditors customize the PowerPoint presentation to be used at the entrance conference and may coordinate with the importer's point of contact to set an agenda for conducting the walkthroughs and interviews.*
	c. Conduct the entrance conference and begin onsite audit work at the importer's facility.
	During the entrance conference, auditors explain the audit objectives and records requirements of the audit and set an estimated completion date. Auditors also explain the following to the importer at the entrance conference: • *Overview of the planned objectives, scope, and methodology.* • *The process for reporting the audit results, including that there will be an opportunity for the importer to comment on the results of the audit prior to the issuance of the final report.* • *Estimated completion date, including an emphasis on the need for timely completion of the audit and the importer's responsibilities for timeliness and responsiveness.* • *General audit procedures to be performed to achieve the audit objectives including procedures that will pertain when testing and sampling plans are to be employed (i.e., since testing and sampling plans are not typically developed by the time of the entrance conference, importer's will be advised that actual testing and sampling*

plans will be presented and discussed in subsequent meetings conducted later in the audit).

- *An agreed upon timetable for the following:*
  - *The planned activities or events that will occur during the audit, including those activities or events that involve interaction with the importer or require action by the importer. For example, when the auditors plan to conduct on-site visits or interviews, when requests for information will be submitted and responses due, when the exit conference will be conducted, and when the final report will be issued.*
  - *Estimated dates for the audit team and importer to complete each activity or event.*
- *The appropriate lines of authority within RA for resolving issues that may arise during the course of the audit. Auditors will request that the importer and its independent third party specialist (i.e., consultant or attorney) follow the lines of authority and will provide the following information for the points of contact and resolution levels:*
  - *Resolution Level 1: AIC's name, E-mail address, and telephone number.*
  - *Resolution Level 2: AFD's name, E-mail address, and telephone number.*
  - *Resolution Level 3: FD's name, E-mail address, and telephone number.*
  - *Resolution Level 4: Professional Standards Division Director's name, E-mail address, and telephone number.*
  - *Resolution Level 5: XD's name, E-mail address, and telephone number.*

In addition, auditors may discuss the following:

- *The types of books, records, and data that may be requested for the audit.*
- *The importer's primary and alternate points of contacts for discussing audit matters during the course of the audit.*
- *Additional topics relevant to the conduct of the audit (e.g., necessary work space, or use of copy machines, fax machines, and telephones).*

The importer will be provided a copy of the agreed upon timetable. If, during the course of the audit, it becomes necessary to adjust estimated dates in the timetable, auditors will coordinate with the importer's point of contact to establish a revised timeline. When additional time is required to complete the audit, the importer will be provided a revised timetable that identifies the additional time required and revised completion date.

B-06	**Examine the importer's accounting records to identify potential cost elements affecting value.**
	The audit approach used to examine the importer's accounting records will vary based on the facts and circumstances of the audit. Auditors use their judgment to decide the most efficient approach for determining whether certain elements of CBP value presents a significant risk of noncompliance (e.g., whether there may be statutory additions to the price paid or payable and/or price adjustments). Once it is clear what risks pertain to the import activity, auditors can then concentrate on what controls are needed to mitigate those risks. *An examination of accounting records is performed to determine whether certain costs elements of CBP value presents a significant risk of noncompliance (e.g., costs comprising the statutory additions to the price paid or payable and/or price adjustments). In most cases, the specific inherent risks relating to declared values cannot be determined from CBP entry data (e.g., which of the statutory additions may be applicable to the imported merchandise), and in order to assess the risk of material noncompliance relating to CBP value, auditors will also make inquiries to understand the nature of transactions with foreign vendors and other transactions that may impact CBP value.* *Initially, auditors may consult with other team members (e.g., other auditors, Import Specialist, National Account Manager) and use what is known of the importer's import activity (e.g., CBP data, port exams, prior audit findings, prior disclosures), industry practices, and commodities to perform a cursory review of the GL account descriptions. Cursory reviews are efficient, for example, when there are known practices common to an industry (e.g., providing assists such as tooling) or the importer is known to have certain cost elements (e.g., prior disclosures for the value of assists to foreign vendors provided for free or at a reduced cost) and CBP data indicates a significant amount of the same or similar items imported during the audit scope period. Cursory reviews may also be useful to eliminate accounts that are not material (e.g., low dollar value) or obviously not relevant to CBP values.* *While transaction value will generally be the appropriate basis of appraisement for items imported from unrelated parties, it is still important for the auditors to understand the terms of sale and be sensitive to any conditions that may constitute a limitation on the use of transaction value. When examining related party transactions, auditors consider whether there is a bona fide sale of merchandise for exportation to the United States, and assess whether the importer is using the appropriate basis of appraisement.* *Auditors make inquiries of the importer's personnel to understand (i) the nature of transactions with foreign vendor(s) and the prices paid for items imported from them, and (ii) whether there are price adjustments or any other payments that impact CBP value and the circumstances under which those price adjustments or payments are made (e.g., domestic transactions such as payments to a U.S. company for the right to*

	import a product may also be dutiable). Auditors also discuss the accounting system and inquire about how payments are accounted for and which accounts are used to record transactions that are relevant to CBP value. *When discussing the accounting system, auditors may request a list of vendor codes, discuss GL fields/attributes, and find out if there are sub-ledgers for different vendors, assets, or types of payments as this information may aid the auditors in selecting transactions from accounts of interest. Inquiries may be made via the PASQ and discussions with the importer's personnel.* *Auditors may use walkthrough entry (entries) and transactions selected from GL accounts to verify the nature of transactions, understand the accounting procedures, and/or determine how transactions can be traced to entry level detail. Once it has been determined there is a preliminary risk for noncompliance relating to specific aspects of CBP value, auditors will perform procedures to validate the accuracy and completeness of the GL working trial balance and to select accounts for compliance testing.* *If the importer is using transaction value as the basis of appraisement, some inherent risk may be eliminated based on additional information obtained in this step. For instance, the risk relating to assists may be eliminated based on discussions with personnel from the purchasing and accounting departments and examination of GL accounts. Auditors use additional information from the analysis of accounting records and discussions with the importer's personnel to complete the assessment of inherent risk for value in step B-08.*
	a. Identify the procedures used by the importer's personnel relative to transactions with the foreign vendors and any other transactions that may impact CBP value, and select related accounts of interest for detailed transaction testing.
	Auditors discuss the procedures used to transact with foreign vendors to obtain information about how prices are negotiated and terms of sale in order to assess whether there are or may be statutory additions to the price paid or payable and/or price adjustments. Auditors also discuss other activities and transactions that may affect CBP value, bearing in mind that certain payments made to domestic vendors could represent additions to the price paid or payable. For example, assists could be sourced domestically and provided to the foreign manufacturer for free or at a reduced cost. Additionally, certain assists (e.g. tools, dies, or molds) may be carried on the importer's books for several years and provided to the foreign manufacturer free of charge or at a reduced cost. In such cases, auditors may utilize alternative procedures such as an analysis of an asset location report. *In some cases, those responsible for CBP compliance (e.g., import department personnel) will have a full understanding of which statutory additions and/or price*

	adjustments pertain to the importer's CBP values. In other instances, auditors may need to interview various personnel from other departments (e.g., purchasing, contracting, or others that are responsible) in order to understand the procedures used to negotiate the price of imported items, the terms of sales (e.g., payment method, discounts, rebates, etc.), and how payments are made. *When a significant amount of the entered value is from related parties, it may be necessary to discuss procedures used to establish or set prices with related parties. Import Department personnel may not always be the best source for this information, and it may be necessary to discuss with accounting personnel or senior management to find out how prices are established.* *Most importers use transaction value as the basis of appraisement; however, unless there is a bona fide sale of the merchandise for exportation to the United States, transaction value cannot be used. Basis of appraisement may impact the types of accounts that will be relevant for the auditors to examine. The Informed Compliance Publication "What Every Member of the Trade Community Should Know About: Bona Fide Sales & Sales for Exportation to the United States," dated August 2005, contains guidelines that may be helpful to assess the conditions of the sale and to determine whether the appropriate basis of appraisement is being used.* *Auditors use their understanding of the importer's import activity, industry practices, commodities, and information obtained through discussions to select GL accounts (i.e., accounts of interest). In some cases, auditors may inquire about miscellaneous expenses, high dollar value liability or expense accounts, or accounts with unusual balances (e.g., an expense account with a credit balance) to verify the nature of any payments or adjustments and to assess whether they relate to elements of the CBP value of imported goods. Using the selected accounts of interest, auditors may verify the nature of transactions, obtain an understanding of the accounting procedures, and/or determine how transactions can be traced to entry level detail.* *When discussing accounts used to record payments, it may be necessary for the auditors to understand if foreign and domestic payments are recorded in separate accounts. If both types of payments are recorded in a single account, there may be concerns that foreign payments might actually be paid to a domestic party.* *In most instances, accounts will be selected for any:* • *Additional payments, whether direct or indirect, made to the seller not reflected on the invoice for the imported goods.* • *Payments relating to the statutory additions to the price paid or payable (e.g., packing costs, selling commissions, royalty or license fees, proceed of subsequent resale, and/or assists).* • *Rebates, allowances, and other credits relating to purchases of imported goods.*

	Auditors may request a list of all transactions posted to the selected account(s) of interest and examine supporting documentation for a small number of transactions prior to selecting additional items to confirm that the transactions are relevant to the CBP values. Refer to Attachment 2 for additional information on identifying accounts of interest.
	b. Assess the reliability of data derived from the importer's accounting system.
	Auditors validate the accuracy and completeness of the importer's data/records containing costs that may impact the values declared to CBP and document the results of those procedures. Typically, auditors validate the <u>completeness</u> of the importer's data/records prior to performing compliance testing. <u>Accuracy</u> of the data/records is typically determined when the auditors test the transactions in the accounts of interest as part of further audit procedures. *In most instances, auditors will need to use a combination of procedures to verify <u>completeness</u>. Note that the purpose of these procedures is not to perform a detailed reconciliation of the importer's financial data, but rather to provide the auditors with a reasonable level of assurance that they are working with a complete set of data and that relevant transactions have not been excluded. Regardless of the approach, auditors will explain the procedures used to verify the completeness of the data and any material variations that could not be reconciled. For example, auditors may:* • *Perform a macro analysis of the total of the payments made to foreign vendors to the total value declared on entry line items. A macro analysis is any high-level analysis not involving the review of individual items or transactions. Macro analysis may include such procedures as considering total value balances or total duty paid, calculating potential value or duty impact, extracting and/or comparing data and totals from CBP and importer systems, analyzing variances, analyzing specific characteristics of extracted data, and analyzing relevant data trends.* *It is not practical or necessary for the auditors to reconcile all payments and adjustments affecting declared value (i.e., it does not have to be exact) because certain cost elements in the importer's books may not be reflected in the CBP value (e.g., amounts for international freight and insurance) and there may be timing differences (e.g., CBP data may contain entries that were recorded in the importer's books as a payable in a prior period or the importer's data may contain accounts payable data at the end of a period for which entries are not yet filed).* *Where the macro analysis shows the importer's payments are less than the declared value, small dollar variations may be acceptable without further inquiry or validation. There may be a legitimate or logical explanation for significant variations that does not preclude use of the data (e.g., the importer may not account for domestic and foreign payments separately). However, if auditors are*

	unable to obtain a reasonable explanation or have unresolved concerns about completeness of the data, they may consider using another approach to assess data reliability. • *Obtain a list of all transactions posted to an account (e.g., accounts payable) and trace the total amount to the amount reported in the importer's financial statements. Again, this does not have to be an exact reconciliation. If it is practical to do so, auditors may have the importer's personnel explain how they reconcile subsidiary accounts to the consolidated financial statements. When feeder statements are difficult to reconcile to the consolidated amounts or there are unresolved concerns about the completeness of the data, auditors may consider using another approach.* • *Other approaches as applicable to the circumstances of the audit. For example, after obtaining an understanding of the importer's accounting system, auditors may observe the extraction of the data from the accounting system and then reconcile the data to other roll-up reports.* *There may be instances in which auditors are unable to assess the completeness of the importer's financial records causing limitations or uncertainties about the evidence. In such instances, the nature of the limitations/uncertainties and the resulting impact on the findings and conclusions will be described in the audit report. Instances where the auditors do not perform procedures to assess the completeness of the data/records will be reported as a scope limitation.*
B-07	**Document the assessment of fraud risk.**
	Assessing the risk of fraud is an ongoing process throughout the audit and relates not only to planning the audit but also evaluating the evidence obtained during the audit. Whether an act is, in fact, fraud is a determination made through the judicial or other adjudicative system and is beyond the auditor's professional judgment. When auditors identify factors or risks related to fraud that the auditors believe are significant within the context of the audit objectives, they will design and perform audit procedures to obtain reasonable assurance of detecting any such fraud (i.e., determine whether fraud has likely occurred), and if applicable, assess the effect of potential fraud on the audit findings. *For CBP purposes, a violation is determined to be fraudulent if a material false statement, omission, or act in connection with a transaction was committed (or omitted) knowingly (i.e., was done voluntarily and intentionally, as established by clear and convincing evidence). Initially, the audit team discusses potential fraud risk indicators when preparing the PAR (refer to B-04d). As the audit progresses, auditors use information obtained from the importer's responses to the PASQ, walkthroughs, discussions with the importer's personnel to evaluate whether there are any fraud risk*

	indicators. Auditors will continue to assess fraud risk throughout the audit as it may become evident when they are evaluating and testing controls. *Note that this is considered a summary step as it involves collectively considering information obtained during the performance of other audit procedures. Auditors consider fraud risk indicators in the aggregate. While one risk factor may not by itself significantly impact the auditor's assessment of the risk of fraud, the combined effect of several factors may be significant.*
B-08	**Document the assessment of inherent risk.**
	Auditors use professional judgment to assess the level of inherent risk by considering the possibility that a mistake, inconsistency, significant error, or fraud will occur assuming there is no internal control to address the risks. Auditors also consider the significance or amount of import activity exposed to the risks and the materiality relating to the potential noncompliance. *Note this is considered a summary step as it involves collectively considering information obtained during the performance of other audit procedures. Auditors use the results of the PAR (Step B-04) and additional information obtained from the importer's responses to the PASQ, identified accounts of interest, walkthroughs, and interviews with the importer's personnel to adjust or finalize the quantitative and qualitative considerations, and to complete the assessment of inherent risk relating to each audit area.* *Inherent risk is assessed in terms of high, moderate, or low. In assessing inherent risk, auditors identify the audit areas as well as the specific risk associated with each audit area. If, based on the information obtained subsequent to the PAR, the audit team determines that the import activity in a particular audit area is not significant/material and does not warrant inclusion in the scope of the audit, the importer will be advised that the audit area will not be included in the scope of the PAS.*
B-09	**Assess whether internal control is properly designed and implemented to provide reasonable assurance of compliance with CBP laws and regulations relevant to the importer's import activity. Develop an expectation about the operating effectiveness of controls and assess control risk.**
	<u>Control Components</u> *The COSO framework and five components are used to frame the auditor's assessment of whether the importer's internal control is likely to reduce the risk of material noncompliance to an acceptable level. Auditors focus on control components relating to compliance objectives and identifying key controls that address the relevant inherent risks relating to CBP laws and regulations. It is not practical to identify and assess*

	every control. Auditors use professional judgment to decide which controls are necessary to mitigate the risk of material noncompliance. When important components are missing or the components do not operate together or function properly, auditors may decide that it is likely that a major deficiency exists and the importer does not have an effective system of internal control. *When evaluating the components of internal control auditors consider the size of the importer because it affects the types of controls and the degree to which implementation may be verified. For example, smaller less complex companies are generally less structured and have simpler processes and procedures to achieve their objectives. Smaller companies may not have detailed written procedures and the owner-manager may singularly perform functions that would be designated to various levels of functional responsibility in a larger company.* *The extent to which the importer relies on IT also affects the controls, achievement of objectives, and business functions. When evaluating the components of internal control, auditors consider how the importer's IT captures events and conditions as well as transactional processing relevant to the importer's import activities.* *The extent to which transactions are compliant with CBP laws and regulations may be impacted by the broker's activities. When evaluating the components of internal control, auditors consider the degree of reliance the importer has on the broker's activities and whether there are significant controls to ensure the broker is producing compliant transactions.* *After reviewing the importer's responses to the PASQ, evaluating written policies and procedures, performing walkthroughs, interviewing the importer's personnel, and inspecting documentation, auditors may decide there are limited controls over compliance for an audit area. When this happens, the audit approach would generally not involve testing the effectiveness of controls.* *<u>Control Design and Implementation</u>* *Understanding the control objective is integral to the auditor's assessment of the control's design. An importer may have several controls relating to an audit area (e.g., classification) and the collective objective of the controls may be to ensure compliance with a specific CBP requirement (e.g., ensure imported items are classified on entries in accordance with Title 19 CFR Section 152). However, individual controls may be designed to accomplish certain tasks and will have more narrowly focused objectives. For instance, the importer may periodically provide an updated copy of the classification database to the broker. The objective of this procedure would be to ensure the broker has current information about the classification of imported items. In some cases, an importer may have clearly defined the objectives for individual controls, and in other cases auditors will need to sort it out by considering what task the individual control is supposed to accomplish.*

When assessing the control design and implementation, auditors consider whether:

- *The controls collectively are likely to achieve the overall objective and appropriately respond to the risk relating to the audit area. If an important procedure is missing, then the controls may not achieve the compliance objective.*
- *Individual controls are complete and likely to accomplish specific tasks. If an important step is missing in a process, then an individual control may not achieve its objective.*
- *Controls occur at key control points either before or after items are imported.*
- *The extent to which a control depends on other controls.*
- *Impact of unwritten policies and procedures (e.g., less assurance that the procedures will be performed consistently and correctly).*

When assessing the implementation of controls, auditors consider the degree to which they will be able to test the operating effectiveness. For example, when there is limited documentation showing that the controls were performed, how, and by whom, it will be difficult for the auditors to obtain assurance that the controls were being used consistently and correctly. When there is limited documentation showing the controls were performed over a period of time, it will be difficult for the auditors to obtain assurance that the controls were performed when necessary.

In some cases, auditors may decide that the controls are not suitably designed for an audit area because, for example, the controls are missing important steps in the process. In other cases, auditors may not be able to obtain assurance that the controls operated effectively because there is limited documentation showing who performed the control and how. In either case, auditors would typically not plan to test the operating effectiveness of such controls.

<u>Expectation of Operating Effectiveness and Assessing Control Risk</u>

The auditor's expectation of the operating effectiveness is their judgment of whether the controls, used collectively (e.g., as a system of internal control over compliance for an audit area) are likely to prevent and/or detect and correct material noncompliance. There will be a correlation between the expectation of the operating effectiveness and the assessed level of control risk.

- *Controls that <u>are likely</u> to prevent and/or detect and correct material noncompliance or fraud will correlate with control risk that is below maximum. That is, auditors believe that the controls are likely to be generally effective at preventing and detecting noncompliance. There may be varying degrees of control risk that is below maximum (e.g., low, moderate, or high). Moderate or high control risk indicates there may be some risk for material noncompliance. Auditors*

	identify the specific controls that are being used and are likely to mitigate the identified inherent risks for the audit area. • *Controls that <u>are not likely</u> to prevent and/or detect and correct material noncompliance or fraud will correlate with control risk that is at maximum. That is, auditors believe either the system of control will be insufficient to mitigate the identified risks (e.g., key controls are missing) or the individual control components contain significant deficiencies (e.g., improperly designed). Auditors identify the control points and control objectives <u>that need to be met</u> for the audit area.* *When there is limited documentation supporting the performance of significant controls (e.g., controls integral to mitigating risk at key control points) over a period of time, auditors may not be able to obtain evidence to support any expectation of the operating effectiveness and may not be able to test the effectiveness of the controls because there is no evidence to support that the controls are being performed at an acceptable level. Under these conditions, control risk is assessed at maximum.* *Attachments 3 - 7 provide questions/information auditors may use as they consider the five components of internal control. The attachments are not intended to be used as checklists. Rather, auditors use their professional judgment to decide what questions and information are relevant for the facts and circumstances of the audit and they may ask questions other than those provided.* *Auditors may decide that it is efficient and convenient to complete tests of the operating effectiveness of certain controls during the risk assessment/additional planning procedures. For example, it may be more <u>efficient</u> when there are two or three significant controls and testing can be done relatively quickly. It may be <u>convenient</u> because the records or documentation supporting the controls are readily available, the individuals performing procedures are available for discussion, and/or the performance of the procedures may be observed while the auditors are at the importer's facility. When using this approach, testing plans are prepared and the results are evaluated before the auditors summarize their assessment of the overall risk of noncompliance (refer to C-01(i) and C-02(i) for guidance on preparing testing plans and evaluating results). As a result, it may not be possible or efficient to obtain supervisory approval prior to performing such testing. In such circumstances, auditors will need to obtain supervisory approval of such testing plans as soon as practical.*
a.	**Obtain an understanding of the importer's control environment, identify significant deficiencies where they may exist, and assess the impact on the other components of internal control.**
	When evaluating the importer's control environment auditors consider information about:

- *The industry and other external factors, including such things as:*
  - *The competitive environment, supplier and customer relationships, and technological developments.*
  - *The market for products and competition.*
  - *Cyclical or seasonal activity.*

- *The nature of the importer including its operations and whether it has a complex structure (e.g., subsidiaries or multiple locations). Auditors may consider:*
  - *The products and markets served.*
  - *The conduct of operations (e.g., stages and methods of productions or exposure to environmental risks).*
  - *Alliances and/or joint ventures.*
  - *Suppliers of goods and services.*
  - *Research and development activities.*
  - *Transactions with related parties.*

- *Ownership and governance structure.*

- *The importer's stated objectives and strategies and related business risks that may result in potential material noncompliance.*

- *Lines of authority, defined responsibilities, and accountability for achieving objectives, particularly for individuals/groups that the importer has designated responsible for ensuring compliance with CBP laws and regulations.*
  - *Processes for hiring, training, and retaining competent individuals.*
  - *If applicable, how the employee's and business's performance is measured.*

The strengths in the control environment collectively provide a foundation for the other components of internal control. Generally, senior management evaluates the resources needed to ensure it will accomplish the company's objectives and provides policies and procedures to manage those resources. For compliance with CBP activities, the importer's management may have evaluated the cost/benefits of recruiting, hiring, training, etc. personnel and outsourcing the work to an independent third party specialist (i.e., consultant or broker) in determining what resources will be allocated.

Auditors interview the importer's personnel responsible for CBP compliance and obtain support for the control environment where it is practical to do so (e.g., a copy of an organization chart might be used to support where the import function is organizationally located and the reporting chain of command; training records may be used to support competency of staff, etc.). Auditors assess the competence of personnel designated responsible for compliance with CBP laws and regulations and how those resources are being managed. In addition, auditors evaluate the impact of the control environment on the other components of internal control. For example, auditors may consider whether management's commitment to competency has a negative or positive

	effect on ensuring that control activities will be performed. Attachment 3 provides additional guidance on evaluating the control environment.
	b. Obtain an understanding of the importer's risk assessment process, identify significant deficiencies where they may exist, and assess the impact on the other components of internal control.
	When evaluating the importer's risk assessment process auditors consider whether the importer has a process for: • *Identifying the specific CBP laws and regulations that pertain to the imported merchandise and defining compliance objectives that correlate to the CBP requirements.* • *Identifying risks relevant to achieving the defined/stated compliance objectives.* • *Estimating the significance of the identified risks.* • *Assessing the likelihood of noncompliance with CBP laws and regulations.* • *Deciding what actions will be used to address the risks.* *The importer's risk assessment may be a continuous process and may not be formally documented (e.g., the importer may not use a formal process or may use an ad hoc process to assess risk and establish or make changes to procedures). Assessing risk generally involves consideration of the potential for fraud (e.g., incentives, pressures, opportunities, attitudes, and rationalizations) that may impact achieving objectives, and consideration of changes in the importer's operating environment (e.g., the combination or economic, social, and political factors that affect an organization's activities). For instance:* • *Changes in personnel (e.g., high turnover and/or surges in recruitment).* • *New or modifications to existing IT.* • *Rapid growth in the business sector.* • *New business models, products, and activities.* • *Corporate restructuring.* • *Expansion in foreign operations.*

	Auditors discuss with management whether the risks relevant to CBP compliance have been identified. While it is unlikely for a smaller importer to have an established risk assessment process, management may have identified risks through direct personal involvement in the business. Regardless of the circumstances, auditors inquire about any changes in conditions and how management has addressed them. *Attachment 4 provides additional guidance on evaluating the importer's risk assessment process.*
	c. Obtain an understanding of the importer's monitoring activities, identify significant deficiencies where they may exist, and assess the impact on the other components of internal control.
	When evaluating the importer's monitoring activities auditors consider whether there is a process to monitor internal control over import activities. Monitoring activities provide important information that may be used by management to assess the effectiveness of internal control over time and to make adjustment to procedures when needed. Monitoring activities are accomplished by performing ongoing evaluations (e.g., supervisory reviews), separate evaluations, or a combination of both. • *Ongoing evaluations are typically used to evaluate the efficiency or effectiveness of operations or to assess whether an activity is achieving performance measures. For CBP activities, post entry reviews align with this control component because they are usually performed to assess the broker's performance or importer's compliance with CBP laws and regulations. Ongoing evaluations such as post entry reviews are more common than separate evaluations.* • *Separate evaluations take an objective look at internal control and may vary in scope and frequency. Generally, these evaluations would be conducted by an independent party such as external auditors or consultants. Depending on the importer's organization and resources, they might also be performed by an internal audit function or independent manager from another department. Separate evaluations to assess internal control over CBP activities are less commonly performed than ongoing evaluations.* • *In small companies monitoring activities are often accomplished through management's close involvement in operations.* *Auditors review the importer's responses to the PASQ and conduct interviews with the importer's personnel to determine what type of monitoring activities are being performed. For ongoing evaluations, such as post entry reviews, auditors obtain an understanding of the process used (e.g., when the post entry reviews are performed, what information is reviewed, how items are selected, etc.) and request documentary support for post entry reviews conducted during the scope period (e.g., summary of*

	results, sampling plans, worksheets of entries examined, etc.). Attachment 5 provides additional guidance on evaluating monitoring activities.
	d. Obtain an understanding of the importer's information and communication processes, identify significant deficiencies where they may exist, and assess the impact on the other components of internal control.
	Various internal and external entities will be users and/or sources of information that support the functioning of the other components of internal control. Communication is a continual, iterative process wherein information is provided or exchanged. *Information and communication may be verbal (e.g., discussions at meetings) or written (e.g., email or formal correspondence), and often relates to:* • *The transactions processed by the importer, including the accounting records/accounts used.* • *IT and manual procedures used to initiate, authorize, record, process, correct, and report transactions.* • *Events and conditions other than transactions relevant to import activities that may be captured in the importer's IT system(s).* *Information and communication processes often align with the importer's business or operational processes, which may include activities for developing/designing, purchasing, producing, accounting, importing, and distributing products. Not all of these will be relevant to every importer, and some business processes may have other names. Auditors consider those that are relevant for the facts and circumstances of the importer. These activities may be thought of as* ***key control points****.* *Auditors use information from interviews and walkthroughs to assess the information and communication processes used by the importer. Auditors use professional judgment to identify the key controls points relative to the importer's operations and to assess whether:* • *Information and communication processes at the significant control points address requirements in CBP laws and regulations. For example, auditors may consider whether the importer's buyers (e.g., purchasing or contracting personnel) consult with those responsible for CBP compliance (e.g., import department) during vendor solicitation and whether information about value (e.g., assists) is or should be discussed and subsequently communicated to the vendor (e.g., the apportioning of the value of assists on the invoice). Note that the information may be verbally discussed between those responsible for CBP compliance (e.g., import and purchasing departments), and then subsequently communicated in writing to the vendor on the Purchase Order.*

- *Information and communication about the importer's import activities occurs amongst the appropriate internal and external sources and users. For example, if there is an import department, internal sources and users would be other functional departments such as accounting, engineering, purchasing, etc. External sources and users would be the broker and CBP (e.g., ruling requests).*

- *IT systems are used to capture and process information and data from the internal and external sources.*

Auditors obtain support for information and communication processes to the extent practical (e.g., email correspondence, records of discussion/interviews with the importer's personnel, copies of Purchase Orders relating to walkthrough entries, etc.). In addition, auditors evaluate the impact on the other components of internal control. For example, if the vendors are instructed to separately identify the cost of an assist on the invoice, auditors will consider the need for a control activity that ensures vendors comply with these instructions (e.g., a comparison of Purchase Orders to invoices). Attachment 6 provides additional guidance on identifying and evaluating information and communication processes.

e. Obtain an understanding of the importer's control activities for each audit area, identify significant deficiencies where they may exist, and assess whether there are specific controls to mitigate the inherent risks.

Control activities support all of the components of internal control, but are particularly aligned with the risk assessment component. The nature and extent of the control activities will depend, at least in part, on the importer's size and the importer's desired level of risk mitigation.

Auditors review written procedures (if applicable), use the walkthrough entries to discuss procedures with the importer's personnel, and conduct interviews of various functional personnel to identify key control points and significant control activities for each audit area. Auditors seek information about who performs the control activity, how often it is performed, and what system, data, records and/or documentation supports the implementation of the control. Attachment 7 provides additional guidance on identifying and evaluating control activities.

Auditors consider whether the controls were being used during the audit scope period and the degree to which the operating effectiveness of the controls can be tested. Where practical, auditors plan to test the operating effectiveness to obtain assurance that the controls were used consistently and correctly over a period of time (e.g., within the audit scope period). For instance, it will not be practical to do this when there is limited documentation showing who performed the control, how it was performed, and that it was performed over a period of time.

	Note that auditors may believe there are limited control activities for an audit area; however, they will still evaluate all five components of internal control in order to plan the audit response to the identified risk. When assessing control risk, auditors consider factors such as the interdependence of the components, whether IT systems and/or information from the IT systems are used in the control activities, and/or whether broker activities may provide compensating controls that could mitigate some risks.
B-10	**Summarize the overall assessment of risk and document the planned response to the identified risks.**
	The overall assessment of the risk of noncompliance is the auditor's assessment of the combined effects of inherent and control risk for each audit area, and is generally expressed in terms of high, moderate, or low. Auditors use professional judgment to decide the level of the overall risk of noncompliance and may designate varying degrees, such as very high or very low. The planned response to the identified risks outlines the procedures the auditors plan to perform to reduce audit risk to an acceptable level. *Auditors decide the planned response by considering:* • *The significance/materiality of potentially noncompliant items (e.g., how much of the total entered value may be at risk for noncompliance; the potential LOR for the items at risk for noncompliance; extent of harm to domestic industries).* • *The significance/sensitivity of requirements pertaining to the importer's import activity (e.g., how important is the risk to CBP or other government officials; is there significant activity relative to CBP's Priority Trade Issues; what actions will be taken when items are noncompliant).* • *The overall risk of noncompliance for the audit area (e.g., the amount of risk that remains given the extent to which controls mitigate the identified risks).* • *The degree of assurance the auditors would like to obtain from the tests performed.* *The planned response includes the types of procedures (e.g., tests of controls and/or compliance testing) and may include possible data sources or records to be used in testing. Control risk impacts the type of further audit procedures that will be performed (i.e., specifically whether or not controls will be tested) and may impact the extent of compliance testing depending on the results of tests of controls. The overall risk of noncompliance impacts the extent of procedures (e.g., how much audit work the auditors plan to perform) and extent of testing (e.g., how many transactions or items will be examined). For instance, when the overall risk of noncompliance is higher, more extensive procedures will be needed to reduce audit risk to an acceptable level.* *Control risk assessed at maximum*

	Recall that auditors assess control risk at maximum because they do not believe the controls will be effective at producing compliant transactions or they are unable to obtain assurance of the implementation of controls (e.g., when there is limited documentation supporting implementation). As such, auditors do not intend to rely on the controls and the planned audit approach would typically not involve performing tests of controls to assess effectiveness. Rather, the planned audit approach would involve compliance testing to determine the extent and cause of noncompliance. Attachment 8 contains additional guidance for planning and performing compliance testing. *<u>Control risk assessed below maximum</u>* *Recall that auditors assess control risk below maximum because they believe significant controls were being used and would like to obtain assurance that the controls may be relied on to some extent to reduce the risk of material noncompliance. Under these circumstances, the planned audit approach would involve a combination of tests of controls and compliance testing. If the auditors intend to rely on internal control, they design and perform tests of controls to obtain evidence about the operating effectiveness of the relevant controls. Tests of controls are performed only on those controls that the auditors have determined are (i) significant controls occurring at key control points, (ii) suitably designed, and (iii) supported by evidence. Attachments 9 and 10 contain additional guidance regarding tests of controls.*

	SECTION C - FURTHER AUDIT PROCEDURES
	Further audit procedures primarily include tests of controls and compliance testing; however, in some instances may also include analytical or other audit procedures such as third party verifications. Typically, when control risk is below maximum, further audit procedures will include tests of controls and compliance testing. However, when control risk is at maximum, auditors forego planning and performing tests of controls and instead, only perform compliance testing. When control risk is at maximum because there is limited evidence pertaining to the implementation of significant control activities, further audit procedures may be designed to target items based on certain risk characteristics and/or may include a combination of audit procedures (e.g., analytical procedures, compliance testing, and/or third party verifications) as necessary for the auditors to obtain the level of assurance needed to reduce audit risk (e.g., risk of forming an incorrect conclusion). *Auditors perform tests of controls and compliance testing in accordance with testing and sampling plans that are approved by their supervisor. However, information may come to the auditor's attention when they are performing the tests that cause them to alter the original planned audit approach. When this happens, auditors may reassess the risk (e.g., inherent risk, control risk, and the risk of material noncompliance) and*

	modify the planned approach (e.g., increase or decrease compliance testing) to appropriately respond to the reassessed level of risk. *When evaluating the results of compliance testing, auditors assess whether compensating controls may have functioned to ensure compliance on the transactions/items tested. This is particularly important to consider when tests of controls were not performed (e.g., due to limited evidence of the implementation); however, the results of compliance testing do not identify material noncompliances. In some cases, auditors may decide to perform additional testing, and in other cases, it may only be feasible to form a conclusion relative to the items tested from the audit scope period.*
C-01	**Prepare testing and sampling plans for the procedures that will be performed including tests of controls and/or compliance testing.**
	Auditors prepare testing and sampling plans to identify the procedures that will be used and the transactions/items that will be tested for each audit area. Testing and sampling plans are approved by the AFD prior to execution and prior to being sent to/discussed with the importer. Each testing and sampling plan will include the following minimum information: • *The objective of the test or procedure.* • *The data source(s) used and a brief summary of the procedures that were used to determine that the data is reliable (refer to B-06b for additional guidance on determining data reliability).* • *The characteristics of the population form which items were selected.* • *The basis used to select items (e.g., random and/or the basis for individually selected items).* • *The specific transactions/items that will be tested.* • *The criteria that will be used to evaluate selected transactions/items.* • *The characteristics that will be tested.* • *If applicable, explanation of how the results will be projected over the universe of transactions (e.g., stop-and-go statistical sampling).* *If a stop-and-go statistical sampling approach is being used, the specifics of the sampling plan and how the results will be projected over the universe will be discussed with the importer and the importer will be requested to provide a written acceptance of*

the sampling plan waiving the right to contest the validity of the sampling plan or the sampling methodology at a later date in accordance with Title 19 CFR § 163.11 (c)(1). Note that Title 19 CFR § 163.11 (c)(1) indicates that the auditors will discuss the plan "before audit work under the plan is commenced," so the discussion and request for written acceptance will occur prior to testing regardless of whether the sample will be completed and the results projected (e.g., when a stop-and-go sampling approach is used, items are incrementally tested and auditors stop when they have obtained the desired level of assurance to meet the audit objectives). Further note that the written acceptance and waiver provisions of Title 19 CFR §163.11 (c)(1) only apply to ***statistical*** *sampling and do not apply to testing methodologies that do not involve a projection of loss of revenue onto the universe. Auditors will perform testing regardless of an importer's agreement (refusal) to provide written acceptance.*

After the approved testing and sampling plans have been discussed, auditors provide the importer with a list of the selected transactions/items and a written request for supporting documentation that identifies a due date for the importer to provide the documentation.

(i) Guidance for preparing a testing plan for <u>tests of controls</u>.

Generally, the objective will be to determine whether internal control is operating consistently and is achieving the intended objective. When designing tests of controls auditors plan to evaluate the operating effectiveness of the controls based on variations in the way the procedures were used during the period tested from the way the importer has explained or described the procedures.

The criteria used to evaluate the performance of the control will be the specific details in the importer's written procedures and/or actions explained or demonstrated by the importer's personnel during the walkthroughs and interviews. Testing plans describe the planned procedures the auditors will use to test the controls. Such procedures may include:

- *Inquiries of appropriate importer personnel, including managers.*
- *Inspection of documents, reports, or electronic files indicating performance of the control.*
- *Observation of the application of the specific control.*
- *Re-performance of the application of the control by the auditor.*

It is important to note that the items being tested may not be transactions or entries. For instance, a control to provide an updated copy of the classification database to the broker may be performed on a quarterly or monthly basis. In this example, the items tested would be the quarterly or monthly copies of the database sent to the broker and the associated correspondence. In most cases auditors will

use professional judgment to select items for testing and the number of items selected for each control will vary depending on the degree of assurance the auditors plan to obtain from the tests performed. Attachment 9 provides additional guidance about tests of controls and the number of items that might be tested.

Note: Auditors may prepare separate plans to test individual control components and tailor the objectives of the individualized plans to correlate with that of the control component (refer to B-09 for guidance about identifying the control objectives).

(ii) Guidance for preparing a sampling plan when performing compliance testing.

The objective of compliance testing is to determine whether the selected transactions are compliant with the relevant laws and regulations. Auditors typically use sampling techniques to select the transactions/items for testing compliance. The number of transactions/items selected will vary depending on the risk of material noncompliance that remains after considering other audit procedures that have been performed (e.g., risk assessment procedures, test of controls, and/or analytical procedures) and, therefore, the auditor's desired level of assurance to meet the audit objective.

OPTIONAL APPROACH: An optional approach would be to use statistical sampling and apply a stop-and-go approach to incrementally test the selected transactions. Attachment 8 provides guidance about the stop-and-go approach.

(iii) Guidance for preparing testing plans when using dual purpose testing.

Dual purpose testing may only be used when the control(s) can be observed at the transactional level (e.g., for CBP purposes the entry detail is considered the transactional level). Dual purpose testing would not be used if, for example, there is limited evidence pertaining to the implementation of a control. Note that while this approach appears convenient, it presents certain encumbrances on the amount of work (and variations) that may be performed (occur). For example, an importer may have several significant controls for an audit area, but only some may be tested using a dual approach. Auditors will separately test the significant controls not examined using the dual approach and consider the combined results of all tests of controls (e.g., controls tested using the dual approach and those tested separately) to form a conclusion about the operating effectiveness of controls.

Generally, when testing transactions using a dual purpose approach, auditors select a single sample of transactions and prepare two testing/sampling plans, one to test the control and the other to test whether the transactions are compliant. Alternately, there may be a single test/sample plan; however it will clearly distinguish between the aspects relevant to each type of testing. CAUTION: It is

	necessary that the population from which the sample is selected is appropriate for testing both objectives. *The objectives for dual purpose testing are:* • *Tests of controls - determine whether the control component is operating consistently, correctly, and achieving the intended control objective.* • *Compliance testing - determine whether the selected transactions are compliant with CBP laws and regulations.* *In most cases judgmental sampling will be used to select transactions; however, the number of transactions/items selected will vary depending on the control being tested and degree of assurance the auditors plan to obtain from the tests performed. Note that dual purpose testing is largely dependent on the population to which the controls apply. For instance, judgmental sampling is used when testing transactions from a post entry review. The importer has already selected a sample of transactions (e.g., entry line items) in order to perform the post entry review, such that auditors are sampling from the importer's sample and statistical sampling is neither practical nor useful. Attachment 10 provides additional guidance about dual purpose testing.*
C-02	**Perform tests and evaluate the results.**
	Auditors perform the tests in accordance with the approved plan(s). For control variations and identified noncompliances, auditors: • *Explain and document the work performed in the audit file.* • *Include examples of the evidential material examined in the audit file.* • *Determine and evaluate the causes (e.g., clerical in nature, due to a control deficiency/systemic, or due to fraud).* • *Assess the potential for material noncompliance in the population.* • *Consider the risk relating to other time periods.* • *Assess whether there are matters (e.g., potential fraud) to be referred to the appropriate enforcement group.* *Regardless of the approach used, information may come to the auditor's attention when they are performing the tests that cause them to alter their original planned audit approach. When this happens, auditors may reassess the risk (e.g., inherent risk,*

control risk, and/or the risk of material noncompliance) and modify the planned approach (e.g., increase or decrease compliance testing). Changes in previously approved testing/sampling plans or the preparation of new or modified testing/sampling plans will be reviewed by the AFD prior to execution and prior to being sent to and discussed with the importer.

(i) Performing and evaluating the results for tests of controls.

Auditors evaluate the performance of the controls and assess whether the controls functioning collectively can be reasonably expected to ensure compliance. Variations that are determined to be clerical in nature generally will not affect the auditor's consideration of whether the controls are effective.

This approach contemplates whether variations in the way controls were used individually or collectively increase the likelihood of material noncompliance in order to plan the extent of compliance testing. For example:

- *If there are no variations in the way the controls were used or only a few minor variations that would be considered clerical in nature, there is a high degree of assurance that the controls were being performed at an acceptable level, thus confirming the auditor's initial expectation regarding the operating effectiveness of the controls.*

- *If there are significant variations in the way controls were used, it is likely that controls were not being performed at an acceptable level to be effective. In this case, it may be necessary to reevaluate the risk and adjust the audit approach as appropriate.*

(ii) Performing and evaluating the results of compliance testing.

When evaluating the results of compliance testing it is important to recall the initial assessment of the risk and the initial planned approach:

- *Control Risk Below the Maximum – The initial planned approach will involve tests of controls and compliance testing. When the results of compliance testing do not disclose material noncompliances or the identified noncompliances are determined to be clerical or non-systemic in nature, it may not be necessary to reevaluate the risk and/or adjust the audit approach. Auditors consider the results of other audit procedures that have been performed (e.g., tests of controls) when deciding whether to reassess risk and/or adjust the audit approach.*

- *Control Risk At Maximum – The initial planned approach will only involve compliance testing. During the PAS, compliance testing is typically used to identify the population at risk for material noncompliance (e.g., ascertain the types of errors and/or target the items based on particular risk*

characteristics) before performing more extensive compliance testing. When the results of compliance testing do not disclose material noncompliances or the identified noncompliances are determined to be clerical or non-systemic in nature, auditors may reconsider the design of the testing. For example, auditors may discontinue compliance testing if there are only a small number of clerical errors and/or the potential LOR is not material (i.e., inherent risk may be lower than it was originally thought). However, excessive clerical errors irrespective of the potential LOR may indicate that a more serious problem exists and auditors may decide to continue testing.

Regardless of the initial planned approach, when material noncompliances are identified, auditors will determine the causes of the noncompliances and assess the potential risk of material noncompliance in the population. Also, auditors will assess whether the identified noncompliances, individually or in the aggregate, and/or other matters (e.g., potential fraud) should be referred to the appropriate enforcement group.

When material noncompliances are attributed to systemic control deficiencies, auditors the potential for material noncompliance in the remainder of the population and other time periods. For instance, it may be necessary to perform more extensive compliance testing to quantify a loss of revenue. In such instances, a PAS report will typically be issued reporting the results of testing performed during the PAS and the more extensive compliance testing is performed by allowing the importer to perform self-testing under CBP supervision or by the auditors under an ACT.

Auditors may use statistical or additional judgmental sampling in performing more extensive compliance testing depending on the circumstances. If statistical sampling is to be used, the transactions tested during the PAS will be excluded from the population used to select the additional items. If judgmental sampling is to be used, auditors will consider whether it may be more efficient to perform the additional testing under the PAS. For instance, if the risk can be isolated to a small population and the testing can be performed relatively quickly, it may be more efficient to complete the testing in the PAS. Otherwise, the additional testing can be performed by allowing the importer to perform self-testing under CBP supervision or by the auditors under an ACT.

If a stop-and-go statistical sampling approach was used, auditors initially test only a portion of the selected items and review the results before deciding whether to proceed with further testing. If it is decided to proceed with further testing, auditors will consider whether it will be more efficient to review the remainder of the items in the sample during the PAS, by allowing the importer to perform self-testing under CBP supervision, or by the auditors under an ACT. Recall that the stop-and-go approach affords the auditor greater flexibility in adjusting the audit approach in these situations. The items already tested will "count" towards the statistical projection.

	(iii) Performing and evaluating the results of dual purpose testing. *Auditors evaluate the results of testing using the guidance included in (i) and (ii) above. Generally, when assessing the operating effectiveness of controls, the combined results of all tests of controls (e.g., controls tested using the dual approach and those tested separately) will be used to form a conclusion about the operating effectiveness of controls, and the results of compliance testing will be used to form a conclusion about compliance.* *When there are opposing conclusions about the controls versus compliance, it is important to recall the initial assessment about controls. That is, there should have been an initial assessment that control risk is below maximum (e.g., low) and there will be few variations in the way the controls were used during the period tested. Attachment 10 provides guidance on special considerations when testing the operating effectiveness of controls using the dual purpose approach.*
C-03	**Evaluate whether the importer's import activities represent an acceptable risk to CBP. Prepare finding sheets where appropriate, and discuss the preliminary findings with the importer and CBP officials. For audit areas where there is unacceptable risk, plan the next phase of the FA.**
	Auditors prepare finding sheets to report significant internal control deficiencies and material noncompliances. Auditors will consider the results of testing performed during the PAS (e.g., tests of controls and/or compliance testing) in order to form a risk conclusion. *Preliminary finding sheets are initial drafts containing the elements of the finding (i.e., condition, cause, effect, and recommendations), and will be reviewed by or discussed with the AFD prior to sending to or discussing with the importer and CBP officials (e.g., IS and NAM). Note that subsequent modifications may be made to the preliminary finding sheets during the report writing process. The importer will be provided a copy of the approved draft audit report with finding sheets reflecting any subsequent modifications (refer to Step D-01 for guidance about finalizing the PAS report).* *An acceptable risk conclusion is generally appropriate when the auditors determine that the risk of material noncompliances is not significant for an audit area (e.g., material noncompliances were not detected; the detected noncompliances were not systemic or material in nature; and/or significant internal control deficiencies were not identified). In most instances, tests of controls would support that the controls were being performed at an acceptable level to be effective and compliance testing would support that material noncompliances are not likely. However, when there is limited evidence pertaining to the implementation of controls, risk may be acceptable when, for example, there are no material noncompliances. Under these conditions, the*

	acceptable risk conclusion may be qualified to limit the scope to which the risk conclusion applies. *An <u>unacceptable risk</u> conclusion is generally appropriate when auditors determine that the risk of material noncompliance is significant for an audit area (e.g., material noncompliances were detected; extensive immaterial noncompliances were detected; significant internal control deficiencies were identified; and/or controls were not being performed at an acceptable level to be effective).* *For audit areas where there is unacceptable risk, auditors will plan the next phase of the FA (e.g., Follow-Up Audit or ACT). Auditors may determine that more extensive compliance testing is needed based on the results of compliance testing during the PAS to quantify a loss of revenue or calculate a compliance rate. Recall that auditors may have performed such testing during the PAS if it was more efficient to do so. Otherwise, auditors will need to determine whether testing should be performed by allowing the importer to perform self-testing under CBP supervision or by the auditors under an ACT. In determining whether to perform such testing under an ACT, auditors consider the significance of the risk and potential impact of material noncompliances and whether the importer is a candidate for self-testing under CBP supervision.* *Auditors will typically discuss whether the importer agrees to develop and implement a CIP and to perform self-testing, if appropriate, at the time they are provided the preliminary finding sheet(s). Compliance testing may be performed by the importer via self-testing under CBP supervision when the importer agrees to take corrective action to address the identified internal control deficiencies (e.g., develop and implement a CIP) and there is consensus about having the importer perform self-testing under CBP supervision. Note that if the importer does not agree to develop and implement a CIP to address the identified internal control deficiencies, it would not be appropriate to permit self-testing and more extensive compliance testing would be performed by the auditors under an ACT.* *Auditors may also discuss with the importer the preparation and execution of testing/sampling plans used to accomplish more extensive compliance testing. When the importer is permitted to perform self-testing under CBP supervision, the testing/sampling plans may be prepared by the auditors or the auditors may review and provisionally approve self-testing plans prepared by the importer. In either case, a Follow-Up Audit to verify the accuracy and acceptability of the importer's work will be necessary.* *Attachment 11 provides additional guidance about the CIP and Attachment 12 provides guidance about self-testing under CBP supervision.*

	SECTION D - FINALIZE THE AUDIT

	Acceptable Risk – For audit areas where auditors determined that risk is acceptable, the PAS report marks the final stage for that audit area. Importers having acceptable risk on completion of a PAS will be eligible to transition to the ISA program, and may have questions about the ISA application process and/or developing a self-testing plan. During the exit conference, auditors may use the FA Transition to ISA PowerPoint presentation to conduct discussions about transitioning to the ISA program (refer to CBP's webpage, http://www.cbp.gov/trade/audits/focused-assessment for a copy of the presentation). *Unacceptable Risk – For audit areas where auditors determined that risk is unacceptable, noncompliances and/or internal control deficiencies identified during the PAS are reported as findings. The PAS report also reflects the next stage of the FA process to be performed. For example, when the importer has agreed to prepare a CIP and, if applicable, perform self-testing under CBP supervision, the PAS report will state as much and indicate that the auditors plan to perform a Follow-Up Audit. Generally, there will be a lapse between the PAS and Follow-Up Audit while the importer implements a CIP and, if applicable, performs self-testing under CBP supervision. Where the auditors have determined to perform more extensive compliance testing under an ACT (e.g., to maintain control over the work due to the significance of the risk and potential impact of material noncompliances), the ACT may be initiated immediately following the PAS.* *When it is planned that more extensive testing will be performed to quantify a loss of revenue either by allowing the importer to perform self-testing under CBP supervision or by the auditors as part of an ACT, auditors will discuss with the appropriate CBP official (e.g., Action Official, FP&F Officer, Assistant Chief Counsel) to ensure their specific concerns and reporting requirements are addressed. Auditors will also discuss the type of information that the port may need to assist them in collecting any resulting loss of revenue (e.g., specific entry details).* *Prior to implementing the CIP, the importer should provide a copy of it to the auditors so the auditors may review the CIP to ensure it will be responsive in correcting the identified deficiencies (note that this may occur after the PAS report has been issued). When there is consensus that the CIP is acceptable, the importer should begin implementation. Auditors may periodically contact the importer to monitor their progress while the CIP is being implemented.* *After the importer has validated that the CIP is fully implemented (i.e., all corrective actions have been taken and the importer is satisfied that the controls are effective to mitigate the risk of material noncompliance), they should notify the auditors and schedule the Follow-Up Audit. Prior to commencing the Follow-Up Audit, ensure that the CIP has been in practice for a sufficient period of time to allow for an adequate amount of import activity to be examined during the Follow-Up Audit. Attachment 11 provides additional guidance on the development and implementation of the CIP.*

	When the importer is permitted to perform self-testing under CBP supervision, auditors monitor the importer's progress completing the self-testing. Alternative ways to accomplish this may be to have regularly scheduled teleconferences to discuss progress or for the importer to periodically provide status reports. When the importer has completed self-testing, they should inform the auditors and schedule a date to begin the Follow-Up Audit. Note that the timing of full implementation of the CIP and the importer's completion of self-testing may not coincide. As a result, it may be necessary to review the results of the self-testing as a separate assignment. Attachment 12 provides guidance on performing self-testing under CBP supervision.
D-01	**Assess compliance with GAGAS, and prepare and process the audit report.**
	Auditors assess compliance with GAGAS by considering whether all applicable GAGAS professional requirements have been met (i.e., determining whether a GAGAS exception applies to the assignment) and whether a modified or unmodified GAGAS compliance statement should be included in the audit report. It may be necessary to include a modified GAGAS compliance statement, for example, when auditors are unable to perform tests of suitably designed controls because the importer's system does not produce evidence of the implementation of the controls. Under these conditions, an acceptable risk conclusion may be qualified to limit the scope to which the risk conclusion applies. *Auditors will provide a copy of the final referenced draft report to the importer, IS, and NAM and request written comments. Auditors will specify a due date for providing the written comments. The importer may provide their written comments in PDF files via email or by sending the signed original via regular U.S. mail. If there are findings and recommendations, the importer's written comments should indicate whether they:* • *Concur with the results and any LOR calculations as applicable.* • *Agree to develop and implement a CIP, if applicable.* • *Agree to perform self-testing under CBP supervision, if applicable.* *Auditors may make word changes or other corrections suggested by the importer provided that the changes do not substantially alter the reported results. If the importer provides additional evidence (i.e., evidence that was not provided during the audit), auditors will evaluate the new evidence and have any substantial changes made to the report referenced. Auditors may prepare a rejoinder to refute arguments that are not fact based or to defend the auditor's position when the importer disagrees with the findings and/or conclusions.*
D-02	**Conduct the exit conference.**
	An exit conference will be conducted to close out the PAS and discuss the next steps in the FA process (e.g., a Follow-Up Audit will be performed to validate implementation of the CIP and/or determine the accuracy and acceptability of the importer's self-

	testing results, if applicable). Auditors will discuss the audit findings with the importer and, to the extent possible, every effort should be made to resolve issues or disagreements prior to the exit conference. When it is necessary to further discuss issues under disagreement, all parties (e.g., the importer and auditors) should make an effort to resolve the issues during the exit conference. Other topics that may be discussed include: • *The general contents of a CIP.* • *The agreed upon date when the importer will finalize the CIP and provide a copy of it to the auditors. Note that the CIP does not need to be finalized prior to issuance of the PAS report because the importer may need time to decide the best course of actions and/or obtain senior level approval to fund actions, etc. The point is to have an agreed upon date for finalizing the CIP that is in the not too distant future so the importer can begin implementation and have it fully implemented within a reasonable time period.* • *Procedures that will be used when the importer is performing self-testing under CBP supervision and timeframes for completing the self-testing.* • *If sampling plans have been prepared by the auditors (and approved by the AFD) for the importer to use when performing self-testing, auditors may provide the list of selected transactions and discuss the auditor's plans to subsequently evaluate the results for accuracy and acceptability (e.g., types of documentation to be requested). Note that the requirements in Title 19 CFR § 163.11 (c)(1) to discuss statistical sampling plans with the importer and obtain written acceptance apply to circumstances in which auditors prepare sampling plans for the importer to use when performing self-testing under CBP supervision. Also, it may be necessary to hold subsequent discussions regarding the design of self-testing plans prepared by the importer.* • *If the importer will be testing from its records, auditors may discuss the records that will be used, procedures for determining the data reliability, sampling methodology, criteria, etc.* *Note that the date of the exit conference commences the Mod Act timeframe for report issuance. It is best to ensure that all open items have been resolved prior to the exit conference to avoid breaching the Mod Act.*

ACRONYMS AND ABBREVIATIONS

Attachment 1 provides a list of acronyms and abbreviations used throughout the FA PAS Technical Guide.

AD	Audit Documentation
ACE	Automated Commercial Environment
ACT	Assessment Compliance Testing
ACS	Automated Commercial System
AD/CVD	Anti-Dumping / Countervailing Duties
ADFO	Assistant Director, Field Operations
AFD	Assistant Field Director, Regulatory Audit Field Office
AGOA	African Growth and Opportunity Act
AIC	Auditor in Charge, Regulatory Audit Field Office
ATPDEA	Andean Trade Promotion and Drug Eradication Act
CAFTA-DR	U.S.-Central America-Dominican Republic Free Trade Agreement
CARS	Commercial Allegation Recording System
CBP	U.S. Customs and Border Protection
CBPO	Customs and Border Protection Officer
CBTPA	Caribbean Basin Trade Partnership Act
CFR	Code of Federal Regulations
CIP	Compliance Improvement Plan
CTE	Office of Commercial Targeting and Enforcement
D&B	Dunn and Bradstreet
DFO	Director, Field Operations
DHS	U.S. Department of Homeland Security
FA	Focused Assessment
FD	Field Director, Regulatory Audit Field Office
FOIA	Freedom of Information Act
FP&F	Fines, Penalties, and Forfeitures
GAGAS	Generally Accepted Government Auditing Standards
GAO	U.S. Government Accountability Office
GSP	Generalized System of Preference
HMF	Harbor Maintenance Fees
HTSUS	Harmonized Tariff Schedule of the United States
HQ	Headquarters, Office of Regulatory Audit
IOR	Importer of Record
IPR	Intellectual Property Rights
IS	Import Specialist
ISA	Importer Self-Assessment
IT	Information Technology
LOR	Loss of Revenue
Mod Act	Customs Modernization Act
MPF	Merchandise Processing Fees

NAFTA	North America Free Trade Agreement
NAM	National Account Manager
OFO	Office of Field Operations, CBP
OT	Office of International Trade, CBP
PA	Privacy Act of 1974 (5 USC 552a)
PAPP	Price Actually Paid or Payable
PAR	Preliminary Assessment of Risk
PAS	Pre-Assessment Survey, FA
PASQ	Pre-Assessment Survey Questionnaire
QBT	Quota Book Transmittal
QRAM	Quantitative Risk Assessment Methodology
RA	Office of Regulatory Audit
RR	Office of Regulations and Rulings, CBP
SFTA	U.S. Singapore Free Trade Agreement
TBT	Textile Book Transmittal
TPAP	Time-Phased Audit Program
TPL	Tariff Preference Level
TPP	Office of Trade Policy and Programs, CBP
TRQ	Tariff Rate Quota
U.S.	United States
USC	United States Code

GUIDANCE FOR EXAMINING RECORDS AND OTHER INFORMATION AFFECTING DECLARED VALUE

Attachment 2 provides additional guidance for examining accounting records and other information affecting declared value. This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Auditors use their professional judgment to decide what questions and information are relevant for the facts and circumstances of the audit. Not all of the information in this attachment will be relevant for every audit and auditors may examine accounts other than those described in this attachment.

Transaction Value

Title 19 U.S.C. § 1401a(b)(1) defines transaction value, in part, as the price actually paid or payable for merchandise when it is sold for exportation to the United States plus amounts equal to five statutory additions and certain exclusions. Transaction value is the preferred method of appraisement and first in the order of precedence; however, auditors may encounter importers who use one of the other bases of appraisement.

Auditors confirm which basis of appraisement the importer uses (e.g., via the PASQ response, interview, or walkthrough). Typically, basis of appraisement is a concern where there are related party transactions; however, there may also be instances where auditors may question the basis of appraisement for transactions with unrelated vendors. Regardless of whether the transactions are with related or unrelated vendors, it is important to understand the terms of sale. Auditors may question conditions that appear to constitute a limitation on the use of transaction value.

During the risk assessment and planning procedures, auditors obtain information about the terms of sale through the importer's responses to the PASQ, interviews with the importer's personnel (e.g., import, purchasing, contracting, and/or accounting departments), and examination of the accounting records and other documentation (e.g., contracts, written agreements, purchase orders, invoices) to determine if there are any:

- Restrictions on the disposition or use of the imported merchandise.
- Conditions for which the value cannot be determined.
- Agreements for the proceeds of any subsequent resale, disposal, or use of the merchandise, accruing to the seller, for which an appropriate adjustment to transaction value cannot be made.
- Related party transactions where either the circumstances of sale indicates the relationship influenced the price actually paid or payable or the transaction value does not approximate test values.

Note that auditors may need to interview the importer's senior management as these individuals may be responsible for setting prices with related parties. Refer to the section in this attachment about "Related Party Transactions" for additional considerations.

Bona Fide Sale

By definition, transaction value requires that a sale of merchandise for exportation to the United States occur. This requires two components to be present: (1) there must be a "bona fide" or "good faith" sale, and (2) there must be a sale of the merchandise for exportation to the United States.

In order for there to be bona fide sale[5], there must be a transfer of property from one party to another party for consideration. Consideration is the payment from one party to another party for the imported merchandise. Evidence that establishes that consideration has passed from one party to another includes payments made by check, bank transfer, or by any other commercially acceptable manner. Further, there must be evidence that the payment was made for the imported merchandise in question.

During the risk assessment and planning procedures, auditors plan to obtain information about the terms of sale, methods of payment, and accounting practices through the importer's responses to the PASQ, interviews with the importer's personnel (e.g., import, purchasing, contracting, and/or accounting departments), and examination of the accounting records and other documentation (e.g., contracts, written agreements, purchase orders, invoices). Throughout the audit, and in particular when examining specific transactions from the accounting records and when testing transactions for compliance, auditors consider whether there is a bona fide sale of merchandise for exportation to the United States.

While several factors may indicate a bona fide sale has taken place, auditors consider the overall relationship of the parties involved in the transaction to discern if in fact there is a bona fide sale. Some of the factors to be considered include:

- FACTOR: Whether property or ownership in property is transferred.

  Auditors consider whether the importer, as the buyer of the imported merchandise, has assumed the risk of loss for the merchandise (i.e., the buyer was liable for the imported merchandise if lost or damaged during shipment) and acquired title to the imported merchandise (i.e., the buyer legally possesses or owns the imported merchandise). Also, auditors consider whether the importer, as the buyer of the imported merchandise, actually paid for the merchandise (i.e., consideration passed between the buyer and seller for the imported merchandise).

  EXAMPLE: Transactions involving goods that are shipped on consignment; gifts, samples, and promotional items furnished free of charge; goods under a leasing contract;

[5] Refer to the Informed Compliance Publication "Bona Fide Sales & Sales for Exportation to the United States" August 2005 for more information.

and goods on loan do not constitute bona fide sales because the items are not the subject of a sale. Thus, transaction value cannot be the basis of appraisement. Therefore, another method of appraisement must be used in these situations.

- FACTOR: When title has been transferred.

  Auditors consider the terms of sale in conjunction with all other relevant evidence. Generally, the terms of sale are provided on the invoices and written contracts or agreements regarding the sale of the merchandise.

- FACTOR: Whether the parties were functioning as a buyer and seller.

  Auditors consider the roles of the parties, circumstances of the transaction, and whether the parties maintain independence in their dealings. In a valid buyer-seller relationship, the buyer:

  (i) Provides or could provide instructions to the seller.

  (ii) Is free to sell the imported merchandise at any price.

  (iii) Selects or could select its customers without consulting with the seller.

  (iv) Could order the imported merchandise and have it delivered for its own inventory (as opposed to the seller delivering the merchandise directly to an ultimate U.S. consignee).

- FACTOR: Whether there is proper proof of payment.

  Auditors consider the substance behind the transfer of money. For example, general transfers of money from one corporate entity to another that cannot be linked to a specific import transaction are <u>not</u> sufficient evidence that a payment was made with respect to the import transaction.

<u>Examining Accounting Records</u>

The examination of accounting records is performed to identify transactions that may have a CBP impact (e.g., costs comprising the statutory additions to the price paid or payable) relevant to determining whether declared values are correct where it has been determined there is a preliminary risk of significant noncompliance relating to CBP value. The audit approach used to examine the importer's accounting records will vary based on the facts and circumstances of the audit. Initially, auditors may perform a cursory review of the GL working trial balance and then make inquiries to understand the nature of transactions with foreign vendors and identify the specific inherent risks relating to declared values. Alternatively, inquiries may be made prior to reviewing the GL working trial balance to target relevant accounts of interest. For instance, there may not be much information available about the industry or importer's compliance history

to provide a basis for selecting accounts, and so auditors may ask questions about the imported merchandises prior to reviewing the GL working trial balance and then develop a structured approach for selecting accounts.

Auditors use their judgment to decide the most efficient approach for determining whether certain elements of CBP value presents a significant risk of noncompliance (e.g., whether there are statutory additions to the price paid or payable and/or price adjustments). Regardless of the approach, once it has been determined there is a preliminary risk of significant noncompliance relating to CBP value and that additional testing is warranted, auditors perform procedures to determine that the data is reliable (e.g., accurate and complete) and identify/select accounts for compliance testing.

Generally, an examination of accounting records will include (i) an analysis of GL working trial balance and account descriptions, (ii) interviews with the importer's personnel, (iii) an assessment of inherent risk for value, (iv) validation of the importer's accounting data, and (v) selection of accounts of interest.

(i) Auditors may analyze the GL working trial balance to identify accounts relating to costs elements affecting CBP value (e.g., statutory additions or price adjustments). When the GL working trial balance can be downloaded in excel format, the auditors may cull the data to:

- Eliminate accounts that do not have significant or material dollar value to warrant further review (e.g., the potential LOR for noncompliance relative to the costs may not be material).

- Select accounts to discuss the nature of transactions posted to them.

(ii) Auditors may interview the importer's personnel to understand such things as how prices are derived, terms of sale, and nature of transactions posted to the accounting records. This process may include:

- Interviewing import department personnel (e.g., if they have a full understanding of the importer's CBP values) or personnel from purchasing, contracting, or other departments to discuss the terms of sales (e.g., payment method, discounts, rebates, etc.) and whether statutory additions or price adjustments pertain to the importer's CBP values.

- Using the walkthrough entry (entries) to discuss GL accounts where purchases and payments are recorded.

- Using selected accounts to discuss the nature of transactions that are posted to them and discern whether transaction amounts can be traced to line item values declared on

entries[6]. If appropriate, the auditors may select one or two transactions to confirm that the transactions are relevant to CBP values.

- Examining documents such as contracts, correspondence, and other written agreements to identify the terms, conditions, any modifications to those terms and conditions, and specific dollar amounts relating to transactions affecting customs value.

(iii) Auditors may finalize the assessment of inherent risk for value based on the significance (e.g., how important is the noncompliance to CBP) and materiality (e.g., how much is the potential LOR). Note that not all of the statutory additions to the price paid or payable and/or price adjustments will be relevant for every importer. Auditors consider the significance of the dollar value for any identified cost elements and the potential LOR if the costs were noncompliant individually and, where there may be several costs pertaining to CBP value, the combined or aggregate potential LOR.

Auditors consider the total payments made or to be made, for imported merchandise. Note that payments may be direct (e.g., invoice price) or indirect (e.g., settlement of a debt), and certain amounts may be excluded for costs, charges, or expenses incurred for transportation, insurance, and related services that are incidental to the international shipment of the merchandise from the country of exportation to the place of importation in the United States.

- Indirect payments can take various forms, including settlement of a debt or payment to a related party for additional operations such as finishing work for imported merchandise either to or for the benefit of the seller. Title 19 CFR § 152.103(a)(b) states, in part, that an indirect payment would include the settlement by the buyer, in whole or in part, of a debt owed by the seller, or where the buyer receives a price reduction on a current importation as a means of settling the seller's debt to the buyer.

- Direct payments may include payment of the invoice, after-the-fact payments such as interest or management fees, reimbursements made directly to the seller for tooling purchases, and payments for currency rate fluctuations, conversions, and adjustments tied to a contract.

(iv) Auditors may validate the importer's accounting data to ensure that the data is accurate and complete. If, based on information obtained through inquiry and the auditor's understanding of the importer's import activity, industry practices, and commodities, they believe there are certain costs affecting CBP value, auditors may opt to validate the accounting data prior to discussing the nature of transactions posted to selected accounts.

(v) Auditors may select accounts they have determined contain certain cost elements affecting CBP value (e.g., accounts of interest) to be used for testing compliance during further audit procedures. Prior to selecting accounts, auditors will confirm that the transactions are

[6] Accounts containing transactions that can be traced to line item values may be used later in the FA process when auditors perform compliance testing.

relevant to CBP values and understand how the transactions can be traced to entry level detail prior to testing compliance.

Related Party Transactions

Title 19 U.S.C. § 1401 a(b)(2)(B) states, in part, transaction value between related parties is acceptable for CBP purposes provided the importation meets one of two specific tests: circumstances of sale or test values. Importers will frequently provide a transfer pricing agreement or, less often, an Advanced Pricing Agreement (APA), as evidence that it has met its burden of proof that transaction value is acceptable. The information contained in an APA or transfer pricing study *by itself* is not sufficient to show that a related party transaction value is acceptable for CBP purposes. The underlying facts and conclusions of an APA or transfer pricing study may contain relevant information; however, the importer has the burden of identifying which pieces of the information are relevant for CBP purposes. The underlying facts and conclusions of an APA or transfer pricing study may contain relevant information; however, the importer has the burden of identifying which pieces of the information are relevant for CBP purposes.

The importer may make indirect adjustments to the invoice price after importation, and may claim the indirect adjustments are in accordance with the transfer pricing study. HQ issued a ruling, HQ W548314, dated May 16, 2012, that when a price paid or payable is determined by a formula, a firm price need not be known or ascertainable at the time of importation. Rather, it is necessary for the formula to be fixed at importation so that the final sales price can be determined at a later time on the basis of an event that neither the buyer nor seller has control. The ruling sets out five factors that apply in addition to the circumstances of sale test.

Before accepting transaction value between related parties, the audit team may examine the totality of the facts and information presented, including the importer's relationship to the foreign related party, any agreements between them, and whether the intercompany transfer price is settled according to a formula that was fixed at the time of importation. When reviewing a transfer pricing study, the audit team may review information such as:

- Product comparability. A transfer pricing study that is based on the comparable price method (CPM) is more persuasive if it uses products of comparable companies that are of the same class or kind as the imported products.

- Relevance of the methodology. A transfer pricing study that is based on the comparable uncontrolled price method (CUP) is more relevant for CBP than, for example, the CPM. The CUP method compares the price charged in a controlled transaction to the price charged in a comparable uncontrolled transaction in comparable circumstances.

Audit Approach

When there is significant risk for items being imported from related parties, the audit team may consider using the following audit approach:

1. Determine whether the transaction is a bona fide sale for export to the United States[7]. To do this it may be necessary to understand the terms of sale.

   a. The audit team may consider the circumstances of the transaction including:

      - Passage of title and the assumption of the risk of loss.
      - Payment of consideration for something of value.
      - The ability of buyer to instruct the seller.
      - The ability of buyer to resell merchandise at any price and to any customer.
      - The ability of buyer to order merchandise for buyer's own account.

   b. The audit team may review the terms of any of the following:

      - Distribution Agreement.
      - Contract provisions or purchase orders stating terms of sale.
      - Insurance policy.
      - Proof of payment through review of bank documents.
      - Fulfillment of obligations through review of entry documents.

2. Once it is determined that there is a bona fide sale, the audit team may examine the relationship between the buyer and the seller and determine whether the relationship has influenced the price paid or payable, and may perform the following procedures:

   a. Request that the importer provide:

      - A written statement explaining how they support transaction value (i.e., circumstances of sale or test values).

      - Supporting documentation evidencing that the CBP criteria for circumstances of sale or test values are met. This should include the importer's explanation of the relevance of the supporting documentation. Note that test values will be used less frequently because related vendors generally do not sell the same/similar items to unrelated buyers.

      - If applicable, a waiver for the auditors to obtain copies of tax returns and other documents directly from the IRS.

   b. When the importer provides either a transfer pricing study or APA, the audit team may assess the relative weight of information by considering whether:

      - The APA is unilateral or bilateral – bilateral would be more balanced because it covers both foreign and domestic interests.

[7] Refer to Informed Compliance Publication "Bona Fide Sales & Sales for Exportation to the United States" August 2005 for additional guidance.

- The transfer pricing methodology is relevant for CBP purposes. For example, an APA based on the CUP methodology has the most relevance for CBP purposes because it is a prospective binding agreement between the taxpayer and the IRS regarding the correct transfer pricing methodology and it involves a methodology where there is a direct comparison between the price charged for a specific product in a controlled transaction and the price charged in an uncontrolled transaction in comparable circumstances.

c. The audit team may review the importer's written statements and supporting documentation and assess whether the criteria for circumstances of sale has been met. For instance:

- If the importer states that the circumstances of sale test is met because price was settled in a manner consistent with *normal pricing practices of the industry*, the audit team may assess whether:

  - The industry claimed by the importer is reasonable for the importer to be in.
  - The importer has provided objective evidence of the normal pricing practices of that industry.
  - The importer has provided objective evidence that the transfer prices were settled in accordance with that industry's practices.

- If the importer states that the circumstances of sale test is met because the price was settled in a manner consistent with *the way prices are settled with buyers who are not related,* the audit team may assess whether:

  - The importer has provided objective evidence that the merchandise is the same.
  - The importer has provided objective evidence of how the seller settles prices with both related and unrelated buyers.
  - There is consistency in manner in which the seller settles prices with both related and unrelated buyers.

- If the importer states that the circumstances of sale test is met because the price is adequate to ensure *recovery of all costs plus a profit that is equivalent to the firm's profit realized over a representative period of time in sales of merchandise of the same class or kind,* the audit team may assess whether:

  - The importer submitted documentation to support a profit that is equivalent to the firm's overall profit. Note that CBP normally considers this to be the overall profit of the parent company (refer to HRL 546998, dated January 19, 2000).

  - The importer submitted documentation to support that the profit is equivalent to profit realized over a representative period of time (e.g. one year) in sales of merchandise of the same class or kind. Note that merchandise of the same class

or kind means merchandise that is within a group or range of merchandise produced by a particular industry or industry sector (refer to ICP "Determining the Acceptability of Transaction Value for Related Party Transactions," April 2007.)

- The importer submitted documentation to support that the profit figures were consistent with the market as a whole to demonstrate that the price between the related parties has been settled in a manner consistent with the normal pricing practices of the industry (e.g., provided objective criteria regarding how the industry sets its prices).

  When the intercompany transfer price is settled according to a formula, auditors may consider whether:

  - There is a written "Intercompany Transfer Pricing Determination Policy" or functional equivalent in place prior to importation.
  - The importer used its transfer pricing policy when filing its U.S. tax return for the audit scope period.
  - The importer's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy.
  - The importer has provided accounting details from its books and/or financial statements to support the claimed adjustments.
  - There are other conditions that may affect the acceptance of the transfer price by CBP.

Computed value

Title 19 U.S.C. § 1401a (e) defines computed value, in part, as the sum of (A) the cost or value of the materials and the fabrication and other processing of any kind employed in the production of the imported merchandise; (B) an amount for profit and general expenses equal to that usually reflected in sales of merchandise of the same class or kind as the imported merchandise that are made by the producers in the country of exportation for export to the United States; (C) any assist, if its value is not included under subparagraph (A) or (B); and (D) the packing costs.

Title 19 CFR § 152.106 is relevant for computed value, and includes interpretive notes about profit and general expenses, assists and packing costs, and merchandise of the same class or kind. Title 19 CFR § 152.106(f) states, in part, that it will be presumed that the computed value of the imported merchandise cannot be determined if: (i) the importer is unable to provide the

required computed value information with a reasonable period of time, and/or (ii) the foreign producer refuses to provide, or is legally prevented from providing, that information.

As a general rule, CBP value is determined based on information that is readily available from the importer in the United States. However, when computed value is used as the basis of appraisement it may be necessary to examine the costs of producing the goods based on information from the foreign vendor/producer located in the country of exportation. In some cases, the producer of the goods may be outside the jurisdiction of CBP's authority, and it may not be feasible to obtain cost and production records. However, when items are imported from related parties, the producer of the imported merchandise should be prepared to provide cost and production information.

CBP laws and regulations provide special rules for the costs included in computed value (e.g., cost of materials, amount of profit, and general expenses). Generally, the cost or value is to be based upon the commercial accounts of the producer, provided that such accounts are consistent with the generally accepted accounting principles applied in the country where the goods are produced.

Auditors determine who is responsible for negotiating (or setting prices) with related parties and discuss with them to determine:

- Intercompany accounts used to record the cost of materials, fabrication or other production processes, profit, general expenses, assists, and packing costs relating to the goods.

- How payments are made (e.g., through accounts payable, intercompany accounts, direct credits to cash accounts, wire transfer, letters of credit, etc.).

Note that importers using computed value as their basis of appraisement will typically participate in CBP's reconciliation program. Therefore, auditors often experience delays due to the fact that the reconciliation entry is not due until late in a given period. Modification to the audit scope period may be necessary if, for example, it is decided to include reconciliation entries filed during the scope period of the audit and the underlying entries flagged in prior periods. The importer will be advised of the modification to the audit scope.

Important reference material and additional guidance may be found at CBP's website, cbp.gov/trade/legal/informed_compliance_pubs:

- "Customs Valuation Encyclopedia (1980 – 2010)," December 2010.
- **"**What Every Member of the Trade Community Should Know About: Bona Fide Sales & Sales for Exportation to the United States," dated August 2005.
- "What Every Member of the Trade Community Should Know About: Determining the Acceptability of Transaction Value of Related Party Transactions," dated April 2007.

EVALUATING THE CONTROL ENVIRONMENT

Attachment 3 provides additional guidance on evaluating the importer's control environment. This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Auditors use their professional judgment to decide which questions and information are relevant for the facts and circumstances of the audit.

Integrity and Ethical Value
How does management convey a message of maintaining integrity and ethical values (e.g., code of conduct, formal ethics programs, and annual statements)? Note that the absence of a formalized ethics program is not necessarily an indication that there are ethical issues.
How has management expressed its support for compliance with CBP laws and regulations (e.g., by requiring and approving written procedures over import activities)?
Organizational Structure and Assignment of Authority and Responsibility
Who has the responsibility for CBP compliance (e.g., individual or department)?
What is the authority of those responsible for CBP compliance? • Do they have authority to hire/fire a broker? • Do they have the ability to get the information they need?
What process ensures, for instance, that accounting or contracts/sales personnel perform actions or provide certain information to those responsible for CBP compliance?
If applicable, where is the import function organizationally located and what is the reporting chain of command?

If the importer is a smaller entity, what compensating controls are needed due to limited staffing?
If the importer is a larger entity, are sufficient resources assigned?
Commitment to Competency
If there is single ownership: • How much discretion does the owner have over controls? • Is there potential risk for management override and fraud?
How experienced is the staff in performing CBP activities?
How long have those responsible for ensuring CBP compliance been assigned to their position?
What are the qualifications of those responsible for CBP compliance or experience do they have with CBP activities?
Does the importer require or monitor that those responsible for CBP compliance receive CBP related training? • Is training tracked (i.e., as part of formal job training)? • Is training included in the budget?
When and how often do those responsible for CBP compliance attend CBP-related training?

Does the importer have formal written procedures for import activities?
If there are formal written procedures for import activities, who prepared the written procedures and how did they go about preparing it? • How often are the procedures updated? • Are control objectives clearly stated? • Are there procedures to mitigate the risk areas identified in the PAR? • Are risk tolerance levels defined?
If there are no written procedures for import activities, then what procedures are being used to ensure compliance with CBP laws and regulations? • How do those responsible for CBP compliance know what to do?
Accountability for Internal Control
What are the responsibilities of those responsible for CBP compliance?
How are those responsible for CBP compliance held accountable (e.g., do they provide weekly activity reports to management)?
If applicable, what performance measures correlate to compliance with CBP laws/regulations?

EVALUATING THE RISK ASSESSMENT PROCESS

Attachment 4 provides additional guidance on evaluating the importer's risk assessment process. This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Auditors use their professional judgment to decide which questions and information are relevant for the facts and circumstances of the audit.

Senior Management
Has the importer defined its compliance objectives? • Do they cover/include CBP laws and regulations to which the importer is subject? • Are they consistent with the risks identified by the auditor (e.g., in the PAR)?
Has management defined risk tolerance levels? • How much variation in performance is management willing to accept while still achieving the company's objectives (i.e., internal control does not provide absolute assurance and some variation would need to be tolerated)? • What degree of variation would cause management to take corrective action (e.g., correct noncompliances by filing a disclosure, put additional control activities in place to address a deficiency, or both)?
Has management designated functional responsibility for performing a risk assessment of CBP activities?
Import Function
Has the import function or those responsible for CBP compliance assessed risk relating to the importer's CBP activities? • If so, is it documented?
If performed, what did the risk assessment process entail? For example:

- What internal and external factors were considered?
- What control points were identified?
- Was the risk for fraud evaluated (e.g., do they look for gaps in processes or procedures where management or its employees may override controls or manipulate records; internal or external factors that may create incentives or pressures to commit fraud)?

EVALUATING MONITORING ACTIVITIES

Attachment 5 provides additional guidance on evaluating the importer's monitoring activities. This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Auditors use their professional judgment to decide which questions and information are relevant for the facts and circumstances of the audit.

When evaluating monitoring activities over compliance with CBP laws and regulations, auditors consider:

(1) What type of evaluations (e.g., ongoing or separate) have been performed?

- Who performed them?
- How often were the evaluations performed?
- What risks relative to CBP compliance were evaluated and what were the results (e.g., findings)?
- Who were the results reported to?
- How is sensitive information such as illegal or improper acts reported?

(2) Were significant internal control deficiencies and material noncompliances reported to all relevant parties?

- Were findings reported to parties with the responsibility/authority to take corrective action?
- Were findings reported to all affected organizational/functional components where findings cut across such boundaries?
- Were findings reported to the appropriate level of management with the authority to ensure corrective action is enforced (e.g., level of management above the person responsible for taking corrective action depending on the nature and significance of the issues)?
- What changes were made to internal control over compliance with CBP laws and regulations as a result of the evaluation?
- Have the changes been fully implemented?

Post entry review procedures

Post entry reviews may be used to evaluate, for example, whether the broker complied with the importer's instructions for complying with CBP requirements; whether the quality of information supplied to the broker was correct; and/or whether the information reported to CBP on the entries were accurate and complete. Typically, post entry reviews are performed on a periodic basis (i.e., quarterly, semiannually) and before entries liquidate to proactively monitor compliance and timely report an adjustment to CBP (e.g., file PEA or prior disclosure). The number of entries or entry lines reviewed depends on factors such as the volume and complexity of the importer's import activity; however, 100 percent review is typically not feasible and some form of sampling would be used.

The importer may give considerable discretion to the broker for classifying merchandise and/or filing entries. Auditors need to understand the degree to which the importer is relying on the broker and the underlying objective of the post entry review procedure. Post entry reviews that monitor the broker's performance may or may not include procedures that:

- Verify the accuracy of the information provided to the broker (e.g., invoice description of the imported merchandise).

- Check mathematical accuracy for currency conversion, duty and fee calculations, etc.

- Verify that the broker followed instructions they were given for filing entries (e.g., using the classifications listed in a database).

When evaluating post entry review procedures, auditors consider:

(1) How much is being examined (and how often) in relation to the volume imported?

The importer may perform post entry review procedures on a periodic basis (e.g., quarterly or monthly) by selecting entries or entry line items filed during that period. Although these reviews may be performed quarterly or monthly, the population to which the procedures are applied is greater. In contemplating whether to test this control (e.g., reviewing all of the entries from two quarterly post entry reviews), auditors consider if the post entry review procedures were used on a sufficient number of entries or line items in order for the control to be responsive to the relevant risks. For example, if an importer files 500 entry line items per month, 10 percent of the total entry line items filed during a quarterly period would be considered a sufficient number, while 10 entry line items per quarter would not.

- In some cases the importer may be targeting certain entries or items they consider to be at risk. Auditors need to understand the importer's basis for targeting entries or items and consider the need to test compliance of entries or items that were not targeted by the importer.

- If the importer is not reviewing a sufficient number of entries or line items, the control may not be properly designed to achieve the control objective and auditors may decide not to test it.

(2) Whether all relevant risk areas are verified, including verification of information such as:

- Costs pertaining to the statutory additions to PAPP when applicable.
- Actual cost of freight and insurance when applicable.
- Rulings when applicable.
- Computational accuracy of duties, fees, currency conversion, etc.
- Documentation to support eligibility when applicable.
- Material and processing costs to support regional value content when applicable.
- Entries flagged for reconciliation are included in the reconciliation entry, and post entry adjustment amounts are accurate when applicable.

(3) Whether the post entry process ensures that accurate entries have been filed. For example, whether the post entry review includes a verification that the broker:

- Used tariff numbers listed in the importer's database or as otherwise instructed by the importer (if applicable).
- Used correct currency exchange rates and converted foreign currency to USD (if applicable).
- Deducted actual freight (if applicable).
- Identified the correct AD/CVD case number and correctly calculated the duties (if applicable).
- Used the special indicators when items are eligible for entry under FTA as determined/identified by the importer.
- Used special classification provisions when items are eligible as determined/identified by the importer.
- Included HMF and/or MPF and correctly calculated fee amounts (if applicable).

(4) Whether corrections for noncompliances identified in the post entry review are reported to CBP. For example, there may be general instructions to have the broker file a PEA, but does the importer follow up to ensure that the PEA is filed?

(5) Whether there is a process to assess the possibility of other entries/line items having the same noncompliances as those identified in the post entry review. For example, there may be general instructions that disclosures are filed when appropriate, but what process/data is used to assess whether there were additional items?

(6) Whether changes are made in procedures that will mitigate the risk of the noncompliances from occurring in the future. For example, there may be a general consensus amongst importer personnel that changes will be made, but what ensures changes are made and will be followed?

EVALUATING INFORMATION AND COMMUNICATION PROCESSES

Attachment 6 provides guidance on evaluating the importer's information and communication processes. This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Auditors use their professional judgment to decide which questions and information are relevant for the facts and circumstances of the audit.

There may be several internal/external communication cycles while the importer engages in vendor negotiations. Auditors consider whether those responsible for CBP compliance (e.g., import department) have been (or should be) included and/or apprised throughout the negotiations. Auditors may also consider whether the negotiation process negatively affects the clear communication of CBP requirements (e.g., a foreign vendor that does not agree to provide documentation for cost and production data may negatively affect the importer's ability to support items claimed under FTA).

Those responsible for CBP compliance (e.g., import department) may perform control activities to assure that CBP requirements were communicated to the foreign vendor and/or to monitor the quality and consistency of the information reported to CBP. Auditors consider the lines of authority necessary to interact with the foreign vendor when evaluating this process (e.g., those responsible for CBP compliance should routinely interact with the purchasing department or have the authority to contact the vendor directly).

Auditors use professional judgment to assess the significance of the information needed from the other departments and may inquire about the following:

Internal Source and Users
Whether those responsible for CBP compliance (e.g., import department) have communicated informational needs in order to achieve CBP compliance objectives. For example, it may be necessary for those responsible for CBP compliance to obtain information about royalty and commission agreements from the legal department. When the legal department is aware of and understands the need to know, there is a stronger possibility that the two functional departments will arrange to discuss the information whenever it is necessary to do so.

Whether CBP requirements and expectations are discussed at control points relating to business processes such as:
 	
• Vendor negotiation, solicitation, and/or selection processes, including when there are:
  o Renegotiations with vendors and/or changes in vendors of existing products.
  o Changes in freight carriers for existing products.
 	
• Product Development, including processes that involve:
  o The design and development of new products.
  o Modifications to existing products.

- Accounts Payable, including processes that involve:
  - Price adjustments, credits, rebates, or other changes made to the vendor's invoice.
  - Changes in the accounting or inventory systems, software, modules, etc. that may impact information that is routinely provided to other departments.

- Other business processes as appropriate.

External Sources and Users

The functional department(s) that regularly communicate with the foreign vendors have discussed:

- CBP requirements with the foreign vendors.

- Information or documentation relative to CBP requirements that the foreign vendor may need to provide.

- Changes or corrections for identified noncompliances that may impact future transactions with the foreign vendor.

Identify the functional department responsible for regularly communicating with the broker, and whether:

- There are agreed upon procedures (e.g., statement of work or written procedures) that the broker uses when filing entries on behalf of the importer. Note that this is not a requirement but a consideration. Alternately, the functional department may have a basic understanding of the broker's activities. Auditors seek to understand the basic agreement that exists between the importer and the broker (e.g., agency relationship) and whether it has been communicated to the broker how the importer stands, for example, on providing internal control over compliance for the relevant audit areas. That is, the broker should know whether the importer intends to support items imported under an FTA and should not declare the items under an FTA simply based on the country of origin shown on the "commercial" invoice, without having been instructed to do so by the importer.

- The importer communicates sufficient, relevant information to the broker about the merchandise being imported.

- Individuals within the functional department have the authority to request or require the broker to make corrections on entries when necessary.

Identify the functional department or individuals (e.g., outside attorney or consultant) responsible for regularly communicating with CBP, and whether:

- The department or individuals have been engaged at a point when there is a need to request a CBP ruling (e.g., before items are imported).
- The department or individuals have been engaged at a point when there is a need to file a prior disclosure.
- Newly issued CBP rulings are provided (communicated) to the broker.

EVALUATING THE CONTROL ACTIVITIES

Attachment 7 provides guidance to aid the auditors when evaluating the importer's control activities. This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Not all of the information in this attachment will be relevant for every importer. Auditors will consider only that which relates to the identified risks for the importer being audited. Auditors use their professional judgment to decide which questions and information are relevant for the facts and circumstances of the audit.

- Section A – Value, including transaction value, computed value, and other value issues such as reconciliation and value issue pertaining to FTA.
- Section B – Classification, including special classification provisions HTSUS 9801 & HTSUS 9802.
- Section C – FTA, Preferential Trade Legislation Programs, including a separate section for NAFTA.
- Section D – AD/CVD.
- Section E – IPR.
- Section F – FTZ.
- Section G – Quantity.

Auditors obtain an understanding of control activities by identifying the importer's significant control points, examining accounts of interests, performing walkthroughs, and interviewing the importer's personnel (e.g., import, purchasing, engineering, and accounting departments). In some cases an importer may have written procedures (e.g., an Import Compliance Manual) that explains control objectives and control activities. If so, auditors may review the written procedures to understand such things as:

- The control objectives.
- Individuals or groups responsible for performing various CBP-related activities.
- When the procedures are performed and how often.
- Specific actions that are performed to accomplish the control objectives.
- Systems, records, or other information that are used when the procedures are performed.
- Records or documentation that is retained evidencing the procedures are performed.

Auditors may also interview the individuals responsible for performing the procedures to obtain a thorough understanding of all CBP-related control activities. For example, the importer's written procedures may provide loose descriptions of the importer's control activities. Supplemental details about the control activities may be learned through discussions with the importer's personnel.

Some importer may not have any written procedures. When this is the case, auditors obtain information about control activities through discussions with the importer's personnel. Auditors may seek to understand the importer's organizational structure and its business operations as a way of identifying the appropriate personnel to interview about procedures that are relevant to CBP activities.

SECTION A – VALUE

The Trade Agreements Act of 1979 (codified U.S.C. 1401a) provides rules for appraisement of imported merchandise, of which the preferred method of appraisement is Transaction Value. Most importers will claim to use transaction value as the basis of appraisement of its imported merchandise although some will use one of the other bases of appraisement. Understanding the basis of appraisement that the importer uses is integral to the auditor's understanding of its control activities for value. Generally, auditors confirm which basis of appraisement is being used via the importer's responses to the PASQ.

The law provides that the transaction value of imported merchandise is the price actually paid or payable for the merchandise when sold for exportation to the United States, plus amounts for certain statutory additions to the price paid or payable:

- Packing costs incurred by the buyer.
- Any selling commission incurred by the buyer.
- The value, apportioned as appropriate, of any assist.
- Any royalty or license fee that the buyer is required to pay, directly or indirectly, as a condition of the sale.
- The proceeds of any subsequent resale, disposal, or use of the imported merchandise that accrue, directly or indirectly, to the seller.

The law also provides that certain amounts may be excluded from transaction value, such as:

- The cost, charges, or expenses incurred for transportation, insurance, and related services incidental to the international shipment of the goods.
- If identified separately, any reasonable cost or charge incurred for constructing, erecting, assembling, maintaining, or providing technical assistance with respect to the goods after importation, or transporting the goods after importation.

Significant control activities for value should ensure all costs to arrive at CBP value are included in the values declared to CBP. However, since not all of the statutory additions will pertain to every entity, an importer may not have or need to have procedures for some of them. Auditors or other members of the audit team (e.g., National Account Manager or Import

Specialist) may have insight about which statutory additions and any adjustments to the price actually paid or payable are relevant to the importer's imported merchandise based on their knowledge of industry practices or commodities, for example, where assists are typically provided. Generally, auditors obtain information about which statutory additions are relevant via the PASQ responses, examining accounts of interest, and interviewing the importer's personnel (e.g., accounting, purchasing, and import departments).

When evaluating control activities for value, auditors consider the procedures relative to the importer's imported merchandise that may be necessary to ensure all costs are included and that values declared to CBP are accurate, including:

Transaction Value

Processes and procedures necessary to ensure the price actually paid or payable includes amounts for the following (as applicable):

- Indirect payments
- Price adjustments
- Transportation costs
- Currency exchange adjustments

Not all of these costs will be relevant for every importer's imported merchandise. Auditors review the criterion (e.g., Title 19 CFR section) that pertains to each of these in order to discern what types of controls may be necessary to ensure the value of these costs is included. For example, Title 19 CFR § 152.103(a)(2) states, in part, that "indirect payments include the settlement by the buyer, in whole or in part, of a debt owed by the seller, or where the buyer receives a price reduction on a current importation as a means of settling a debt owed him by the seller."

Auditors consider when and what process in the importer's business operations is relevant to making indirect payments (e.g., during vendor solicitation or vendor negotiations). Control activities may involve such instruments as a contract or other written agreement wherein the terms, conditions, and values of such indirect payments are stipulated. Auditors consider whether the import department is included in the process in order for them to know that indirect payments are being made and to provide (e.g., establish and perform) other control activities that will ensure the amounts for indirect payments are declared to CBP.

Processes and procedures necessary to ensure the price actually paid or payable includes amounts for statutory additions (as applicable):

- Packing
- Assists

- Proceeds
- Royalties
- Selling Commissions

When applying the criteria for statutory additions, auditors bear in mind that Title 19 U.S.C. § 1401a (b)(1) states, in part, the price actually paid or payable for imported merchandise shall be increased by the amounts only to the extent that each amount (i) is not otherwise included within the price actually paid or payable, and (ii) is based on sufficient information. If sufficient information is not available, for any reason, the transaction value of the imported merchandise shall be treated as one that cannot be determined.

Auditors review the criterion that pertains to each type of statutory addition in order to discern what types of controls may be necessary to ensure the costs are included. For example:

- Title 19 CFR § 152.102 (e) defines packing costs as "the cost of all containers (exclusive of instruments of international traffic) and coverings of whatever nature and of packing, whether for labor or materials, used in placing merchandise in condition, packed ready for shipment to the United States."

- Title 19 CFR § 152.103 (b)(1)(i), "packing costs incurred by the buyer with respect to the imported merchandise."

Auditors consider when and what process is used to decide or agree that the cost of packing will be separately charged (e.g., during vendor solicitation or vendor negotiations). Control activities may involve such documents as contracts and purchase orders where the terms of sale and costs of packing are stated. Auditors consider whether the import department is included in the process in order for them to know that the cost of packing for the imported merchandise is separately charged and to provide (e.g., establish and perform) other control activities that will ensure the cost of packing is included in the values declared to CBP.

Individuals or departments that may be responsible for submitting requests for binding rulings to CBP and procedures used to ensure the ruling is followed.

Auditors consider when and what process is used to define the costs comprising imported items or establish the price that will be paid for imported items (e.g., during product development/modification or vendor solicitation/negotiations). Auditors consider whether the import department is included in the process in order for them to (i) raise concerns about cost components comprising the imported items, (ii) initiate a request for binding ruling prior to importation of the items, and (iii) provide (e.g., establish and perform) other control activities that will ensure binding rulings are followed (e.g., values declared to CBP conform with the decision in the ruling) and/or correct values are declared to CBP.

Auditors consider when price adjustments to the values of imported items are discussed or agreed upon (e.g., during vendor negotiations or vendor payment). Auditors consider whether the import department is included in the process in order for them to know that price adjustments were made and which items were affected by the price adjustment, and to provide other control activities that will ensure the price adjustments are reported to CBP.
For entries flagged for reconciliation of value: Procedures used to ensure all entries with post-entry adjustments are included in the reconciliation entries and filed in a timely manner.
For imported items purchased from related parties, auditors consider whether those responsible for CBP compliance (e.g., import department) are involved when prices are set and/or ensure that CBP requirements are communicated to and considered by those responsible for setting prices with the related party.

Computed Value
Processes and procedures necessary to ensure that the computed value is accurately reported to CBP. Auditors may consider whether procedures are necessary to ensure the value of assists and packing is included in the computed values.
Individuals or departments that may be responsible for requesting binding rulings from CBP and procedures used to ensure the ruling is followed. Auditors consider when and what process is used to determine the value of imported items (e.g., during product development, vendor solicitation, or vendor negotiations, and who decides what costs will be included). Auditors may consider whether those responsible for CBP compliance (e.g., import department) have been included in the process and whether CBP requirements pertaining to computed value are discussed. Auditors may also consider whether requests for binding rulings are initiated prior to the importation of items and whether those responsible for CBP compliance (e.g., import department) have established and perform procedures to ensure that the binding rulings are followed.
Processes and procedures necessary to ensure that industry rates for general expenses and profit (i.e., gross profit) in the country of export are checked and used.

Process for reconciling standard costs to actual costs and to ensure adjustments are reported to CBP when appropriate.
Procedures necessary to ensure that material costs include transportation costs to the place of production.
Procedures necessary to ensure that material costs and other costs are properly allocated between dutiable and non-dutiable tariff numbers.
Procedures necessary to ensure that freight costs are properly allocated between dutiable and non-dutiable material.
Procedures necessary to ensure that internal taxes imposed on imported material by the country of exportation are excluded from the value of the imported material.
Procedures necessary to ensure that computed values include all foreign operating expenses applicable to the production of exported merchandise and the profit reported on the foreign assembler's income statement.
Procedures necessary to ensure that computed values include material scrap value, less any proceeds from the sale of scrap.
Procedures necessary to ensure that exchange gains are reported as part of the computed value and that translation gains are not reported as part of computed value.

SECTION B - CLASSIFICATION
Note: For footwear, alcoholic beverages, watches, and other areas where the HTSUS provides specific or compound duty rates based on quantity, also refer to Section G for quantity considerations. When evaluating control activities for classification, auditors consider the procedures relative to the importer's environment that may be used to ensure items are correctly classified and may consider the following types of control activities:
New products/items are properly classified. Auditors consider who determines how items are classified (e.g., the importer's personnel or the broker), and when the determination is made about how items are classified (e.g., during product development or vendor solicitation if importer's personnel determine classification; or at the time of entry if classification is determined by the broker). Auditors may consider the amount and type of information needed in order to properly determine how the items are classified (e.g., are details about component materials or how the items function or operate needed in order to classify the items), as well as the procedures necessary to ensure sufficient (detailed) information is provided or may be obtained by those responsible for determining the classification (i.e., drawings, spec sheets, or other additional information not conveyed on an invoice).
Binding rulings are obtained and followed. Auditors consider whether those responsible for determining the classification have an opportunity (i) raise concerns about interpreting the HTSUS GRI or explanatory notes, (ii) initiate a request for binding ruling prior to importation of the items, and/or (iii) establish and perform other procedures to ensure the binding ruling is followed when the items are imported.
The database of products (if applicable) or other product information given to the broker includes the part number, a complete description of the product, and identifies the country of origin.
Classification of items listed in the importer's database (if applicable) is periodically reviewed and updated when appropriate.

Changes in products are monitored and the determination of the classification updated as appropriate.
For entries flagged for reconciliation of classification: Procedures used to ensure all entries with post-entry adjustments are included in the reconciliation entries and filed in a timely manner.
Items imported under HTSUS 9801/9802
When evaluating control activities for items imported under HTSUS 9801/9802, auditors consider the procedures used to ensure:
New items are eligible. Auditors consider the individuals or departments that may be responsible for determining items are eligible (i.e., it should be importer's personnel and not the broker) and when the determination is made that U.S. goods will be returned (e.g., during the purchasing or contracting process). Auditors consider the type of documentation that may be appropriate to support the origin of items (e.g., export documentation, proof of origin, warranty records). Auditors may also consider other procedures used to ensure that the broker does not declare items under the special classification provision without having been instructed to do so (e.g., the importer may have procedures requiring the broker to obtain the importer's consent prior to importation).
Imported items are the same ones that were exported. Auditors consider is the individuals or departments that may be responsible for verifying that the imported items are the same items previously exported, the type of information that may be necessary to track items (e.g., serial numbers, lot numbers), and the type of documentation that may need to be verified (e.g., commercial invoice, proof of origin, and/or export documentation).

Drawback was not previously claimed. Auditors consider the individuals or departments that may be responsible for verifying that drawback was not previously claimed, the type of records may need to be verified, and the timing of the procedures to verify drawback occur before the items have been imported under the special classification provision.
The broker knows which items are to be declared under the special classification provision (i.e., written instructions from the importer or the broker is provided a database that indicates which items the importer has determined to be eligible and plans to support eligibility).
Procedures necessary to ensure that the statements in Manufacturer's Affidavits, assembler's declarations, and other documentation are true (e.g., statements that the merchandise was not advanced in value or improved in condition are true). Auditors consider the individuals or departments that may be responsible for verifying the underlying facts/statements in the Manufacturer's Affidavits or assembler's declarations, and the procedures, records, or other information that may be necessary to ensure items were not advanced in value or improved in condition prior to importation of the new products.
As applicable to the special classification provision, auditors may consider the procedures that may be necessary to ensure that a description of the assembly process has been obtained prior to the importation of new products.
<u>For items imported under HTSUS 9801</u>: auditors may consider the procedures that may be necessary to ensure items are not produced with materials temporarily imported under bond or produced in a bonded warehouse.
<u>For items imported under HTSUS 9802.00.40/50</u>: auditors may consider the procedures that may be necessary to ensure the foreign operations did not cause the identity or classification of the exported article to change.

SECTION C - FTAs and Preferential Trade Legislation Programs
CAUTION: Most of the considerations listed here are generic. Auditors refer to the specific provisions in the trade agreement(s) and assess the type of controls that will be needed to mitigate the relevant risks. Sources for the FTAs and Preferential Trade Legislation Programs include the following websites: • The Office of the United States Trade Representative (USTR): www.USTR.gov has the full text for all of the FTAs and other pertinent information. • CBP (internet): www.cbp.gov/trade/priority-issues/textiles has resources for textiles and apparel FTA and other pertinent information, and www.cbp.gov/trade/priority-issues/trade-agreements has information related to the various Trade Preference Programs for Non-Textiles. Where commodities may be subject to quota, also refer to Section G for quantity considerations. When evaluating control activities for FTAs and Preferential Trade Legislation Programs, auditors consider the procedures used to ensure:
New items are eligible for entry under the FTA or Preferential Trade Legislation Program. Auditors consider the individuals or departments that may be responsible for determining that items are eligible (i.e., this should be the importer's personnel and not the broker) and the timing for making the determination that items are eligible (e.g., prior to importation such as during product development or vendor solicitation). Auditors consider the types of information about the foreign vendor that may require validation prior to producing the items (e.g., physical inspection of factory capacity), or after the items have been produced (e.g., actual production cost) to ensure that items were in fact eligible under the FTA or Preferential Trade Legislation Program. Auditors may also consider other procedures necessary to ensure that the broker does not declare items under the FTA or Preferential Trade Legislation Program without having been instructed to do so (e.g., importer may have procedures requiring the broker to obtain the importer's consent prior to importation).

For the factories in the countries where products are produced, auditors consider procedures that may be necessary to ensure the factories are approved, inspected, and evaluated for compliance with the FTA requirements. For example:

- Procedures necessary to ensure that the individuals responsible for performing periodic factory inspections (e.g., in-country managers, importer's personnel, or agents acting on behalf of the importer) have knowledge of and understand the FTA or Preferential Trade Legislation Program requirements.
- Procedures necessary to ensure that the factory is performing the production process within the terms of the contract or stated on the purchase order (i.e., CMT operations).
- Periodic verifications are performed to verify the factory's production capacity (i.e., comparison of the number of workers to production/packing machines).
- Procedures necessary to ensure that supporting documentation for factory costs and production records will be available and can be provided to CBP.
- Procedures necessary to ensure that the factories are monitored for potential illegal transshipment.

The broker knows which items are to be declared under the FTA or Preferential Trade Legislation Programs (i.e., written instructions from the importer, or the broker is provided a database that indicates which items the importer has determined to be eligible and plans to support eligibility).

Letters of Credit identify the beneficiary manufacturer and state that illegal textile transshipment will incur penalties.

Items imported under NAFTA

When evaluating control activities for NAFTA, auditors consider the procedures used to ensure:

Specific rule changes for items imported under NAFTA are identified and followed. Auditors consider the individuals or departments that may be responsible for identifying specific rule changes and procedures that may be necessary to evaluate whether the change pertains to any of the items that have been imported under NAFTA.
Valid certificates of origin are obtained prior to importation. Auditors consider procedures that may be necessary to authenticate the certificates of origin and the type of records or other information that may be used.
The broker knows which items are to be declared under NAFTA (i.e., there are written instructions from the importer, or the broker is provided a database that indicates which items are to be declared under NAFTA).
Contracts with vendors contain provisions to ensure compliance with NAFTA eligibility requirements. Auditors consider the individuals or departments that may be responsible for negotiating with foreign vendors (e.g., purchasing or contracting department) and procedures that may be necessary to ensure contracts include provisions for complying with NAFTA eligibility requirements.
For entries flagged for reconciliation of NAFTA eligibility: auditors consider procedures that may be necessary to ensure all entries with post-entry adjustments are included in the reconciliation entries and are filed in a timely manner.

SECTION D – AD/CVD
When evaluating control activities for AD/CVD, auditors consider the procedures used to ensure:
New items are evaluated for being subject to AD/CVD.

Auditors consider the individuals or departments that may be responsible for determining which items are subject to AD/CVD (e.g., the importer's personnel or the broker), and the timing for making the determination (e.g., prior to importation such as during product development or vendor solicitation, or at the time of entry if determined by the broker). Auditors may consider the type of information needed in order to properly determine that an item is subject to AD/CVD (e.g., vendor's name and address, country of origin, classification of item, AD/CVD case number) as well as the procedures necessary to ensure sufficient (detailed) information is obtained by those responsible for determining whether the items are subject to AD/CVD (i.e., some information may not conveyed on an invoice).
If applicable, the importer's database of products or product information given to the broker indicates the items are subject to AD/CVD and identifies the AD/CVD case number.
Newly issued AD/CVD case orders are identified and recurring imported items not previously subject to AD/CVD are evaluated to ensure that AD/CVD will be declared in the future. Auditors consider the individuals or departments that may be responsible for identifying newly issued AD/CVD case orders and identifying recurring imported items, and the procedures that may be necessary to determine whether the recurring imported items will be imported in the future and ensures, for example, that the database of products is updated to indicate that the items are subject to AD/CVD.
Foreign vendors are monitored for potential illegal transshipment. Auditors consider the individuals or departments that may be responsible for monitoring the foreign vendors (e.g., contract management, in-country manager, or other agent) and procedures that may be necessary to ensure that the foreign vendor has not illegally transshipped the merchandise. Auditors consider the types of information requiring verification to ensure that the items have not been illegally transshipped (e.g., shipping records). Auditors may also review contracts or other written agreements to verify they contain clauses that prohibit illegal transshipment of the imported items.

SECTION E – IPR
When evaluating control activities for IPR, auditors consider the procedures used to ensure:

Items are evaluated for being subject to IPR. Auditors consider the individuals or departments that may be responsible for determining which items are subject to IPR (e.g., importer personnel or the broker), and the timing for making the determination (e.g., prior to importation such as during vendor solicitation/negotiations, or at the time of entry if determined by the broker). Auditors consider procedures that may be necessary to ensure that there is a written authorization from the IPR owner.
Imported merchandise subject to IPR requirements is correctly labeled or properly marked. Auditors consider when the importer has physical control over the imported merchandise (e.g., shipping and receiving) and the procedures that may be necessary to examine the items and verify that the items are correctly labeled or properly marked.

SECTION F – FTZ
Note: Some of the considerations listed below can be ascertained by reviewing the Port's zone file. When evaluating control activities for FTZs, auditors consider whether:
A copy of the FTZ procedure manual has been provided to the Port Director when changes are made to it.
The importer is using an inventory method that is approved by CBP.
The inventory control and record keeping system have been reviewed annually in accordance with Title 19 CFR § 146.25.
Identified deficiencies and corrective actions taken as a result of the annual internal review of the FTZ are reported to the Port Director in accordance with Title 19 CFR § 146.53.

Physical inventory cycle counts and annual reconciliations are performed and overages/shortages are reported to CBP.
Documentation is maintained for the admission, control, and removal of merchandise from the zone.
Items entered into a <u>Petroleum FTZ</u> only:
Note: For items entered into a Petroleum FTZ, also refer to Section G for quantity considerations. When evaluating control activities for a Petroleum FTZ, auditors the procedures used to ensure:
Fuel consumption, flaring, and evaporation are accounted for.
Approval is obtained for any proposed attribution schedule where a final product or a feedstock is not listed in the Industry Standards of Potential Production (aka: tables published in T.D. 66-16).
Material code and product table set-ups are accurate in the inventory system.
Feedstock type, product category, producibility, and relative values are correct in the inventory system.
Items entered into a Manufacturing FTZ only:
When evaluating control activities for a Manufacturing FTZ, auditors consider the procedures necessary to ensure that waste, scrap, and merchandise destruction is accounted for.

SECTION G - QUANTITY
Note: There may be risk that incorrect quantities are being declared for imports of petroleum (FTZ), footwear, alcoholic beverages, watches, commodities subject to quota (i.e., GSP, FTA), and other areas where HTSUS provides specific or compound duty rates that are based on quantity. When evaluating control activities for classification, GSP, and FTA, auditors may also consider procedures used to ensure:
Items are counted when received and actual quantities are recorded in the inventory system. Auditors consider when the importer has physical control over the imported merchandise (e.g., shipping and receiving) and procedures that may be necessary to count the items when received and record the actual quantities in the inventory system.
The quantity received is compared to the quantity ordered (i.e., P.O.) and/or claimed to have been shipped (i.e., shipping report or packing list) and action taken to reconcile differences. Auditors considered the individuals or departments that may be responsible for recording the receipt of items in the inventory system and procedures and/or system that may be used to reconcile the quantity of items. Auditors also consider procedures that may be necessary to (i) contact the vendor to obtains an adjustment in the invoice amount, and (ii) inform other departments (e.g., accounting and import departments) about any overages/shortages so they can perform other procedures (e.g., import department instruct the broker to file a PEA). Auditors may also consider other procedures necessary to ensure the authority to override quantity variances is restricted to the appropriate personnel.
Quantities have been converted to units of measure prescribed in HTSUS, FTA, or other instructions, and are accurately declared to CBP. Auditors consider the individuals or departments that may be responsible for converting the quantities to the prescribed units of measure (e.g., importer personnel or the broker) and procedures that may be necessary and/or systems that may be used to convert quantities to the prescribed units of measure. Auditors may also consider other procedures necessary to ensure that the quantities are accurately declared to CBP.

GUIDANCE FOR PLANNING AND PERFORMING COMPLIANCE TESTING

Attachment 8 provides guidance to aid the auditors when planning and performing compliance testing. This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Auditors use their judgment to decide the extent of testing as appropriate based on the facts and circumstances of the audit and may use sample sizes other than those described herein.

Auditors design and perform compliance testing to obtain evidence about the importer's compliance with applicable CBP laws and regulations. The nature, timing, and extent of compliance testing depend on the circumstances of the audit and can be performed during all phases of the FA (e.g., PAS, ACT, or Follow-Up Audit). Compliance testing may also be accomplished by allowing the importer to perform self-testing under CBP supervision subsequent to the PAS with verification by the auditors during a Follow-Up Audit to determine the accuracy and acceptability of the importer's work.

The compliance testing performed during a PAS is typically not as extensive as that which may be performed via self-testing under CBP supervision or by the auditors under an ACT to quantify the loss of revenue or calculate a compliance rate. The purpose of compliance testing performed during the PAS is to:

- Support the auditor's findings and conclusions about the risk to CBP. When control risk is assessed below maximum, the combined results of compliance testing and tests of controls provide a basis for the auditor's findings and conclusions.

- Identify risky or significant items and to better target transactions/items for more extensive compliance testing that may be performed via self-testing under CBP supervision or under an ACT (e.g., to quantify the loss of revenue or calculate a compliance rate).

- Identify specific internal control deficiencies which will aid the importer in developing more targeted corrective actions.

A. Nature and Timing of Compliance Testing

When deciding the nature and timing of compliance testing, auditors consider the assessment of control risk and the overall risk of noncompliance. Control risk impacts the type of testing that will be performed (e.g., a combination of tests of controls and compliance testing, or foregoing tests of controls and only performing compliance testing) and may also impact the extent of compliance testing depending on the results of tests of controls. The overall risk of noncompliance impacts the extent of audit procedures (e.g., how much work the auditors plan to perform) and the extent of testing (e.g., how many transactions or items will be tested).
Note that as auditors obtain and evaluate evidence, information may come to their attention that causes them to alter their original expectations regarding the risk of material noncompliance and they may alter their audit approach (e.g., reduce or expand testing). Diagram D8 provides an overview of compliance testing that may be used during the PAS.

Less Extensive (Decreased) Compliance Testing Performed During the PAS

When tests of controls are performed during the PAS and the results of testing confirms (supports) that the controls are being performed at an acceptable level to be effective at mitigating the identified risk and producing compliant transactions, it is expected that transactions will be compliant and any noncompliances found during compliance testing would be clerical or non-systemic in nature. Under these conditions, less extensive (or decreased) compliance testing may be sufficient to reduce detection risk (e.g., the risk that the procedures performed by the auditor will not detect instances of material noncompliance). Less extensive compliance testing uses the smallest sample size needed in order to meet the audit objective (i.e., as risk *decreases* the amount of testing necessary to sufficiently address that risk *decreases*). Note that sometimes auditors may initially plan and perform tests of controls and less extensive (decreased) compliance testing during the PAS (e.g., execute the testing plans concurrently). When tests of controls do not support that controls were being performed at an acceptable level to be effective, the results of less extensive compliance testing (e.g., identified material noncompliances) may be used to target transactions/items for more extensive compliance testing.

When controls can be observed at the transactional level (e.g., entry detail), auditors may perform dual purpose testing which involves testing both controls and compliance concurrently using the same sample of transactions. Refer to Attachment 10 for guidance on planning and performing dual purpose testing.

More Extensive (Increased) Compliance Testing Performed During the PAS

When tests of controls are not performed or the results of tests of controls do not support that controls were being performed at an acceptable level to be effective, the extent of testing necessary to evaluate whether transactions are compliant will be more extensive (increased) to sufficiently reduce detection risk (i.e., as risk *increases* the amount of testing necessary to sufficiently address that risk *increases*).

Compliance testing during the PAS enhances flexibility, increases audit efficiency, and reduces detection risk by targeting items that have the largest effect on noncompliance. For example, if 80 percent of the total value can be examined by testing the largest 10 transactions, detection risk may be reduced such that the level of assurance will be lower for a sample of the remaining 20 percent of the untested items. This approach is appropriate when:

- The entire population is not at equal risk for material noncompliance. Compliance testing may be used to identify risky or significant items and to better target transactions/items for more extensive compliance testing that may be performed via self-testing under CBP supervision or under an ACT to quantify the loss of revenue or calculate a compliance rate.

- The importer has limited internal control processes and procedures (e.g., relies extensively on broker's activities to ensure compliance and may provide limited oversight over the broker's activities). Compliance testing may be used to identify specific deficiencies and the results can be used to aid the importer in developing more targeted corrective actions.

- There is limited documentary evidence to support the *implementation* of controls (e.g., as may be the case with smaller, less complex importers). Compliance testing may be used to identify risky or significant items or specific control deficiencies thereby allowing more targeted corrective actions.

Note that extensive compliance testing to quantify a loss of revenue or calculate a compliance rate may be performed during the PAS if it is more efficient to do so (e.g., it can be accomplished within the timeframes of the PAS). For instance, auditors may determine that it is necessary to review all items in a stop-and-go statistical sample in order to quantify the loss of revenue and it is more efficient to complete the review during the PAS rather than move onto to an ACT (refer to section D below for an explanation of this approach).

More Extensive Compliance Testing Under ACT or Self-Testing Under CBP Supervision

Auditors may determine that more extensive compliance testing is needed to quantify a loss of revenue or calculate a compliance rate based on the results of compliance testing performed during the PAS. Typically statistical sampling is used in performing this manner of compliance testing. In determining whether to perform such testing under an ACT, auditors consider the significance of the risk and potential impact of material noncompliances and whether the importer is a candidate for self-testing under CBP supervision.

Compliance testing may be performed by the importer via self-testing under CBP supervision when the importer agrees to take corrective action (e.g., develop and implement a CIP) to address the identified internal control deficiencies and there is consensus for the importer to perform self-testing under CBP supervision. In such instances auditors may provide testing/sampling plans to be executed by the importer's personnel or the auditors may review and approve self-testing plans prepared by the importer. In either case it will be necessary to perform a Follow-up Audit to verify the accuracy and acceptability of the importer's work. In determining whether to pursue this option, auditors consider whether the importer is a good candidate for self-testing based on the cooperation and competency displayed by the importer's personnel during the course of the PAS. Auditors also consider whether they will need to retain control over the work based on the significance of the risk and potential impact of material noncompliances.

B. Extent of Compliance Testing in the PAS

For each review area, the extent of compliance testing will depend on the overall risk of material noncompliance and the risk that remains after considering the results of other audit procedures (e.g., risk assessment procedures, test of controls, and/or analytical procedures) and, therefore, the auditor's desired level of assurance to meet the audit objective.

Compliance testing performed during the PAS typically involves judgmental (non–probabilistic) sampling. **Note that the extent of testing (e.g., sample sizes) described below do not apply when using statistical sampling.**

- For populations comprising less than 250 items, a general rule is to test approximately 10 percent of the population.

- For populations comprising 250 or more transactions, typical sample sizes may range from 25 – 40 items depending on the risk for material noncompliance and the desired level of assurance needed to meet the audit objectives. However, smaller or larger sample sizes may be used depending on the circumstances. For example, the auditors may determine that the risk is confined to a specific MID or tariff number and sufficient, appropriate evidence can be obtained from a smaller sample size for the portion of the population subject to that risk. On the other hand, the auditors may determine that there is a high degree of complexity and variability in the importer's import activity (e.g., mass merchandisers) and a larger sample size is necessary to address the risk presented by that variability.

Sampling may involve selecting a combination of individually significant items (e.g., based on relevant risks and significance and significance) and random items. Auditors may consider using a stop-and-go statistical sampling approach if it is determined to be more efficient (refer to Section D below for guidance about stop-and-go statistical sampling).

C. Evaluating Results of Testing in the PAS

Auditors perform compliance testing in accordance with approved sampling plans and evaluate the results, including:

- Determining and evaluating causes for identified noncompliances.
- Assessing the significance/materiality of the noncompliances and whether significant/material noncompliances are confined to a particular risk characteristic (e.g., MID, tariff, or item).
- Assessing the potential for material noncompliance in the population.
- Considering the risk relating to other time periods.

Regardless of the planned approach, information may come to the auditor's attention when they are performing compliance testing that causes them to alter their original expectations regarding the risk of material noncompliance. When this happens, it may be necessary to change the assessment of control risk (e.g., from below maximum to at maximum) and/or to adjust the planned approach to appropriately respond to the risk. For example:

- If compliance testing confirms that only certain items are at risk, auditors may determine through an analysis there is only a small population for which the extent of noncompliance can be determined without extensive effort and/or audit work can be timely completed within the PAS timeframe. In this example, there is no change in the assessment of control risk; however, the planned approach would be adjusted from "performing compliance testing" to "quantifying the loss of revenue" relating to the identified risky items. Note that the objective of the PAS will need to be expanded to include quantifying the loss of revenue.

- If compliance testing discloses material noncompliances, auditors may decide to expand (increase) testing in order to quantify a loss of revenue, and the expanded compliance testing

will be accomplished subsequent to the PAS. In this example, it may be necessary to reassess risk (e.g., if control risk was originally assess below maximum). However, the planned approach of the PAS would not change because the expanded compliance testing is to be accomplished under another phase of the FA or by allowing the importer to perform self-testing under CBP supervision. The auditors would report the identified material noncompliances in the PAS report, determine who will perform the expanded compliance testing subsequent to the PAS (e.g., importer as self-testing under CBP supervision or auditors under an ACT), and plan the next phase of the FA as appropriate.

- When tests of controls do not support the auditor's expectation that controls are likely to produce compliant entries, auditors may decide that less extensive compliance testing will not be sufficient to reduce detection risk. In this example, it will be necessary to reassess the risk (e.g., assessment of control risk will change from below maximum to at maximum), and to adjust the audit approach (e.g., increase the extent of compliance testing). The adjusted audit approach may be accomplished either in the PAS, under an ACT, or by allowing the importer to perform self-testing under CBP supervision.

D. Stop-and-Go Statistical Sampling

Stop-and-go statistical sampling provides flexibility in the audit approach because it can be used to incrementally test items, thus allowing auditors to determine whether there are material noncompliances from the smallest possible sample size. Typically, auditors would use statistical sampling techniques to select items and then examine the selected items in increments before deciding when to stop or proceed with further compliance testing. Note that this approach is used for compliance testing and does not apply to tests of controls.

Extent of Testing

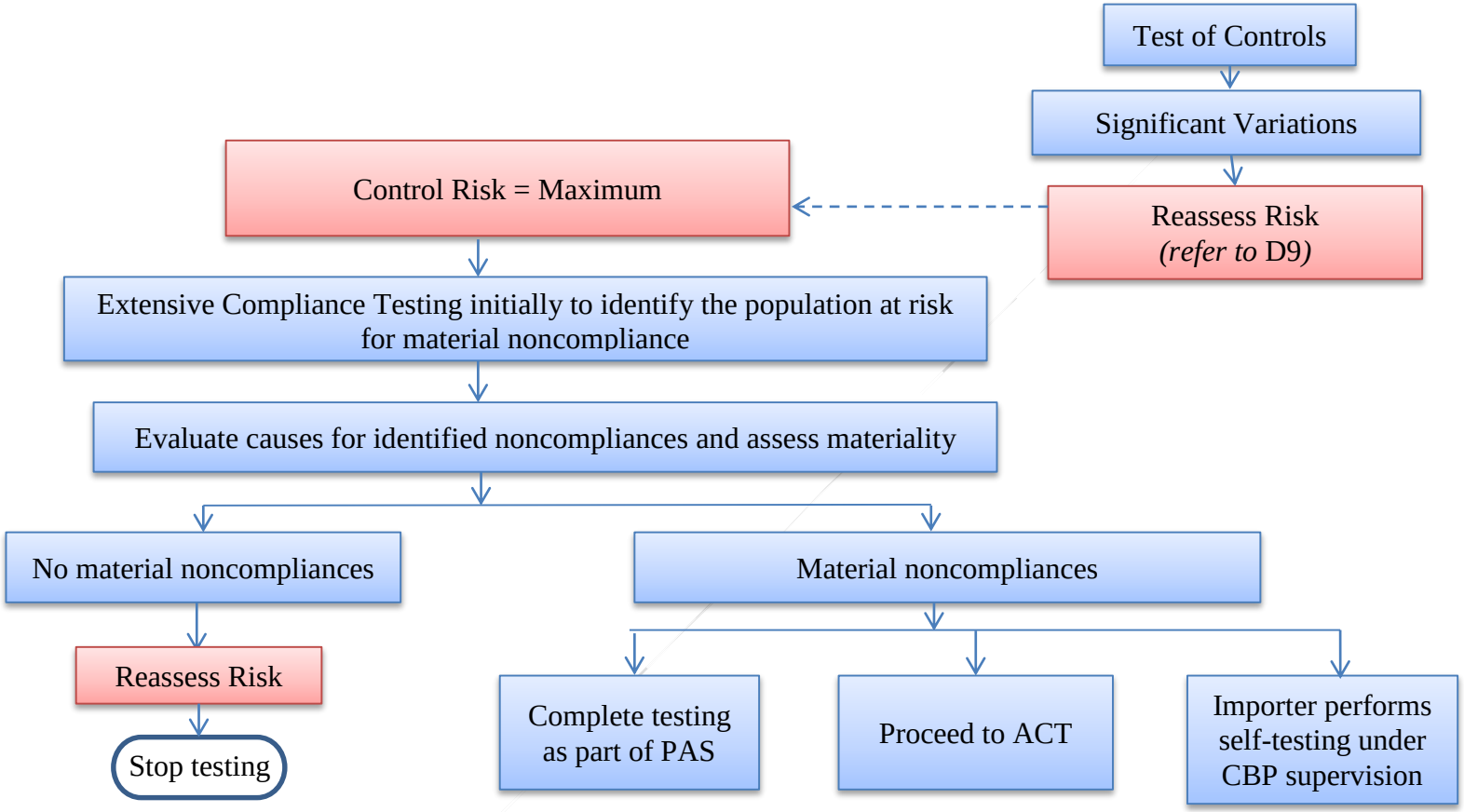
Auditors initially plan to examine a smaller number of the statistically sampled items (e.g., first 25 or 30). If, based on the initial items examined, there are no systemic errors and there is no risk for potential material noncompliances, auditors may decide to stop and not review the rest of the sample items. In the event that there are systemic errors, auditors may continue to incrementally examine items and stop when they have obtained the desired level of assurance to meet the audit objectives. In the event that there are systemic material noncompliances and a statistical projection is necessary, the items already tested will "count" in the statistical projection. Note that auditors may still test individually significant items; however, those items would need to be included in a separate stratum from the randomly selected items and the results for those items cannot be projected onto the universe.

Important Considerations when using Stop-and-Go Testing

When this approach is used in conjunction with tests of controls (e.g., control risk was assessed below maximum) and noncompliances are identified in the stop-and-go testing, it will be necessary to reassess control risk and alter the planned audit approach. If a statistical projection is necessary, auditors will consider whether it is more efficient to complete the review of the remaining sample items during the PAS (vs. proceeding to ACT or allowing the importer to

examine the remaining items under self-testing). If compliance testing for the remaining sample items will be completed in the PAS, the audit objective will be expanded to include quantifying the loss of revenue or calculating a compliance rate as applicable.

DIAGRAM D8: Performing Extensive Compliance Testing During the PAS



GUIDANCE FOR PLANNING AND PERFORMING TESTS OF CONTROLS

Attachment 9 provides guidance to aid the auditors when planning and performing tests of the operating effectiveness of controls (tests of controls). This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Auditors use their judgment to decide the extent of testing as appropriate based on the facts and circumstances of the audit and may use sample sizes other than those described herein.

Tests of controls provide information about how the controls were being used (applied) over a period of time, thus lending assurance that the controls can be relied upon to reduce the risk of material noncompliance. Assurance about controls provides the basis for auditors to perform less extensive compliance testing (e.g., using the smallest sample size needed in order to meet the audit objective). Diagram D9 provides an overview of tests of controls that may be used during the PAS.

Recall that auditors consider the five components of internal control for each audit area, and that control risk is assessed by considering factors such as the size of a company, amount of resources allocated to CBP activities, and the cumulative (or collective) effect of all components of internal control over compliance for each audit area. In most cases, tests of controls will be performed during further audit procedures. However, some of the documentation for the implementation of controls may be obtained during the risk assessment/additional planning procedures. For example, evidence of the control environment, information and communication, and control activities that are performed sporadically or "as needed" may be obtained during the risk assessment and additional planning procedures. Tests of controls are performed only on those controls that the auditor has determined are (i) significant controls occurring at key control points, (ii) suitably designed, and (iii) supported by evidence of:

- How the controls were applied at relevant times during the period under audit.
- The consistency with which the controls were applied.
- By whom or by what means the controls were applied.

Various procedures may be used to test the operating effectiveness of controls, including (i) inquiries of appropriate the importer personnel, including managers; (ii) the inspection of documents, reports, or electronic files indicating performance of the control; (iii) the observation of the application of the specific controls; and (iv) re-performance of the application of the control by the auditor.

Testing plans for tests of controls include test procedures that are distinctively different from the test procedures used in compliance testing. In addition, the population of items examined in tests of controls, in most cases, will be different from the population of items examined in compliance testing. Auditors may execute testing plans in a progression (e.g., perform tests of controls first, analyze results, then prepare and perform compliance testing) or concurrently (e.g., prepare testing plans for tests of controls and compliance testing and execute both at the same time).

Note that when the controls can be observed at the transactional detail level (e.g., entry detail) auditors may use a single sample to test controls and compliance. This is known as dual purpose testing (refer to Attachment 10 for additional guidance on dual purpose testing).

Extent of Testing

The extent of the tests of controls increases when the auditor intends to obtain more assurance about the controls. When determining the extent of tests of controls, auditors consider how many items or observances of the application of the control will be examined based on the following factors:

- The degree of reliance on the control. That is, auditors may increase the extent of testing when a control is relied upon to a great extent. This may be when the control itself is critical or when the control is integral to the effectiveness of other controls in the system.

- How frequently the control is performed during the audit scope period.

- The expected amount of variation in the way the procedures were performed (e.g., variation from the way it was explained). There may be variations in the way controls are used caused by factors such as changes in key personnel, seasonal fluctuations in volume, and human error. When deciding the extent of testing, auditors usually plan to observe no variations; however, they may decide to accept a small number of variations (e.g., one or two clerical errors) before they would need to reassess the level of control risk.

- The relevance and reliability of the audit evidence that will be obtained regarding the operating effectiveness of the control.

- The extent to which audit evidence will be obtained from tests of other controls.

Test of Controls – Frequent Controls and Populations > 250 Items

Where auditors do not expect to find variations in the way controls were being used, typical sample sizes range from 25 to 40 items depending on the auditor's assessment of risk. However, a smaller or larger number of items may be appropriate depending on the circumstances of the control.

Test of Controls – Infrequent/Sporadic Controls and Populations < 250 Items

There are a variety of methods the auditor may use when testing controls, including some that may not involve sampling. For instance, this may be the case when testing controls that are performed sporadically, infrequently, or as needed. Information and communication controls generally fit this category. For controls that do not occur frequently and the population is fewer than 250 total items, approximately 10 percent of the population may be tested. For smaller populations where the controls are performed on a weekly, monthly, or quarterly basis and the total number of items is less than or equal to 52, auditors may select from 2 to 10 items as depicted in the following table:

Table A9: Number of Items When Testing Infrequent Controls

Frequency and Population Size	Minimum Number of Items
Quarterly (population = 4)	2
Monthly (population = 12)	2 – 4
Semi-monthly (population = 24)	3 – 8
Weekly (population = 52)	5 - 10

Expected Amount of Variation

When testing controls, auditors are primarily concerned about whether there are variations in the way the procedures were being used from the way the procedures were explained. Because internal control can only provide reasonable assurance, there may be some variations that auditors would be willing to accept without altering the planned assessed level of control risk. The expected amount of variation is the maximum number of times and the types of variations that the auditor is willing to accept without altering the planned assessed level of control risk.

Factors relevant to the auditor's consideration of the expected amount of variation include the auditor's understanding of the business (in particular, risk assessment procedures undertaken to obtain an understanding of the importer's system of internal control), changes in the importer's personnel or internal control, and the results of other audit procedures. Auditors use professional judgment to decide the expected amount of variation based on the facts and circumstances of the audit. When tests of controls reveal that performance of the controls meets this threshold it may be necessary to reassess control risk and modify the planned audit approach.

Auditors often plan to find no variations in the way controls were performed and if testing reveals no variations, then a high degree of assurance is achieved that controls are being performed at an acceptable level to be effective. Note that variations may increase the risk of material noncompliance, but may not always result in material noncompliance. The expected amount of variation should be explained in the testing plans for tests of controls (e.g., include an explanation in the criteria that will be used to evaluate the controls).

Performing Tests of the Operating Effectiveness of Controls

When testing the operating effectiveness of controls, the criteria are the specific details in the importer's written procedures and/or actions explained or demonstrated by the importer's personnel during the interviews and walkthroughs. For each selected item, auditors examine evidence of the procedure and consider whether the control/procedure was used consistently, correctly, and operating as intended.

- Consistency means the control was used the same way. The amount of documentation needed to support consistency will be based on the auditor's judgment and will depend on the frequency with which the procedure is performed among other considerations (refer to the discussion about the extent of testing above).

- Correctly means the control was used as it was explained (e.g., in accordance with the written or the way it was described to the auditors during the interviews and walkthroughs).

- Operating as intended means the control accomplished the control objective. Recall that individual controls may be designed to accomplish a single specific task and that controls collectively (e.g., as a system of control) ensure compliance over the audit area.

Auditors use professional judgment as to whether there is sufficient evidence indicating that a procedure was performed. For instance, an annual procedure used to ensure that information in the classification database is accurate, current, and relevant (e.g., obsolete or discontinued items/products are deleted from the database and an independent determination of the classification of selected items is performed, etc.) may be evidenced by:

- Summary records that identify the individual that performed the review and when it was performed.

- Records showing the research performed (e.g., queries of purchase orders; email correspondence).

- Records or files with copies of the documentation used to independently determine the classification of items/products (e.g., style specification sheets, engineering drawings, email correspondence, etc.).

- Records showing the items/products that were deleted from the database.

- Records showing changes in the classification of items/products as a result of the independent review.

- Prior disclosures, Post Entry Amendments, or Supplemental Information Letters to CBP to report corrections in the classification of items/products.

Evaluating the Results of Testing

It is important to note that information and other evidence about some control components (e.g., control environment and risk assessment) will be obtained during risk assessment and additional planning procedures. Auditors consider all of the information and evidence about internal control (e.g., information obtained during risk assessment and additional planning procedures as well as from tests of controls performed during further audit procedures) when evaluating the operating effectiveness of controls.

When evaluating the results of tests of controls, auditors will determine the nature of all variations and, where possible, evaluate the potential effect that could occur due to the control failure (e.g., types of noncompliance). Variations may occur due to misapplication of the control, misunderstanding of the procedures, carelessness, or fraud. Auditors will discuss with the importer's personnel to understand the nature of the variations, assess whether the variations

have a common feature (e.g., occur when there are certain products, occur when certain individuals perform the procedure, or occur during certain periods of time), and consider whether the variations individually or collectively increase the likelihood of material noncompliance.

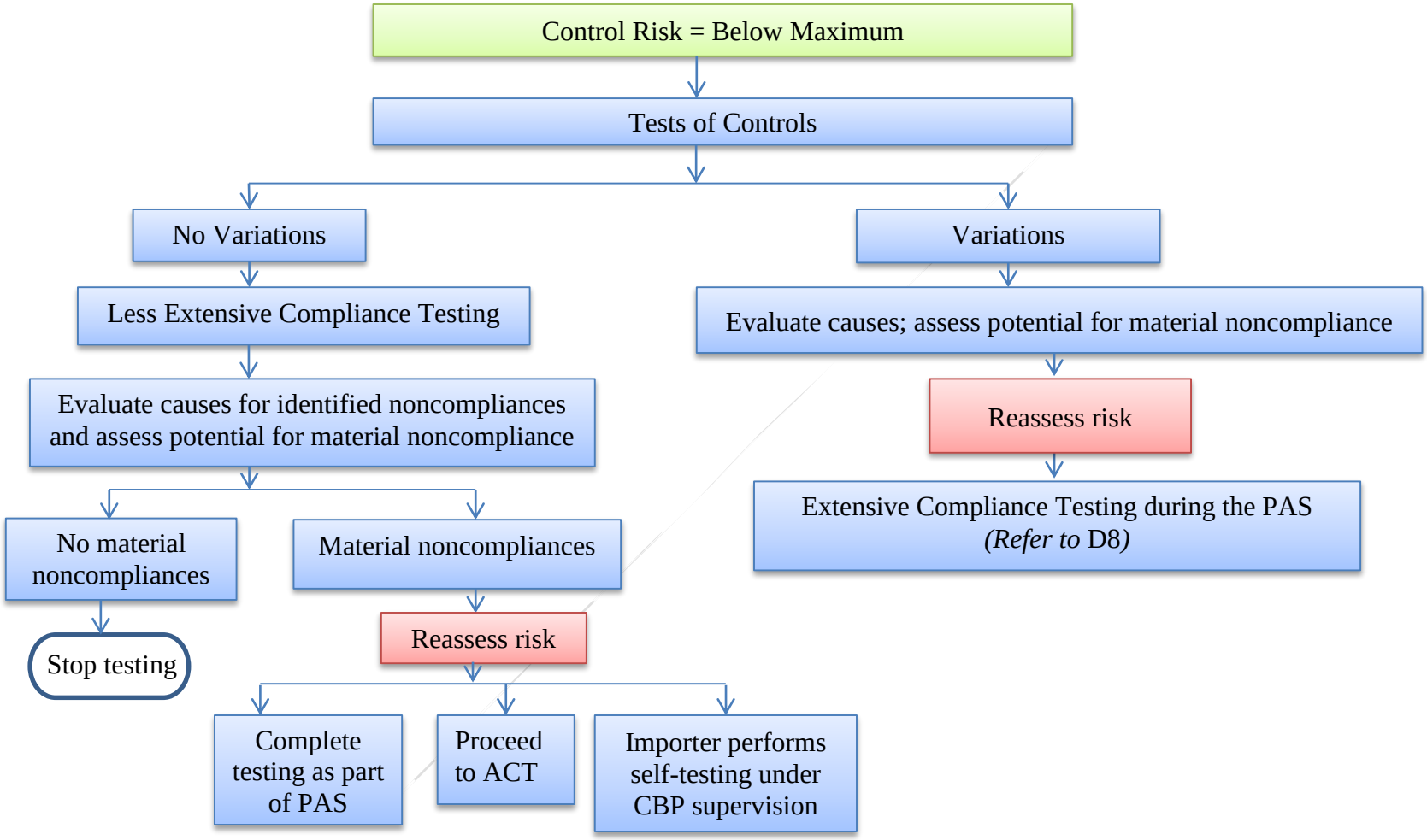
When there are no variations based on tests of controls or the number of variations did not exceed the expected amount of variations, a high degree of assurance is achieved that the controls were being performed at an acceptable level to be effective. Auditors may proceed with the initial approach to perform less extensive compliance testing (e.g., using the smallest sample size needed in order to meet the audit objective).

When there are significant variations based on tests of controls, the desired level of assurance is not achieved that the controls are being performed at an acceptable level. It may be necessary to reassess risk and adjust the planned audit approach. For instance,

- If tests of controls were executed before compliance testing, it would be appropriate to reassess risk and adjust the audit approach. Recall that initially the auditors would have assessed control risk below maximum and planned to perform less extensive compliance testing. In this example, auditors reassessed risk because there were variations based on tests of controls and they do not believe the controls will be effective in producing compliant transactions. The audit approach may be adjusted to perform extensive (increased) compliance testing.

- If tests of controls were executed concurrently with less extensive compliance testing, but there were no material noncompliances based on the compliance testing, it may be necessary to consider whether there were compensating controls. In this example, the determination to reassess risk and adjust the audit approach will be based on professional judgment. In some cases, auditors may decide to reassess risk (e.g., reassess control risk at maximum) and adjust the audit approach (e.g., increase compliance testing) in order to reduce audit risk. In other cases, it may only be feasible to form a conclusion relative to the items tested from the audit scope period.

DIAGRAM D9: Performing Tests of Controls During the PAS



GUIDANCE FOR PLANNING AND PERFORMING DUAL PURPOSE TESTING

Attachment 10 provides guidance to aid the auditors when planning and performing dual purpose testing. This attachment does not provide a comprehensive list of considerations and is not intended to be used as a checklist. Auditors use their judgment to decide the extent of testing as appropriate based on the facts and circumstances of the audit and may use sample sizes other than those described herein.

Dual purpose testing involves designing tests of controls (refer to Attachment 9 for guidance about planning and performing tests of controls) and compliance testing (refer to Attachment 8 for guidance about planning and performing compliance testing) to be performed using a single sample of transactions. It is important to note that dual purpose testing can only be used for controls that can be observed at the transactional level (e.g., for CBP purposes the entry detail), and the population of items must be suitable for performing both types of testing (e.g., tests of controls and compliance testing). In an FA, it would be appropriate to perform dual purpose testing for an importer's post entry review process.

It is also important to note that dual purpose testing presents certain encumbrances on the amount and variations of audit work performed. For example, an importer may have several significant controls for an audit area, but only some may be tested using a dual purpose sample (e.g., single sample of transactions). It would be necessary to separately test any significant controls that cannot be examined using the dual purpose sample, and then use the combined results of all tests of controls (e.g., controls tested using the dual purpose sample and those tested separately) to form a conclusion about the operating effectiveness of controls. Diagram D10 provides an overview of dual purpose testing that may be used during the PAS.

Sampling Plans When Performing Dual Purpose Testing

Generally, a single sample of transactions will be selected and two testing/sampling plans will be prepared, one to test the control(s) and the other to test whether the transactions are compliant. Alternately, there may be a single test/sample plan; however, it should clearly distinguish the characteristics examined, procedures performed, and conclusions for each of the test objectives. In most cases, judgmental sampling techniques will be used to select transactions and the number selected will vary depending on the control(s) being tested and degree of assurance the auditors plan to obtain from the tests performed. Recall that dual purpose testing is largely dependent on the population to which the controls apply. For instance, judgmental sampling is used when testing transactions from a post entry review. The importer has already selected a sample of transactions (e.g., entry line items) in order to perform the post entry review, such that auditors will be sampling from the importer's sample and statistical sampling is neither practical nor useful.

Objectives for Dual Purpose Testing

The general objectives of dual purpose testing are:

- To determine whether the control component is operating correctly, consistently, and achieving the intended objective.

- To determine whether the selected transactions are compliant with the relevant laws and regulations.

Criteria

Each selected transaction will be evaluated for two sets of criteria:

- For tests of controls, the criteria will be the specific details in the importer's written procedures and/or actions explained or demonstrated by the importer's personnel during the interviews and walkthroughs.

- For compliance testing, auditors will use the applicable laws and regulations. When planning compliance testing, auditors consider factors that affect the risk of material noncompliance.

Extent of Testing

In most cases auditors will use judgmental sampling to select items/transactions and the number selected will vary depending on the control being tested and the degree of assurance the auditors plan to obtain from the tests performed. When deciding the number of items/transactions to be selected, and there is a difference between the sample size that would be used for tests of controls and the sample size for compliance testing, the larger of the two sample sizes will be used. For example, if only 10 items/transactions are needed for tests of control, but 25 items/transactions for compliance testing, a total of 25 items/transactions will be selected. Dual purpose testing will be performed on 10 items/transactions and compliance testing on the remaining 15 items/transactions. Refer to Attachment 8 for additional guidance about the extent of compliance testing and Attachment 9 for additional guidance about the extent of tests of controls.

Special Considerations When Testing the Operating Effectiveness of Controls

When testing the operating effectiveness of controls using a dual purpose approach, auditors would have made a preliminary assessment that there is an acceptably low risk that the variations in the performance of a control will exceed the expected amount of variation. Refer to Attachment 9 for additional guidance about the expected amount of variation, applying the criteria, and performing test of controls.

During dual purpose testing, auditors may reach opposing conclusions about the controls and compliance for the sample items/transactions. For example, there may be variations in the way the controls were used, but the items/transactions were compliant, or vice versa. When there are opposing conclusions, it is important to understand and assess why the variations occurred. Generally, when controls operate effectively but the transactions are noncompliant, the noncompliances will be attributed either to variations in controls tested separately or control deficiencies (e.g., controls that did not exist).

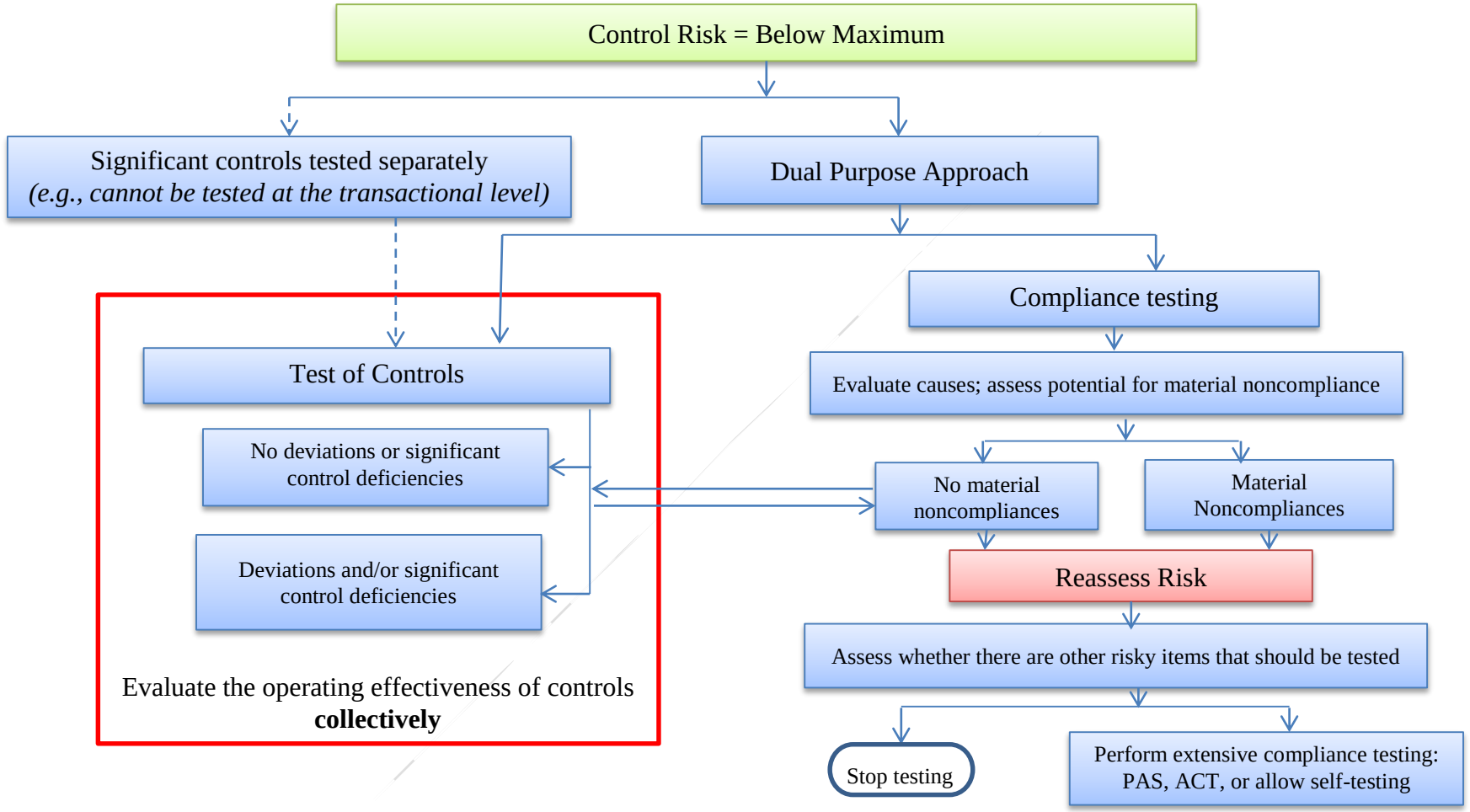
There may be instances when the items/transactions are compliant, but there were variations in the way the controls were performed. When this happens, auditors consider whether the variations have a common feature (e.g., occur when there are certain types of transactions, for certain products, or during certain periods of time), and whether other items/transactions may be noncompliant. In addition, auditors assess:

- Whether the controls were necessary to ensure compliance.

- Whether there were other controls that basically compensated the variation in the control.

- The materiality of the other transactions and consider the need to perform additional compliance testing, particularly if none of the items/transactions tested were from a population other than the one used for dual purpose testing.

DIAGRAM D10: Performing Dual Purpose Testing During the PAS



GUIDANCE FOR COMPLIANCE IMPROVEMENT PLANS

Attachment 11 provides guidance about procedures used when the importer agrees to develop and implement a CIP. Auditors use their judgment to decide whether the CIP includes corrective actions that are appropriate for correcting the reported deficiencies.

The importer is responsible for developing the CIP and ensuring that it is fully implemented. Prior to implementation, the importer should provide a copy of the CIP to the auditors to obtain their consensus that the corrective actions are appropriate for the reported deficiencies and is ready for implementation. Auditors may contact the importer while the CIP is being implemented to monitor progress and to determine when the importer has completed implementing the CIP. It is critical that the importer has validated the implementation of corrective actions and determined for itself that the CIP is fully implemented before notifying the auditors and scheduling the Follow-Up Audit.

Purpose of the Compliance Improvement Plan

The purpose of the compliance improvement plan is to make changes or improvements to internal control over compliance for audit areas that the auditors have determined represent an unacceptable risk to CBP and to mitigate the risk of noncompliances from occurring in the future.

CIP Content

A compliance improvement plan is a written document that details the importer's plan of actions that will be taken to correct control deficiencies and noncompliances found during the FA, and includes timeframes for the development and implementation of the corrective actions. There is no specific format for a CIP; however, it should contain the following information relative to each noncompliant audit area:

- Deficiencies or Noncompliances. Deficiencies or noncompliances described in the audit report (i.e., the problem that needs to be corrected).

- Corrective Actions. Corrective actions are the importer's planned changes or improvements to internal control to mitigate the risk of noncompliance in the future. The cause section of the finding sheet explains what was determined to be the underlying reasons for the deficiencies/noncompliances, and the recommendations section of the finding sheet have possible changes the importer may take (e.g., a recommendation to develop and implement procedures).

  Generally, the importer's corrective actions should correlate to one of the five components of internal control (e.g., control environment, risk assessment, information and communication, control activities, monitoring activities). Before deciding what specific actions will be taken, the importer should define the control objective as it will provide the foundation for the desired outcome. Each corrective action in the CIP should identify:

- What will be performed (i.e., action or task).
- Who will be responsible for performing the action or task.
- When and how often the action or task will be performed.
- What records will be prepared, if applicable.
- What data will be used, if applicable.

- Responsibility. Responsibility should be assigned for the development and implementation of the CIP, and there should be accountability to ensure the CIP will be fully implemented. The importer should identify the individual that is responsible and accountable for the development and implementation of the CIP. The importer may also include individuals that may be separately responsible for the corrective actions.

- Validation Procedures. Validation procedures are the methods that will be used by the importer to evaluate the implementation and effectiveness of the corrective actions. If, based on the validation procedures, the new procedures are not effective in producing the desired outcome, the importer should investigate why and make adjustments to the procedures.

  - Implementation and effectiveness of the corrective actions. The importer should plan the following details for each corrective action:

    - The criteria or measure that will be used to determine that the corrective action has been implemented (i.e., used consistently and correctly) and is effective (i.e., achieving the desired outcome). The importer should also describe any allowances for errors.
    - The records that will be verified.
    - Individuals that will be responsible for performing the validation procedures and evaluating the results.
    - Documentation and records from the validation that will be retained/maintained on file. Auditors may review this documentation when they return to perform the Follow-Up Audit.

  - Optional CIP Testing. There may circumstances where the corrective actions comprise the majority of internal control over compliance for an audit area. At the importer's discretion, the CIP may also include a plan to test compliance over a short period of time when the corrective actions were in place (i.e., the importer tests items/transactions to obtain assurance that the new controls are effectively mitigating the risk of material noncompliance). The CIP testing plan may include the following types of information depending on the nature of the testing:

- Source of the data that will be used for testing.
- Description of the population and selection of items that will be tested.
- Explanation of the methodology that will be used to test items.
- Criteria that will be used to evaluate compliance.

- Estimated Completion Dates. The importer should plan the timeframe for implementing the CIP. The initial estimated completion dates should be reasonable and achievable based on what the importer believes will be necessary to put the actions into place. The importer should consider how much time will be needed, for example, to have written policy approved, develop training materials, provide training to those who will be performing the actions/tasks, conduct a "trial period" when the actions/tasks are being used, perform the validation procedures, and evaluate the results of the validation.

  At a minimum, the importer should provide estimated dates for:

  - Providing a copy of the CIP (plan) to the auditors (i.e., prior to implementation).
  - Completing the validation procedures relating to each corrective action.
  - Fully implementing the CIP (i.e., all corrective actions have been validated and the importer is satisfied that the controls are effective to mitigate the risk of material noncompliance).

CIP Timeframe

The amount of time necessary to implement and validate the CIP will depend on the nature and extent of the deficiencies. For example, where an importer that has no written policies and procedures, is missing control activities at numerous critical control points, has no monitoring procedures, and has extensive material noncompliances, implementation of the CIP could take up to as much as 12 - 18 months. On the other hand, an importer that has written policies and procedures and is only missing a few controls to address the material noncompliances, implementation of the CIP could take only three months. The amount of time should be reasonable and consistent with the nature and extent of the deficiencies. Again, it is critical that the CIP is fully implemented before the auditors begin the Follow-up Audit as this will avoid the need for multiple Follow-Up Audits.

The importer may request additional time when they believe the estimated timeframes will be exceeded. When additional time will be needed, documentation from the importer's validation process will generally show that the importer is making a good faith effort to improve and may be used to support the need for additional time.

CIP Development and Implementation

When the importer is preparing the CIP, they may have questions or need information about developing controls. Auditors may explain the relevant CBP requirements (e.g., Title 19 CFR Section), provide CBP informed compliance publications, or discuss internal control concepts (e.g., COSO's Internal Control - Integrated Framework). However, it is the importer's responsibility to decide and explain the corrective action that will be taken.

For material noncompliances, the auditors will have stated the causes and provided recommendations in the audit report. While specific recommendations are generally more effective, that specificity should be directed at addressing the cause rather than the specific actions to be taken by the importer. The importer does not have to implement the auditor's recommendations verbatim, but should provide corrective actions that will be responsive to the risk of noncompliance and address the cause for the deficiency/noncompliance.

- Prior to CIP implementation, the importer provides a copy to the auditors. To the extent practical, auditors will consider whether the corrective actions are appropriate, logical, and complete. For example,

  - Actions are *appropriate* when they address the specific CBP requirement pertaining to the identified noncompliances, and occur when actions may be taken to prevent or detect and correct a noncompliance.

  - Actions are *logical and complete* when they occur at a key control point and all components of a procedure have been clearly articulated. That is, it should be clear who will perform the task/procedure, when and how often it will be performed, what data, records, or other information will be used, etc.

  Note that poorly defined or vague corrective actions will not result in meaningful changes. It may be necessary to have a discussion about the missing details (e.g., who, what, and/or how often) prior to implementation. Auditors and importers are encouraged to resolve any obvious deficiencies or defects in the CIP prior to its implementation to avoid unnecessary or duplicative efforts by either party. Note that the auditor's consensus at this point does not constitute the auditor's official determination that the CIP is effective as there may be unknown factors at that time impacting the suitability of the CIP's design. For instance, during CIP implementation, the importer may find it necessary to modify corrective actions or during the course of the Follow-Up Audit additional information may come to the auditor's attention that causes them to alter previous judgments regarding the suitability of the CIP's design. A determination of the CIP's effectiveness will not be made until the Follow-Up Audit when the auditors obtain sufficient, appropriate evidence supporting that the CIP is effective.

- During CIP implementation, auditors periodically contact the importer's personnel to monitor the progress and find out when the CIP has been fully implemented. There should be consensus as to the best way to accomplish this. For example, it may be agreed to have regularly scheduled teleconferences or for the importer to provide periodic status reports.

The importer may find it necessary to make adjustments in the corrective actions and may request additional time to implement the CIP. Extensions may be allowed provided the importer demonstrates a good faith effort that they are implementing the CIP, there is a reasonable explanation for the extension, and the amount of time needed is not excessive.

- When the importer has completed the planned validation procedures and the CIP is fully implemented (i.e., all corrective actions have been taken and the importer is satisfied that the controls will be effective to mitigate the risk of material noncompliance), they should notify the auditors to schedule a date for the Follow-Up Audit.

GUIDANCE FOR PERMITTING THE IMPORTER TO PERFORM SELF-TESTING UNDER CBP SUPERVISION

Attachment 12 provides guidance about procedures used when permitting the importer to perform self-testing under CBP supervision. Auditors use their judgment to decide whether the importer is a good candidate for self-testing under CBP supervision as appropriate for the facts and circumstances of the audit.

An importer may be permitted to conduct self-testing under CBP supervision to independently determine the extent of noncompliances (e.g., submit a disclosure) or to address risks identified by auditors during the PAS and calculate the associated LOR (e.g., perform more extensive compliance testing relating to identified material noncompliances). Self-testing under CBP supervision is a collaborative process based on agreements between the auditors and the importer. In such circumstances:

- Auditors consider whether the importer is capable of performing the self-testing. In most circumstances, the importer will have demonstrated the competency and cooperation during the PAS before they are permitted to perform self-testing under CBP supervision. For example, auditors consider the amount, type, and frequency of CBP-related training that the individuals responsible for CBP compliance have had, as well as their tenure/experience in their positions. Auditors may also consider whether management is supportive in maintaining the competency of individuals responsible for CBP compliance and/or providing sufficient resources to achieve their objectives (e.g., funding, equipment, temporary personnel, external consultants or attorneys, etc.). Also, auditors consider the significance of the risk and potential impact of material noncompliances.

- Auditors will advise the importer on the development of the testing or sampling plan(s) and methodology. The importer can apply statistical sampling in self-testing only in circumstances in which the criteria at Title 19 CFR § 163.11 (c)(3) are satisfied. Either the auditors will provide the sampling plan to the importer for its execution or they will permit the importer to develop its own sampling plan and present that plan to the auditors for acceptance prior to execution.

    - If the auditors prepare a statistical sampling plan for the importer's execution, they will discuss with the importer the specifics of the sampling plan and how the results will be projected over the universe and request the importer's written acceptance of the sampling plan waiving the right to contest the validity of the sampling plan or the sampling methodology at a later date in accordance with Title 19 CFR § 163.11 (c)(1).

    - If the importer prepares its own statistical sampling plan, the auditors will review the plan to ensure it is consistent with generally accepted sampling procedures, and address/correct any defects prior to the plan's execution. Note that the written acceptance and waiver provisions of Title 19 CFR § 163.11 (c)(1) do not apply in these situations (i.e., the importer is not required to submit in writing acceptance of its own plan). Also note that the auditor's review and acceptance of the importer's sampling plan is provisional (i.e., temporary acceptance until the auditors perform additional audit work to

verify the accuracy and acceptability of the results). The auditor's provisional acceptance does not constitute CBP's *approval* of the sampling plan or *acceptance* of the results derived from executing the sampling plan as explained in the next paragraph.

- If the potential noncompliances extend to prior years, the auditors may request the importer to provide a signed waiver of the statute of limitations.

Auditors will plan to verify that the importer executed the testing procedures in accordance with the testing/sampling plan, and will review, evaluate, and test the results to the extent appropriate in the Follow-Up Audit. While the auditors and importer may come to an agreement regarding testing or sampling plan(s) and methodologies prior to execution, this does not preclude auditors from altering their previous judgments should previously unknown information come to their attention while they are verifying the results. Just as auditors may reassess risk and modify planned audit approaches in performing their testing, this may also be the case in self-testing under CBP supervision.

When the importer is permitted to perform self-testing under CBP supervision, auditors will monitor the importer's progress while self-testing is being performed. Alternative ways to accomplish this may be to have regularly scheduled teleconferences to discuss progress or for the importer to periodically provide status reports. After the importer has completed self-testing, they should notify the auditors and schedule a date for the Follow-Up Audit.

GENERAL GUIDANCE FOR DEVELOPING SELF-TESTING PLANS

Auditors and importers are encouraged to resolve any obvious deficiencies or defects in self-testing plans prior to implementation to avoid unnecessary or duplicative efforts by either party. Note that the auditor's consensus at this point does not constitute the auditor's official determination as in many cases auditors will need to subsequently review the results of the self-testing for accuracy and acceptability. Self-testing is limited in that there is a possibility that previously unknown information or factors may come to the auditor's attention while reviewing the results that causes them to alter their previous judgments and, as a result, it may be necessary for the importer or the auditors to perform additional work.

The following is intended to provide general guidelines regarding the design of self-testing plans to be executed by the importer:

- The objective of the test or procedure (i.e., the question you are trying to answer about the universe; defines the characteristics, occurrences, errors, and/or values to be evaluated). This is especially important if statistical sampling is used since the sampling objective significantly impacts the composition of the sampling frame. A poorly defined sampling objective could impact the reliability of the associated projections.

- Description of the type and approach of testing/sampling to be used (e.g., 100 percent testing, statistical sampling). If statistical sampling is used, identify the approach (e.g., attribute sampling or variable sampling). Provide an explanation for the chosen approach.

- Attribute sampling is used to reach a conclusion on the frequency or occurrence of a particular attribute in a sampling frame (e.g., to calculate a rate of compliance).

- Variable sampling (e.g., physical unit or dollar unit) is used to reach a conclusion about errors in a sampling frame in terms of erroneous amounts (e.g., dollars in error). The primary difference between the variable and dollar unit is the method used to select sample items and later evaluate the sample results. Variable sampling is generally more appropriate for determining the monetary impact of any sample error(s). As such, attribute sampling would generally be an uncommon approach to quantifying loss of revenue. Also, where possible, physical unit is preferred over dollar unit.

- Description of the deviation or misstatement condition (i.e., represents the monetary error or irregularity being measured and is an exception when testing for amounts or variables; includes the characteristics that will be tested and the criteria for identifying and reporting errors).

- The characteristics of the population from which items were selected. If statistical sampling is used include:

  - The data source(s) used and a brief summary of the procedures that were used to determine that the data is accurate and complete to meet the sampling objective.

  - Time period (note that a typical defect in sampling plans involve importers limiting the sampling frame to a small time period and then attempting to project the results to other time periods outside the sampling frame; such an approach is not statistically valid and is often not suitable).

  - Scope (e.g., types of entries, specific classifications or manufacturers, MIDs, etc.).

  - Descriptive characteristics of the sampling frame (e.g., size and value, mean (average value), mode (most frequently occurring value), median (middle value), standard deviation (measure of the average difference of the individual values from the mean value), and coefficient of variation (standard deviation expressed as a percentage of the mean). These characteristics are generally used to stratify the sampling frame and/or provide a basis for determining judgmental sample sizes using sample size guidelines (e.g., the more variability in the sampling frame, the larger the sample size).

  - Explanation of any stratification methods used (i.e., the process of separating a universe into different subgroups for separate selection, review, and evaluation; mainly used to group like items together and is generally used for purposes of improving the precision of sample results in a universe with a high amount of variability).

  - Differences between the sampling frame and universe (e.g., such as individually significant items that are removed from the universe for separate evaluation; in such instances the results are considered separately from the results of the sample and are not

projected onto the universe nor are the results of the sample projected onto the individual items).

- The specific/selected transactions/items that will be tested and the basis used to select them. If statistical sampling is used:

  - Parameters used for determining sample size (i.e., variables/factors used to determine an appropriate sample size). For statistically determined sample sizes, describe the defined parameters (e.g., confidence level, critical error rate, presumed error rate, precision, etc.) and identify the formulas or software used (e.g., EZ-Quant). For sample sizes determined using sample size guidelines, describe the basis for the guidelines used and explain why the selected sample size was considered appropriate in the specific situation. Note that it would not be appropriate to use the sampling guidelines found in the FA Kit exhibits as the basis for the sample size without substantiation and an associated evaluation of the precision of the sample results. The sample size guidelines in the FA Kit are intended for the auditors to use when they are determining the appropriate variable sample sizes for compliance testing in an FA, and do not include procedures that address all possible situations for which self-testing may be used. Further, the FA Kit is not intended to provide guidance for applications outside of CBP audits. The use of these guidelines requires the application of judgment to the specific facts and circumstances.

  - Sample selection process should ensure all items in the sampling frame have an equal or known chance of selection. Random selection is preferred (e.g., random number generator using statistical software; provide random start seed).

In providing the results of the self-testing to the auditors, auditors will typically request a schedule identifying tested items, the outcome of each item, and the basis for the determination. Specific details should be discussed with the audit team.

If statistical sampling is used, the evaluation and projection of the sampling results including the number and nature of the errors found and the treatment of those errors and the point estimate and precision interval. Precision measures the accuracy of the point estimate by how close it is likely to be to the true error or value in the sampling frame. The point estimate is the single figure that serves as the "best estimate" of the projection of sample errors to the sampling frame. The precision interval is the range within which the true error or value should fall given the confidence level (e.g., "we are 95 percent confident that the loss of revenue is $100,000 give or take $10,000; the true number is between $90,000 and $110,000).

The following are issues that could invalidate a statistical sample:

- Using an approach that is not statistically valid (e.g., applying average duty rates).

- Projecting the results of the sample onto a different universe than the sample was selected from (e.g., including additional time periods, excluding certain entries from the universe after sample selection but before projection).

- Projecting the results of a sample from one time period on to other time periods without statistics or other explanations supporting that the sampled time period is representative of the others (regardless this approach is not considered statistical).

- Proposing a two stage approach where errors are expected (e.g., randomly selecting a number of sample items but only reviewing half). This method is only appropriate where the expected error rate is zero.

- Not addressing variability in the universe (e.g., no analysis or descriptive statistics being provided; poor stratification or sample sizes that are too small to allow for sufficiently reliable results of highly variable sampling frames, etc.).

- Not sufficiently evaluating sampling frames and poorly designing samples to increase the reliability of the sample results (e.g., inconsistencies between the sampling objective and the sampling frame).

- Not ensuring the accuracy and completeness of the sampling frame (e.g., entries subject to the identified risks are not included; general ledger accounts containing possible additions to price actually paid or payable are left out).

- Not sufficiently explaining the excluded items, un-projected errors, or sample size parameters.

- Inappropriately excluding errors from projection.

- Not addressing the evaluation of results (e.g., confidence level, precision, etc.).